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THE IMF GOLD AGREEMENT

HEARING

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL ECONOMICS

OF THE

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THE IMF GOLD AGREEMENT

FRIDAY, OCTOBER 10, 1975

Congress of the United States,
Subcommittee on International Economics
of the Joint Economic Committee,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Henry S. Reuss (chairman of the subcommittee) presiding.

Present: Representatives Reuss and Rees; and Senator Taft.

Also present: Sarah Jackson and John R. Karlik, professional staff members; and George D. Krumbhaar, Jr., minority counsel.

Opening Statement of Chairman Reuss

Chairman Reuss. Good morning. The subcommittee today begins its examination of the gold agreement reached last month by the International Monetary Fund's Interim Committee.

The interim committee's agreement on gold would abolish the official price of gold and the obligation of Fund members to use gold as part of their quota subscriptions. Under the agreement, one-third of the Fund's gold stock also would be disposed of, one-sixth returned to IMF members, and one-sixth sold for the benefit of developing countries.

Today we would like to examine what impact this agreement will have on the future role of gold in the international monetary system. Will it diminish or enhance the position of gold relative to other reserve assets? How will the agreement affect the total supply of international liquidity? Are there preferable ways to phase gold out of the world monetary system?

Because the House went into recess this morning, a number of Members who would have liked to have been here will not be able to be with us today. We have also invited to participate in the discussions the members of the Subcommittee on International Trade, Investment and Monetary Policy of the House Committee on Banking, Currency, and Housing. chaired by Congressman Rees of California.

We have before us five very distinguished private witnesses to discuss the gold agreement. They are Henry Fowler, former Secretary of the Treasury, now with Goldman, Sachs; Jacques de Groote, Executive Director of the International Monetary Fund, appearing in his personal capacity; Fritz Machlup, professor of economics at New York University; Ronald McKinnon, professor of economics at Stanford; and Frazar Wilde, chairman emeritus of Connecticut General Life Insurance.

Under the rules and without objection, the extremely helpful papers which you all prepared and their appendixes will be admitted in full into the record. I am going to call on each one of you to proceed in any way you prefer.

Mr. Fowler, would you start.

STATEMENT OF HENRY H. FOWLER, FORMER SECRETARY OF THE TREASURY

Mr. FOWLER. Thank you, Mr. Chairman.

I, too, appear here solely in my personal capacity. I am not speaking for my firm or any other organization. I appreciate very much this opportunity.

In passing, I would like to acknowledge once more the extremely valuable and constructive role your subcommittee and its chairman performed in conceptualizing the special drawing rights amendment, consulting and working with the Treasury during my tenure there during the course of evolving negotiations stretching over 4 years, and, finally providing the exposition of the rationale of the amendment leading to its bipartisan approval by the Congress by overwhelming majorities.

In a very real sense, Mr. Chairman, this committee and the related legislative committees on Banking and Currency are the ultimate guardians and custodians of the ground rules and arrangements governing the participation of the United States in the International Monetary Fund.

The essential underpinning of the tentative interim committee agreement on gold—specifically, the abolition of the present official price of gold fixed pursuant to the IMF Articles—cannot become operable without favorable action by the Congress. Accordingly, the views of this commitee on the propriety of the tenative agreement on gold ought to be given great weight by those responsible in the executive branch for the further conduct of negotiations concerning revision of the IMF Articles and collateral arrangements having to do with the role of gold in the international monetary system.

In appearing here today, I merely am standing by some very strongly held convictions and principles which I had long prior to the announcement of August 31st. They were the subject of some public comment on June 5th that I made at a meeting to the Conference Board of Canada, which I would like to include as an exhibit to my prepared statement in the record. I also include this comment because it contains some very relevant excerpts from the published views of Mr. Witteveen, the Managing Director of the International Monetary Fund on May 14, 1975, which demonstrate his highly relevant attitudes as of that time on the role of gold in the international monetary system.

In my view, and I hope it proves to be the view of this committee and the Congress, it would be a tragic blunder and a grave disservice to present and future efforts to develop a more effective International Monetary Fund and international monetary system to approve the tentative interim committee agreement on gold and facilitate its effectuation by amending the IMF Articles of Agreement to abolish

the official price of gold in the light of the collateral arrangements of the Group of Ten set forth in the tentative agreement.

The fatal flaw in the tentative agreement is the combination of an abolition of the official price for gold for official monetary transactions with the implicit freedom in the complementary understanding among the Group of Ten that, after two years, any national central bank may buy gold from another central bank at any price or from the private market at any price and in any amount.

This result would be destructive of international monetary reform because it would set back or undermine a decade of effort to deal more effectively on an international basis with international official reserve assets and the control of their volume and composition.

In my prepared statement, to support this generalization, I cite and quote at length a recent statement from the report last July of 17 outstanding private economists of Western Europe, Japan, and North America, who are expert technicians and who discuss the current problems of international reserves and liquidity and the treatment of gold in the monetary system. This is highly relevant background, I think, for an appreciation of the fatal effects of this tentative Interim Agreement.

However, I would like to just read you very quickly the particular reasons for my position, as I have stated it.

First, the combination of an amendment of the IMF articles to abolish the official price of gold with no restraint after 2 years on dealings in gold by central banks with each other or in the private gold market is far more likely to increase rather than reduce the role of gold in the international monetary system.

The Governor of the South African Reserve Bank, Mr. T. S. de Jongh, gave his appraisal to a symposium on gold in New York after the recent IMF meeting. He is quoted in the New York Times of September 9th, on the tentative agreement, as follows:

"Far from being a step towards the phasing out of gold, it clearly has the effect of giving gold an increased and more meaningful monetary role than it has had for some time." That coming from the spokesman for the principal supplier of newly mined gold—South Africa—tells the story.

Now, what he meant was confirmed at the same symposium by John Exter, a noted and respected proponent of a larger role for gold in the monetary system, when he noted that three decisions embodied in the tentative agreement pointed to an enlarged role for gold. In Mr. Exter's words:

> First, the official price for gold was abolished and every government is now clearly free to do what they want with the gold on their books.
>
> Second, central bankers are free to buy as well as sell gold in the open market now.
>
> Third, central bankers are now free to use gold in transactions among themselves.

No amount of generalized whistling while walking through the graveyard of this tentative agreement by those who entered into it can cover up those stark truths by the advocates for an enlarged role for gold in the system.

And yet the gradual reduction of the role of gold in the international monetary system in order to provide a better international manage-

ment of global liquidity has been and still is the long agreed and avowed objective of international monetary reform. It was specifically and repeatedly set forth in the Outline of Reform submitted by the IMF Committee of Twenty on June 14, 1974, after nearly 2 years of intensive examination by all of the official experts from the member countries and on the staff, and reaffirmed by the interim committee on January 16, 1975—see Documents of Committee of Twenty on International Monetary Reform (1974), Outline of Reform, paragraphs 8, 15, 16–17, 22, 163, 228.

In addition to opening the door to what is generally agreed would be a retrogressive tendency and moving away from rather than towards a better IMF management of global liquidity, the features of the tentative agreement to which I have referred would have many unfortunate consequences.

Two, there would be a new burst of inflationary pressures resulting from this tentative interim committee agreement to the degree that gold in official monetary reserves becomes usable at prices nearer the private market price, resulting an a sudden and drastic enlargement of international reserves, particularly in countries with large gold holdings. A revaluation of the current official holdings of monetary reserves in gold from the current approximately $44½ billion value at the official price to somewhere around the current market price would increase these gold reserves approximately 3.3 times to a value of more than $140 billion. This is world liquidity creation that makes a mockery out of the monetary system and the efforts stretching over two decades to devise a system in which a deliberate, orderly, and carefully measured increase in global liquidity becomes the manageable function of the IMF.

Three, the distribution of the increase in real or potential liquidity resulting from the tentative agreement would be highly inequitable and unfair to the vast majority of the member countries of the IMF.

All the developing countries and many of the developed countries who have held the great bulk of their official reserves in nongold assets, particularly dollars, would have a wholly justified economic and political grievance, bound to grow and fester with the passage of time.

The effect of the agreement in conferring large windfall increases in official reserves on a few large gold-holding developed countries while the less developed ones grasp for crumbs to keep their economies alive, would constitute a reverse in international cooperation, which the United States should strongly oppose. Its only moral and proper role is to seek to prevent this inequitable handling of the role of monetary gold and join with those who would seek a fairer settlement to all concerned, which would forward the more effective international management of global liquidity growth.

I included, as an exhibit to my prepared statement, a tabulation of the official gold holdings of the various member countries. These show, as of May 1975, the central banks of the Group of Ten, plus Switzerland, had over $37 billion of gold valued at the official price, while all the remaining nations in the IMF owned a little over $7 billion worth. Their holdings of foreign exchange, mainly dollars, showed a sharp differential, however. The Group of Ten, plus Switzerland, held $70 billion in foreign exchange, while the remaining countries have nearly the same amount; namely, $68 billion worth of foreign exchange.

There are special reasons why the United States has a special responsibility for seeking an alternative solution in this problem of monetary gold to the tentative agreement. For decades, the United States has been a party to the accumulation of dollar balances in the reserve holdings of central banks for countries rich and poor around the world. An integral part of this process was the implied assurance that the dollars so accumulated by other countries in their reserves could be converted at will into gold at $35 per ounce by presenting them to the Federal Reserve Bank of New York which also served as the fiscal agent for the U.S. Treasury. When this practice and position was unilaterally terminated by the announcement of President Nixon on August 15, 1971, the United States, in my opinion, assumed something of a moral and political obligation. It is obliged to insist that the future role of gold in the monetary system should be resolved in a manner that would not visit a discrimination or inequity on those countries whose reserve assets were largely in dollars. At least to the extent they were held on August 15, 1971.

Surely, the United States has a special responsibility in the light of this history to oppose a differential writeup of the world's monetary reserves based on gold holdings. To assent to any arrangements that would work a grievous inequity on those central banks who held our dollars resulting from U.S. balance-of-payments deficits rather than present them to the Federal Reserve window in exchange for gold is not worthy of a great nation. This is particularly true when the United States would itself stand to reap the greatest monetary profit from this inequitable arrangement since its gold reserves are the largest.

There is another, more current, reason I think why the United States should take leadership in preventing the effectuation of this delicate agreement.

The U.S. delegation at the special session of the United Nations General Assembly sought to play a leadership role that is continuing in an international effort "to redress the economic imbalance between developed and developing countries," to quote from the preamble of the resulting resolution. The transfer of real resources for development and monetary reform were major elements of this initiative and important features of the resolution adopted. The very text of the resolution of September 16, with the United States voting affirmatively, stipulated that "arrangements for gold should be consistent with the agreed objective of reducing the role of gold in the system and with equitable distribution of new international liquidity."

It is clear already that the developing countries have a major intellectual difficulty in reconciling the views of the U.S. Secretary of State in subscribing to this U.S. resolution and of the U.S. Secretary of the Treasury in assenting to the tentative interim committee agreement.

I included in my prepared statement some excerpts from the press communique of the Interim Committee of August 31, 1974 and also the communique on the day before of the Committee of Twenty-Four, which shows the less developed countries recognizing this inequity and indicating that it is a grievance to them.

The fourth and last point, Mr. Chairman, is the effectuation of the tentative interim agreement on gold would forfeit the opportunities to improve the international monetary system so painfully achieved during the past decade through the special drawing rights amendment.

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It has been long agreed that a main feature of international monetary reform should include arrangements designed to achieve better international management, through the IMF, of global liquidity, with the SDR becoming the principal reserve asset and the role of gold and of reserve currencies being reduced.

Once the tentative decisions of the interim committee are effectuated by amendments to the IMF articles of agreement by the abolition of the fixed price of gold, there is nothing to prevent an immense increase in effective liquidity for the benefit of gold holders.

Can there be any doubt that, with the experience of OPEC to serve as a lesson, the two principal producers of most of the world's newly mined gold will manage the supply along either cartelized lines or by conscious parallelism to induce upward price movements?

Is there any doubt that they will be assisted in this endeavor by speculative private gold holding elements in many corners of the globe?

The fact is that in the future, the likelihood exists for an immense increase in liquidity for the major gold holding countries will curtail, if not eliminate, any further periodic creation and allocation of SDR's, as contemplated by the special drawing rights amendment.

Thus, the making of the SDR into the principal reserve asset with the consequent advance toward a rational system for the creation and management of international liquidity and the avoidance of further inequitable distribution of additional liquidity, will be arrested wholly, or most certainly, seriously impaired.

Now, Mr. Chairman, I am going to conclude my comments here, without responding in my comments to the question the committee poses as to what do we do in lieu of this. The principal brunt of my testimony here today is that we should not approve—is that the U.S. Congress should not approve the effectuation of this agreement. I have included in my prepared statement, however, some observations on the alternatives. But in the interests of concluding my comments in a timely fashion, I will leave those for subsequent discussion in the colloquy that will presumably follow.

Mr. REUSS. Well, I appreciate your confining yourself to the time-span which we have indicated, but I think if you take a couple more minutes to tell us exactly what you think the IMF ought to do and what the Congress ought to suggest to the IMF, I think it would be relevant.

Mr. FOWLER. Well, I will try to keep it brief.

In concluding this critique of the tentative interim committee agreement, let me observe that it has some features in this agreement which are commendable. They should be preserved in any alternative method of settlement, should the present proposal be revised before effectuation.

Primarily, I find commendable the first proposition that the articles of the IMF agreement and the IMF procedures should be amended to eliminate the Fund's authority to accept gold in transactions unless the Fund so decides by an 85-percent majority. This arrangement should be without prejudice to the adoption of a gold substitution or consolidation account. I would have no objection to that amendment to the articles.

Second, I would have no objection to some authorization to the IMF to sell its gold stock for the benefit of the developing countries.

I do object to the restitution at this time of any part of that gold stock to the principal gold-holding countries, because I think it would simply add to their stores and, too, you might say, to a capital gain which would be unconscionable in my judgment under current circumstances.

These measures would ultimately remove the role of gold from the day-to-day workings of the International Monetary Fund and leave only the question of the disposition and use of the gold held by national central banks.

The best way to protect the monetary system from a huge expansion of gold reserves by the differential up valuation of the gold held by national central banks and monetary authorities would be to maintain the prohibition against buying gold from each other above the official price and from buying gold from private markets at any price.

Now, this brings up, so I think, a most important point, the most important point, perhaps, to be made in these hearings apart from the desirability of arresting this so-called tentative agreement, and that is to concentrate the attention of the authorities on the development of either a gold substitution account in the Fund or a gold consolidation account, which I am sure will be the subject of much of our discussion.

In connection with the gold consolidation account approach, I think it would be useful to explore the question of providing some transforming of the largely dormant liquidity that exists in the official gold stocks; that is, transforming it into effective liquidity. But if that is done, its consequences ought not to be detrimental to the system as a whole, or inequitable to the nations now holding important gold reserves.

Therefore, I would think that one line of exploration would be to establish a gold consolidation account whereby a member could receive 35 SDR's per ounce of gold that it chose to deposit in this account, but retaining title to the gold. Under this arrangement, the gold could be reclaimed from the IMF in whole or in part by paying in 35 SDR's per ounce for the purpose of effecting a sale in the private market, or in the event the country wished to withdraw from membership in the Fund. It would be necessary to provide, in this type of arrangement, that once gold was withdrawn from the gold consolidation account by a depositing member, it could not be redeposited. Otherwise, the shuffling of reserves might prove disruptive.

This type of arrangement would convert the dormant liquidity in existing gold stocks in central banks into effective liquidity at the official rate, and yet reduce the role of gold in the workings of the system while tending to make the SDR the primary reserve asset and the centerpiece of the system. Any inequity to nations holding minimum amounts of gold would not be conferred by the IMF and would be partially compensated if this scheme were combined with a sale of the Fund's gold holdings with the proceeds used for concessional aid.

I think, Mr. Chairman, that would conclude my presentation.

[The prepared statement of Mr. Fowler follows:]

Prepared Statement of Henry H. Fowler

My name is Henry H. Fowler, I am a general partner of Goldman, Sachs & Co., an investment banking firm at 55 Broad Street, New York City. However, I appear here today solely in my personal capacity and am not speaking for my firm or any other organization.

I served from April 1965 to December 1968 as Secretary of the Treasury and from February 1961 to May 1964 as Undersecretary. As the U.S. Secretary I was

a Governor of the International Monetary Fund, representing the United States in all of the negotiations which culminated in the memorable Amendment to the Articles of Agreement creating the Special Drawing Rights.

In private life I have continued an active interest in international monetary affairs, and in particular the deliberations and reports of the IMF Committee on Reform of the International Monetary System, the so-called Committee of Twenty and its successor the Interim Committee.

In passing I should like to acknowledge once more the extremely valuable and constructive role which this Subcommittee and its Chairman performed in conceptualizing the Special Drawing Rights Amendment, consulting and working with the Treasury during the course of the evolving negotiations stretching over four years, and, finally providing the exposition of the rationale of the amendment leading to its bipartisan approval by the Congress by overwhelming majorities.

In a very real sense this Committee and the related legislative Committees on Banking and Currency are the ultimate guardians and custodians of the ground rules and arrangements governing the participation of the United States in the International Monetary Fund. That is a highly important responsibility. It is why I feel a duty to appear here today to testify in opposition to some of the basic features of the tentative agreement on gold announced by the IMF Interim Committee on August 31 and the complementary understanding among the Group of Ten reflected in the communique.

An amendment of the IMF Articles cannot be adopted without the affirmative vote of the United States which possesses well over 20 per cent of the 80 per cent weighted vote of the member countries necessary for an amendment. The U.S. Governor cannot cast an affirmative vote for an amendment except with the authorization of the Congress. Hence the essential underpinning of the tentative Interim Committee agreement on gold—specifically, the abolition of the present official price of gold fixed pursuant to the IMF Articles—cannot become operable without favorable action by the Congress. Accordingly, the views of this Committee on the propriety of the tentative agreement on gold ought to be given great weight by those responsible in the Executive branch for the further conduct of negotiations concerning revision of the IMF Articles and collateral arrangements having to do with the role of gold in the international monetary system.

I appear here today with some reluctance to urge that this Committee and related legislative Committees in the Congress indicate their unwillingness to approve Amendments to the IMF of Agreement that would permit this tentative interim agreement on gold to be effectuated. My reluctance stems from several factors.

First, I realize that this so-called "Tentative Agreement" is a painful compromise worked out by the responsible officials of many governments, including our own, in an effort to move off dead center international monetary reform which has been stalled for three years.

Second, it has been my personal policy since leaving the Treasury to avoid the posture of a Monday morning quarterback, who rushes to criticise publicly the very difficult choices that are being made and always must be made in the conduct of international negotiations. For a compromise is often the grease that makes the wheel of progress turn. I have had enough experience in this very field of international monetary negotiations to understand how difficult it is to achieve results. It took over three years of intensive detailed negotiations to obtain an Amendment of the International Monetary Fund on Special Drawing Rights that could achieve ratification by the holders of more than the required 80% of the vote.

But I cannot escape the conviction that it is more important to have a good agreement than a quick one or one which amounts to a huge backward step in the process of improving the system. And I feel some responsibility when I see my own country lending its support, however reluctantly, to a set of international arrangements that would be highly destructive to international institutional arrangements that are the best hope of intensifying the international economic and financial cooperation so sorely needed in the Free World.

My appearance here is not after-the-fact captious criticism but a decision to stand by strongly held convictions and principles prior to the announcement of August 31. They were the subject of my public comments on June 5th at a meeting of the Conference Board of Canada which I would like to include as an exhibit to my statement in the Record. (See Exhibit A).

I also include this portion of my public comments on June 5th, because it contains some very relevant excerpts from published views of Dr. Johannes Witteveen, Managing Director of the International Monetary Fund, as recently as May 14th, 1975, which demonstrate his highly relevant attitudes as of that time on the role of gold in the international monetary system.

Of course, I have no way of knowing what Dr. Witteveen would say were he here today on the tentative Interim Committee agreement. But a mere reading of the excerpts from his statement of May 14th, 1975, or the full text of that statement will indicate that the tentative agreement falls far short of the solution of the gold problem in the international monetary system that he viewed as desirable in May.

In my view, and I hope it proves to be the view of this Committee and the Congress, it would be a tragic blunder and a grave disservice to present and future efforts to develop a more effective International Monetary Fund and international monetary system to approve the tentative Interim Committee agreement on gold and facilitate its effectuation by amending the IMF Articles of Agreement to abolish the official price of gold in the light of the collateral arrangements of the Group of Ten set forth in the tentative agreement.

The fatal flaw in the tentative agreement is the combination of an abolition of the official price for gold for official monetary transaction with the implicit freedom in the complementary understanding among the Group of Ten that, *after two years*, any national central bank may buy gold from another central bank *at any price* or from the private market *at any price* and in any amount.

This result would be destructive of international monetary reform because it would set back or undermine a decade of effort to deal more effectively on an international basis with international official reserve assets and the control of their volume and composition.

Officially held monetary reserves have and will continue to play a major role in making the international monetary system work. They enable the IMF and nation states and their control banks to avoid destructive restraints on trade and capital movements while the adjustment processes work their way.

Adjustments of serious balance of payments deficits to equilibrium are not likely to occur, without resort to these undesirable measures, in a short period of time, even after substantial exchange rate declines. Therefore, governments and central banks feel the need for availability and access to foreign exchange reserves sufficient to finance sizable payments to other countries while adjustment takes place.

A Report last July of seventeen outstanding private economists from Western Europe, Japan and North America, who are expert technicians in international monetary affairs, discussed current problems of international reserves and liquidity and the treatment of gold in the monetary system. (See Brookings Report "The World Economy in Transition" (pp. 37–42).) Their analysis is highly relevant background for an appreciation of the fatal defects in the tentative interim Committee agreement. A list of these economists and their affiliations is attached to my statement as Exhibit B. The Report comments in part as follows:

"How to control the supply of reserves has been an issue in monetary discussions for more than a decade. Concern used to be about the possibility of reserves being inadequate, but now the concern is that reserve creation might be excessive, thus worsening inflationary pressures. In addition, the mix of dollars and other currencies in the present stock of reserves may be a source of instability in exchange rates. Change in the present system should be aimed at bringing the volume and composition of reserves under international control. Additions to reserves should neither be so large as to add to inflation nor so small as to impede the growth of the international economy.

"The total stock of monetary reserves more than doubled in the five years between 1970 and 1975, as a result, first, of large U.S. dollar outflows and then, in 1974, of the accumulation of massive financial surpluses by the oil-producing nations. To the degree that gold in monetary reserves was to become usable at prices nearer the private market level rather than at the IMF official level, the increase in total reserves would be much larger still. International management of reserve creation is all the more needed because the present drift toward multiplying rather than consolidating reserve currency assets could destabilize the system and because actions that could restore a primary role for gold would have a dangerous inflationary potential.

"With gold valued at the official IMF price, current world reserves of some $220 billion consist predominantly of currencies (about $155 billion, of which

two-thirds are in dollars and one-third in deutsche marks, sterling, and other currencies), and secondarily of gold (about $43 billion). Only a small part (about $10 billion) consists of Special Drawing Rights (SDRs), the international reserve asset that was created specifically because of the disabilities of the two other major forms of reserves. The continuing dominance of currencies and the trend toward their rapid diversification over the past few years are potential threats to monetary stability. Gold, in spite of its historic associations, is not a suitable element in a rational system, because its supply lies outside international control. . . .

"Gold, like the reserve currencies, is a capricious force for a monetary system. To be sure, large new gold finds that would swell monetary stocks are not very likely, although they are not inconceivable. Rather, the principal suppliers, South Africa and the Soviet Union, appear to have limited productive capacities so that additions to reserves from gold production will probably require continuing price increases. Far from being a stabilizing factor, this traditional monetary base could well be the most unreliable and inconstant of the possible elements in world monetary arrangements.

"For some years it has been agreed that gold is not to be relied upon as a source of new international liquidity and that its importance in the system is to decline. In contrast, however, it has also been agreed more recently that holders of gold reserves may value their stocks at market prices. Taken literally, and assuming that central banks would be willing to use monetary gold in tranactions with each other, this would represent a massive addition to the supply of effective reserves. The result could be to make gold again the principal component of monetary reserves.

"Major consequences could be anticipated. The most important would be greater inflationary pressures through a sudden and drastic enlargement of international reserves in countries with sizable gold holdings. Another would be to heighten political tensions. South Africa and the Soviet Union would gain from a guaranteed high price for the metal. The leading gold holders among the industrial countries—the United States, Germany, France, Switerland, Italy, and the Netherlands—would find their reserve positions significantly enhanced, whereas others, like Japan and the United Kingdom, would benefit to a lesser degree. The developing countries taken together, with under 10 percent of the world's official gold holdings, would have a substantial cause for grievance at this differential write-up of the world's monetary reserves. Finally, speculators in gold would have their highest expectations realized. They would surely begin a new round of gold speculation, which would further weaken confidence in national currencies at a time when confidence is badly needed.

"The instabilities inherent in both the reserve currencies and in gold argue for measures that would provide greater international control over the composition and volume of international reserves. This could be achieved by consolidating reserve currencies into SDRs and by agreement on rules that would ensure a declining role for gold in the monetary system. Both kinds of action would move the system toward an SDR standard."

Let me now review the particular reasons for my position as generally stated above.

1. *The combination of an amendment of the IMF Articles to abolish the official price of gold with no restraint after two years on dealings in gold by central banks with each other or in the private gold market is far more likely to increase rather than reduce the role of gold in the international monetary system.*

The Governor of the South African Reserve Bank, Mr. T. W. de Jongh, gave his appraisal too a symposium on gold in New York after the recent IMF meeting. He is quoted in the New York Times of September 9th, on the tentative agreement as follows: "Far from being a step towards the phasing out of gold, it clearly has the effect of giving gold an increased and more meaningful monetary role than it has had for some time."

That coming from the spokesman for the principal supplier of newly mined gold—South Africa—tells the story.

According to Mr. John Exter, a noted and respected proponent of a larger role for gold in the monetary system: "The agreements on gold at the International Monetary Fund meeting in Washington marked a major retreat by those countries attempting to substitute paper currencies for gold". (See N.Y. Post, September 9, 1975, p. 47.)

He noted that three decisions embodied in the tentative agreement pointed to an enlarged role for gold. In Mr. Exter's words: "First, the official price for gold

was abolished and every government is now clearly free to do what they want with the gold on their books. Second, central bankers are free to buy as well as sell gold in the open market now. Third, central bankers are now free to use gold in transactions among themselves."

No amount of generalized whistling while walking through the graveyard of this tentative agreement by those who entered into it can cover up those stark truths by the advocates for an enlarged role for gold in the system.

And yet *the gradual reduction of the role of gold* in the international monetary system in order to provide a better international management of global liquidity has been and still is the long agreed and avowed objective of international monetary reform. It was specifically and repeatedly set forth in the Outline of Reform submitted by the IMF Committee of Twenty on June 14, 1974, after nearly two years of intensive examination by all of the official experts from the member countries and on the staff, and reaffirmed by the Interim Committee on January 16, 1975. (see Documents of Committee of Twenty on International Monetary Reform (1974), Outline of Reform, pp. 8, 15, 16–17, 22, 163, 228).

In addition to opening the door to what is generally agreed would be a retrogressive tendency and moving away from rather than towards a better IMF management of global liquidity, the features of the tentative agreement to which I have referred would have many other unfortunate consequences.

2. *There would be a new burst of inflationary pressures resulting from this tentative Interim Committee agreement to the degree that gold in official monetary reserves becomes usable at prices nearer the private market price, resulting in a sudden and drastic enlargement of international reserves, particularly in countries with large gold holdings.* A revaluation of the current official holdings of monetary reserves in gold from the current approximately 44½ billion dollar value at the official price to somewhere around the current market price would increase these gold reserves approximately 3.3. times to a value of more than 140 billion dollars. This is world liquidity creation that makes a mockery out of the monetary system and the efforts stretching over two decades to devise a system in which a deliberate, orderly and carefully measured increase in global liquidity becomes the manageable function of the IMF.

3. *The distribution of the increase in real or potential liquidity resulting from the tentative agreement would be highly inequitable and unfair to the vast majority of the member countries in the IMF.*

All the developing countries and many of the developed countries who have held the great bulk of their official reserves in non-fold assets, particularly dollars, would have a wholly justified economic and political grievance, bound to grow and fester with the passage of time.

The effect of the agreement in conferring large windfall increases in official reserves on a few large gold holding developed countries while the less developed ones gasp for crumbs to keep their economies alive, would constitute a reverse in international cooperation, which the United States should strongly oppose. Its only moral and proper role is to seek to prevent this inequitable handling of the role of monetary gold and join with those who would seek a fairer settlement to all concerned, which would forward the more effective international management of global liquidity growth.

To borrow a telling description from the Chairman of this Committee in referring to another feature of this tentative agreement—this would be an application of the Golden Rule IMF style—those who have the gold make the rules. For the record a tabulation of the official gold holdings of various member countries of the IMF, as of the last five years ending with June 1975 is included as Exhibit C. As of May 1975 the Central Banks of the Group of Ten industrialized countries plus Switzerland had over $37 billion dollars of gold valued at the official price while all the IMF remaining nations owned 7.4 billion dollars worth. Their holdings of foreign exchange, mainly dollars, shows a sharp differential. The Group of Ten plus Switzerland held 70 billion dollars in foreign exchange official balances while the remaining countries held nearly 68 billion dollars worth of foreign exchange.

There are special reasons why the United States has a special responsibility for seeking an alternative solution to this problem of monetary gold to the tentative agreement. For decades, the United States has been a party to the accumulation of dollar balances in the reserve holding of central banks for countries rich and poor around the world. An integral part of this process was the implied assurance that the dollars so accumulated by other countries in their reserves could be converted at will into gold at $35 per ounce by presenting them to the

Federal Reserve Bank of New York which also served as the fiscal agent for the U.S. Treasury. When this practice and position was unilaterally terminated by the announcement of President Nixon on August 15, 1971, the United States, in my opinion, assumed something of a moral and political obligation. It is obliged to insist that the future role of gold in the monetary system should be resolved in a manner that would not visit a discrimination or inequity on those countries whose reserve assets were largely in dollars—at least to the extent they were held on August 15, 1971.

Surely, the United States has a special responsibility in the light of this history to oppose a differential write-up of the world's monetary reserves based on gold holdings. To assent to any arrangements that would work a grievous inequity on those central banks who held our dollars resulting from U.S. balance of payments deficits rather than present them to the Federal Reserve window in exchange for gold is not worthy of a great nation. This is particularly true when the United States would itself stand to reap the greatest monetary profit from this inequitable arrangement since its gold reserves are the largest.

Wholly apart from this moral responsibility based on the past, there is another special reason based on the present and future why the United States should take the leadership in preventing the effectuation of this inequitable agreement.

The U.S. delegation at the Special Session of the United Nations General Assembly sought to play a leadership role that is continuing in an international effort "to redress the economic imbalance between developed and developing countries", to quote from the Preamble. The transfer of real resources for development and monetary reform were major elements in this initiative and important features of the Resolution adopted. The very text of the Resolution of September 16th, with the U.S. voting affirmatively, stipulated that "arrangements for gold should be consistent with the agreed objective of reducing the role of gold in the system and with equitable distribution of new international liquidity."

It is clear already that the developing countries have a major intellectual difficulty in reconciling the views of the U.S. Secretary of State in subscribing to this U.S. Resolution and of the U.S. Secretary of the Treasury in assenting to the tentative Interim Committee agreement.

You will find in the press communique of the Interim Committee of August 31st, 1974, the following paragraph which comes at the end of the description of the Tentative Agreement on Gold:

"Many members from developing countries expressed concern that the proposed arrangements for gold would give rise to a highly arbitrary distribution of new liquidity, with the bulk of gains accruing to developed countries. This would greatly reduce the chances of further allocations of SDRs, thereby detracting from the agreed objective of making the SDR the principal reserve asset and phasing out the monetary role of gold. This aspect should be studied, and measures explored to avoid these distortions."

On August 30, the day before the tentative Interim Committee agreement was announced, the Intergovernmental Group of Twenty-four on International Monetary Affairs, representing a much larger number of the developing countries issued their own communique. Their position on gold as announced stands in sharp contrast to the tentative Interim Committee agreement. It reads as follows:

"On gold, Ministers reaffirmed that the amended Articles of the Fund should oblige each member of he International Monetary Fund to undertake to collaborate with the Fund and with other members regarding the policy of the member with respect to gold, and that any action by any member or arrangements among members with respect to gold should be consistent with the Articles of Agreement and with policies designed to ensure the gradual reduction of the role of gold in the international monetary system and the strengthening of the role of the SDR.

"Ministers also affirmed that no arrangements with regard to gold would be acceptable to the developing countries unless they met the above principles and also unless,

"(a) they were designed to raise substantially the flow of financial resources to the developing countries, without imposing a loss on any individual developing country;

"(b) they did not accentuate the already inequitable distribution of international liquidity.

"In this context, Ministers agreed that there was a need to expedite the study of a gold substitution account."

4. *The effectuation of the tentative Interim Agreement on gold would forfeit the opportunities to improve the international monetary system so painfully achieved during the past decade through the Special Drawing Rights Amendment.*

It has been long agreed that a main feature of international monetary reform should include arrangements designed to achieve better international management, through the IMF, of global liquidity, with the SDR becoming the principal reserve asset and the role of gold and of reserve currencies being reduced. Most of the significant constructive changes in the Fund Articles and procedures in recent years have tried to promote this objective. Much effort has been expended on developing a system based on the SDR as a reserve asset stable in value and conducive to deliberate and orderly international decision making in the creation of additional international liquidity that would not be inflationary but sufficient to facilitate the orderly growth of trade and capital movements.

Once the tentative decisions of the Interim Committee are effectuated by Amendments to the IMF Articles of Agreement, there is nothing to prevent an immense increase in effective liquidity for the benefit of gold holders. The mere fact that this additional liquidity may be realized legally will have far reaching consequences. It will be contended that even in the absence of an amendment, central banks could buy gold from each other and in the market. But the fact that the proposed amendment would enable them to do so legally will add to freedom of action. Moreover, pressures will build up among some of the major gold holders to peg the price of gold or at least keep it above some minimum price. These pressures will increase, if not immediately, as soon as the two year period for adherence to the collateral arrangements expires.

The fact that in the future the likelihood exists for an immense increase in liquidity for the major gold holding countries will curtail, if not eliminate, any further periodic creation and allocation of SDR's, as contemplated by the Special Drawing Rights amendment.

Thus, the making of the SDR into the principal reserve asset with the consequent advance towards a rational system for the creation and management of international liquidity and the avoidance of further inequitable distribution of additional liquidity will be arrested wholly, or most certainly, seriously impaired.

The volume of additional liquidity would depend upon whimsical and unmanageable factors like balance of payments deficits in countries whose currencies are used as reserves, decisions of a few major gold holding countries as to what price ranges for the purchase and sale of monetary gold reserves should be established to engineer additional differential increases of reserves for their benefit, and purchases of gold from the private market by central banks.

Can there be any doubt that, with the experience of OPEC to serve as a lesson, the two principal producers of most of the world's newly mined gold will manage the supply along either cartelized lines or by conscious parallelism to induce upward price movements?

Is there any doubt that they will be assisted in this endeavor by speculative private gold holding elements in many corners of the globe?

If these forces for pushing up the price of gold in the market or in transactions between central banks were not enough, the mere prospect of world inflation raising the market price of gold, and thereby increasing real or potential gold reserves would undermine and thwart any possibility of making the SDR the principal reserve asset and developing a rational system for the creation and management of international liquidity. Moreover, it would perpetuate the inequitable distribution of international liquidity along wholly indefensible lines as far as the overwhelming majority of the IMF members are concerned.

In concluding this critique of the tentative Interim Committee agreement let me observe that it has some features which are commendable. They should be preserved in any alternative method of settlement, should the present proposal be revised before effectuation.

First, the Articles of the IMF agreement and the IMF procedures should be amended to eliminate the Fund's authority to accept gold in transactions unless the Fund so decides by an 85 percent majority. This arrangement should be without prejudice to the adoption of a Gold Substitution or Consolidation Account.

Second, the IMF should be authorized and instructed to sell its gold stock valued officially at $6.7 billion to industrial and other private buyers *instead* of the proposed sale in the tentative agreement of 1/6 for the benefit of the developing countries and the restitution of 1/6 to gold holding members. The profits or surplus value of these sales should be used to finance concessional aid to the neediest developing countries. The disposal of these stocks could provide a sup-

plementary flow of real resources to developing countries. It would be a major step in the gradual reduction of the role of gold in the international monetary system, the transfer of real resources to the developing countries to help redress the imbalance to which the recent United Nations Assembly Resolution is addressed, and the relief of those most seriously affected countries from the terribly adverse effects on their development resulting from the oil price explosion and the unfavorable terms of trade in recent years.

These measures would ultimately remove the role of gold from the day to day workings of the International Monetary Fund and leave only the question of the disposition and use of the gold held by national central banks.

The best way to protect the monetary system from a huge expansion of gold reserves by the differential up valuation of the gold held by national central banks and monetary authorities would be to maintain the prohibition against *buying* gold from each other *above* the official price and from *buying* gold from the private market *at any price.*

This course of action would make the revaluation of official gold stocks by central banks and monetary authorities a matter of secondary, if not academic importance. Yet it would leave open the opportunity to sell gold in the market or to use it as collateral at a negotiated price for borrowing currencies from other central banks, whenever a gold holding central bank was in need of additional currencies or preferred to shift its composition of reserves from gold to national currencies.

This brings us to the final question of what additional steps, if any, should be taken to transform the largely dormant liquidity represented by official gold stocks into effective liquidity. If anything is to be done, clearly its consequences should not be dangerous or detrimental to the international monetary system, the nations not holding important gold reserves, or the gold holding countries.

Moreover, any action of this nature should be consistent with the clearly avowed monetary reform objectives of reducing the role of gold in the system and be a step toward making the SDR the central reserve asset.

An ideal way to accomplish all of these objectives would be to establish a Gold Substitution Account in the IMF whereby all gold holding countries could convert in a fixed span of months or years their monetary gold into SDRs at the official price of $42 an ounce.

However, given the existing price spread between the present market price and the official price, this is not a realistic approach.

This being so, the question presented is whether there is a reasonable alternative meaningful price that could serve as a basis for conversion to SDRs or what terms and conditions of substitution would be fair and equitable to the nations not holding important gold reserves and not detrimental to the working of the system.

An initial allocation of 35 SDRs to an ounce of gold to the nation transferring gold to the Substitution Account would serve to transform the dormant liquidity in gold stocks into effective liquidity. An allocation in excess of that level which is paid over time as there was a determination by the IMF of the desirability of additional liquidity would not be damaging to the working of the system. But it would amount to a differential up valuation of reserves favorable to large gold holders and inequitable to those whose reserves did not include much gold.

Is there any way in which this excess of SDR allocation above the 35 SDRs per ounce of gold level can be managed as to reflect a reasonable division between the major gold holders and those central banks whose gold holdings are a minor portion of their reserves? Would this division be acceptable to the major gold holding countries? If not, what provisions could be designed to induce voluntary acceptance? Would making the opportunity for utilization of the substitution account an option which expired after a given period for a given part of a nation's gold holdings produce results?

These are the kinds of questions which should be thoroughly explored before the next meeting of the IMF Interim Committee in January.

Another line of exploration would be to establish a Gold Consolidation Account whereby a member would receive 35 SDRs per ounce of gold deposited but would retain title to the gold. Under this arrangement the gold could be reclaimed from the IMF in whole or in part by paying in 35 SDRs per ounce for the purpose of effecting a sale in the private market or withdrawing from membership in the IMF. It would be necessary to provide in this type of arrangement that once gold was withdrawn from the Gold Consolidation Account by a depositing member, it could not be redeposited. Otherwise, the shuffling of reserves might prove disruptive.

This type of arrangement would convert the dormant liquidity in existing gold stocks in central banks into effective liquidity at the official rate, and yet reduce the role of gold in the working of the system while tending to make the SDR the primary reserve asset and the centerpiece of the system. Any inequity to nations holding minimum amounts of gold would not be conferred by the IMF and would be partially compensated if this scheme were combined with a sale of the Fund's gold holdings with the proceeds used for concessional aid.

Finally, it would seem clear that any overall settlement of the role of gold in the system should include the imposition of an obligation on the members to collaborate with each other and with the IMF on matters pertaining to gold so that the agreed objective of reducing the role of gold in the international monetary system can be realized. This idea has been explicitly endorsed by the Interim Committee in June, but was inexplicably dropped in the recent Communique of August 31.

Exhibit A

A Portion of Remarks of Henry H. Fowler at Conference Board of Canada Meeting on June 5, 1975, in Vancouver, British Columbia

IV. INTERNATIONAL MONETARY REFORM—STALLED ON DEAD CENTER

One of the most discouraging aspects of the current international financial outlook is the fact that an intensive effort towards a comprehensive international monetary reform was halted by the oil price explosion in the fall of 1973 and, thus far, the momentum towards that objective has not been regained.

One facet of the reform, a system for deliberate and controlled liquidity creation through the Special Drawing Rights mechanism, thereby lessening the dependence of the system on gold and reserve currencies, such as the dollar and pound, was completed and put in place in 1968–69.

This far-reaching Special Drawing Rights amendment went to the heart of a healthy world economy—the need for effective management of the international monetary system to perform in the international financial area much the same functions as a central bank performs in a nation. It was a major step towards enabling the member nations of the International Monetary Fund to develop and maintain collectively by deliberate decision making the level of international monetary reserves and credit facilities adequate to meet the increasing demands of international trade and investment within the limits necessary to avoid stimulating worldwide inflation.

The amendment gave the International Monetary Fund the authority, with approval of the members representing 80% of the weighted vote in the body, to provide sufficient monetary reserves on the growth side.

But the continued huge expansion of world liquidity through the uncontrolled generation, holding and treatment of national currencies as reserves by central banks and the changing value of the gold reserves held by central banks has removed the power of the IMF to hold down the growth of world reserves and liquidity to amounts compatible with the stable and non-inflationary growth of world trade and capital movements.

Until new issues of SDR's and their gradual substitution for gold and reserves in national currencies, under the control of the IMF, becomes the prevailing feature of the international monetary system, there is no equivalent of a world central bank of issue and a controlled international supply of reserves conducive to stability and non-inflationary sustained growth.

A recent address, on May 14th, 1975 in Washington, by Mr. Johannes Witteveen, Managing Director of the International Monetary Fund, has logically and forcefully pointed up this aspect of the international financial outlook. It should be required reading for all interested in achieving a viable international financial system.

He observed: "Controlling liquidity means ultimately basing the monetary system on an international asset such as the SDR, subject to international management and control. It involves reducing the role of gold in the monetary system, and regulating the aggregate volume of national currencies in reserves. These objectives have already been accepted in principle as a purpose of monetary reform. Nevertheless, they are still far from being achieved."

Since August 1971, when the United States terminated the convertibility of the dollar into gold at the official price fixed in the IMF Articles of Agreement, the market price of gold has been sharply upwards and it now stands at about four times the official price. Because central banks can only exchange gold with each other at the official price and some are reluctant to sell gold in the market,

this development has tended to immobilize gold reserves in central banks. There is pressure from a few of the major gold holding governments who hold disproportionate amounts of gold in their reserves to amend the IMF Articles of Agreement to allow them to engage in transactions at market prices rather than the official price.

But as Mr. Witteveen makes clear: "Freedom for central banks to trade in gold, if effectively usable, would imply recognition and acceptance of a very large increase in international liquidity. The total monetary gold stock of about $50 billion at the official price would be revalued at anything up to the $200 billion impled by present market prices. This is of course an important consequence in itself. But complete freedom for central banks to buy and sell gold could also open the door to additional uncontrolled increases in international liquidity through a further rise in the market price of gold. If central banks were to become net buyers of gold, this could have a strong upward impact on prices, given the relatively narrow base of the gold market."

To give way to the pressure of a few large gold holding countries to this course of action would be to invite a new burst of international inflation, be very unfair to the overwehlming majority of the nations, (including all the developing nations) who have held the great bulk of their reserves in non-gold assets, and lose the opportunity to forge a system based on deliberate and orderly decision making in the creation of appropriate amounts of international liquidity.

The world monetary system should be based on a reserve asset stable in value, such as the SDR, which is measured in value according to a basket of the major national currencies designed for the very purpose of achieving maximum stability for the value of the asset.

The world monetary system should not be based on a reserve asset such as gold whose price or value is subject constantly to the variable pressures of a volatile and speculative private gold market, dependent primarily for additional supply on two countries—South Africa and the U.S.S.R.—whose understandable interest is that of a raw material producer seeking an ever higher price for the product.

Dr. Witteveen concludes on gold as follows: "There is now agrement that gold should be phased out of the international monetary system. But since the existing stock of monetary gold is large, this will have to take place gradually. The difficulty lies in devising arrangements which will, at the same time, insure the gradual reduction in the role of gold in monetary reserves; preserve its usefulness as a reserve asset during the phase-out period; avoid the danger of pushing the price of gold upwards; and be equitable as between holders and non-holders of gold. This is a tall order, but since there is agreement on the ultimate purpose, we should meet this challenge and put the divisive issue of gold behind us."

Exhibit B

The World Economy in Transition—A Tripartite Report by Seventeen Economists From The European Community, The Brookings Institution, Washington, D.C.

Jacques de Bandt, Institute of Productivity Research, Nanterre.

H. C. Bos, Erasmus University.

J. H. Dunning, University of Reading.

Herbert Giersch, Kiel Institute for World Economics.

Lutz Hoffman, University of Regensburg.

Karl Schiller, Former minister of economics and finance, Federal Republic of Germany.

Pierre-Paul Schweitzer, Bank of America International, Paris.

JAPAN

Kenzo Hemmi, University of Tokyo.

Hisao Kanamori, Japan Economic Research Center.

Yoichi Okita, Economic Planning Agency.

Toshio Shishido, Nikko Research Center, Tokyo.

NORTH AMERICA

Carl E. Beigie, C. D. Howe Research Institute, Montreal.

C. Fred Bergsten, Brookings Institution.

James S. Duesenberry, Harvard University.

Edward R. Fried, Brookings Institution.

Philip H. Trezise, Brookings Institution.

Paul A. Volcker, Princeton University.

Exhibit C

INTERNATIONAL RESERVES

[End of period; millions of U.S. dollars]

	1970	1971	1972			1973				1974				1975			
			II	III	IV	I	II	III	IV	I	II	III	IV	March	April	May	June
GOLD																	
All countries	37,219	39,198	38,746	38,813	38,861	43,213	43,210	43,210	43,186	43,143	43,155	42,476	43,768	44,556	44,336	44,550	-------
Industrial countries	31,143	32,944	32,388	32,330	32,325	35,918	35,926	35,914	35,915	35,918	35,918	35,344	36,451	37,107	36,930	37,092	-------
United States	11,072	11,081	10,490	10,487	10,487	11,652	11,652	11,652	11,652	11,652	11,652	11,467	11,826	12,017	11,959	12,010	11,910
Canada	791	862	834	834	834	927	927	927	927	927	927	912	941	958	954	958	950
Japan	532	738	801	801	801	890	891	891	891	891	891	877	905	922	917	921	914
Austria	707	791	793	792	792	881	881	881	881	882	882	867	895	912	907	911	903
Belgium	1,470	1,676	1,682	1,648	1,638	1,781	1,781	1,781	1,781	1,781	1,781	1,752	1,807	1,841	1,832	1,840	1,825
Denmark	65	69	69	69	69	77	77	77	77	77	77	75	78	79	79	79	79
France	3,532	3,825	3,826	3,826	3,826	4,260	4,268	4,261	4,261	4,262	4,262	4,194	4,325	4,407	4,386	4,405	4,368
Germany	3,980	4,426	4,437	4,436	4,459	4,964	4,958	4,965	4,966	4,966	4,966	4,887	5,040	5,135	5,110	5,133	5,090
Italy	2,887	3,131	3,131	3,130	3,130	3,483	3,483	3,483	3,483	3,483	3,483	3,427	3,535	3,601	3,584	3,600	3,569
Netherlands	1,787	2,072	2,079	2,078	2,059	2,287	2,292	2,294	2,294	2,294	2,294	2,257	2,328	2,372	2,361	2,371	2,351
Norway	26	36	36	36	37	41	41	41	41	41	41	41	42	43	43	43	42
Sweden	200	217	217	217	217	244	244	244	244	244	244	241	248	253	252	253	251
Switzerland	2,731	3,158	3,158	3,158	3,158	3,513	3,513	3,513	3,513	3,153	3,513	3,457	3,565	3,633	3,615	3,631	3,600
United Kingdom	1,349	842	816	800	800	900	900	886	886	886	886	872	899	916	-------	-------	-------
Other Europe	1,750	1,917	1,940	1,956	1,972	2,193	2,193	2,206	2,194	2,208	2,214	2,181	2,245	2,289	2,278	2,289	-------
Finland	29	53	53	53	53	59	59	59	35	35	35	34	35	36	36	36	36
Greece	117	107	132	132	133	148	148	148	148	149	150	149	155	158	157	158	157
Ireland	16	17	17	17	17	19	19	18	18	18	18	19	19	20	19	20	19
Malta	10	13	13	13	13	15	15	15	15	15	15	15	15	15	15	15	15
Portugal	902	1,000	1,004	1,021	1,021	1,136	1,136	1,151	1,163	1,176	1,180	1,161	1,193	1,216	1,210	-------	-------
Spain	498	541	541	541	541	602	602	602	602	602	602	593	611	623	620	623	-------
Turkey	127	130	122	122	136	151	151	151	151	151	151	148	153	156	155	156	154
Yugoslavia	51	55	56	56	56	61	61	61	62	62	62	61	63	64	64	64	64
Australia, New Zealand, South Africa	906	729	791	886	963	1,106	1,117	1,134	1,115	1,094	1,094	1,073	1,099	1,104	1,090	1,090	1,083
Australia	239	282	283	283	281	313	312	313	311	312	312	307	316	323	320	322	319
New Zealand	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1
South Africa	666	445	507	601	681	793	804	820	802	780	781	765	782	780	768	767	763
Less developed areas	3,194	3,403	3,420	3,434	3,395	3,766	3,745	3,726	3,732	3,694	3,700	3,649	3,739	3,817	3,800	3,841	-------

EXHIBIT C—Continued

INTERNATIONAL RESERVES—Continued

[End of period; millions of U.S. dollars]

	1970	1971	1972			1973				1974				1975			
			II	III	IV	I	II	III	IV	I	II	III	IV	March	April	May	June
Oil exporting countries	1,200	1,294	1,292	1,288	1,288	1,430	1,442	1,434	1,450	1,452	1,460	1,441	1,501	1,536	1,526	1,556	-------
Algeria	191	208	208	208	208	231	231	231	231	231	231	227	235	239	238	239	237
Ecuador	19	20	14	14	14	15	15	16	16	15	16	16	17	17	17	17	17
Guatemala	18	19	19	19	19	21	21	21	21	21	21	20	21	22	21	21	21
Indonesia	4	2	2	2	2	2	2	2	2	2	2	2	2	-------	-------	-------	-------
Iran	131	142	142	142	142	157	159	159	159	159	159	155	159	162	162	163	163
Iraq	144	156	156	156	156	173	173	173	173	173	173	170	176	179	178	179	-------
Kuwait	86	94	99	94	94	105	114	105	120	123	130	128	150	159	157	181	158
Libya	85	93	93	93	93	103	103	103	103	103	103	101	105	106	106	106	106
Nigeria	20	21	21	21	21	24	24	24	24	24	24	24	24	25	25	25	25
Oman	2	1	1	1	1	1	1	1	1	1	1	5	5	-------	-------	-------	-------
Saudi Arabia	119	117	117	117	117	130	130	130	130	130	130	128	132	135	133	134	134
Trinidad and Tobago	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------
Venezuela	384	425	425	425	425	472	472	472	472	472	472	465	479	488	486	488	484
Other Western Hemisphere	699	697	725	747	711	791	790	781	773	733	732	721	744	772	772	778	-------
Argentina	140	98	130	152	152	169	169	169	169	169	169	166	171	174	174	-------	-------
Bolivia	13	15	15	15	15	17	17	17	17	17	17	17	18	18	18	18	18
Brazil	45	50	50	50	50	56	56	56	56	56	56	55	57	58	-------	-------	-------
Chile	47	51	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------
Colombia	17	15	16	16	16	18	18	18	18	18	18	18	18	34	36	39	39
Mexico	176	200	188	188	188	209	207	199	196	156	155	152	157	160	-------	-------	-------
Panama	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------
Peru	40	43	41	41	41	46	46	46	42	-------	-------	-------	-------	-------	-------	-------	-------
Uruguay	162	161	169	169	133	148	148	148	148	148	148	146	150	153	152	-------	-------
Other Middle East	495	567	567	563	563	622	622	624	624	621	620	614	633	644	641	643	-------
Cyprus	15	16	16	16	16	18	18	18	18	18	18	18	18	19	19	19	19
Egypt	93	92	92	92	92	103	103	103	103	103	103	101	104	-------	-------	-------	-------
Israel	43	47	47	43	43	46	46	46	46	46	46	46	47	48	48	48	-------
Jordan	28	30	30	30	30	34	34	34	34	34	34	33	34	35	35	35	35
Lebanon	288	350	350	350	350	389	389	390	389	387	386	383	395	402	400	402	399
Syria	28	30	30	30	30	33	33	33	33	33	33	33	34	34	34	34	-------

Other Asia	695	730	721	721	717	794	761	759	756	758	758	748	771	783	781	782	-------
Burma	63	23	16	16	12	14	14	10	8	8	8	8	9	9	9	9	9
China, Republic of	82	87	87	87	87	97	97	97	97	97	97	96	99	100	100	100	100
India	243	264	264	264	264	293	293	293	293	293	293	290	298	304	302	-------	-------
Korea	3	4	4	4	4	5	5	5	5	5	5	5	5	5	5	5	5
Malaysia	48	63	63	63	63	70	69	70	70	70	70	69	71	72	72	72	72
Pakistan	54	60	60	60	60	67	67	67	67	67	67	66	68	69	69	69	69
Philippines	56	73	72	72	71	79	45	45	45	45	45	44	45	46	46	46	46
Singapore	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------
Thailand	82	89	89	89	89	99	99	99	99	99	99	97	100	102	102	102	101
Other Africa	105	115	115	115	116	129	129	129	129	129	130	126	89	82	81	82	-------
Ethiopia	8	9	9	9	10	11	11	11	11	11	11	11	12	12	12	12	12
Ghana	6	6	6	6	6	7	7	7	7	7	7	7	7	7	7	7	7
Kenya	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------
Morocco	21	23	23	23	23	26	26	26	26	26	26	25	26	27	26	27	-------
Tunisia	4	5	5	5	5	6	6	6	6	6	6	6	6	6	6	6	6
Zaire	50	55	55	55	55	62	62	62	62	62	62	61	21	11	11	11	11
Zambia	6	6	6	6	6	7	7	7	7	7	7	7	7	7	-------	-------	-------
FOREIGN EXCHANGE																	
All countries	44,719	78,229	92,342	98,717	103,423	117,685	121,707	125,908	121,633	125,407	136,901	146,941	153,140	159,323	159,213	160,556	-------
Industrial countries	26,106	50,961	58,529	61,245	61,145	71,547	70,915	72,441	66,237	64,678	64,704	68,001	68,036	71,345	70,369	70,098	-------
United States	629	280	457	323	241	8	8	8	8	9	94	246	5	19	2	4	25
Canada	3,037	4,074	4,551	4,552	4,368	4,305	4,191	3,869	3,940	4,275	4,288	3,924	3,781	3,666	3,375	3,237	3,125
Japan	3,188	13,783	14,039	14,661	16,483	16,059	13,129	12,739	10,203	10,389	11,376	11,066	11,347	11,914	12,094	12,275	12,323
Austria	849	1,335	1,460	1,910	1,690	1,797	1,963	2,143	1,737	1,628	1,572	1,969	2,268	2,538	2,634	2,641	2,697
Belgium	780	706	1,088	1,274	1,104	1,836	1,954	2,114	1,969	1,680	1,628	2,118	2,197	2,669	2,707	2,825	2,752
Denmark	375	548	568	498	637	832	875	648	960	599	535	508	656	660	585	590	609
France	1,257	3,577	4,543	5,071	5,059	5,683	5,953	5,594	3,725	3,284	3,295	3,568	3,753	4,155	4,408	4,843	5,278
Germany	8,455	12,567	16,767	17,962	17,195	25,045	25,077	28,053	25,076	24,794	25,822	24,233	24,016	25,710	24,922	24,524	24,042
Italy	2,113	3,063	2,567	2,566	2,225	1,973	1,760	2,369	2,181	2,502	1,089	3,949	3,185	2,993	3,118	2,990	2,953
Netherlands	771	406	1,008	1,515	1,420	2,354	2,304	1,901	3,306	2,940	2,440	3,473	3,495	3,612	3,537	3,358	3,125
Norway	642	992	1,099	1,145	1,118	1,138	1,350	1,351	1,351	1,565	1,399	1,642	1,694	1,465	1,590	1,648	1,828
Sweden	397	723	970	975	1,144	1,635	1,901	1,887	2,049	1,812	1,301	1,182	1,247	1,333	1,620	1,770	1,886
Switzerland	2,401	3,808	3,870	4,272	4,399	4,616	5,204	5,136	5,007	4,508	4,900	4,833	5,446	5,343	4,500	4,768	5,112
United Kingdom	1,212	5,090	5,542	4,521	4,062	4,265	5,246	4,629	4,725	4,693	4,965	5,290	4,945	5,268	-------	-------	-------
Other Europe	3,548	6,265	7,676	8,963	10,084	10,782	11,425	13,137	13,368	12,877	12,026	12,661	12,081	11,243	10,695	10,685	-------
Finland	361	541	609	656	562	446	365	353	451	455	506	456	437	284	243	178	421
Greece	159	376	541	648	834	875	884	908	827	726	733	808	749	718	682	702	706
Ireland	637	911	941	884	1,023	898	921	966	911	932	850	1,059	1,146	1,105	1,099	1,164	1,215
Malta	143	177	209	223	252	269	292	282	299	315	331	344	376	383	406	420	417
Portugal	583	913	962	1,176	1,259	1,444	1,463	1,581	1,641	1,464	1,347	1,303	1,125	911	945	-------	-------
Spain	1,231	2,520	3,311	3,901	4,221	4,457	4,888	5,752	5,889	5,587	5,218	5,562	5,562	5,478	5,204	5,299	-------
Turkey	304	626	666	940	1,193	1,498	1,596	1,897	1,889	2,025	1,938	1,907	1,619	1,185	992	907	975
Yugoslavia	78	141	381	466	670	833	939	1,313	1,376	1,311	1,048	1,186	1,027	1,152	1,098	1,036	1,029

Exhibit C—Continued

INTERNATIONAL RESERVES—Continued

[End of period; millions of U.S. dollars]

	1970	1971	1972			1973				1974				1975			
			II	III	IV	I	II	III	IV	I	II	III	IV	March	April	May	June
Australia, New Zealand, South Africa	1,558	3,259	4,999	5,858	6,617	6,409	7,028	6,567	5,996	5,942	5,377	4,715	4,482	4,656	4,622	4,797	4,832
Australia	1,096	2,674	3,858	4,632	5,423	4,906	5,110	4,943	4,902	4,672	4,439	3,741	3,616	3,695	3,797	3,908	3,990
New Zealand	206	407	703	717	714	804	1,063	950	761	736	609	695	638	675	591	605	609
South Africa	256	178	438	510	480	700	855	675	333	535	328	280	229	286	234	284	233
Less developed areas	13,375	17,600	20,998	22,508	25,432	28,788	32,178	33,605	35,872	41,752	54,636	61,405	68,382	71,913	73,360	74,813	-------
Oil exporting cities	3,726	6,977	8,187	8,421	9,297	10,080	10,816	11,335	12,622	17,024	28,080	36,597	43,351	47,156	48,871	50,429	-------
Algeria	101	233	150	155	204	137	151	315	823	1,080	1,557	1,671	1,362	750	609	428	782
Ecuador	64	41	72	89	123	164	155	152	211	298	415	309	314	299	275	234	218
Guatemala	59	63	69	66	98	147	169	169	167	195	193	157	156	197	230	257	252
Indonesia	156	185	322	433	533	639	730	873	753	853	1,304	1,498	1,386	-------	-------	-------	-------
Iran	76	478	634	603	760	904	940	734	976	1,899	5,178	6,258	7,653	7,455	8,327	8,774	8,793
Iraq	319	432	505	541	582	812	998	1,062	1,323	1,927	2,648	2,752	3,036	2,669	2,499	2,566	-------
Kuwait	96	171	260	259	247	305	441	422	357	510	805	788	933	1,090	909	1,142	1,037
Libya	1,499	2,566	3,049	2,900	2,826	2,849	2,607	2,324	2,017	2,368	2,886	3,573	3,504	2,870	2,507	2,449	2,242
Nigeria	176	365	244	298	301	351	425	350	473	998	2,034	3,899	5,506	5,871	6,455	6,298	5,948
Oman	126	155	157	157	161	135	114	110	113	105	174	178	200	-------	-------	-------	-------
Saudi Arabia	520	1,291	1,777	2,057	2,347	2,726	2,965	3,911	3,707	4,694	6,917	11,157	13,424	17,804	18,665	19,323	19,127
Trinidad and Tobago	36	54	63	52	43	36	39	37	38	51	89	244	375	336	441	423	389
Venezuela	472	886	831	762	1,058	878	1,116	906	1,671	2,060	3,859	4,015	5,412	6,230	6,430	7,009	7,098

Other Western Hemisphere	2,954	3,149	4,166	5,049	6,395	7,542	8,863	9,505	9,840	10,498	10,904	9,402	8,829	7,758	7,649	7,658	
Argentina	343	70	59	83	294	411	585	980	1,073	1,206	1,584	1,241	1,028	621	483		
Bolivia	30	37	34	31	41	58	53	41	52	54	131	161	173	201	183	172	169
Brazil	962	1,450	2,139	3,001	3,836	4,573	5,633	6,076	6,031	6,150	6,130	5,315	4,853	4,091			
Chile	320	129															
Colombia	189	179	181	219	290	393	424	396	441	494	442	335	353	268	237	225	271
Mexico	385	550	742	707	731	801	754	622	888	1,112	1,120	934	960	1,036			
Panama	12	14	24	27	32	25	54	28	30	21	38	42	37				
Peru	275	166	321	324	375	354	384	476	426								
Uruguay	14	20	12	34	56	60	76	50	71	105	40	28	52	38	36		
Other Middle East	1,058	1,507	1,888	1,993	2,186	2,473	2,676	2,588	3,445	3,328	3,608	3,540	4,020	4,823	4,751	4,728	
Cyprus	184	253	276	290	285	310	302	301	268	244	232	254	237	239	231	223	224
Egypt	74	61	61	57	51	48	70	115	250	230	259	465	200				
Israel	405	676	1,000	1,024	1,147	1,376	1,308	1,397	1,695	1,505	1,312	1,066	1,151	1,442	1,427	1,432	
Jordan	219	211	185	196	225	232	267	275	263	255	278	284	300	454	440	433	439
Lebanon	96	195	243	280	322	369	505	507	470	515	673	694	1,276	1,259	1,244	1,266	1,261
Syria	27	58	69	93	101	79	162	202	438	524	791	712	791	1,160	1,141	1,103	
Other Asia	3,932	4,519	5,294	5,478	5,902	6,765	7,686	7,748	7,840	8,783	9,572	9,498	9,671	9,786	9,720	9,568	
Burma	831	49	48	43	34	34	72	78	80	105	172	162	171	152	163	148	135
China, Republic of	338	439	740	878	952	1,132	1,144	1,094	1,026	1,011	983	997	1,055	1,073	932	982	1,061
India	698	699	639	574	566	629	722	639	461	736	968	762	733	782	816		
Korea	584	535	565	640	694	712	851	983	1,034	971	985	980	1,049	880	956	974	
Malaysia	542	665	746	712	807	876	1,093	1,193	1,143	1,281	1,309	1,324	1,411	1,277	1,219	1,197	1,235
Pakistan	126	115	194	176	200	264	381	306	380	332	280	477	368	326	374	260	388
Philippines	195	309	374	378	456	606	775	796	964	1,116	1,464	1,456	1,425	1,481	1,504	1,492	1,515
Singapore	287	582	714	834	863	1,009	1,165	1,198	1,225	1,314	1,381						
Thailand	790	736	913	874	896	1,118	1,126	1,095	1,132	1,527	1,656	1,600	1,681	2,041	2,018	1,952	1,946
Other Africa	1,705	1,449	1,462	1,567	1,652	1,928	2,138	2,159	2,124	2,118	2,471	2,368	2,512	2,390	2,370	2,430	
Ethiopia	57	52	63	70	76	114	145	158	158	183	225	225	255	260	265	267	271
Ghana	52	38	59	79	90	128	156	197	163	113	143	75	62	56	63	86	144
Kenya	202	145	142	161	170	207	279	250	198	202	183	174	190	218	210	196	186
Morocco	119	148	213	205	165	192	212	252	187	164	192	321	337	339	389	418	
Tunisia	55	141	152	192	203	237	252	279	278	304	352	409	388	385	364	366	369
Zaire	92	43	34	60	85	63	45	75	130	91	177	84	76	49	73	58	25
Zambia	480	236	152	147	158	188	213	111	186	204	336	263	150	36			

Chairman REUSS. Thank you very much.
Next, Mr. de Groote.

STATEMENT OF JACQUES de GROOTE, EXECUTIVE DIRECTOR, INTERNATIONAL MONETARY FUND

Mr. DE GROOTE. Thank you, Mr. Chairman.

I thank the Subcommittee on International Economics for this opportunity to express my view on the position taken by the interim committee of the IMF on the question of gold.

May I begin with three introductory remarks. First, I am speaking in a personal capacity without committing the two institutions which I serve as an Executive Director, nor the Governments that have elected me to these functions. This enables me to suggest for further reflection an approach which differs somewhat, as far as certain technical modalities are concerned, from the ones that have been contemplated so far. Such an approach is hopefully still useful. Indeed, the issues this committee takes into consideration are still open for discussion and personal reflection as far as they have not yet been expressed in the form of final political decisions.

Second, in trying to find an answer to the questions asked by the chairman and in particular on how to arrive at a more effective way to implement the interim committee's agreement on the use of the Fund's gold to the benefit of developing countries, I was led to consider a mechanism that might be applied in dealing with the problem of gold in the international monetary system as a whole. The main thrust of my communication will be directed at this broader issue.

Third, I will limit my presentation to one specific aspect of the problem; namely, the best use that can be made of gold, the Fund's gold to begin with, as well as of gold in general. By doing so I fully realize that I do not answer the whole range of questions raised by the chairman. Many of these questions can be answered more fully and more competently by others, while under the approach I suggest, several questions would become irrelevant or would receive an implicit answer.

The interim committee has decided that one-sixth ofthe IMF's gold holdings will be used for the benefit of the neediest countries. This apparent easy and straightforward decision raises difficulties. Its very aim, which is to provide a maximum of additional resources out of a fraction of the Fund's gold for the poorest countries, might indeed be defeated by the technique envisaged for its implementation. The necessity arises therefore to draw attention on alternative approaches, that might be envisaged if a further use of the Fund's gold is contemplated or if other modalities have to be taken into account to implement the decision under review.

You will have noticed that the mere prospect of sales of gold of a magnitude comparable to South Africa's annual production has already resulted in a substantial drop in the market price during the last weeks. This development, considered in itself, is not necessarily unwelcome. However, if gold had effectively been sold on the market, the amounts available for assistance to the neediest countries would have been much less than what had been contemplated when the decision was taken. As far as the future use of the balance of the Fund's gold and eventually of countries' gold is concerned, the lesson of this

experience seems to be that any mechanism implying an even more important volume of gold sales would, by its very nature, be self-defeating.

The dependency on the gold market is not the only difficulty arising from the decision to help the developing countries with the sales of part of the Fund's gold. This decision also raises a number of serious legal problems, some at the international and others at the national level. Anyway, even in the absence of economic or legal problems, it seems hardly justified, on almost ethical grounds, to make assistance to the neediest countries in particular, and international liquidity in general, too dependent on the vagaries of the private gold markets and on the whims of speculators.

I submit that it might therefore be desirable to study means more appropriate to achieve the objective of providing supplementary resources to the neediest countries or any objective relating to further use of the Fund's gold. A straightforward way to this end would consist in implementing a mechanism under which gold would be consolidated and replaced by SDR's. In practice, this could be realized by two simultaneous, but legally distinct, operations: on the one hand, the Fund's gold to be used to the benefit of developing nations would be transferred to a special account opened in the IMF to this end. Let us call this account the gold account. Against relinquishment of its gold to this gold account, the Fund would acquire a nonliquid, noninterest-bearing claim.

On the other hand, simultaneously with the transfer of Fund's gold to the gold account, the fund would issue new SDR's. An amount of SDR's calculated on basis of 35 SDR's per ounce of gold would have to be allocated to the Fund in substitution for the gold it has given up. An additional amount of SDR's calculated on the basis of the difference between a conventional market-related value for gold and its SDR price, would be allocated by the Fund to the trust fund or directly to developing countries. This would associate those members who do not hold a substantial part of their reserves in the form of gold to the increase in international liquidity connected with the increase in the market price of gold.

This technique could be applied for any part of the remaining gold assets of the Fund, conceivably pari passu with further restitution, if the latter were necessary in order to obtain the agreement of all interested parties.

Although the attention is now primarily on the use of the Fund's gold to the benefit of a thrust fund for the neediest members, it seems relevant to indicate how the same substitution mechanism could also be used, in a more general way, for the gold assets of IMF member countries: these countries could also surrender part or all of their monetary gold to the gold account in exchange for a nonliquid, noninterest-bearing claim on that account. They could be entitled to an SDR allocation corresponding to the amount of gold they had delivered and calculated on basis of a conventional price for gold. To avoid inflationary effects, they would receive 35 SDR's per ounce of gold at once, the balance being made available to them over time, in a controlled and rational way on basis of an assessment of the need for international liquidity.

If the approach I just outlined by way of example, were adopted, a number of issues would obviously arise, some of a technical, others of a more political nature.

First, amendment of the articles of agreement of the IMF would be required to put a consolidation mechanism into effect. The provisions to this end can only have the form of an enabling clause, to be made operative by a decision taken at a suitable majority. To have to wait for the implementation of an amendment to the articles of agreement may, however, seem to be in contradiction with the aim to provide assistance to the neediest countries as soon as possible. I submit that this process would not necessarily be longer than sales of gold on the market as has been envisaged so far, if those sales are to be conducted in such a manner as to maximize profits for the benefit of the neediest nations and up to amounts of substantial magnitude. Furthermore, the Fund is in the process of reviewing its policies with regard to access to its resources, in particular by the poorest countries, so that help might be forthcoming in the meantime.

A second issue relates to the management of gold holdings of the gold account. The gold account would not be under the obligation to sell gold on the market. Consideration would have to be given to the use the gold account could make of its gold. Countries that held a consolidated claim on the gold account would have to decide collectively whether to keep gold frozen in the gold account for some time as a physical guarantee for their claim in case of withdrawal or liquidation, or to sell gold on the markets at a later stage.

A third issue pertains to the nature of the SDR's. Under the substitution scheme, SDR's would be allocated as a counterpart for gold consolidation, while they are now allocated in proportion to members' quotas in the IMF. However, the fundamental character of the SDR's would remain unchanged, since their staggered allocation to member countries would still be based on a collective judgment of the global need for liquidity.

Another issue is the fact that many countries, and among them the countries of the EEC, attach the greatest importance to the necessity to proceed simultaneously to the consolidation of holdings of reserve currencies if gold consolidation is envisaged. The problems related to this position have to be dealt with in the general framework of further agreements on international liquidity. This issue seems, however, not directly relevant for the use of a substitution mechanism for the Fund's gold. A decision could be taken on this latter point, under amended articles of agreement, pending decisions on other types of substitution.

Finally, a last issue to consider is whether a substitution mechanism as suggested has enough attraction to be ever put into effect. The necessary motivation obviously exists with regard to the Fund's gold, since the implementation of such a mechanism would maximize the amounts available for assistance to the neediest countries. Hereby also, those members of the Fund who do not hold a substantial part of their reserves in the form of gold could be associated to the expansion in international liquidity connected to the increase in the market price of gold. As to the holdings of central banks, consolidation of gold may become more attractive if they come to regard this metal more and more as a volatile asset so that any preoccupation with the maximization of profits would accordingly decline.

The problems I just mentioned have to be balanced against the advantages of a consolidation scheme.

First, it is the technique most likely to benefit the neediest countries and the ones who do not own gold by using, to this end, part of the gold assets of the IMF. Second, to the extent to which gold would be consolidated, the mechanism would liberate member countries and the Fund from the vagaries of the gold market and the domination of speculation; the market price of gold would only be used as a reference; neither supply nor demand for gold on the market would be affected. More fundamentally this mechanism would ensure a phasing down of the role of gold in the international monetary system, without increasing the role of reserve currencies. It would considerably enhance the SDR to which you agreed to give the central role in the international monetary system. The implementation of such a consolidation scheme would be tantamount to an acceptance and strengthening of IMF's role as a monetary institution.

[The prepared statement of Mr. de Groote follows:]

Prepared Statement of Jacques de Groote

My comments on the tentative agreement on gold reached in the Interim Committee at the occasion of the IMF's recent Annual Meetings will be directed at one aspect of these agreements, namely the intention to sell on the market one sixth of the Fund's gold and to use the proceeds of these sales to the benefit of the developing countries, by putting them at the disposal of a separate Trust Fund; the latter would give balance of payments assistance on concessional terms to the neediest countries.

In my opinion, this aspect of the agreement raises serious difficulties, to such an extent that its very aim, which is to provide additional resources for the poorest countries, might be partly defeated by the technique envisaged for its implementation. I submit that it would be more appropriate to achieve the objective of providing supplementary resources to the neediest countries by means that do not imply reliance on the gold market. A mechanism that deserves attention in that respect would consist in the allocation of SDR's to the General Account of the Fund against relinquishment of one sixth of the Fund's gold to a gold consolidation account. I will outline hereunder the possible modalities of such technique when applied to the use of one sixth of the Fund's gold to the benefit of the developing countries, in accordance with the recent decision of the Interim Committee. The same technique could also be applied for the consolidation, against allocation of SDR's, of the totality or part of the remaining gold holdings of the Fund, as well as for the consolidation of a fixed or increasing part of countries' own gold reserves. The further recourse that could be made to the mechanism I suggest here, apart from its immediate use for financing the Trust Fund out of one sixth of the IMF's gold, would give this mechanism a central role in the reform of the international monetary system hereby enhancing the status of the SDR and ensuring, without sales on the gold market, the phasing out of gold.

In brief, the approach I have adopted here addresses mainly the issue raised by the distinguished Chairman of this Committee when he asked whether there is a superior way to phase gold out of the international monetary system than the one envisaged by the tentative agreement reached at the IMF's Interim Committee.

Difficulties Relating to the Financing of the Trust Fund by Gold Sales

Sales of gold on the market, up to an amount of 25 million ounces, are a built-in feature of the tentative agreement on gold reached at the IMF's recent Annual Meetings. The mere prospect of such sales, the magnitude of which is comparable to South Africa's annual production, has resulted in a substantial reduction of the market price of gold during the last weeks. I admit that this might be regarded as a welcome evolution, if one took only into consideration the diminishing role gold should play in the future. However, the dependency on the vagaries of the gold market for the financing of the Trust Fund has turned this evolution into a severe potential loss for the developing countries.

As far as the future use of the balance of the Fund's gold and of countries' gold is concerned, it also became clear that any mechanism implying an even more important amount of gold sales would, by its very nature, be self-defeating, unless the sales were spread over a long period.

The dependency on the gold market is not the only difficulty arising from the decision to help the developing countries with the sale of part of the Fund's gold. There is also a serious legal issue. Under the present Articles of Agreement (Article VII, section 2), the Fund can sell gold in order to replenish its holdings of a member's currency: gold can therefore only be sold to countries whose currency is held by the Fund in an amount under 75 percent of quota, in other words to countries already in the position of net lender to the Fund whose currency might be needed for further Fund transactions. Those sales have to be made at the official gold price. The difference between this price and the free market price has, somehow, to be transferred to the Trust Fund; this can be done either by a grant of this amount to the Trust Fund by the country having purchased the gold from the Fund, after it had sold it on the free market, or by a resale of the gold by this country, at the official price, to the Trust Fund. The latter would have then the responsibility to realize the benefit by sales on the market. Both methods are complicated and make the resources of the Trust Fund completely dependent on the reactions of the gold price to the increased sales of this metal; few countries seem, moreover, to have the legal power of selling gold at another price than the official price, which is required if the first method is applied. On the other hand, the purchase at the official price of the gold by the Trust Fund from the countries that obtained it initially from the IMF would entail, at the end of the operation, the replacement for these countries of a Fund reserve position by a foreign currency position. Many countries would not welcome this substitution.

The various complications and legal difficulties inherent to the mechanism envisaged for financing the Trust Fund out of gold sales under the present Articles of Agreement could obviously be dealt with under amended Articles. In that case, however, the mechanism suggested hereafter, which also requires an amendment, seems to be more appropriate.

AN ALTERNATIVE MECHANISM FOR THE USE OF THE FUND'S GOLD TO THE BENEFIT OF DEVELOPING COUNTRIES

(i) Restitution of one sixth of the Fund's gold would take place, as has been decided at the fourth meeting of the Interim Committee.

(ii) Irrespective of the amounts involved, the following consolidation mechanism could be used for any portion of the balance of the Fund's gold:

The General Account would relinquish gold to a Gold Consolidation account, henceforth referred to as the Gold Account, in exchange for a consolidated claim on that Account, so as to balance the Fund's books;

The Fund would correspondingly allocate SDRs to the General Account on the basis of SDR 35 per ounce of gold, so as to preserve the liquidity of the General Account;

An additional amount of SDRs, calculated on basis of the difference between a market related value for the gold relinquished by the General Account and the official SDR price of gold could be allocated by the Fund to the Trust Fund or directly to member countries, in order to associate those members who do not hold a substantial part of their reserves in the form of gold to the increase in international liquidity connected with the increase in the market price of gold.

(iii) The technique sketched under (ii) above could be used for one sixth of the Fund's gold or for a fraction of that percentage, if no other method were to be found satisfactory to achieve the aim of providing a meaningful amount of resources to the Trust Fund. The same technique could be applied for any part of the remaining 4/6th of the Fund's gold, conceivably pari passu with further restitution, if the latter were necessary in order to obtain the agreement of the industrialized countries.

POSSIBILITY OF A SUBSTITUTION MECHANISM FOR GOLD HELD BY COUNTRIES

The attention is now primarily on the use of the Fund's gold to the benefit of a Trust Fund for its neediest members. Within the framework of present efforts to amend the international monetary system through a revision of the IMF's Articles of Agreement, it seems relevant to indicate how the substitution

mechanism could also be used, in a more general way, to deal with countries' gold. Gold held by the Fund is not in essence different from gold held by member countries; any decision taken on either the gold holdings of the Fund or the gold holdings of member countries necessarily affects both. A global approach that would encompass member countries' gold as well as the Fund's gold seems therefore preferable. The principles of such global approach should be laid out in the amended Articles, with a faculty to put immediately into operation those dispositions that are needed to finance the Trust Fund out of the IMF's gold. The probability of a broader use of a substitution mechanism beyond what is required for the implementation of the recent decision on one sixth of the Fund's gold to the benefit of developing countries is indeed no longer as remote as it appeared some time ago. Recent circumstances have shown that gold is a highly volatile asset; central banks might gradually come to the point where they find it preferable to have at their disposal the faculty to obtain, against part of their gold reserves, a known amount of SDRs.

Possible provisions of a substitution mechanism for gold held by countries could be sketched as follows:

(i) When the Fund found that members that held a large proportion of the stock of monetary gold were prepared to renounce all or a major part of their gold holdings, and substitute SDRs for gold in their reserves, the Fund would set a date and announce the terms on which it would stand ready to make such substitution. The Fund's decision to this effect should presumably be governed by a high majority, for instance 85 percent.

(ii) The terms set by the Fund would include the following:

The Fund would allocate SDRs to member countries willing to renounce part or all of their gold holdings at a price based on the market price of gold at the time of the decision. These member countries would be entitled to a total allocation of SDRs corresponding to the amount of gold they had delivered. The Fund would allocate SDRs 35 per ounce at once, and the balance in installments which would be determined on basis of an assessment of the need for international liquidity. There could be a provision for a member with payments problems to draw down in advance some future installments.

No distinction would be made in any respect between SDRs received by countries under general allocations and SDRs allocated contingent upon the relinquishment of gold to the Gold Account. The Gold Account would neither be allocated, hold or otherwise use SDRs for substitution purposes. This approach rests on the assumption that no financial incentive would be needed to foster substitution in view of the fact that members would exchange an asset frozen in practice for a more readily usable asset, with a predictable value. It could be argued that members, who will be net users of SDRs acquired for gold, and who would therefore have to pay charges, would have been better off had they settled with gold; however, cession of gold in payment of a debt also entails a loss, namely the potential income on the proceeds of gold sales.

Each member that would benefit from such allocation would relinquish its gold to a Gold Consolidation Account, against a non-interest bearing claim on the Account that would be activated only in case of withdrawal from the Fund or liquidation of the Fund. This nonliquid claim would no longer be a monetary asset.

The Gold Account would not be under the obligation to sell gold on the market Consideration would have to be given to the use the Gold Account could make of its gold. Countries that held a consolidated claim on the Gold Account would have to decide collectively whether to keep gold frozen in the Gold Account for some time as a physical guarantee for their claim in case of withdrawal or liquidation, or to sell gold on the markets at a later stage and use the proceeds, for instance, for loans to the General Account or investment in securities of other international organizations. It might be envisaged that the Gold Account could borrow against gold collateral.

MAIN ADVANTAGES OF A SUBSTITUTION MECHANISM

The main advantages of the alternative approach suggested above would seem to be the following:

1. The financing of the Trust Fund from the increase in value of one sixth of the Fund's gold, beyond other possible sources of financing, would become operationally simple and the amounts available would be known instead of being

dependent on the success of sales of gold on the markets. In this way, it would be possible to avoid the basic conflict between the desire to maximize profits on sales of gold to the benefit of the Trust Fund and the effects of such sales in the markets, which frustrate the aim of the operation.

2. To the extent to which gold would have been relinquished to the Gold Account, either by the Fund's General Account or by member countries, the volume of international liquidity would be isolated from the vagaries of the private gold markets.

3. The substitution mechanism could ensure to the same extent a one-way effective demonetization of both gold held by the Fund and gold held by member countries in their reserves. Some revision of accepted ideas would, however, be required on this point, in order to admit that consolidation is in itself a more direct and appropriate way to demonetize gold than sales on the market.

4. Whatever the extension of the proposed substitution mechanism, it would avoid the intrinsic conflict present in all schemes that are under the pledge not to support the price of gold while they remain dependent on transactions on the gold markets.

Indeed, unless uncertainties for member countries are overlooked, unless permanent concern of central banks for the market depressing effect of gold sales is disregarded and unless financial risks for the IMF are neglected, the feasibility of such schemes implicitly requires that the gold sales would be profitable in the long run, which means that they would have to be conducted in such a way as not to disappoint the expectation that the trend in the price of gold would be upward.

5. Any link between the SDR and gold would disappear, not only as a matter of law, but also as a matter of fact. One might even venture the thought that the decisions on the timing of SDR allocations, contingent upon relinquishment of gold, could be regarded as a decision on the volume of international liquidity in the years to come, without any relation to gold; indeed, such decisions would be based on assessment of the need for international liquidity.

6. The role of the SDR would be considerably enhanced, not only by the mere fact that the total volume of SDRs would increase, but also because of the fact that the General Account would become the beneficiary of SDR allocations. It has become evident in the discussions on the amendment of the Articles that the present provisions concerning the General Account as an "other holder" of SDRs are unduly restrictive, and that the General Account should be given the same rights and obligations as the participants in the SDR system.

POINTS FOR FURTHER CONSIDERATION

Some aspects of the approach suggested above would need very careful consideration:

1. The price of gold, or, more exactly the total number of SDRs to be allocated contingent upon relinquishment of one ounce of gold, remains a very delicate political and economic issue. This price, in order to be meaningful, has to relate to an average market price. The latter, however, would no longer be an intrinsic element of the scheme, nor would it be influenced by the movement of gold into the substitution account and by the resulting allocation of SDR. The market price of gold would only be used as a reference. The expectations as to the price of gold on the market and members' aspirations as to this price would become less relevant. A first step in that direction is envisaged by the recent agreement on gold between the ten largest industrial countries. If gold sales and purchases and loans on the basis of gold collateral between the central banks of these countries become effective, within the general commitment not to increase their official gold stocks, some conventional gold price will have to be used in these transactions. The agents operating on the gold market are sophisticated enough to quickly realize that such recourse to a conventional gold price is without effect on supply and demand on this market.

2. The approach I suggest here raises the problem that a now largely dormant liquidity in the present official gold stock would be transformed into effective liquidity. However, potential inflationary effects of such transformation should not be overestimated, since the increased liquidity would only become available over time in a controlled and rational way, on the basis of an assessment of the need for international liquidity. It should be mentioned, moreover, that any sub-

stitution scheme would avoid the potential inequity that could result from the fact that some countries might be tempted to do away with their gold on the markets in order to benefit from higher prices, thereby depressing the price at which others might find themselves obliged to use their gold for balance of payment purposes.

3. The allocation of SDRs to the General Account and to the Trust Fund would entail an allocation without a corresponding increase in the obligation to provide currency, since it would not appear meaningful for either the General Account or the Trust Fund to assume such an obligation. However, the overall reduction in the obligation to provide currency in relation with the SDRs outstanding would seemingly be relatively small; moreover, since the member countries who would relinquish gold would probably be in a position that would enable them to fulfill the obligation to provide currency, the strength of the SDR is not likely to be appreciably affected.

4. The allocation of SDRs to the Trust Fund raises the additional question on how the charges, which are payable on net cumulative allocations, would be met. In order to maintain its financial equilibrium, the Trust Fund's charges on its lendings would have to be equal to the rate of charges on SDRs, which would conflict with the role of the Trust Fund as a lender on highly concessional terms. However, different solutions could be envisaged, for instance in earmarking part of the gold profits for an interest subsidy on lending of the remainder or in utilizing to this end part of the other sources of financing of the Trust Fund.

5. Some legal problems might be involved in the drafting of withdrawal and liquidation clauses and in the assignment to the General Account of the quality of beneficiary of SDR allocation.

6. It might prove necessary to provide for the possibility of a two-step sterilization of member's gold or for successsive consolidation operations, if participation in a first-round, though successful, were not widespread enough.

7. The legal framework for the substitution mechanism should be an enabling clause in the amended Articles of agreement of the IMF. This clause has to be drafted in such way that the financing of the Trust Fund becomes possible by this technique, even if no other forms of gold substitution are envisaged at the same time. On the other hand, many countries, and among them the countries of the EEC, give great importance to the necessity to proceed simultaneously to the consolidation of reserves in national currencies if gold consolidation is envisaged. The problems related to this position have to be dealt with in the general framework of further agreements on international liquidity. This issue, the most fundamental one if a real improvement in the world monetay situation is to be achieved, is however not directly relevant for the use of a substitution mechanism in order to make one sixth or any further fraction of the Fund's gold profitable for its neediest members. A decision can be taken on this latter point, under amended Articles of Agreement, pending decisions on other types of substitution.

CONCLUDING REMARKS

The substitution scheme for gold I have presented here would contribute to achieve the following interrelated objectives:

(1) To enable the Fund to utilize the increase in value of its gold holdings to grant financial assistance to the poorest among its member countries, either directly or through other international organizations.

(2) To associate to a reasonable degree the countries that do not hold a substantial part of their reserves in the form of gold to the increase in international liquidity connected with the increase in the market price of gold.

(3) To establish a mechanism that would ensure a phasing down of the role of gold in the international monetary system while enhancing the role of the SDR, thereby increasing the volume of international liquidity that would be brought under international management.

(4) To give the Fund as well as members an opportunity to convert part or all existing gold holdings into a usable and more stable asset.

The implementation of those various objectives is tantamount to an acceptance and a strenghtening of the IMF's role as a monetary institution.

Chairman REUSS. Thank you.

Next, we will hear from Mr. Machlup.

STATEMENT OF FRITZ MACHLUP, PROFESSOR OF ECONOMICS, NEW YORK UNIVERSITY

Mr. MACHLUP. Thank you, Mr. Chairman.

Permit me first to explain a change in my affiliation. In my previous appearances before your committee, I was a professor at Princeton University. Now, I am a professor emeritus of Princeton University, and my new affiliation is New York University.

Mr. Chairman, in your invitation, you asked four questions and I think they are very pertinent questions. I answered them at length in my prepared statement. I added a fifth question, which I also considered important and to which I also devoted some space in my prepared statement.

If you permit me, I shall briefly summarize my answers to each of these five questions. Then I should like to call attention to the immediate consequences which we may expect for the gold market and other short-term matters, provided the tentative arrangements become effective.

Your first question was about the equity of the agreed scheme. My answer is that the scheme is inequitable. If gold were a nontradable commodity, a writeup of the value of that commodity in the books of the monetary authorities would not affect anybody. But, gold is a tradable commodity. And if a few of the holders of gold agree that a higher price might be paid for it, then the writing up of the price does indeed affect matters. It affects the international distribution of wealth and income.

Approximately 83 percent of the gold is held by 14 industrial countries. There are only eight countries which hold, at the official valuation, more than $1 billion worth of gold each. Their combined holdings are 80 percent of the total. No more than nine countries hold more than one-third of their reserves in gold. Their combined holdings are 69 percent of the total. However you look at it, it is a most lopsided distribution. And to allow these few countries to raise the value of their gold as a tradable asset is surely inequitable.

I fully agree with what Mr. Fowler has said about the U.S. past pronouncements or, we may say, its moral commitments. I have expressed my indignation about the agreement rather bluntly in my prepared statement. I consider the arrangement shameful, a real disgrace.

I referred to statements made, at the annual meeting, by two Governors of the International Monetary Fund. You may recognize them, even if I do not mention their names. One Governor tried to refute the complaint made by the developing countries about the inequity of the scheme, and said in effect: "What do you want? We gave you the profits made from the sale of 25 million ounces of gold." I have calculated that the profits made by the countries holding the bulk of the monetary gold, at last week's price of $140 an ounce, amount to $83 billion. The profits to be distributed to developing countries, from the gold which the IMF is to sell for their benefits, would, if $140 per ounce were to be realized, amount to $2.5 billion. The $2.5 billion may be much needed by the poor countries—but in comparison with the $83 billion appropriated by the rich countries, this payoff is frivolous.

The second Governor to whom I refer endorsed the link between the issue of SDR's and financial aid to the developing countries, he expressed great pride about the fact that his country has been endorsing such a link for several years. But, at the same time he was endorsing a proposal which may make it impossible for any SDR's to be issued in the next 10 years or so; for, with the huge gold reserves, no more SDR's will be needed. This is a kind of cynicism which ought to be exposed.

With regard to your second question, there is no doubt that the proposed arrangements would actually enhance the role of gold in the international monetary system. The share of gold in total reserves was 30 percent in December of 1971 and only 19 percent in May of 1975. If the value of gold is raised to something like $140, its share would jump up to 43 percent. These figures do not mean much as long as gold is not a liquid asset, as it has been for several years. However, in 2 years gold might become a highly liquid asset, if a group of countries agree to trade in gold with one another at relatively stable prices.

They could, for example, use the so-called double peg, a lower price at which they buy and a higher price at which they sell. Such an arrangement would reduce the risks taken by any gold holder, including the private gold speculators, and it would make gold again a highly liquid asset. This is the crux of the problem. The promise not to peg the price of gold holds only for 2 years; afterwards countries are free to do as they please.

At a value of $140 per ounce, monetary gold holdings would amount to $141 billion. Add to this the even larger holdings of foreign exchange, and you find these two reserve assets amount to over $300 billion. Compare this with the $11 billion worth of SDR's in the reserves. The SDR, supposedly the principal reserve assets, the central reserve asset, would thus amount to a minute fraction of total international reserves. This is in flagrant contradiction to everything that had been agreed upon among the countries, or their representatives, negotiating over more than 10 years.

My answer to your third question—the effects on the total supply of reserves and on prices—is implied in what I have just pointed out. The enormous increase in reserves would in time—not immediately, of course—but gradually encourage an increase in M-1 and M-2, an increase in liquid money in many, if not all, countries. And this increase would in time promote demand inflations, income inflations, and price inflations.

Now to your fourth question: What arrangements might be preferable? I do not think it would be very wise of use to go into details here, but Mr. de Groote has given us a good example of how things could be done. I have consistently endorsed the creation of a consolidation account or substitution account. And I still believe this may be the best of the possible alternatives.

One might favor, however, an arrangement under which the profits from a reevaluation of monetary gold would be used for long-term loans to reserve countries, which, in turn, would use the proceeds from these loans to buy back their own currencies now held as foreign exchange reserves by other monetary authorities. In this fashion we would prevent the total of reserves from being so radically and so drastically increased as a result of the writeup of the gold holdings.

With regard to the fifth question—the one I added to yours—let me refer to my prepared statement, where I have documented my con-

clusion that the arrangements, or tentative arrangements, constitute a betrayal of principles previously agreed. The most important of these principles is that there should be international control over total reserves. Such international control is given up by the arrangements now proposed.

Mr. Chairman, in the last few days, many people have speculated about the probable consequences of the sale, in the near future, of one-sixth of the gold holdings of the International Monetary Fund. There are two kinds of speculators: the active ones, who sell and buy in the market, and the academic ones, who merely think and talk about future developments. The active speculators have evidently concluded that gold is not worth $160 an ounce, but only $140. They feel it in the tips of their fingers. The academic speculators rely on assumptions and hypotheses, which may not prove correct, but may be interesting for the arguments put forth. Thus, let us speculate what would happen if actually one-sixth of the gold holdings of the IMF were offered for sale. It will help us to recall that 25 million ounces correspond to almost a year's output of the gold mines of South Africa.

Assume you have to rely on private buyers. Private hoarders and speculators could not possibly absorb so much gold at $140 an ounce; there just isn't that much money around. The price of gold might drop to—well, we don't know how low. If we realize that it was not so long ago—in fact, it was only in 1973—that gold for the first time went over $100 an ounce, then it would not seem so incredible if the price went far below $100 as a result of the attempt to make such sales. If there are no official purchases, large quantities of gold could be privately absorbed only by speculators believing that the price of gold would rise again before long.

Assume that private buyers are willing to acquire some of the gold; what would be the effects of such purchases? We must make a distinction between two possibilities. Do these buyers hold dollar balances or do they hold balances in their own currencies? If they hold dollar balances, this is a simple exchange. They get the gold and give their dollar balances to the IMF. And if the IMF chooses to hold the dollar balances in the same form in which the private holders have been holding them, the transactions would hardly have any effect at all on the distribution of liquidities among the various countries except that private dollar balances would be reduced.

If, on the other hand, the private buyers had been holding French francs, Swiss francs, German marks, or other nondollar balances, they would have to purchase dollars from their banks to purchase the gold; this might have deflationary effects in some of these countries, because balances previously held in national currencies would suddenly be reduced. I wonder whether any of the gentlemen who gave their blessings to the Washington agreement had enough time to think about such possibilities. Of course, any such deflationary effects could quickly be offset by credit operations of the monetary authorities; but, still, there is an interesting question of monetary policy. The main point, however, is that private buyers probably would not be able to buy much, if any, of the Fund's gold. Hence, one may have to count on official purchases if a rout in the gold market is to be avoided. Would Central Banks be willing to acquire the gold, and at what price?

Now, this raise several questions of law and of policy. If central banks can buy the gold from the IMF, do they have to pay for it in

dollars, or a few other convertible currencies, or may they pay in their own currencies? If under IMF rules domestic currencies are acceptable—which I cannot say—there may be legal questions in various countries—some might have to change their laws in order to buy gold at a market-related price. Moreover, if they buy the gold with their own currencies, some interesting consequences may follow. As the gold goes from the IMF to the national monetary authorities, a lot of national currencies would be accumulated in the IMF. And this raises the question of what the IMF would do with these currencies? Would they be treated as part of the general account? Would they be added to the currency holdings in the credit tranche of these countries or what?

I mention these possibilities only because I am convinced that very few of the experts who agreed to that arrangement had given a minute's thought to the host of technical questions that would arise.

Mr. Chairman, I hope we shall have good discussions this morning. For the sake of having more time for such discussions shall I stop now.

[The prepared statement of Mr. Machlup follows:]

PREPARED STATEMENT OF FRITZ MACHLUP

This statement has been prepared in response to the invitation from the Chairman of this Subcommittee, tendered on September 29, to examine the tentative agreement on gold of the "Interim Committee of the Board of Governors on the International Monetary System," and the complementary understanding among the Group of Ten, of August 31, 1975.

Chairman Reuss asked the following four questions: "First, are these arrangements equitable? Second, wil they tend to enhance rather than diminish the international monetary role of gold relative to other reserve assets? Third, what will be the likely impact of these arrangements on the total supply of international reserves and, possibly, on prices? Fourth, according to your own appraisal, what sort of arrangements regarding gold would have been preferable?"

I am taking the liberty of adding a fifth question, which I consider important: "Are the arrangements as proposed by the Interim Committee in conformance with the principles on which the Committee or its predecessors had agreed in previous Outlines of Reform?"

I shall undertake to answer the five questions in the order in which they were stated.

I. Are the arrangements equitable?

The answer to this question is an unqualified No. But it is not immediately obvious and, therefore, requires some explanation.

If a few nations possessed some valuable assets which were not transportable or for some reasons not salable or exchangeable, and these nations, exhibiting the assets on their balance sheets, raised the value at which they carried the assets on their books, this write-up would mean nothing with regard to the international distribution of world income, apart from purely psychological, sentimental considerations. If, however, nations undertake to raise the value of assets that are used chiefly for potential sale to other countries, and if the present distribution of these assets is the result of past political decisions and international understandings and agreements, then the revaluation may be inequitable. Such is the case regarding monetary gold.

The 14 industrial countries are holding over 83 percent of all the monetary gold; the other 114 countries included in the statistics of the International Monetary Fund are holding the remaining 17 percent. There are no more than eight out the 128 countries in the tabulation that have monetary gold worth one billion dollars or more at the present official price of $42.22 per ounce; their combined holdings, at this price, amount to $33.8 billion, or to 80 percent of the total held by the 128 countries.[1] Finally, there are only nine countries that hold more than a third of their reserves in gold; their combined holdings of gold amount of $29.1 billion at the official price or almost 69 percent of the total.[2]

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[1] The eight countries are the United States, Germany, France, Switzerland, Italy, the Netherlands, Belgium, and Portugal.

[2] The nine countries are the United States, South Africa, France, Portugal, Italy, Switzerland, the Netherlands, Belgium, and Lebanon.

What these figures tell us is that the profits from revaluing the gold accrue chiefly to a very small number of countries. And one of the underlying ideas of the agreement of August 31 is to make their gold more easily salable for foreign currency and, thus, more easily exchangeable for foreign goods.

The magnitude of the inequity, however, is exaggerated by these figures, because the profit from the proposed write-up of the gold reserves is to a large extent offset by a previous loss of interest earnings over a good many years. Holding foreign-exchange reserves yields interest, holding gold reserves does not. If countries have collected interest on their exchange reserves for many years, the cumulative earnings from this source should be considered as a partial compensation for nonparticipation in the scoop now proposed. How much this amounts to is hard to say, for it depends on the length of time for which countries have held varying portions of their reserves in foreign exchange rather than gold. But it may be said that most countries have been assuming that a scheme like the one now proposed and agreed to by the Group of Ten would never be seriously considered. Why not? Because the inequity and unreasonableness which it implies had been discussed for more than 15 years, and countries had a moral right to expect decency and understanding on the part of the men in charge of decision-making in international affairs.

The fact that the implications of an increase in the official price of gold have long been known can be documented by quoting from the writings of many economists. I find relevant quotations wtih the least trouble in my own publications. (It is lack of time more than lack of modesty which makes me refer to my own statements.) As early as 1962, in a study of *Plans for Reform of the International Monetary System*, I presented hypothetical accounts of countries holding only gold, other countries holding partly gold, partly dollar reserves, and a third group of countries holding only dollars; and I showed the consequences of an increase in the price of gold on the distribution of the resulting capital gains, and also of the possible use of the gains for converting dollars holdings into gold. In subsequent years economists have tried to devise techniques for avoiding inequitable distributions of the profits from raising the price of gold. In a testimony before the Joint Economic Committee in February 1968, I said that the United States should not agree to a scheme of writing-up the official value of gold because "it would be morally indefensible to hurt those who have helped us by carrying large dollar holdings and to reward those who have hurt us by converting them into gold." I proposed a Gold-and-Exchange Conversion Account of the IMF in which the monetary authorities of the Group of Ten were to deposit all their gold and all their foreign-exchange holdings (beyond necessary working balances) in exchange for credit balances with the Fund. Under this scheme, "neither gold nor national currencies [would] be carried as monetary reserves of the participants." The conversion of gold and reserve currencies into deposits with this "conversion account" was to be a "one-time procedure" and irreversible. (*Hearings*, Part 2, pp. 410–411.)

I had no illusions, of course, about this proposal being accepted; as a matter of fact, I suggested that we submit it as an alternative to terminating the convertibility of official dollar holdings in gold. Unfortunately, this decisive step, proposed in February 1968, was carried out only in August 1971. It would have been used in 1968 as a negotiating alternative of the gold-and-exchange conversion account.

Many other economists have proposed similar plans which would avoid the capture by a few rich countries of the lion's share of profits from writing-up the official gold holdings. One plan deserves particular mention, because it called for a doubling of the then official price of gold from $35 to $70 an ounce. I refer to the plan of Jacques Rueff, the eminent French economist. He proposed that the revaluation gain be used for purchasing dollars and pounds sterling from monetary authorities holding these currencies in their reserves. Since the gold profits of the United Kingdom and the United States would not have sufficed to buy back the pounds and dollars from the countries who had accumulated them, Rueff prescribed that all other countries holding gold would use their profits from the write-up of their gold for long-term loans to the U.K. and the U.S.; these two reserve-currency countries could then use the proceeds of the loans for retiring the pounds and dollars held by the other countries. The British and American obligations, payable over twenty years, would not qualify as reserves; the liquid liabilities of the U.K. and the U.S. would have disappeared, and only gold would be held as monetary reserves.

Most economists, including myself, objected to Rueff's plan, chiefly because we did not believe that the nations of the world would actually use their gold

profits the way Rueff proposed (but would, instead. use them as the basis of current spending and additional expansions of the money supply) and because we did not believe that the countries would be playing the classical gold-standard game (which does not permit monetary policy to be put into the service of national goals such as easy credit and full employment). But on grounds of equity the Rueff plan could not be faulted: the gold profits, invested in long-term obligations, would not give the profiting countries increased buying power in the world markets.

The inequity of the agreement of the Interim Committee appears to be quite clear to the experts of the developing countries. Their representatives "expressed concern" that the proposed arrangements for gold would give rise to a highly arbitrary distribution of new liquidity. with the bulk of gains accruing to developed countries. In the discussion at the Annual Meeting of the IMF, a governor of a developed country undertook to reply to this complaint and, as a counterargument, referred to the agreement that the developing countries would receive the profit realized from the sale of 25 million ounces of gold now held by the IMF. This counterargument misses the disproportion in the two magnitudes. The gold holdings of the 14 most-developed countries amount to approximately $36 billion at the present official valuation. Hence, the gain accruing to these 14 countries, if they were allowed to retain all of it as a net addition to their official reserves, would be about $83 billion, calculated on the basis of last week's market price of gold of $140 an ounce. To the $83 billion we may have to add the value of these countries' share in the 25 billion ounces of gold to be restituted, under the proposed or agreed arrangements, to the members which delivered gold to the IMF when they paid for the gold tranche of their quotas. The members would get this gold at the official price of $44.22 (payable in their own national currencies?). Valued at $140 an ounce, it would have a current worth of $3.5 billion. Hence, counting only the share going to the industrial countries, about $3 billion. we may put the increment in the gold holdings of these 14 countries at $86 billion. If the same market price of $140 can be attained for the other 25 billion ounces to be sold by the Fund "for the benefit of developing countries," the cash proceeds would be $3.5 billion and the profit less than $2.5 billion. This sum allotted to developing countries compares with the gain of $86 billion going to the 14 industrial countries. These 14 countries would pocket. therefore, more than 34 times the profit distributed to the developing countries directly or through a newly established trust fund.

Another governor from a developed country devoted a part of his speech to the generous support which his country has given, and will continue to give, to the proposal of linking future allocations of SDRs with development finance. One must wonder whether this governor realized that the creation of between 100 and 150 billion dollars of new liquid reserves through the revaluation of gold may for years to come saturate the need for world reserves and thereby effectively prevent further allocations of SDRs. Making a promise to link future allocations of SDRs with financial aid for developing countries. but at the same time promoting an action which may effectively block any such SDR allocations, represents a rather cruel cynicism.

The developing countries are thus disadvantaged on two scores: enormous and disproportionate increases in monetary reserves are to accrue to the rich countries. and their hopes for getting a share in future SDR allocations are practically destroyed. I submit that on these two counts my emphatic No to your question regarding equity in the new arrangements is amply supported.

II. Will the arrangements tend to enhance rather than diminish the international monetary role of gold relative to other reserve assets?

Assuming that we assess the monetary role of gold by its relative share in the total of monetary reserves. the answer cannot be other than that the new arrangements would immensely enhance the role of gold. A glance at the statistics of total monetary reserves may suffice to support this reply.

The table below presents the international monetary reserves of reporting countries for selected years from 1949 to the present. Total reserves include gold, foreign exchange. net reserve positions with the IMF. and special drawing rights with the IMF. The last column of the table shows the percentage of gold in the total of reserves.

In December 1949, gold holdings represented 73 percent of total reserves; in 1958. 66 percent; in 1968. 53 percent; in December 1971 (despite a raise of the official valuation of gold), only 30 percent; in December 1974, 20 percent; and

in May 1975, 19 percent. This continuous decline in the part of gold in monetary reserves over a period of 25 years was chiefly due to the increases in foreign-exchange holdings. Throughout the discussions of international monetary reform from 1963 to the present, it was fully understood that the monetary role of gold should decline further, though not through increases in foreign-exchange reserves but rather through allocations of a new reserve asset. The creation of this new asset, the special drawing right, was agreed upon in 1967 and came into effect in January 1970. The idea was that the SDR would become the principal reserve asset, with the roles of both gold and foreign-exchange reserves declining.

INTERNATIONAL MONETARY RESERVES OF REPORTING COUNTRIES, 1949 TO 1975 (IN BILLIONS OF DOLLARS)

			Foreign exchange						
Year	Total	Gold	Total	Owed by United Kingdom	Owed by United States	Other[1]	Net reserve position with IMF	SDR	Percent of gold to total
1949 (December)	45.5	33.1	10.8	£7.8	$3.0		1.6		73
1950	48.4	33.5	13.2	7.5	4.7	1.0	1.7		69
1958	57.7	38.0	17.1	6.0	9.6	1.5	2.6		66
1965	71.0	41.9	23.8	7.1	15.8	.9	5.4		59
1966	72.6	40.9	25.4	7.9	14.9	2.7	6.3		56
1967	74.3	39.5	29.0	8.3	18.2	2.6	5.7		53
1968	77.4	38.9	32.0	9.7	17.3	5.0	6.5		50
1969	78.3	39.1	32.4	8.9	16.0	7.5	6.7		50
1970	92.7	37.2	44.7	6.6	23.8	14.3	7.7	3.1	40
1971	130.8	[2] 39.2	78.3	7.9	50.7	19.6	6.9	[2] 6.4	30
1972	158.5	38.9	103.4	8.8	61.5	33.1	6.9	9.4	25
1973	182.9	[3] 43.2	121.6	7.8	66.8	47.0	7.4	[3] 10.6	24
1974	219.0	43.8	153.5	10.2	76.6	66.7	10.8	10.8	20
1975 (May)	228.7	44.5	160.5	10.0	79.7	70.8	12.6	11.0	19
Hypothetical	325.1	[4] 141.0	160.5	10.0	79.7	70.8	12.6	11.0	43

[1] Foreign-exchange holdings other than the liquid dollar liabilities to official foreign holders reported by the United States and the liquid sterling liabilities to official foreign holders reported by the United Kingdom consist of 2 kinds plus one correction item: (1) holdings of currencies other than dollars and pounds, (2) holdings of dollars and pounds placed in third countries (e.g., Eurodollars), and (3) discrepancies in the reports between the reserve holder and the debtor country. The large increases in foreign-exchange reserves other than dollars and pounds owed by the United States and the United Kingdom since 1968 are chiefly due to official holdings of Eurodollars and Euro-German mark.

[2] Reflects the increase in December 1971 of the official price of gold from $35 to $38 per ounce.

[3] Reflects the increase in February 1973 of the official price of gold from $38 to $42.22 per ounce.

[4] Reflects an increase in the valuation of gold from $42.22 to $140 per ounce.

Source: International Financial Statistics, International Monetary Fund, Washington, D.C. (various issues).

The agreement of the Interim Committee last August 31 stops this trend and contradicts the basic idea of the reform. If existing monetary gold stocks are written up from the present official value to a market-related price, the part of gold reserves in the total is most drastically increased. Taking the market price of last week as a basis for the calculation, we find that gold could be written up from $44.5 billion to about $141 billion. With all other reserve assets in the magnitudes shown for May 1975, the share of gold in total reserves would jump from 19 per cent to 43 per cent—a remarkable jump indeed.

So much about sheer numbers. The effect of the arrangements on the monetary role of gold is, however, greater than the numbers indicated: a qualitative change accompanies the quantitative change. During the past three years, gold has not been a liquid asset. The new arrangements may restore gold to the status of a liquid reserve, and this implies a strong enhancement in its monetary role. Let me explain this change in status.

No asset is regarded as truly liquid if its realization or liquidation, its use for payments or settlements, is expected to cause a loss to the user, either through a current fall in its dollar equivalent or through the sacrifice of a later rise. The holder of an asset hates to dispose of it when he stands to incur such a loss. Precisely this has been the situation regarding gold during the past few years. Monetary authorities have been unwilling to use gold in international transactions because they expected a loss in doing so. When a central bank was in urgent need of foreign exchange (in order to intervene in the market and thereby avoid a fall in the external value of its currency) it did not sell gold but, instead, used it as a collateral to secure a foreign loan. The case of Italy may serve as an example: at a time when gold was selling in the free market at about $170 an ounce, Italy pawned some of its official gold holdings to obtain foreign exchange, with the gold valued at $120 an ounce for this purpose. This was a

very exceptional transaction, and it shows clearly that the monetary use of gold has been confined to that of serving as a lien for a loan.

The new arrangements do not change this situation immediately but are intended to do so eventually, when, after two years of agreed "abstinence," monetary authorities may become free to intervene in the gold market in support of the price of gold. This would restore the liquidity of monetary gold reserves—which surely would substantially enhance the monetary role of gold.

The increase in the monetary role of gold implies a decrease in the role of the SDR. This reserve asset, still supposed to become the "principal" reserve asset of the reformed system, becomes a tiny, almost negligible part of total monetary reserves. In January 1970, when the first SDRs were issued, the $3 billion worth were 4.3 per cent of total reserves; a year later, when the second allocation doubled the amount issued, the relative share rose to 7.5 per cent; in January 1972, with the third and last allocation, SDRs were still only 7.3 per cent, because by then foreign-exchange reserves had much increased. By May 1975, after further accumulations of exchange reserves, the part of SDRs in total reserves had fallen to 4.8 per cent. With a write-up of gold reserves to a market price of $140 per ounce, the part of SDRs in total reserves would be reduced to 3.4 per cent, which is less than on the day of the first allocation. Exchange reserves of $160 billion and gold reserves valued at $141 billion, together more than $300 billion, would really dwarf the $11 billion worth of SDRs now in existence.

The reference, in the Communiqué of the Interim Committee, to the agreed "gradual" reduction in the monetary role of gold cannot possibly relate to the fact that gold is no longer the common denominator for fixed par values of currencies. This role lapsed automatically when the par value system was abandoned. Nor did the SDR become the "principal reserve asset" when it was made the reference point for expressing the relative values of currencies in the foreign-exchange markets. For this purpose neither a reserve asset nor any asset is needed: the number system taught in arithmetic suffices for this purpose. Any number, say, the number 1, can be the common denominator. Expressing relative currency values in terms of SDRs does not affect the status of the SDR as a reserve asset, and surely does not make it "the principal reserve asset," as had been agreed in 1973 and 1974.

The language used in the Communiqué of the Interim Committee is rather deceptive on these matters. When the Interim Committee recites its earlier "general undertaking" to "ensure that the role of gold in the international monetary system would be gradually reduced," one must wonder whether the parties to such an agreement try to kid themselves or the public.

III. What will be the likely impact of the arrangements on the total supply of international reserves and, possibly, on prices?

The impact on the total stock of monetary reserves has been described in my answer to the second question. It remains to examine the probable effects of the increase in reserves on the creation of money in the various nations, the effects of such money creation on aggregate spending, and the effects of additional spending upon prices.

The relation between official reserves and the so-called monetary base is not always an automatic one. Some highly-respected economists assume that an increase in monetary reserves will regularly be followed by an increase in the monetary base, though perhaps only in the long run, with a time lag of uncertain length. Other economists deny that any such regularity exists.

We should distinguish between two types of increase in monetary reserves: One, where the new reserves are acquired by the monetary authorities and paid for through the issue of new liquid liabilities; and the other type, where additional reserves need not to be paid for and, therefore, do not directly increase the reserve banks' liquid liabilities. In this case, the addition to monetary reserves is accompanied merely by an increase in contingent or dormant liabilities, like an increase in undistributed surplus or a blocked account of the Treasury or some other official agency. The increase of the first type results in a one-to-one increase in the monetary base and, usually, a simultaneous increase in the lending capacity of commercial banks. The reserve increase of the second type can conceivably be sterilized, either for good or for the time being. Experience has taught us that permanent sterilization is rare, and that sterilization for the time being elicits in due course political forces pressing for the use of the latent capacity to expand lending and spending. In the monetary history of the United States we have seen the rare case in which the profit

from a revaluation of gold was sterilized as an "exchanged-stabilization fund." (This was in 1934. The U.S. Treasury used most of that fund in 1945 to pay the gold tranche of our quota in the IMF.) I do not know whether history provides more such instances of monetary virtue. As a rule, a reserve increase due to a write-up of official gold holdings leads sooner or later to a policy of monetary expansion on the part of the authorities.

One possible and rather likely way in which increased gold reserves may affect the monetary policies of the countries in question is through the postponement of adjustment measures in times of deficits in the balance of payments. A dearth of reserves serves the purpose of preventing countries from postponing for too long to take adjustment measures when an excess supply of their currencies has developed in the exchange markets. Whether the adjustment measures take the form of tightening domestic credit or of letting the exchange rates of the weakened currencies decline, in either case these highly unpopular measures usually become politically feasible—at least in some countries—only when scarce reserves threaten to become depleted. Empirical evidence confirms the opinion that ample reserves tend to prolong the periods of excessively easy money and overvalued currencies.

The effects on aggregate spending and on the prices of goods and services are easily inferred from the preceding argument. Expansion of effective demand will be promoted, pressures for higher wage rates and higher material prices will not be resisted, and thus the traditional wage-price spiral will go on and on if countries have ample monetary reserves. Some economists and politicians have thought that all this is "good for full employment," but we have had now enough occasion to recognize that higher rates of inflation of demand and prices and reduced rates of employment are not disjunctive alternatives; I have called them Siamese twins.

To summarize my answer to your third question: the probability is high that the new arrangements regarding gold reserves will lead to expansions in the total supply of international reserves and in the supplies of national money in several countries, and consequently to higher rates of price inflation.

IV. What sort of arrangements regarding gold would have been preferable?

Ever since 1963, when the International Monetary Fund and the Group of Ten began to study international monetary reform, it has been almost universally recognized that any workable system would have to provide for an effective adjustment mechanism and, consequently; for a controlled increase in international monetary reserves. It was realized that the growth of reserves should be neither too fast nor too slow, and that a system securing stable growth could not allow either rising gold reserves or rising foreign-exchange reserves.

It was recognized in the late 1950's that the increase in monetary gold would be haphazard and in the increase in foreign-exchange reserves would depend on the balance of payments of reserve-currency countries. It was concluded that only a newly-created, international reserve asset could satisfy the requirement of stable growth. This was the essential purpose in the creation of SDRs, hailed by the contracting governments as the only practical solution to the problem of securing an adequate but noninflationary growth of international liquidity.

In such a system, with the SDR as the principle reserve asset, increases in gold reserves and in foreign-exchange reserves have to be strictly limited, if not definitely excluded. More radical solutions would also prescribe the gradual substitution of existing gold and currency reserves by SDRs. More moderate solutions would allow the existing gold and currency reserves to continue, but with their relative magnitude steadily declining in favor of increasing amounts of SDR reserves.

The phasing-out of gold could be achieved in several ways: through gradual sales of official gold by the national authorities in the free market; through a substitution account exchanging the gold holdings of national authorities into SDRs or similar reserve assets, with the substitution account either holding or gradually disposing of the acquired gold; a revaluation of gold held by national authorities with the entire profit being used for long-term loans to reserve-currency countries, which in turn would use the proceeds of these loans to buy back their currencies from the official holders; or any combination or variants of these schemes.

All of these or any alternative arrangements would have to meet the following requirements:

(1) to avoid inequitable appropriations of profits from gold revaluation by the countries that happen to hold the gold reserves;

(2) to prevent any of the profits from gold revaluation to inflate aggregate monetary reserves of national authorities beyond the totals (in terms of SDR) now in existence;

(3) to obviate any further expansions of reserves beyond a magnitude regarded as sufficiently "snug" to promote policies conducive to adjustment of imbalances of payments;

(4) to provide for a system in which total reserves grow at a moderate and steady rate under control by the International Monetary Fund.

V. Are the arrangements as proposed by the Interim Committee in conformance with the principles on which the Committee or its predecessors had agreed in previous Outlines of Reform?

We can find a remarkable degree of consistency in the ways certain basic principles for a reformed system were formulated by a succession of committees on international monetary reform—The Group of Ten, the Group of Twenty, the Executive Directors of the Fund, and finally the Interim Committee. This is not surprising, since all experts recognized that the Bretton Woods System had been suffering from a lack of an effective adjustment mechanism and from a lack of control over the increase in total monetary reserves.

In the following I shall reproduce relevant quotations from a sequence of committee reports, beginning with a statement released in August 1964 and ending with one of June 1975.

1. From *Ministerial Statement of the Group of Ten and Annex Prepared by Deputies*, 1st August 1964:

"5. The smooth functioning of the international monetary system depends on the avoidance of major and persistent imbalances and on the effective use of appropriate policies by national governments to correct them when they occur. The process of adjustment and the need for international liquidity are closely interrelated. (p. 4).

"If, . . . there is too much liquidity, the adjustment mechanism may function too slowly, and a delay in taking measures necessary to restore balance will in the end be harmful at home as well as abroad" (p. 5).

2. From Group of Ten, *Report of the Study Group on the Creation of Reserve Assets*, Report to the Deputies of the Group of Ten, 31st May 1965:

"150. There is a close relationship between the volume of reserves and the functioning of the adjustment process. Generally speaking, if international reserves are plentiful, countries will be prepared to draw them down, and will react slowly to any deficit" (p. 69).

"153(b). Too liberal use of this means of reserve creation would tend to weaken the incentive for countries to take measures to restore equilibrium in their balance of payments, with the risk of inflationary consequences" (p. 71).

"159(a). Distribution of newly-created C.R.U.s among countries in proportion to gold reserves would be inequitable" (p. 75).

"(e) . . . would represent a disguised increase in the gold price for the countries concerned" (p. 76).

3. From Group of Ten, *Communiqué of Ministers and Governors* and *Report of Deputies*, 25th and 26th July 1966:

"Deliberate reserve creation . . . should take place on the basis of a collective judgment of the reserve needs of the world as a whole" (p. ii).

"8. We are conscious that deliberate creation of new reserve assets represents a bold venture. The possibilities are numerous, the pitfalls are substantial and the consequences weighty" (p. 3).

"13. . . . We have recognized that the supply of international reserves has a bearing on the functioning of the adjustment process. Indeed, in assessing the need for reserves, this relationship is highly relevant" (p. 4).

"38. . . . an excessive supply of reserve assets may weaken the constraints on domestic monetary economic policies and thereby contribute both to inflationary pressures and to persistent payments imbalances. The supply of reserves should therefore be such as to promote a proper functioning of the adjustment process" (p. 8).

4. From *Reform of the International Monetary System: A Report by the Executive Directors to the Board of Governors*, 18th August 1972:

"Any approach involving an increase in the official price of gold is, however, strongly opposed by all those who argue that it would undo the progress made

so far toward a rational monetary system, undermine the SDR facility, and be highly inequitable among members. They do not believe that the potentially serious inflationary and distributional consequences of such an increase could effectively be overcome. . . . To the extent it was considered desirable to reduce the spread between the two prices, the action required would in their view consist of measures to bring down the price in the private market, which would call for the sale of monetary gold into that market, perhaps in substantial amounts. While this could be done by the major gold-holding countries individually or collectively for their own account, it might be desirable for such sales to be organized through the Fund, acting as an agent for all members wishing to participate. Alternatively, the Fund might on its own account sell either gold from the General Account or gold acquired in exchange for newly issued SDRs through a reserve substitution facility: these two last-mentioned arrangements would require an amendment to the Articles of Agreement" (p. 36).

5. From *Communiqué of Committee of Twenty*, 27th March 1973:

"4.(b) There should be better international management of global liquidity. The role of reserve currencies should be reduced and the SDR should become the principal reserve asset of the reformed system."

6. From *First Outline of Reform*, forwarded to the Board of Governors under cover of *Report from Committee of Twenty*, 24th September 1973:

"1. . . . The main features of the international monetary reform should include:

> "(d) better international management of global liquidity, with the SDR becoming the principal reserve asset and the role of gold and of reserve currencies being reduced."
>
> "3. . . . Countries should direct their policies to keeping their official reserves within limits which would be internationally agreed from time to time in the Fund and which would be consistent with the volume of global liquidity."

7. From *Report of Technical Group on Global Liquidity and Consolidation* to Committee on Reform of The International Monetary Issues (Committee of Twenty), 7th March 1974. Quoted from *International Monetary Reform: Documents of the Committee of Twenty:*

"4. . . . it was stressed that the question of the volume of global reserves could not be separated from the valuation and usability of existing reserve assets, in particular gold. It was pointed out that official purchases of gold at prices above the official level are contrary to the Fund's present Articles. Strong concern was expressed by many participants that, quite apart from the effects of any future actions that might be taken, the decision to terminate the 1968 agreement, under which certain countries refrained from selling gold on the free market, might lead to a higher valuation being put on gold holdings. In the view of many participants, including the representaives of the less developed countries, the resulting increase in global reserves would be highly arbitrary and inequitable; not only would it exacerbate what they regarded as the existing maldistribution of reserves, but it would also postpone indefinitely the possibility of further allocations of SDRs and the time when the objective of making the SDR the principal reserve asset of the international monetary system could be realized" (p. 163).

"9. . . . Some participants pointed out that most countries had accepted that an increased role for the SDR required a reduction in the role of gold as well as of currency balances, and that, while the Group's discussion had focused on the reserve currency aspect, the agreed objective for the SDR would not be attained if the role of gold was not also reduced" (p. 166).

"29. . . . These uncoordinated methods of generating international liquidity had created reserves in amounts far in excess of the volume of SDR creation, thus sustaining inflationary pressures and making it impossible for the international community to increase global reserves at an agreed rate and in a manner that distributed increases more equitably than had been the case in recent years" (p. 176).

8. From *Communique of Committee of Twenty*, 13th June 1974:

"6.(a) The Committee . . . recommends that the Fund should assess global reserves and take decisions on the allocation and cancellations of SDRs . . . and should periodically review the aggregate volume of official currency holding . . . and, if they are judged to show an excessive increase, should consider with the countries concerned what steps might be taken to secure an orderly reduction.

"(b) The Committee further recommends that the Fund should give consideration to substitution arrangements.

"(c) Finally, the Committee recommends that there should be further international study in the Fund of arrangements for gold in the light of the agreed objectives of the reform."

9. From *Outline of Reform*, forwarded to the Board of Governors under cover of *Report from Committee of Twenty*, 14th June 1974:

"2. The main features of the international monetary reform will include:

"(d) better international management of global liquidity, with the SDR becoming the principal reserve asset and the role of gold and of reserve currencies being reduced;"

"4. There will be a better working of the adjustment process . . . To this end:

* * * * * * *

"(b) Countries will aim to keep their official reserves within limits which will be internationally agreed from time to time in the Fund and which will be consistent with the volume of global liquidity."

"24. The SDR will become the principal reserve asset and the role of gold and of reserve currencies will be reduced. The SDR will also be the numeraire in terms of which par values will be expressed."

"25. As part of the better international management of global liquidity, the Fund will allocate and cancel SDRs so as to ensure that the volume of global reserves is adequate and is consistent with the proper functioning of the adjustment and settlement systems."

"28. Appropriate arrangements will be made for gold in the reformed system, in the light of the agreed objectives that the SDR should become the principal reserve asset and that the role of gold should be reduced."

10. From *Communiqué on the Third Meeting of Interim Committee*, 10th and 11th June 1975:

"4. The Committee held a detailed discussion of the role of gold and there was widespread agreement that a solution would have to be based on the following broad principles:

"(i) The objective should be an enhancement in the role of the SDR as the central asset in the international monetary system and, consequently, a reduction of the role of gold.

"(vi) A reasonable formula should be found for understandings on transactions by monetary authorities with each other and in the market, which would include understandings that would be designed to avoid the re-establishment of an official price and would deal with the volume of gold held by monetary authorities."

"The Executive Directors should study the establishment of a gold substitution account through which members would be able to exchange a part or all of their gold holdings for SDRs issued by the Fund for this purpose."

These excerpts from ten documents embodying the recommendations of the official committees established to formulate the principles of reforming the international monetary system were addressing the closely interrelated problems of adjustment and monetary reserves. The principles which they laid down are clear and need no summary or commentary.

Equally clear is the answer to the question whether the gold arrangements proposed by the Interim Committee on August 31, 1975 are in conformance with the principles of reform previously outlined. They do not conform with, but flagrantly disregard or contradict these principles. Perhaps even blunter language is justified: they betray the principles of the reform of the international monetary system that had been hammered out in arduous discussions over a period of twelve years.

Chairman Reuss. Thank you. Next, Mr. McKinnon.

STATEMENT OF RONALD I. McKINNON, PROFESSOR OF ECONOMICS, STANFORD UNIVERSITY

Mr. McKinnon. Thank you, Mr. Chairman.

My name is Ronald McKinnon. I am a professor of international economics at Stanford University, I have a prepared statement entitled "Gold Demonetization and the Link to Less Developed Countries." I

will submit that to you, but with your permission not read it. I will simply comment informally on each of your three basic questions, namely: Will the international role of gold be enhanced or diminished? Will there be global inflation? And are the arrangements equitable vis-a-vis less developed countries?

When I heard that Fritz Machlup was going to be on the same program, and having learned much of my international finance at his knee, I was quite worried that we were going to present the same paper. But, after listening to him right now, and listening to Mr. Fowler and Mr. de Groote, I realize my submission is quite different from the others. It is different in the overall respect that I sympathize, more or less, with the thrust of what the IMF is trying to do. Although I differ in detail with some of the recommendations, my views are much more in accord with the Fund's position.

Let me start off with the issue of demonetization. The question is, are we going to reduce the role of gold as a monetary asset, as a kind of international money in the system? And I would submit this means treating gold as any other metal, like copper, silver, or zinc. Thus, I would abolish the official price of gold as a necessary condition for such demonetization, since we don't try to peg the price of other metals. I would also allow free trade among central banks in gold as well as other metals because this freedom to transact at competitively determined market prices is for the long-range demonetization and the eventual official dishoarding of gold.

But, what is a little confusing in the demonetization process is that the short-run effect of the IMF's proposal is different from the long-run effect. The short-run effect is simply one of unfreezing heretofore unusable gold hoards, unusable because they had been priced below the market level. The immediate effect would allow deficit countries, particularly industrial countries with significant gold stocks, to utilize the gold to cover those deficits if they so wished. So in this immediate sense, there will be an increased monetary role for gold. But, we don't have to look more than 1 or 2 years hence, before gold begins to lose its luster.

How competitive and stable will gold look eventually as a store value, as a kind of money, relative to national currencies once we allow this price to vary freely in the open market? The question is whether or not gold will retain its luster as a monetary asset. And that question depends not so much on events directly associated with the market for gold, although they are important, but rather on how national fiat moneys, national currencies—are managed, and in particular how the U.S. dollar is managed.

Now, suppose that the Federal Reserve Bank is fairly conservative in the rate of monetary expansion so that the rate of inflation in the dollar prices of goods and services is moderate. At the same time, suppose we further provide the world with attractive dollar assets, such as demand deposits, certificates of deposits, savings deposits, treasury bills, and so on that are not circumscribed by interest ceilings such as regulation Q. Under these circumstances of low or moderate inflation and free rates of interest, fiat moneys like dollars will be very attractive relative to gold.

And in this respect, we are very fortunate in having the Eurocurrency system, which is a totally unregulated off-shore market in

national currencies bearing very attractive interest yields and high liquidity. With this amount of freedom in the system, possibly enhanced by removing interest rate restrictions in this country arising out of the recommendations of the Hunt Commission, and with moderate management by the Fed, I would submit that the dollar will eventually be more competitive with gold. It need not be very long before gold is relegated to the status of other industrial metals.

In this respect then, I am fairly optimistic. But, if the national currencies are managed badly, if we suffer high and variable inflation, people will naturally move away from paper money. They will seek out commodities money, even though it is socially very costly for them to do so. And if it won't be gold, then it will be some other kind of commodity.

OK, let me be an optimist then, and suppose that paper moneys are managed adequately so thaat gold demonetization is a real prospect. We would then expect a significant amount of dishoarding of gold from official and private stocks. Particularly at the present time when central banks have suddenly valued upwards their gold assets very sharply, so that they are three or four times as great as they were, you might say they suffer from a kind of portfolio imbalance: that the value of their gold reserves relative to foreign exchange and other assets is now very high. Hence they may wish to protect themselves against a future fall in the price of gold by unloading. This then brings up the question of global inflation arising out of the freeing of the official price and unrestricted sales by central banks. Would this be inflationary? And my answer is a very cautious no.

The basic reason is that the price of gold is free to fluctuate. If any central bank with a significant gold stock tried to sell it, we would get an inflation of a kind, but it would be an inflation in gold prices, not dollar prices. Gold prices of commodities would rise and the price of gold in dollar terms would fall sharply. But this very fall in the price of gold would reduce the purchasing power of the holders of gold and would really limit the effective demand for real goods and services that they can exercise from these gold stocks. Thus, the free market price provides a very valuable insulating device to prevent any significant inflatonary effect coming out of the dishoarding process.

Now, the outcome would be very different and would be inflationary if the IMF Committee had, in fact, tried to peg the price of gold at $140 an ounce or so. Then we wouldn't have the safety valve of the downward floating price. People could dishoard gold and they wouldn't force the gold price down in dollar terms, and they would better maintain their purchasing power. Such dishoarding would now be more inflationary in terms of goods and services. But, as long as we have a flexible market price, then gold simply has book value that cannot be exercised effectively.

I would just mention parenthetically that the IMF Agreement allowing free trade among central banks simply recognizes the inevitable; we are moving to that anyway and they are simply formalizing it. Already many loans have been made between central banks using gold as collateral at the open market price. And if the IMF didn't put its formal seal of approval on central banks so using gold, we would have a more disorganized extralegal system.

Let me then come to the third big issue and that is the concern with equity. On the surface, the IMF proposal seems highly inequitable. Here we have these very rich industrial countries with huge gold stocks writing up their bookkeeping value by a factor of four, and then we have this one-sixth IMF distribution back mainly to the wealthy countries at a very low price of $42.22, and finally this very small tidbit, which is being given to the Third World, to the poorest countries, amounting to the profits from another one-sixth of the IMF's holdings. Appearances to the contrary, this does not constitute a bonanza for the major industrial countries. They, in fact, cannot exercise this purchasing power as we have seen.

You remember Adam Smith's criticism of the mercantilists? The mercantilists confused gold with real wealth in looking at a nation's balance sheet. Well, one shouldn't look at the large stocks of highly liquid gold in the portfolios of major industrial countries as something that can be effectively exercised to buy goods and services. If anyone tries to do it, the monetary value of those stocks will simply disappear. Although it seems inequitable, in fact, the industrial countries are not getting real goods and services net as the result of this proposed distribution.

The second aspect of the equity issue hinges on the one-sixth that is given to the less developed countries. Now, it is probably possible, given the state of the private market in gold even when central banks are not allowed to participate, for the market to absorb a certain limited amount of gold so that there are significant net proceeds from such sales. However, there is probably an optimum amount of gold to give to less developed countries in order to maximize the profits or proceeds from the gold sales. And perhaps the one-sixth that the interim committee hit upon is close to the optimum. I, myself, am not sure. But, we have already seen a significant fall in the price, as the result of the tentative agreement.

But a paradox exists. Suppose the interim committee had decided to be much more generous to less developed countries and said, "Why don't we give them half of the IMF's gold." In that case, the fall in the open market price would have been much more precipitous. The flow of real goods and services, which the less developed countries can acquire could be substantially less if the IMF were to give them half of the gold as compared to giving them just one-sixth. Thus, it may turn out by luck probably more than design that the one-sixth is close to that amount of gold that can be sold off so as to maximize the proceeds available for less developed countries. So they are getting something, although probably not as much as we would like. But to give them more, would require tax financing through regular budgetary channels rather than taxing international monetary assets.

The only quibble I have with the interim agreement—and this is a fairly minor quibble—is with the provision to give back one-sixth to fund members on a pro rata basis, which mainly means giving it back to the industrial countries. There doesn't seem to be any great rationale for this. However, I think that the industrial countries will simply add this gold to their basically unutilizable hoards, so that this distribution doesn't matter too much one way or the other.

Thank you.

[The prepared statement of Mr. McKinnon follows:]

Prepared Statement of Ronald I. McKinnon

Gold Demonetization and the Link to Less Developed Countries

On August 31, 1975, an Interim Committee of the Board of Governors of the International Monetary Fund agreed to a set of proposals designed to reduce the role of gold in the international monetary systems and to distribute profits from the open-market sale of some of the IMF's gold to less developed countries (LDCs). These agreements remain to be formalized by the Board of Governors of the IMF, possibly in January of 1976, and to be ratified by member governments. The new plan follows a tradition within the IMF of attempting to link international monetary reforms—such as the creation of Special Drawing Rights (SDRs)—to the provision of finance and largesse for poor countries.

I shall comment first on the overall monetary impact of these new arrangements and whether or not demonetization is the likely outcome; then I shall analyze the link between successful demonetization of gold and aid to LDCs.

AN ENHANCED OR DIMINISHED ROLE FOR GOLD?

The main provisions of the tentative agreement are:

(i) abolition of any official price for gold;

(ii) eliminate gold in all transactions of member countries with the IMF;

(iii) distribute one-sixth of the IMF's gold to the original contributing countries at the official price of $42.22 per ounce;

(iv) sell a further one-sixth on the open market and distribute any "profits" above $42.22 to LDCs through a trust fund, the nature of which is yet to be determined; and

(v) allow free exchange of gold among central banks at the open-market price, with a temporary (two year) proviso that the "Group of Ten" countries collectively not increase their gold stock beyond existing levels plus the one-third sold by the IMF.

On the question of reducing the role of gold within the international monetary system, there is a discrepancy between the immediate impact of the agreement and its likely long-run consequences.

If the old official price of $42.22 per ounce is imposed on transactions between central banks, and if authorities in the industrial economies feel constrained by prior agreements not to buy and sell gold as a matter of course in the private market, then a huge volume of official gold hoards is effectively frozen. Industrial countries are loathe to use such undervalued gold to cover temporary deficits in their balance of international payments. Hence their gold reserves do not serve as liquid assets—international money.

Once the official price is abolished, however, and trade among central banks can take place at say, $140 per ounce, then official reserves are unfrozen and may well be traded more actively. Insofar as the IMF unfreezes one-third of its gold stock as well, the role of gold in the international monetary system is further enhanced in the *short run.*

However, what happens to the monetary role of gold in the long run—say, in more than a year or two—can be a quite different story. The termination of official attempts to peg the price of gold in terms of national currencies—whether American dollars or French francs—is a precondition for eventual demonetization: the treatment of gold as if it were any other metal. Moreover, it is impractical either to destroy existing official gold hoards or permanently enjoin individual national central banks from dealing in the yellow metal. Permitting free trade in official as well as private gold holdings simply reflects what is likely to happen in the absence of any such agreement, and what already exists de facto in markets for other metals. I believe that the ending of official pegging and free trade in national gold reserves stands a good chance of inducing demonetization in the not-too-distant future; hence I support points (i), (ii) and (v), above in the IMF agreement.

Once official gold is unleashed into a free open market, the decisive consideration in whether it will become "demonetized" resides not so much in the market for gold itself, but in the market for national currencies—particularly U.S. dollars—vis-a-vis goods and services. In other words, if high and unstable price inflation—say, as measured by movements in consumer price indices—continued in the major convertible-currency countries of the OECD, governments as well as individuals will seek out some commodity "money"—gold or more compre-

hensive commodity hoards—as a more stable store of value. Movements out of socially costless paper money into socially costly commodity money would be further accentuated if authorities peg nominal rates of interest on, say, U.S. dollar assets. Low ceiling rates of interest on savings deposits, certificates of deposit, even demand deposits, treasury bills, and so on in the face of substantial price inflation erode the attractiveness of national currencies vis-a-vis gold and other commodities. And the attempt to demonetize gold could well fail on this account.

However, I am more optimistic regarding the future attractiveness of interest-bearing dollar assets (and those denominated in many other convertible currencies) in being superior to gold and other metals as a monetary store of value. Much depends on the future policies of the Federal Reserve Bank. If the Fed convincingly maintains a tight rein on the expansion of the dollar money supply in the United States, thus throwing out a strong signal that one can expect future price inflation in dollar terms to be more moderate, this will reduce the perceived usefulness of gold as a monetary store of value. Liberalization of interest rate restrictions within the United States in implementing the recommendations of the Hunt Commission report would help further. Most fortunately at the present time, the huge unregulated eurocurrency (eurodollar) market provides liquid financial assets whose interest rates are competitively determined. Hence euro deposits in American dollars and other currencies provide attractive stores of value—for some national central banks[1] as well as private firms—that are competitive with gold and other metals.

After all, gold is an inert non-interest-bearing asset whose value can be quite unstable (as we have observed recently) if not pegged by governments. Hence only moderately good management of fiat (paper) monies should be sufficient to transmute gold into an ordinary industrial metal.

In summary, I would expect the monetary role of official gold to be enhanced in the very near future as a result of the IMF agreements, but the longer run and dominant effect will be to diminish the international monetary role of gold.

THE PRICE OF GOLD AND WORLD INFLATION

If the dominant effect of the IMF agreement is toward demonetization of gold, and if this trend is perceived as such in financial markets even before the agreement is finally ratified, substantial downward pressure on the price of gold would result. Although world production of newly mined gold (inclusive of Russian output) is hard to calculate, the current flow of production and industrial usage is very, very small relative to existing monetary stocks—both official and private. Hence, the dishoarding of existing monetary stocks could well drive the price down, for a period of 10 to 20 years, below the mining costs of supplying industrial needs. In this period, therefore, the open-market price of gold will be completely dominated by how people and governments view its usefulness as a monetary asset.

And how will governments likely behave under the new IMF scheme? At the end of 1973, most official gold reserves were still effectively frozen at the old price of $42.22 per ounce; official gold stocks were valued at about 49 billions SDR[2] out of total official exchange reserves of about 150 billion SDR. Gold was about 26 percent of the total. The years 1974 and 1975 have been transition years in the unfreezing process. However, if one now values official gold reserves at, say, $140 per ounce, then gold amounts to 126 billion SDR: 48 percent of official exchange reserves of all kinds. Although industrial countries with convertible currencies have been traditionally very slow to alter their portfolios of reserve assets, their gold holdings may now appear "excessive" if future demonetization seems likely. Some may dishoard whereas the remainder will, at least, be unwilling buyers.

Into this world of reluctant official buyers, we then superimpose the international distribution of one-third of the IMF gold—about 6 or 7 billion SDR (dollars) at current prices—points (iii) and (iv) above. Of this, 3 to 3½ billion or so is to be auctioned in the open market with any "profits" accruing to less developed countries. The greater these open-market sales, the sharper will be downward pressure on current gold prices. Even though the agreement has not been formally ratified and sale of IMF gold have yet to take place, the

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[1] Apart from those OECD countries who are party to the 1971 agreement not to hold official reserves in the form of eurocurrencies.

[2] See IMF *Survey*, Aug. 25, 1975, p. 246. One SDR is approximately equal to one dollar.

prospect itself has been an important factor in the recent fall in the world prices of gold.

Are this proposed new distribution of gold, and sharp upward revaluation of old gold stocks of the OECD countries, likely to exacerbate worldwide inflation because they add to the international stock of "money"?

Surprisingly, I submit that the answer is a cautious "no". In order to be "inflationary" in the sense of driving up the prices of goods and services in *dollar* terms, there must be a significant attempt to dishoard existing gold stocks. But any such large-scale attempt will be cushioned by a sharp fall in the dollar price of gold that reduces the effective purchasing power of the owners of gold. Indeed, this fall in purchasing power may even occur before any sales of gold are actually consummated—as we have seen from recent speculation in the gold market over an IMF agreement not yet concluded. The variable price of gold acts as an important safety valve in *confining inflation to the gold prices of goods and services* and hence insulates the dollar prices of goods and services from inflationary pressure.

On the other hand, if the IMF interim committee had unwisely chosen to peg the price of gold in terms of a "cocktail" of convertible national currencies at, say, $140 SDR (dollars) per ounce, and then allowed free dishoarding, such a system would have been highly inflationary. The purchasing power of the owners of gold would be maintained even as they dishoarded to acquire real goods and services. The fixed high price of gold would then have exacerbated price inflation measured in national currencies, and contributed further to the debasement of the dollar, franc, guilder, and so forth. Fortunately, the interim committee chose wisely to allow the price of gold to be market determined, and so defused much of the inflationary potential from the demonetization process.

AID TO LESS DEVELOPED COUNTRIES AND DEMONETIZATION

One might well be concerned with the *equity* of IMF interim agreement. After all, it appears as if industrial countries are achieving a sharp upward valuation of their own gold stocks and receiving one-sixth of the IMF's gold at a low $42.22 price; whereas LDCs are merely receiving the profit on an additional one-sixth. Should the demonetization process not be directed more toward favoring the world's poorest countries?

I would submit, however, that the worthy demonetization objective is itself in conflict with the idealistic notion of transferring resources to the poorest countries. The more successful the demonetization program, the more the international price of gold will be forced down and the less will be the profits from sales of IMF gold. Equity considerations are not as important as they might first seem.

Although the gold hoards of the industrial countries may be valued upwards in an accounting sense, they really don't have the option of collectively dishoarding on a significant scale without driving down the open-market price of gold and thus diminishing the value of their own gold reserves. Hence, the mere accounting revaluation of reserve assets does not, from a collective point of view, increase the command over real goods and services of the major industrial countries because they dominate the market for gold. The industrial countries are not receiving the bonanza it might seem at first sight.

On the other hand, the non-oil-producing LDCs are likely to be a much smaller factor in the gold market. And some limited sales by (for) them may be possible without precipitously driving down the price of gold. Hence relatively modest distributions of the IMF's gold to LDCs, as has been proposed by the Interim Committee, may succeed in transferring a one or two billion dollars in real resources to needy countries.

Paradoxically, the real resources transferred to the LDC's may actually *decline* if they are given a more generous gold allotment! Suppose, for example, the Interim Committee had decided to sell off half the IMF's gold in the open market, with the profits (sales at prices about $42.22 per ounce) put at the uninhibited disposal of the poorest LDCs. This could well cause the price of gold to fall so sharply that the profits available for LDCs are actually less than they would be under their one-sixth allotment. The private market is simply not robust enough to withstand very large sales of official gold. The amount of gold that can be deliberately sold off to maximize official "profits" is probably quite small—and perhaps the Interim Committee's guess of one-sixth is as good as anybody's.

Given the temporary and modest nature of the "profits" from officials IMF gold sales, my own preference would be to have these profits simply added to the oil facility of the IMF without creating a whole new trust fund.

SUMMARY OF CONCLUSIONS

(1) Whereas the Interim IMF Agreement may have the immediate effect of making official reserves of gold available for monetary use, the long run and likely dominant effect is toward demonetization with gold becoming a more purely industrial metal.

(2) As long as the price of gold is market determined, the revaluation of official exchange reserves and new gold distributions should not exacerbate global inflation.

(3) Given the demonetization objective, only relatively modest amounts of real resources can be transferred to poor countries by selling off IMF gold. It is not clear that the IMF's present proposals are "inequitable."

Chairman REUSS. Thank you. And next, Mr. Wilde.

STATEMENT OF FRAZAR B. WILDE, CHAIRMAN EMERITUS, CONNECTICUT GENERAL LIFE INSURANCE CO.

Mr. WILDE. Mr. Chairman and gentlemen, my name is Frazar B. Wilde. I used to be connected directly with an insurance company, which means a large exposure to handling money and the relationship of that money to the economy. Today, I want to try to answer, partly indirectly and partly directly, the very pertinent questions the chairman has brought before us, namely, the treatment of gold in the International Monetary Fund and the future of gold in the world economy. It raises many questions.

We have, in our Secretary of the Treasury, Mr. Simon, an especially able official in that office, and I respect his judgment. But when it comes to the matter of refunding the gold in the International Monetary Fund to the original subscribers or to its conversion to other uses, I am compelled to raise what seem to me to be relevant and important questions.

In the late 1960's, the new SDR reserve asset was developed, with the first actual distribution taking place on January 1, 1970. May I interject at this point the recognition that the chairman and Secretary Fowler and Secretary Dillon were all participants in that very valuable contribution. I was a minor participant, so I know how well they worked on what to me ought to be, for the future, a useful contribution to the world order. It was intended to contribute to more orderly growth in world reserves and a more stable exchange market. The SDR was a substitute for reserve currency and fixed-price gold reserves. Many feared that the value of gold reserves would not keep pace with the needs of world trade and finance.

Since 1970, the Bretton Woods system has not worked effectively, not necessarily because of the failure of its terms, but because of the failure of countries to use it properly. The world exchange markets have been largely operated on a so-called floating exchange basis. This is a floating exchange system that has not been free, but heavily manipulated by the different countries as they saw best and in their own interests.

In the paper this morning there is an announcement that the Japanese have spent $100 million of American dollars to prevent the American dollar rising.

Now, the floating exchange system has apparently worked rather well on net balance, but that is because of relatively good conduct on the part of many countries. We should not go into a beggar neighbor

program, which happened after 1931. But on the other hand, the idea that it has worked entirely well is, in my judgment, a debatable one. We have had very serious losses in commercial transactions. And let us not forget that with the American dollar, after two devaluations selling at 10 to 20 percent discount, foreigners have been able to buy our assets at this discount. If they want to buy United States Steel or if they want to buy a forest, they can get a very handsome discount. We, in turn, pay the full price for foreign oil, which they buy at a discount. In fact, it has been alleged that one of the reasons for the last 10-percent increase in foreign oil is because that while our dollar has depreciated, most of the dollars we paid them were below the values originally estimated.

So, it is the judgment of many that we ought to return to a more stable, but not necessarily fixed, foreign exchange system, if our country and the world are to enjoy maximum real growth without inflation. Since the new monetary and exchange system have not yet been developed, the amount of reserves necessary to support the system or the role of gold, if any, in the system cannot be determined. Gold may play a significant part in the future system.

Historically, gold has been involved both in national monetary measures and in international trade. As a result, it is deeply imbedded in the traditions and practices of individuals and countries.

We were obliged to eliminate its place in our domestic economy because we were not willing to accept its discipline. This point of view was made strongly many years ago by a famous candidate for the Presidency, William Jennings Byran, in 1896, who said we could no longer be crucified on a cross of gold. We did not, however, abandon its role in domestic transactions until 1932, and then we still contained a proportionate gold reserve. It took 36 years to get gold out of our system.

Because of this world history and tradition, we can have no assurances that a new plan to regulate international currency matters will not return to some insistence on the use of gold, at least in part, as an international reserve. Countries and civilizations have moved away from gold in the past only to return to it in some form at a later date. Furthermore, any conference on international currency matters must merge the different interests and approaches of diverse nations, cultures, and economic systems, and find the common denominators upon which all can agree to operate. The history of gold in peace and war suggests that its abandonment as a reserve by the IMF before a new system is developed may be premature.

America no longer speaks with the same authority as in former days. A new plan can, and probably should, be developed without the use of gold, but it will not be easy, and it is not before us as yet.

There are pedestrian reasons to retain gold supply within our own country and control. Gold is an especially valuable metal in modern technology. The total usage is not large, but it may increase. It is the best known metal for sophisticated use in highly technical miniature machinery and electronics because it resists corrosion almost entirely. Its use in jewelry and in the arts is significant. The concept of gold as value is deeply embedded even in our sophisticated society. Today there are still people who believe in formal marriage and gold wedding rings. Since the supply of gold in our own country does not increase

to any significant extent, we ought to keep what we have for specific uses now known, or which may develop.

The proposal for the elimination of gold as a part of international reserves raises questions which are full of contradictions. If the central banks can buy and sell gold, it is quite likely that gold will become a more active speculative commodity. Instead of being eliminated as the basis of foreign reserves and a stabilizing influence in the exchange system, the fluctuations of currencies relative to each other and to gold can enhance gold and deny the overall project which our country supports of eliminating gold as a basis of a new international plan. It can also have an impact on the international problem of inflation. The gold distribution can act in a deflationary manner in some countries, particularly in those countries which this proposal is thought to help. Any poor country with a history of gold hoarding is liable to be hurt more than helped by this proposal.

If there is one thing that both domestically and internationally we need to solve, it is the overall question of establishing price stability. While we all realize that absolute stability is unattainable even if we follow the Russian route, we do want a relatively free system to do everything possible to maintain steady growth with relatively stabilized prices. The present price chaos arising only in small part from the incredible increases in energy costs will be partially mitigated if we show the courage to use rational measures both of conservation and increased supply. But our country and the world economy cannot be stable in price and growth if we increase monetary reserves in the world by such figures as maybe four times, which has happened. The unregulated growth of world reserves and the distribution of reserves without regard to production can only lead to inflation and instability.

A basic question is raised under the proposal before us today, that a portion of our gold refund would be allocated to underdeveloped countries. We have a great interest in the third and fourth level nations of the world, and properly we would like to help them in every way we can. But, the subject is a large one and very complicated. The amount of aid which America is asked to share with these countries is very large. Some of the figures that have been suggested are staggering. While the allocation of the increase in value of our gold deposit to these countries might be helpful in the short run, because of the fundamental nature of the subject and its magnitude, it seems only proper that all of our aid be made directly as a result of congressional debate.

Frustration among developing countries over their unstable commodity earnings and over the reluctance of developed countries to appropriate what are believed to be adequate development funds, has caused the developing countries to seek alternatives for bypassing this Congress and other legislative bodies. We deposited a portion or our national savings in the IMF in the form of gold and currencies to contribute to a world transaction and exchange system. The World Bank and the IDA rather than the IMF, were established as development agencies. To transfer and convert the increase in value of assets, which we contributed, from a transaction and exchange system to a foreign aid program by executive agreement seems to bypass the constitutional prerogatives of this Congress to control our domestic monetary system and to appropriate and authorize the spending of our national resources. Our share in that distribution to developing coun-

tries would be approximately $500 million, a larger sum than many of the disputed sums before the new Budget Committee. The final determination and appropriation in the case of AID programs should come from Congress. The present project would appear to be a simplified version of finding some money you didn't know you had and giving it to the first charity that seems worthy to you. Foreign aid to me is too big a subject and too important to be treated in any way except by the full legislative process and by careful, very thorough consideration.

In summary, my position is that we should not support the present plan to refund a portion of the gold in the International Monetary Fund. We should accelerate our efforts to reestablish an interational foreign exchange system and carefully review the international political need for gold in that system. We should review new proposals for their possible impact on growth and price stability in this country and in the world at large. We should review all aspects of our direct and indirect foreign aid programs, including a review of the appropriateness of transferring funds authorized for one purpose to another purpose. And, finally, before we agree to strip the IMF of its gold reserves, we should be certain that it can function in a constructive and noninflationary manner without them.

Thank you for your consideration.

Chairman REUSS. Thank you very much, Mr. Wilde. I want to thank the entire panel for an extraordinary contribution. As has been pointed out, we in Congress ultimately have to act on any agreement to amend the IMF articles that the administration in power brings back to us. Therefore, it has been the general view of our committee that to the extent that we may give advice beforehand on what kind of agreement we would be disposed to ratify and what kind we wouldn't, it is our duty to speak out so that the administration is not stopped or even entrapped because of our silence. That is why we are having the hearing this morning. Even though the IMF interim committee made what it termed an agreement on August 31, there is a place of repentance; namely, its meeting again in January. So, if we can head them off before they do something rash, which would cause us to have to repudiate them later, now is the time to do it.

Bearing in mind that it is probably impossible for the world money authorities to answer every question in an agreement early next year, or even to answer in a considerable number of questions, would you not agree that there are certain things which they should not do?

Let me see if I can distill out of the testimony of Mr. Fowler and Mr. Machlup, and to some extent Mr. de Groote and Mr. Wilde, a consensus on that. What the IMF interim committee has tentatively done on new quotas and on the elimination of the gold tranche seems to me good. We ought to give them a pat on the back and tell them to go ahead. We will be in ratifying mood if they bring that back, unless other participants turn out to be dogs-in-the-manger and will not agree to the little that is good, because we fail to agree to the great mass that is bad. So we can then expect something on quotas.

Everyone here is for our passing favorable judgment on the good work done by the negotiators on the two aspects of quotas: namely, the new numbers and the leaching out of gold from the gold tranche Is that correct?

Mr. DE GROOTE. Yes.

Chairman REUSS. Fine. One hates to be purely negative. So, I did manage to say something good about that.

Thereafter, however, one gets into trouble. Nothing was done about the fixed-floating exchange rate controversy; that was put over until January. This committee, in the past, has given plenty of advice to the administration on exchange rate policy. I have been completely supportive of Secretary Simon. I think he has been quite steadfast in the national interest there. And this committee has fully supported him, so there is nothing new to be said on that.

Let us, however, get on to the business of gold.

Would it be a good idea to give an indication now to the administration that the Congress would not be disposed to ratify a change in the IMF articles which could allow central banks to increase their gold holdings above what they may buy from each other? In other words, not to let the IMF dispose of its store of gold by selling, giving or donating it at a cut rate back to individual central banks. That would seem to be the fundamental principle.

Mr. FOWLER. Yes, as far as I am concerned, yes.

Chairman REUSS. Let me go down the line. What would you say to that as a congressional sticking point? You notice I stayed away from suggesting that all the countries agree next January on an excellent gold substitution proposal, like the one, for instance, offered by Mr. de Groote, because I think it is a little unrealistic to impose that kind of a time burden on our own negotiators.

Mr. DE GROOTE. May I intervene on that point, Mr. Chairman.

Chairman REUSS. By all means.

Mr. DE GROOTE. The issue here is that of an enabling clause in the amended articles of the IMF. What is not envisaged in the proposal I submitted to you is to open now, at once, a gold account for the central banks with the hope that countries like the United States or Belgium or other countries would now deposit gold to that account. That would be unrealistic at this stage.

What could be done, however, is to open a substitution account to consolidate and convert some of the Fund's gold and precisely that one-sixth if it cannot be sold effectively on the market to achieve the aims that have been decided for that one-sixth; namely, to help developing countries. Furthermore, one could certainly, after amendments, open up a consolidation account whereby the Fund would convert part of its remaining gold aginst SDR's that would be used for the developing countries. This is a clean solution and an easy one. It is a clean solution also politically speaking, because now expectations have been built up and developing countries believe that they will be helped out of the sales of that gold. As Professor Machlup has shown, anyway, it doesn't amount to much, but even then it amounts to probably less than is hoped by them.

There is a feeling among some very able and responsible spokesmen of developing countries that if this idea of gold sales has been at all supported, it is not in order to help those countries but rather to exert a downward influence on the gold price. This is a very unhappy interpretation of the decision. So, I really believe that the idea of a substitution account is realistic, very much indeed, for that fraction of the gold of the fund that should be used for developing countries.

Second, as far as countries' gold is concerned, nobody would imagine that such a consolidation account could be put into operation

today, but what should be done is to have in the articles of agreement an enabling clause whereby countries would be in a position to open such an account when the circumstances warranted it.

I would find it an extremely unhappy decision if in the new articles of agreement this possibility was not envisaged. I haven't seen any good argument stating it is better not to have such an enabling clause than to have one.

Of course, we don't know what might be desirable a few years from now. I firmly believe central banks one day will find it better to have a possibility to acquire an asset that has some known value than to depend on an asset that is submitted to the vagaries of the price of the gold market and that they cannot sell if they want to use it.

So, I would think it would be highly desirable in the new articles of agreement to have the possibility for an enabling clause to be introduced and put into operation immediately after the amendments for a fraction or the totality of the remaining fund's gold and later for whatever is desired for the countries' gold.

Chairman REUSS. Unless I am mistaken, so far there isn't a word about this in the interim committee's announcement?

Mr. DE GROOTE. This generally has been a desire expressed that the interim committee would first study the issue of a consolidation account. This meets, of course, with great opposition from the spokesmen of a number of important countries. When the Board of the International Monetary Fund discussed this, there were first only two Executive Directors who, in fact, proposed a solution along those lines and it met with opposition in the beginning. I now have the impression people are getting used to the idea. And the reason I submitted to you this kind of proposal worked out in detail was not to take your time up, but to show that it is practicable and it is possible.

Chairman REUSS. Let me ask you this. Do the French want this? Do they want a substitution account?

Mr. DE GROOTE. No; certainly not at this stage.

Chairman REUSS. I am looking for some way to tell the French, who have caused so much trouble you know, that they were right about something. Is there anything we can tell them?

Mr. DE GROOTE. All the developing countries have taken the position during the discussion of the IMF in favor of a consolidation account, and so have the executive directors of a number of industrialized countries, but I don't think, up to now, the French are in favor of that idea. That idea would ultimately strengthen the position of the SDR's in the international monetary system and would tend to replace gold by SDR's. It would really mean a very direct step in that direction.

Chairman REUSS. Thank you.

Now, let me restate the proposition that I stated earlier, and the proposition is that whatever other advice Congress may give the administration to be taken into account in the negotiations when they resume in January, but it should include the following; namely, that central banks, while they may acquire gold from each other at whatever price they agree to pay, that they cannot acquire gold either from the International Monetary Fund or the open market. Do you agree with this advice?

Mr. FOWLER. Mr. Chairman, I would qualify that as to the part that would maintain the present official price of gold, I would say that we leave that in the articles and don't abolish it, and I think that would have the effect of keeping the central banks from buying and selling

to each other at the official price, leaving them the current recourse that they have of pledging the gold for borrowing from each other, like Germany and Italy——

Chairman REUSS. So you would advise eliminating the present official price?

Mr. FOWLER. No, I would not.

Chairman REUSS. You would keep it?

Mr. FOWLER. I would keep the present official price because that is the only way I see to maintain and affect the development of a system of buying and selling between central banks at prices that do not move up as the market price, as the private market price moves up. Thereby, you would have a little club that, in effect, prevents the upvaluation of these reserves. So I think the maintenance of the official price at this time for trading with each other, that is, the purchase and sale between central banks, is important. In addition to that, I would also try to maintain the proposition that you could not buy gold from the private market at any price, which would be adding to the supplies of gold within the workings of the monetary system.

Chairman REUSS. Before I reput the question, Mr. Machlup, let me say this. Mr. Fowler, I am not sure that I agree with your perception that removing the official price of gold would be all that much of a re-enthronement of gold. But, I thank you for making your position clear.

Mr. FOWLER. Well, I tried to give you my reasoning on that in my prepared statement in the portion that I did not read or did not cover in my oral remarks, but you will find that in my prepared statement. You will find my exposition for the proposition that amending the Articles to remove the official price of gold will make legitimate whatever activity the central banks carry on with each other in buying and selling gold, or if they choose to go into the open market to buy gold.

Chairman REUSS. But, the proposition I put would prevent central banks from choosing to go into the open market.

Mr. FOWLER. Would prevent their choosing to go into the open market, but not buying and selling to each other at $100 an ounce or $120 an ounce. or whatever they might negotiate.

Chairman REUSS. In other words, you think the proposition I put would be too soft on re-enthronement of gold?

Mr. FOWLER. Precisely.

Chairman REUSS. For I am simply putting this out for precisely the kind of comments I have gotten.

Well, let me put the original proposition, then, to Mr. Machlup, which is that Congress' sticking point may well be that central banks should not purchase gold, irrespective of price, from either the open market or the IMF, and thus they could purchase only from other central banks.

Mr. MACHLUP. Mr. Chairman, for what period could such prohibitions be stipulated? I don't think it would be wise to say that never would a central bank be permitted to purchase either from the IMF or from the free market any amount of gold.

Chairman REUSS. The period would be until the rule is changed for good and sufficient reasons.

Mr. MACHLUP. Yes, but if we think of the articles of agreement, I doubt that we can formulate such a provision in a section or para-

graph in the articles of agreement. I agree fully with Mr. Fowler that we would "lock in" the gold, so to speak, if we continued the official price or official valuation of gold. He is quite right in that, but I do not believe we could, for practical-political reasons, insist on that, because too much has already been officially said on this issue; indeed, your committee, Mr. Chairman, has proposed to the administration that we abolish the official price of gold.

Chairman REUSS. Let me say on that, however, the fact that our committee has said so, that doesn't mean that we are going to, if we are wrong, not change our minds. We can change our advice.

However, I have still to be convinced of that.

Mr. MACHLUP. Yes, we should also consider that we would be the only country taking this position. In most of our wishes, desires, and hopes we are joined by some other countries. I believe, if we wanted to continue the official price of gold, we would probably be completely isolated and I doubt that this would be a good stance for negotiation. What I would like to see undone is the agreement to restitute one-sixth of the Fund's gold to the national monetary authorities; such restitution would be precisely the opposite of what ought to be done. We want the gold from the national authorities consolidated in an international pool. The interim committee would "deconsolidate" gold, would distribute something from a supra national pool that already exists. So, really, the reform would go into the wrong direction. This ought to be avoided.

Chairman REUSS. If I may interrupt at this point? Maybe, if in a couple of years, we come to our senses, we would be paying people $150 an ounce for what we just sold them at $42 an ounce.

Mr. MACHLUP. Precisely. I think if one foolishly takes a wrong road, one should not go in the diametrically opposite direction.

Chairman REUSS. So you would say no restitution?

Mr. MACHLUP. No restitution. That would be one thing. Another thing is the "no pegging" rule ought to be clarified. Many people mean by "peg" only one peg in only one hole, but there has never been just one peg. There always was a double peg, one for buying and one for selling. And I am afraid that, without clear definition, countries will say: "I am not pegging. I am buying at this price and selling at another price." It should be stated quite explicitly that any official purchases of gold in magnitudes large enough to support the market price is not legitimate and must not be permitted.

I question that a 2-year period for this restraint is enough. The interim committee declared that after 2 years every country can do what it likes. Here I come to the very dangerous speculations of my good friend, Professor McKinnon, when he said that the countries would have no incentive to keep their gold or to purchase more of it, or, as he put it, to continue hoarding gold. If a few central banks, say, six national monetary authorities own an amount of gold that is something like 30 times the annual world output of gold, they have an incentive to keep the price from fluctuating and not to allow private speculation to lower the price too much. The French have already been burned, by the fluctuating gold price. After the Martinique agreement they revalued their gold, changing the valuation from $4.4 billion to $17.2 billion on their books. Of course, this was expressed in French francs. They made a paper profit of $12.8 billion, and now, since the

market price has fallen, they have to reduce the valuation and the profit. It is clear that central bankers will want to avoid large fluctuations of the gold price.

There may very well be a group of, let us say, six central banks that will agree not to let the price fall so much that they become embarrassed. And their intervention would be a type of pegging, on the basis of a gentlemen's agreement to support the price from going down too much for their taste.

I submit, therefore that the rule of "no pegging" ought to be clarified. It ought to be stated that there must be no official action to support the price of gold, or to keep the price of gold from falling. Conceivably, one might agree on a lower limit, say, below $70 an ounce or something like that level. But, as I say, something ought to be done to clarify the arrangements. Otherwise, we are really back to a situation where a few countries can fix the price of gold, not only for themselves but practically for the entire system.

Chairman REUSS. So you would say, in terms of what advice Congress should give to our negotiators in the January session, to (1) delete the restitution provisions; and (2) draw the pegging clause up so it reads not just pegging, but any other kind of manipulation?

Mr. MACHLUP. Right.

Mr. FOWLER. May I interrupt there, just to say that playing around with the tightening and modification of these additions or arrangements that were stipulated in the interim agreement about pegging and so forth ignores the fifth point which is made, which obviates everything.

And that fifth point in the agreement on gold is that each party agreed that these arrangements will be reviewed by the participants at the end of 2 years and then continued, modified, or terminated, and any party to these arrangements may terminate adherence to them after the initial 2-year period. After the initial 2-year period, it is a free ball game.

Now, under the present articles of agreement, which all of these countries have entered into, including the United States, as I understand it, article IV or section 2 on gold purchases based on par values states:

"The Fund shall prescribe a margin above and below par value for transactions in gold by members. No member shall buy gold at a price above par value plus the prescribed margin or sell gold at a price below par value, minus the prescribed margin.

Now, when we strike that provision out of the articles of agreement that we have entered into with all of these countries without having an adequate substitution of a consolidation or some other type of arrangement that accomplishes the objectives of monetary reforms to reduce the role of gold and enhance the role of SDR's, we have given the ball game completely away. As far as the negotiating position of the United States is concerned, I consider it to be very strong in that regard, particularly as we stand here, as I have indicated, something of a trustee for the morality of the previous arrangements under which many countries accumulated dollars.

Mr. MACHLUP. Fine, but Mr. Fowler, read from the section about "par values." But, the United States itself gave up——

Mr. FOWLER. I understand that. We all sinned, insofar as we have moved away from the fixed system, but one sin does not justify another sin.

Mr. MACHLUP. Yes, but reliance on this particular section of the Articles will not be very helpful. I agree fully with you on our aims but not on our negotiating stance. If I had to negotiate an agreement that would bar countries from acquiring gold at whatever price they were willing to pay, I would not rest my argument on a provision that forbids gold purchases above par values, if at the same time I was opposed to the establishment of fixed par values.

Chairman REUSS. Well, if I were a negotiator devoted to getting a good deal for the United States, I would be very grateful to Secretary Fowler, because I could then say, "look, if you don't take what we've got here, you are really going to get it." So, I think it is a very useful thing he has put on the table.

But, let me finish up, Mr. Machlup, with your advice to these advisers here in Congress. You said (1) no agreement to restitute gold to the IMF members and (2) fix up the pegging sections so that covers not just pegging but all forms of manipulation.

However, are you going to allow making thoroughly legal the buying by central banks of gold in the open market?

Mr. MACHLUP. I would not. I would most decidely oppose it.

Chairman REUSS. Well, then, you are advising us to advise against it?

Mr. MACHLUP. If you have that power of persuasion, I would be very much in favor that you use it. Let me say again that there should be no further purchases of gold for additions to national monetary reserves. On the other hand, if you agree to the sale of one-sixth of the IMF holdings in order to give the benefit of the profits to the less developed countries, will you really try to do that and yet insist that the monetary authorities are not permitted to buy any part of that gold?

Chairman REUSS. Well, I will tell you my personal disposition. I think that this little crumb to the less developed countries is an illusion anyway. I don't see why we should louse up the whole package to make the less developed countries' finance ministers a little happier for a few moments. I don't think it will really help them much anyway. As Mr. Wilde said, if you want to aid the less developed countries, which I happen to do, give them multilateral aid.

But, anyway, you say "no" to purchases by central banks in the open market. What do you say to purchases by central banks of the one-sixth which they have set aside for the less developed countries? I don't propose to be in the position of denying that crumb to the less developed countries. So I think I favor that crumb to the less developed countries. Do you want to pay the price of letting the national central banks end up with more gold that way?

Mr. MACHLUP. The international monetary system would not end up with more gold. The national and international authorities would still have the same amount of gold.

Chairman REUSS. Of course, there is a big difference between the multilateral IMF owning the stuff where its disposition at least has to be voted on.

Mr. MACHLUP. Perhaps one could at least say that the national authorities should not be permitted to buy the gold with their own currencies. If a central bank buys gold with its own currency, this is far too cheap, because you can print any amount of your currency at practically no expense. It takes only a little ink.

Chairman REUSS. Well, thank you very much.

Now, Mr. McKinnon and Mr. Wilde, I am about to call on you, but Senator Taft has been extraordinarily kind. I have gone much beyond my 10 minutes. I want to give you full opportunity to answer that question, but first we will turn to Senator Taft.

Senator TAFT. Thank you, Mr. Chairman.

Your knowledge in the field exceeds mine by some great amount. I think the time limit might already be up on me at this point.

Professor Machlup, with the current system of the floating exchange rate and the freedom of the capital mobility and interest rates suggested by Professor McKinnon, doesn't the question of which reserve assets to hold and how many to hold become somewhat academic?

Mr. MACHLUP. I am sorry. I did not quite hear the last part.

Senator TAFT. I said, with the flexibility of exchange rates, as explained by Professor McKinnon, does't the question of which reserve assets to hold and how many reserves to hold become somewhat academic?

Mr. MACHLUP. Well, we do not have really full flexibility of exchange rates, and I do not think that we shall have it in the future. We shall always have managed floating. With managed floating, the various national monetary authorities need reserves in order to intervene in the market. And, hence, the magnitude of their reserves is quite important for the working of that system of managed floating.

For example, there may be an excess supply of their own currencies in the foreign-exchange markets. If they have very large reserves, they can prevent their currencies from going down in the exchange markets and the whole process of international adjustment is thereby jeopardized.

Uncontrolled increases in reserve holdings will make the system of managed floating largely inoperative, because the national authorities can, with their large reserves, intervene so much that we are virtually back at a system of fixed exchange rates.

Senator TAFT. So we are trying to eliminate the managing to the extent we can?

Mr. MACHLUP. That is right. And, therefore, we have to see to it that monetary reserves are as small as possible and cannot be increased at will.

Senator TAFT. Professor McKinnon, did you wish to answer?

Mr. MCKINNON. I would just make a little amendment to Professor Machlup's comment. When national central banks enter the foreign exchange markets to support their currencies, they almost always enter using dollar reserves. Dollars are the intervention currency. Now, insofar as gold is going to be mobilizable to support the kind of intervention that Professor Machlup suggested, somehow each national central bank in Europe has to be able to sell off its gold and acquire dollars, and then use the dollars for the managed intervention. But, it is precisely the attempt to sell off these gold hoards that will be driving down the price, and be self-defeating.

Mr. MACHLUP. If other central banks won't buy.

Mr. MCKINNON. If they won't buy it on the open market.

Mr. MACHLUP. But they will buy it. They will buy it directly.

Mr. MCKINNON. It becomes a difficult issue. If there was an official price for gold, then each national central bank would be assured of a

market at that official price. Once there is a free market and the real possibility of demonetization in the future, central banks start to get leery about how much of this gold they want to pile up. And I don't think they view this quadrupling of the book value of their gold as a real asset which they can use.

Senator TAFT. Going on from that point with respect to the question of inflation following upon a revaluation of gold, wasn't it the inflation that caused this current situation?

Mr. MCKINNON. You mean the breakup of the Bretton Woods system in 1971 when we changed the par value?

Senator TAFT. Yes.

Mr. KCKINNON. Yes; I think that was a bookkeeping exercise to permit the U.S. dollar to depreciate vis-a-vis the European currencies, but it was preceded by the high rate of inflation in the United States.

Senator TAFT. Whether we demonetize gold or not, won't the attractiveness of the dollar depend on our own conduct and policies here in the United States?

Mr. MCKINNON. Very much. If we mismanage paper moneys, people will gravitate toward this socially costly form of holding wealth as yellow metal. But, if we are willing to take the step of actually freeing the gold market, this sets up the opportunity at least that gold will be demonetized.

Senator TAFT. The thing that concerns me is it seems to me as we demonetize gold, the tendency will be to turn to the dollar as the exchange medium again. And I am not sure we are willing or able to run our own fiscal and monetary policy in a way that will be a stabilizing influence upon the world monetary situation.

Mr. MCKINNON. Well, under the managed floating that Professor Machlup alluded to, there has been very extensive intervention by national central banks using dollars. It is not all that different a state of affairs, although there is no longer a formal parity in dollar terms. Seven European countries are floating together in the snake and intervene in each other's currencies. But, otherwise, most interventions are in dollars. For example, when the Japanese Government intervenes in a highly managed way to support the value of the yen, it uses dollars and uses them about as extensively as they ever did under the old fixed-exchange system.

Senator TAFT. Do you think that will continue to be true?

Mr. MCKINNON. Yes; independent of the gold policy.

Senator TAFT. Is that a concern we should have, to try to prevent that from happening, to try to eliminate it from happening, or what?

Mr. MCKINNON. Well, it is a great convenience to the rest of the world to have a single intervention currency which is also an attractive asset for national central banks. Otherwise, each central bank would find itself in the situation of having to hold 30 or 40 different currencies. That would be not only cumbersome, but would raise the possibility of intervention at cross-purposes. As long as they intervene only in dollars and the United States stays relatively passive in the foreign exchange markets, then the system works quite well. We can put up with a lot of intervention without conflict.

Senator TAFT. But, it is true that the conduct of our own fiscal and monetary policies then does have an effect upon the whole picture?

Mr. MCKINNON. That is true. The United States is still the balance wheel of the system, basically.

Senator TAFT. You don't see any way of eliminating that in transactions?

Mr. MCKINNON. Well, it is a question of voluntary choice on the part of other central banks, on the part of other countries. I mean, nobody says that you have to intervene in dollars. They don't have to. They can try something else, or they said not intervene at all. We are not forcing them into this mode.

Senator TAFT. Mr. Fowler, you have to deal with this. Do you have a comment on that?

Mr. FOWLER. Just on that last question. I think the negotiators in the Committee of Twenty spent a good deal of time in considering whether or not multi-intervention, using currencies other than the dollar, whether a system of that sort could be arrived at. There is a good deal of technical literature on that in the so-called outline of reform, a report that was submitted in June of 1974. So that I am not prepared to make any judgment on where the discussions in the negotiations came out, except to know that multi-intervention through the multiple-currency approach has been fairly carefully examined at the technical expert level.

Mr. MCKINNON. I might add, with no solution forthcoming; that is. no easy technical solution for multiple intervention on which people can agree.

Senator TAFT. If there is no agreement, perhaps we'd better be more ready to tailor our own fiscal monetary policies to that reality, if it is going to continue?

Mr. MCKINNON. At the present time, I would say "yes."

Mr. MACHLUP. Perhaps it should be stated, Senator, that the Treasury Department, in a proposal 2 years ago, tried to reduce the freedom of management. The proposal provided that, if the reserves of a monetary authority were either rising above or falling below some norm, it should take adjustment measures. It should either allow the exchange rate to adjust or they should adjust their fiscal and monetary policy to restore balance. Here was an attempt to limit the freedom of managing the floating system in a completely uncontrolled fashion.

Senator TAFT. Thank you very much.

Chairman REUSS. Mr. McKinnon, then, let me restate the proposition I was presenting to your colleagues at the table.

Do you think it is in our country's national interest now to cooperate in bringing about an amendment to the IMF articles whereby one-sixth of the IMF's gold will be returned to its contributors at a $42 an ounce price?

Mr. MCKINNON. Let me say first that I agree fully with the idea of getting rid of gold as an official monetary asset on a long-term basis and with eliminating IMF dealings in gold. The question of restitution should not be a central issue; that is, the one-sixth going back to the original contributors is of relatively minor importance. But, I would be in favor of no restitution if that is the consensus view here and if there is no violation of some legal clause of the original agreement by which the gold was given to the Fund. I am not a lawyer. However, if the Fund is just simply viewed as a custodian, do not the contributors have some legal claim? But provided that there is no violation of any legal claim of that sort, I would go along with the consensus view on no restitution.

Then I would agree fully with with Fritz Machlup that we should abolish the official price and go further with his rider to prevent some subgroup of major central banks from setting up an informal peg, and trying to maintain that peg in a certain concerted way. No cartel, as it were, should be permitted to operate in the open market for gold.

Finally, on the question of whether or not central banks should be able to buy and how much, I think if we are really——

Chairman REUSS. And from whom?

Mr. MCKINNON. And from whom?

Chairman REUSS. We have already said that they should be allowed to buy it from each other?

Mr. MCKINNON. Right.

Chairman REUSS. And the question is, should they be allowed to buy it (a) in the open market and (b) from the IMF?

Mr. MCKINNON. We said that they can't buy from the open market beyond the one-sixth being distributed to the less developed countries, but there is a distribution problem across central banks that is a collective problem. And we haven't decided the mechanics of that. I think that may be difficult but maybe I am wrong.

Anyway, the IMF agreement had a sort of 2-year rider—that the national central banks of industrial countries not be able to buy gold net for the 2 years after the agreement is signed, including this one-sixth going to LDC's. I would certainly agree to the 2-year rider.

Now, whether we want a permanent injunction is more debatable. I think a complete injunction may simply be unrealistic.

Chairman REUSS. Would it be satisfactory—and I think I have been following you—would it satisfy you if the articles of agreement said no purchases in the open market for 2 years?

Mr. MCKINNON. That is correct.

Chairman REUSS. It would be understood that this question would be reviewed and the members would vote whether they wanted to change it at the end of 2 years?

Mr. MCKINNON. I would say that is satisfactory, yes.

Chairman REUSS. In other words, permanent, but reviewable in 2 years?

Mr. MCKINNON. Yes.

Chairman REUSS. And then the final point and really it is quite a small one, should central banks be able to buy from the IMF to enable the IMF to get a better price for the one-sixth of its gold which is tentatively earmarked for the LDC's?

Mr. MCKINNON. Yes, if the central banks of industrial countries want to do that individually—not as a cartel to support the open-market price.

Chairman REUSS. Thank you. We are very much appreciative of your statement.

Mr. Wilde, I will go through the same list with you. You have already indicated that you, as well as the rest of your colleagues, approved of the IMF quota changes and the abandonment of the gold tranche. Do you oppose or favor the proposition of the restitution by the IMF of one-sixth of its gold to members in proportion to their contribution?

Mr. WILDE. I have no strong opinion about that, Mr. Chairman. On this whole matter that is being discussed here on the relation of gold,

I hope that we are going to eliminate gold entirely, so that we don't have the debate about the price between the central banks and so forth.

But, I argued the other way merely that I don't think we are ready for the new plan.

Chairman REUSS. In your paper, you stated your position as follows: "In summary, my position is that we should not support the present plan to refund a portion of the gold." Is that your position on that?

Mr. WILDE. That is my temporary position, you might say, until we get a better plan.

Chairman REUSS. Yes; thank you.

Now, let me ask the panel this question. How necessary is an agreement next January? One would, of course, certainly like to get an agreement on the first matter, on the matter of quotas and the gold tranche, and one would also like an agreement on the fixed versus the flexible exchange rate question, although that has so far not even tentatively been agreed upon. But, beyond that would it not be better to have no agreement rather than a bad agreement. Let us see what our witnesses say about this.

I will start with Mr. Fowler.

Mr. FOWLER. Well, it has been my fundamental position, and I think I said in my statement, too, that I can't escape the conviction that it is more important to have a good agreement than a quick one, or certainly one which amounts to a backward step in the process of improving the system. And I think, taken altogether, this agreement as I read it and see its ultimate operation, particularly after the 2-year period, it amounts to a very major backward step. Indeed, it destroys whatever has been done in recent years moving toward the direction of the international management of the amount of reserve assets.

Therefore, I would just like to rest on a quote from the report of the Brookings group of 17 leading economists, which included Pierre Paul Schweitzer and Paul Volcker and a number of other familiar names. This is just one paragraph summarizing my position that:

> How to control the supply of reserves has been an issue in monetary discussions for more than a decade. Concern used to be about the possibility of reserves being inadequate. Now the concern is reserves might be excessive, thus worsening inflationary pressures. In addition, the mix of dollars and other currencies in the present stock of reserves might be a source of instability in exchange rates. Change in the present system should be aimed at bringing the volume and composition of reserves under international control. Additions of reserves should be neither so large as to add to inflation nor so small as to impede the growth of the international economy.

I think this amounts—I think this, taken in total, because of the particular parts I have focussed on, this combination of measures is a backward step away from that laudable objective.

Chairman REUSS. Mr. de Groote.

Mr. DE GROOTE. Mr. Chairman, your question, as I understand it, is about an agreement on gold and not an agreement on new articles for the International Monetary Fund. Is that your question? I think this agreement on gold has to be seen within a broader framework and it is certainly part of a total deal. I believe it would be extremely difficult to go forward and come to amended articles of agreement of the Fund if some concessions were not made to the point of view of those governments who want to have legalization of floating and so on. So there are contradictory points of view. And one has to find a way of

reaching an agreement between countries that are not all equal and some are more equal than others, but all have a say in this discussion. And they want sometimes conflicting or contradictory aims.

The best example of that is the desire of the U.S. Government to legalize floating and the desire of the French Government to go back to parity.

I think this whole arrangement has to be seen within this framework. In that respect, I believe it is possible, by making some concessions on points that are not that essential, to come to amended articles of agreement of the Fund that would be workable in the future, provided a sufficient role is given in those new articles of agreement to enabling clauses that can be put into operation if the necessity arises.

So, I would really feel that it would be possible and desirable to come to an agreement. First of all, the developing countries expect some benefits from the Fund's gold. This you cannot get unless you have an amendment of the articles of agreement. And while you have to have an agreement on the amendment of the articles of agreement for this, why not try to agree on a number of other problems simultaneously?

On gold, I am not too certain, really, that the discussion on the gold price is that important. The real important issue is that the countries' central banks should not increase their total stock of gold, otherwise gold will play a greater role in the system.

The other important element is that the Fund's gold should be put to some useful service.

But, the question of the price central banks apply amongst themselves is not, I think, that important. I would disagree with Mr. Fowler on that point. I firmly believe that central banks attached great importance to gold because it had a fixed price. I think things are the other way round than is generally supposed. It is because there was a U.S. decision in the Gold Act to maintain full convertibility of gold into U.S. dollars, which is, after all, what you need to intervene on your exchange market, that gold was so important. Central banks knew they had a stable and important asset they could use for what they have to do on the exchange market. And if the gold price becomes entirely free and volatile, I am quite certain, after a while, central banks would begin to realize they have an asset that is not any longer exactly what they had under the previous system. And for that reason, I would not be afraid of fluctuations in the gold price. And I think it would be a very good idea in a system where there is no longer the principle of a stable exchange rate, to do away with the official gold price without worrying too much about further fluctuations of the market price, if—and I think this is important—if, at the same time, possibilities are opened for creating liquidity under a more rational way by allocation of SDR's and by progressively converting gold assets of the Fund and of countries into a more stable reserve.

Mr. MACHLUP. Well, Mr. Chairman, we have here two opposing points of view. And I, perhaps because I am stubborn, go more with Mr. Fowler. I would say it is not so terribly important to get an agreement so very soon. We have been getting along for the last 2 or 3 years without an agreement. We have all been sinning. Every country has been breaking the Fund's articles of agreement, and nothing bad has happened as a result. I do not see why we should now hurry to legalize

our practices and legalize also a number of things which we do not like at all. I do not take this business with the "free" gold price quite so lightly, because, as I said before, five or six countries may easily get together and get back to a fixed gold price without any sanction or penalty and, after two years even without breaking any rule or agreement.

So, I would think that we should not agree to a new set of articles of agreement if we do not really get as a result a better-functioning international monetary system: a monetary system that assures a better adjustment mechanism. And this can be done only with a system of international control of total reserves.

Chairman REUSS. Mr. McKinnon.

Mr. MCKINNON. From the general discussion, I think there is something of a consensus in that almost all the important clauses in the IMF agreement we have agreed to except the restitution, really, and the rider that there be no cartel in the pegging process. But, it is really the restitution, the one-sixth, which holds up everything. So, we are not that far apart. And I would say that there should be a major effort to have the restitution clause deleted.

But, suppose it can't be deleted, then what should our position be? In order to maintain the authority of the International Monetary Fund, it may actually be fairly important to go along with the agreement. If what European central banks are now doing is not formally recognized as being legal, then of course all this trade at what is effectively the market price will simply be a violation of the Fund's rules. The role of the Fund will be diminished as an agent of international monetary reform. It seems politic to go along with the overall agreement despite the restitution problem because the Agreement contains necessary conditions for the eventual demonetization of gold.

Chairman REUSS. Mr. Wilde, do you have any comment on this point?

Mr. WILDE. What is your question?

Chairman REUSS. My question was should the United States feel impelled to make some sort of major international agreement next January or is no agreement better than a bad agreement?

Mr. WILDE. I think the second, that no agreement is better than a bad one because I place so much weight on the future world exchange and trade based on a relatively good one. I know it can't be perfect, but I think we've got to have a pretty good one, especially I am on the side of working towards the elimination of gold as part of it.

Chairman REUSS. Gentlemen, thank you very much indeed. If any of you have any additional statements to make on issues that were not covered——

Mr. FOWLER. I would just like to make one comment. I think the last comment Professor McKinnon made about instead of this agreement, which has imperfections of various sorts, which has different ones in different peoples' eyes, that the effort ought to be try to arrive at a treatment of gold which will be a constructive one, working in the interests of overall monetary reform, his statement, I think is interesting. And I think his conclusion suggests that the kind of proposal that Mr. de Groote has put forward here, the much more thorough examination of a gold consolidation account, is the most promising approach and that the negotiators, between now and January would do a far better service for the future of the international monetary

system to concentrate on what kind of gold consolidation account, either along the lines Mr. de Groote proposed or some variation of it. And I made a somewhat similar suggestion of my own statement, in a much more abrieviated form. I think they should do that, rather than going down the other road, which the current agreement would take us.

Chairman REUSS. In short, you would advance the really astounding proposition that next year we should not make an agreement, not a bad agreement, but a good agreement?

Mr. FOWLER. A good agreement.

Representative REUSS. We will certainly consider that.

Thank you all very much.

[Whereupon, at 12:30 p.m., the subcommittee adjourned, subject to the call of the Chair.]

APPENDIX

[Press release No. 75/40—Aug. 31, 1975]

INTERNATIONAL MONETARY FUND

PRESS COMMUNIQUÉ OF THE INTERIM COMMITTEE OF THE BOARD OF GOVERNORS ON THE INTERNATIONAL MONETARY SYSTEM

1. The Interim Committee of the Board of Governors of the International Monetary Fund held its fourth meeting in Washington, D.C. on August 31, 1975 under the chairmanship of Mr. John N. Turner, Minister of Finance of Canada. Mr. H. Johannes Witteveen, Managing Director of the International Monetary Fund, participated in the meeting. The following observers attended during the Committee's discussions: Mr. Henri Konan Bédié, Chairman, Bank-Fund Development Committee, Mr. Gamani Corea, Secretary General, UNCTAD, Mr. Wilhelm Haferkamp, Vice President, EC Commission, Mr. René Larre, General Manager, BIS, Mr. Emile van Lennep, Secretary General, OECD, Mr. F. Leutwiler, President, National Bank of Switzerland, Mr. Robert S. McNamara, President, IBRD, and Mr. Gardner Patterson, Deputy Director General, GATT.

2. The Committee had a discussion of the world economic situation and outlook, and expressed its concern about the current severe problems of recession and unemployment, balance of payments disequilibria, and inflation. The Committee felt that industrial countries which have slack domestic demand conditions and relatively strong balance of payments positions, and which have made progress in reducing inflation, should lead in the promotion of a satisfactory rate of expansion in world trade and activity. The Committee believed that, on the basis of such a coordinated policy approach, a resumption of economic growth might be expected for the industrial world during the latter part of 1975 or the first half of 1976. Although rates of price increase in industrial countries have generally been subsiding, the Committee noted the disturbing fact that economic recovery in the industrial world will get under way with rates of inflation still unacceptably high.

Throughout the Committee's discussion, particular concern was expressed for the many primary producing countries, and especially the developing countries, whose current account deficits have been greatly enlarged by the increase in import costs and the downturn in global demand. Resumption of growth in world trade is urgently needed to alleviate the plight of such countries. Moreover, the Committee feared that, unless they were able to obtain adequate financing, many primary producing countries might have difficulty in fending off pressures to restrain imports, either through deflationary demand measures that would undermine their development efforts or through resort to trade restrictions. In view of these dangers, the Committee expressed the hope that the Executive Board would consider various steps that might be taken by the Fund to meet the present urgent need for a greater volume of financing.

3. The Committee noted the improvements in the 1975 Oil Facility introduced as a result of the July review by the Executive Directors and endorsed the efforts now in progress to raise the amount of resources that the Fund would be able to borrow for the financing of purchases under that facility to the total of SDR 5 billion that was agreed at the meeting of the Committee in January 1975. The Committee also endorsed the intention of the Executive Directors to have another review of the 1975 Oil Facility at an early date, one purpose of which would be to determine what action needs to be taken in the best interests of the international community, and also to undertake at about the same time a broader examination of the Fund's policies on the use of its resources.

4. The Committee welcomed the establishment of a Subsidy Account to assist those members that have been most seriously affected by the current situation to meet the cost of using the Oil Facility and commended those members that have already stated their willingness to make contributions to that account. At the same time, the Committee expressed concern at the fact that the total amount of the contributions by members that have already stated their willingness to contribute is substantially short of the total support that was contemplated and urged those members that have not yet pledged their support to make every effort to do so as soon as possible.

5. The Committee noted the progress made by the Executive Directors on the Sixth General Review of quotas within the framework of the understandings reached at previous meetings of the Committee. The Committee noted the agreement on increases in the quotas of almost all members. In particular, the increases for the industrial countries and for the major oil exporting members have been agreed. The differences that remain among the other members are few and are expected to be resolved soon. The Committee asked the Executive Directors to prepare and submit to the Board of Governors a resolution on increases in the quotas of individual members. The Committee also asked the Executive Directors to complete their work on the mode of payment of the increases in quotas on the basis of the understandings already reached in the Committee so that appropriate recommendations can be submitted to the Board of Governors at the same time as the resolution on increases in quotas. The Committee reiterated its view that all of the Fund's holdings of currency should be usable in its transactions. The Committee agreed that on the question of majorities for the adoption of decisions of the Fund on important matters, a majority of eighty-five percent should be required under the amended Articles for those decisions that can now be taken by an eighty per cent majority. It also agreed that amendments of the Articles should become effective when accepted by three-fifths of the members having eighty-five per cent of the total voting power.

6. The Committee discussed the problem of gold, including the disposition of the gold holdings of the Fund. The elements of the consensus reached are described in this paragraph.

At the meeting of the Interim Committee on January 16, 1975, it was decided to move "toward a complete set of agreed amendments on gold, including the abolition of the official price and freedom for national monetary authorities to enter into gold transactions under certain specific arrangements, outside the Articles of the Fund, entered into between national monetary authorities in order to ensure that the role of gold in the international monetary system would be gradually reduced."

To implement this general undertaking, provision should be made for:

1. Abolition of an official price for gold.

2. Elimination of the obligation to use gold in transactions with the Fund, and elimination of the Fund's authority to accept gold in transactions unless the Fund so decides by an 85 percent majority. This understanding would be without prejudice to the study of a Gold Substitution Account.

3. Sale of ⅙ of the Fund's gold (25 million ounces) for the benefit of developing countries without resulting in a reduction of other resources for their benefit, and restitution of ⅙ of the Fund's gold to members. The proportion of any profits or surplus value of the gold sold for the benefit of developing countries that would correspond to the share of quotas of these countries would be transferred directly to each developing country in proportion to its quota. The rest of the Fund's gold would be subject to provisions in an amendment of the Articles that would create enabling powers exercisable by an 85 percent majority of the total voting power.

The Committee noted that, in order to give effect to the understandings arrived at in this Committee, the countries in the Group of Ten have agreed to observe during the period referred to below the following arrangements, which could be subscribed to by any other member country of the Fund that wishes to do so. Other members might adhere to these arrangements, and on such occasions the necessary modifications in them would be made:

1. That there be no action to peg the price of gold.

2. That the total stock of gold now in the hands of the Fund and the monetary authorities of the Group of Ten will not be increased.

3. That the parties to these arrangements agree that they will respect any further condition governing gold trading that may be agreed to by their central bank representatives at regular meetings.

4. That each party to these arrangements will report semi-annually to the Fund and to the BIS the total amount of gold that has been bought or sold.

5. That each party agree that these arrangements will be reviewed by the participants at the end of two years and then continued, modified or terminated. Any party to these arrangements may terminate adherence to them after the initial two-year period.

Many members from developing countries expressed concern that the proposed arrangements for gold would give rise to a highly arbitrary distribution of new liquidity, with the bulk of gains accruing to developed countries. This would greatly reduce the chances of further allocations of SDRs, thereby detracting from the agreed objective of making the SDR the principal reserve asset and phasing out the monetary role of gold. This aspect should be studied, and measures explored to avoid these distortions.

7. The Committee noted the work done so far by the Executive Directors on the subject of the establishment of a trust fund and the possible sources of its financing in response to the request of the Development Committee. It was agreed to ask the Executive Directors to pursue their work with a view to completing it at an early date, taking into account the understandings reached in the Committee with regard to the use of profits from the sale of part of the Fund's gold for the benefit of developing countries, without neglecting the consideration of other possible sources of financing.

8. It was agreed that acceptable solutions must be found on the subject of the exchange rate system under the amended Articles, so that these agreed solutions can be combined with those on quotas and gold. The Executive Directors were requested to continue their work in order to arrive at acceptable solutions and to prepare for submission to the Board of Governors, after examination by the Committee at its next meeting, appropriate proposals for amendment of the Fund's Articles on all aspects that have been under consideration.

9. The Committee noted that the Executive Directors are in the process of conducting a review of the Fund's facility on compensatory financing with a view to improving a number of its aspects. It was agreed to urge the Executive Directors to complete their work on this subject as soon as possible, taking into account the various proposals that have been made by members of the Committee.

AUGUST 30, 1975.

INTERGOVERNMENTAL GROUP OF TWENTY-FOUR ON INTERNATIONAL MONETARY AFFAIRS

ELEVENTH MEETING OF MINISTERS

COMMUNIQUE

1. The Ministers of the Group of Twenty-Four held their Eleventh Meeting at the Sheraton-Park Hotel, Washington, D.C. on August 30, 1975. Mr. H. E. Tennekoon, Governor of the Central Bank of Sri Lanka, was in the chair, with General Amilcar Vargas Gavilano, Minister of Economy and Finances of Peru, and Mr. K. Gyasi-Twum, representing the Commissioner for Finance of Ghana, as Vice-Chairmen. The meeting was attended by Mr. H. J. Witteveen, Managing Director of the International Monetary Fund, Mr. Gamani Corea, Secretary-General of the United Nations Conference on Trade and Development, Mr. E. Stern, Director, Development Policy, World Bank, and Mr. Konan Bédié, Chairman of the Joint Development Committee.

2. Ministers discussed the international economic situation and current problems. They expressed concern at the slow and uncertain nature of the recovery in the industrial countries, continued inflation, and the worsening terms of trade of the developing countries. They expressed particular concern that the developing countries were faced with increasing payments deficits and, on present indications, gloomy prospects for the future; by contrast, the developed countries had largely overcome their payments problems. Ministers agreed that the causes of the difficulties being faced by developing countries lay in world economic conditions, and in trade restrictions, including discriminatory restrictions, on products of export interest to developing countries, imposed by developed countries. Ministers pointed out that the developing countries were bearing the brunt of maladjustments in developed countries through reduction in the demand for their exports.

3. Ministers felt that a vicious circle had set in, whereby the fall in export income of the developing countries and the general balance of payments difficulties faced by them were restricting their demand for imports from developed countries, thereby aggravating the recession in those countries. They were therefore of the view that the time was particularly appropriate for the industrial countries, in their own interest, to expand the flow of real resources to developing countries and thereby also fulfill their international commitments regarding official development assistance. Such an approach would provide added support to ensure the needed recovery of the world economy, through the expansion of the export sector of the industrial countries.

4. Ministers agreed that developing countries would need substantial balance of payments assistance in the coming months. In this connection, they pointed to the heavy responsibilities that would fall upon the IMF. They stressed the need to fashion the policies and procedures of the Fund to meet the exigencies of the situation. In particular, the Ministers felt strongly that conditions traditionally attached to drawings from the Fund were no longer appropriate because they placed the burden of adjustment on the developing countries and did not facilitate the correction of the maladjustments which are to be found in the developed countries. They urged the IMF to review its policies and procedures with a view to ensuring their suitability to meet the exceptional and new needs of developing countries. In this connection, they called for increasing the amounts available under the tranche policy.

5. Ministers agreed that the oil facility had proved to be very useful. They were also of the opinion that in view of the uncertainty of other forms of financing available to developing countries, there would be a continuing need for this or a similar facility for the next year but with less conditionality, in addition to, and not as a substitute for, a widening of the tranches. They felt that access to the 1975 oil facility should be allowed to the full extent of maximum eligibility, and urged all countries in a position to contribute to its financing to do so. Ministers urged that developed countries that had recourse to other sources of finance should voluntarily refrain from using the oil facility. Ministers urged that developing countries, many of whom were contributors to the facility, should have a greater say in determining the conditions of drawings.

6. Ministers welcomed the establishment of the Oil Facility Subsidy Account. However, they noted with disappointment that less than half the required amount of contributions had been pledged and that some contributions were subject to conditions. Ministers urged that all countries with the capacity to contribute should do so, and without conditions.

7. Ministers, while welcoming the agreement reached by the Executive Directors of the IMF to allow drawings under the buffer stock financing facility to "float" alongside the gold tranche, urged that the Fund should be empowered to lend directly to buffer stock agencies. They also reiterated their support for a substantial improvement in the compensatory financing facility.

8. Ministers reaffirmed their support for establishing a Trust Fund, and agreed that the Executive Directors should work out the details of a Trust Fund in order to permit its establishment as expeditiously as possible.

9. Ministers noted with regret that the Sixth General Review of Quotas is being held up by the absence of agreement among industrial countries and expressed the hope that agreement would be reached on the occasion of the forthcoming Joint Annual Meetings of the World Bank and the Fund to double the aggregate share of the major oil exporting countries, while maintaining the aggregate share of the other developing countries, which is presently 22.73 percent.

10. Ministers stressed that in future quota reviews the share of developing countries should progressively increase, and that countries not satisfied with the quota increase should have an opportunity to make representations before quotas are approved. Ministers reaffirmed that the present representation of developing countries in the decision-making bodies of the Bank and Fund should be substantially improved and the broad geographical representation of developing countries should not be adversely affected.

11. On gold, Ministers reaffirmed that the amended Articles of the Fund should oblige each member of the International Monetary Fund to undertake to collaborate with the Fund and with other members regarding the policy of the member with respect to gold, and that any action by any member or arrangements among members with respect to gold should be consistent with the Articles of Agreement

and with policies designed to ensure the gradual reduction of the role of gold in the international monetary system and the strengthening of the role of the SDR.

12. Ministers also affirmed that no arrangements with regard to gold would be acceptable to the developing countries unless they met the above principles and also unless,

(a) they were designed to raise substantially the flow of financial resources to the developing countries, without imposing a loss on any individual developing country;

(b) they did not accentuate the already inequitable distribution of international liquidity.

In this context, Ministers agreed that there was a need to expedite the study of a gold substitution account.

13. Ministers considered the various proposals currently under discussion regarding the disposal of the gold held by the Fund, and found that none of them in their present formulation was entirely acceptable to the developing countries.

14. Ministers reaffirmed their support for the early establishment of a link between allocations of SDRs and development finance.

15. Ministers reviewed the work of the Development Committee and they stressed the need to pay attention to the longer-term problems of the transfer of real resources in addition to dealing with immediate issues.

16. Ministers welcomed the establishment of the Third Window. They expressed disappointment that total contributions thus far were not enough to permit a total lending program of $1 billion, which was, in the view of the Ministers, a modest sum in the light of the capital requirements of developing countries. Ministers urged all countries with a capacity to contribute to do so and ensure that there contributions to the Third Window and that Third Window lending were additional to the normal levels of development assistance.

17. Ministers noted with satisfaction that the Development Committee is working on the question of access to capital markets, and expressed the hope that this work will result in concrete action to widen and strengthen the access of developing countries to capital markets.

18. Ministers emphasized the importance of giving due consideration to the long-term problems of all developing countries, and in this connection they stressed the need for the Bank to update its estimates of and for the Development Committee to review the capital requirements of developing countries, and for the international financial institutions to gear their lending programs in the light of such estimates. Ministers attached high priority to a selective followed by a general expansion of the capital base of the Bank, in order to allow the Bank to expand its lending program and thereby cater to the needs of all developing countries. With regard to fiscal year 1976 Ministers stressed that the $4.7 billion agreed by the Board should not be taken as a limit, but rather as a minimum figure for lending by the Bank. Ministers also stressed the importance of the continuation of the transfer of the net income of the Bank to IDA in the next year.

[From the Congressional Record, Sept. 17, 1975]

The Golden Rule, IMF Style

The SPEAKER pro tempore. Under a previous order of the House, the gentleman from Wisconsin (Mr. Reuss) is recognized for 20 minutes.

Mr. REUSS. Mr. Speaker, for years statesmen have been warning of the plight of the less developed countries and their desperate need for more help from the wealthy. The less developed countries came to the annual meeting of the World Bank-International Monetary Fund family in Washington early this month hoping that their needs would at last be recognized.

What happened is hard to believe. They were met on arrival with the August 31 set of "principles" agreed to by the IMF's Interim Committee, a body of the 20 finance ministers representing the 127-member countries. Under those principles, one-sixth of the IMF's $23 billion stock of gold—at current prices—was to be earmarked for the less developed countries, with the profits when, as, and if those profits were made, to be distributed in some undetermined fashion to the poor.

An equivalent pile of one-sixth of the IMF's gold was to be sold, not at its current $150-or-so an ounce market value, but at a cut rate of $42 an ounce, to an "insiders" list of distributors which almost exactly corresponds to the world's

wealthiest countries, with the poor countries getting a few crumbs. For example, at the current market price, the profit to the United Sates could be $500 million, to the oil producers—Saudi Arabia, Kuwait, and Iran—$250 million, to Great Britain $230 million, to Germany $140 million, to France $130 million, and to Japan $100 million.

In contrast the potential profits of Malaysia would be $16 million, Korea $8 million, Afghanistan $3 million, drought-stricken Mauritania $1 million, Bangladesh $11 million, Sri Lanka $9 million, Honduras $2 million, and Colombia $14 million.

The Golden Rule—the idea of all the world's great religious faiths that you should do unto others what you would have them do unto you—is what the poor countries expected to have applied to them when they got to Washington.

Instead, what they got was the Golden Rule, IMF style: those who have the gold make the rules!

Developing country members immediately expressed their displeasure at giving IMF aid to the wealthy. The IMF's press release disclosed that the developing countries felt "that the proposed arrangements for gold would give rise to a highly arbitrary distribution of new liquidity, with the bulk of the gains accruing to developed countries."

In justice to the U.S. Treausry, it should be said that they did not think up this monstrosity. The doubtful honor here seems to belong to our French friends.

What comes next? The Interim Committee is scheduled to meet in January, 1976, to hash over its August 31 package of "principles" once again. Then the IMF Executive Directors and then the Governors must agree. Then the complete package of reforms, on quota, gold, and exchange rates, would have to be submitted to each government for its parliamentary approval, including to the U.S. Congress.

I serve notice now that I shall oppose any distribution of IMF foreign aid to the greedy rather than the needy, as the August 31 "principles" propose.

The tentative "principles" on which the Interim Committee is working are:

1. QUOTAS

General agreement was reached in January 1975, to increase total IFM quotas by 32.5 percent or from 29.2 billion special drawing rights—SDR's—to 39 billion SRD's. But there had been continuing disagreement on how much the quotas of some industrial countries, including the United States, should be reduced proportionately and on how much the quota share of other members, especially oil producers, should be increased. Finally, at the last meeting of the Interim Committee, quota increases for the industrial countries and for the major oil exporting members were agreed.

The U.S. quota will be reduced slightly, to 20 percent. At the same time, the majority required in the Fund to approve important decisions will be increased from 80 to 85 percent of the total voting power. Thus, the veto capability of the United States will be preserved. The modest proportional reduction in the U.S. quota seems consonant with new economic realities.

2. EXCHANGE RATES

Another issue that has blocked agreement on international monetary reform is whether members of the IMF should commit themselves to an eventual return to fixed parity exchange rates. The U.S. position is that Fund members should be able to choose whether to state a fixed parity for the external value of their currencies or to let that value be determined primarily by the interaction of private supply and demand in the exchange markets. Our officials have therefore resisted any commitment to a particular exchange rate regime. The floating exchange rate regime has served the United States well, and has helped keep the international monetary system functioning despite an oil embargo, the quadrupling of the cost of imported oil, and wide discrepancies among IMF members in rates of inflation, the level of interest rates, and the extent of declines in output during the recent recession.

Either fixed or floating, market-determined exchange rates can be manipulated to foist on other countries domestically induced unemployment or inflation. So long as an IMF member is not exporting economic problems that could be managed domestically, it should be able to choose without prejudice the type of exchange rate regime that it considers best for its own purposes.

This is the view of U.S. monetary authorities, of the House Committee on Banking, Currency, and Housing and of the Congressional Joint Economic Committee. It was most recently articulated in a report published jointly in August by the House Banking Subcommittee on International Trade, Investment and Monetary Policy, chaired by Representative Thomas M. Rees, and by the Joint Subcommittee on International Economics, which I chair.

The staunchest advocate in the IMF of a commitment to an eventual return to fixed parities is France. At its most recent meeting, the IMF Interim Committee did not attempt to reach a position on exchange rates that would be mutually acceptable to both the United States and France. This issue was deferred until the next meeting, scheduled for January 1976.

3. GOLD

The agreement on gold announced by the Interim Committee would abolish the official price of gold, currently set by the IMF at 35 SDRs per troy ounce, and abolish the obligation of Fund members to use gold to pay 25 percent of their quota subscriptions and in certain other transactions. The agreement specifies that one-third of the Fund's gold stock will be disposed of. A sixth of the stock, or 25 million ounces, will be sold in the market, and the profits used for the benefit of developing countries. Precisely how these profits will be shared, or the mechanism through which they will be disbursed, has not yet been decided.

The U.S. proposal is that the profits be used to finance a trust fund that will make long term balance-of-payments financing available to developing countries most seriously affected by commodity price increases and export revenue shortfalls. Another sixth of the Fund gold stock will be returned to the members that initially paid the gold into the IMF to satisfy their quota obligations. Included in the proposed amendments to the IMF Articles will be a request for enabling powers to dispose of the remaining two-thirds of the existing Fund gold stock in a manner acceptable to members holding at least 85 percent of the total voting power.

To accompany the Interim Committee's agreement on gold, the 10 largest industrial countries have undertaken certain commitments to help implement that agreement. Most importantly, the Group of Ten has agreed "that there be no action to peg the price of gold" in the market, and that as a consequence of central bank purchases of gold in the market, the total number of ounces of monetary gold, including gold now held by the IMF, will not be increased. The Group of Ten agreed that these arrangements would be reviewed 2 years after initial implementation to determine whether they should be continued, modified, or terminated.

Many details regarding the implementation of the gold agreements are still unresolved. For example, it is uncertain whether the IMF will offer its gold through dealers in the major cities where gold markets exist, through public auction, or whether private placements with individuals or monetary authorities will be considered.

Nor is it known over what period the sales will be executed, in what increments they will be paced, or the extent to which sales may be curtailed in reaction to declines in the market price. Whether the agreement will decrease the automatic gold tranche drawing rights of IMF members is presently uncertain. Nor is it clear that the Group of Ten pledge to take "no action to peg the price of gold" prohibits central bank purchases in the market to slow or diminish a decline in the price.

The gold agreement has defects additional to its inequity. It may well increase the proportionate value of international monetary reserves held in the form of gold and delay further distribution of special drawing rights in the future. The IMF will sell a sixth of its gold stock at market prices and a sixth at the existing official price to monetary authorities. National monetary authorities could conceivably purchase most of the gold that the Fund sells in the market. Thus, one-third of the Fund gold stock, or 50 million troy ounces, could be transferred from the Fund to the monetary authorities of member states and carried on the books of the latter at a price three or four times the price now used by the IMF. This procedure would constitute a partial revaluation of the world's gold reserves. During the next year or two, therefore, a significant proportion of additions to the reserve stocks of monetary authorities could—as a consequence of this agree-

ment—be in the form of gold. Other things being equal, the greater the supply of gold reserves, the less is the need for additional reserves created by the IMF in the form of special drawing rights.

Moreover, the gold agreement does not clearly signal a reduction in the future international monetary role of gold. Instead, this question is clouded by ambiguity. There is some basis to hope that the most dire of these possible consequences will not actually come to pass. Nevertheless, the agreement fails to take a clear stand on the international monetary role of gold, and to indicate that this role will necessarily be diminished in the future. On the contrary, that role might grow.

The gold agreement is not cast in concrete. It is possible to substitute a superior arrangement in its place, although doing so at this stage will admittedly be difficult. Another meeting of the Interim Committee is scheduled for January 1976. The package of reforms is not yet complete. The report of the Interim Committee will be transmitted to the IMF Executive Directors as a recommendation. The Executive Directors and Governors will vote on the Interim Committee's recommendation for monetary reform, and if approved, transmit them to the individual member states for ratification. Thus a superior plan does have opportunities in January.

What would be the characteristics of a superior plan? It would be equitable, it would not increase either the proportion or the total value of international monetary reserves held in the form of gold, and it would unequivocally signal a future diminution in the international monetary role of gold. Of course, as a major reserve asset constituting presently about 20 percent of all reserve holdings, gold cannot be phased out overnight. But the international monetary reform now being negotiated should immediately begin the process of diminishing the significance of gold, rather than permit the question to be determined by the disparate actions of various central banks.

It would be preferable to sell the full one-third of the IMF gold stock that is being disbursed in the market. The proceeds from the sale of 50 rather than 25 million ounces of gold could then be used to benefit developing countries. There is no need to confer windfall gains on the wealthy. If the rich countries stick at giving one-third of the gold to the poor, let them at least refrain from grabbing the widow's mite of one-sixth largely for themselves.

If the sale of a portion of the IMF's gold produced a shortage of international reserves—and there is some dispute now about whether the total stock of international liquidity is deficient or excessive—the members of the IMF can agree to create sufficient additional special drawing rights to eliminate any such deficiency.

Such an arrangement would be equitable, it would permit more precise control over the growth of international liquidity than the existing agreement, and along with abolition of the official price of gold and the need to use gold in transactions with the IMF, would unambiguously signal the beginning of a gradual movement to phase out gold as international money.

I hope that all interested parties will give this alternative proposal serious consideration, and that the January Interim Committee meeting will succeed in producing a complete package that is equitable and sensible. If countries want to foist an inequitable plan on the world, let them stand up and be counted. Let us not join with them. Even on opportunistic grounds, the proposed purchase is not worth it.

The current reform exercise is the first complete overhaul of the IMF Articles since Bretton Woods. When the time comes to consider proposed amendments for ratification, the Congress will want to examine a package that reflects sound monetary economics and sound development policy—not political accommodation.

THE SECRETARY OF THE TREASURY,
Washington, D.C., November 1, 1975.

Hon. HENRY S. REUSS,
Chairman, Subcommittee on International Economics, Joint Economic Committee, Washington, D.C.

DEAR MR. CHAIRMAN: I have studied with interest and concern your remarks in the Congressional Record of September 17 about the recent Interim Committee agreement, as well as reports of the hearing your recently held on the same subject. I appreciate your support of the portion of the agreement dealing with IMF

quotas and of the U.S. position on exchange rates. I am, however, concerned that your views on the aspects of the agreement relating to gold are strongly critical.

There is no doubt that we share the same objectives of phasing out the monetary role of gold and putting part of the IMF's gold to use for the benefit of the developing countries. Where we differ is whether the Interim Committee agreement represents a major step toward achievement of these objectives. You and some of the panelists at the hearing have expressed doubts about this and apparently feel that the agreement represents a major and inequitably distributed increase in world liquidity; might lead to an increasingly important role for gold in transactions between monetary authorities; and means an unfair use of IMF gold for the "greedy rather than the needy."

I would like to respond to these concerns and explain why I believe that the agreement, taken as a package, will put gold on a one-way street leading out of the monetary system.

Most of the concerns about the agreement rest fundamentally on the assumption that the agreement represents an effective major expansion of world liquidity in the form of gold. Based on this assumption, it is then predicted that there will be a significant role for gold in transactions between monetary authorities, a reduction in the need for increases in other forms of reserves, and a potentially substantial inflationary impact.

This basic assumption is incorrect, and the consequences foreseen do not follow. The agreement neither represents nor implies an important increase in world liquidity.

First the valuation of gold reserves is not a feature of the agreement. Countries were free to value their gold reserves at market-related prices before the Interim Committee agreement. Only France has revalued its gold holdings, and we are not aware that any other countries plan to follow suit. By abolishing the official price of gold in the IMF, strengthening the prospect of future sales of officially-held gold into the market, and establishing transitional provisions against future pegging of the price, the Interim Committee agreement will in fact greatly discourage any uniform treatment of gold holdings for official purposes—and thus provides no basis for a revaluation of official holdings.

Second, the price at which countries may choose to value their gold balances does not determine their worth as liquidity—that depends essentially on the price that could be realized through gold sales, a very uncertain and shifting price. In principle, there are two ways in which an increase in liquidity through gold sales might be realized: sales to the market or sales to other governments. The first is permissible now and unrelated to the agreement; the second is highly unlikely to occur to any significant extent.

Countries have been free under the existing IMF Articles to sell gold in the market at any time, and thus to realize any gains that may be made as a result of the difference between the official and market prices. Any real increase in liquidity in the form of gold on this score has thus occurred as a result of increases in the market price of gold over the past few years, not because of the Interim Committee agreement, and any realization of liquidity through sales to the market will decrease the size of official stocks. The agreement is irrelevant in this respect, except insofar as it may have contributed to the recent decline in the market price of gold.

There is no reason to expect the agreement to result in a significant increase in transactions in gold among monetary authorities or in substantial official purchases of gold from any other source, even though the formal restraints on such transactions in the IMF Articles will be lifted. There is a very large element of risk involved in purchases of gold. There are no provisions for use of gold in international settlements. Transactions with the IMF are effectively eliminated. There are few, if any, indications of interest in the purchase of gold—and, indeed, important countries are signalling to the world that they have no such interest. There is every reason to expect the "no pegging" provision of the agreement to be respected.

The latter point regarding official transactions is essential to an understanding of the meaning of the Interim Committee agreement. Even when there was an official price closely linked to private prices, official gold settlements were infrequent. The gold market is a highly speculative one, always uncertain and risky, as reflected by the sharp price movements in light of U.S. gold sales, the prospect of IMF sales, and the possibility of sales by others. The myth of a permanently high and rising gold price has been broken, and the risks involved in acquiring gold, either through official settlements or purchases from the market, have be-

come enormous under the recent agreement. It is highly improbable that any country or group would assume the risks and costs involved in attempting to stabilize the market price for gold. Yet stabilization would be central to any important role for gold in official settlements. And, since it is the expressed intent of the IMF membership that gold should be phased out of the system, the disapproval of the U.S. and others—and knowledge that the U.S. would not participate—will be strong deterents to any efforts to reestablish a major role for gold in official transactions. In addition, the agreement among the Group of Ten countries provides for possible additional limitations, restrictions or administrative guidelines which might be worked out among central banks if future events suggest there is a need. The U.S. will not hesitate to press for such provisions if the need arises.

Elimination of an official price for gold in the IMF Articles of Agreement will, of course, remove the existing legal restraint on official purchases of gold at higher-than-official prices. Nevertheless, elimination of the official price of gold is essential to its demonetization. The concerns raised at the imminence of this step by some who support demonetization illustrate the nature of the problem, which has always been to work out an arrangement which would achieve the long-term objective of phasing gold out of the system while at the same time enabling those countries for which gold remains an important part of their reserves to mobilize their holdings in case of need.

There is clearly a natural tension between these objectives. Some strong advocates of phasing gold out of the system have urged the establishment of stiff transitional rules on transactions in gold after the legal restraint is removed, while other advocates of demonetization have urged the avoidance of any rules, and treatment of gold comparable to any other commodity. While more stringent transitional safeguards relating to the circumstances under which monetary authorities might acquire gold might have been useful, any limits on transactions beyond the agreed "collective" limit were strongly opposed by some as representing an unacceptable restraint on their sovereign freedom. For reasons I have outlined, I am persuaded that the element of risk and other deterrents to official purchases of gold make a significant role for gold in official settlements extremely unlikely. Thus I believe that the Interim Committee agreement on gold signals, unequivocally, the future elimination of the monetary role of gold. It is noteworthy that the markets appear to have received that signal and placed that interpretation on the agreement.

With regard to the second major area of concern—the agreed uses of IMF gold—I do not share the view that the agreement is inequitable and favors the wealthy. The developing nations will of course receive the gains on all the gold—25 million ounces—sold for their benefit, and will receive their quota share, about 28 percent, of the 25 million ounces to be distributed to all IMF members in proportion to quotas. Moreover, at any realistically imaginable price, the profit on the amount of gold to be distributed to members according to quotas would represent a miniscule proportion of world reserves, and simply could not be regarded as important in terms of judgments about needed reserve growth in the future. (Nor, as I have previously indicated, does the agreement provide a basis for realization of increases in liquidity, equitable or inequitable, arising from the disparity between the private and official prices.)

The U.S. could certainly have accepted—indeed, would have preferred—a solution which did not call for a distribution of one-sixth of IMF gold to members in proportion to quotas, but this was not a practical approach. Such a distribution is strongly favored not only by some of the developed nations but by a number of developing countries as well. It became quite clear in the negotiations that refusal to agree to any such distribution would have destroyed any chance to use some IMF gold for the benefit of the developing nations.

I should mention also the various proposals for establishment of a "gold substitution" on account in the IMF, to which some of your panelists referred. The U.S. has indicated its willingness to consider such proposals, but only on the understanding that they be designed for the purpose of facilitating a reduction of the role of gold in the system. Some proponents of a gold substitution account see it as a vehicle for establishing an IMF-guaranteed floor price and ready official market for gold, or for changing the distribution of world reserves. A gold substitution account which put a floor under the price would pace the way for a return of gold to an important role in the system and would be the antithesis of what we seek. The detailed provisions of a substitution account would make

a crucial difference in its implications. I have not seen any specific proposals to date that would be both consistent with our own objectives and workable in a technical sense—and I would not favor acceptance of vague "enabling" language that could permit a substitution account to be established against U.S. interests at some future date. We will continue to examine the subject, but we must be careful to avoid accepting provisions that would operate contrary to U.S. objectives with respect to gold.

In conclusion, I am convinced that the Interim Committee has progressed from *words* favoring phasing gold out of the system to *action* that will accomplish that result. I am not surprised that the move has generated some concern, for any new departure must involve some uncertainty. But the existing situation with respect to gold was not a stable or indefinitely sustainable one, and the greater risk was that failure to reach a broad agreement on gold could have led to serious strains and pressure for action outside an agreed framework.

In my judgment, the Interim Committee agreement is true to our gold objectives and sets the stage for a comprehensive settlement of monetary issues, including the crucial issue of exchange arrangements under the IMF Articles of Agreement. I urge your support, and that of your colleagues, for this agreement.

Sincerely yours,

WILLIAM E. SIMON.

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., December 24, 1975.

Hon. WILLIAM SIMON,
Secretary, U.S. Department of Treasury,
Washington, D.C.

DEAR MR. SECRETARY: According to recent newspaper reports, the agreement on gold announced by the International Monetary Fund's Interim Committee on August 31, 1975, may be implemented before the normal legislative procedures for amending the IMF's Articles are completed. Any such prospective action deeply concerns me on the grounds that illegal implementation of this agreement could both seriously weaken the authority of the International Monetary Fund in future years and impair the statutory authority of the Congress.

The Bretton Woods Agreements Act of July 31, 1945, stated that "The President is hereby authorized to accept membership for the United States in the International Monetary Fund . . . provided for by the Articles of Agreement of the Fund . . . deposited in archives of the Department of State." The Bretton Woods Agreements Act further states "unless Congress by law authorizes such action, neither the President nor any person or agency shall on behalf of the United States . . . accept any amendment under Article XVII of the Articles of Agreement of the Fund." Article XVII states that to be adopted, an amendment must secure the approval of three-fifths of the Fund members having four-fifths of the total voting power. Currently the voting power of the United States in the IMF is approximately 22 percent.

Article IV, Section 2 of the IMF Articles of Agreement states "the Fund shall prescribe a margin above and below par value for transactions in gold by members, and no member shall buy gold at a price above par value plus the prescribed margin, or sell gold at a price below par value minus the prescribed margin." However, newspaper reports indicate (for example, the Wall Street Journal of December 22, 1975) that the Bank for International Settlements, acting as an agent of its central bank members, may begin purchasing gold sold by the IMF at market prices as early as February, 1976. Such action by the BIS would constitute an illegal subterfuge, violating the IMF Articles of Agreement and flouting the authority of the Congress.

I therefore urge that no central bank or its agent be permitted to purchase gold at a price above the stated par value plus the prescribed margin until the Congress has ratified a proposed amendment to the IMF Articles permitting such purchases by abolishing the official price of gold.

In the December 17, 1975, report of the Subcommittee on International Economics, Senators Ribicoff and Taft and Representative Rousselot voiced their opposition to using the profits from sales of IMF gold in the market to benefit developing countries. While I personally disagree with my colleagues' position on this, I am obliged to note that such sales would also be of dubious legality.

Apparently these sales would be conducted under Section 2 of Article VII, the scarce currency clause that obliges members to sell their currency to the Fund for gold. Employing the scarce currency clause in this fashion would put it to a use for which it was never intended.

Therefore, out of respect for my colleagues' opinions, I further urge that no provisions of the tentative gold agreement reached by the Interim Committee in August be implemented until the Congress has ratified appropriate amendments to the IMF Articles unequivocably authorizing these actions.

Proponents of early implementation of the "gold agreement" argue that the IMF Articles of Agreement have been ignored so widely in recent years, that a further violation can do no additional damage.

I disagree.

First, the amendments to the IMF Articles of Agreement that are now being considered are intended to bring the charter of that organization back into conformity with reality, to revitalize the Fund, and to give it a new legitimacy. To begin this process by further violating the Articles is to defeat the purpose at the start.

Second, in 1972 and again in 1973, the Congress, by passing dollar devaluation legislation, twice attempted to reinstitute the United States as a member in good standing of a fixed exchange rate IMF. In both instances, these attempts were overwhelmed by market forces. Now, however, the central bankers and finance ministers of the leading industrial nations have apparently agreed, after long and serious deliberations, to violate the Fund's Articles. There is a great difference between illegality brought about by the buffeting of the market, and that brought about by the machinations of ministers.

In conclusion, let me reiterate my belief that the International Monetary Fund will be a far more vital and effective organization in future years, and that Congressional endorsement of long-awaited and much-needed amendments to the IMF Articles is much more likely to be readily forthcoming if no initial attempt is made to violate the Articles or circumvent Congressional authority.

Sincerely,

HENRY S. REUSS,
Chairman, Subcommittee on International Economics.

THE SECRETARY OF THE TREASURY,
Washington, January 26, 1975.

Hon. HENRY S. REUSS,
Chairman, Subcommittee on International Economics, Joint Economic Committee, Washington, D.C.

DEAR MR. CHAIRMAN: In recent weeks there have been discussions among governments and comment in the press about the implementation of the gold agreement reached by the IMF Interim Committee on August 31, 1975. I am writing to clarify the understandings which were reached by the Committee in August and at its most recent meeting in Jamaica.

The August 31 gold agreement contains a number of provisions designed, as you know, to reduce the role of gold in the international monetary system.

We have tried, during the course of our negotiations, to keep the Congress fully informed. Let me assure you absolutely that those parts of that agreement which require amendment of the Articles will be submitted to the Congress for authorization, and that any implementing measures which the United States or the International Monetary Fund will take prior to amendment are in fact authorized by the present Articles of Agreement.

The provisions of the August 31 agreement that call for amendment of the Fund's Articles before they can be implemented include the provision for eliminating the official price of gold and for eliminating present requirements that members use gold in certain IMF transactions. When draft language has been agreed, these proposed amendments to the IMF Articles will be submitted to the United States Congress for the necessary authorization for U.S. acceptance as part of a package of amendments dealing with gold, exchange rates, and other matters. The amendments will enter into force, as prescribed under Article XVII, when accepted by three-fifths of IMF members having four-fifths of the total voting power.

Other provisions of the August 31 gold agreement can be implemented prior to amendment of the Fund Articles, and it was agreed at the Interim Committee meetings on January 7 and 8 that action should be taken without delay for the simultaneous implementation of those provisions. Since the United States strongly supports the objective of a reduction in the role of gold, which the August 31 agreement is designed to achieve, there are, in my view, important advantages in implementing as promptly as possible those elements of the agreement which legally can be implemented under the present Articles.

One provision which can be implemented promptly is establishment of a trust fund to provide balance of payments financing for developing IMF member countries, with resources obtained in part through mobilization of one-sixth (25 million ounces) of the IMF's gold.

I would like to emphasize two points with respect to the proposed trust fund. First, this facility can contribute both to a healthier world payments balance and to a reduced monetary role for gold. Second, the proposed facility is not a new aid program, but is an extension of traditional IMF activities, using existing IMF resources through a technique well-established by IMF precedent, and is fully consistent with the purposes of the IMF and the present Articles.

The need for the trust fund is a point I need not labor. At a time when high oil prices and deep world recession have combined to place a severe financing burden on a number of the poorest developing countries, it is essential to a sound world payments balance that we establish this additional facility.

The trust fund, while helping the poorest developing countries will not provide development financing—typically within the purview of the international development institutions and bilateral aid programs. Rather, it will provide the balance of payments financing which is a major function of the IMF, on terms appropriate to the difficult payments position facing some of the poorest developing countries in the period immediately ahead.

The trust fund will also substantially further our objective of reducing gold's monetary role. It will enable us to take steps promptly for the market sale of some of the IMF's gold, finally demonstrating by actions, not merely by words, that IMF members are indeed seriously committed to the objective of reducing gold's monetary role. Further delay would merely allow for unnecessary speculation regarding the future role of gold. Delay would also stimulate alternative proposals for emergency balance of payments financing for the poorest countries and could weaken the existing momentum behind the gold sale agreement.

The method proposed for mobilizing the IMF's gold is based on IMF precedent and specifically has the sanction of the IMF legal staff. The technique to be used is the familiar one of "replenishment," whereby the IMF, to the extent it has a need for currencies, exchanges gold for those currencies, at the official price, and uses the currencies in its operations. The difference between past uses of IMF gold for replenishment and that proposed for the trust fund is that, in this case, the "profits" on the gold used in replenishment will accrue to the proposed trust fund and thus to developing country members. The replenishment provisions of the IMF Articles also form a legal basis for implementing the provision of the August agreement—which the United States did not propose—for sale at SDR 35 an ounce of a further one-sixth of IMF gold to members in proportion to quotas.

It is important to note, in this regard, that it is the IMF which has legal title to the gold to be sold. The member countries that paid gold to the IMF as part of their subscriptions, receiving in return drawings rights in the IMF, transferred title to the gold to the IMF and have no legal claim to it. In fact, the gold in the IMF was always intended as a source of usable currencies under the replenishment provisions and the IMF has, on a number of occasions in the past, sold gold for this purpose. Thus the sale of gold to obtain usable currencies is in no way novel or a departure from past practices. The establishment of the trust fund provides a way in which the IMF gold can be disposed of in effect at a market price rather than the official price, with the IMF receiving usable currencies for the "book value" of this asset and the trust fund receiving usable currencies equal to the difference between the "book value" and the market price.

The Interim Committee has agreed that market sales of gold by the trust fund should be conducted in public auctions over a four-year period and according to an appropriate timetable. It is my understanding that in any market sales of gold by the IMF acting on behalf of the trust fund, bids would not be accepted from IMF members or from entities acting as agents for such members, prior to

amendment of the Articles, in light of the provision of Article IV, Section 2, that members shall not buy gold at a price above par value plus a prescribed margin.

The Bank for International Settlements would be able to bid, for its own account, in IMF gold auctions conducted for the trust fund. This seems perfectly proper to me. The BIS is not an IMF member. It is an independent institution, whose separate legal status and independence from goverments are clearly established. The BIS has express legal authority to buy and sell gold for its own account. Thus, in allowing the BIS to bid at its auction, the IMF would merely be recognizing these existing facts.

There have been expressions of concern about purchases of gold by central banks of IMF members, prior to amendment, at a price above that prescribed in Article IV, Section 2. I can assure you that the United States has no intention of making any such purchases. Some IMF member governments have taken the view that since the sole purpose of Article IV, Section 2, was to prevent members from undermining the par value system through gold transactions, and the par value system has now collapsed, the provision is no longer legally operative. The United States does not agree with that view.

Mr. Chairman, I hope this letter has served to resolve any uncertainties and remove any doubts which may have arisen concerning actions we have taken and agreements we have made on these matters. I believe we have an opportunity for major progress toward our objectives with repsect to both balance of payments financing and gold. I hope that you and other members of Congress will be able to give your full support to the proposals I have described.

Sincerely yours,

WILLIAM E. SIMON.

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., January 28, 1976.

Hon. WILLIAM E. SIMON,
Secretary of the Treasury, Treasury Department,
Washington, D.C.

DEAR MR. SECRETARY: Thank you for your January 26 response to my letter of December 24, 1975. While I still have a number of questions about the details of implementing the agreement on disposition of the International Monetary Fund's gold stock and on the sort of exchange rate regime that will be adopted in the future, my apprehensions have been substantially allayed by the assurances contained in your letter. I refer particularly to the following:

"Let me assure you absolutely that those parts of the agreement which require amendment of the Articles will be submitted to the Congress for authorization, and that any implementing measures which the United States or the International Monetary Fund will take prior to amendment are in fact authorized by the present Articles of Agreement."

To avoid possible misunderstanding between the Treasury and myself regarding the substance of the agreement reached in Kingston or the measures contemplated to implement it before the Fund's Articles have been amended, I would be most appreciative if you could respond to a series of questions about the details of these arrangements. If you could deliver a written response in advance of your scheduled testimony before the Joint Economic Committee on February 4, it would be extremely helpful.

Let me turn first to your remarks regarding the activities of the Bank for International Settlements with respect to IMF gold sales. You stated in your letter that:

"The Bank for International Settlements would be able to bid, for its own account, in IMF gold auctions conducted for the trust fund. This seems perfectly proper to me. The BIS is not an IMF member. It is an independent institution, whose separate legal status and independence from governments are clearly established. The BIS has express legal authority to buy and sell gold for its own account. Thus, in allowing the BIS to bid at its auctions, the IMF would merely be recognizing these existing facts.

To me purchases of gold by the BIS seem proper as long as they are conducted within the obligations that the eight central banks which manage the Bank

for International Settlements accept under the IMF Articles and as long as the BIS purchases gold not as an agent of any central bank but, in the event of such purchases, as distinct investor.

Pertinent to the understanding regarding gold, could you please answer the following questions:

(1) Presumably until the IMF Articles are amended to abolish the official price of gold, the Fund will not sell gold at above the official price either to central banks or to their agents. Is my assumption correct?

(2) During the interim when amendments to the Fund Articles are under consideration but have not yet been ratified, what measures does the IMF intend to take to insure that gold sales are not made at market prices to the agents of monetary authorities?

(3) What sort of information will the Treasury receive regarding the amount, price, and disposition of any gold from the current IMF stock that the Bank for International Settlements may purchase?

(4) If the Bank for International Settlements does not retain whatever gold it may purchase from the IMF stock, but instead sells such gold to the monetary authority of an IMF-member country at a market-related price, will the Treasury through the U.S. Executive Director to the IMF insist that sales of Fund gold to the BIS be halted?

(5) Your letter states that, "The Interim Committee has agreed that market sales of gold by the trust fund should be conducted in public auctions over a four-year period and according to an appropriate timetable." If the market price of gold falls substantially, will the schedule of sales be altered? Will the period during which these sales are executed be extended beyond four years?

(6) The understanding reached by the Group of Ten to accompany the Interim Committee's agreement on gold announced August 31, 1975, states that for a period of at least two years, "there will be no action to peg the price of gold". Particularly in the light of this anti-pegging pledge subscribed to by the United States, would you explain Treasury gold sales policy and enumerate the relevant factors determining whether or not a sale is to be carried out and what its volume should be?

(7) The communique issued by the Interim Committee on January 8, 1976, in Kingston states that given the approval of members with 85 percent of the total voting power, the Fund under the revised Articles will have wide latitude to sell or distribute the 100 million troy ounces of gold remaining after sale of 25 million ounces in the market and restitution of another 25 million ounces. When in the future further distribution of Fund gold is contemplated, will the Congress be notified well in advance of the execution of any such plan and have an opportunity, through a specified mechanism, to advise the Secretary of the Treasury that he reject any proposed distribution not supported by a majority of Members in either the House of Representatives or the Senate?

Let me now turn to arrangements regarding exchange rates. The proposed draft of Article IV seems acceptable as far as it goes. The Committee of Twenty appended to its report an annex including proposed guidelines specifying the circumstances under which the monetary authorities of countries choosing to let the value of their currencies be determined in exchange markets either would be expected to intervene or could do so at their own discretion. No comparable guidelines have been published to accompany a proposed new Article IV. The only operative public statement on this subject is contained in the November 17, 1975, Rambouillet declaration by the chiefs of state of six industrial countries. It said, "Our monetary authorities will act to counter disorderly market conditions or erratic fluctuations in exchange rates". To clarify the circumstances under which U.S. monetary authorities intend to intervene in exchange markets, either independently or in cooperation with the authorities of other countries, could you please answer the following questions:

(1) Does an "erratic fluctuation" in exchange rates occur if and only if markets are disorderly? What determines whether or not a change in market-determined exchange rates constitutes an "erratic fluctuation"?

(2) From time to time significant amounts of liquid assets have either moved into or out of the United States in response to a change in the differential between interest rates in this country and abroad. Such transfers of liquid assets are frequently accompanied by a noticeable change in the sup-

ply of or demand for dollars in exchange markets. If the change in the volume of exchange transactions is significant, the value of the dollar in terms of one or more foreign currencies will be altered. Does such a shift in dollar exchange rates resulting from a change in interest rates here or abroad constitute an "erratic fluctuation"? Do you consider that such a shift in exchange rates ought to be countered through intervention by monetary authorities?

(3) If the change in economic conditions inducing the international capital flow and hence the shift in exchange rates outlined in the previous example were a change in the rate of inflation in the United States relative to that abroad, would that movement in exchange rates be considered an "erratic fluctuation"? Would intervention by monetary authorities be appropriate?

(4) What sort of information does the Treasury receive about the frequency and volume of exchange market intervention affecting the dollar executed by foreign monetary authorities?

(5) In August 1975, the Subcommittee on International Economics of the Joint Economic Committee and the Subcommittee on International Trade, Investment and Monetary Policy of the House Committee on Banking, Currency and Housing published a report including a recommendation on intervention in exchange markets. The recommendation said:

"The United States monetary authorities should intervene in exchange markets only to combat or to prevent the emergence of disorderly conditions. Intervention should not attempt to influence the trend of exchange rate movements. Swap borrowings and loans entered into between the Federal Reserve and foreign monetary authorities should normally be liquidated, i.e., the position fully reversed, within six months of the initial transaction. Only as a result of the most extraordinary circumstances should swaps remain outstanding for more than a year. U.S. monetary authorities should not accumulate additional reserves in the form of foreign exchange."

Does the Treasury subscribe fully to this guideline? In the event of any reservations, could you specify and explain them?

(6) The proposed Article IV states that each member of the IMF shall "avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members". What determines whether or not a competitive advantage enjoyed by a given nation at any particular moment is "unfair"? Why was not a similar injunction included against a member's exporting inflation, rather than unemployment, by pegging or supporting the external value of its currency at an unrealistically high level?

Sincerely,

HENRY S. REUSS,
Chairman, Subcommittee on International Economics.

THE SECRETARY OF THE TREASURY,
Washington, February 3, 1976.

Hon. HENRY S. REUSS,
Chairman, Subcommittee on International Economics, Joint Economic Committee, Congress of the United States, Washington, D.C.

DEAR MR. CHAIRMAN: I am writing in response to your letter of January 28, in which you raise a series of questions regarding the details of the recent agreements on gold and exchange arrangements.

The following are responses to your questions on gold:

Question 1. Presumably until the IMF Articles are amended to abolish the official price of gold, the Fund will not sell gold at above the official price either to central banks or to their agents. Is my assumption correct?

Answer. Your assumption is correct. The Fund will not knowingly sell gold above the official price to the monetary authorities, or the agents of monetary authorities, of IMF member countries prior to amendment of the IMF Articles abolishing the official price of gold.

Question 2. During the interim when amendments to Fund Articles are under consideration but have not yet been ratified, what measures does the IMF intend to take to insure that gold sales are not made at market prices to the agents of monetary authorities?

Answer. Details of procedures for conducting IMF auctions have not yet been discussed in the Executive Board. However, we would expect the IMF to state, in connection with any auctions, that it would not accept bids above the official price from the monetary authorities, or the agents of the monetary authorities, of IMF member countries, and to request bidders to specify the capacity in which they are bidding. We will seek the inclusion of such a provision when details of auction procedures are discussed in the Board.

Question 3. What sort of information will the Treasury receive regarding the amount, price, and disposition of any gold from the current IMF stock that the Bank for International Settlements may purchase?

Answer. While detailed procedures for the auctions have not yet been developed or agreed, we expect to receive full information regarding amount, prices and buyers of IMF gold. The IMF would not be expected to have the right to insist on knowing the further disposition of gold by a successful bidder—the BIS or any other bidder—beyond assurance that the bidder is not acting as agent for the monetary authorities of a member country. However, a member of the IMF buying gold at above SDR 35 an ounce would be in violation of the IMF Articles, and the monetary authorities of IMF member countries would be required under the IMF's regular reporting procedures to report to the IMF any additions to their gold holdings regardless of the source from which purchased.

Question 4. If the Bank for International Settlements does not retain whatever gold it may purchase from the IMF stock, but instead sells such gold to the monetary authority of an IMF-member country at a market-related price, will the Treasury through the U.S. Executive Director to the IMF insist that sales of Fund gold to the BIS be halted?

Answer. The BIS would not be permitted to purchase gold as the agent of an IMF member country. But in the example given, the BIS would presumably be buying gold from the IMF for its own account and representations in the IMF would, therefore, not be appropriate. However, the question of BIS participation is a false issue. A central bank that was determined to acquire gold could simply purchase gold on the market in a transaction wholly unrelated to the IMF sales, or could purchase gold on the market immediately following an IMF Trust Fund auction.

Question 5. Your letter states that, "The Interim Committee has agreed that market sales of gold by the trust fund should be conducted in public auctions over a four-year period and according to an appropriate timetable." If the market price of gold falls substantially, will the schedule of sales be altered? Will the period during which these sales are executed be extended beyond four years?

Answer. Our discussions with participants in the private market suggest that the approach that has been agreed is least likely to be disruptive to the market, and we would not expect the sales schedule, once fixed, to be extended or otherwise altered. No price objective will be involved, and a decline in the price of gold should not, in and of itself, cause the IMF to alter its plans. At the same time, however, the IMF is entering a new and untested area. If there were to be a drastic change in market conditions, the IMF could decide to reexamine its plans.

Question 6. The understanding reached by the Group of Ten to accompany the Interim Committee's agreement on gold announced August 13, 1975, states that for a period of at least two years, "there will be no action to peg the price of gold." Particularly in the light of this anti-pegging pledge subscribed to by the United States, would you explain Treasury gold sales policy and enumerate the relevant factors determining whether or not a sale is to be carried out and what its volume should be?

Answer. Sales of U.S. gold by the Treasury to date have been related to helping meet net import demand for gold from abroad, and are consistent with our view that the international monetary role of gold should continue to diminish. We have not attempted to enunciate a long-term sales policy, but would expect to continue to conduct sales from time to time to help meet import demand. We will in no way conduct sales in a manner that would "peg" the market price of gold or that could be construed to have that objective.

Question 7. The communique issued by the Interim Committee on January 8, 1976, in Kingston states that given the approval of members with 85 percent

of the total voting power, the Fund under the revised Articles will have latitude to sell or distribute the 100 million troy ounces of gold remaining after sale of 25 million ounces in the market and restitution of another 25 million ounces. When in the future further distribution of Fund gold is contemplated, will the Congress be notified well in advance of the execution of any such plan and have an opportunity, through a specified mechanism, to advise the Secretary of the Treasury that he reject any proposed distribution not supported by a majority of Members in either the House of Representatives or the Senate?

Answer. The IMF takes decisions regularly on the use of its resources, and, in our view, it would be undesirable and inappropriate to give special treatment, such as is suggested in the question, to the use of one particular IMF asset—gold. All uses of IMF resources must be consistent with the purposes of the IMF. At present, the IMF may take a decision to sell gold, through the replenishment provisions, by a simple majority vote, and such decisions have been taken frequently in the past. Under the amended Articles, a negative vote by U.S. representatives in the IMF would block any proposed sale. U.S. representatives in the IMF would obtain their instructions on any such issue following the same procedures as apply to any other issue which comes before the Executive Board. We would, of course, expect to report to the Congress on any decisions taken on gold sales, and would be guided by the basic objecttive—an objective widely supported in the Congress—of a continued reduction in the international monetary role of gold.

The following are responses to your questions on exchange arrangements:

Question 1. Does an "erratic fluctuation" in exchange rates occur if and only if markets are disorderly? What determines whether or not a change in market-determined exchange rates constitutes an "erratic fluctuation"?

Answer. These are general terms which we have used to try to convey in a broad sense the type of situation which we feel could warrant exchange market intervention. In our view, the terms "erratic" and "disorderly," while not precisely defined or precisely definable in advance, are synonymous, in the sense that they are both meant to describe a situation in which the markets are not functioning properly. Put another way, it is in our view likely that erratic fluctuations would be characterized by disorderly market conditions. The issue is unavoidably and appropriately judgmental, and decisions must be taken on the basis of continuing surveillance and analysis of market developments.

Question 2. From time to time significant amounts of liquid assets have either moved into or out of the United States in response to a change in the differential between interest rates in this country and abroad. Such transfers of liquid assets are frequently accomplished by a noticeable change in the supply of or demand for dollars in exchange markets. If the change in the volume of exchange transactions is significant, the value of the dollar in terms of one or more foreign currencies will be altered. Does such a shift in dollar exchange rates resulting from a change in interest rates here or abroad constitute an "erratic fluctuation"? Do you consider that such a shift in exchange rates ought to be countered through intervention by monetary authorities?

Answer. Exchange rates move in response to pressures affecting capital as well as trade accounts. We would not generally characterize a change in exchange rates as "erratic" because it was associated with changes in interest rate differentials. In considering whether an exchange rate fluctuation is "erratic", judgments would have to be made about a particular exchange rate change and the conditions surrounding it.

In the normal course of events, changes in interest rate differentials are to be expected, and to the degree they reflect the fact that key economies are not expanding or contracting in lock-step fashion, they are one manifestation of a desirable situation.

In our view, efforts to superimpose stability by intervention designed to offset the effects of changes in interest rate differentials would normally be unwise—"stability" is desirable and can only be obtained through more attention to underlying economic and financial conditions and less to intervention operations.

Question 3. If the change in economic conditions inducing the international capital flow and hence the shift in exchange rates outlined in the previous example were a change in the rate of inflation in the United States relative to that abroad, would that movement in exchange rates be considered an "erratic" fluctuation"? Would intervention by monetary authorities be appropriate?

Answer. In our view, the term "erratic" describes conditions in the exchange market and cannot be defined by, or associated in advance with, any particular cause of exchange rate movements. If one country were inflating at a very rapid

rate and another at a very slow rate, it is reasonable and desirable that the exchange rate relationship between them change to reflect that difference. This is one of the advantages of a more flexible exchange rate system.

The thrust of the Rambouillet Agreement, and the proposed Article IV that resulted from it, is to fix the basic responsibility for variability in exchange rates on changes in underlying economic and financial conditions. Included in the latter are capital flows triggered by changes in economic and financial conditions as well as market expectations as to what might occur.

Question 4. What sort of information does the Treasury receive about the frequency and volume of exchange market intervention affecting the dollar executed by foreign monetary authorities?

Answer. The Treasury receives, on a confidential basis, daily reports on exchange market intervention undertaken by the monetary authorities to the major foreign industrial countries.

Question 5. In August 1975, the Subcommittee on International Economics of the Joint Economic Committee and the Subcommittee on International Trade, Investment and Monetary Policy of the House Committee on Banking, Currency and Housing published a report including a recommendation on intervention in exchange markets. The recommendation said:

"The United States monetary authorities should intervene in exchange markets only to combat or to prevent the emergence of disorderly conditions. Intervention should not attempt to influence the trend of exchange rate movements. Swap borrowings and loans entered into between the Federal Reserve and foreign monetary authorities should normally be liquidated, i.e., the position fully reversed, within six months of the initial transaction. Only as a result of the most extraordinary circumstances should swaps remain outstanding for more than a year. U.S. monetary authorities should not accumulate additional reserves in the form of foreign exchange."

Does the Treasury subscribe fully to this guideline? In the event of any reservations, could you specify and explain them?

Answer. We agree fully that the purpose of these swaps should be to finance market operations undertaken to counter disorderly conditions and not to influence the trend of exchange rate movements. Swap positions should normally be reversed in the short-term—say, six months. However, a rigid limit is not desirable. It may also be desirable to hold some balances so as to be able to finance intervention in the event of need without drawing on a swap line.

Question 6. The proposed Article IV states that each member of the IMF shall "avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members." What determines whether or not a competitive advantage enjoyed by a given nation at any particular moment is "unfair"? Why was not a similar injunction included against a member's exporting inflation, rather than unemployment, by pegging or supporting the external value of its currency at an unrealistically high level?

Answer. By obligating members to avoid manipulations which would prevent effective balance of payments adjustment, the new Article IV clearly foresees action to avoid overvalued as well as undervalued exchange rates. Members are to focus their efforts on achieving underlying economic stability, and such stability is not compatible with the inefficiencies that occur as a result of exchange rate manipulation.

The basis for determination of whether a country is gaining an "unfair" advantage will clearly have to be developed with experience, as we build a history of "case law" under the new Articles. An initial approach might be based on two types of data. First, there are data on exchange market operations which—over time—will give a very good indication of whether or not adjustment to persistent trends is being resisted. In addition, we are developing improved consultation procedures which will provide a broad basis on which to determine whether a country's policies are reflective of underlying economic conditions or are designed to manipulate the rate or the system.

I am pleased to have this further opportunity to respond to your questions on the monetary agreements. If there is any further information which you might find useful, please do not hesitate to let me know.

Sincerely yours,

WILLIAM E. SIMON.

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