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# THE BOOK VALUE OF MONETARY GOLD

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Princeton, New Jersey

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# THE BOOK VALUE OF MONETARY GOLD

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, conversions 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 distribution 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 monetary 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.

The argument regarding the purchasing power of gold reserves is not immediately connected with the realignment of exchange rates. To repeat, the exchange value of gold is not relevant to the economic problems regarding relative prices, relative incomes, the realignment of exchange rates, and resulting changes in the volumes, balances, and composition of international trade. How many U.S. dollars a monetary authority can obtain for an ounce of gold will become important only when a country with large gold reserves has had a payments deficit so long that it is about to run out of dollars. Can any country now truthfully say that it is in this situation?

*The Exchange Value of SDRs and Fund Positions*

Much the same argument can be made in support of a revaluation of SDRs and reserve positions with the Fund.

The Articles of Agreement contain provisions for the maintenance of the "gold value" of the Fund's assets and for the rights and obligations of members in cases of devaluations, revaluations, and depreciations (and by implication also appreciations) of their currencies and of currencies they have purchased from the Fund. The new Articles concerning Special Drawing Rights stipulate that they are fixed absolutely (that is, not subject to a waiver by a decision of the Fund) in terms of gold. These provisions are of importance in the eventual decisions concerning the gold value of the dollar, or the dollar value of monetary gold.

One of the arguments made by the Managing Director of the Fund supporting an increase in the official dollar value of gold in conjunction with increases in the official dollar values of several major currencies is that failure to raise the dollar value of gold reduces the purchasing power of SDRs. As long as a unit of SDRs is equal to one U.S. dollar, which now buys fewer D-mark, fewer pounds sterling, fewer Dutch guilders, fewer Japanese yen, and less of several other currencies than it did before August 15, 1971, the SDR is in fact depreciated. This is especially disadvantageous to developing countries that have counted on using large parts of their allocations to finance purchases from industrial countries whose currencies have been allowed to float upward vis-à-vis the dollar. If there is a chance that some time in the not too distant future the dollar will be officially devalued in terms of gold, SDRs may be expected to gain in value relative to the dollar and, with such expectations, developing countries may prefer to hold on to their SDRs and to postpone spending. Any asset that is expected to appreciate at an uncertain date in the future is illiquid in that its holder by its "premature" use would forfeit the chance of gain.

From this point of view, one may say that the current controversy about the dollar value of gold has made gold-guaranteed reserves illiquid along with gold reserves, that it has thus reduced international liquidity to about half what it would be if the question of the dollar value of gold had been settled or never raised. To conclude from this that the world now suffers from a lack of reserves would, however, be an exaggeration, to say the least. What has happened is merely a bad case of Gresham's Law: the excess supply of dollars has "driven out" the other reserve assets from their role as actively "circulating" or usable monetary reserves.

Not only SDRs were *de facto* depreciated as several currencies were allowed to appreciate in terms of dollars; and not only SDRs became illiquid as a result of expectations that they may eventually be worth more in terms of dollars and other currencies. The same happened to regular reserve positions with the Fund. Can a country now afford to borrow dollars from the Fund and run the risk of being obliged to pay back more dollars if the United States should in the meantime be persuaded to devalue in terms of gold? Can a country afford to borrow other currencies and run the risk of their being revalued?

These are among the considerations supporting the view that the present state of uncertainty should not be allowed to last. It should be clear by now that there are arguments for and arguments against an early change in the dollar valuation of gold.

### *Illusions of Resumption of Gold Convertibility*

Militating against an increase in the dollar book value of gold at the present juncture is the possibility that it may raise the hopes of several governments that the increase might be a first step toward a return to gold convertibility of the dollar. Such hopes could be obstacles in coming to an agreement on building a sound international monetary system. The forthcoming discussions and negotiations would be more promising if the ministers and governors of the various countries succeeded in shaking off the orthodoxy of times long since passed and came to the conference room with realistic ideas of what constitute workable arrangements.

Even with exchange rates properly realigned, the dollar cannot again become convertible in gold. "Cannot" is perhaps too strong a word, because it is possible to conceive of rules, provisions, and safeguards that would allow gold convertibility to be "workable." The required arrangements would include the funding of all official dollar reserves above reasonable working balances, perhaps through their exchange for claims against the Fund—so that the bulk of the now-existing dollar holdings could never be presented at the gold window—and strict rules to the effect that countries gaining reserves too rapidly or beyond certain levels would be compelled to upvalue their currencies. Even such safeguards may not be sufficient in a world in which the dollar is widely used as a private international transactions currency and widely held in private liquid balances; the world will probably continue to be just like that. Trying to construct a system in which the dollar would again be convertible into gold would be a useless exercise (like building what older readers may remember as a Rube Goldberg contraption). There is no advantage in gold convertibility that could not be secured through other institutions more safely and with far less trouble. It seems from the speeches of the governors at the Annual Meeting of the Fund that most of the governments have accepted the "phasing out" of gold from the monetary system, and it would be a costly retrogression to put gold back into a role for which it is no longer suitable. After the experience of the last twenty-five years, the United States should under no circumstances consent to a resumption of gold convertibility.

This is not the place to discuss the practicality and desirability of making the dollar *convertible into any other assets*, such as SDRs or claims against the Fund. What matters in this essay is only the negative proposition that the illusion of a return to gold convertibility must be given up, and the warning that an increase in the book valuation of gold at this time might keep the illusion alive and thereby obstruct the attempts to come to an agreement on the principles of a new international monetary order.

Just to avoid a possible misunderstanding, it should be noted that in the new system the exchangeability of gold from existing monetary reserves into dollars or other national currencies may be secured (preferably through the Fund) without providing for the convertibility of the dollar or any other currency into gold.

*The Price of Newly Mined Gold*

To secure the exchangeability of existing gold reserves into dollars is one thing; it would be quite another thing to provide for official purchases of newly mined gold or of private gold stocks at a fixed price.

The agreement of March 1968, which established the two-tier system of gold transactions, included an understanding that national monetary authorites would no longer buy gold from private sources or from new production. The South Africans complained bitterly about the loss of an official outlet for their gold. In December 1969, when the gold price in Zurich and London was about to fall below \$35 an ounce, arrangements were made for South African gold sales to the Fund at \$35, less a handling charge. Such sales—of stocks of gold held by the monetary authorities of South Africa in March 1968, of gold they acquired after March 1968, and of newly mined gold—were to be limited with respect to circumstances and amounts.

Since the gold price in the private markets increased again in 1970 and was above \$40 for most of 1971, the uninitiated may wonder why the South Africans preferred to sell considerable amounts of gold to the Fund at \$35. (Sales amounted to \$672 million between January 1970 and April 1971.) The answer lies in the prudent estimation by the South Africans of the elasticity of private demand for gold: by disposing of a portion of their output through sales to the Fund, and thus withholding these quantities from the private market, a much better market price was obtained, with total proceeds from the two outlets together larger than they would have been if all the gold had been offered for sale in the private tier.

What would a change in the book valuation of gold by the United States imply for the official price of South African gold in terms of rands and for the selling arrangements with the Fund? The par value of the rand, as established in 1961, is \$1.40 for one rand, or S.A. rand 25.00 for an ounce of gold. Assume, just for purposes of illustration, that the United States were to raise the official valuation of gold by 5 per cent to \$36.75. If this "devaluation" of the dollar is regarded as the American "contribution" to the adjustment of the exchange rates between the dollar and other currencies—an adjustment the Minister of Finance of the Republic of South Africa recognized as being necessary—the other countries would have to revalue their currencies in terms of dollars by more than 5 per cent, say, by 10 per cent. If they did, they would have to reduce the value of gold in terms of their own currencies. South Africa, for example, would have to reduce the value of an ounce of gold to S.A. rand 23.75 and raise the par value of its currency from \$1.40 to \$1.55 for one rand. If South Africa maintained that its balance of payments would permit no larger adjustment of the rand-dollar exchange rate than that commensurate to the 5 per cent devaluation by the United States, it would keep its official gold valuation at S.A. rand 25.00 and would raise its exchange rate to \$1.47 for one rand.

The arrangements for gold sales to the Fund would probably have to be renegotiated, since they are explicitly geared to a price of \$35. The Government of the United States, even if it agreed to an increase in the value of gold in existing official reserves, would surely object to an undertaking that promised a higher dollar price for purchases of newly mined gold by the Fund. In any case, however, the proceeds from such sales of South African gold would not increase in terms of South African currency—they would even be reduced if the revaluation of the rand were larger than the American revaluation of gold—and it is in rands that the costs and the profits of South African gold-mining companies are calculated.

This does not mean that the South Africans would lose interest in maintaining the possibility of selling newly mined gold to the Fund. If Soviet Russia should resume selling gold or if private holders of gold wanted to liquidate some of their large stocks, South Africa would find it most helpful to be able to withhold portions of its current output from the private market.

### *Concluding Remarks*

This paper was chiefly designed to clarify the issues, not to make policy recommendations or predictions. However, in discussing the major arguments for and against an early change in the dollar valuation of gold one cannot help showing the strengths and weaknesses of the two positions. Yet even a complete scoreboard would not necessarily show us where we come out on balance. The weights of the various arguments are quite different; moreover, to demolish an argument for one position need not strengthen the arguments for the other side. If an argument in favor of raising the dollar valuation of gold is proven untenable, this does not constitute an argument against such an action.

A case in point is the argument that the effects of exchange-rate realignment upon exports, imports, prices, and production would be different if the adjustment were accompanied or initiated by an increase in the dollar value of gold. This argument is completely wrong: the American action would neither lighten the economic burden of the adjustment nor change its distribution. On the other hand, an American initiative regarding gold would not injure the trading interests of the United States.

I leave it to the reader to judge where the balance of the arguments lies from the point of view of the decision makers. There are reasons for early action and reasons against early action. One issue that deserves more attention than it was given in the discussion relates to the learning process among those in charge of the international negotiations. There is some danger that a quick "solution" would retard the reforms essential for a viable system. Too many of the men in high positions in national governments and international organizations still talk about an early return to "fixed" exchange rates. All they have learned thus far is that a wider band of permissible fluctuations of exchange rates might be helpful, but even there one hears reservations that this should be merely temporary. As long as this way of thinking prevails, the chances for the establishment of a viable system are slim.

A wider band is not enough. The parities themselves must be adjustable in small steps, and there must be a presumption that such adjustments should be made more than once a year. In addition, rules for these continuing readjustments must be agreed upon—rules of thumb, not fixed formulas. (Fixed formulas for adjustment may be as bad as fixed parities that are adjusted only when every imbecile knows they are misaligned.) The width of the band and the speed limit for the crawl are interrelated. The band must be wide enough to make it possible for the largest permissible crawl of the parity to leave the actual exchange rate in the market unchanged.

The resistance to such flexibility is understandable, because most "experts" went to university when we taught the classical adjustment mechanism (where wage rates and prices went down, or at least failed to increase, when gold was flowing out) and when we did not know the effects on the rate of unemployment. Some people cannot get it into their heads that times have changed. They continue to talk about the discipline imposed by the gold standard and about the desirability of returning to that golden age. The new international monetary arrangements, if they are to work, must be made by more enlightened people.

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