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Myth and Reality of the Soviet Gold Policy

by Siegfried G. Schoppe, Hamburg *

The Soviet Union has good prospects of becoming the dominant supplier of gold in the world, for its own mining reserves are large and the deposits in the Western world are nearing exhaustion. This need not however — as is shown in the following article — give rise to excessive fears in the West as the interests of the Soviet Union are pointing in the same direction as those of the West.

No other metal has held such fascination for man as gold which was invested with a special mystique in prehistoric times already. This is doubly true of the Soviet gold although according to communist doctrine it should no longer play any role at all.

That the Soviet gold is again and again giving rise to speculation in the West is due to the following facts in particular:

□ Since 1933 the Soviet Union has not published any information on the trend of gold production. The country is however undoubtedly the second largest gold producer after South Africa.

□ Figures on the domestic consumption of gold for industrial purposes in the USSR are lacking. Soviet citizens are not allowed to own gold although since 1976 the Chervonets, a 10-ruble gold coin, has been on sale through banks in the West (7.74 grammes \approx 0.25 troy ounces) to benefit from value added tax exemption as for instance in the Federal Republic of Germany.

□ Exports of gold are not shown in the foreign trade accounts of the Soviet Union, so that the

Soviet gold sales in the world market can only be estimated ¹.

□ Fears are often voiced in the West that the Soviet Union may cause all sorts of mischief by its gold policy. These fears extend over the whole gamut of speculation from attempts to influence the apartheid policy of South Africa to disruption of the Western monetary system.

□ Another popular subject is the Spanish gold treasure of about 500 ts (i.e. 16.08 mn troy ounces) which was taken to Russia in 1936. It was claimed back by the Franco regime ever after, while the Soviet Union has laid claim to it as payment for arms deliveries. The latest version of the Soviet argument is that the gold store, since it could not be disposed of lawfully, was handed over as collateral security and that the Soviet Union has in the meantime become its lawful owner. De facto the Spanish gold has certainly to be included in the Soviet gold reserves.

Quantitative Changes

An indication of the magnitude of the Soviet gold output, gold sales and gold reserves and their significance on a world scale will do most to answer the questions which have been raised and to de-mythologize the Soviet gold ².

The difficulties encountered in compiling such data suggest that it would be wrong to take too much notice of certain individual figures in Tables 1 and 2; but it is equally clear that the tables in their entirety and in regard to the various several years' periods are an important and approximately accurate basis of information. It is true that the figures given by the consulted sources ³ for Soviet foreign currency earnings in various calendar years differ in part substantially, but a comparison of such figures over several years shows that the over- and under-estimates of gold sales cancel out. — The Western estimates of the Soviet gold reserves range for the end of 1976 from 2,000 to 3,000 ts: Compilation and extrapolation of various estimates actually leads to a total

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¹ Such estimates can be made easily however because there are only two principal markets — London and Zürich — of which the latter is definitely preferred by the Soviet foreign trade authorities, so that the bulk of the Soviet exports is channeled to the gold market through a few big banks (Swiss Bank Corporation, Credit Suisse [Swiss Credit Bank], Union Bank of Switzerland). Cf. *Wirtschaftswoche* No. 12, March 11, 1977, p. 73.

² For lack of official Soviet data on the balance of payments and gold situation volume and value figures for the output, sales, domestic consumption and reserves of Soviet gold are shown (in several dimensions as customary in gold statistics) in self-consistent tables. Where the consulted sources give different estimates, later estimates are given preference over earlier ones; this seems justified as the institutes themselves often revise their figures. Where figures were not available, the author computed them as a rule from differences between available estimates. For various years annual figures had to be imputed because the available estimates covered several years together. Where this has been done, the sum of the annual figures equals the estimate for the several years' period while each of the annual figures is by itself indicative of a plausible trend.

³ The following are the major sources of primary information on Soviet gold production, sales and reserves: US Department of the Interior — Bureau of Mines (*Minerals Yearbook*); Central Intelligence Agency, CIA (USA); Zürich banks, especially the banks belonging to the "Zürich gold pool", but also Bank Leu which does not belong to the gold pool but is very active in the gold trade; London gold dealers, such as Samuel Montagu & Co.; New York traders in precious metals, including for instance J. Aron & Co; Hudson Institute, Europe (a subsidiary of the institute in the USA); international monetary authorities; *Pick's Currency Yearbook*.

of 2,330 ts which includes the 500 ts of "Spanish" gold.

The particular features of the "world gold market" will be traced first in the attempt to judge what real grounds there exist for Western fears. The world gold market is in fact more akin to the international stock markets than to the commodity markets, for gold is a commodity held for investment and usufruct (without planned amortization) rather than as an article of consumption which loses its identity through processing and manufacture, as happens normally with raw materials.

Another feature which the gold market and the stock markets have in common is that only a fraction of the total stock is being turned over in any given period (a daily session, a month or a year) and that the market price for this fraction determines the value of the whole stock. In this respect the gold market may be compared with the market in the shares of a company with one big shareholder of which comparatively little stock is held and bought and sold by others. In 1976 for instance a turnover of no more than 1,257 ts determined the valuation of a total stock of about 80,000 ts. Inverse movements of supply and demand — greater demand because of rising prices, larger offerings because of falling prices — and high price flexibility due to low supply and demand elasticities intermingle, partly for speculative reasons, in almost unaccountable market developments.

These indications of extreme vulnerability of the gold market may be disquieting. But how much scope is there in fact for the Soviets to sway the world gold market?

Limitations as a Collateral Security

If the *collateral security function of the Soviet gold* is to be regarded as a sign of the creditworthiness of the USSR, the assessment can clearly not be based on the actual size of the gold reserves (i.e. on a simple static calculation of the gold cover) since they would have to be sold well below their estimated value of about US \$ 10 bn if a sudden liquidation were contemplated, but on the ability and willingness of the Soviet Union to go on producing increasing quantities of gold and to dispose of these continually in the West in exchange for hard currencies in such a way as not to upset the market⁴.

⁴ The use of the gold reserves as a legal pledge to Western countries, as practised by Italy vis-à-vis West Germany, is hardly conceivable but would have the advantage of not encumbering the market and of an automatic expansion of the credit volume if the price of gold rises. Direct transfers of Soviet gold reserves to Western central banks at an agreed price without use of the gold market are presumably also out of the question. And so is the placing of USSR loans covered by gold in the West as many of Russia's creditors are still waiting in vain for the redemption of the old Russian loans.

It may be assumed that the USSR is selling as much gold as the gold market can absorb without detriment; this invisible borderline also marks the limit to which the Soviet Union can go to offset balance of trade deficits with the West by sales of gold. With the trend of world trade and world trade balances as at present gold sales can compensate only for a very small fraction of the shortfall: In 1975 the Soviet trade with the West showed a deficit of about US \$ 5 bn while the foreign currency earnings from sales of gold amounted to no more than US \$ 780 mn — 15 % of the trade deficit — even at the record average gold price of US \$ 161.09 per fine ounce. In 1976 the foreign currency proceeds from gold sales rose to US \$ 1,220 mn, but the total indebtedness of the Soviet Union continued to grow rapidly.

These facts imply that the Soviet foreign trade authorities are in a position to refrain temporarily from offering gold in the market, that there is therefore no need whatsoever for distress sales of gold, for instance because loans are maturing, and that the Soviet Union is also exploring new channels and methods of selling gold. Recently it was learnt for instance that 50 ts of gold had been sold in 1975 for US \$ 250 mn directly to Arab oil states like Kuwait and Saudi Arabia.

Parallel Interests

The decline of the Western share of the gold production and market shows that the current trend is favouring the Soviet Union. In the long run it will be able to sell progressively larger quantities in the world market at favourable prices, for the requirements of industry and demand for jewellery are increasing in the West. The attitude of the Soviet foreign trade authorities to date suggests moreover that the Soviets have been paying closer attention to the mode of operation of the gold market than perhaps to any other market and want to use it for their own purposes. Intensive gold sales as occurred in 1963–1965 would have ruinous consequences in such a narrow market.

Western observers who are watching the Soviet gold production and hoarding with concern should bear in mind that in the gold market the economic interests of the USSR and of the Western world are pointing in the same direction. This also is a feature of the gold market which distinguishes it from most commodity markets. Rising prices mean higher earnings for the sellers; but the additional outlays of the gold buyers are overcompensated by the gain in value of the gold in the hands of gold owners. With gold stocks of about US \$ 300 bn (1976) in the West and about US \$ 10 bn in the Soviet Union a rise of the gold price by about 10 % means — assuming the turnover fig-

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ures do not change — that while the Western outlays on new gold rise by about US \$ 500 mn, the value of the Western gold stocks increases by US \$ 30 bn. In the USSR on the other hand the additional foreign currency earnings of about US \$ 125 mn compare with a value growth of the Soviet gold hoard of about US \$ 1 bn. The "gain" of the West would amount to US \$ 29.5 bn and that of the USSR to US \$ 1.125 bn. This is surely a unique instance of producer and consumer interests in a raw material market pointing in the same direction.

Gold buyers are finding it as a rule easy to accede to higher prices: Manufacturers in the electrical industry can pass on the price increases without greatly troubling the final consumer because the cost of the gold accounts for a very small fraction of the end product; buyers of gold jewellery, gold coins and gold bars see the prestige value of the gold article go up and hope for further rises; and even the affected States see little to object to if

their revenue from turnover taxes, import levies and the "national wealth" increases and their currencies become more "solid".

As no one who is unable to pass on the higher price for unprocessed gold is under any compulsion to purchase gold, no complaints have been heard either in the West or in the Eastern bloc about rising gold prices. Rather the reverse!

In the opposite case of a 10% reduction of the gold price Western gold buyers would spend US \$ 500 mn less while the foreign currency income of the USSR would be US \$ 125 mn lower. The West could feel happy about such a turn of events, considering that the gold hoards are intended as a long-term investment and depreciation losses need not be realized. The gold sellers on the other hand would have to regard their loss of foreign currency income as definitely incurred and non-compensatable; this is an aspect which in view of the Soviet balance of trade deficits with the West would certainly make itself felt.

Table 1
Gold Production, Consumption, Sales and Reserves of the USSR from 1945/46 to 1977
(in ts and mn fine ounces) ¹

Year	Production		Own Requirements ²		Sales		Stock Changes		Gold Reserves	
	ts	mn f.oz	ts	mn f.oz	ts	mn f.oz	ts	mn f.oz	ts	mn f.oz
1945	.	.	.	.	.	.	.	.	2,305	74.11
1946	67	2.15	22	0.71	0	0	+ 45	+1.45	2,350	75.55
1947	77	2.48	22	0.71	0	0	+ 55	+1.77	2,405	77.32
1948	81	2.60	26	0.84	0	0	+ 55	+1.77	2,460	79.09
1949	85	2.73	25	0.80	0	0	+ 60	+1.93	2,520	81.02
1950	89	2.86	24	0.77	0	0	+ 65	+2.09	2,585	83.11
1951	90	2.89	25	0.80	0	0	+ 65	+2.09	2,650	85.20
1952	94	3.02	29	0.93	0	0	+ 65	+2.09	2,715	87.29
1953	98	3.15	28	0.90	35	1.13	+ 35	+1.13	2,750	88.41
1954	102	3.28	32	1.03	35	1.13	+ 35	+1.13	2,785	89.54
1955	106	3.41	31	1.00	35	1.13	+ 40	+1.29	2,825	90.83
1956	109	3.50	34	1.09	135	4.34	— 60	—1.93	2,765	88.90
1957	109	3.50	34	1.09	230	7.39	—155	—4.98	2,610	93.91
1958	112	3.60	32	1.03	195	6.27	—115	—3.70	2,495	80.22
1959	121	3.90	36	1.16	220	7.07	—135	—4.34	2,360	75.28
1960	128	4.10	38	1.22	180	5.79	— 90	—2.89	2,270	72.98
1961	137	4.40	37	1.19	270	8.68	—170	—5.47	2,100	67.52
1962	127	4.08	32	1.03	195	6.27	—100	—3.22	2,000	64.30
1963	136	4.37	36	1.16	500	16.08	—400	—12.86	1,600	51.54
1964	145	4.65	5	0.16	410	13.18	—270	—8.68	1,330	42.76
1965	156	5.03	11	0.35	500	16.08	—355	—11.41	975	31.35
1966	167	5.37	17	0.55	0	0	+150	+4.82	1,125	36.17
1967	177	5.70	23	0.74	14	0.45	+140	+4.50	1,265	40.67
1968	188	6.04	27	0.87	11	0.35	+150	+4.82	1,415	45.49
1969	185	5.95	30	0.96	0	0	+155	+4.98	1,570	50.48
1970	193	6.21	33	1.06	0	0	+160	+5.14	1,730	55.62
1971	201	6.46	36	1.16	0	0	+165	+5.30	1,895	60.93
1972	254	8.17	39	1.25	150	4.82	+ 65	+2.09	1,950	62.70
1973	302	9.71	42	1.35	275	8.84	— 15	—0.48	1,935	62.21
1974	355	11.41	45	1.45	220	7.07	+ 90	+2.89	2,025	65.11
1975	404	13.00	49	1.58	150	4.82	+205	+6.59	2,230	71.70
1976	451	14.50	51	1.63	300	9.65	+100	+3.22	2,330	74.91
1977	500	16.08	54	1.74	311	10.00	+135	+4.34	2,465	79.25

Note: The figures for the past year — 1977 — indicate a possible trend based on information from the Hudson Institute, Europe. In view of the uncertainties surrounding the price of gold they must however be treated with caution.

Sources: Cf. Table 2 and Footnote 2.

¹ 1 fine ounce = 1 troy ounce = 31.103477 gr. ² The "own requirements" are here as in table 2 the industrial requirements in the USSR.

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Besides, the Soviets' gold profit margin is probably not so very high, despite a substantial machinery and technology input in the production of precious metals, because the USSR has to open up more and more remote mines and to draw on deeper and less productive strata in the old mines which involves considerable costs for spoil removal and prospecting. Aside from the by-product output of gold in non-ferrous metal smelters which is growing automatically, the gold production has by now to be moved farther and farther from the Urals and Kazakstan to Siberia and the Far East.

This is the obverse of the change of the gold price in recent years; the latter allowed new gold deposits and regions to be exploited profitably, but if the price falls, the immediate result is that costs are left uncovered. Hard currency earnings are certainly a strong argument for producing gold in the USSR, but even a planned economy cannot for long be indifferent to profitability considerations in regard to any industry.

Soviet Gold as a Political Weapon

To dispel the worst fears of Western watchers of the Soviet gold policy it shall be assumed that the Soviets will use their supplier position to put individual Western countries or indeed the whole West under pressure — that they would thus assign a *political function* to their gold.

One possibility would be to suspend all gold sales. It would certainly be rash to say that this would have no consequences at all as proved by events in 1966–1971 when hardly any Soviet gold reached the market, for the Soviets have since then secured a sizeable share of the market — about 25%. The price of gold would reach a new record high when the IMF auctions come to an end at the latest but more probably already on the announcement of an Eastern supply boycott, for the prosperous population of the West is likely to want more gold in the longer term and the central note-issuing banks are also showing a great liking for storing gold, despite all their declarations in favour of the demonetization of gold.

The dependence of the West upon the Soviet gold production is not however such as to enable the USSR to avail itself of a monopoly position. Substantial price increases would make the working of Western deposits to which nobody is as yet giving any thought a paying proposition. And the gold stocks are so high that a real supply crisis is inconceivable; if the price rises far enough, gold will also be offered from existing stocks. There would certainly be no price explosion strong enough to compensate the Soviets for, let us say, a ten-year supply boycott and the loss of interest until sales are resumed, to say nothing

of the fact that when sales would be resumed, only a small fraction of the gold store accumulated by then could be sold off without endangering the price level.

It is clear therefore that such conduct would give the greatest satisfaction to the USSR's competitors, especially to South Africa, and also to the owners of gold in the West. South Africa would see the end of its balance of payments problems much nearer, and the gold dealers would profit

Table 2

Gold Sales and Gold Reserves of the USSR from 1945/46 to 1977: Foreign currency earnings, annual and cumulative, and reserves at end of year

(in US \$ mn — Annual average prices in 1945 and 1969–1977
in US \$ per troy oz)

Year	Gold Price US \$ / troy oz	Foreign Currency Earnings from Gold Sales US \$ mn		Gold Reserves US \$ mn
		annual	cumulative	
1945	35.00	0	0	2,595
1946		0	0	2,645
1947		0	0	2,705
1948		0	0	2,770
1949		0	0	2,835
1950		0	0	2,910
1951		0	0	2,982
1952		0	0	3,055
1953		40	40	3,095
1954		40	60	3,135
1955		40	120	3,130
1956		150	270	3,110
1957		260	530	2,935
1958		220	750	2,810
1959		250	1,000	2,655
1960		200	1,200	2,555
1961		300	1,500	2,365
1962		220	1,720	2,250
1963		560	2,280	1,800
1964		460	2,740	1,495
1965		560	3,300	1,095
1966		0	3,330	1,265
1967		15	3,315	1,425
1968		12	3,327	1,590
1969	41.10	0	3,327	2,075
1970	35.95	0	3,327	2,000
1971	40.79	0	3,327	2,485
1972	58.10	280	3,607	3,645
1973	97.12	860	4,467	6,040
1974	59.09	1,120	5,587	10,360
1975	161.09	780	6,367	11,550
1976	126.77	1,220	7,587	9,495
1977	140.00	1,400	8,987	11,095

Note: On 1977 cf. Table 1.

Sources: John T. Farrell, Soviet Payments Problems in Trade with the West, in: Soviet Economic Prospects for the Seventies. A Compendium of Papers, Submitted to the Joint Economic Committee — Congress of the United States, Washington 1973, p. 690-711; John T. Farrell and Paul Ericson, Soviet Trade and Payments with the West, in: Soviet Economic Prospects in a New Perspective. A Compendium of Papers, Submitted to the Joint Economic Committee — Congress of the United States, Washington 1976, p. 727-738; Barry L. Kostinsky, Description and Analysis of Soviet Foreign Trade Statistics (Foreign Economic Reports, No. 5), Washington 1974, p. 51; Michael von Berg, *ibid.*, p. 19 ff.; Brockhaus Encyclopedia, Article: Gold, Vol. 22, Wiesbaden 1975, p. 576; Statistisches Jahrbuch der BRD 1976 and earlier years; Monatsberichte der Deutschen Bundesbank, various issues; Handelsblatt, various dates; Wirtschaftswoche, various copies.

from larger turnovers; for the price would probably tend more strongly upwards than the volume of sales declined.

So the West need not worry about a Soviet withdrawal from the Western world gold market. But would manipulations in the opposite direction — sudden flooding of the sensitive market with vast quantities of gold — also be an empty threat? If it wanted to, the Soviet Union could instantly supply twice as much gold as is normally turned over in a full calendar year⁵.

If it did so, the price would inevitably in the short term fall far below the level needed to cover the variable costs of even the most productive gold producer, and the West would certainly fail if it attempted to organize a buyers' boycott blocking all outlets for a Soviet Union determined to ruin the gold price; for many speculatively-minded would-be gold buyers would take the opportunity to stock up at extremely low prices and to wait for the day when prices rise once more. Having sold off its reserves, the Soviet Union would be unable however to offer more than its ongoing

⁵ Cf. Michael von Berg, 'Ökonomische und politische Aspekte des Ost-West-Handels (Economic and political aspects of the East-West trade)', in: *Berichte des Osteuropa-Instituts an der Freien Universität Berlin*, No. 87, Berlin 1968, p. 64.

production which covers only about one-third of the annual world market requirements.

A glutted world market with ruinous prices would hit South Africa immediately and very hard; other salient consequences need not be expected in the West as the demonetization of gold has made the Western monetary system independent of the gold price and gold supply. The West could, besides, very easily develop a countervailing strategy: The glut would soon be over if the seven central note-issuing banks with the largest gold reserves in the West were to seize the opportunity for a joint ten-per-cent restocking operation at favourable prices.

Since it is to be hoped that most of the myths which have sprung up around the Soviet gold will by now have been reduced to their proper dimensions, the last remaining myth — that of the Spanish gold hoard in Soviet hands — may also give way to a realistic judgment. This store of 500 ts admittedly still accounts for about 20% of all Soviet gold reserves. But the USSR is today capable of reproducing this amount of gold in a single year of mining while in 1954 about five years' output would still have been needed to replace it.

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