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THE BOOK VALUE OF MONETARY GOLD

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The debate over a devaluation of the U.S. dollar in terms of gold has been going on for months, but the parties seem unable to sort out sense from nonsense, truth from fiction, economics from politics and cosmetics. The difficulty lies partly in an unwillingness to do this job of sorting out as long as each side hopes that the "opponent" will give in, but it lies chiefly in the continuing use of ambiguous words, which are confusing everybody, the speakers themselves as well as their audiences.

They speak of "burden" and "burden sharing" where no burden, at least no economic burden (loss, disadvantage) is involved; and they speak of the dollar price of monetary gold where neither a price nor an exchange value is involved but only a book value. The chief purpose of this paper is to clarify the issues.

Price, Exchange Value, Book Value

Between 1961 and 1968 a fixed price of gold was maintained by the United States together with six other member countries of the Gold Pool. Everybody—individuals, business firms, commercial banks, as well as monetary authorities—was able to buy and sell gold in London at a price of $35 an ounce. This price was maintained through sales and purchases of gold by the Bank of England acting for the Pool. When the Bank through its interventions in the free market increased its gold holdings, the other members shared in these purchases by buying parts of the acquired gold from the Bank of England with U.S. dollars; when the Bank intervened by selling gold in the market, the other members shared in these sales by selling some of their monetary gold to the Bank of England for U.S. dollars. In 1967 and early 1968, when speculation in gold led to private purchases far in excess of current production of gold, the net sales were ultimately made by the United States, since the other monetary authorities could present the dollars they received (as proceeds from their sales) to the United States for conversion in gold.

In March 1968, with the introduction of the "two-tier system," the price of gold in the free market was cut loose from the fixed exchange value of gold in official transactions among monetary authorities. For legal reasons the authorities continued to speak of an official "price" of gold, although the $35 per ounce of monetary gold was in fact no more than an exchange value of a gold token in official reserve transactions. It was understood among the national monetary authorities that large-scale "purchases" of monetary gold from the United States, that is, con-

versions of official dollar holdings into gold, were against the rules of good behavior. Thus, while the foreign-exchange holdings (chiefly dollars) of the other countries increased from $27,606 million in December 1967 to $53,222 million in June 1971, their gold holdings decreased in this period (through payments to the Fund, chiefly for increased quotas) from $27,440 million to $25,973. It is quite evident that the countries were fully aware that they could not buy gold from the United States except in negligible amounts and that the dollar was therefore not "really" convertible in gold. Still, for very small official transactions among the monetary authorities, the official exchange value of gold continued to be $35 per ounce.

On August 15, 1971, even this merely symbolic practice was terminated: the United States announced that it would no longer sell gold to other monetary authorities. With this action the dollar was cut loose from gold. Where there are no sales, no purchases, and no exchanges of gold against dollars, there can be neither a price nor an exchange value of gold in dollars. For accounting purposes, however, a valuation is still needed; so the $35 became a book value of an ounce of gold in the accounts of the U.S. Government. The great debate about a devaluation of the dollar is, therefore, under given circumstances, only a squabble about the book value at which the United States and other countries carry their monetary gold stocks. Why should anybody but a bookkeeper, accountant, or corporation lawyer get excited about a book value in a financial statement? Let us examine the arguments and the possible reasons for and against a change in the official book value of gold. The arguments relate chiefly to two separable issues: exchange-rate adjustments with their effects on international flows of goods and services, on the one hand, and balance-sheet adjustments together with the purchasing power of monetary reserves, on the other.

The Economic Burden of Exchange-Rate Realignment

It has taken the officials a very long time to find out, but they are now generally agreed that the dollar is overvalued in terms of the other major currencies of the non-Communist world. This overvaluation could be "cured" by means of a devastating deflation in the United States and/or poisonous inflations in the surplus countries; but only fools or brutes would prescribe such a cure. All responsible officials now understand that a major realignment of exchange rates is needed to bring about the required adjustment without subjecting several economies to damaging deflationary and inflationary treatments. However, while all agree that the exchange rates must be realigned, many believe that the realignment could be accomplished more easily or at less cost or with a fairer distri-

bution of the inevitable "burden" if the United States were to raise the book value of monetary gold. What cost or burden do they have in mind?

Most of those who speak of economic (not political) costs or burdens associated with a reduction in the exchange rate of the dollar in the foreign-exchange markets think of the resulting changes in foreign trade and their consequences for production, employment, and consumption. With the dollar cheaper in terms of the major currencies, exports will increase and imports decrease in the United States, while exports will decrease and imports increase in the previous surplus countries. Three types of economic cost or burden may be associated with these changes:

1. A transitional cost will be incurred with the implementation of the structural changes involved in the shifts of production between export industries and import-competing industries, on the one hand, and industries in the nontrade sector, on the other. These "change-over costs" may be especially high if adjustment is to be fast. For example, if the turnaround of the American balance of payments is to be achieved chiefly by a change in its trade account from one year to the next, the previous surplus countries may suffer reductions of employment and capital values in both their export and their import-competing industries.

2. A permanent burden will have to be borne by the previous deficit country, as it will have to give up more of its output to foreign countries, mainly to those that previously were willing to accept liquid dollar claims but now will have to be given real goods. If "economic burden" is defined as the portion of the national product that is transferred abroad, then it is clear that such a burden will be imposed on the United States and that the output share it loses will accrue to the countries whose dollar surplus is replaced by real resources.

3. A "mercantilistic pseudo-burden" will be imposed on countries that have their payments surplus eliminated and thus will no longer have to accept claims on foreign banks and governments but will receive real resources instead. Students of international economics understand that this is not really a burden; the happiness of the exporters with large export orders must not be confused with the economic welfare of their country. An export surplus for which a country receives only large inflows of monetary reserves (dollars or, even worse, gold) constitutes a sacrifice of present consumption or of domestic investment or both; the surrender of the goods and the receipt of monetary reserves drive up price levels, and the additional reserves may never be needed. To get rid of an export surplus of this sort is a clear economic advantage. Economic illiterates regard it as a burden.

No matter how we evaluate these benefits and costs, they are not affected in any way either by the techniques used to realign the exchange

rates or by the division of roles in achieving the realignment. The U.S. dollar can become cheaper by 10 per cent in terms of the French franc in a variety of ways: the Americans may raise the dollar book value of gold by 10 per cent while the French leave the franc book value of gold unchanged; the French may reduce the franc book value of gold by 10 per cent while the Americans leave the dollar book value of gold unchanged; the Americans may raise the dollar book value of gold by, say, 5 per cent while the French reduce the franc book value of gold by 5 per cent; or neither the French nor the Americans may bother with the book value of gold while the French let the exchange rate of the dollar in Paris float down from the official level (set in August 1969) of frs. 5.55 to frs. 5.00. (Some readers may like to be reminded that this reduced exchange rate of the dollar would still be higher than the par value between 1959 and 1969.) Symmetry may suggest a fifth technique: the American authorities may purchase French francs at 20 cents; but the American authorities have always stayed out of the foreign-exchange markets. In all those cases, the effects upon production, exports, imports, prices, international competitiveness of producers, incomes, and employment *would be precisely the same.*

Whatever economic burdens may be imposed on one country or another by any of the changes in the enumerated variables, these changes are effected by the adjustment of the exchange rates and not by anything that is or is not done to the book value of gold. Hence, as long as these (and not other) burdens are under consideration, the talk about sharing them is pure claptrap; and the plea that the United States could, by raising the book value of its gold, make a "contribution" to lighten the "burden" on other countries betrays a lack of understanding of the economic relationships involved.

The Internal Politics of Exchange-Rate Adjustment

Some politicians who speak of "burden" may think of political difficulties. In democracies they may think of the popular reactions to their actions, as expressed in votes at the next election, in contributions for election campaigns, or in other favors and amenities. A revaluation of a currency or its appreciation in the foreign-exchange market would be unpopular with producers of goods for export or competing with imports; many stockholders, managers, and workers, with all their families and friends, may join the opposition of a government that raises the exchange value of the currency.

Yet, since this adjustment of the exchange rate is inevitable, can it perhaps be so arranged that all the responsibility for it can be shifted to

the United States? If the United States were to raise the dollar book value of gold while the French (and other nations) did nothing to the book value of gold in terms of their own currency, would not the price of the dollar be "automatically" reduced in terms of French francs (and other currencies)? The answer is "no." To call this reduction in the franc price of the dollar "automatic" is sheer humbug. The franc price of the dollar is determined by the price at which the Banque de France purchases dollars in the market.

The Banque does not buy or sell gold, it buys and sells dollars. It intervenes in the foreign-exchange market by offering French francs for U.S. dollars. It may offer frs. 5.55, frs. 5.25, frs. 5.00, or whatever price it deems desirable. If the Americans change the dollar book value of gold, the French may still set the intervention price for dollars at whatever level they like. There may be at best a dozen persons in France who know the "equivalent" of a franc in grams of gold and the equivalent of that in ounces of gold and the equivalent of that in U.S. dollars according to the official dollar book value of gold. But to French exporters, stockholders, and workers it means nothing. The price of the dollar is what a seller of dollars gets in the Paris market, and that depends on what the Banque de France pays for it. The French Government cannot in truth tell anybody that the franc price of the dollar is an automatic result of a decision by the American Government to raise the book value of an ounce of gold by $3.50, or any such amount.

A very honest central-bank governor admitted all this, but nevertheless said to me that the industrialists in his country, while still worrying about their competitiveness in export markets, would forgive him an appreciation or upvaluation of their currency if he could tell them that at least half of it was the "automatic consequence" of the Americans' decision to raise the dollar value of gold. I cannot imagine that these industrialists are quite that naïve or, if they are, that they could not be educated by a few lectures.

Many politicians believe that it is easier to take the myths and illusions of the masses for granted and to act accordingly; instead of trying to enlighten the people, governments often find it politically less costly to argue and act along the lines of least public resistance. Yet this precept was shown to be wrong in the German elections of 1969: the conservative party used all the popular slogans and customary fallacies in arguing against letting the German mark appreciate, while the social democrats courageously explained the economic reasons for letting the currency float upward. The voters showed that education in economic matters is possible.

Any government or national or international monetary authority that

deliberates about an "acceptable" exchange rate that may be viable (at least for a year or two) must reason and argue in terms of changes in price levels and wage costs and in terms of possible effects on the current balance of payments. The idea that the book valuation of gold may be a factor in making a given adjustment of exchange rates more or less viable, or in making the resulting structural adjustments in production and trade more or less tolerable, is untenable. To be sure, the man on the street does not understand all economic arguments and may find it difficult to give up old myths; but if he has to be given some plausible explanations for desirable or inevitable changes in exchange rates, it should be possible to replace the fairytale about "passive acceptance" of a change in the book value of monetary gold in the United States with something that is a little closer to the truth.

Simultaneous Alignment of Exchange-Rate Pattern

If the dollar is overvalued relative to many currencies, would it not be much simpler to devalue the dollar instead of upvaluing dozens of other currencies? The answer to this question would be emphatically affirmative if it were possible by an action of the United States to devalue the dollar in terms of other currencies (and not only in terms of gold). As it is, however, exchange rates are not dictated by the United States and are not even influenced by any action of the American authorities, since all interventions in the foreign-exchange markets are executed by the monetary authorities of other countries selling and buying dollars at exchange rates of their choice, and not of the choice of the United States.

Those who advise the United States to devalue the dollar in terms of gold, that is, to raise the book value of its gold stock, believe in an irresistible "announcement effect" upon the rest of the world. How could such an announcement by the United States force all other countries to change the exchange rates at which they intervene in the markets? The announcement would have no influence, either mechanical or hypnotic. If the United States, by an act of Congress signed by the President, were to say that henceforth an ounce of gold had a value of $38.50, every single country of the world would have to make its own decision whether it should lower its buying and selling price of the U.S. dollar by 10 per cent or by more or by less or not at all. There is nothing automatic, coercive, mandatory, compulsive, instinctive, or imitative in their reactions. The "action" of the United States would not save any of the other countries the trouble or the political inconvenience of making a decision and taking action regarding the exchange rate of the dollar in terms of its own currency. On the contrary, if the United States leaves the dollar valuation of gold unchanged, *some* countries—running neither surpluses

nor deficits in their foreign payments—may decide to do nothing; if, on the other hand, the dollar valuation of gold is changed by the United States, *every* country must take action, changing either the gold parity or the dollar parity of its currency (or perhaps both).

One advantage may perhaps be claimed for an American initiative regarding the valuation of gold: it might induce several countries to make their decisions earlier and perhaps simultaneously and collectively. Simultaneous realignments of exchange rates are politically more easily defensible and economically more prudent. It is much harder for a government to move alone, not knowing whether and when other countries will follow and by how much. If an American initiative with regard to the dollar valuation of gold could be relied upon to result in *collective* adjustments of exchange rates, this would be a strong argument. Some experts also see a great advantage in an *early* reestablishment of a pattern of fixed exchange rates. Others, however, fear that an early return to fixed rates would merely mean a return to rigidity and a series of recurring monetary crises. It may well be preferable that the decisions regarding an "acceptable pattern" of exchange rates be postponed until there is an agreement about rules for their continuing gradual readjustment. At the moment, a fixing of the book values of gold would hardly assist, and might delay, the establishment of the required system of limited flexibility of exchange rates. Indeed, the naïve belief that a one-time correction in the gold value of the dollar would be an important move in the reform of the par-value system indicates that many of the negotiating parties have still not learned what was wrong with the way that system worked.

The Balance Sheets of Central Banks

If the official book value of monetary gold remains unchanged in the United States—$35 per ounce—while the exchange rate of the dollar vis-à-vis the stronger currencies is reduced by their official revaluations, many central banks may be told by legal counsel that they have to write down on their books (in terms of their own currencies) not only the value of their dollar holdings but also the value of their gold reserves, their SDRs, and their gold-tranche position with the Fund. If, on the other hand, the Americans raise the official dollar value of monetary gold by approximately the percentage by which other countries lower the exchange rate of the dollar, the book values of gold, gold-tranche positions, and SDRs can remain unchanged in the currencies of these countries. The central banks will have to write down on their books the value of their dollar holdings, but will have avoided the losses on their other reserve assets.

Such a differential treatment of reserve assets would be most attractive to countries that hold their monetary reserves largely in gold and only to a smaller degree in dollars. A glance at the composition of reserves of three countries will indicate how different the interests of various countries are in this respect.

COMPOSITION OF MONETARY RESERVES, AUGUST 31, 1971
(*in per cent*)

	France	*Germany*	*Japan*
Gold	46.1	24.3	5.4
SDRs and Fund positions	9.8	9.0	6.1
Foreign exchange	44.1	66.7	88.5
	100	100	100

Thus, for Japan the issue is almost irrelevant; the interest of Germany is slight; only France would find it important to see the need of a write-off limited to its dollar holdings and not to "lose" anything on 56 per cent of its monetary reserves.

The capital losses caused by write-downs of monetary reserves may raise legal and political questions in several countries. Central banks can absorb modest losses on their profit-and-loss accounts (as the Deutsche Bundesbank did when the German mark was revalued in 1969). Larger write-downs of their reserve assets may have to be covered by the issuance of special (perhaps interest-free) obligations of the government, to be held as dormant assets of the central bank. To arrange all this may give temporary headaches to the legal and financial experts charged with the solution of these accounting matters. But as long as the central bank does not plan to sell the gold for dollars, it makes no difference to anybody whether a portion of the previous book value of the gold stock and of gold-guaranteed claims is replaced by a balancing entry on the asset side of the balance sheet.

The Purchasing Power of Gold Reserves

The gimmickry of balance-sheet repair has no economic significance, but the future purchasing power of reserves has. After all, reserves are held for use in the future when a country may want to finance a deficit in its balance of payments instead of making the deficit disappear through a depreciation of its currency. The larger the monetary reserves, the longer will they last if the deficit is persistent. Such deficits have to be financed with foreign currencies or, what is the same thing, the exchange rate of the national currency has to be supported by intervening in the foreign-exchange market through offering dollars for sale. If the mone-

tary authority in question runs out of dollars, it can obtain dollars from other national or international monetary authorities by selling them some of its gold. It would surely make a difference if it could get $38.50 instead of only $35 for an ounce of gold. Thus the dollar-buying power of monetary gold depends on its official exchange value.

Why, some will ask, would this monetary authority be dependent on what other monetary authorities were willing to pay for its gold? Could it not get a higher price on the free market in London or Zurich? Yes, it might, if the quantity of gold it sells is quite small. If, however, much gold from monetary reserves were offered for sale in the free market, a drastic plunge in the market price might occur. The free market cannot easily absorb sudden increases in supply; large quantities thrown on the market as a result of demonetizing of some official gold stocks, and perhaps also of induced dishoarding of private gold stocks, may be far too much for the given elasticity of private demand.

No asset can function as a liquid reserve unless the holder can count on what he will get for it when he needs to liquidate it. If gold is to continue to be a part of monetary reserves, it will be necessary, sooner or later, to establish a fixed exchange value for it. This will probably be done by the International Monetary Fund standing ready to acquire at a fixed price gold offered to it by monetary authorities out of their existing reserves. It is possible that the price will be no higher than the present official book value established by the United States. On the other hand, countries with relatively large gold stocks will exert strong pressures in favor of a higher exchange value of monetary gold. Moreover, from an international point of view, one may be able to make an increasingly impressive argument against the loss of purchasing power of existing gold reserves that would be implied by having gold stay depreciated, along with the dollar, in terms of most other currencies. Thus, the final arrangements for controlling and providing "international liquidity" will more likely than not include an increase in the exchange value of officially held gold in terms of dollars.

Although this argument has been made from the point of view of countries other than the United States, we should not forget that the purchasing power of gold reserves may also be a factor from the American point of view. While other countries may use their gold reserves for acquiring dollars, the United States may one day want to use its gold reserves for purchasing foreign currencies (or for reacquiring dollars held by foreign countries), perhaps chiefly or exclusively through the International Monetary Fund. The time may come when it will be regarded as wasteful to "sit" on a "reserve," which is a reserve only if it can be used for something.