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UNITED STATES GOLD POLICY:
THE CASE FOR CHANGE

JOHN PARKE YOUNG



INTERNATIONAL FINANCE SECTION

DEPARTMENT OF ECONOMICS

PRINCETON UNIVERSITY

Princeton, New Jersey

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UNITED STATES GOLD POLICY: THE CASE FOR CHANGE

The international-payments system has not lacked attention during recent years. While a great deal has been said, there is much to be settled, and it does not necessarily follow that much will be settled soon. The appropriate function of gold in a revised international monetary system is a matter of debate. What the United States does about gold has an important bearing upon the developing system. This paper discusses the gold policy of the United States, particularly the policy of unlimited sales of gold at the option of foreign governments.

I propose that the United States sell gold only at its own discretion, as do all other governments, at the same time firmly maintaining the exchange rate and convertibility of the dollar. Such discretion is needed in the interest of an orderly utilization of our gold reserve, and especially to prevent erratic gold outflows from leading to further misconceptions regarding the strength of the dollar, and perhaps a gold crisis.

The proposed move, by reducing excessive dependence upon the gold element in our monetary reserves, would relax the limitations imposed by gold over desired domestic and foreign policies. It would provide greater flexibility for government policies directed toward goals such as economic growth, stable full employment and production, and foreign economic and political objectives. It would be another step in the evolution of money where gold is supplemented or replaced by credit arrangements—a development which has gone a long distance in domestic monetary systems in all countries. The move would be part of a program of international monetary reform that takes account of the declining role of gold in monetary systems. The pros and cons of restricting gold purchases by the United States are also considered, but such action is not recommended, at least for the present.

PRESENT GOLD POLICY OF THE UNITED STATES

The gold policy of the United States has throughout this country's history undergone two major changes excluding small reductions in the gold content of the dollar in 1834 and again in 1837, which made it profitable to bring gold to the mint for coinage. The country was legally on bimetallism, but the mint ratio of 15 ounces of silver to one ounce of gold favored silver and little gold was coined. The new ratio, after 1837, of 15.988 to one favored gold. Changes have been made from

time to time in the percentage of gold reserve required to be held behind the country's money and bank deposits.

The first major change was the well-known shift from legal bi-metallism to the gold standard by the law of 1873. This law abolished free coinage of silver into dollars—a measure which at the time attracted little attention, since the price of silver discouraged its presentation for coinage. For a quarter of a century thereafter, however, as the price of silver declined, the merits and demerits of the gold standard were subject to heated, and often not very illuminating, political debate.

The second major change in gold policy came in 1933 when gold was withdrawn completely from domestic circulation, concentrated in the hands of the Government, and its price raised substantially. The Administration under Franklin D. Roosevelt suspended redemption of all money in gold, made illegal the holding of gold by the public and banks, prohibited the export of gold except under license, and commenced buying gold at higher and higher prices. The price was finally fixed by the Gold Reserve Act of January 1934 at \$35 an ounce, compared with the previous price of \$20.67. These are the only basic changes that this country has made in its gold policy.

According to present policy, the U. S. Treasury will sell gold in unlimited amounts at \$35 an ounce to friendly foreign governments and their central banks wishing to use the gold to add to currency reserves or settle international accounts. It will not sell gold to private persons, although there are exceptions for domestic buyers with legitimate use for gold in industry or the arts. American citizens are in general prohibited from holding gold either at home or abroad. The United States, conversely, will buy gold freely in unlimited amounts at \$35 an ounce from foreign governments or central banks, and lawfully acquired gold from private persons, such as gold from domestic mines. (The Treasury collects a handling charge of $\frac{1}{4}$ of one per cent, so that the purchase price is actually \$34.9125 and the selling price \$35.0875.) The United States thus maintains unlimited convertibility internationally of dollars into gold or gold into dollars on the above basis. No other government maintains convertibility of its currency into gold on any basis.

DECLINING ROLE OF GOLD

A positive long-range gold policy for the United States must recognize the fact that gold has long been losing ground in monetary systems. For generations there has been a progressive substitution of credit for commodity money, first domestically and more recently internationally. The trend has been irregular but unmistakable. After the First World War and during most of the interwar period gold lost much of its influence over monetary policy and domestic economic conditions, also

disappearing completely from circulation in virtually every country of the world. Gold played little part in monetary affairs during the Second World War. After the war, various restrictive devices were used to maintain exchange rates. Gold continued relatively inactive during the early postwar years.

During the past decade gold has regained monetary importance as the payments deficits of the United States and the removal of payments restrictions by major countries have focused attention on the role of gold in international reserves—its principal surviving function. Proposals for reforming the international monetary system generally downgrade gold.

The demise of gold, however, does not seem imminent. It is possible to ridicule the digging of gold from the ground only to bury it at Fort Knox, but the glitter of gold remains, and holds the world in its spell. It is universally accepted by central banks in settlement of accounts. It is widely regarded as an assured means of payment and considered to be the most conservative type of reserve. Predictions regarding the final demonetization of gold are precarious.

But events could move further against gold. If it were not for this country's policy of buying gold freely at \$35 an ounce—a policy criticized by many economists—the price of gold would probably decline. The future of gold as a monetary metal is to a considerable extent in the hands of the United States. As the owner of the world's largest gold hoard, as well as for other reasons, it has an important stake in the future role of gold.

The United States supported the price of silver, under pressure from silver producers, long after silver had ceased to be a monetary metal—except in China and a few outlying parts of the world, and as the material used in fiduciary coins. The U. S. Treasury was finally bailed out of this costly project, in which huge and unneeded hoards of silver were accumulated at high prices, by the rise in industrial demands for silver and by demands for subsidiary coinage.

Is gold going the way of silver in the foreseeable future, with this Government in similar fashion supporting the price of gold through unlimited purchases at \$35 an ounce? Is the United States likely to find itself the owner of large stocks of a cheapening metal, a decline concealed by its own artificial support? Will increasing industrial demands for gold spare the United States from possible losses in the value of gold, as they did in the case of silver? So long as the United States is selling rather than buying much gold, and with gold apparently firmly entrenched in the public mind as an immutable article of value, these questions may seem irrelevant. Perhaps they are looking too far into the future; perhaps not. At the present time it seems unlikely that other

countries will alter their link to gold in the foreseeable future, or cease to desire it as a reserve component, particularly so long as the United States continues to buy it freely. It would, moreover, be unrealistic to assume that this country is about to refuse to accept gold. (This subject is discussed below.)

In light of the long-term downtrend of gold, however, it could be argued that the United States, as part of a long-range gold policy, should gradually and by orderly process reduce the large gold element in its currency reserves, converting part of this gold into other forms of liquid reserves available to support the dollar internationally. These might consist of holdings of strong currencies of leading nations, the relative amounts to be varied according to demands and developments affecting these currencies. The United States also could repay in gold its outstanding drawings from the International Monetary Fund, thereby reinstating reduced drawing rights available to meet balance-of-payments needs. A possible undesirable aspect of such repayment is some loss of independent control over available reserves, since access to the gold tranche requires action by the IMF. Such action, however, is largely a formality, as the Fund does not deny drawing of the gold tranche.

Repayment by this country in gold would eliminate the need for technical transactions between the Treasury and the IMF, in which the United States draws foreign currencies, such as Canadian dollars, and sells them for U. S. dollars to countries desiring to repay drawings to the Fund. Such countries are debarred from paying U. S. dollars to the Fund because the latter is overstocked with dollars—that is, Fund holdings of dollars exceed 75 per cent of the United States quota. Such transactions make it unnecessary for foreign countries to use their U. S. dollars to buy gold for repayment to the Fund. Outstanding drawings by the United States in August 1966 totalled \$1.510 billion, but, because of drawings of dollars by other Fund members, the amount repayable to the Fund was only \$881 million.

Several years ago the United States bought \$800 million of gold from the Fund, with a Fund right of repurchase. The Fund received interest-bearing U. S. Treasury bills and short-term notes, which it considers as investments and not holdings of dollars.

A deliberate reduction of gold reserves, the timing and amounts involved, would depend largely upon (1) judgments regarding the prospects for a further decline in the importance of gold, (2) consequent risks in holding large amounts of gold as compared with risks in holding a larger share of reserves in currencies that might depreciate, (3) possible repercussions upon confidence in the dollar and its use as a reserve currency, and (4) the effect upon international financial markets. There

is also the question whether a guarantee of currencies held as reserves should be sought and, if so, in what form—in gold, the escape from which was the reason for holding other currencies, or perhaps in terms of a composite of leading currencies.

Views regarding gold and its future run the gamut from shock at any thought that gold is not the ultimate measure and safest storehouse of value to belief that gold is an obsolete and primitive monetary base, whose days are definitely numbered. Keynes, writing in 1923, said, "In truth the gold standard is already a barbarous relic."¹ Under present conditions it appears safe to say that the United States, apart from the effect of its own possible but improbable actions against gold, need not be unduly concerned over the large gold element in its reserves.

SALES OF GOLD ONLY AT THE DISCRETION OF THE UNITED STATES

Regardless of views as to the future of gold, the United States, I believe, needs to exercise full control over disposition of its gold reserves. I propose, therefore, that the United States sell gold only at its own discretion—the practice of all other countries. Gold would be sold when foreign exchange was needed to maintain exchange-rate stability, at such times and in such amounts as the United States deemed expedient.

The case for cessation of free sales of gold rests largely on three grounds: first, that erratic gold sales lead to misconceptions as to the basic strength of the dollar; second, that a run on the gold reserves of the United States, with unfortunate consequences, is possible under present free convertibility of dollars into gold; and, third, that maintenance of unlimited access to its gold hampers this country in pursuing policies directed toward economic needs and present-day goals.

Gold Outflow and Misconceptions Regarding the Dollar

The weakness of the payments position of the United States has been magnified by world focus on gold exports from this country. These exports are commonly regarded as a gauge of the strength of the dollar. Doubts as to the ability of the United States to maintain free sales of gold have thus been a major factor in world confidence in the dollar. They have also, unfortunately, been reflected in attitudes within the United States regarding its own currency, thereby contributing to the adoption by this country of restrictive and other inherently undesirable policies.

The United States is actually an economic giant and the dollar the strongest currency in the world; in world markets the dollar is in extensive and usually preferred demand. The purchasing power of the dollar

¹ John Maynard Keynes, *Essays in Persuasion* (London: Macmillan, 1931), p. 204.

has remained relatively stable for over a decade. While there is no assurance that such stability will continue, in contrast with other currencies the record of the dollar is excellent.

The large amount of liquidity, actual and potential, which is behind the dollar is being obscured by undue focus on gold exports, often capricious. The defensive position of the United States in international financial affairs has been nurtured by erroneous views regarding the real strength of the dollar. Erroneous views regarding the dollar have hurt the United States in its position of world leadership. These misconceptions regarding the dollar have been abetted by uncontrolled movements of gold.

A Gold Crisis

Predictions have been made that the United States will be confronted with further large and accelerated outflows of gold, and that prospects for restoring balance in external payments without imposition of stronger capital controls, and even some controls on current transactions, are not bright. Gold reserves have declined from \$22.9 billion at the end of 1957 to about \$13.4 billion in August 1966. The loss of several billion dollars more in the next year or two is foreseen in a number of quarters and is expected to lead to public nervousness, and perhaps a financial crisis. Heavy gold losses, it is said, could trigger a run on the dollar, fears of dollar depreciation or formal exchange restrictions, stock-market collapse, forced suspension of free gold sales, and other untoward events. The dollar exchange rate would doubtless survive intact (the support given the pound sterling in recent crises illustrates what can be done to sustain a currency in a situation far more precarious than would be likely to confront the dollar). But any events of the sort mentioned would involve economic loss and other difficulties. Such events are not necessarily dependent upon payments deficits, but could take place regardless of progress in restoring balance. Whether these forecasts are right or wrong, and I believe them overly pessimistic, the possibility of a gold crisis cannot be dismissed.

Control over sales of gold would make it impossible to have a run on gold and a crisis leading to involuntary suspension of free sales of gold. A run on the dollar as distinct from gold would, of course, continue to be possible but would be more orderly than if there were a scramble to get gold while the gold vault was still open. Withdrawal of the right accorded foreign governments to purchase gold at will from the United States would permit this country to regulate the outflow of gold in orderly fashion, to utilize holdings of foreign exchange in place of gold, and to sell gold as the United States itself considered desirable. It would remove whatever possibility there is of foreign attacks on the dollar

through gold withdrawals for political ends. The possibility of a sudden outflow of gold, with accompanying consequences, would no longer hang over this country. A controlled reduction in our gold reserves might be necessary but would be less disturbing than erratic outflow. If the United States controlled the outflow of gold this country would have less interest in preventing premiums in the free gold market, which at present tend to increase the demand for gold. Operations in the free gold market through the gold pool could, of course, continue if considered desirable.

The United States might wish to build up its holdings of foreign exchange substantially, so as to be prepared to meet possible demands without large and untimely exports of gold. For this purpose it could export gold gradually at its own initiative, or could acquire additional amounts of foreign currencies through credit arrangements.

A useful device that has been employed by the United States for this purpose is the sale of nonmarketable bonds to the monetary authorities of a country whose currency is basically strong and convertible. These so-called "Roosa bonds," named after Robert V. Roosa, former Under Secretary of the Treasury who developed them, are often denominated in the currency of the foreign country, thereby providing an exchange guarantee for the owner. Their maturities have generally been about two years. The holder of the bonds has the option of converting them into 90-day Treasury bills, which in turn can be converted into dollars upon two days' notice. The bonds carry an interest rate comparable to that on U. S. Government obligations of similar maturity. Through the sale abroad of obligations of this and other types the United States could enlarge its holdings of foreign exchange as it desired, thereby obviating sales of gold.

Desired Policies Hampered by Gold Convertibility

The United States has been hampered in domestic and foreign policies by undue dependence upon gold and maintenance of gold convertibility, namely, by fears lest desired measures add to the outflow of gold. An adequate attack on the sluggishness of the American economy and low growth rates during the early 1960's was considerably delayed by such fears. Indicated measures would, it was anticipated, encourage capital outflow, lack of confidence in the dollar, and other consequences leading to loss of additional gold. Foreign policies such as aid to developing countries, encouragement to foreign investment, and trade liberalization have similarly felt restraining pressure from gold losses.

While the payments deficit is the underlying problem and responsible for most of the limitations on policies, gold outflow is a matter of considerable official concern. To many persons the loss of gold looms large

and is the visible culprit. Newspapers refer to the "gold gap." Policies such as tied aid, "Buy American," and limitations upon capital exports have to a considerable extent been adopted in order to prevent an undue outflow of gold. Control over gold outflow would help to remove excessive concern over the dollar because of payments deficits. Control over sales of gold would, of course, not promote balance in international payments, which is the underlying problem, except perhaps indirectly through its effect upon capital flows. Measures to promote balance in international payments would still be needed.

Although the United States would under the proposed policy still need to export gold to help finance the payments deficit, control over gold exports so as to avoid psychologically disturbing movements, and possession of greater ability to utilize foreign-exchange holdings in settling accounts, would provide more flexibility and strengthen this country's international position. The proposed policy would not only prevent disorderly outflow of gold, but would lessen dependence upon gold by facilitating settlements in means other than gold, as noted above. The United States could develop further its various foreign-credit arrangements as substitutes for gold.

Withdrawal of free access to our gold reserves would thus reduce gold's influence over monetary, fiscal, and other policies. It would be an extension into the international field of measures taken in 1933 affecting this country's monetary and banking system, when domestic redemption of U. S. currency in gold was abolished. This removal of the obligation to redeem currency in gold domestically provided needed latitude for monetary and fiscal policies. Continuation of gold redemption internationally, however, constitutes a loophole in control over gold. If large payments deficits continue, convertibility in gold can be the source of serious difficulty. So long as our gold reserves were more than ample no problem arose. In recent years, however, when large payments deficits have persisted and our gold reserves have shrunk, the handicaps and dangers imposed by unlimited convertibility internationally have become clear. (A corollary is that the legal limitations upon the amount of gold to be held as reserves behind U. S. currency should be removed, thereby permitting all of our gold to be available for international settlements. The knowledge of this availability would be a positive factor in this country's payments and dollar position.)

Many persons doubtless would not consider the weakening of the so-called discipline imposed by gold an advantage. They would regard gold as a check upon irresponsible policies, and a means of forcing more rapid external adjustment. Opponents of the proposed policy who do not have confidence in government would note that removal of gold's restraining influence opens the door to mismanagement, a complaint

similar to the "managed currency" outcry heard during the 30's. The record of Federal Reserve policies since then, however, does not lend much support to such fears. Moreover, external adjustment need not be subjected to a mechanistic and perhaps unduly harsh schedule.

The proposed policy would be a move in the direction of an international monetary system in which the excessive importance of the gold element in reserves would be reduced. Reduction of reliance upon gold would provide more leeway for the creation of an amount of international liquidity appropriate for growing world trade and an expanding world economy. Maintenance of gold convertibility places a limit upon the volume of liquidity, and sooner or later can be a deflationary force. International liquidity cannot yet be expanded in response to needs as readily as can domestic credit by central banks. We are still waiting for a mechanism to provide the necessary amount of elasticity in the supply of international money. Plans currently under discussion will, hopefully, be a constructive step toward meeting this need. The proposed policy would be in furtherance of the developing trend of international monetary reform. It would continue the historic trend toward diminution of the power of gold.²

In addition to these points there are other related considerations which make desirable the withdrawal of unlimited convertibility of the dollar into gold. The size of the gold element in the reserves of the United States has been left almost entirely to decisions in which this country has had little or no part. Foreign countries, presently in a position to put pressure on the dollar via gold, can reduce, perhaps substantially, the gold holdings of the United States. Until a stronger international monetary system has been established and financial nationalism further reduced, the amount of this country's gold reserves is a matter of consequence. With control over sales of gold, the United States might decide, for example, that it is wise to keep gold reserves approximately at their existing level, at least for the present, and meet demands for foreign exchange by means other than gold exports whenever feasible.

Free sales of gold by the United States have permitted foreign central banks to build up their gold reserves by drawing down the gold reserves of the United States. From the standpoint of redistribution of this country's abnormally large postwar gold holdings, this transfer of gold from the United States to foreign countries, thereby strengthening depleted reserves of Europe, has been a healthy development. The question is raised, however, how far this outflow should go. From the stand-

² A typographical error in a draft of this paper omitted the letter "l" in the word *gold*. Persons desiring to dethrone gold completely might consider the abbreviated spelling appropriate for some who worship the gold standard.

point of those who wish to reduce the gold element in this country's reserves, continued outflow of gold would not be a misfortune.

The transfer of gold reserves to foreign countries reduces the total liquidity of the United States, unless the gold establishes a credit balance in favor of this country in a foreign bank. The latter has not generally been the case since exports of gold have been used largely to help pay for the importation of goods and services and the exportation of American capital, particularly heavy private foreign investment and government outlays abroad. Gold reserves of the United States have, therefore, been supplemented by swaps and various other credit devices as substitutes for gold lost, a constructive development.

The United Kingdom has generally sought to maintain some 90 per cent of its reserves in gold, recognizing its special responsibilities and recalling the devaluation of the dollar in 1933. France not long ago decided to increase the gold portion of its reserves. A number of other countries having confidence in the dollar exchange rate prefer to maintain the major portion of their reserves as liquid earning assets in New York.

The large gold reserves of the United States have enabled this country to meet major obligations abroad, and to achieve particular foreign policy objectives, especially military and foreign-aid objectives. They have helped it finance payments deficits and maintain dollar stability at a time when large foreign expenditures by the United States are of special importance. The amount of this type of assured liquidity is at present largely subject to foreign decisions. While the trend of monetary affairs is away from gold, and the United States at some stage might wish to liquidate much of its gold, this country should be in a position to make its own decisions. The proposed policy would permit this.

FREE SALES OF GOLD UNNECESSARY

Unlimited sales of gold by the United States at the option of foreign central banks are unnecessary for maintenance of the exchange rate of the dollar at \$35 an ounce of gold. (Even if the United States were to introduce wider exchange-rate margins, control over gold sales would in no way interfere.) Numerous countries have shown that, given appropriate monetary and fiscal policies, exchange-rate stability can be maintained through purchase and sale of foreign exchange by the central bank and without gold movements. Nor are free sales of gold essential to world confidence in the dollar (apart from an initial jolt if present policy were to be changed), to the free convertibility of the dollar into other currencies, and to the functioning of the dollar as a reserve currency.

Maintenance by the United States of unlimited access to its gold

reserves by foreign governments not only promotes a false judgment of the strength of the dollar, making possible a gold crisis and limiting desired policies, but it is not an economically significant objective in international monetary policy. The meaningful objectives are: (a) stability of the dollar in the foreign-exchange market, (b) free convertibility of the dollar into other currencies, (c) strong foreign-exchange reserves to assure continuance of convertibility and exchange stability, (d) maintenance of stable internal purchasing power of the dollar, and (e) avoidance of prolonged and unwieldy payments deficits—a basic objective underlying all of the above. Success in achieving these objectives facilitates use of the dollar as a reserve currency. Free sales of gold, however, are unnecessary for the attainment of any of these objectives.

Since the world is largely upon the dollar-exchange standard, wherein foreign central banks aim to provide convertibility of their currencies into dollars, and since the United States maintains free interchangeability of gold and dollars in either direction for such banks, the United States is indirectly maintaining gold parity for world currencies generally. It is primarily dollar parity, however, rather than gold parity, in which countries are interested. They wish to maintain their exchange rates at the official parity with the dollar. Since their currencies and the dollar are both defined in terms of gold, gold parity and dollar parity are identical. This identity is recognized in Article IV Section 1(a) of the IMF Articles of Agreement, which reads: "The par value of the currency of each member shall be expressed in terms of gold as a common denominator or in terms of the United States dollar of the weight and fineness in effect on July 1, 1944."

Gold parity has become largely symbolic. It can, moreover, be effectively maintained by the United States without free sales of gold. Control over sales of gold would place the major task of maintaining exchange parity (also gold parity) on this country's total reserves, gold plus foreign exchange, without putting undue emphasis upon the gold element. Control over gold sales would not eliminate gold parity of the dollar. The dollar would also continue to provide such parity for other currencies convertible into dollars.

The United States has gone a certain distance toward the substance of control over gold exports by obtaining restraint and cooperation of principal central banks. The restraint, however, varies from country to country, is uncertain, and of limited scope. Moreover, in the event of serious fears abroad regarding the dollar, even though unfounded, foreign central banks could not be expected to refrain from asking the United States for gold or to subordinate their personal responsibility in order to help the dollar. Experience to date indicates that central

bankers are not necessarily immune to rumors and to the influence of actions by others, rational or irrational. Central bankers understandably do not wish to take chances with their own currency for the sake of the dollar. In meeting a central bank's request for gold under a system of controlled gold exports, the United States would be conferring a favor rather than asking one, as it must when it urges restraint on other countries in taking its gold.

Cessation of free sales of gold need not await possible modifications in the international monetary system, such as expansion of the functions of the International Monetary Fund, liberalization of automatic drawing rights on the Fund, wider exchange-rate margins, creation of a composite reserve unit (CRU) with or without a tie to gold, or procedures to facilitate external adjustment. These modifications are not dependent upon free sales of gold by the United States. Control over gold outflow, and resultant elimination of the need for foreign cooperation regarding gold withdrawals, would strengthen the hands of the United States in negotiations regarding international monetary reform. Less dependent upon European restraint in taking its gold, this country would be better able to exercise the degree of leadership warranted by its economic strength.

The abolition in 1933 of domestic access to monetary gold was a far more drastic step in view of public opinion at that time regarding the function of gold, together with fears of paper money and of a "managed currency," than would be abolition of free access internationally. Domestically, the purchasing power of the dollar was the significant factor, rather than the ability of a private citizen to obtain gold.

In regard to charges that the United States would be violating a moral obligation to countries which have chosen to maintain reserves largely in dollars instead of gold, these countries would suffer no loss since the exchange rate and convertibility of the dollar would be maintained. Furthermore, the United States would still export gold, and could provide gold to any central bank to which this country had an obligation. The official price of gold would be unaffected, and holders of gold would still be able to sell their gold to the United States at \$35 an ounce. Whether the United States should alter its gold-buying policy is a separate question.

CONSEQUENCES OF CONTROLLING SALES OF GOLD

Immediate Impact

Announcement that the United States would henceforth sell gold only at its own discretion would doubtless cause public nervousness. Since the function of gold is often not well understood, strong reactions might

be expected, with forecasts of inflation, dollar devaluation, and other consequences. The move would be interpreted in some quarters as a sign of weakness. This country's foreign-currency reserves might thus be under pressure.

The United States would need to be prepared to meet a possible immediate withdrawal of funds by foreign holders of dollars. Private holders do not have access to gold and would thus not be directly affected, but nevertheless might sell their dollars because of general nervousness. Central banks, recipients of dollars sold, might decide to convert some of their dollar balances into other foreign currencies. Under certain conditions they could require payment either in gold or their own currency at the option of the United States (IMF Articles of Agreement, Article VIII, Section 4).

Large withdrawals of dollars by central banks, however, would appear unlikely. In the first place these banks would be confronted with the question of where they could place their funds with greater security than in the United States. Some funds might go into Swiss francs and other strong European currencies, but none of these currencies is freely redeemable in gold and in this respect would offer no attraction over the U. S. dollar. Official holders of dollars would find little benefit in shifting to other currencies.

In the second place, central bankers, although perhaps unhappy over the change, would doubtless recognize that the exchange rate and free convertibility of the dollar were the significant factors, and that the U. S. Government was pledged to continue these unchanged; moreover, that the Government was in a strong position to make good on this pledge. Furthermore, dollars are needed to finance current international transactions. This policy regarding gold sales would also be similar to that of their own governments.

Additional factors discouraging withdrawal of dollars by foreign holders, official and other, are the needs for dollar working balances, the availability of liquid earning assets, and the extensive facilities offered by American financial institutions, particularly in New York. A large or sustained withdrawal of funds as a result of this Government's action would appear improbable. As the days passed and no untoward results appeared, and as public discussion clarified the issue, the business and financial community would doubtless settle down to business as usual.

The Dollar as Reserve Currency

Insofar as one of the present attractions of the dollar as a reserve currency is its free convertibility into gold, cessation of such convertibility would be a handicap. On the other hand, the facts that no other country offers gold convertibility, nor greater security, liquidity, and access to

such extensive financial facilities necessary for a reserve center, would be compelling incentives for central banks to leave reserve funds in dollars.

The strengthened ability of the United States, as a result of control over gold outflow, to deal with payments deficits and possible dollar crises, coupled with renewed pledges of exchange stability and dollar convertibility, might well result in even greater confidence in the dollar. It is unlikely that the basic position of the dollar as a reserve currency would be impaired.

Liquidity

Cessation of convertibility of the dollar into gold would have little or no direct effect upon international liquidity. An additional portion of this country's gold would, however, become effectively available to it for settling balances. Apart from the 25 per cent legal-reserve requirement, which locks up most of its gold, the United States under the present policy of free sales of gold would find it difficult to use most of the free gold without causing public fears and possible economic disturbances. Such fears would be intensified if the Federal Reserve Board were compelled to exercise its right to suspend temporarily the reserve requirement. The free gold's effectiveness as a working reserve is thus limited.

If gold exports could take place only at the discretion of the United States, the likelihood that gold exports would suggest to the public a possible gold crisis would no longer exist. The United States could use its gold in an orderly manner, and with fewer newspaper headlines raising fears of trouble. This country's liquidity would in substance be increased.

To the extent that the proposed action led to greater use of credit as a supplement to gold for reserve purposes, it would add to world liquidity. If the move caused governments to negotiate more bilateral credits or currency swaps, perhaps in order to avoid selling gold in view of uncertainty as to whether gold could later easily be acquired, international liquidity would thereby become greater.

International liquidity would be reduced if the proposed action led to a withdrawal of foreign balances from the United States and their conversion into the currency of the holder. If France, for example, converted dollars into francs, international liquidity would be contracted. If, however, France converted the dollars into Swiss francs or some other currency available as international reserves, no net reduction of international liquidity would take place.

Inflation

The proposed action would in itself be neither inflationary nor de-

flationary. To the extent, however, that it indirectly resulted in an expansion of liquidity, or to lessened confidence in money and a flight into goods, it could increase inflationary pressure. If, for example, it led to arrangements for increased international credit as a supplement to gold, the tendency would be in the direction of monetary inflation. In view of the relatively small probable increase in liquidity or flight to goods as a result of the cessation of gold convertibility of the dollar, together with continuous growth of world trade, any inflationary consequences would be negligible.

Conversely, there would appear to be no incentive for contraction of credit arrangements as a result of the proposed action. If, however, it were to lead to withdrawal of dollars and their conversion into the currency of the holder, such withdrawal would reduce liquidity, as noted, and tend toward monetary deflation. Since large dollar withdrawals appear unlikely, for reasons discussed, no serious deflationary consequences seem likely. Moreover, any deflationary contraction of liquidity could be offset by arrangements for the expansion of international credit. Discussions in the Group of Ten and in the International Monetary Fund of means to accomplish any needed expansion of credit are well advanced, despite lack of agreement. The amount of credit contraction, if any, would doubtless be small.

Effect Upon Gold

The effect of the proposed action upon gold itself would probably be different in the short run from the long run. The free market for gold might consider the action as indicating a scarcity of gold, with a resultant husbanding of gold and increased prospects for a rise in the price of gold. This could result in upward pressure on the price of gold in free markets.

The United States would not wish to encourage preference for gold or to have the action interpreted as upgrading gold. It should be considered rather as a means for orderly utilization of this country's gold. A statement by the United States that it would not hesitate to utilize its gold, perhaps coupled with an actual export of gold at its own initiative, would probably suffice to avoid misinterpretation. If necessary, a hint that it regarded its gold reserve as large in relation to other forms of reserve, would probably put matters in proper perspective. The United States could avoid having the action increase the appetite for gold by public statements geared to the necessities of the situation. For example, a statement noting proposals to reduce the price of gold, and stating that these did not represent official policy, would have a depressing effect upon gold demand by merely raising the possibility of such action. In any event, since the United States would be controlling gold exports, a possible increase in the demand for gold would not harm this country.

If there were public discussion and substantial support for the proposals that the United States should not buy gold except in selected cases, and that the price for purchases should be less than \$35 an ounce, such discussion would tend to weaken the demand for gold. It would dispel some of the aura surrounding gold.

Discontinuance of free redemption of dollars in gold by the United States, the last country to maintain such redemption and this only for governments, could hardly be considered as strengthening the role of gold. It would be pushing gold farther into the background and weakening what influence it still retains. It would be limiting even further the effect of gold upon this country's monetary, fiscal, and economic policies. The implications of the move would sooner or later become evident.

INTRODUCTION OF DISCRETIONARY SALES OF GOLD

The time for introduction of a policy of selling gold only at the discretion of the United States is when gold outflow has slowed down and no disturbing economic events have occurred. If such action were taken during a period of large gold losses, public apprehension, or economic difficulties, it would be likely to accentuate any loss of confidence in the dollar. The action would then be misinterpreted and regarded as a sign of weakness.

Announcement would presumably be made on a week-end when markets were closed. In order to minimize misinterpretation, the announcement should state emphatically that (1) exchange rates for the dollar vis-à-vis leading currencies would be unaffected by the move, (2) large resources were available to maintain the dollar exchange rate and that gold would be exported as necessary, (3) convertibility of dollars into other currencies would continue without restriction, (4) private commercial exchange operations would be unaffected, and (5) Congress was being requested to remove restrictions on utilization of the country's entire gold reserve. The last would involve political difficulties which might preclude or suggest deferment of such a request.

The advantages of control by the United States over sales of gold appear substantial, particularly in light of the dangers inherent in the present policy of maintaining unlimited gold sales. Possible difficulties which might accompany such a move appear manageable and, in fact, minimal. Subsequent control and limitation on the purchase of gold—much more of a departure from present policy—merits study, as discussed in a later section.

OTHER PROPOSALS REGARDING THE GOLD POLICY OF THE UNITED STATES

A Rise in the Price of Gold

A number of proposals have been made in recent years for changes in

the gold policy of the United States. A proposal widely discussed is that the official dollar price of gold be raised substantially—from the present \$35 an ounce to perhaps twice this level. A main purpose would be to increase the monetary value of existing reserves by writing up the value of gold, thereby adding to world liquidity. Other purposes include stimulation of the production of gold, assistance to foreign countries by increasing the value of their gold holdings, and financing aid to developing nations through utilization of the “profit” from writing up the value of reserves, thus reducing the burden on taxpayers.

There are strong arguments against such a measure. The resulting large increase in the supply of money, including extensions of credit based upon expanded gold reserves, could be seriously inflationary. Moreover, the additional amount of liquidity accruing to the international monetary system would be arbitrary and not well-related to needs; these needs grow year by year. Revaluation of the dollar, as well as that of the pound sterling and other currencies that would doubtless follow a change by the United States in the dollar price of gold, would be disturbing to trade, investment, financial markets, and the business community generally. Principal beneficiaries would be the Soviet Union, with its large gold production and reserves, and the Union of South Africa, the major producer of gold. The developing nations as a group own relatively little gold. Speculators against the dollar and pound would be rewarded, whereas those who accepted in good faith official assurances regarding the stability of these currencies, and who thereby helped avert a collapse, would be penalized. Stimulation of gold production would result in a wasteful expenditure of labor and other resources, since less costly means of increasing liquidity are available.

Proposals to reduce the gold content of the dollar—that is, to devalue the dollar for external payments—refer similarly to a rise in the price of gold, but in a different context. These proposals have as their objective a reduction in the payments deficit by making American goods and services cheaper to foreigners, assuming that other major countries would not devalue their currencies by similar percentages—an unrealistic assumption. Dollar devaluation would be a drastic and unsettling move with far-reaching consequences. Under present and prospective conditions it offers more disadvantages than advantages. It has been firmly rejected by all recent Administrations.

Flexible Exchange Rates

Related to the proposal for dollar devaluation is that for flexible exchange rates, wherein rates would be allowed to move in response to market supply and demand. If rates were allowed to move without limit, the dollar would have no effective gold par. Under such a system no reserves would be needed, although exchange-rate fluctuations could

be wide. If, however, exchange-rate movements were to be confined within established limits, such as a fixed margin either side of par, reserves would be necessary in order to maintain these limits. Under such a system of wider exchange-rate margins, a tendency for the dollar to fall below the limit would be met by sales from reserves. Any intervention by government to prevent excessive instability within the limits would similarly require use of reserves.

According to requirements of the International Monetary Fund's Articles of Agreement, exchange rates for spot transactions must be confined within a margin of one per cent above or below par. Liberal interpretations of this requirement, however, have enabled countries, such as Canada, to employ a system of flexible exchange rates for an extended time. A system of wider exchange-rate margins has substantial support as a means of promoting external adjustment, whether the problem be deficit or surplus. It is, however, not free from disadvantages, such as greater uncertainty and risk for exchange transactions.

Proposals for a rise in the price of gold, dollar devaluation, completely flexible exchange rates, and wider exchange-rate margins have received extensive discussion elsewhere. To enter into further discussion of these questions here would take us far afield.

Gradual Reduction in Price of Gold

Another proposal, offered originally in 1960 by Professor Fritz Machlup of Princeton University, is for a gradual and periodic pre-announced reduction in the official price of gold.³ He proposes that the United States reduce the dollar price of gold by small amounts, perhaps two or three per cent, in a few instalments spread over a period of time. The first reduction might be two per cent, followed a year later by a previously announced two or three per cent. The objective would be to discourage a flight out of key currencies into gold; the future reduction in price would be definitely known. The plan would presume prior and essentially open negotiations with other countries—especially those with leading currencies—under the auspices of the International Monetary Fund, so that these countries could reduce the price of gold in their currencies by similar percentages and at the same time.

Machlup points out that lack of confidence in the dollar and concern by foreign central banks over their large dollar balances is based upon fear that the dollar may be devalued. Demands for gold thus represent a hedge against the contingency that the price of gold may rise. If, how-

³ "Comments on the Balance of Payments and a Proposal to Reduce the Price of Gold," *The Journal of Finance* (1961), pp. 186-193. See also his *International Payments, Debts, and Gold* (New York: Scribner, 1964), pp. 240-244, 347.

ever, it were definitely known that the price of gold was going to fall, this knowledge would reverse the trend and lead to a conversion of gold into dollars and other currencies; the gold could later be bought back more cheaply if desired.

Speculators operate upon the principle that the price of gold can move only in one direction, and that is up. Their expectations are supported by the facts of history. Announcement that the price of gold will go down by a certain amount and at a certain date would cool their ardor—provided that the future price reduction is credible. The Machlup Plan, therefore, provides that in order to remove any doubt whether the announced price reduction will take place and the lower price continue, the Government should sell gold freely and without hesitation at the lower price. Hoarders would not wish to buy something which they know will have a lower price later.

Offerings of gold to central banks, he notes, would increase. Central banks, desiring to avoid a loss in their reserves, would tend to switch from gold back into dollars and other key currencies. Gold drawn out of hoards and deposited in central banks would add to international liquidity. It would not be necessary to continue the periodic reductions indefinitely, since the chief objective would be to make clear that the price of gold can go down as well as up, and that hoarders can lose money. An incipient run on gold reserves could be averted by announcement of a forthcoming price reduction, which would force a retreat of speculators. The Machlup Plan was proposed as an intermediate measure until the international monetary system is strengthened. It could serve a useful purpose if governments were prepared to cooperate sufficiently to make it effective.

Gradual Rise in Price of Gold

Proposals have been made to raise the price of gold periodically and by such small amounts, announced in advance, that speculators would find little or no advantage in hoarding gold. Such proposals, made independently by Kiyozo Miyata in 1962 and Paul Wonnacott in 1963, are based on the thought that if the annual percentage increase in the price of gold is less than the current rate of interest, the costs of carrying the gold are in excess of the profit. An announced plan to raise the price of gold about two per cent a year would, they believe, discourage hoarding. The objective would be to increase the value of international reserves by raising the price of gold but avoid some of the disadvantages accompanying a single large increase. An unanswered question is whether speculators would be convinced that the rise would be confined to two per cent, especially since there would doubtless be agitation for a substantially higher price.

Removal of Price Floor for Private Transactions

In order to discourage speculation on the price of gold, L. Albert Hahn in 1963 suggested that when central banks bought gold from private individuals and from the free market they should buy only at reduced prices. The official price for transactions among central banks would remain unchanged. A small reduction for private purchases, he believes, would be sufficient to discourage speculation. Alternative proposals of Hahn are that central banks should neither buy from nor sell to hoarders and speculators, that central banks should sell gold only to other central banks, and that private ownership of gold should be prohibited by all countries.

A variation of the alternative proposals of Hahn was made in 1965 by Professor James Tobin of Yale University. He proposed that the London gold pool, which buys and sells gold in the free market in order to confine price fluctuations within narrow limits, should never buy gold in the free market. The pool would thus not place a floor under the price of gold. At present the pool in effect guarantees speculators against loss. The United States, which participates in the pool with other countries, should, he suggests, seek agreement of the others that none of them will buy gold in the free market, and that none will buy gold from any government that does buy gold in the free market. If the others do not agree, he believes the United States should seriously consider putting the plan into effect unilaterally.⁴

Refusal to Buy Gold Freely

A number of proposals have been made to the effect that the United States should refuse to buy gold or buy only on a restricted basis. The earliest such proposal with which I am familiar was made by Lord Keynes back in 1923. He wrote,

... The present policy of the United States in accepting unlimited imports of gold can be justified, perhaps, as a temporary measure, intended to preserve tradition and to strengthen confidence through a transitional period. But, looked at as a permanent arrangement, it could hardly be judged other wise than as a foolish expense. If the Federal Reserve Board intends to maintain the value of the dollar at a level which is irrespective of the inflow or outflow of gold, what object is there in continuing to accept at the mint gold which is not wanted, yet costs a heavy price? If the United States mints were to be

⁴ The proposals of Miyata, Wonnacott, and Hahn are discussed in Machlup's book (fn. 3); that of Tobin in *Guidelines for International Monetary Reform, Part 2, Joint Economic Committee*, Hearings Before the Sub-Committee on International Exchange and Payments, Eighty-ninth Congress (Washington 1965), pp. 597-598.

closed to gold, everything, except the actual price of the metal, would continue precisely as before.

Confidence in the future stability of the value of gold depends therefore on the United States being foolish enough to go on accepting gold which it does not want, and wise enough, having accepted it, to maintain it at a fixed value. . . . (*Op.cit.*, p. 204.)

The London *Economist* in its issue of December 24, 1960, contained an article entitled "Where the Rainbow Ended," which was a parody representing what the memoirs of Per Jacobsson, then Managing Director of the International Monetary Fund, might be as written ten years in the future. In these imaginary memoirs Per Jacobsson describes a decline in 1961 in the gold reserves of the United States, and general nervousness leading up to a short statement by the Federal Reserve Bank of New York, agent for the Treasury, to the effect that its undertaking to buy and sell gold at \$35 an ounce, or at any price, lapsed forthwith. The memoirs added, "In three sentences the Fed had demonetized gold."

The memoirs then state that the International Monetary Fund promptly announced it would buy gold from central banks, giving in return deposits at the Fund, but that after December 31 it would assume no obligation to buy gold; it would continue, however, to sell gold to anyone. At one stroke, the memoirs said, the International Monetary Fund became a central bank for central banks. The price of gold fell sharply, and was about \$2.50 an ounce when the International Monetary Fund decided to put all its gold out for public tender.

A proposal to withdraw the present undertaking to buy gold freely from foreign governments was offered in the Minority Views on the Annual Report of the Joint Economic Committee on the January 1962 Economic Report of the President, 87th Congress, 2nd Session. Such a proposal had been discussed in 1961 by Howard S. Piquet in a study prepared for the House Foreign Affairs Committee. The Minority Views, presented by three members of the House of Representatives and three members of the Senate, contain the proposal that the United States "terminate its guarantee to buy gold from foreigners at \$35 an ounce or at any other predetermined price." The United States, according to the Minority proposal, should avoid devaluation of the dollar and, therefore, should continue to sell gold to foreigners at \$35 an ounce.

A guarantee to buy gold at fixed prices, the Minority Views note, encourages speculation. If the speculator is wrong and devaluation does not take place his loss is slight, whereas if devaluation does take place he collects a profit. Removal of the guarantee would reduce speculation and, according to the Minority Views, lead to a return flow of gold to the United States.

The Minority Views do not state that the United States should cease to buy gold, but merely that it should no longer agree to buy gold in unlimited amounts at any predetermined price. Unless the United States, however, actually refused to buy gold at \$35 an ounce, or unless withdrawal of a guarantee were interpreted as a genuine threat of such refusal, it is questionable whether speculators would be greatly deterred. Moreover, if other governments continued to buy gold at the equivalent of \$35 an ounce, speculators would still have an outlet for their gold with little risk to themselves.

A carefully developed proposal, somewhat similar to that presented in the Minority Views (pages 548-561), was offered by Professor Emile Despres of Stanford University in 1965. He believes that the dollar is not merely as good as gold but better than gold, and that only because the United States is willing to buy gold freely at \$35 an ounce is gold kept as good as the dollar. Despres proposes that the United States deprive gold of its present unlimited convertibility into dollars, that is, that it cease to buy gold except on its own terms. This action, he believes, would cause gold to depreciate and reveal the true strength of the dollar. He would continue unlimited sales of gold for dollars. His aim would be to remove the "tyranny of gold" and build a strong international monetary system based upon credit. A strengthened dollar-reserve system, he feels, would result from his proposal.

Despres would establish on a country-by-country basis ceilings on the amount of gold the United States would be prepared to buy from each country at \$35 an ounce. At the same time the United States would provide countries with firm lines of credit in substitution for their gold made redundant by the ceilings. Foreigners' access to dollars would thus remain unimpaired, since countries selling gold to the United States would simultaneously draw upon these credits in an agreed ratio to the sales of gold. In this manner, while a substantial portion of their gold holdings would no longer be a potential source of dollars, credit would take the place of this gold. International liquidity would not be reduced.

Professor Gottfried Haberler of Harvard University has suggested that in the event of a run on our gold reserves, the United States should pay out gold freely and announce that it will no longer buy gold at \$35 an ounce, or in fact at any price. The United States should at the same time declare that if and when the gold is exhausted the dollar would be allowed to float. It would thus be permitted to seek its own level in the foreign-exchange market. He believes that the value of gold would probably depreciate in terms of foreign currencies, and that the dollar might depreciate in terms of gold and in the foreign-exchange market. These prospects, he notes, would not be attractive to foreign monetary authorities.

Haberler believes that the dollar problem has been allowed to become needlessly difficult for the United States. He describes the official American attitude as "frozen into a position which exposes the country, quite unnecessarily, to the blackmail of foreign dollar holders."⁵ He reasons that a hint by the United States that it was prepared to undertake the proposed action regarding gold would place this Government in a position to negotiate international monetary reform in accordance with this country's real strength.

A view similar to that of Haberler regarding the course the United States should follow in the event of a run on its gold reserves was set forth by Emile Despres, Charles P. Kindleberger, and Walter S. Salant in an article in the London *Economist* (February 5, 1966). They note "The real problem is to build a strong international monetary mechanism resting on credit, with gold occupying, at most, a subordinate position." They state that the United States could by itself bring about this change, in several ways, namely, by widening the margin around parity at which it buys and sells gold, reducing the price at which it buys gold, and otherwise depriving gold of its present unlimited convertibility into dollars. The resulting system which they visualize would be one based upon the dollar.

Refusal by the United States to purchase gold, or willingness to purchase gold only in limited quantities, would have far-reaching consequences for the international monetary system and the status of gold as a monetary metal.

GOLD PURCHASE BY UNITED STATES ONLY AT ITS OWN DISCRETION

The policy of purchasing freely unlimited quantities of gold at \$35 an ounce has been criticized as supporting an artificial value for gold, harmful to the dollar, and perpetuating a role for gold in the international monetary system not adapted to modern conditions. Were it not for this country's maintenance of unlimited convertibility of gold into dollars, the price of gold would probably decline. The dollar, in strong world demand, is considered by a number of economists to be basically more valuable than gold.

Possible Consequences

It has been suggested that the United States should withdraw support from gold and either refuse to buy gold, or buy gold only in amounts and on a basis determined by the United States, perhaps at less than \$35 an ounce. Such a policy, insofar as it caused gold to depreciate, would

⁵ Haberler's views are set forth in a paper entitled "The International Payments System," presented in a Symposium sponsored by the American Enterprise Institute, Washington, D.C., September 1965.

reveal the underlying strength of the dollar. Dollars, it is said, would be in even stronger demand than at present for international reserves, being commonly preferred to gold in view of the depreciation and uncertain position of gold. Dollar balances would thus serve as the base for a dollar-reserve system, already in existence to a large extent. (The less developed countries have for a number of years been reducing their gold reserves and operating largely on the basis of the U. S. dollar or the pound sterling. Gold holdings of the Latin American countries have steadily declined from a total of \$1.955 billion at the end of 1951 to \$1.050 billion at the end of 1965. Foreign-exchange holdings of these countries, on the other hand, increased over the same period from \$1.025 billion to \$2.235 billion.) The proposed action, if the results were as expected, could be a stepping stone to further development of the international monetary system. The bargaining position of the United States in international monetary affairs would be strengthened if the dollar were in a stronger position.

If other countries continued to buy gold, while the United States refused gold, and their currencies continued to be convertible into dollars, such countries could be a channel for the conversion of gold into dollars. So long as any major country with a convertible currency accepted gold at a price equivalent to \$35 an ounce, gold could readily be converted into dollars at this present price. The world price for gold, moreover, would not fall below this level.

The crucial question is what action other countries would take, and whether they could long continue to accept gold at the present price in the face of the refusal of the United States to accept gold freely. A strong world demand for dollars, whether because of a payments surplus on the part of the United States or because of increased world trade and the consequent need for more dollar reserves, would result in other countries with convertible currencies receiving gold that would otherwise have gone to the United States.

These countries, therefore, might receive large amounts of gold because of (a) growing world demands for dollars and the fact that their currencies were a means of obtaining dollars for gold, or (b) lack of confidence in the price of gold and the desire to convert gold into strong currencies. They could experience increased demands on their dollar and other foreign-exchange holdings, gold being offered in payment. At the same time, these countries would experience an expansion of their own currency, which would be paid out to persons wishing currencies instead of gold. The receipt of gold and resulting loss of foreign-exchange reserves could become a problem, because of the possibility that other countries would close their doors to gold and because of

inflationary consequences of the currency expansion. What would these countries be likely to do under such circumstances?

If the situation became serious they could restrict the sale of dollars and other exchange convertible into dollars, or they could refuse to accept gold, as did Sweden during the First World War. Exchange restrictions would check the indirect conversion of gold into dollars and the consequent loss of foreign-exchange reserves, but would not restore confidence in the price of gold and halt resulting gold offerings. Exchange restrictions have a number of well-known difficulties. If refusal to accept gold became widespread, particularly if a few leading nations refused gold, any country which held out and continued to accept gold would probably receive larger amounts, and sooner or later be forced to refuse gold. In the event of a general refusal by central banks to accept gold, many countries, including the United States, would find themselves the owners of large amounts of gold for which no monetary outlet, or a limited one, existed. The free-market price of gold would decline.

If the United States continued the present policy of buying all gold offered, but only at a lower price, and would also sell at the lower price, this would amount to appreciation of the dollar exchange rate, with repercussions on trade and the balance of payments. The consequences would depend largely upon whether the new price were fixed or open to further decline, and upon the actions of other countries regarding their exchange rates, that is, whether they made similar exchange adjustments. This is not the proposal of those suggesting that the United States refuse to buy gold, except perhaps at its own discretion.

If the United States reduced its buying price but not its selling price, whereas other countries with convertible currencies accepted gold at the equivalent of \$35 an ounce, gold would not be offered to the United States at the lower price. The situation would be similar to its refusal to buy gold. Apprehension over the \$35 price could reduce demands for gold so that little gold would be sold by the United States.

The International Monetary Fund, unless it found some way to refuse gold, could become a dumping ground for gold—perhaps a useful instrumentality to spread internationally the loss resulting from the depreciation of gold. This could be a bit hard on the International Monetary Fund, until the situation was remedied through provision of additional resources or revision of Fund functions regarding credit creation.

As to the likelihood and timing of the above course of events, refusal by the United States to buy gold would undoubtedly cause central bankers to reconsider their own policies and the wisdom of accumulating large gold reserves. They might decide that no change in policy was

called for, at least for the time being. On the other hand, some of them might follow the lead of the United States and not wait for the above events to develop and run their course. This country's action could thus lead to a similar rejection of gold by other countries. It would, in any event, tend to weaken the monetary role of gold.

Refusal by the United States to buy gold could bring about a situation close to the demonetization of gold for much of the world. A flight from gold internationally could develop and snowball, hastening if not causing the complete dethronement of gold. (The pattern of exchange rates would not necessarily be altered by the demonetization of gold, especially in the case of rates that are realistic.) If a chaotic market for gold ensued, the price of gold could doubtless be stabilized by the United States through its buying policy, as conditions might warrant. The possibility, however, of further reductions in the price of gold would create uncertainty for central banks wishing to continue to accept gold.

On the other hand, refusal by the United States to buy gold might be interpreted in some quarters as a sign of weakness. It is possible that the dollar, rather than gold, would depreciate. Doubts as to whether the rejection of gold by the United States would stick, and speculation that gold would survive and stage a monetary comeback, would tend to deter foreign central banks and to limit gold's expected depreciation. Demands for hoarding, especially in disturbed and backward parts of the world, would not disappear. Gold might have the proverbial nine lives and retain all or most of its value.

Depreciation of its large gold reserves would reduce the international liquidity of the United States, with possible effects upon confidence in the dollar—a further counter to the expected depreciation of gold in terms of dollars. Such a loss of liquidity would be less if the United States were to convert part of its gold into other forms of reserve before taking any action that would depreciate gold. Depreciation of gold would, similarly, cause a decline in world liquidity. The development of additional credit arrangements to fill the liquidity void for the United States and the world generally would be essential.

Refusal by the United States to accept gold, and the resulting need for new credit arrangements, could accelerate the establishment of a more effective and broadly based international monetary system. Replacement of gold in the international monetary system would require multinational administrative machinery to assure competent and reliable policy management over the creation of international means of payment. This machinery now exists to a large extent in the International Monetary Fund and elsewhere, and could be further developed to meet new requirements. Proposals for a composite reserve unit, CRU, envisage additional machinery of this type.

Effect on International Monetary System

A major aspect of the question of limitation on purchases of gold by the United States obviously has to do with the role of gold in the present international monetary system. Gold is currently serving a valuable function as a common denominator among currencies, along with that of providing a large amount of international liquidity. It is universally accepted without question in payments. While these functions could be replaced by an IMF unit and the further development of credit devices, the world may not be ready for such advanced and inherently rational procedures. Disagreement and inadequate action could result, with the monetary system the loser. Furthermore, opponents of the suggested move can point out that the range of possible depreciation of gold is less than that of credit money, which can theoretically depreciate to zero.

Against gold are the facts that the purchasing power of gold is unstable, that the cost of increasing the supply of gold is in a sense a wasteful expenditure, and particularly that the relatively fixed amount and slow growth of the supply of gold is the source of problems for the international monetary system. The commitment to maintain parity with gold, coupled with its limited and relatively inflexible supply, can have deflationary consequences and cause a slowdown of economic growth. Parity commitments require economic adjustments that are often painful, and in many cases otherwise unnecessary. This is the main case against gold. Proposals to raise the price of gold flow out of this situation of limited supply and poor adaptability to growing needs for liquidity.

Under present monetary practices, wherein pressures to maintain gold parity fall particularly upon this country, it is free sales rather than purchases of gold that constitute a special problem for the United States. Hence my proposal to withdraw unlimited convertibility of the dollar into gold. Control over sales of gold would not require a departure from gold parity, as noted. On the other hand, refusal by the United States to purchase gold could destroy the monetary role of gold. While such demonetization would remove certain difficulties, it would have far-reaching consequences.

The probable consequences would be disruptive of international financial conditions; the economic repercussions would doubtless be extensive; the psychological reaction would be considerable, as would the political. The United States would be subjected to severe criticism at home and abroad, especially in countries with large holdings of gold and in gold-producing countries. These disturbances, not necessarily unmanageable, would be of unknown intensity, magnitude, and duration.

The proposed move would be a divisive factor in the Western financial cooperation that has evolved in recent years. Even though cooperation in planning international monetary reform and in other matters leaves much to be desired, central banks have learned that a considerable amount of cooperation is essential—another case where they must all hang together or they will hang separately. The fact that the proposal would not contribute to further cooperation, however, does not necessarily mean that the United States should fail to take such action if and when conditions indicate its desirability.

These consequences reveal the need for thorough study and preparation if the United States were to refuse to buy gold, or to limit its convertibility into dollars. Matters requiring analysis include the difficulties inherent in the present role of gold and possible alternative solutions, long-run objectives including transitional measures, and such things as guidelines regarding prices to be paid and amounts of gold, if any, to be purchased. The United States might wish, for example, to purchase at present prices existing gold holdings of the developing nations, so as to avoid causing them loss. Decisions would need to be reached as to whether existing gold holdings of other friendly nations should receive some form of special consideration, and if so what kind of treatment. In view of the importance of sterling, gold holdings of the United Kingdom might warrant special treatment. One of the major questions to be studied is the role of gold (perhaps eventually none) in an adequately revised international monetary system and an expanded International Monetary Fund. There is also the question of what action the Fund should be prepared to take in the immediate sense, apart from a possible fundamental change in its structure and functions. These questions all need thorough exploration.

If the view is accepted that gold is on the way out as a monetary metal, the United States may discover it has a bear by the tail. It can hold onto a large stock of a metal with a prospective loss of value, and also face a reduction in reserves. If it should withdraw free convertibility of gold into dollars at \$35 an ounce, it probably would precipitate such decline.

This paper is concerned primarily with the reverse problem, namely, the inadvisability on the part of the United States of maintaining unlimited convertibility of dollars into gold. Control over sales of gold could be undertaken immediately and without the disturbances that would accompany limitations on the purchase of gold. Such limitations on the purchase of gold could be considered for subsequent action, depending particularly upon developments in international monetary reform, and the possible need for independent action by the United States. To appraise and determine how to deal with the gold problem and its long-

range aspects is part of the broad question of international monetary reform. The world in this connection should remember that gold is not an end in itself.

LEGAL PROVISIONS REGARDING GOLD PURCHASES AND SALES

There do not appear to be any legal requirements of the U. S. Government or commitments as a member of the International Monetary Fund which would prevent the President from putting into force the proposal made in this paper that the United States sell gold only at its own discretion.

United States Legal Provisions

The Executive has authority under the Gold Reserve Act of 1934 to discontinue the free purchase and sale of gold, a privilege now accorded only to foreign governments and under regulations determined by the Treasury. The President's authority to change the gold content of the dollar terminated June 30, 1943, but his discretionary authority over the purchase and sale of gold did not terminate.

The President, therefore, can sell gold entirely on a discretionary basis, as proposed herein, without additional legislation. Similarly, the President has authority to refuse to buy gold, or to buy gold only in amounts and from sellers determined by this Government. Since under present laws the United States cannot buy or sell gold at a price other than \$35 an ounce, apart from minor charges, proposals that involve departure from the present official price of gold, such as a gradual reduction of the price, or a gradual increase in price, would require new authority from Congress.

Obligations as a Member of IMF

The Articles of Agreement of the International Monetary Fund do not require members to buy or sell gold freely, although under certain conditions the Fund may require a member to buy gold from the Fund itself. Sales of gold by the United States only at its own discretion, or refusal by the United States to buy gold, would not contravene the Fund's Articles.

Members are required to declare to the Fund the par value of their currencies in terms either of gold or the U. S. dollar of the present gold content (Article IV, Section 1). Members must maintain their exchange rates within one per cent of this par (Article IV, Section 3) and do so without exchange restrictions on current transactions, unless such restrictions are specifically authorized by the Fund (Article VIII, Section 2). A change in the par value, that is in the price of gold, must be

only "to correct a fundamental disequilibrium" (Article IV, Section 5 a), and a change of more than ten per cent requires Fund approval. Proposals involving small changes in the official price of gold, therefore, do not require Fund concurrence, unless the accumulation of such changes reaches ten per cent of the initial par value.

The Articles provide that the obligation to maintain exchange rates within the prescribed limits is satisfied if the member's monetary authorities "freely buy and sell gold within the limits prescribed by the Fund" (Article IV, Section 4 b). The United States has notified the Fund that it is meeting this obligation by buying and selling gold freely. This method of meeting the obligation is, however, optional with the United States. The United States has the right to maintain exchange rates within the limits through exchange operations, as do other countries, and is not required to buy or sell gold freely in order to fulfill this obligation.

The Fund has the right to buy a member's currency with gold if the Fund desires to replenish its holdings of such currency (Article VII, Section 2 ii). The United States, therefore, would be required to accept gold from the Fund if the Fund felt it needed more dollars and chose to use gold in acquiring the dollars. The Fund must itself accept gold from its members (Article V, Section 2 and Section 7), and conceivably could require the United States to buy some of this gold. The United States, however, has an important voice in Fund actions.

Another provision in the Articles of Agreement requires a member to redeem balances of its currency held by another member when asked to by the other member (Article VIII, Section 4). The country redeeming its currency can do so either by paying the other member in gold or in the currency of such other member. This means that if the United States desired to convert its holdings of a foreign currency into dollars, the foreign central bank would have the option of paying either in gold or dollars. The United States, of course, is not required to convert such currency into dollars, and could sell the currency for some other currency, unless the foreign country restricted such transfer.

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