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MEMORANDUM FOR: D/OER; U/

The attached paper is the background material on Soviet gold policy for an oral briefing on 12 December of Deputy Assistant Secretary Slighton at Treasury. A Memorandum for the Record of the briefing is also attached.

Acting Chief

Attachments:
As stated

16 December 1975
(DATE)

S-09110

FORM NO. 101 REPLACES FORM 10-101
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Soviet Gold Policy

Key Points

The USSR is expanding gold production facilities and will probably increase output by about 40% in the next 4-5 years. Soviet output is now in excess of 300 tons.

Soviet production costs have declined. Production has stagnated in the more marginal areas in the Northeast and expanded in Muruntau where production costs are relatively low.

Concomitant with the decline in production costs, high free market gold prices have made Soviet gold an attractive alternative and/or supplement to Western credits to finance hard currency deficits.

The Soviets have become more sophisticated in handling sales of gold. They sell more when prices are rising and less when they fall -- depending on the severity of hard currency deficits.

The Soviets are apparently willing to part with their gold at the right price, but will probably try to maintain a reserve at about its present level. Sales out of current output (net) <u>could</u> thus increase from about 270 tons in 1975 to roughly 400 by 1980.

Production

The Soviet leadership has consistently espoused a policy of expanding gold production. Under conditions of "capitalist encirclement," Stalin believed that he had to accumulate a hoard of gold to take care of emergencies such as crop failures, economic blockades, and the like. He reasoned that the capitalists would buy his gold even if they did not buy other Soviet export commodities. The Soviets managed to add to their stockpile in spite of the need to sell gold on a number of occasions to cover deficits. In 1955 it reached a peak of about 2,750 tons.

The postwar leadership has maintained Stalin's policy of expanding gold production. Unlike Stalin, it has never pursued a policy of producing gold at any cost, although production in the past has been pushed in areas which would be considered uneconomic in other gold producing countries.*

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* Current South African exploitation of marginal deposits may be an exception.

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In any event, until the appearance of the free gold market, Soviet gold was produced at a cost significantly higher than the $35 per ounce the Soviets got paid for it.

Early in the 1960s Moscow decided to explore and develop gold reserves in regions where climate and terrain are more favorable than in the traditional gold fields of the Northeast. Discoveries of new deposits in Central Asia and the Armenian SSR were made about that time and Moscow decided to develop mines and processing facilities for their exploitation. The benefits of that decision are now being realized. The world's largest gold mine in the Muruntau Mountains of Uzbekistan has come on stream. Costs at the new facilities are much lower than those at old producing sites. Current Soviet policy is to promote further large increases in production of gold. Construction of additional facilities at Muruntau and a new plant at Zod in the Armenian SSR are well advanced. The new gold producing facilities have enabled the Soviets to increase output substantially. Production has risen from 200 tons in 1970 to an estimated 310 tons this year. By comparison in 1974 South Africa produced 784 tons. Within the next 4-5 years a 40% increase in Soviet gold output will be possible because of the new facilities.

Sales

Khrushchev, enjoying the comfortable reserve position bequeathed by Stalin, regarded gold as a normal export commodity and increased sales to finance imports of Western equipment. In the early 1960s, the Soviets were also forced to sell large amounts of gold to buy grain. In the period 1962-1965 reserves fell by a thousand tons to a level of roughly 900 tons, causing considerable concern among the Soviet leaders. Their decision to make large investments in gold production facilities and to rebuild the gold stockpile despite the fact that it cost the Soviets considerably more to produce the gold than $35 an ounce, indicated that the leadership's devotion to gold was not essentially different from Stalin's.

Soviet gold virtually disappeared from international bullion markets from 1965 to 1972. Hard currency deficits were financed mainly by Western credits. By the end of 1971 the Soviet gold stockpile had grown to roughly 1,700 tons. But the poor grain harvest in 1972 brought Soviet gold back into the market. With the free gold market and rising demand for gold, however, the Soviets got a better return on their sales than they had in the past.

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Current Policy

The large Soviet reserve, increasing production and higher prices for gold have given the Soviets a flexibility in gold sales policy they never had in earlier years. Adding to this flexibility is Soviet ability to attract substantial amounts of credit in the West. Even with substantial deficits, the Soviets have opted to withhold gold from the market when gold prices are not to their liking. Moscow has shown skill in responding to gold price movements. The attached chart based on information for the period January 1974-July 1975 shows Moscow's responsiveness to price changes. It increased the volume of sales during periods of rising prices and cut back on volume when prices fell. Larger sales during June and July 1975, when prices were tending downward, indicate that Soviet flexibility has its limits, however. The record hard currency trade deficit in 1975 is reason enough to sell in the face of decreasing prices. Moscow was obviously aware of the impact of its sales on prices. As it happened, Moscow supplied more than 30% of the Zurich market in each of those two months (compared with 15% in 1972-74). The rumored 50-ton sale in July to the Middle East, if it took place at all, would have been a logical move to circumvent European markets and minimize effects on the gold price.

Over the long run, we expect Moscow to continue to sell gold to augment export earnings and Western credits. We believe, moreover, that relatively high selling prices, lower production costs and increasing output will enable the Soviets to offer substantial quantities on the market. At current market prices, Soviet annual net output could earn $1.5 billion this year and more in the future without drawing down reserves. Moscow, of course, is aware of the restrictions that the market imposes on its sales efforts. For example, faced with a hard currency trade deficit that may total some $5 billion this year, Moscow surely was frustrated by market developments which pushed the gold price down below $130 per troy ounce in the wake of the announcement by the International Monetary Fund that it would sell some of its gold holdings. Moscow still might be able to realize some $1 billion from the sale of 200 tons of gold this year, but we believe it would have sold more if the market had allowed.

Moscow now appears to be seeking alternate methods of marketing its gold in the West. In addition to selling gold on traditional markets, Moscow has begun to experiment with selling directly to buyers outside of the established market. Aside from the reported Middle East sale, the Soviets bypassed the European markets and sold gold directly to a US importer for the purpose of supplying small amounts of gold to what was hoped to have been a growing market of small, individual investors. The US market fell far short of what was anticipated, however, and only $533,000 worth of Soviet gold was imported into the United States during the first eight months of the year.

There are also reports that Moscow intends to mint gold coins and market them in the United States, Canada, and Western Europe. If the coin sales prove successful, the USSR would also produce commemorative coins and other memorabilia for the 1980 Olympics. The coin in question is the 10 ruble "chervonets" (nominally worth $13 at the present ruble-dollar exchange rate), but it would be priced according to the 1/4 ounce gold content. The chervonets will probably sell for about $40 or less under current market conditions and therefore be attractive to the small investor. Test marketing reportedly is to begin this year in the United States, where Moscow hopes to be able to sell as many as 500,000 of these coins during 1976. At $40 apiece, these sales would earn Moscow some $20 million.

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USSR: Production and Allocation of Gold

Metric tons

Year	Production	Domestic Consumption	Exports	Reserves
1955	93	18	62	2,750
1956	93	18	137	2,688
1957	93	18	244	2,519
1958	98	20	162	2,435
1959	102	22	269	2,246
1960	110	24	132	2,200
1961	118	25	275	2,018
1962	127	27	212	1,906
1963	136	27	465	1,550
1964	146	28	462	1,206
1965	156	30	435	897
1966	167	32	39	993
1967	177	32	34	1,104
1968	184	34	19	1,235
1969	195	37	--	1,393
1970	201	39	3	1,552
1971	218	39	19	1,712
1972	252	40	158	1,766
1973	261	41	304	1,682
1974	267	42	131	1,776
1975 *	310	43	N.A.	N.A.

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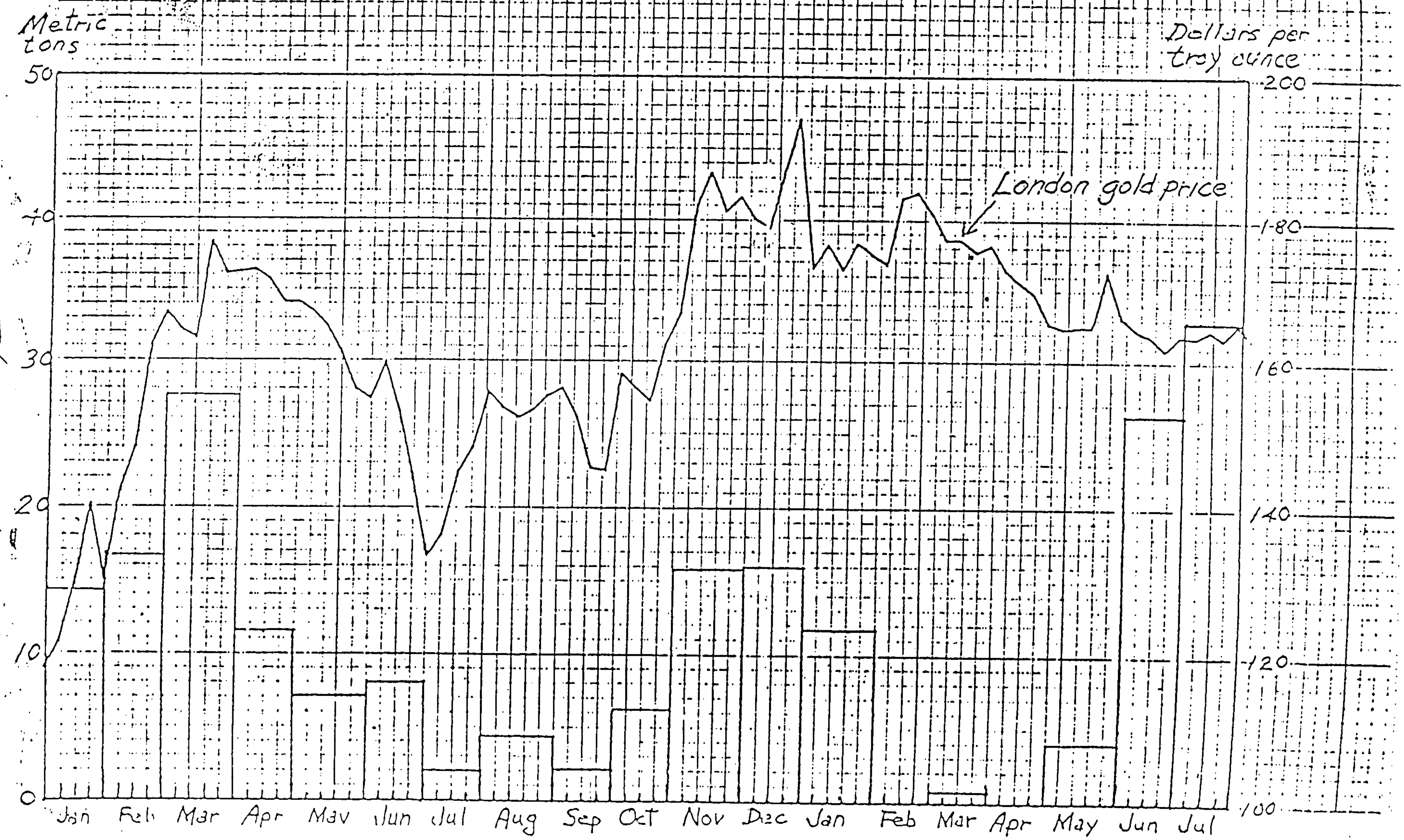
Soviet Deliveries of Gold Bars to Switzerland
January 1974 – July 1975



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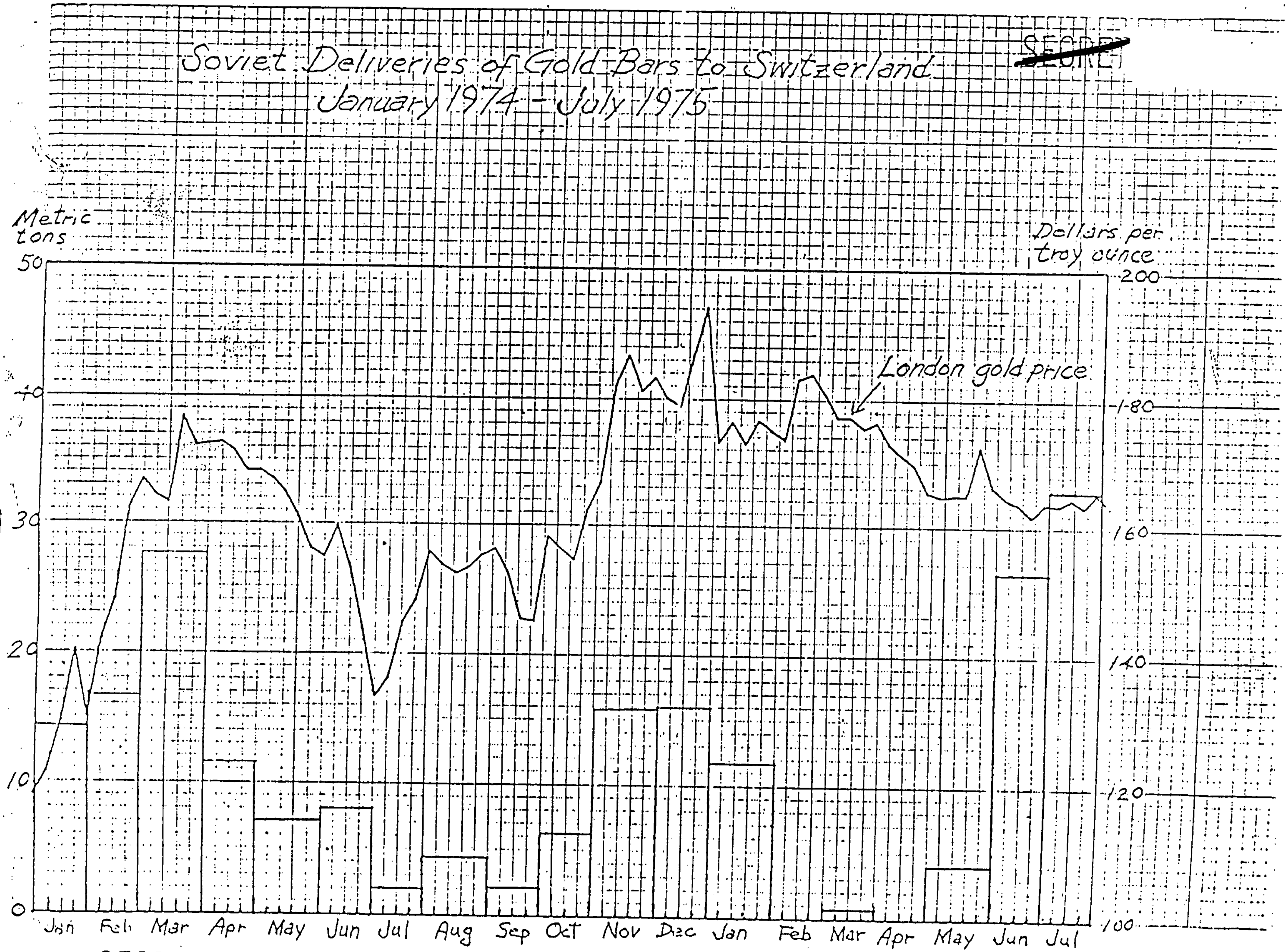

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16 December 1975

MEMORANDUM FOR THE RECORD

SUBJECT: Briefing on Soviet Gold Policy for Robert L. Slighton, Deputy Assistant Secretary for Research and Planning, Office of the Assistant Secretary for International Affairs, Department of Treasury

1. On 12 December I met with Secretary Slighton in his office at the Treasury Department to discuss Soviet gold policy. Thomas Wolfe, a consultant to Assistant Secretary for International Affairs Charles A. Cooper -- and apparently Treasury's specialist on gold and precious metals -- also was present at the briefing, which lasted two hours and fifteen minutes. Secretary Slighton immediately took the initiative, asking specific questions about Soviet policy on gold production, sales, and reserves. The conversation progressed rapidly, but in an orderly fashion and in a very relaxed atmosphere, so that by the end of the meeting all of the conclusions of the prepared briefing paper had been covered although there was no formal presentation as such.

2. Secretary Slighton indicated that the US has no clear policy toward gold sales and before one can be formulated it was necessary to know what Soviet policies were toward production and sales of gold in both the short-run and the long-run. Regarding production, Treasury is interested in the grade of Soviet ores being worked, the type of mining activity (e.g., deep mines, strip mines, etc.), average production costs, and if there are any indications that the Soviet production is responsive to world gold prices. He asked specifically if there was any evidence of an early stage of development of new ore bodies not currently being exploited, and how long it takes to move from initial surveys to putting an operation on stream, as for example at Maurantau or Zod.

3. Regarding sales, Treasury is interested in the entire marketing mechanism, from the producer to the foreign buyer. The Secretary was curious as to how the gold producers could stay in business when Soviet gold was being sold below cost on

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the world market. He appeared satisfied with my explanation that such losses were covered by the State budget and that, within reason, such losses did not affect the decision to continue production at such facilities. He recognized, however, that Soviet appreciation of high costs has led to the development of gold fields in Kazakhstan and Armenia. Regarding sales on foreign markets, the Secretary was impressed with the graphic showing Soviet responsiveness to price changes during January 1974-July 1975, and requested that the chart be expanded to include data since the beginning of the two-tier system. He also requested historical data which shows the importance of gold sales to the balance of payments. I said that we could provide a hard currency balance of payments statement for the period 1959 to date, as well as the earlier series on gold sales. He also requested a projection of Soviet hard currency trade for the next five years to see what the requirements might be for future Soviet gold sales. The Secretary also wants to know the exact nature of the Soviet sales arrangement with the Swiss banks. For example, do the Swiss banks buy on their own account or do they job for the Soviets? He suggested that perhaps we can get DDO to get this information as well as information on production for us.

4. At the end of the meeting, the Secretary made a pitch for closer working relations between OER analysts and analysts at Treasury. I said that we would welcome the opportunity to meet and exchange ideas with Treasury analysts. He said that he would provide names of the appropriate Treasury analysts so that contact can be initiated. I then made a pitch for the Bank for International Settlements quarterly report on gold, which Treasury gets via the Federal Reserve Bank. The report contains information on Soviet gold exports to the West and presently is available to us only through Treasury channels. Our receipt of this document over the past year has been irregular, however, The Secretary said that he would look into the matter.

5. In addition to the two sets of materials on gold sales and balance of payments, I propose that we also provide the Secretary with a copy of , USSR: Long-Range Prospects for Hard Currency Trade, (A(ER) 75-61, Jan 75), which still has considerable merit when addressing future trade deficits and how they can be covered, and the more recent Soviets Face Massive Trade Deficit in 1975 (ER IM 75-20, Dec 75). The Secretary also expressed interest in Soviet Eurodollar operations (he apparently was not aware of their magnitude). Therefore, I propose that we also send him a copy of our recent research

paper, Soviet and East European-Owned Banks in the West (ER RP 75-32, Dec 75), which addresses the subject.