Chapter VI

South Africa

In October 1940, after the fall of France in the previous June, the cost in gold and foreign exchange of the second year of war was estimated at £800 million, while at the end of September gold and dollars had been reduced to £222 million; there were £175 million securities, difficult to sell. The U.K. needed at least £150 million as an essential reserve.

Help was expected from the U.S.A. but nothing could be done until after the Presidential election in November. In October an approach was made to India and South Africa. An attempt to obtain part of the Reserve Bank of India's gold was abandoned almost at once on representations from the Viceroy. In the case of South Africa, Mr.John Martin* was first engaged in sounding ~~[illegible]~~ General Smuts, who was known to be sympathetic. It was suggested that the Reserve Bank's gold, still valued at 84s. per fine ounce, should be revalued at 168s., which would make some £35 or £40 mn. available even if the existing proportion of over 53% were maintained. But the change would eventually have needed Parliamentary sanction and the political situation made it somewhat unlikely that this would be forthcoming. Moreover there was a War Loan in progress, and the South Africans suggested as an alternative the provision of some £30 million gold for sterling at once, and the retention in South Africa of newly-mined gold until this amount had again been made up. All that was offered was thus temporary assistance of no very large amount. South Africa would not do more unless pressure came from the U.S.A.

By January 1941 the Treasury were of opinion that the matter should be dropped for the time being, though the Governor appears to have still favoured a request for an outright sale of £30 million gold.

During

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*A Director of the Bank of England and the Managing Director in South Africa of the Central Mining & Investment Corporation. He conducted negotiations in Washington during the war on behalf of the Union Government.

During the first war year the Union had produced some 14 million ounces of gold, but had sold to the U.K. 10 million ounces only. This was not the only trouble: South Africa was also spending too much on imports from the U.S.A., and was believed to have an inadequate exchange control.

A new High Commissioner for the U.K., Lord Harlech, had now been appointed, to serve from 1941 to 1944, and in the middle of March the Treasury and Bank prepared a brief to assist him. This makes clear the difficulties with which this country was faced as a result of South Africa's policy and action.

March 1941

"Our financial relations with South Africa raise some difficult questions which could be more easily solved if it were not for political considerations. The fundamental difficulty is that South Africa remains, consciously and deliberately, on the gold standard and attempts to practise the gold standard while nominally being a member of the Sterling Area. As bankers of the Sterling Area we are liable to/be called upon to provide such gold as may be needed to meet the international commitments of its members, and we feel correspondingly entitled to the custody of the Empire's centralised reserves in gold. But South Africa has shown a marked reluctance, since the war, to bank with us in sterling and avoids selling us more gold than is needed to meet her own international liabilities. The rest is retained in a separate reserve of her own, as a national store of value for international purposes. We are interested in arranging (1) that South Africa should treat gold, like Canada, as a commodity for export and sell us as much of it as possible for sterling, (2) that the amount of gold required to meet South Africa's international liabilities during the war should be as small as possible.

South Africa is certainly doing less than she could do to help us in meeting the financial strain of our common war effort, but the matter is very delicate because the Opposition in South Africa are constantly representing the Union as being in financial chains to this country and are doing their utmost to argue that the Union should be detached from any form of financial dependance on us, and, in particular, that the South African pound should no longer be linked with the pound sterling.

South Africa remains persuaded that the rise which has already taken place in the sterling price of gold will not be reversed and is more likely to be continued further. This accounts for their reluctance to hold sterling .... Even the "gold scare" of some years ago did not shake the belief of South Africa in the permanence of a high price for gold and of the uses of gold as the means for international settlements. As gold normally represents 50% of South Africa's exports, a sharp fall in its value would be disastrous to the country and has therefore become psychologically inconceivable to them. The fact remains that the future of the value of gold has probably never been so precarious as it is to-day.

There are four ways in which South Africa could help us ..

1. South Africa could sell us the whole of her current gold production for sterling instead of only such part as is needed to cover her adverse balance of payments with us.
2. South Africa could impose severe restrictions on imports from non-sterling countries.
3. South Africa could tighten up her Exchange Control if, as we suspect, it is at present administered in such a way as to enable a considerable flight of capital to take place either from the pound sterling into the South African pound and thence into the United States dollar, or direct from the South African pound into the United States dollar.

The fourth way in which South Africa could help us is one of very special importance. The South African Reserve Bank is by law obliged to hold in gold or specie a reserve of at least 30 per cent. of its sight liabilities. The gold holding of the Reserve Bank is still valued at 84s. an ounce. If the gold reserve were revalued at 168s. an ounce, which is the present price of gold, the Reserve Bank could spare a considerable sum in gold which could be sold to us for sterling and would be of the utmost help to us now that our gold and dollar reserves have been exhausted and we are likely to find the utmost difficulty in reconstituting an adequate working balance which is essential to us. A proposal on these lines was made to the Union Government in October 1940, but they then regarded it as politically impossible for them to give us this help. The exact amount of gold which could thus be sold to us varies of course from time to time, but on the 13th December 1940 the gold holding of the Reserve Bank, valued at 84s. an ounce, was £43.8 million, and if revalued at 168s. an ounce was £87 million. On that date the ratio of gold to sight liabilities was 56.7 per cent. as against the statutory minimum of 30 per cent. If the gold had been revalued at 168s. the Reserve Bank could have spared over £40 million even if the ratio were kept at the existing level of 56.7 per cent.

Such revaluation could be effected by a Regulation, but the Regulation would require to be approved subsequently by Parliament and it was felt that this would cause serious political difficulties. We were told in October that the Opposition had already made determined efforts to impair confidence in the currency and the financial position, and that revaluation would be seized upon for the same purpose. We were told that South Africa's hopes of being able as far as possible to finance her war expenditure from her own resources were built on the strength of the reserve of the Bank and that large subscriptions for the loan which was at that time about to be floated had been promised on the specific assurance that subscribers could be accommodated at any time by the reserve of the Bank.

We have not renewed this suggestion in view of the political difficulties and of the fact that until now we have had other gold and dollar resources to draw upon. These have been exhausted and the latest news from Washington indicates that the help which we shall receive under the Lease-Lend Bill will leave us with dollar liabilities outside the Bill far greater than our dollar resources. We may therefore find ourselves bound to take this up again in the near future."

Meanwhile, towards the end of March the Union Government, still unwilling to hold sterling, suggested the vesting of various South African securities, to be paid for in gold. The amount to be raised in this way appeared to be between £30 and £40 million. They proposed to deal with restriction of imports by a system of priorities applied through the Union Purchasing Mission in the U.S.A. The Acting U.K. High Commissioner pointed out, however, that non-essential purchases would not pass through the Mission. The reply was that any restriction of imports could only be relatively small in amount and yet would produce far-reaching consequences on the internal economy. General Smuts, always ready to help within the limits imposed by the political situation and his considerable reliance on his Finance Minister, Mr.Hofmeyr, asked for arguments to show that restrictions would be in the interests of the Union itself.

The South Africans also maintained that there must have been some mistake about capital export as no capital transfers outside the Sterling Area had been permitted since 8th November 1940.

By the middle of April 1941 the Treasury wished to advise South Africa that the vesting scheme was accepted, but the Bank thought that this should be delayed until Lord Harlech arrived in South Africa. Further briefs were prepared for him, one by the Treasury mentioning that South Africa's annual expenditure in foreign exchange had been £66½ million, which meant that more than half the gold production had been used for this purpose, while another quarter of it had been added to internal reserves. The Bank's memorandum referred to the fact that when the Lend-Lease Act was passed the U.K. had dollar commitments, falling due mostly within a year, of £360 million, and that while eventually the Sterling Area should be able to pay its way, there would be a deficit in the next 12 months of £100-£150 million. South Africa ought to sell the U.K. the whole of her current gold production, which would provide a further £35 or £40 million a year; reduce her imports from outside the Sterling Area; and ensure that the proceeds of exports were surrendered (as it was in this form apparently that some of the export of capital was believed to have taken place).

About the same time the Dominions Office informed the High Commissioner that pressure was being put on the U.S. to extend Lend-Lease to cover the important needs of the whole Sterling Area. It would be an advantage if South Africa would accept Lend-Lease, thus freeing gold for other Sterling Area needs.

But an arrangement had just been made to pay the Union Government for an Air Training Scheme. Capital expenditure by the U.K. on this Scheme was expected to be £18 million, and maintenance would cost up to £12 million a year. It was evident that if South Africa did not sell her current gold production the receipt of this sterling by her would soon mean that the U.K. would get no gold at all from the Union.

In May, legislative provision having been made in South

Africa, the Treasury proposed to go ahead with the vesting scheme, which it was thought would provide about £31 million.

Lord Harlech had now reached South Africa, and began discussions on 11th June. He found the Minister of Finance still reluctant to hold any large sterling balances. For political reasons - an excuse always put forward - the Minister wished to proceed by repatriation. There appeared to be about £105 million of securities in all which could be used for the purpose. What would be the maximum amount the U.K. could make available? The High Commissioner spoke of Mr.Hofmeyr and the Governor of the Reserve Bank as "intensely conservative and orthodox, as well as nationalistic".

Lord Harlech was told that the cardinal policy of the U.K. must be to overcome South Africa's objections to accumulate sterling as the other Dominions, including Canada, had done. Repatriation tended to produce discontent in investors, and London would prefer not to exceed about £30 million immediately and to leave at least 3 months between repatriations. It appeared that the South African gold surplus would do no more than cover such an amount in the early future.

The Minister of Finance, however, suggested £50 million, which the Bank of England resisted, pointing out that the Registrars could not handle so large a figure and that the vesting of even £30 million securities would probably push up prices against South Africa. Again, payment of gold could not be received concurrently with payment of sterling to the holders, but would apparently be spread out over a year. The gold was wanted at once. A telegram, conveying these points, was sent, and by 23rd July the Union Government had agreed to the figure of £30 million. They could, however, pay in gold at once for only £10 million, but held out the prospect of £45 million by August 1942. The Governor now felt that a stronger stand should be made, and on 5th August a telegram stated that the Finance Minister's attitude was most disappointing and pressed for information of the earliest date by which £30 million gold could be paid over. By September agreement had been reached on payment in 3 instalments covering 10 weeks.

Meanwhile, in June there had been talk in South Africa about a licensing system for imports, though the Government seemed far from enthusiastic, and the U.K. High Commissioner was told that probably no more than £2 million could be saved on purchases from the U.S.A.

In Auguat the Dominions Office emphasised the urgent need for restrictions on petrol consumption in the Union,* pointing out that even the U.S.A. were cutting consumption to aid the Commonwealth.

In September 1941 a new proposal was made through the South African High Commissioner in London that the Union might pay the U.K. in gold for Lend-Lease supplies passed on to them. The Bank pointed out that in the short run this would not affect the total amount of gold to be received from South Africa but merely diminish the amount of securities repatriated; they feared that the proposal would lead to misunderstandings with the U.S.A. 1
On settlement of the repatriation programme the suggestion was dropped.

The first vesting was made under an Order of 10th October 1941 (Cape 3% 1933/43, Natal 3% 1929/49, Union of South Africa 4% 1943/63 and 5% 1945/75). About £32.4 million (nominal) out of a total of £40.4 million outstanding was acquired and was covered by the sale of £33.6 million gold.

The position now reached provisionally was that the South African Government had agreed to sell the U.K. virtually the whole current output of gold partly against current sterling requirements and partly against further repatriation of debt - at any rate up to August 1942.

In November 1941 Washington was refusing to give Lend-Lease facilities for gold-mining machinery** and the U.K. herself had decided to supply the mines as much as possible, and only

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* In February 1942 the Union Government apparently introduced a basic ration, sufficient for car journeys of 400 miles a month.

**For some details see Appendix ..... "Lend-Lease Administration".

only to ask the U.S.A. for the balance where withholding it would threaten a reduction in the output of gold. The gold-mining industry was, of course, essential for South Africa's economy, but it was necessary to ensure that it demanded essentials only. The Bank were asked by the Treasury whether they could suggest someone to assist in getting a proper control set up, and they turned again to Mr.John Martin. He discussed the question with Field Marshal Smuts and advised that effective measures would be
1942 adopted. By the following March the High Commissioner reported that progress in economies had been made and by July it appeared that some 50,000 tons of steel a year would be saved. Meanwhile, in December, the U.S.Treasury told the South African Minister that the U.S.A. were only likely to help if it could be shown that South Africa or the Empire were in need of dollar exchange. They received the answer from South Africa that the reduction of gold-mining "would not create exchange difficulties for the Union but would naturally embarrass the U.K."

The next development came in the spring of 1942, when the British Government made an attempt to obtain a further contribution from South Africa to the cost of their Forces in the field. A telegram on this subject, which the Bank helped to draft, went off on 10th April. It pointed out that if the Union could raise funds to repatriate debt these could equally well be used to cover the cost of her Forces. In this connection, at the end of April and beginning of June, the Bank again raised with the Treasury the point that the U.K. contribution to the Air Training Scheme would involve a marked decline in gold receipts. The U.K.High Commissioner transmitted the British Government's view to Field Marshal Smuts on 12th June.

Mr.Hofmeyr had been expecting proposals for a further vesting of securities and anticipated that the total would be raised to £50 million by an operation in the spring, or at any rate before the end of August. On 26th June he asked the High Commissioner to enquire about the U.K.'s intentions. An answer was not sent until 31st July, and was then not communicated to the

Finance

Finance Minister because of the expected arrival in London of the South African Minister of Railways and Harbours and Mr.Martin. All that Mr.Hofmeyr was told at the moment was that the U.K. did not wish to repatriate further debt at that time. The delay in replying had been partly caused by the intervention of the Board of Trade, who clearly did not understand the importance of the gold industry to the war effort. The situation was also changing, as exports from this country to South Africa had been much reduced, and were likely to be further cut to about one-third of the 1941 level. The telegram, the contents of which were not conveyed to the South African Government, stated that South African imports of steel in 1942 might, if the U.S.agreed, be 300,000 tons,of which 30,000 tons were to come from the U.K. Of this total not more than 140,000 tons were to be used by the mines. The readiness and ability of the U.K. to press the Americans to accept these figures depended on South Africa making available all gold in excess of their internal requirements. It was hoped that the U.K.'s proposals of 12th June on Military expenditure would be accepted, which would give adequate relief over the next few months. The U.K. did not wish for further repatriations except as part of a general agreement to hold sterling. The receipt of a large sum of gold might make the U.S.A. or Canada think that this country could finance its needs in North America. In view of other war requirements, production of gold in the Union should not exceed what could be made available for the war effort. An unavoidable reduction in supplies might force lower production, and perhaps the Union Government would prefer the reduction to be made in this way.

At the end

At the end of August Lord Harlech reported that Mr.Hofmeyr had been "somewhat surprised" at the reply concerning repatriation. His Government had organised their borrowing programme on the assumption that further repatriation would take place. (The High Commissioner also mentioned that there seemed to be some danger that the Government would give way to political pressure and relax exchange control to allow "firms and individuals to send money to the U.S.A. and Canada" and were considering putting gold coin into circulation or selling "ounce blocks" which the public would take as a "hedge" against inflation.) He gave it as his opinion that "appeals to sentiment, co-operation or war necessity" were of no use with Mr.Hofmeyr whose "intransigeance is complete". The best hope for a change of attitude would be in the negotiations with Mr.Sturrock (the Minister of Railways and Harbours) and Mr.Martin in London.

The Treasury and the Bank now began drafting memoranda for the London meeting. The Chancellor and Sir Richard Hopkins met the South African representatives on 7th September, when Sir Richard used a brief on gold and sterling prepared by the Bank. In addition to the arguments previously used it claimed that the holding of sterling by South Africa would be an insurance policy "against some American whim in relation to gold - a revulsion, resulting in the refusal to buy at a fixed price. By holding sterling as well as gold South Africa would have it both ways: a more than adequate gold reserve; and something else to fall back upon if the gold prop were pulled away". At this talk Mr.Sturrock referred to the plans which had been made for the repatriation and said that the propositions now put forward would be new to the Finance Minister and to Field Marshal Smuts. South Africa's contribution to military expenditure was also discussed, and also the subject of reciprocal Lend-Lease.

On the same day the Bank prepared the following memorandum, to be given to Mr.John Martin for use by Mr.Sturrock and himself in discussions with Mr.Hofmeyr. It was written in a form purporting to give Mr.Martin's own views (i.e. more as a South

African) and appears to have been accepted as such by him, though he added some personal comments. These included the opinion that he did not think the views and needs of the U.K. had ever before been fully represented to the Union Government, that the Minister of Finance had been quite justified in assuming that repatriation was acceptable to the U.K., and all that was necessary for the time being .... "If the real need had been put to him and a much larger problem presented to him, I feel sure from my knowledge of his whole attitude towards a Commonwealth co-operation in the prosecution of the war that his disposition would have been to support the utmost measure of practical participation by South Africa." Mr.Martin supported the principle of selling surplus gold for sterling "essential alike from the stand-points of the interests of South Africa and the identification of the gold output with the Allied war effort".

"SOUTH AFRICA AND GOLD

1. It is a commonplace to state that South Africa's economic well-being is largely dependent on -

(a) the continued exploitation of her resources of new gold,

(b) the continued acceptance of gold internationally as a measure and store of value.

What is not so clearly realised is that, in present and prospective circumstances, neither of these conditions can safely be taken for granted. In other words, the position of gold, though still strong, is by no means impregnable.

2. In regard to (a) above - gold production - it should not be forgotten that forces, both of physical shortage and sentimental revulsion, are working against the provision of sufficient steel to keep the South African mines in substantial production. It is not enough to assume that the merits of gold proclaim themselves. Positive and effective arguments are necessary to secure steel - and they are arguments that must appeal to the U.S.A. - since, with the best will in the world, the U.K. cannot supply more than a fraction of our needs.

3. As regards (b) above:- the continued international use of gold depends preponderantly on the readiness of the U.S.A. to go on buying gold from all comers at a fixed price. If the U.S.A. refused to buy it is difficult to see how other substantial buyers - chiefly the U.K. - could continue. It is not difficult, indeed, to picture the disarray into which the U.K.'s affairs would drift if she continued to buy unlimited amounts of gold which (referring, of course, to post-war years) she was unable to dispose of to her chief creditors - including the U.S.A. and Canada.

4. The attitude of the U.S.A. on both these factors - current production and international acceptance - is therefore of fundamental importance to South Africa.

What is likely to influence the U.S. attitude; firstly, to continued production of gold? The most convincing argument to advance to the U.S. is one that shows that gold is of real and <u>immediate</u> service to the Allied cause. That argument has been used both by ourselves and by the U.K. representatives in our support. It is, however, an argument of decreasing validity with the recent (and continuing) change in South Africa's balance of payments. So long as South Africa was a strongly deficitory country, a large part of her gold was automatically (so to speak) acquired by the U.K. and passed on to those who had current claims on the sterling area. But now, South Africa's deficit on current balance of payments has shrunk to half, or less, of what it was. (The reasons for this need not be developed here, but they are likely to continue in war conditions.) So that the U.K. can now acquire, in the ordinary course, only, say, £40 mn. of South African gold per annum, instead of £90 mn. The remainder is merely added to South Africa's already more than adequate reserve. It will not be easy to go on convincing the Americans that steel, for which they are crying out in the States, and sea transport, of which everybody is short, should be allotted to South Africa in order to give the South African Reserve Bank the doubtful privilege of ending up the war with a gold reserve of 200% of its sight liabilities.

5. Some other and better reason than that must be found. The reason advanced - and as strongly by the U.K. as by ourselves - is that the U.K. needs the gold now, as well as hereafter, for several legitimate war purposes, e.g. -

(a) to meet part of her increasing deficits with neutral countries, such as Argentina, Portugal, Sweden, Switzerland, and Persia, from whom she buys essential supplies.

(b) to use as a support for her credit in those and other countries, which will the more readily hold sterling if they know that gold is available to back it.

(c) in all likelihood, to meet claims from parts of the sterling area (e.g. Egypt) which are piling up unwieldy sterling balances.

6. We thus come to a point at which gold in the hands of the U.K. can be shown to be of real and immediate service to the Allied cause, but, owing to war conditions, the ordinary means of acquiring it from South Africa is not available to the U.K.

Other parts of the Empire sell their products to the U.K. against sterling, of which they hold varying, and, in some cases, very large amounts. There is an arguable case for South Africa's doing likewise. It would not be putting all our eggs in one basket because we retain - and could always retain - a gold reserve sufficient to carry us over any possible (even if unlikely) interruption in the usefulness of sterling.

But there is another aspect - from which a holding of sterling would have certain serious advantages to us. Reference is made in paragraph 3 above to the possibilities of a change in the attitude of the U.S.A. to gold. While it is not suggested that such a change is imminent, or even probable, it is not inconceivable; and, if it happened, South Africa would be in a worse and not a better position from holding no sterling. In other words, a sizeable holding of sterling can quite well be looked upon as a reasonable insurance policy against a change in the American attitude to gold.

Moreover, it can confidently be asserted that the U.K. will at all costs maintain the international usefulness of sterling - which she was able to do, incidentally, even during the most difficult days of 1940 and 1941. So that sterling in South African hands could always be spent, after the war, on goods or services we shall badly need. If these arguments be added to the more general, but nonethe less important, aspect of co-operation within the Commonwealth in the prosecution of the war, there is a by no means negligible case for the selling of newly-mined gold by South Africa against sterling.

7. One immediate answer, however, is that there are South African sterling stocks that still could be repatriated with the co-operation of the U.K. Authorities, thereby providing gold, pro tanto, for London.

There is force in this contention; but scarcely sufficient to outweigh the other arguments about holding sterling. Vesting Dominion securities is unpopular in London - and rightly so. It is an interruption of contracts which ought only to be undertaken as a last resort. And it is to be observed that the vestings of Empire securites that have been made are precisely of this nature. The virtual extinction, by repatriation, of the Indian sterling debt, is to be weighed against the still enormous holding of Indian sterling (nearly £300 mn.). This huge, and increasing amount, is one which the U.K. Authorities may well have wished to keep within bounds by any measures that lay open to them. As regards Canada, the virtual extinction of the Dominion's sterling debt had as a counterpart, first, the holding of very large amounts of sterling, and, subsequently, the avoidance of the whole issue by a direct and unconditional gift to the U.K. of $1,000 mn.

The previous South African vesting was a crisis measure; i.e., was asked for whilst the need for dollars was still paramount, and few resources but the Commonwealth's gold remained. Now things are somewhat different: there is no "gold" crisis; but a need on a substantial scale for a continuous supply of new gold.

It is scarcely surprising, therefore, that the U.K. Authorities are now shy of using their vesting powers in favour of South Africa. They see a gravely deteriorated balance of payments with South Africa; i.e., no new gold worth speaking of available; and the suggestion is that they liquidate over a brief period the last remaining London claim on South Africa, leaving themselves, within a twelve-month, with no means at all of securing gold in any appreciable quantity."

At the end of September gold mining in the U.S.A. was severely restricted, and a similar move followed in Canada. An American Economic Mission to South Africa had already suggested a cut of 15% in South African production, a proposal which the Union Government had resisted on the ground that this would only be a beginning and would be a precedent for Canada. (The Governor also shared this view and expressed it to the Bank of Canada.) In the middle of October the Canadian Prime Minister had made a reassuring statement on the future of gold and gold mining; but these still favoured the repatriation of sterling debt by South Africa and the use of the gold received as soon as possible, in case the U.S.A. had any ulterior motives for their action. Later, towards the end of November, the British Ambassador in Washington reported that there was bound to be some pressure there for a reduction of gold mining in South Africa. The Administration hoped that Field Marshal Smuts, who was to visit London, would return via Washington for consultations. He had, however, left South Africa before this message arrived.

The South African Prime Minister reached London early in November and saw the Chancellor on the 6th. He expressed himself anxious to have one more repatriation of £35 or £40 million, after which he would hold sterling "pretty extensively". The Bank told the Treasury that they would prefer the proposition put the other way round. If Surplus gold were made available for the duration of the war they would gladly repatriate the desired amount - though this would not be convenient until the end of December or in January. The Chancellor, however, wished to put the matter in a somewhat different way. An inconclusive meeting took place on the 16th, when Field Marshal Smuts asked for repatriation at an earlier date, and no clear proposals about gold seem to have been made. The Bank consequently gave Mr.Martin, who was still in London, a memorandum offering repatriation in January and February, and making clear that a figure of £90 million gold against payment in sterling, which the Chancellor had asked for in each year from 1st January 1943 to the end of the war, would be at the option of the U.K. And they also proposed that the Union should sell "all surplus gold as at 31st December 1942" to cover the repatriation. Mr.Martin substituted for "£90 million" "whatever amount the Union from time to time may consider surplus to its domestic needs", which he stated to have been the Union Prime Minister's intention. However, on the same day, the Chancellor wrote to the Prime Minister to make matters clear and used the figure of £90 million a year, though mentioning that this was at the option of the U.K.; and offered repatriation of £40 million in the third week of January to be paid for out of "gold at present held".

The reason why the U.K. desired an option only was because they feared that they might be embarrassed in their relations with the U.S.A. in 1943 if their gold reserves were "suddenly swollen".*

Field Marshal Smuts' reply came from South Africa in the first week of December. He offered £90 million gold in all in 1943 and indicated that it might not be possible to supply so large a figure in subsequent years if gold production were reduced below £120 million.

The Bank now thought that the U.K. would have to be satisfied with this offer, while the British Ambassador in Washington stated that it would not be possible to use in America the argument that South African gold mining must continue on the existing scale in order that the U.K. might get their £90 million.

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*c.f. also "Financial Relations with the U.S.A."

The Dominions Office on 16th December advised the High Commissioner in South Africa that the £90 million would <u>not</u> include gold to pay for the repatriation. They added estimates showing that it was likely that, if the Union reimbursed expenditure on her Armed Forces to the extent desired, the £90 million gold would be obtained without the Union having to hold any sterling.

Misunderstanding on the total amount of gold to be expected in 1943, dating from the Chancellor's talk with Field Marshal Smuts on 16th November 1942, remained until 10th March 1944, when the Bank (who had claimed a further £40 million at the end of 1943 in addition to £90 million received) told Mr.Postmus*, who understood that £90 million was an inclusive figure, that the matter would not be pursued further. There was felt to be no need to clear up the confusion, as the Bank had received £90 million and it seemed evident that the Union Government would have claimed inability to supply more in view of the decline in gold production.

A second repatriation took place as a result of a Vesting Order made on the 18th December 1942, covering five Union Stocks, viz. -

			£ millions Amount outstanding less estimated Sinking Fund holdings	
5%	Union of South Africa	1950/70	9.5	
4½%	do.	1955/75	4.4	
3½%	do.	1953/73	7.9	
3½%	do.	1955/65	10.9	
3%	do.	1954/64	10.5	
			43.2	(Market value, end Dec.1942 45.3)

Documents were to be lodged by 25th January 1943, and payment made either on 15th February or, for later lodgments, three weeks after lodgment.

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* Governor of the South African Reserve Bank

The Union Government were understood to have aimed at an operation costing about £40 million. The amount of sterling eventually transferred was £40 million (including £0.5 million acquired in 1944/5).

The Union Treasury complied with the U.K.Chancellor's request that the Vesting Order should exclude Transvaal 3% Stock 1958 (guaranteed by the Imperial Government) and Union of South Africa 3½% Inscribed Stock 1954/59. These would have cost about another £5 million each.

At the beginning of January 1943 it was reported from Washington that, in view of the large gold reserves of the Union, the U.S.Administration might ask South Africa to pay for all supplies in dollars other than supplies of finished munitions, and that this would include past receipts under Lend-Lease. H.M.Treasury thought that although no large sum would be involved acceptance of the latter suggestion would be dangerous in principle. It would bring the whole idea of valuation into Lend-Lease and this might be applied elsewhere in the Sterling Area and prejudice ultimate settlement. In any event it was hoped that there would be no direct sales of gold in New York. It appeared that the State Department expected strong criticism of the way in which Lend-Lease had been administered.

Another aspect of the matter mentioned by the Dominions Office was a fear that as a result of such an arrangement South Africa would become more difficult in current negotiations, particularly as regards War Office and Air Ministry claims.

Before the middle of February a new proposal had been made by the President to Field Marshal Smuts: the formation of a Supply Council in the Union, composed of representatives of the U.S.A., the U.K. and the Union. While the U.S.A. seemed to be ready to send the Union necessary supplies provided the South African Government agreed to utilise the maximum proportion of its resources directly for war purposes, no guarantee was given that supplies would be forthcoming, in view of shipping difficulties, etc.; and the position of the gold mining industry was not specifically mentioned.

While Sir Frederick Phillips in Washington apparently did not welcome the idea of the new Council, the Bank of England thought it might have its advantages and should be accepted if it did not exclude provision for the gold mining industry. South Africa also was disposed to agree to the Council, provided that there were an understanding in advance on the gold mines. The Treasury and the Bank were in some doubt as to whether to use their need for gold as an argument with the U.S.A., since if they did not exercise their option there would be an appearance of inconsistency.

The question of reverse Lend-Lease was also involved, and South Africa apparently wished to be reimbursed for this on a cash basis. The Treasury advised Washington that they would not object to such cash payments, but reiterated their dislike of payment for goods supplied in the past.

Field Marshal Smuts' reply to the President stated that there were limits to the extent to which the gold industry could be cut down without jeopardising South Africa's war effort, and asked for an understanding in advance as to those limits. The President answered on 15th April agreeing to this point, but stating that a joint decision on the limits should be made by the Union, British and American Governments, taking into account the total requirements of the Union, the maximum expansion of its war effort, and the needs of its domestic economy; to which suggestion South Africa in turn agreed.

In 1943 Lord Harlech was in London and in July had a conversation with the Governor and Mr.Cobbold*. In a subsequent talk in August Mr.Cobbold told Lord Harlech that the fact that the option on gold was not being exercised did not mean that gold would not be needed in the next year or so. He explained the reasons (vis-à-vis U.S.A.) for the present policy; reminded the High Commissioner of the Bank's anxiety that there should be no direct gold movements between South Africa and U.S.A.; and mentioned that South Africa's growing purchases in South America were rather embarrassing as they increased the sterling holdings of countries who already had plenty. Lord Harlech agreed but thought that not much ~~much~~ could be done about the last-named tendency; with the end of the war coming into sight South Africa would probably become intolerant of any further restriction.

By the end of 1943 a settlement had been arrived at on the question of South Africa's military expenditure, under which the Union Government agreed to pay the U.K. a further £35½ million.

During

*There appears to be no record of this. (Incidentally, it may be mentioned here that in May a fund had been started in South Africa as a birthday present to Field Marshal Smuts and had reached a total of over £100,000, to be used for war purposes. The Lord Mayor, asked to open a fund for subscriptions in London and seeking the Governor's opinion, was told that he "did not view the suggestion favourably" as he "did not think such a fund would be appropriate at this moment". The Lord Mayor agreed.)

During 1944 there appears to be little to record. In January the Dominions Office estimated that gold production in South Africa during the year would be about £90 million, and that about £107 million gold might be available for export. They had counted as surplus gold all the Reserve Bank's holding in excess of 30% of their liabilities. The Bank pointed out that at least 40% would be required, since no Central Bank could work without a margin over its statutory proportion. On the other hand, the Dominions Office expected a growth in the Reserve Bank's total liabilities during the year of nearly £90 million, whereas the Bank of England estimated this at only £40 million (in fact it was £39 million). They put gold production at £95 million, and it was actually £103 million. The net result was that the Bank expected an export of £85 million; and in the event £76 ~~80~~ million in all was sold to the U.K. in 1944, leaving £4 million to be carried forward to 1945.

In the beginning of 1945 the Dominions Office told the High Commissioner that South Africa would need to sell £50 million in 1945 for their current needs, and might be able to spare another £25 million. After seeing the High Commissioner and Mr.Cobbold, who was then visiting South Africa, Mr.Hofmeyr agreed to a total of £75 million, provided that the output of gold was not further reduced or the liabilities of the Reserve Bank much increased.

In all £79 million South African gold was sold to the Bank of England during 1945.

In the first few weeks of 1946 the South African Minister of Finance, being asked to lay on the Table in Assembly the text of the agreements for the sale of South African gold to the Bank of England in 1940-48, requested the High Commissioner to ascertain whether there would be any objection from the U.K. point of view.

The Governor (Lord Catto) replied that "on grounds of precedent and principle we should not wish to see Bank to Bank cables quoted textually but that we have no objection to full statement by Minister making use of extracts of cables under reference".

The South African Finance Minister agreed to use a suitable paraphrase of the inter-Bank correspondence.

The following are figures of gold sales by South Africa to the Bank of England, valued at 168/- (s) throughout. The price was raised to 172/3 (s d) per fine ounce on 9th June 1945 (see under "Gold: Purchases"). The new price was the London Market price; but so far as South Africa was concerned the rise was retrospective to 1st January, and 172/3 (s d) was paid from the beginning of the year.

£ million

	Ordinary Purchases	Against Securities	Total	Repatriation of Securities
1939 (from outbreak of war)	29.2		29.2	
1940	91.0		91.0	
1941	88.8	30.0	118.8	30.0
1942	51.0	3.6	54.6	3.6
1943	50.6	40.0	90.6	39.5
1944	76.3*		76.3*	.4
1945	78.4		78.4	.1
	465.3	73.6	538.9	73.6

*A further 3.3 was carried forward to 1945.

U.K.STERLING LIABILITIES TO SOUTH AFRICA

(comprising deposits, advances, bills, British Government securities if held for banking offices in South Africa and U.K.sterling securities if held with the Crown Agents)

£ millions	Total	South African Reserve Bank Holdings(a)	Funds with Crown Agents	Other Official Holdings and Funds with Commercial Banks (net)
At 31st December 1941	- 2.3≠	1.1	.1	- 3.5≠
At 31st March 1942	5.2	6.9	.1	- 1.8≠
" 30th June "	.2	1.9	.1	- 1.8≠
" 30th September "	1.8	1.8	.1	- .1≠
" 31st December "	2.3	1.9	.1	.3
" 31st March 1943	15.3	11.2	.3	3.8
" 30th June "	15.8	13.3	.3	2.2
" 30th September "	13.9	13.5	.3	.1
" 31st December "	20.4	14.6	.3	5.5
" 31st March 1944	23.9	22.7	.3	.9
" 30th June "	24.1	22.6	.3	1.2
" 30th September "	21.8	19.2	.3	2.3
" 31st December "	27.9	24.4	.3	3.2
" 31st March 1945	38.6	32.6	.5	5.5
" 30th June "	32.7	27.6	.4	4.7
" 30th September "	35.8	29.8	.3	5.7
" 31st December "	71.7	60.7	.4	10.6
" 31st March 1946	51.1	47.2	.5	3.4
" 30th June "	35.3	32.7	.4	2.2
" 30th September "	27.8	22.8	.4	4.6
" 31st December "	5.6	5.5	.4	- .3≠

≠ U.K.Net Asset.

(a) Includes small amounts held on Government and Private Accounts in the Drawing Office.

Statistics Office,
18th May 1950.
R.H.J./565.