ESSAYS IN INTERNATIONAL FINANCE

No. 47, June 1965

THE ROLE AND THE RULE OF GOLD: AN ARGUMENT

JACQUES RUEFF AND FRED HIRSCH

INTERNATIONAL FINANCE SECTION

DEPARTMENT OF ECONOMICS

PRINCETON UNIVERSITY

Princeton, New Jersey

This is the forty-seventh in the series ESSAYS IN INTERNATIONAL FINANCE *published from time to time by the International Finance Section of the Department of Economics in Princeton University.*

Strictly speaking, this number is not an essay. Rather, it takes the form of a dialogue, reproducing a discussion held by Jacques Rueff and Fred Hirsch in Paris on Sunday, February 7, 1965. This was arranged for publication in THE ECONOMIST, *where substantial excerpts from the discussion were published in the issue of February 13, 1965. In view of the importance of the subject and the views expressed, it was thought that publication of the argument in its entirety would be welcomed by our readers.*

Jacques Rueff, former Inspecteur Général des Finances and Vice-Governor of the Bank of France, is now member of the French Academy and Chancellor of the Institute of France. He has served numerous times as an economic adviser to the French Government, most recently as Chairman of the official Committee on the Financial Situation which submitted its report in 1959. His published works include a major two-volume study on L'ORDRE SOCIAL.

Fred Hirsch is an Assistant Editor of THE ECONOMIST, *and his views on international monetary questions are often expressed in the pages of that weekly. He has also written numerous signed articles in other financial journals. Like Professor Rueff, he was among the 32 economists in the international study group whose discussions were reported in* INTERNATIONAL MONETARY ARRANGEMENTS: THE PROBLEM OF CHOICE *(International Finance Section, August 1964).*

The Section sponsors the essays in this series but takes no further responsibility for the opinions expressed in them. The writers are free to develop their topics as they will. Their ideas may or may not be shared by the editorial committee of the Section or the members of the Department.

FRITZ MACHLUP, *Director*
International Finance Section

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L.C. Card 65-25645

Printed in the United States of America by Princeton University Press
at Princeton, New Jersey

PREFACE

AT his press conference on February 4, 1965, General de Gaulle proclaimed not only a new turn in France's international financial policy, but delivered his famous paean to the role of gold. It was included in the following statement:

> . . . France recommends that the system be changed; . . . We consider that international exchanges must be established, as was the case before the great world-wide disasters, on an unquestionable monetary basis which does not bear the mark of any individual country.
>
> What basis? Actually, it is difficult to envision in this regard any other criterion, any other standard than gold. Yes, gold, which does not change in nature, which can be made either into bars, ingots or coins, which has no nationality, which is considered, in all places and at all times, the immutable and fiduciary value par excellence. Furthermore, despite all that it was possible to imagine, say, write or do in the midst of major events, it is a fact that even today no currency has any value except by direct or indirect relation to gold, real or supposed. Doubtless, no one would think of dictating to any country how to manage its domestic affairs. But the supreme law, the golden rule—and indeed it is pertinent to say it—that must be enforced and honored again in international economic relations, is the duty to balance, from one monetary area to another, by effective inflows and outflows of gold, the balance of payments resulting from their exchanges.

Three days later Fred Hirsch talked to Jacques Rueff in Paris.

Fritz Machlup, Director

THE ROLE AND THE RULE OF GOLD: AN ARGUMENT

F.H. M. Rueff, you are a man, to say the least, of distinctive ideas; and most people, ourselves included, have hitherto dismissed your ideas on a return to the gold standard as irrelevant nostalgia. Yet now, as one commentator has put it, we see you as scriptwriter to General de Gaulle. How do you get your ideas across?

J.R. Well, first I must protest against this notion. I am not in any degree scriptwriter to General de Gaulle. You see, General de Gaulle does not need a scriptwriter. Still more: I have no responsibility at all in the wording of his last message and I do not know anybody who has any responsibility; he has done it absolutely alone. It is true that I have had many opportunities since the financial reform of 1958 to express my view, and my concern about the gold-exchange standard is a very old one. Early in 1959 I made clear to him that we had more or less stabilized the franc in terms of the dollar and that we were strongly interested in the stability and the solvency of the dollar itself. And therefore, that we had not only the right, but the duty, to see that there was no danger in the money standard which was the base of our own money. My only influence has been to express my view in the most candid way, through my writings and through my talk with various friends.

F.H. Do you see yourself, in exerting this general influence, as in any rivalry with the official advisors in the Bank of France and the Ministry of Finance?

J.R. Well, they are all friends of mine. I have served many years both in the Treasury and on the board of the Bank of France; I do not think there is any question of rivalry. There may be a different tendency. Well, there is no doubt that there has been some difference of inspiration. But the trend is changing quite a lot.

F.H. The official trend?

J.R. The general trend in the world. If we look at the wind from the east, it is teaching some principles on the role of the price mechanism and of profits which are very valuable for us. And if we look at what has happened in Germany in the realm of the *Soziale Marktwirtschaft*, we see a policy which is basically established on market forces, corrected with social inspiration which tries to make it acceptable even politically for the people. We have more or less the same trend in France. I am sometimes considered a survival of the past. . . . I many times feel bold enough to consider myself a precursor of the near future.

F.H. That's interestingly put. But may I ask you this? You have a very respected intellectual position in France; you are a member of the Académie Française. But within your own discipline, among economists, you are relatively isolated, especially in your international ideas. Do you feel at all worried about this?

J.R. You said I am a member of the French Academy. I have the great privilege of being the successor of a poet, Jean Cocteau. And he said somewhere that to be influential you have to be dead. *Il faut être un homme vivant, mais un auteur posthume.* Well, of course, as long as you are alive there are always some objections; but I remember the teaching of my predecessor and I hope that my posthumous influence may be effective.

And I am not so sure that I am isolated; because, for instance, in my second committee in 1960 on the obstacles to economic expansion, I had with me about 60 rapporteurs who were all the young people in the administration, and we felt extraordinarily united. And don't forget that my report has been unanimously approved even by the representatives of the three noncommunist trade unions. Of course, there has been a lot of divergence about my views; but may I say that in the end they have always been adopted—which doesn't suggest any isolation!

F.H. I meant on the international-gold-standard side. Could you perhaps tell us now your particular objections to the gold-exchange standard and why in particular you think that it should be replaced, not as people like Triffin and we ourselves believe, by an increase in international credit, but rather by a return to gold itself?

J.R. I wrote in 1961 that the West was risking a credit collapse and that the gold-exchange standard was a great danger for western civilization. If I did so, it is because I am convinced—and I am very emphatic on this point—that the gold-exchange standard attains to such a degree of absurdity that no human brain having the power to reason can defend it. What is the essence of the regime, and what is its difference from the gold standard? It is that when a country with a key currency has a deficit in its balance of payments—that is to say, the United States, for example—it pays the creditor country dollars, which end up with its central bank. But the dollars are of no use in Bonn, or in Tokyo, or in Paris. The very same day, they are re-lent to the New York money market, so that they return to the place of origin. Thus the debtor country does not lose what the creditor country has gained. So the key-currency country never feels the effect of a deficit in its balance of payments. And the main consequence is that there is no reason whatever for the deficit to disappear, because it does not appear.

Let me be more positive: if I had an agreement with my tailor that whatever money I pay him he returns to me the very same day as a loan, I would have no objection at all to ordering more suits from him.

F.H. But isn't this to some extent in the nature of all credit? After all, I deposit money in a bank and the bank will lend the money to somebody else—possibly even somebody connected with me. Isn't your objection to this international use of credit really an objection to the internationalization of what is in the nature of all credit?

J.R. I don't think I agree with this presentation. Of course, you could say that what the gold-exchange standard does not do, that is, contract global demand in the debtor country, could be done by deliberate credit policy.

F.H. Yes.

J.R. Theoretically it seems possible. But let us first realize that, if any country in the world had been in a position to do that, it would be the United States. They have in government employ more economists, and I think more readers of *The Economist*, than any other country in the world. And they have had for five years an enormous deficit in their balance of payments. If they have not done by credit policy what the gold standard would have done by automatically restricting purchasing power, it is proof that it is not possible. And why is it not possible? I cannot imagine any parliamentary country with a democratic regime in which you could do such a difficult thing.

F.H. Except under stress.

J.R. Not except under stress—but when the natural restrictive effects are undone more or less automatically and are not felt by anybody.

F.H. Many of us largely agree with your criticisms of the gold-exchange standard, which interestingly are much the same kind of criticisms as are made from the other wing by Triffin. But what I cannot understand in your proposed solution to return to gold is this. Suppose, for example, that the United States had taken your advice in 1961 and had then trebled the price of gold, to $100 an ounce. Would it not now, with so much larger a gold reserve in relation to its liabilities, feel able, in fact, to continue its balance-of-payments deficit for much *longer*?

J.R. Well, this point must be taken in detail. You have first named my friend Triffin. I must say that we are in full agreement on the diagnosis. We differ on the remedy, but the diagnosis is the same. You have spoken of trebling the price of gold in 1961. I consider the price of gold as only a side issue. It is not at all the aim; it is not at all a remedy; rather it is only a small condition of which I shall speak later. The aim is to restore a system which is not contrary to the most elementary common sense; in other words, to ensure that the debtor country loses what the creditor country gains. And let us be more positive on this point. It needs no economic theory to identify the main reason for the deficit of the U.S. balance of payments: it is that despite all the past deficits there has never been any scarcity of money in the New York money market. Why? Because the money which is paid out is immediately returned to the New York money market and is always available there for further investment, at home or abroad. We sometimes complain of the excessive invasion of foreign interests in Europe. Personally, I am not afraid of that. The cause is not at all a desire of the United States to conquer Europe. The cause is that the creditor countries themselves have created the situation which makes it possible and automatic for the United States to invest abroad, because there is always so much excess liquidity on the New York money market. It has to find an outlet.

F.H. You are referring here to the flow of Eurodollars back to New York?

J.R. I am referring to the simple mechanism of the gold-exchange standard which involves that, when a central bank receives dollars, it returns them the very same day by wire, say, through the purchase of Treasury bills on the New York market.

F.H. But may one try to pin you down on this? I accept that in principle an increase in the gold price may not be your *aim*; but, nevertheless, if it is part of the *means*, we do have to consider what the result would be.

J.R. I have until now always avoided speaking about the price of gold explicitly, because I did not want to create difficulty for the central banks or to engender speculation in gold. But now the question is in the open and there is no reason to keep the same discretion. The price of gold is to me incidental: what I want to restore is the rule of the gold standard. That means that from the date of the reform the central banks shall return to the old rule, of creating money only against gold or bills in national currency. In other words they shall not build up, except for daily settlement, any assets in dollars. Well, from that moment on, I am entirely convinced, the deficit of the balance of payments of the United States will disappear in less than three months. This is a very audacious prediction. But I have never seen a country with a real system of international payments in which the deficit stayed more than three months after it has reestablished the balance of purchasing power; I mean, after it has suppressed the inflationary excesses. So, what I really have in mind is to restore such a system.

But then there appears the side issue—and purely a side issue—which is the liquidation of the past. We have accumulated such large currency balances that we can only come back to the free play of a transfer mechanism, a real transfer mechanism as in the gold standard, if we are no longer under the menace of these balances and of the insolvency they may bring. Therefore, they must either be funded or reimbursed. The funding would be very difficult to obtain and would do great harm.

F.H. It would be very deflationary; and you say you are not a deflationist!

J.R. Most certainly not. I will come back to that. Well, for the reimbursement you have two solutions, you have an option. One is the Triffin plan to put the balances into IMF deposits, the other one is the increase of the price of gold. All the other plans are in between; and these are the two families of remedy.

F.H. Yes.

J.R. Well the Triffin plan is a plan. I do not like it, because I think it will give a monetary authority or a fiscal authority the power to decide the amount of credit that ought to be created. I myself have acted for a monetary authority during many months: I know that these authorities are not able, they have not the power—the human possibility, at least in our regime—to follow the policy which they ought to. I repeat, if it were possible, the Federal Reserve Board—probably intellectually the loftiest organization in the field of money—would have done it; but they have done just the reverse; you see that they have always compensated the outflow of gold by creation of new credit. I do not mean to say that they have done it intentionally.

F.H. Why not? They do after all follow a conscious managed credit policy and not an automatic one. Surely they do not claim, and they do not want, and ought not to want, blindly to follow an automatic policy?

J.R. I am not sure that you are right. Let me tell you that my friends in Washington told me in 1962 that I was wrong in thinking that the deficit of the balance of payments in the United States would survive as long as the gold-exchange standard survived. They told me they had a timetable according to which the deficit would be reduced by one-half at the end of 1962, and disappear at the end of 1963. But it did not; it could not, because the very essence of the gold-exchange standard is to maintain the deficit. As long as the debtor country does not itself feel the effect of the deficit automatically, the deficit goes on. So I do not hesitate to forecast the future. I am absolutely *convinced* that the deficit of the balance of payments of the United States will not disappear as long as we maintain the gold-exchange standard. And in 1962 I backed this forecast with a rash bet with one of my Washington friends: a bet of one dollar a year.

F.H. Gold-guaranteed, I trust?

J.R. Not gold-guaranteed.

F.H. You say, and many people will instinctively agree, that you don't believe that any human management could be so all-knowing as to manage credit correctly in exactly the right way. But the objection many people have to your preference for the gold standard as such is that this would leave the volume of credit not, as now, in the imperfect hands of the best central-banking authorities we have, but rather in the completely arbitrary hands of the gold-mining companies of South Africa, the trading policy of the communist party of the Soviet Union, or whatever technical discoveries happen to be made that might increase or decrease the world's credit base by quite wild amounts, in a way that not even the stupidest monetary authority would do.

J.R. But it was not I, it was first Adam Smith and then Keynes, in his last letter, who have spoken of the "hidden hand," which results from the price mechanism. Credit management is not stupid, as such. But it very often is stupid when it is done in the wrong direction, so as, for instance, to compensate for the internal consequences of the gold movement. I fully accept the conscious use of the discount rate and of open-market policy—provided it takes account of the market situation that should be created by the gold movements and does not systematically reverse it.

F.H. Are you in favor of the pre-1931 gold standard where all parities were constantly stable?

J.R. I am not in favor of floating exchange rates. I am not in favor of daily changes of parity. But when you have had very exceptional situations you may need exceptional policies to clean up the past. Let us take a positive example. It is what President Franklin D. Roosevelt did in raising the price of gold in 1934—and I would like my friends in Washington to keep that in mind.

It is often said that what we want to avoid is the return of the trouble and the mischief of the gold standard in the twenties. But if you take the balance sheets of the central banks you will see that the mischief was not the mischief of the gold standard but the mischief of the gold-exchange standard. The evolution of the balance sheets of the central banks is exactly the same, exactly parallel in the years '27 and '28 and '29 to what it is now, and it is the collapse of this system in 1931 that was responsible for the depth of the depression.

F.H. But one of the countries which saw the biggest constriction imposed by the gold standard was of course Britain—which held no foreign exchange in its reverse. And, as we have always seen it, Britain at this time suffered precisely *because* of the harsh and inflexible disciplines of the gold standard, which you now want to restore.

J.R. Let me tell you that you touch a point on which I have quite personal recollections. In 1930, I was financial attaché in the French embassy in London, and as such I was responsible for the deposits of the French Treasury. I had in my hands 10 per cent of the deposits of the London banks. They were the direct result of eight years of the gold-exchange standard, because we had kept the pounds sterling in London, as my colleagues in New York had kept the dollars which had been pouring into the French Treasury from 1927 onwards. Then, in 1931, the failure of the Austrian Creditanstalt caused successive waves of repatriations; and it was this collapse of the gold-exchange standard that, without any possible doubt, transformed the depression of 1929 into the great depression of 1931.

F.H. While you are on this historical episode, what would your comments be on the very widespread view that it was to a substantial extent French pressure on London at that time, through the withdrawal of sterling balances, that was in part responsible for the general collapse later on?

J.R. Let me tell you that, unhappily for the world, the French pressure did not exist, or was so mild that it had no effect. There is a very interesting document from this period, a letter from Sir Austen Chamberlain, who was then Foreign Secretary in London, to M. Poincaré, who was Prime Minister and Finance Minister in France; it must be of 1928. Sir Austen said "we know that you are entitled to ask gold for your sterling but in the frame of the close friendship between Britain and France we ask you, so as to avoid trouble for the City of London, not to do that." And we were, I must say, feeble enough to obey this demand and not to ask for gold. The fact that I had in London such important sterling deposits shows that we did not at all use this right to ask for gold. The adjustment, which would have been small if taken in due time, was not made, and we had the enormous boom period of '27, '28, and '29. This explains the depth of the collapse and of the depression, because the adjustment was so long delayed; we were too gentle in responding to official appeals not to convert our sterling balances into gold.

It is exactly the position in which we are now. We are moving without any doubt to a result of the same kind as in 1931, because it is so clear that the dollar is approaching the end of its acceptability for payment abroad, and we shall have the same collapse. But in delaying it through various devices—by the increase of the quotas of the International Monetary Fund, the Roosa bonds, the central-banking swap credits, the Basle agreement, the agreement of the Group of Ten, and all the rest—we are doing exactly the same thing, namely, delaying the correction of the U.S. balance-of-payments deficit. If we acted as genuine friends of our friends, we should do exactly the reverse.

F.H. But would you not say, M. Rueff, that the very developments that you cite—first the Basle agreement, then the growing agreement among even some Continental central banks on the need to replace dollar and sterling liquidity by an expansion of the International Monetary Fund—that this very movement is itself an indication that a return to the crude gold base as such is not necessary and that the threat of another 1931 is, or ought to be, now an entirely artificial threat? It is artificial to the extent that there is a certain movement towards the creation of some kind of international credit management, which many people, starting from Keynes, have seen as the only logical development of credit management on a national scale.

J.R. Well, your question has two sides. I would be in full agreement with you if I could believe that this process of avoiding the facts could go on long enough; in other words, that we could maintain indefinitely, for instance, what we did in 1928-1929, not asking for gold in London. But do you not see clearly that the dollar is very near the limit of its payment abroad? Look at the figures. The dollar stock in the United States is diminishing by a billion dollars every year and the claim on gold increasing two billion dollars every year. Of course you can gain some gold by lowering or abolishing the requirement of gold reserve for the internal currency. I have no objection to that, it is purely arbitrary. But the situation, if it continues—and it will continue, that is the basis of my reasoning—is bound to come to a point where there will be no foreign exchange left and no gold left to pay abroad. I know this situation very well. In 1958, when I had to look at the French situation, we had no foreign exchange at all left in the Equalization Fund and we were informed by the United States—and they were quite right, they acted as