Glut of Gold: The Tripartite Agreement and the Gold Scare of 1937

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ABSTRACT: The Gold Scare of 1937 revolved around fears that the United States and Britain would reduce the price of gold. Supply of the metal had risen to such an extent that observers thought the governments would tire of purchasing it; the concern triggered panic in the markets. Ultimately, there was no change in price and the anxiety subsided, leading economic historians to view the Scare more as an anomaly—resulting from the sorry state of economic policy and the skittishness of market psychology—than an event with lasting significance. I argue, to the contrary, that the months surrounding the Gold Scare were a pivotal time in 1930s monetary history. The crisis forced Anglo-American policymakers to confront the critical issue of gold's role in the international monetary system, all while testing the cooperative spirit ushered in by the Tripartite Agreement of 1936. They concluded that no asset would suffice as a substitute for gold in clearing international transactions. Gold's value therefore needed to be maintained so that faith in its role as the universal money did not diminish. Actions by both countries to this end demonstrated their commitment to the new collaborative relationship.

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The 1930s were a dizzying decade, not least for the central bankers trying to restore order to the international monetary system. During the first years of the Depression, there was much talk of a "gold shortage" and the need to economize on the coveted metal.[1] But by the second half of the decade, after a slew of devaluations increased the price of gold and spurred production, there seemed to be a glut. For officials in Britain and the United States—by far the leading buyers of gold—it appeared as if they actually could have too much of a good

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[1] For a synopsis of the gold shortage theory, see Eichengreen (1996, 198-203).

thing. In fact, as the problem became acute in the spring of 1937, the Federal Reserve Bank of New York (FRBNY) suggested to the Bank of England (BoE) that Britain acknowledge its share of the "white man's burden" and buy more gold.[2] The metal had become a millstone.

The consequences of this perceived oversupply of gold were many. Market participants thought that the United States would reduce its $35 buying price to stem the inflowing tide of gold; many believed that Britain would reduce the sterling price of gold in tandem. The resulting Gold Scare, from April to June 1937, threatened chaos in the exchange markets and beyond. This tumult, in turn, imperiled the improvement in international monetary relations initiated by the Tripartite Agreement of 1936, whereby Britain, the United States, and France—soon joined by Belgium, the Netherlands, and Switzerland—had promised to cooperate to minimize exchange volatility.

In the end, there was no reduction in the price of gold. Indeed, within months, market sentiment underwent a dramatic volte-face: the fear in the autumn was that the United States would *increase* the price of gold (thereby depreciating the dollar) in response to the worsening recession. For these reasons, the Gold Scare sometimes appears as a farce in the literature—when it appears at all. As Einzig (1938, 41-42) writes in his essential, if highly opinionated, account, the event was a "comedy of errors," fueled by gossip, governmental confusion, and "scaremongering." There was no validity to the fears of a glut of gold, nor was there any reason for governments to contemplate any change. A retrospective report from the Bank for International Settlements acknowledges that there were some genuine issues with the supply of and demand for gold in the spring of 1937 but insists that "a great deal of nonsense was also talked at the time about gold losing its value as a rare commodity."[3] Other studies tend to focus on the high drama of the Scare without delving into the behind-the-scenes concerns of officials.[4] Sayers (1976) and Drummond (1981) are the exceptions in

[2]Sproul conversation with Siepmann, April 28, 1937, FRBNY C261.
[3]"The Gold Scare of 1937," December 31, 1953, BISA 9.1 002 CB 249.
[4]See, for example, Sumner (2004).

that they begin to dig into policymakers' attempts to grapple with the gold question.

Investigating the Gold Scare anew suggests a deeper significance to these months. The fundamental truth was that Britain and the United States, as well as other countries, were worried about their large gold holdings. The world may have been devastated by deflation, but inflation remained a bugbear as the economy grew apace; allowing the money supply to increase with the gold stock risked stoking an uncontrollable boom. Authorities could insulate the domestic monetary system from gold flows through sterilization, but the increase in the debt needed to offset gold purchases resulted in higher interest payments—a recipe for political opposition. Moreover, gold's role in the monetary system had become progressively circumscribed during the previous six years as governments responded to the Great Depression; it was only natural to wonder whether the trend would continue.

Tracing the response of British and American policymakers, I argue that the debate over what to do with gold was more serious and involved than previously acknowledged. There were a host of considerations at play, from the cost of sterilization to the value of holdings to the psychology surrounding the metal. The decision to push forward at the current price pivoted on the realization that gold was the only medium with which policymakers could fathom conducting international transactions: in a world without pegged exchange rates, none of the big powers wanted to hold foreign exchange. While other factors—foremost the impact of a lower price on gold holdings and gold producers—were important, preserving gold's remaining monetary role was the decisive consideration. Eager to build on the Tripartite Agreement, officials believed cooperation to this end was imperative. Examining a little-explored diplomatic spat between Switzerland and the United States, revolving around the former's attempt to sell gold in anticipation of a price reduction and the latter's use of the Tripartite Agreement in protest, brings these issues into relief. The end result was that gold's value had to be maintained, and it was up to each member of the Tripartite Agreement to do its share.

This paper proceeds in five sections. Section I provides background on the monetary situation in the months before the Scare, focusing on the Tripartite Agreement and the gold policies of the United States and Britain. Section II recounts the key features of the Scare. Section III discusses the Anglo-American debate and response. Section IV considers the Swiss episode. Section V concludes.

I Background

September 1936 marked the final collapse of the gold standard. France, the Netherlands, and Switzerland devalued their currencies after years of depression, joining the rest of the world by freeing themselves from the system's unforgiving strictures.[5] Yet rather than prompting despair and triggering fears of a renewed currency war, the moves engendered hope. France devalued in conjunction with the proclamation of the Tripartite Agreement, whereby Britain and the United States made clear that they would not retaliate and all three countries promised to avoid competitive devaluations, minimize exchange volatility, and cooperate on monetary matters.[6] Henceforward, they would work toward achieving the "greatest possible equilibrium in the system of international exchange" in the hopes of "safeguard[ing] peace" and "promot[ing] prosperity" (Bank for International Settlements 1937, Annex VII). The Agreement was informal—it consisted of three separate, nearly identical statements that broadly promised much but specifically required little—leading many scholars to judge it insignificant.[7] Without this informality, however, there would have been no agreement. Moreover, the move toward cooperation was in fact dramatic, marking a sharp departure from the rampant ill will of the first half of the decade.[8] The Agreement would become the

[5]See Eichengreen (1996) for a history of the breakdown of the gold standard during the Great Depression.

[6]Clarke (1977) provides the classic history on the negotiations leading to the Agreement.

[7]Drummond (1981, 216 and 223), for example, mocks the "flowery phrases about truth, beauty, and goodness" and considers collaboration under the Agreement to have been "incomplete, spasmodic, and perfunctory."

[8]See Harris (2018) for a history of the Tripartite years and the gold mechanisms described below.

bedrock of the international monetary system in the last years of peace.

Within weeks of the French devaluation, the Tripartite members developed technical facilities to help manage exchange rates, adding substance to the accord. To understand the importance of these channels, it is first necessary to review the differing monetary systems established in the Depression's wake. Of the three countries, the United States was now the only one to have a fixed price for gold. Since 1934, it had promised to buy and sell gold at $35 per ounce, plus/minus 0.25 percent handling charges, though—crucially for the Gold Scare that would erupt in 1937—the Administration retained the authority to set a new parity between $34.45 and $41.34 and/or alter the handling charges.[9] In addition, while the United States purchased gold from anybody, it sold gold only on consignment to central banks in countries that had fixed buying and selling prices for gold. Ever since Britain suspended gold convertibility in 1931, the BoE had not maintained fixed prices, so it could not use dollars to buy gold in the United States.

The inability of the British to exchange dollars for gold and of the Americans to convert sterling into gold at a fixed price embittered relations in the years leading up to the Tripartite Agreement. Exchange intervention had become a top priority as the gold standard's fixed rates faded into memory; it had also bred suspicion as countries created secretive funds to carry out the interventions.[10] Barred from U.S. gold, the British foreswore intervention in dollars, viewing them as too risky an asset when President Franklin Roosevelt could devalue again at any moment. This firm resolution against dealing in inconvertible currencies—shared by France and the United States—derived from the massive loss the British had

[9]In addition, the Secretary of the Treasury could buy and sell gold at whatever prices he deemed appropriate, so that the effective dollar price could change without altering the formal parity (Harris 2018, 74).

[10]When Congress debated establishing an exchange fund in 1934, Frank Vanderlip, a former Assistant Secretary of the Treasury, testified that the British fund was "a manipulative fund in the hands of an economic general, and is operated solely in the interests of England...I regard it as dangerous as military airplanes crossing our borders without any aircraft guns to meet them." *Gold Reserve Act of 1934: Hearings on S. 2366, Day 2, Before the Senate Committee on Banking and Currency*, 73rd Cong. 174 (1934) (Frank A. Vanderlip).

taken on their dollar holdings when Roosevelt first began depreciating in 1933.[11] Instead, the British managed sterling through the franc, immediately converting purchases into gold to avoid any risk. But when the French devalued in 1936, officials in Paris decided not to repeg the franc at a definite gold content, promising only to maintain the currency within a range of gold values.[12] This decision cut the French off from U.S. gold, left the British without a major currency for exchange operations, and caused the United States to worry that other countries—freed from the discipline of gold—would depreciate.

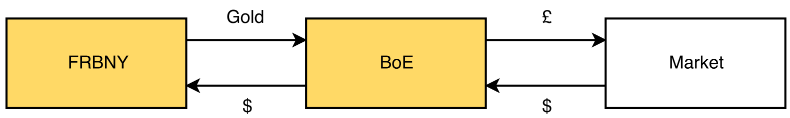
With exchange intervention essential but holding foreign exchange anathema, the prospects of fulfulling the Tripartite Agreement's aims were slim.[13] To square this circle, the countries established reciprocal gold facilities with one another in October 1936. Each country promised to buy and sell gold for its currency—through central banks operating on behalf of the exchange funds—at prices set each day. For the United States, the price was the official parity plus or minus the handling charge, though the government retained the right to change it with 24 hours' notice; the British and French provided new prices each day. In order to limit the potential drain on gold holdings, the agreement to sell gold applied only to bal-

[11]Harris (2018, 58-65). The United States, however, undertook some minor operations in sterling since gold could be purchased in London. The British held over £40 million worth of dollars in March 1933 and ended the year with a £14.5 million valuation loss on those assets. The British willingness to accumulate such large amounts of dollars and francs in 1932 was a result of their belief that France and the United States would remain on the gold standard. The countries had the greatest gold reserves in the world. But Britain had been on the gold standard as well until it suddenly was not, proving that currencies could depreciate at any moment and suggesting that more caution would have been appropriate. Indeed, the British were well aware of the consequences of reserve losses. Some central banks lost so much on their sterling holdings in 1931 that they demanded restitution from Britain, and when that was not forthcoming, required a government infusion of funds. The Bank of France in particular was so incensed that the Governor told a British Treasury official, as recorded by the latter, "if this question [of Britain compensating the Bank of France for its losses] could not be satisfactorily solved, it would not be possible for the Bank of France in future to co-operate with the Bank of England." Leith-Ross, "Note of an Interview with Monsiuer Moret," October 9, 1931, BoE G1/459.

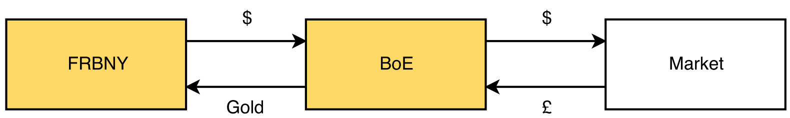
[12]The French reduced the value of the franc from 65.5 milligrams of gold to between 43 and 49 milligrams; the midpoint corresponded to a devaluation of 30 percent and a sterling rate of approximately 105 francs to the pound (Mouré 2002, 228).

[13]This refusal to hold foreign exchange was not universal and applied only to countries in charge of key currencies in the system. Smaller countries often held these key currencies as reserves; for example, members of the sterling area—comprising the Empire, much of the Commonwealth, and some of Britain's biggest traiding partners—tied their exchange rates to sterling and maintained balances in London as reserves.

ances obtained that day through exchange intervention. This "24-hour gold standard" gave countries the confidence to intervene in exchange markets without needing to accumulate foreign exchange balances and risking capital losses. Figure 1 depicts the reciprocal facilities, demonstrating the relationship between foreign exchange intervention and gold conversion.



(a) BoE converting dollars purchased in the market into gold at FRBNY



(b) BoE obtaining dollars from FRBNY to sell to the market

Figure 1: Gold conversion of foreign exchange intervention

As Figure 1a shows, the U.S. gold facility allowed the BoE to convert any purchases of dollars from the market into gold. On the other hand, sales of dollars to the market were financed through sales of gold to the FRBNY, as illustrated in Figure 1b.

In November, Belgium, the Netherlands, and Switzerland joined the "Currency Club." The Big Three thought of the new members as junior partners and, as a result, did not feel the need to consult them to the same extent as one another. Nevertheless, the expansion of the Club further solidified its importance. As *The Economist* noted after the accession of the new members, "the world is now passing under a form of quasi-gold standard, the key to which lies in semi-rigid parities maintained by official international transfers of gold."[14] Six countries did not constitute the world, but given the reach of these currencies, the Tripartite system certainly defined the democratic world's approach, one that pivoted on gold.

Confidence in the monetary situation and the world economy grew in the aftermath of the

[14] "Financial Notes," *The Economist*, November 28, 1936.

devaluations and the Tripartite Agreement. One of the consequences of this improvement in sentiment was an increase in the gold supply. The early years of the Depression had witnessed a rush into gold, as individuals sought safety in the one asset that seemed incapable of losing value. This hoarding—the bane of monetary authorities—had been attractive when investment prospects were lackluster and devaluation seemed perpetually around the corner. Conditions were different now, so holding gold was no longer as appealing. While Europeans had hoarded roughly \$1.8 billion in gold between January 1931 and October 1936, they dehoarded \$1 billion from October 1936 to June 1937.[15] Rather suddenly, the majority of gold that had been stockpiled over many years was back on the market.

This decrease in private holdings was only part of the increase in the available gold supply. Gold production had been stagnant throughout the 1920s, but it surged with the devaluations of the 1930s, setting records year after year. When Britain suspended gold convertibility in 1931, the sterling price of gold rose 42 percent within months. The real value of gold jumped drastically as a result, as did the profitability of mining (since sticky prices meant inflation in general and mining costs in particular did not increase by nearly as much). Roosevelt's devaluation of the dollar from \$20.67 to \$35 an ounce in 1934 implied a 70 percent increase in the dollar price of gold, further incentivizing production. By 1936, annual world gold production in ounces was nearly 50 percent greater than it had been in 1931. In dollar terms, production was over 120 percent greater, reaching almost \$1.2 billion. Figure 2 shows gold production by weight and by value, demonstrating the enormous increase relative to the 1920s.

[15]Even though gold sales reached their peak during the Gold Scare itself, the movement began right after the Tripartite Agreement. "The Gold Scare of 1937," December 31, 1953, BISA 9.1 002 CB 249.

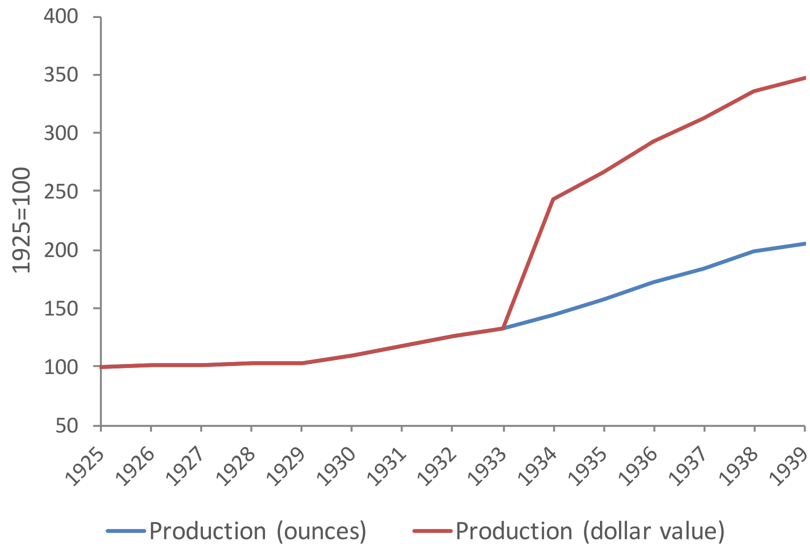


Figure 2: World gold production (1925=100)

Note: Dollar value is $20.67 per ounce until 1933 and $35 per ounce beginning in 1934.
Source: U.S. Gold Commission (1982), 188-89.

Supply was therefore increasing, but private demand was weak, leaving central banks and governments on the hook. Dehoarded and newly mined gold went to one of three places: industry and the arts, private holdings, and monetary reserves.[16] Demand from industry and the arts was never more than a small fraction of the supply, averaging less than 7 percent in the years leading up to the Tripartite Agreement.[17] Private holdings, as mentioned above, were decreasing in Europe, had been decreasing in Asia for years, and were illegal in the United States.[18] The final source of demand, and the one that would have to absorb the vast majority of the supply, was monetary reserves. Though countries had all left the gold standard in various ways, the metal was still a part of their monetary systems, serving as a backing for their note issues and the clearing asset for exchange intervention. The question was whether monetary authorities could and would ingest all the gold on offer.

At the end of 1936, the reported gold reserves of governments and central banks totaled

[16] Gold no longer circulated in the form of coin or certificates, as first the Great War and then the Depression had put an end to the practice.

[17] Bank for International Settlements (1938, 45).

[18] By Executive Order 6102 on April 5, 1933, Roosevelt prohibited ownership of gold coin and certificates in excess of $100 (Edwards 2018, ix-x).

nearly $22 billion, about twice the value four years earlier.[19] The holdings were heavily skewed. The United States, with $11.3 billion, had just over half the total; France and Britain were second and third with $3.0 billion and $2.6 billion, respectively. Figure 3 depicts the evolution of reserves for the Big Three.

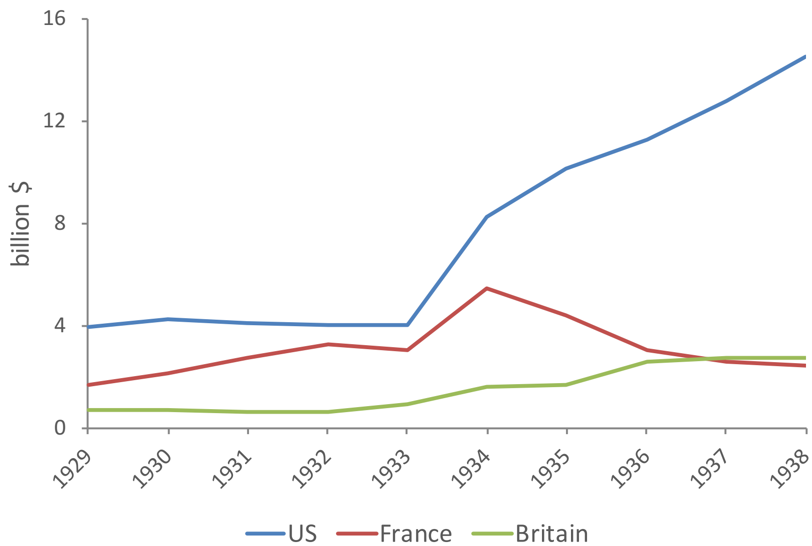


Figure 3: Reported gold reserves

Note: Reserves are valued at $20.67 per ounce until 1933 and $35 per ounce beginning in 1934.
Source: Board of Governors of the Federal Reserve System (1943, 544-554).

Belgium and Switzerland had over $600 million, and the Netherlands had nearly $500 million.[20] Not only did the monetary system as a whole have to take in most of the new gold, but there were also movements between countries of existing gold that impacted the final distribution. Capital flows were highly sensitive to political developments, and as international crises raised the prospects of war, capital moved from the continent to Britain, and most important, the United States. These "hot money" flows threatened exchange rate stability; to counteract the downward pressure on their exchange rates, monetary authorities

[19] Bank for International Settlements (1934, 25) and Bank for International Settlements (1938, 49).

[20] Countries that relied on exchange controls tended to have much less gold. Germany, for example, had under $50 million. It is important to note that while the depletion of Germany's gold reserves had at first been lamented in Berlin, the system of controls that developed in response soon became a point of pride in the totalitarian system.

sold gold, increasing the amount that Britain and the United States needed to purchase.[21] The United States was so concerned about this incoming capital sparking inflation—and its potential one day to reverse and threaten deflation—that Roosevelt publicly ordered an inquiry into how to moderate the flows.[22]

Of course, the reported reserves detailed above excluded the unreported reserves. The secretive exchange funds that handled intervention rarely published information on their holdings, though archival sources now help to clarify the picture. The British Exchange Equalisation Account (EEA), created in 1932, had an additional $900 million of gold at the end of 1936, constituting about one-quarter of Britain's total reserves, as shown in Figure 4.[23]

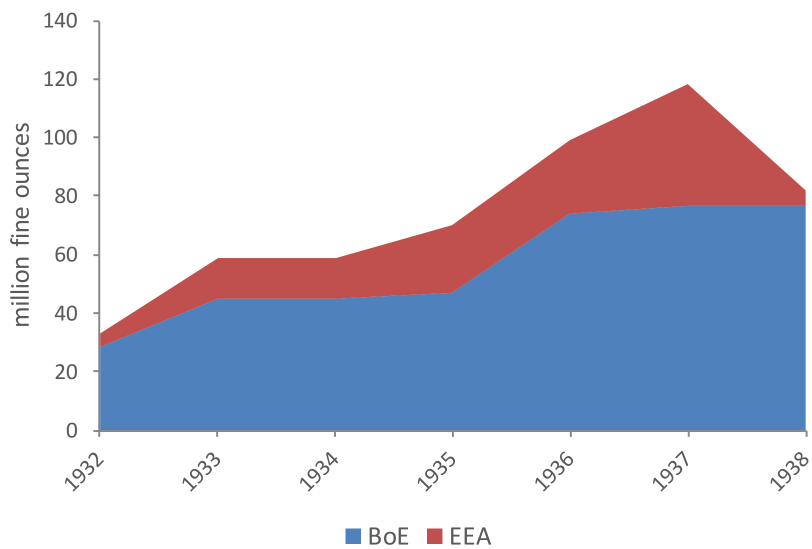


Figure 4: British gold reserves (million fine ounces)
Source: Parliamentary Papers (1951).

The U.S. counterpart to the EEA, the Exchange Stabilization Fund (ESF), had about $2 billion in gold.[24] These funds were the frontline tools for maintaining exchange stability,

[21]In November 1936, Roosevelt employed the term "hot money," which had referred to illegal gold movements, to characterize capital seeking refuge. This use of the term became standard thereafter (Rauchway 2015, 127).

[22]"Roosevelt Begins Inquiry on Alien Funds in Market," *New York Times*, November 14, 1936.

[23]See Howson (1980) for a history of the EEA during the 1930s.

[24]The ESF consisted of $2 billion from the profits of devaluation; however, only $200 million was actively

which depended in part on the price of gold. Whereas the United States had a fixed price for gold but no gold market, Britain had no fixed price but housed the world's gold market in London. Much of the gold for sale in London made its way to the United States through arbitrage shipments, but the market did not operate free from government interference. Changes in the sterling price of gold in London had ramifications for the all-important dollar-sterling exchange rate. The EEA therefore intervened frequently in the gold market to influence the price of gold and complement its efforts in the exchange markets.

From the EEA's inception, the British sterilized gold purchases and sales, preventing gold flows from impacting the domestic monetary system.[25] Because Parliament limited the EEA's size—in 1936, its capital was £371 million ($1.8 billion or approximately 7 percent of GDP)—authorities sometimes had to transfer gold from the EEA to the BoE to free up space for further purchases of gold. By December 1936, the British were purchasing so much gold, partly due to substantial sales of French gold to counter renewed weakness in the franc, that the EEA neared its limit and officials effectuated a transfer of £65 million.[26] This move was a temporary expedient that could not be repeated indefinitely, however; should large inflows of gold continue, either Parliament would have to increase the EEA's size or the EEA would have to stop purchasing gold.[27]

The United States, on the other hand, had not sterilized gold flows as a practice, but the

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used for intervention (Schwartz 1997). The other Tripartite members, except for Belgium, also had exchange funds.

[25]Sterilizing gold flows meant preventing them from influencing the reserves in the banking system. When the EEA purchased gold, it sold Treasury bills to finance the transaction, thereby leaving the reserves unchanged; when the EEA sold gold, it purchased Treasury bills. The process was largely automatic because the EEA's capital consisted of Treasury bills.

[26]The transfer of gold to the BoE's Issue Department would have resulted in a one-for-one increase in the note issue, but officials simultaneously reduced the Fiduciary Issue—government securities backing part of the note issue—by £60 million, so that the actual increase was only £5 million. Fisher, "Note on Fiduciary Issue and Bank return," June 12, 1937, T 160/660.

[27]Transferring gold to the BoE resulted in the immobilization of some of the EEA's sterling assets. The EEA, by law, was responsible for carrying any difference between the cost of gold it sold to the BoE and the BoE's valuation of the gold at the old statutory parity. The £65 million of gold entering the BoE's books had cost the EEA £108 million, meaning that the EEA's potential sterling resources fell by £43 million.

onslaught of gold coming ashore led to a new policy in December. U.S. Treasury Secretary Henry Morgenthau, feeling trapped between "four gold walls with no door," believed that sterilization offered him a way out: incoming gold would no longer add to banking reserves and thus would pose no risk of setting off an uncontrollable inflationary boom.[28] Henceforth, the government would offset gold flows, thereby maintaining its promise to purchase gold from all comers without further adding to excess reserves.[29]

The U.S. decision brought an end to a year full of momentous monetary developments. The Gold Bloc had devalued, the Western democracies had banded together in a novel attempt at cooperation under the Tripartite Agreement, and the United States had embraced a policy of segregating gold flows from the money supply. Observers were well aware that the international monetary system had many points of weakness. The franc was once again in trouble after its brief post-devaluation honeymoon.[30] Rising political tensions also provoked destabilizing capital flows that seemed more likely to get worse than better with each international development. But there was little sense that the fate of gold would be up for debate within months.

II Gold Scare

"In the circumstances," Einzig (1938, 25) writes, "the gold scare of 1937 came as a bolt from the blue." After years of currencies depreciating against gold, it was difficult for operators to imagine currencies appreciating against the metal. Until, that is, the thought suddenly

[28]Treasury meeting, November 24, 1936, MD 46 (208). Perhaps more important to Morgenthau was sterilization's role as a preventive measure in building up a stock of inactive gold so that large outflows in the future would not wreak havoc on the economy. He "pointed out to the President that I was much more interested in preparing ourselves for the time when gold would go out than I was in the immediate situation of stopping the increase of excess reserves through the inflow of gold." Morgenthau conversation with Roosevelt, December 17, 1936, MD 48 (262).

[29]Irwin (2012) argues that the sterilization program contributed to the 1937-1938 recession.

[30]Indeed, internal problems in France would contribute to the increased supply of gold and keep the country preoccupied, so that it was not as involved as Britain and the United States in addressing the gold issue (except to the extent that all parties hoped to find a way to stop France from hemorrhaging gold).

became plausible, at which point it seemed almost inevitable. Once the Scare erupted in April, it continued—at varying degrees of severity—until the end of June. This section reviews the sparks that set off the Scare, its main features, and its impact on markets.

On April 6, George Bolton, foreign exchange manager at the BoE, reported that certain U.S. banks had advised their London offices not to engage in gold arbitrage to New York. The reason appeared to be that the "Head Offices fear a possibility of a reduction in the United States Treasury buying price for gold," since any gold in transit would suffer a loss in such an event.[31] What precisely prompted this suspicion is unclear. The continued gold flows to Britain and the United States had generated comment as to whether the countries would keep buying and sterilizing the metal. In March, the Russians had started selling large amounts of gold in London; U.S. officials had also expressed concerns about inflationary tendencies. More proximately, on April 5, Morgenthau had responded "[n]ot right now" to a question about whether he intended to alter the handling charge on gold, an answer that left the impression that a future change could be in the offing.[32] Around the same time, Oliver Sprague, a Harvard economist who had previously worked at the BoE and U.S. Treasury, was on a European tour, where he expressed his belief that a reduction was necessary; many believed Washington had encouraged his comments.[33] For somebody inclined to think that the gold situation was untenable, there were enough signs to believe a change probable—even if this required ignoring conflicting evidence.

Whatever the reasons, the Gold Scare broke out on April 7, the day after Bolton's memo. As the *Financial Times* reported on April 8, "[w]ithin a few minutes [of hearing the rumors] all the markets of the Stock Exchange likely to be influenced by a drop in the price of

[31] Bolton, "The Dollar Price for Gold," April 6, 1937, BoE C43/92.

[32] Press conference, April 5, 1937, MDPC 8 (199).

[33] Decades later, Winfield Riefler, economist and U.S. Treasury adviser in the 1930s, told Richard Sayers, who was working on his history of the BoE, that Sprague "admitted he had told [Governor of the BoE Montagu] Norman that Morgenthau w[oul]d change the price of gold," though he had no inside information. The rumor spread from there. "All had been irresponsible action on Sprague's part—an innocent sweet person." Interview with Mr. W. W. Riefler, April 5, 1974, BoE ADM 33/31.

gold...had developed spasms of weakness."[34] The crisis fed on itself thereafter. The rumors evolved to suggest that the British would likely allow the sterling price of gold to fall as well; if they did not, the dollar would appreciate and the Tripartite Agreement would break down. It did not matter that the U.S. Administration denied the rumors. On April 9, Roosevelt said neither he nor the Treasury knew of any plan to reduce the price, blaming the "foreign press" for starting the speculation.[35] But that rejection hardly put an end to the matter. Morgenthau often refused to rule out any potential change in the future when batting down rumors, feeling it essential to maintain the executive's prerogative in monetary matters. The widespread confusion over U.S. gold regulations—they were "extremely obscure," as the British Treasury put it—added to uncertainty over just how much power Roosevelt had.[36] More fundamentally, Roosevelt's word was not worth much when it came to the dollar: his money experiments in 1933 had harmed his monetary credibility thereafter.[37] And though much of the press found the idea of a reduction in the price "absurd," in the words of *The Economist*, there were many outlets and experts who felt otherwise.[38]

The Gold Scare affected markets in a variety of ways. The distinctive feature of the Scare was the periodic halt in gold arbitrage deriving from concern that the price would fall during the five-day journey across the Atlantic. When banks refused to purchase gold in London to ship to New York, a shortage of dollars resulted. The British and U.S. exchange funds intervened during these times to provide dollars, using the reciprocal gold facilities in the process. But the Gold Scare also coincided with enormous shipments of gold to the United States. When banks felt momentarily reassured that no change in price would occur, the profit margin on this arbitrage was substantial and massive amounts of the metal crossed

[34] "An Unsettled Day," *Financial Times*, April 8, 1937.

[35] Press conference, April 9, 1937, RPC 359 (2).

[36] Hawtrey to Waley, April 12, 1937, T 160/940.

[37] Roosevelt's infamous "bombshell" message effectively ending the 1933 World Economic Conference in London, coupled with his gold purchase program, fomented distrust around the world and led many governments to view him as untrustworthy and even duplicitious.

[38] "An Unfounded Gold Rumour," *The Economist*, April 10, 1937.

the Atlantic. The United States imported \$216 million of gold in April, compared to \$154 million in March and \$28 million in April 1936.[39] Oddly, despite the rumors of a revaluation of the dollar and the official focus on a dollar shortage, the dollar actually depreciated slightly against sterling during these months, from \$4.91 to \$4.94 per pound.[40]

The decline in the price of gold was not as drastic as perhaps one would expect during a panic known as the Gold Scare. Over the course of the three months, it dropped from roughly 142 shilling to 140 shilling per ounce.[41] But the relatively muted fall was a result of the near-constant intervention by British authorities. The EEA purchased gold frequently, particularly when gold arbitrageurs were sitting out, some days buying the majority of the metal offered on the London market. This intervention was for the most part a crisis imperative designed to prevent further chaos. It did not mean that the British were wedded to the current price, as discussed in the following section.

Moreover, the key indicator in the gold market was not the price but what was termed the "discount on the dollar parity." An arbitrageur earned \$34.77 per ounce of gold shipped from London to New York, the 23 cent difference from the \$35 parity representing the U.S. handling charge as well as costs of shipping (such as insurance and handling). When the sterling exchange rate was e, the sterling value of the \$34.77 outturn was $\frac{34.77}{e}$. Letting g represent the sterling price of gold in London, the discount was defined as $\frac{34.77}{e} - g$. That is, a positive discount implied that shipping gold from London to New York was profitable. Discounts were rare and almost never exceeded one or two pence per ounce since any discount was usually a strong incentive to arbitrageurs. But during the Scare, the discount often surged, reaching 10 pence at times, without attracting arbitraguers. They did not enter

[39] Board of Governors of the Federal Reserve System (1943, 537).

[40] However, the three-month forward premium on the dollar increased as expected. The sterling spot rate may have appreciated in part due to the demand for sterling coinciding with the Coronation ceremonies in May. This subject requires further research.

[41] Prior to decimalization in the 1970s, one pound (£) equaled 20 shilling (s), each of which equaled 12 pence (d).

the market to purchase gold because they thought the United States would lower the price, meaning that the outturn would have been less than \$34.77 and the transaction unprofitable. The higher the discount, the riskier gold appeared—certainly, holders of gold thought, some change must be imminent if market experts refused to buy the metal—leading to greater sales and bigger discounts. The British worked to reduce the discount by purchasing gold but, for reasons that remain unclear, did not seek to eliminate it.[42]

Rumors about the price of gold also infected the market for gold mining shares in London, since the industry would become less profitable if the price of gold fell. Trouble in this sector then spread more broadly. On April 29, the *Financial Times* wrote that the "slump has assumed all the characteristics of a snowball... The trouble in the [South African gold mining shares], and the difficulties with which New York is struggling, are two of the levers with which practically everything else is being depressed."[43] By the end of the Scare, gold mining stocks had plummeted 16.5 percent, and industrial stocks overall had fallen 4.4 percent.[44] In the United States, the *New York Times*' average of 50 industrial stocks fell 9 percent.[45] Wholesale prices in both countries flatlined. While there was much else going on at this time—the Federal Reserve increased reserve requirements in May, for example—there is no doubt that the Scare contributed to the disinflationary mindset.[46] Economies had recovered significantly after the devaluations; many worried the process would reverse with revaluation.

The Scare was not constant. Fears would abate, only to be rekindled by new rumors. The *Financial Times* declared the "Gold Scare finally scotched" on April 21; little more

[42]A memorandum on the EEA's tactics written in October 1937 stated that when "gold is offered in excess of market capacity to absorb it, as during the 1937 gold scare we allowed the price to fall to between 6d.-8d. discount." There is no evidence as to why this range was chosen, though one reason must have been the EEA's limited resources. "Some Reflections on Dealing for Profit: A Rather Discursive Essay," October 7, 1937, BoE C43/77.

[43]"The Need for Cash," *Financial Times*, April 29, 1937.

[44]Data on the *FT Gold Mine Index* and *FT Industrial Index* from Global Financial Data.

[45]*New York Times*, various issues.

[46]The Federal Reserve had already announced the changes in reserve requirements at the end of January, so the increase in May was expected.

than a week later, it deprecated that "most foolish story, but one that did a great deal of damage in the closing hours" of April 28, which revolved around "an assertion that President Roosevelt was imposing a duty on gold imports."[47] Political agitation also kept the issue alive. Congressmen attacked the U.S. gold policy. The Treasury had started transferring the nation's gold to an underground, bomb-proof vault at Fort Knox at the beginning of the year; the notion of borrowing money to buy gold to bury in Kentucky struck many as baffling.[48] "[W]e now sterilize all this excess useless gold, which we go right on buying at the same old swollen price," Senator Arthur Vandenberg decried at the end of April. "We sterilize it, which is to say that we bond ourselves to buy it before we bury it."[49] Representatives introduced various resolutions, including one demanding the Secretary pay no more than $25 per ounce.[50] Across the Atlantic, the Chancellor of the Exchequer faced pressure in the Commons. As one MP asked, are we "to go on indefintely buying gold which we do not want in order to keep up the price of that which we have got?"[51]

The Scare eventually came to an end in June. Partly, the crisis fizzled as attention turned to France's worsening political and monetary crisis, which resulted in the fall of the government and devaluation of the franc.[52] In addition, the prodigious dehoarding of gold perforce reduced the size of private holdings that could be sold, thereby diminishing the future danger. Policy actions to combat the Scare helped as well. Most important, the Chancellor of the Exchequer announced on June 25 that Britain would increase the capital of the EEA from £371 million ($1.8 billion) to £571 million ($2.8 billion), a massive move demonstrating to markets that the government intended to purchase gold as necessary. The United States also continued to purchase all offered gold at the same price, putting the

[47] "A Sting in the Tail," *Financial Times*, April 21, 1937 and "That 'Fear of Fear,"' *Financial Times*, April 29, 1937.

[48] "Treasury to Start Moving 4 Billions in Gold in Week," *New York Times*, January 11, 1937.

[49] Cong. Rec. April 29, 1937, 81:3934.

[50] Cong. Rec. April 28, 1937, 81:3904.

[51] Parl. Deb. H.C. (5th ser.) (1937) col. 1582.

[52] See Mouré (2002, ch. 8) for details on the French monetary situation from 1936 to 1939.

rumors to rest. At this point, it was clear that the countries favored the status quo. They had doubled down on gold at its current price. Yet, while it appeared on the outside that not much had changed, behind the scenes there had been an intense debate to reach that outcome.

III Official Debate and Response

The Scare stimulated intensive investigation into the role of gold in the international monetary system. Sifting through the archives, it is evident that there were many considerations when deciding whether or not to alter the price of gold, including the impact on gold producers, the effect on inflation, power dynamics, and inertia. Viewed *in toto*, however, the files suggest two key determining factors. First, officials considered the problem through the lens of the Tripartite Agreement; any solution had to abide by and uphold it. The implication was that the United States and Britain had to act in concert. Second, policymakers were convinced that—no matter how nominal gold's role in the domestic monetary system had become—the metal was essential for the international system. No other asset was suitable for handling international balances. Ultimately, maintaining the price seemed to be the best method for preserving this function.

It must be emphasized at the outset that gold's role was far from predetermined. Since the outbreak of the Depression, countries had drastically weakened the relationship between gold and their monetary systems. Gold coin no longer circulated, fewer currencies were defined in terms of gold, and the gold backing required for the note issue was increasingly a relic. Perhaps the metal had outlived its monetary use as silver had. Indeed, Germany had developed a system that required no gold for international purposes. Through exchange controls and clearing mechanisms, it showed that alternatives to gold shipments existed. No doubt, the Tripartite countries saw much evil in the German setup: restriction of trade, distortion of markets, enabling of fascism. Nevertheless, there were legitimate reasons to wonder about gold's future.[53]

The issue of gold was already on policymakers' minds prior to the Scare. The first reference to a possible reduction in the price appears to be a U.S. Treasury memorandum written at the beginning of March 1937 that considered lowering the buying price of gold to \$30 while maintaining the selling price at \$35 as a means of reducing capital inflows.[54] The analysis was part of a larger effort aimed at finding ways to get a grip on the hot money problem. Across the Atlantic, Henry Clay, a key advisor at the BoE, began expressing concerns in mid-March on the sustainability of the current situation. He wrote that "[i]f nothing is done, the accumulations of gold will reach a point at which they break down the willingness or capacity of Governments to carry gold which they do not use for monetary purposes [due to sterilization]. Gold will then rapidly lose its value, and large areas of the Empire will be ruined."[55] He then broached the topic with the U.S. financial attaché in London.

On March 26, Morgenthau—aware of Clay's approach—discussed the issue with the British financial attaché, Thomas Bewley. The Secretary said that he did not believe the Tripartite Agreement explicitly covered the price of gold, but that "if any member of the Tripartite Agreement was considering dropping the price of gold that we should consult with one another."[56] He was making it clear that even if the Agreement did not unambiguously mention gold, the two were intimately connected. After all, the question of gold was inextri-

[53]In fact, Kindleberger (1986, 269), who was an economist at the FRBNY during these years, claims that there was an active investigation into demonetizing gold at the time, though this inquiry appears to have been about the domestic aspect of gold. For example, John Williams, simultaneously a professor at Harvard, Vice President at the FRBNY, and adviser to the Treasury, suggested an end to domestic gold covers so that reserves were used only for international purposes. Williams, "International Monetary Organization and Policy," 1937, FRBNY John H. Williams Papers Series 1. The Macmillan Committee in Britain had suggested the same in 1931 (Stamp 1931).

[54]Schmidt to White, "The Lowering of the United States Purchase Price of Gold as a Method of Checking Capital Flows," March 2, 1937, JVP B49F6.

[55]Clay, "Memorandum," March 18, 1937, BoE G1/488.

[56]Morgenthau conversation with Bewley, April 1, 1937, MD 61 (155A-B).

cable from the issue of exchange rates. If the United States reduced its buying price for gold, the dollar would appreciate unless the British allowed the sterling price of gold to fall by the proportionate amount. If the British allowed the sterling price of gold to fall—perhaps because the EEA no longer had resources to purchase gold—and the United States maintained its buying price, sterling would appreciate. Both actions, not to mention the reactions of the other Tripartite members, threatened the Agreement's commitment to stability. Morgenthau went on to wonder out loud whether, moving forward, Tripartite members should buy exclusively from central banks, which would have the effect of creating two prices for gold. The meeting was informal, however, and nothing came of it.[57]

Once the Scare broke out, the British found the matter more urgent, particularly since London was the epicenter of the market turbulence. The current situation was simply unsustainable. Either the price would have to drop, the amount of gold offered in London would have to fall, or the EEA would soon need greater buying capacity.[58] Sir Frederick Phillips, the Treasury's monetary expert, declared the problem "extremely pressing."[59] Officials at the Treasury and BoE were in unanimous agreement that any response had to involve consensus among the Tripartite members, which effectively meant in coordination with the United States, the support of the French, and at least the acquiesence of the others. Phillips wrote in May that the British should "decline to commit ourselves to any change unless it was agreed generally by all members of the Currency Club."[60] Harry Siepmann of the BoE concluded that "[o]ur greatest asset has come to be the Tripartite agreement, and it would be still more useful if it could be made the pivot of our solution for gold."[61] The Tripartite

[57]Bewley reported to London that Morgenthau, "ignorant of financial matters," would not take any action without a review by his staff. Bewley, "Financial matters raised with Mr. Morgenthau," April 14, 1937, T 177/35.

[58]Indeed, the EEA ran out of sterling assets at the end of June before Parliament authorized the £200 million increase. The BoE and Treasury worked out a temporary arrangement whereby the BoE purchased gold that it would later transfer to the EEA. "EEA and Banking Department," July 5, 1937, BoE C43/25.

[59]Phillips, "The Present and Future of Gold," May 1, 1937, T 177/39.

[60]*Ibid.*

[61]Siepmann, "The Price of Gold," May 7, 1937, BoE C43/141.

Agreement could help the countries solve the gold problem, and the successful handling of the gold problem could further strengthen the Agreement.

There was also a consensus in London on the various tradeoffs at play. Officials believed that the gold inflow was too large to continue indefinitely and feared that the current price, if maintained, could become untethered from reality. To be sure, even though Britain and the United States were suffering from "gold indigestion," they realized that other countries, notably France, were struggling with too little gold.[62] In this sense, the problem could have been one of distribution rather than production. But there was so little faith that the French would be able to right their ship—a struggle that kept them preoccupied during these months and incapable of worrying about a world with too much gold—that policymakers felt unable to orient their strategy around a French recovery.[63] At the same time, they understood that a decrease in price could devastate parts of the Empire, which produced the majority of the world's gold, and worried that a reduction could damage confidence in growth prospects. Finally, there was the fact that Britain held a lot of gold and would therefore take a paper loss should the price fall. While the magnitude of the potential loss was by no means a decisive factor, the scale of the gold holdings underscored Britain's vital interest in the outcome.[64]

The most important factor, however, was the necessity of maintaining trust in gold for international purposes. As Phillips argued, "[g]old is a monetary metal," and "[u]nless some great powers were willing to buy any amount at an approximately fixed price. . . gold ceases to be a monetary metal."[65] The consequences of such an outcome would be stark:

> The approximate stability of exchange rates which has marked the last two years would again be replaced by chaotic conditions. For the dollar, franc and sterling

[62]Phillips, "The Present and Future of Gold," May 1, 1937, T 177/39.

[63]As Sir Richard Hopkins, a top Treasury official, wrote, "[u]ntil recently we have been trying to believe that the wrost of the French crisis was over and that there would be at any rate some moderate tendency for the gold which had come out of France to go back there. It seems now wiser to abandon any hopes of that kind." Hopkins, Untitled memo, May 25, 1937, T 177/39.

[64]After suspending convertibility in 1931, the British had not revalued the gold holdings at the BoE; they would not be revalued until 1939. There was therefore additional space to lower the price of gold without suffering a loss.

[65]Phillips, "The Present and Future of Gold," May 1, 1937, T 177/39.

> are only kept on a steady footing, because there is a fourth money, gold, which the United States, France and ourselves are willing to buy and sell from each other. . . While France might be willing to hold dollars and sterling we should not be willing to hold any large supply of dollars nor would the Americans be willing to hold large amounts of sterling.[66]

The Tripartite system was predicated on gold. Precisely because nations were either off gold (Britain and France) or on it in a constricted form (the United States), officials considered gold the only suitable reserve asset: every exchange manager wanted to avoid being caught with foreign currency that could depreciate unexpectedly (as had happened earlier in the decade). There was no alternative, and the implications for exchange stability, the Tripartite Agreement, and even democratic solidarity were dire in a world where gold was not trusted. In its international role, then, gold was just as important, if not more, than it had ever been. The Gold Scare did not lead policymakers to question this status; rather, it reaffirmed the necessity of this international function. Gold had to remain a monetary metal.

The desire to uphold gold's role did not actually dictate whether or not to alter the price. Most thought maintaining the price was the best way to preserve faith in gold. Some influential officials, however, argued that a well-executed reduction that prevented a later collapse in price was preferrable. Governor Montagu Norman of the BoE strongly favored a reduction, and the BoE devoted much effort to analyzing the effects of such a course on Britain, the Tripartite members, and countries around the world.[67] Those in Whitehall were more circumspect, especially the new Chancellor, John Simon, who took office at the end of May and was hesitant to pursue any action. They found the notion that reducing the price of gold would reaffirm its status as the international reserve asset par excellence—including its store of value function—difficult to accept. All believed, however, that the proper course hinged on what the United States would do. If the United States thought reducing the price advisable, the British seem to have been willing to take the plunge; if the United

[66] *Ibid.*

[67] See many of the papers in BoE OV48/11, which include estimates of the effects of a reduction in the price of gold on countries from Brazil to Latvia to Yugoslavia.

States thought not, the British would certainly not act alone. That is, the sine qua non of preserving gold's monetary role was Anglo-American agreement on any change in gold's price: there would be no trust in gold unless the two great purchasers were on the same page. But the Treasury, as opposed to the BoE, did not want to press the issue with the United States: they thought it better for the United States to take the initiative.[68] In the meantime, "there is no escape from buying what is now offered" on the gold market, and the British continued to intervene through the EEA to lessen the chaos in markets.[69]

Whereas the Gold Scare made the British more willing to consider action, it made the Americans more cautious. The rumors swirling around were nearly all about the United States, and Morgenthau was never one to have his hand forced. Externally, therefore, the government reassured that there was no change planned. Morgenthau repeatedly told the foreign exchange manager at the FRBNY that "[t]here's nothing to get excited about on this side" and that he could inform his Tripartite counterparts accordingly.[70] Internally, officials considered a range of options, from reducing the price to limiting output to imposing an embargo on gold imports. The archival sources for the United States are not as rich as those for the British in tracing the debate, but insight into the U.S. conception of the situation can be gleaned from two documents written by Harry Dexter White, the Treasury's monetary expert and future architect of Bretton Woods. The first is 60-plus-pages of fictitious Congressional testimony in which White wrestled with the issues at hand.[71] The second is a detailed analysis of the problem.[72]

[68]The Treasury attitude annoyed Norman, who ridiculed their plan to wait "as late as possible" in reaching out to Morgenthau and "[h]ope that 'price question' will be forgotten & go to sleep with enlarged EE A/C." The BoE, in comparison, believed that "the sooner considered & settled by contact with M[organtheau] the better." Norman, Handwritten note, June 22, 1937, BoE G1/488.

[69]Phillips, Untitled memorandum, June 4, 1937, T 177/39.

[70]Morgenthau conversation with Knoke, April 9, 1937, MD 64 (4).

[71]White, "Transcript of Imaginary Hearings," May 28, 1937, HDWP B2F8.

[72]White, "The Gold Problem," undated, HDWP B2F9. The memo is undated, save for a handwritten note "Sep 1937?" on page 23. A more complete version of the memo was completed in September 1937 (see White and Glasser, "The Gold Situation," September 15, 1937, HDWP B3F7). However, the original draft mentions the possibility of a "reduction in the franc to the maximum limit set last fall," implying that it

The imaginary testimony is illuminating as it makes clear the U.S. understanding of the international monetary system. White created it for Morgenthau in May as a means of justifying the current policy, including the $35 price, and the emphasis on the international role of gold is evident throughout. Senators berate the Secretary and Assistant Secretary, questioning why the country should continue to purchase gold only to sterilize it. When one senator suggests ending imports of gold, White has the Assistant Secretary quash the idea: "In the first place were we to declare an embargo on gold imports we would deal a severe blow to the value of gold as a monetary metal, and knock such foreign exchange equilibria as we have into a cocked hat."[73] Another Senator wonders whether gold will continue to have value if it eventually stops serving as a backing for the note supply, to which the Secretary replies:

> You may be correct in saying that the day may come when specie requirements against our note issue may be eliminated, but that doesn't mean that gold will cease to have use as a monetary value. Remember, I said that gold has <u>two</u> uses as money. The other use, and by far the most important use, is its employment as a means of settling international balances among nations. Gold has been used for that purpose from time immemorial and as I have said before modern governments have as yet found no effective substitute, nor is there any visible sign of an effective substitute on the horizon.[74]

Gold may have been tarnished domestically, but it remained invaluable internationally. Of course, the United States held half of the world's monetary gold, so its interest was also pecuniary in the sense of looking after the Treasury's bottom line. But this aspect was inseparable from the international role. "We have too much interest in the future of gold," the Assistant Secretary testifies, "to so threaten its use a medium of exchange among nations."[75]

White was well aware that his exercise in monetary playwriting might serve only as a "mild cure for insomnia," so he made sure to prepare a more conventional analysis as

was written before June 30, 1937.

[73] White, "Imaginary Testimony," 29.

[74] *Ibid.*, 55.

[75] *Ibid.*, 29.

well.[76] His memorandum exhaustively reviews the gold problem and potential solutions. "The world gold problem will become more acute as time goes on," he argued, and it "can be solved only through international cooperation."[77] A full embargo on gold imports, never seriously considered by the Treasury but suggested by politicians and pundits, would "[b]reak the tripartite understanding and introduce a period of fluctuating exchanges with all its attendant uncertainties. The end result of such instability is unpredictable. Shake world confidence in gold as a monetary metal, and thus imperil the value of our gold stocks."[78] The less drastic option of reducing the price would be ineffective in halting the inflow "unless the cut in price introduces a recession and gives rise to the general expectation that a lengthy business recession was in prospect."[79] Such a consequence could not be countenanced. He favored an international agreement to implement quotas on production, but whatever the desired action, he believed it best not to take the lead. Though coordination was essential for any solution, the United States should wait for the other parties to seek cooperation first. "It is to our advantage now to let England absorb as much gold as possible, let her become more aware of its urgency and thus put her in a frame of mind more conducive to a final settlement."[80]

In short, both the British and the Americans were committed to an international system based on gold. Some in London thought a coordinated reduction in the price of gold could help in this regard but only if Washington agreed; what was crucial was that both countries acted together. While there was an informal exchange of views, there were no in-depth negotiations: the U.S. desire for Britain to reach out first and the British desire for the United States to reach out first precluded formal discussions. Suffice it to say that the potential for a price reduction ended when Morgenthau informed the British at the beginning of June that

[76] White to Morgenthau, May 28, 1937, HDWP B2F8.
[77] White, "The Gold Problem," undated, B2F9.
[78] *Ibid.*
[79] *Ibid.*
[80] *Ibid.*

he did "not feel that the solution lies through dropping the price of gold."[81] Precisely why Morgenthau made this statement when he did is not entirely clear. Certainly, inertia and the troubles in the stock market contributed. But there can be no doubt that he believed that sticking with the current price of gold would best protect its monetary status and all the attendant benefits.

For the British, this decision effectively settled the matter. There was no interest in altering the price independently of the Americans.[82] But they also understood that the price would not maintain itself; the British had to intervene proactively. "We must be prepared to buy gold ourselves if we expect the Americans to," a BoE memorandum declared shortly after Morgenthau's verdict. "This means enlarging the E.E.A."[83] To this end, the government vastly increased the EEA's size at the end of June so that it could purchase enough gold to keep the price from falling. This action, by upping the EEA's firepower, helped bring the Scare to an end. There was no question where Whitehall now stood. The State Department's top economic official emphasized this to Morgenthau, noting that "the British Treasury has just augmented its stabilization fund as an indication of doing its full part in meeting the present gold situation."[84] The public understood the significance of the move as well. As the *Baltimore Sun* explained after the British announcement, "[t]he willingness of the British Government to respond to this need as well as its desire to provide for the continued absorption of gold is to be welcomed... [I]t represents a further step in the program of monetary cooperation which was initiated in the tripartite monetary agreement of last September."[85]

[81] Morgenthau conversation with Mallet, June 7, 1937, MD 72 (35).

[82] In a telegram expressing his agreement that the price of gold should remain the same for the time being, Simon took Morgenthau up on an earlier suggestion and offered to send Phillips to the United States for discussions on gold and other monetary matters in September. By time the meeting occurred, other issues had become more prominent, and there was little discussion of any change in the price of gold (Drummond 1981, 230-234).

[83] "Notes and Comments," June 18, 1937, BoE G1/304.

[84] Feis letter to Morgenthau, June 29, 1937, MD 74 (123).

[85] "British Cooperation," *Baltimore Sun*, June 27, 1937.

A sea change had occurred. At the beginning of the decade, large exchange funds that accumulated gold had provoked suspicion and anger; they appeared to be mechanisms to gain advantage at the expense of others. Now, with gold's future on the line, they were the epitome of cooperation. Britain's expansion of the EEA cemented the decision to move forward with gold at its current price. In this way, gold would retain its monetary properties so essential to the functioning of the international system.

IV The Swiss Episode

Though the willingness of the United States and Britain to continue purchasing gold ended the Scare in public, the matter was not yet resolved behind the scenes. The solution was to maintain the price of gold, and this hinged on monetary authorities cooperating. When small central banks with strong currencies sold gold, not only did others have to purchase more but markets interpreted the move as a negative signal for gold's future. During the height of the Scare, Switzerland sold large amounts of gold to the United States in exchange for dollars, angering Morgenthau and threatening the unity of the Currency Club. Morgenthau responded by presenting Switzerland with a statement of principles—agreed to by Britain and France—that summarized the responsibilities of Tripartite membership and the role of gold. Reserves were to be in gold, not foreign exchange, and each country had to do its share in carrying this gold.[86]

Switzerland began selling gold to the United States in exchange for dollars in May 1937 in response to its rapid accumulation of the metal. These sales—at the same time Britain was purchasing in the market and the United States was buying at its fixed price—seemed uncooperative and short-sighted to the other Tripartite members. The Anglo-American archives are full of conversations and memoranda expressing exasperation with Switzerland.

[86] Clay (1957, 431) appears to be the only work that refers at all to the episode, though he maintains discretion by speaking only of a "European Central Bank."

George Harrison, President of the FRBNY, told Morgenthau that the Governor of the Swiss National Bank was "stupid and he's shy, and he gets scared—he's skittish."[87] The BoE recorded a conversation with the head of the Netherlands Bank, who was "very annoyed with the Swiss, whose gold sales he thinks contrary to the spirit of Tripartite Agreement."[88] Morgenthau sent Merle Cochran, Financial Secretary in the Paris Embassy and Morgenthau's de facto financial ambassador in Europe, to discuss the situation with the Swiss.

After some back and forth, Morgenthau decided in July to draft a letter to the Swiss expressing general principles regarding gold. The letter is quoted at length below, for as Morgenthau said, "every word... was carefully weighed:"[89]

> At the present time, we who have joined in the tripartite accord are engaged together in an attempt to bring a greater measure of stability and of genuine equilibrium into the market for foreign exchanges. This market has, as you know, in recent years been characterized by exceptionally large movements of capital, many of which do not represent normal financial or commercial transactions. Under these circumstances, some of us are likely to be called upon, at least temporarily, to hold exceptionally large quantities of gold. I do feel, however, that the central banks and treasuries of these countries which have declared their adherence to the tripartite accord should refrain from increasing these movements by unilateral decisions to transfer their gold reserves into foreign currencies.
>
> In our opinion, the normal function of international gold movements is to liquidate international balances of payments arising from the natural flow of international commercial and financial transactions. Governments and central banks should, we believe, in their own operations conform as closely as possible to this general principle. We believe that this principle makes it incumbent upon the adherents of the tripartite declaration to hold their reserves in the form of gold either at home or earmarked abroad, and where a central bank deems it desirable to maintain foreign balances, such balances should in the main be kept with the Central Bank of the selected country and should, furthermore, be maintained essentially as working balances. We further feel, and especially in the case of those countries that have adhered to the tripartite declaration, that central banks or governments should make investments in other countries only after consultation with, and perhaps only at the invitation of, the government concerned.
>
> We suggest that an acceptance of the above principles would be a constructive

[87] Morgenthau conversation with Harrison, May 28, 1937, MD 70 (234).
[88] "Note of conversation with De Jong," June 14, 1937, BoE OV48/11.
[89] Morgenthau conversation with Butterworth, July 19, 1937, MD 79 (126).

> development of the spirit of monetary cooperation envisaged in the tripartite declaration, and would contribute toward enduring stability in the international monetary field. We hope that the other adherents to the tripartite declaration share this interpretation of its implications.[90]

These paragraphs reflect the emerging orthodoxy of gold's new role. Reserves were to be exclusively in the form of gold save for working balances in foreign currencies.[91] The gold facilities were meant to enable intervention to stabilize rates, not to provide a means for altering reserve composition. And each member of the Currency Club had to do its share, holding enough gold so that the metal retained its monetary properties.

Before presenting the letter to the Swiss, Morgenthau sought British and French input. The French were in agreement. The British were sympathetic, and as Siepmann wrote Phillips in analyzing the contents, "the general principles and apparent intentions underlying Mr. Morgenthau's draft are in fact entirely acceptable" to the government. But they believed it ill-advised to "formulate a code for Control."[92] More important, they worried that the Swiss could interpret the letter as suggesting that the Americans were in fact wary of purchasing all offered gold. In replying to Morgenthau, Chancellor of the Exchequer Simon gently asked, "[m]ay it not also be wiser at the present moment when confidence in gold is recovering to avoid putting into the minds of the junior members of the Currency Club that any real doubt could exist of our willingness to take gold from them?"[93] Fears regarding gold's future had receded in public; now was not the time to amplify them among governments.

Morgenthau moved forward but made sure to heed Britain's advice. He directed Cochran to be informal in his presentation of the letter, delivering it verbally and leaving a copy only if necessary. More important, Morgenthau stressed to Cochran that, so long as the Swiss

[90] Morgenthau telegram to Butterworth, July 14, 1937, MD 78 (329-331).

[91] Though every word may have been "carefully weighed," the key phrase "working balances" was left undefined.

[92] Siepmann to Phillips, July 15, 1937, BoE C43/327.

[93] Simon telegram to Morgenthau, July 19, 1937, BoE C43/327.

agreed to the principles contained in the letter, he should tell them that the United States would "stand ready to accept any amount of gold they wish to send us."[94] There would therefore be no reason to doubt the U.S. commitment to the $35 price of gold. In this way, Morgenthau could make his point clear—all Tripartite members needed to cooperate on the gold situation—without saddling the Currency Club with formalized rules and risking serious disagreement.

Cochran made his way around Europe, visiting the three junior members of the Club. As instructed, he left the Swiss an "unheaded and unsigned memorandum" after reading it and informed them that, while the British and French supported the contents of the letter, the former "preferred that we should not endeavor to codity too precisely and formally at this early date the tripartite principles."[95] He also emphasized the U.S. willingness to purchase all gold offered. The Swiss could not agree to the letter on the spot—it required internal discussion—but Cochran's interlocutor found it acceptable, said they did not plan to convert more gold into dollars, and hoped for further Tripartite cooperation. The Swiss later sent word of their agreement to Cochran.[96]

The meetings with Belgium and the Netherlands similarly reaffirmed the necessity of holding gold and using it for international transactions. While both insisted on maintaining ultimate discretion to act as they saw fit—it was a gentlemen's agreement, after all, and the U.S. reserved the right to alter its parity on a daily basis—they made clear their concurrence with the main points. The Governor of the Belgian National Bank told Cochran that he was "opposed to any club member attempting to shift its gold load onto the shoulders of another member."[97] The President of the Netherlands Bank would make no blanket promise, but he had not yet sold gold and would be frank with any action taken. Both countries reiterated

[94]Morgenthau conversation with Cochran, July 19, 1937, MD 79 (119).
[95]Cochran telegram to Morgenthau, July 24, 1937, MD 79 (176-177).
[96]Cochran telegram to Morgenthau, September 20, 1937, MD 89 (47).
[97]Cochran telegram to Morgenthau, July 24, 1937, MD 79 (190).

the importance of the Tripartite Agreement. The members now understood where everyone stood.

Switzerland's actions had threatened Tripartite unity and exacerbated fears during the Gold Scare. To Einzig (1938, 240), the Swiss were worse than "rats leaving a sinking ship," for at least rats bailed when the ship was actually sinking: the Swiss ended up being wrong about gold's trajectory. But the ensuing back-and-forth provided an opportunity for Tripartite members to clarify what membership entailed. With the conclusion of the Swiss episode, gold's status among the Tripartite countries was secure.

V Conclusion

The Gold Scare was the acute manifestation of a chronic problem. Policymakers had been worried about the burden of gold purchases for some time; the panic in the markets forced them to decide whether to double down or alter their strategy with respect to gold. Though many factors were at play, the guiding consideration was the desire to maintain gold's role in the international monetary system. To this end, the United States and Britain—the principal owners of gold—resolved to purchase and hold gold as necessary. And the Tripartite members agreed not to unload the metal on one another. The policy pursued was bound up with the cooperative spirit of the Tripartite Agreement. As a BoE memorandum stated, "our obligations under the Tripartite Agreement make it obligatory upon us to accept gold freely."[98]

Soon enough, the monetary debate centered on the opposite fear. With the recession worsening in the autumn, markets believed an increase in the dollar price of gold possible. But throughout this "Dollar Scare" and the chaos of the rest of the decade, one constant remained for policymakers: the international monetary system depended on gold. This

[98] "Reasons for holding so much gold," undated, BoE C43/25.

conclusion—reached when gold appeared overpriced—was equally applicable when it seemed underpriced. And when the United States again faced an avalanche of gold during the first year of the war, the sentiment remained. Writing in 1940 on "The Future of Gold," Harry White summarized gold's transformation over the past ten years. "[G]old really derives its importance as a monetary metal not from its use within a country but because of its utility as a medium of international exchange. Even such importance as it may be thought to possess within a country derives largely from its utility as an international medium of exchange. In the performance of that function gold is as yet without peer."[99] Only with the destruction of the Second World War would the dollar—deriving much of its strength from its connection to gold—emerge as a rival to the metal itself.

[99]White, "The Future of Gold," undated, JVP B49F3.

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