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INTERNATIONAL MONETARY DEVELOPMENTS
AND THE MINING INDUSTRY

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It was my friend Erwin Frizelle, President of the First Metals Bank and Trust Company of Butte, Montana, who originally contacted me about joining you here at your 1968 convention, and I am, of course, grateful to him and to your convention officers for having invited me. As I am sure you will agree, it would not be good for a Federal Reserve Bank president to be seen spending time in the casinos that abound here. This country may very well be in the throes of a social revolution, but most people would still prefer, I believe, that bank presidents, even Federal Reserve Bank presidents, stay clear of the gaming tables. And unfortunately I came away from Minneapolis without an effective disguise. Even so, it is a pleasure to be in Las Vegas, and to have a chance to talk to all of you.

I have to begin with an apology. When Mr. Frizelle first wrote to me, he suggested that I talk about the implications of recent international financial developments for the mining industry. And without sufficient thought, I accordingly chose "International Monetary Developments and the Mining Industry" as the title of my talk. Not very original, you will say; and I quite agree. But this title is unfortunate for another reason. It promises that I shall be talking about the future of the mining industry, at least as it has been affected by recent international financial developments. Even if there were time enough, though, which there is not, I would

not be able to fulfill this promise. The simple truth is that I do not know enough about your industry to talk intelligently about its future. So I do apologize for possibly having misled you.

I cannot claim, however, to be completely ignorant about our mining industry. Only last August I was treated to a fascinating trip through the Homestake Mine in South Dakota, so I do know that gold is produced in the United States. And I know that there are those of you here, a small minority perhaps, who are vitally interested in the future price of gold. I can therefore fulfill the promise of the announced title of these remarks, if only to a very small extent, by discussing the international liquidity problem, and more particularly, recent efforts to solve this problem. Quite obviously, how it is solved matters very much to gold producers, not only in the United States, but around the world, for it has been suggested by some that a solution would be to increase the official price of gold and then have the western world's governments support this higher official price in private gold markets.

As you are aware, I am sure, the United States Government is completely opposed to increasing its official gold price--the price, that is, at which it sells gold to and buys gold from other western world governments. And wisely opposed, it seems to me. But this is not to say that the outlook for gold producers is necessarily bleak. Even if the official price of gold is not increased, gold producers may in years to come still find themselves selling at higher prices. There is no contradiction here, as I hope I shall be able to make clear.

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Just as firms and households find it convenient to hold spare cash, so do governments. And just as the desired cash balances of firms and households increase with increases in output and wealth, so do the desired balances of governments. For a country such as the United States, an increase in the

desired balances of firms and households is no problem. The Federal Reserve, our central bank, is able to supply additional cash to satisfy private demands. It does not always do so in the short run. But in the long run, or on average over a stretch of years, it does. The world, however, has no central bank. Which is perhaps just as well. But we have had no way of deliberately adding, when appropriate, to the stock of international money or reserves. This is why as we looked ahead it seemed we were increasingly risking a shortage of international reserves or liquidity, and a slower rate of growth of world output and trade than would be possible.

Through the early postwar years, it mattered not at all, at least to practical men, that the world's monetary authorities had never bothered to invent a way of deliberately supplying international reserves--or of deliberately satisfying, whether in whole or in part, governments' demands for international money. The United States was in deficit on international account even in the years before, say, 1958. And when this country has a deficit, it supplies dollars to the rest of the world. To put the point differently, a United States deficit makes possible an increase in the world's stock of international money, for dollars, like gold bars, serve as international money. Of course, for a United States deficit to result in an increase in world reserves, it is necessary that foreign governments not use the dollars supplied them to purchase gold from our Treasury, and for many years after the end of World War II, these governments were quite happy to acquire dollars--or better, dollar assets such as short-term Treasury obligations, which are known as Treasury bills. These assets earned them interest, and, as they believed, could at any time be exchanged for gold at a fixed price, \$35 per ounce.

I doubt very much the U.S. balance of payments deficit was in

itself a consciously and deliberately contrived instrument of national policy to ease the problems of central banks around the world. Our deficit came about for a number of very complicated reasons flowing out of the efforts of this country to assist in specific ways the reconstruction of the free world after the Second World War. It was endurable by everyone because these programs had independent economic and humanitarian justifications. The reserves they contributed to world liquidity, although not primary objectives of our national effort, were desirable. But we have had too much of a good thing.

The trouble is that foreign governments, taken together, have not persevered in a clear preference for dollars. They are more inclined now than they were a decade ago to use newly acquired dollars to purchase not dollar assets but gold bars. And no wonder. The United States gold stock has dwindled; and foreign official holdings of dollar assets, which amount to claims on our Treasury's gold, have increased. In brief, it is today much less apparent than it was a decade ago to those foreign governments which hold dollar assets that the U.S. gold stock assures they can be cashed in for gold at a price of \$35 an ounce. We are as concerned as they in restoring equilibrium to our balance of payments. The current program is a deliberate effort to bring this about.

It might be argued that if certain countries had not made large purchases of gold from our Treasury, thereby decreasing the U.S. gold stock and raising doubts about dollar-gold convertibility, then satisfying the official demand for international money would not have become a problem. But this, I believe, is wrong. It was inevitable, it seems to me, that we should have got into a fix. It was only a matter of time. For what happens when the U.S. has a deficit and, as a result, world reserves increase? The

liquid liabilities of the U.S. increase; and so, even if its liquid assets (gold) remain unchanged, there is a deterioration in the U.S. liquidity position. And surely foreign governments would not go on indefinitely accumulating dollar assets, if all the while the U.S. liquidity position were deteriorating; which, of course, is why the U.S. is making a strong effort to redress its balance of payments position.

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If the western world's monetary authorities cannot any longer count on U.S. deficits to increase international reserves or liquidity, neither can they count on current production of gold. In fact, it has been a long time since the supply of newly mined gold was such as to allow a sufficient increase in international liquidity. To be sure, even just a few years ago the supply of newly mined gold still exceeded private demand. For a long time, the central banks of the U.S. and certain European countries--acting as residual buyers at \$35 per ounce through the gold pool--were able to add to their holdings of gold. But even when private speculative demand was insignificant, the monetary authorities were not adding sufficiently to their gold reserves. Of late, moreover, speculative demand has been anything but insignificant. For awhile the central banks of the so-called gold pool, bent on keeping the free market price of gold from going above \$35 per ounce, were selling gold to the private market. Official holdings of gold were actually decreasing.

With the official price of gold fixed at \$35 per ounce, it was not to have been expected that supply would keep pace with demand, or that the western world's monetary authorities, acting as residual buyers at this price, would get sufficient gold to satisfy their increasing demands for international reserves. And it hardly takes a genius to figure out what the future holds, whatever happens to the monetary role of gold. And I do not have in mind

that speculative demand is going to remain what it has been.

The point is that the private nonspeculative demand for gold is increasing. One expert has projected an annual rate of increase of 12 percent. I have no basis for knowing whether this is a reasonable projection, but it is plausible to assume some continued growth of demand, for gold is a useful metal. There is the possibility, of course, that substitutes for gold will be developed, and supplied at relatively low cost. For myself, I have seen too many statements that started with "there is no substitute for . . ." discredited by American technology to stick my neck out very far in predicting future demand for anything--including, I might add, central banks. I would say, though, that for gold producers, non-monetary, nonspeculative market factors are on their side.

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It might seem as if I have been building up to a recommendation that the official price of gold be increased, and that to ensure an adequate increase in international reserves, the central banks of the developed western countries stand ready to buy all the gold offered at the new higher official price. This is one way of increasing international liquidity. Overnight the reserves of gold-holding countries would increase. Also, since presently sub-marginal gold mines could be operated profitably, there would be more gold added each year to the vaults of European and North American central banks if that were their sole objective.

But there is a strong case, I believe, for not increasing the price of gold, and I should like to present it before going on to the plan for increasing international liquidity, the so-called Special Drawing Rights plan, which has been all but officially adopted by the member countries of the International Monetary Fund.

It has been suggested that if the United States were to increase its gold price, and other countries were to follow, then the gold-producing countries, most notably South Africa and Russia, would benefit handsomely. And, so the argument goes, the U.S. should do nothing which benefits countries such as Russia and South Africa. For myself, I find this argument unconvincing. In reality, the inequities are much broader than this simplistic statement suggests. But even if only South Africa and Russia benefited, I do not believe the case against an increase in the price of gold should be made in these terms, provided that the advantage to the U.S. and the rest of the free world were in scale.

But the U.S. would not be doing itself or its monetary allies a favor, great or small, by increasing its gold price. Most importantly, it would be reneging on a moral commitment to those countries which through the years have accumulated not gold but dollar assets. Of course, and I want to emphasize that I am speaking conjecturally here, if there were to be an agreement among IMF members that all should increase their gold prices in proportion, then the U.S. could go ahead. Other countries, in signing the agreement, would in effect be releasing the U.S. from its moral commitment to continue supplying gold at \$35 an ounce. The probability, however, of such an agreement is zero in the predictable future, given the exchanges of solemn commitments this spring at Washington and Stockholm.

In any case such an agreement would be a disservice to the western world. Why? The argument is simple enough: If the price of gold were increased only a little, then there would be speculation on a further increase, and the central banks of the western world would end up getting no more gold than presently they are. And if the price of gold were increased sharply, enough so that no one could believe another increase was in the offing, then

inflationary pressures might result. And sometime in the future another increase in the price of gold would be necessary. Sometime in the future the western world would have to relive 1966-68 all over again.

This is a fundamental argument against proportionate increases in all official gold prices. Providing increases in international liquidity by periodically increasing gold prices could be destabilizing. With an increase in gold prices, countries are drowned in international liquidity. Through time, though, the excess of liquidity disappears, partly perhaps as prices increase; and then another increase in gold prices becomes necessary. The central problem, which is the orderly expansion of reserves, would not have been solved at all.

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How much better to provide reserves at a reasonably steady rate over the years, or at a rate appropriate to current and prospective needs for reserves. This is what the countries which belong to the International Monetary Fund have decided to do. This is what will be done if, as seems likely, the Special Drawing Rights plan is accepted as an amendment to the Articles of the IMF, and thereafter put into operation. The U.S. Congress, I might point out here, has already ratified the amendment, and ratification by other countries, France excepted, is pretty much assured.

The plan is best described, I believe, as a way of creating money, or Special Drawing Rights, with no gold backing, which when needed can be used by governments to finance balance of payments deficits. Within limits, participating surplus countries will have to accept SDRs in exchange for currencies, and this is all that is required to make SDRs serve as money. It might take time for SDRs to gain full acceptability. In the beginning there could be minor difficulties encountered in transferring them. Careful

management will be required. Fortunately, the IMF is entirely capable. But the will for the SDR plan to work has, I believe, been demonstrated, and will be the sine qua non of any international agreement.

It may be that member IMF countries will one day, maybe even one day soon, go a step further, and create another new reserve asset--one backed by all official reserves of gold and dollars, and by countries' holdings of SDRs. This would seem a good idea. With only one reserve asset, there would be no problem of destabilizing changes in official asset preferences, or of transferring SDRs. And, of course, the stock of this newly created reserve asset would increase with every increase in the stock of SDRs.

Edward M. Bernstein, formerly of the U.S. Treasury and the IMF and long a distinguished specialist in international economics, has proposed the creation of a new reserve asset--the "composite reserve asset," as he calls it, or for short the CRU. His suggestion is that member IMF countries earmark all their reserves, in effect depositing them in an IMF Reserve Settlement Account, and receive CRUs in return. Countries would then use their composite reserve assets in making final settlements on international account.

It might seem to some, I suppose, that even simply earmarking reserves for an international account would involve a loss of national sovereignty. But this is wrong. Those who drew up the Special Drawing Rights plan provided for withdrawal, and under Dr. Bernstein's plan an individual country would be able to withdraw its reserves from the Fund Reserve Settlement Account at any time. The individual country would be able, that is, to give up its outstanding CRU credit at any time, and get back its original reserves contribution, adjusted of course for any gain or loss along the way.

Moving on to some kind of single reserve asset seems to me, as I have said, a good idea, and an entirely natural development. But in talking

about a new reserve asset I may have got myself a long way into the future, so let me return to today and SDRs.

There is a question as to what dollar amount of SDRs will be created each year. This the participating countries will decide--in light, however, of current and prospective needs for reserves. Under the plan, therefore, the supply of international reserves will increase at an appropriate rate, and there should be no sudden sharp changes in the rate. This in the end is why the western world will be much better off if instead of relying on gold as international money and periodically increasing gold prices, it goes ahead and activates the Special Drawing Rights plan, or in other words, starts creating SDRs.

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Looking ahead, I can see the day when countries will no longer use gold to settle their accounts. That day is, however, a long way off. Of this I am quite certain. Activation of the SDR plan is not going to end the official use of gold. But if the western world comes more and more to use SDRs--or, as would seem necessary, some other newly created reserve asset, backed by dollars, gold and SDRs--they could become less and less concerned about the free market price of gold. Using deliberately created, or man-made, reserves, the monetary authorities could without concern let free market gold prices increase as, through time, private nonspeculative demand increased with the growth of the world economy. I am certainly not predicting an increase in private market gold prices, but rather simply speculating about what could happen--provided, however, that the monetary authorities come to rely less and less on gold.

In summary, 1) it is reasonably clear market prices of gold will fluctuate widely and quite possibly around a rising trend if the usage

projections are correct, unless they are kept down by sales of gold from official stocks or speculative hoards. As to the former, there is a present agreement among governments which would preclude private market sales by official holders of gold--and ponder, if you will, the price consequences if this were not so.

2) In the present political and economic climate there is no likelihood there will be an increase in the official price of gold. I mentioned earlier a caveat to the statement that starts, "there is no substitute;" while substitute may be too strong, certainly the technological breakthrough to SDRs has started us on the way to the halcyon day when international reserves will grow predictably and rationally to meet world needs.

3) If the day comes--and I hope it comes soon--when the market price of gold will have no greater significance to central bankers than the price of copper or jute, then speaking quite personally, and as a former resident of a mining state with strong convictions about freedom of choice, I hope the market for gold will become at least as free as those for copper and jute--which means U.S. nationals, if they wish, can buy, sell, bury, or in any other way use this queen of metals.