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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

May 1, 1968

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A Review of Monetary Reform and the Price of Gold

7 pages

This paper reflects the personal opinion of the author and must not be interpreted as representing the opinion of the Board of Governors

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Monetary Reform and The Price of Gold[1/]

A conference was convened in Bologna in early 1967 under the auspices of Johns Hopkins' School of Advanced International Studies to discuss the interrelated problems of world monetary reform and the price of gold. Its proceedings are brought together in this book: there were studies presented by recognized specialists on the recent growth in international reserves and the effects of a higher gold price on gold output, and on private gold demand; Rueff, Triffin and Bernstein explained their proposals for reform in detail; and Lord Robbins presented two masterly surveys of the field, first, to introduce the expert discussion and, later, to summarize the discussions at these meetings.

1/ Monetary Reform and The Price of Gold, edited by Randall Hinshaw, Baltimore: The Johns Hopkins Press, 1967, pp. Vii, 180.

Comparisons between the reform proposals of these three distinguished advocates, and the cross-questioning and debate among them, emerge as the useful contribution of this book. Rueff is concerned to eliminate the gold-exchange standard in order "to create a situation in which the deficit country will lose what the surplus country gains". (40). He suggests an international convention in which countries would agree:

a. To cease adding to their dollar and pound holdings and, instead, use only gold for international settlement;

b. To "approximately" double the price of gold;

c. To have the U.S. and U.K. use their gold profits to repay immediately in gold their liabilities to central banks; and

d. To provide long-term credits to the U.K. to repay outstanding sterling balances.

To Rueff, the main question is not the price of gold but the need to establish a payments system in which aggregate demand is made sensitive to the balance of payments position in each country. Thus, he would cure the U.S. deficit by domestic deflation; to him, a program to reduce foreign spending directly "only reduces the surplus in the balance of trade and does not re-establish equilibrium".[1/] (39).

Although Triffin's diagnosis of the sources of current international financial instability finds much common ground with Rueff's emphasis on the gold-exchange standard, he cannot accept the notion of an "automatic system" in which countries could "escape responsibility for managing their own affairs." (49). Instead, Triffin is seeking "to design expedients" which would accelerate the evolution of the payments mechanism in the direction of centralized reserves at an international institution -- a development which he regards as historically inevitable.

Because it will satisfy his ends, Triffin finds the Bernstein prescription to be generally congenial. Under Bernstein's proposal, Reserve Units would be created by international agreement to ensure "a moderate, regular increase, equivalent to what we would have had if gold production were adequate to the

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1/ However, the deterioration of the U.S. trade balance since late 1964 has been due to an accelerated rise in U.S. imports and not to any slowdown in the rate of export expansion. Thus, U.S. exports rose by 8.0 per cent per annum between 1960-61 and 1964-65 compared to 7.9 per cent from 1964-65 to 1966-67. (See "U.S. International Transactions: Trends in 1960-67" in Federal Reserve Bulletin, April 1968, Table 3, p. 347).

monetary needs of the world". (162). These Reserve Units are "composite foreign exchange assets" of the currencies of participating countries, to be issued through the IMF at annual rates agreed upon for periods of five years. Distribution would be in proportion to quotas at the IMF and participating countries would accept them for payments settlements.

World events have moved rapidly since this conference was held. In early 1968, just after this book was released, the leading industrial countries were able to complete two important international financial agreements which had the effect of resolving -- for the moment, at any rate -- the two main issues debated at the conference. Instead of a rise in the gold price, the major "gold pool" countries agreed in Washington in mid-March to hold the $35 price for official gold transactions and stated that "they no longer feel it necessary to buy gold from the market".[1/] In this way, current gold output -- too limited for both official and private needs -- would be reserved to meet private demand and the private gold price would be allowed to fluctuate in response to demand and supply conditions, with official supplies no longer being placed in these private markets.

1/ See "Meeting of Governors of Central Contributing to Gold Pool: Communique" in Federal Reserve Bulletin, March 1968, p. 254.

In early April, in a complementary step designed to ensure an orderly growth in official reserve assets to supplement gold holdings, the G-Ten countries (excluding France) agreed to activate a facility for deliberate reserve creation under the Fund. Amendments to the Fund's Articles to put this scheme into operation were published on April 22 1/ and are now being ratified by Fund members. The Special Drawing Right facility is kin to -- but with some differences from -- the Reserve Unit Proposal. A major difference stressed by Bernstein is that management is to be by Triffin's Group of 105 rather than by Bernstein's Group of Ten: on this point, he noted, "I have lost and Triffin has really won." (163).

This measurable progress in monetary reformation has brought international financial discussions a step beyond the body of the materials in this book. But these agreements can be consolidated only if the Free World countries are able to master the difficulties of the major adjustment in world payments which must now be achieved as a matter of some urgency: the transition from a position of large surpluses in Europe and large deficits in the United States to one of much greater balance on both sides of the Atlantic. Unfortunately, much of the diagnosis in this

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1/ Proposed Amendment to Articles of Agreement", International Monetary Fund, April 1968.

book is focused rather narrowly on international reserves and liquidity, on the price of gold and on the iniquities of the gold-exchange standard rather than on the problems associated with a process of mutual transitional adjustment between the two sides of the North Atlantic trade and payments area.

To be sure, Emminger has a valuable chapter on the difficulties of payments adjustment in the modern world. In reaction to the Rueff-Triffin emphasis on the gold-exchange standard as the basis of our financial difficulties today, he pointed out that "the gold exchange standard for all practical purposes has been dead since 1964" (100) and that the return to "a pure gold standard has not had any perceptible impact on the balance-of-payments-adjustment policies" of the United States. He could only conclude that we "need more than just a return to the pure gold standard in order to improve balance-of-payments performance in this world". (101).

Our present challenge is whether we can achieve adjustment toward balance at a rate sufficiently rapid to ensure that the recent financial agreements can become an historic turning point in the evolution of the world's payments system, and not merely temporary improvisations swept away by subsequent crises. For this reason, Meade's comment is worth repeating:

> "I am saddened at the sight of so many people in such positions of great responsibility, and in such positions of intellectual and academic influence in these matters, spending such a high proportion of time discussing the differences -- which I admit are very important, between the various ways of controlling and increasing international liquidity -- relative to the proportion of time which they have given to what in my view is the much more important problem of how the countries in the free world -- the developed, industralized, liberal countries of the Atlantic community, if you like -- adjust their payments to each other." (121-122).

As we consider the question of how countries can improve adjustment performance during this period of transition -- with its historic implications for international relations within our western world, as well as for our liberal trading and payments system -- one can share some of Meade's regret that the question of international liquidity, rather than that of international adjustment, has occupied the center of professional attention for so many years.