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UNITED STATES GOLD POLICY: THE CASE FOR CHANGE

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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 bimetallism 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 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