

Gold by Montresor

A new kind of extortion

Will debtor countries be forced into gold collateralization for loans, without benefit to themselves?

Mr. John Gutfreund, the managing partner of Salomon Brothers who last month became an indirect employee of Mr. Harry Oppenheimer of South Africa, told the London *Financial Times* Sept. 6 that gold-collateralized lending might be the wave of the future, adding that he hoped that the new combination of Phibro and Salomon Brothers would be an ideal firm to organize such arrangements.

It has not taken long to confirm that Mr. Gutfreund was right on the money. At least two countries, Portugal and Romania, have been backed to the wall by their bankers during the past two weeks with a demand that their gold reserves be put up as collateral for loans. Whether they will accede is not a settled question, but, in any event, the incidents show how great the pressure is for the mobilization of monetary gold. The great danger in the present events is that countries which should preserve their monetary gold for participation in a gold monetary system to come may be stripped of these reserves, to the detriment of their trading partners in the future.

Most unusual in the present situation is that the banks concerned have suspended already-in-place credit facilities in order to press home this demand, rather than merely delaying new credits. The Romania story broke on the front page of the London *Financial Times* Sept. 21, although it was well

known in financial circles that Romania had run up a \$60 million overdraft at one major New York bank two weeks earlier. In a departure from past practice, the banks forced Romania, whose trade deficit this year will exceed \$1.2 billion and which must pay \$2.4 billion in debt service in addition, to "clean up" its overdrafts, and proceeded to suspend other short-term credit facilities. Said one of the East Europe desk officers managing the New Yorkers' role in the affair, "We merely thought that since Romania is sitting on \$2 billion in gold reserves, there is no need for us to take additional credit risks."

Not yet in public view is the parallel situation of Portugal, NATO member and prospective member of the European Community, hardly a "Third World country." Mysteriously, short-term credit lines for Portuguese companies and banks on the Eurodollar market dried up in mid-September.

A number of sophisticated banking sources in Western Europe emphasized to me that this occurrence had little to do with Portugal's well-known economic problems, aggravated this year by a drought that reduced the country's agricultural exports and compelled it to buy electricity from France. Portugal "is still an infinitely better credit risk than many countries who are still obtaining credits on the markets," a German friend noted.

In addition, Portugal has a dis-

proportionately large gold reserve, relative to the size of the nation's economy, at \$9 billion. That gold accumulation dates from the opening of the Brazilian mines in the mid-17th century and the first major gold flows to Europe. Wisely, Portugal never parted with it. In 1975, along with Italy, Portugal obtained gold-collateralized credits from West Germany, all of which were since repaid.

What Portugal's bankers now demand is a different sort of gold collateral, one which would ultimately result in the pillage of the country's gold stock. Market rumors that the Portuguese have given in to the demand are not likely to be true, say bankers I have spoken with; Portugal has friends in Western Europe who would not gladly see it subjected to such ill treatment, and who also view its gold stockpile as a useful potential addition to a European pool.

These negotiations indicate not only how firmly the idea of remonetization of gold has implanted itself in the minds of the financial community, but how tortuous the road back to a gold standard could be. In the 19th century, as much as in the 16th century, control of gold by private interests enabled them to dictate terms to governments. Merely because central banks now control slightly over half the gold above the earth's surface does not mean they would for long, if gold were brought back as a principal means of international payments. Foolish central banks and their gold will be soon parted. To the extent that gold is merely mortgaged to secure debts that arise from unsound economic circumstances, its remonetization will do little good to the world economy.