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THE PRICE OF GOLD

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THE PRICE OF GOLD

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I. INTRODUCTION

GOLD in the world today has many facets. The nostalgia for gold convertibility sometimes gives rise to the belief that the restoration of a full and automatic gold standard domestically and internationally would solve, in some undefinable but inexorable way, the problems of economic and social balance. At the other extreme, gold is held to be an anachronism—"a barbarous relic"—that fits in badly with the current trends of political and economic thought; and, accordingly, it is asserted, it should not have any official monetary function. I shall not deal here with the whole gold problem. To my mind it is its price aspect that calls at the present juncture for a thorough discussion from the angle of domestic and international monetary policies. Accordingly, I shall discuss, first, the limited significance of the prices at which gold is traded on the so-called free and black markets; secondly, the fundamental flaws in the case of the gold miners who seek to obtain a higher price for their product; and thirdly, the proposal sometimes advanced that an appreciation of the monetary gold price would provide a solution of the so-called dollar shortage. The appropriateness of the present world price of gold will then be reviewed in the light of the resolute opposition of the United States and the International Monetary Fund to a gold price rise.

However, prior to re-examining the arguments for a higher gold price, I ought to make clear what its advocates actually mean. They do not mean a mere rise in the local official gold prices in terms of non-dollar currencies, but a rise in the United States gold price that would be accompanied by a proportionate increase in gold prices of other countries. In actual fact, a substantial increase in official gold prices has taken place since the end of the war in those countries which have devalued their currencies. These local gold-price rises have of course been merely an incidental result of currency readjustments, but they have had marked domestic effects, especially on the position of the gold-mining industry in the devaluing countries. Nevertheless, the advocates of a higher gold price have by no means been satisfied by these in-

[1] The views the author expresses are personal and do not purport to reflect those of the Federal Reserve Bank of New York. This essay, in a slightly different form, was originally prepared for presentation at the Third Meeting of Experts of the Central Banks of the American Continent, Havana, Cuba, February 25-March 7, 1952.

creases. On the contrary, the agitation in some quarters for a higher United States dollar value for newly-produced gold and existing private hoards and official monetary stocks has, if anything, become more vocal since the readjustments of national currencies in terms of the United States dollar in 1949. Such an upward revision in the United States gold price, so runs the argument, could best be made under the guise of a proportionate rise in gold prices in all countries, including the United States, within the framework of the International Monetary Fund.[2]

II. THE LIMITED SIGNIFICANCE OF THE FREE AND BLACK MARKET GOLD PRICES

The limited significance of the market price of gold will first be discussed in the light of gold trading and gold hoarding in those areas of the world where private gold hoarding and internal trading in gold are legal or where the emotional and instinctive predilection for gold is so strong that legal prohibition of gold hoarding merely results in large-scale clandestine gold trading. However, all gold hoarding should not be regarded as necessarily speculative. In the Middle and Far East gold hoarding appears as part of the normal saving pattern of the people, and the popular demand for gold in these countries is therefore determined more by the level of incomes than by the anticipation of gold price changes. When prices of the goods produced in these countries are rising, as in recent years, the hoarding demand increases; when prices are low relative to the official domestic gold price, as after the devaluations of the early 'thirties, there is a wave of dishoarding. On the Continent of Europe and in some parts of the Americas, the hoarding appears essentially as a means of minimizing losses that are expected to result from political, economic, and social upheavals and the concomitant inflationary pressures and currency depreciations. Finally, along the routes of the international premium gold traffic, there are various centers where middlemen and speculators buy and sell gold in order to derive a profit from short-term fluctuations in the market price of gold—fluctuations that depend in turn largely on the actual and an-

[2] Under Article IV, Section 7 of the Articles of Agreement of the International Monetary Fund, the Fund, by a majority of the total voting power, may make uniform proportionate changes in the par values of the currencies of all members, provided each such change is approved by every member whose quota is 10 per cent or more of the total. Theoretically speaking, a unilateral rise in the United States dollar price of gold would likewise, of course, increase the dollar value of the existing monetary gold stocks and current gold output. But such a rise would be equivalent to a devaluation of the dollar—a proposition that is manifestly absurd. A rise in the United States dollar price of gold is therefore conceivable only within the framework of a multilateral increase in world gold prices, and these two terms may accordingly be used interchangeably.

ticipated changes in the gold supply and demand in those countries where gold is hoarded in large amounts. It is because the tide of gold hedging against monetary instability in some parts of the world has coincided with the tide of high commodity prices and incomes in other areas that the hoarding demand in recent years has been particularly intense.

The net absorption of gold into nonmonetary uses, i.e., the professions, arts, and industry, as well as private hoards, had apparently fallen to a low level by mid-1950, prior to the outbreak of hostilities in Korea.[3] Since then, however, large amounts of gold have been again absorbed into nonmonetary uses.[4] This high rate of gold absorption has reflected partly releases from official gold holdings for nonmonetary purposes, and partly the increased proportion of newly mined gold made available for such purposes, especially from South Africa, whose sales of nonmonetary gold at premium prices represented in 1951 some 40 per cent of its output. It was apparently because of this increased supply of gold for nonmonetary purposes, and perhaps also because the demand for gold was less insistent than, for instance, in the first three quarters of 1949, that premium prices were much lower in 1951 and in the early part of 1952 than before the 1949 currency readjustments. Indeed, at no time since the outbreak of the Korean hostilities have the prices at which gold is traded directly for United States dollars in the clandestine or open markets—prices whose limited significance will be pointed out in the next paragraph—returned to the high point of $55 per fine ounce that had been reported in May 1949. By mid-1950, the quotations most frequently reported were in the neighborhood of $36, or very close to the United States Treasury price, but following the outbreak of the Korean war, they rose sharply to a peak of about $44 early in January 1951; by December 1951 the price had declined again to somewhat less than $39, and by mid-May 1952 to about $37.

Great care, however, should be taken not to read too much into these prices. There is no free market for gold coin or bullion in the United States. Gold prices that are said to be United States dollar prices of gold reflect transactions by speculators and traders in gold that is either located outside the United States or is merely shipped to the United States for refining prior to re-shipment abroad. These premiums in

[3] Cf. International Monetary Fund, *Annual Report 1951*, p. 73.

[4] In 1951 gold production outside the United States (and also exclusive of the USSR) may be estimated at about 770 million dollars. Of this amount, some 600 million dollars of gold either went into industrial uses or private holdings or was otherwise unaccounted for. In 1950 this unexplained residual amounted to 300-350 million dollars, out of an annual foreign gold output that was likewise about 770 million dollars. This residual largely reflects the absorption of gold into nonmonetary uses, but part of it may be explained also by the "disappearance" of gold into undisclosed official holdings.

terms of the United States dollar are explained partly by the cost of overcoming the hurdles that impede the flow of premium gold, and partly by the actual and anticipated changes in the gold supply and demand on the markets where gold is traded in terms of various local currencies.

Where gold is traded against local currencies, still wider and more erratic premiums over the official dollar price of gold apparently exist. The actual prices embodying these premiums are of course quoted in local, inconvertible currencies. Whenever they are converted into United States dollars, they are merely computed figures arrived at by converting the local currency price into dollars. For most local currency quotations, different dollar equivalents can be obtained by converting the local currency price at different exchange rates (black market, official market, free market, etc.) and it is often difficult or impossible to know which rate will give a realistic dollar equivalent. In the Middle and Far East, where gold premiums are highest, dollar transactions are relatively few and unimportant; hence the so-called Far Eastern dollar prices of gold, which are the highest ones extant, are especially lacking in realism so far as any relation to the dollar price of gold is concerned. In Western Europe, on the other hand, free or black market dollar transactions are of some importance; and when the respective rates are used to convert the local currency gold prices, the apparent dollar premiums are much smaller than in the East. In those instances where the seller of gold wishes to make an actual conversion of his local currency proceeds into dollars, and is able to do so (such conversions being as a rule prohibited by law), the conversion is ordinarily made through free or black markets at rates that are usually at a substantial discount from the official rates of exchange.

The gold premiums in free and black markets therefore reflect, in the first place, the cost of overcoming the restrictions that impede the flow of gold between countries, and within countries where internal trading is restricted. To an even larger extent, however, they also reflect the monetary habits of the population, the efficiency and stability of the local monetary system and of government finances, as well as the varying prospects of the national government. In their very essence, foreign gold prices are therefore a reflection of local conditions in various countries, and cannot be looked upon as an indication of the intrinsic value of the United States dollar.

III. THE PRODUCERS' CASE

The gold producers argue that in the face of rising mining costs the gold price is unduly low, first, because the prices of other metals and

commodities have increased considerably in the last fifteen years and, secondly, because higher gold prices prevail on the free and black gold markets. Since, on the other hand, the mining costs have risen, 'something should be done for the gold miners.'

The gold producers' argument that mining costs are high and the gold price low bears a close resemblance to the standard argument of all producers of price-controlled commodities. It is sometimes argued even by disinterested observers that the gold industry's case deserves as much attention as that of any other industry whose end-price is controlled by the government, and accordingly, it is asserted, the producers have a right to a price that covers the cost of production. This analogy rests on the assumption that gold is a commodity. However, gold is not primarily a commodity, but a monetary metal since its marketing and its price are determined not by market forces but by actions of governments. It is for monetary reasons that there is a fixed official gold price to which the national currencies are related directly or indirectly, the mutual links between currencies in turn reflecting their relation to gold. The price of gold in terms of any currency has therefore a monetary significance of great import, both domestically and internationally. Whether the fixed gold price continues to serve fully its purpose must accordingly be judged solely from the monetary viewpoint. Gold producers themselves, in electing to engage in the business of producing the world's primary monetary metal, must be prepared to accept both the windfalls and the risks of their very specialized type of industry.

It is appropriate to point out that the bulk of international gold transactions takes place at the price of $35 per ounce at which the United States Treasury is willing to buy gold and other countries are ready to sell it, or vice versa. There is little reason to doubt that, over much of the period since 1934, the price available to gold producers would actually have been well below $35 if the United States had not been maintaining this fixed purchase price. It is at this price that the United States was offered and actually acquired 14.5 billion dollars' worth of gold from 1934, the year of dollar devaluation, to the end of 1951. During those years, gold production outside the United States (excluding also the USSR) was worth about 14.3 billion dollars. The United States purchases of foreign gold from 1934 to the end of 1951 exceeded therefore the equivalent of the whole new gold production in the rest of the world. In the light of these official United States gold purchases from the rest of the world, the transactions in nonmonetary gold appear relatively insignificant in comparison with the official movements of monetary gold. Whether it is in the long-term interest of the gold producers to secure a steady market for gold at a stable price rather than to encourage highly erratic free markets is a consideration that the miners

themselves should carefully ponder under present-day circumstances. As already noted, by mid-1950, after the disturbances of the early post-war years, practically all newly mined gold began again to flow into official monetary reserves, and premium gold prices fell quite close to the official prices. The post-Korean gold disappearance into hoards and the resurgence of gold premiums must not obscure the long-run monetary position of gold. The post-Korean premium gold prices, which as noted above had already declined considerably by mid-May 1952, are no indication of what the official United States gold price should be.

In actual fact what matters, from the viewpoint of gold miners outside the United States, is not the United States gold price, but the price of gold in terms of their local currencies. Although the United States Treasury gold price has remained unchanged since 1934, the price actually received by foreign gold producers in their own local currencies has been considerably increased as the rates of exchange of various currencies have been lowered in terms of the United States dollar. The sterling price of gold increased by about 16 per cent in 1939, when the dollar value of sterling was reduced from slightly over $4.68 to $4.03, and again by 44 per cent in 1949 when the rate was lowered to $2.80. Producers in other countries that devalued likewise benefited from their higher official gold prices. The rise in official gold prices in these currencies was, of course, only an incidental result of the currency re-adjustments, but since the countries that devalued in 1949 account together for some 80 per cent of the world gold output outside the USSR, the profitability of gold mining was generally enhanced, although in varying degree in different countries.[5] However, the continuing rise in costs under the impact of world-wide inflation has offset to some extent the original benefits conferred on gold producers by the currency re-adjustments.

The second argument, namely that gold producers should receive a price high enough to cover their costs, likewise appears valid only so long as gold is regarded as a commodity, and not as a monetary metal—an assumption that has already been challenged in general terms. Some specific considerations seem, however, called for here. The very fact that the gold producers are caught between a fixed gold price and rising costs of production merely reflects the nature of risks inherent in the production of a monetary metal. Actually, the marginal producers in many countries have obtained some relief from rising costs by shifting from lower to higher-grade ores.[6] They have also improved their tech-

[5] In Canada, however, the effect of currency depreciation in September 1949 was only temporary since the price received for Canadian gold production declined again in October 1950 when a free exchange market was established and the Canadian dollar subsequently appreciated in terms of the United States dollar.

[6] In the Union of South Africa, however, the gold mining industry took advantage

niques. However, the cost-price problem in the gold mining industry is by no means a new one. Under the nineteenth-century gold standard, the gold price was kept stable and the gold miners had to readjust their output to the variations in their costs. Indeed, the very way in which, at least in strict gold-standard theory, the changes in the gold supply were brought about by the variations in gold-mining costs was one of the essential mechanisms supposed to produce a stable price level. It is a matter of historical record that in the periods of rising prices prior to 1945 there never was any notable demand for an increase in the price of gold. The fixed price of gold that is basic to the monetary status of gold was fully respected.

Furthermore, in a number of foreign countries the gold producers' claim that they are unable to meet their rising costs has in actual fact received consideration in recent years, not for the sake of the gold industry itself, but because of the industry's importance for a country's balance of payments. In some countries, such as South Africa, the burden of taxation of mining profits was reduced in 1948; and it was only in 1951 that taxation was restored to the previous level in view of the changed position of the industry, as will be noted below. Another device for increasing the gold-mining receipts was the use of subsidies. When the 1949 currency readjustments increased the profit margins of the gold industry, Australia and Southern Rhodesia abolished the subsidy, but Canada, which devalued in 1949 to a much smaller extent than the sterling area countries and beginning in October 1950 let its dollar appreciate in terms of the United States dollar, continued its subsidy through 1951. Finally, the South African producers were allowed, beginning in 1949, to sell part of their output for nonmonetary purposes at premium prices, a procedure which brought additional revenue to the industry.[7] In the latter part of 1951, following the reinterpretation of the International Monetary Fund's gold policy that will be discussed later, Canada, Southern Rhodesia, Australia, and other gold-producing countries likewise allowed the miners, on certain conditions,[8] to sell part of their current output for nonmonetary uses at

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of the higher gold price to process lower grades of ore. This was one of the reasons why gold output failed to rise after the 1949 devaluation.

[7] The additional revenue from premium sales by the South African mines amounted to $2 per ounce in the early part of 1951, but it declined toward the close of the year; in the second half of 1950 it amounted to roughly 70 cents.

[8] In Southern Rhodesia and West Africa, premium sales were at first to be limited to about 40 per cent of current output—a purely arbitrary figure that corresponded to the proportion of newly mined gold that South Africa was selling for nonmonetary uses in mid-1951—but in April 1952 South Rhodesian and West African gold mines were allowed to sell the whole of their production in the free market. In Canada and in Australia, on the other hand, there was no specific limitation on the amount of gold the industry was allowed to sell at premium. In Canada, however, a further condition was

premium prices. However, with the free gold price at about $37 per ounce, as in mid-May 1952, the margin of profitability offered by the premium market was rather narrow.

The currency readjustments of September 1949, tax relief, the subsidies, and premium sales have variously alleviated the profit-and-loss position of the gold-mining industry in many countries. However, they have not by any means restored the exceptionally high degree of prosperity that the industry enjoyed in the 'thirties after the United States dollar devaluation in 1934 had raised the price of gold to $35 per ounce (an extremely remunerative level, given the relative cheapness of labor and capital in these years). It is a similar rise in the United States dollar price of gold, under the guise of a uniform proportionate increase in the official gold prices of all principal countries, that some spokesmen for the gold-mining industry seem to consider as the cure for its difficulties.

Altogether apart from the broad economic issues inherent in a uniform appreciation of gold that will be discussed later, it may be questioned whether a high priority in over-all economic policy should be given to gold production. Gold is not an armament metal, and this was indeed the reason why direct government restrictions were imposed during the last war on gold mining in Canada, the United States, and Australia in order to release manpower and other resources for the armed forces. Whether a special incentive should be given to gold production during the present international emergency is a problem that must therefore be examined not from the viewpoint of the gold industry itself, but rather from that of the international economic policies of the United States, the British Commonwealth of Nations, Continental Western Europe and its overseas territories and Latin America.

IV. THE INTERNATIONAL LIQUIDITY ARGUMENT

The third line of approach put forward in recent years has been that the world price of gold should be raised for the sake of ensuring international liquidity. This argument has been made in two forms, one presenting world gold appreciation as a desirable instrument of monetary policy and the other treating it openly as a matter of sheer expediency.

In terms of monetary policy, the case for an upward revaluation of

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established, namely that producers who sold gold in premium markets did so without subsidies; such subsidies were provided for in 1947 under a temporary legislation that was gradually extended (for the last time in December 1951 for another two years). In Canada, as well as in Australia, Southern Rhodesia, and West Africa, the sales were to be made against payment in United States dollars; in South Africa the payment of premiums, but not of the official dollar gold-price equivalent, was accepted in currencies other than United States dollars.

the world gold price[9] starts from the assumption that gold is the only real money and that in view of the wartime and postwar increase in nominal money incomes and bank credit all over the world, the "measure of gold" should be changed in order to restore a proper proportion between the "cash" of each country—i.e. gold—and its money supply and external liabilities. If the "measure" is not properly adjusted, it is held, a worldwide deflation will ensue, as after the First World War.[10] Both domestic and international liquidity are thus identified with gold, the only real medium of payment, and the only way of increasing them is to raise the world price of gold.

However, this metallistic concept of money, which treats gold as the only real medium of exchange in domestic as well as in international trade, appears an exceedingly narrow one in the light of the modern economic history of the Western world. Both common observation and economic analysis suggest, on the contrary, that money is generally defined by its acceptability, which in turn is not necessarily related to gold as the ultimate means of payment. Without discussing in this context whether final payments can be made only in goods, actual experience shows that final payments in international trade were made even under the 19th century gold standard through a complicated network of credit arrangements in sterling;[11] and under the gold standard as it existed just before the outbreak of the Second World War, the acceptability of sterling, which even then was the principal international medium of payment, was entirely divorced from the convertibility into gold at a fixed rate, as the whole history of the sterling area clearly illustrates.

[9] Cf. W. J. Busschau, *The Measure of Gold*, Central News Agency Ltd., South Africa, 1949, 162 pages. *The South African Journal of Economics* published last year a series of articles dealing with the gold problem generally and with its price aspect in particular: W. J. Busschau, "Keynesian Views on the Price of Gold" (March 1951); C. Rist, "Gold and the Return to the Ideas of John Law" (March 1951); P. F. D. Wallis, "The Price of Gold and its Place in Monetary Theory" (March 1951); J. E. Holloway, "The Debacle of Money" (June 1951); Sheila van der Horst, "The Price of Gold: a Comment" (September 1951); Colin Bruce, "The Gold Controversy—a Comment" (December 1951); and W. J. Busschau, "Dr. van der Horst and the Price of Gold—a Rejoinder" (December 1951). Cf. also Harry G. Johnson, "The Case for Increasing the Price of Gold in Terms of all Currencies: A Contrary View," *Canadian Journal of Economics and Political Science*, May 1950, and his review of "The Measure of Gold" by W. J. Busschau, *The Economic Journal*, September 1950.

[10] Cf. W. J. Busschau, *The Measure of Gold*, page 6: "The case submitted here is, in its simplest form, that because of the growth in incomes and credit (particularly long term obligations), increases in gold prices are necessary in order to obtain that degree of banking liquidity which will ensure the maintenance throughout the world of high levels of incomes and employment and that failure to increase gold prices sufficiently and in time will lead, as did the similar failure after World War I, to a severe credit deflation with its inevitable consequences of widespread unemployment and human misery."

[11] Cf. Roy F. Harrod, "The Pound Sterling," *Essays in International Finance*, No. 13, February 1952, International Finance Section, Princeton University.