STATEMENTS ON GOLD

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Under what conditions and for what purposes should the price of gold be altered? What consideration should be given to the volume of gold production and the profits of gold mining? What effect would an increase in the price of gold have on the effectiveness of Federal Reserve policy and on the division of power over monetary and credit conditions between the Federal Reserve and the Treasury?

An increase in the price that the United States pays for gold would have two major monetary results aside from dangerous psychological repercussions: (1) The amount of the increase *with respect to any gold purchased* would provide monetary aid from the American economy as a whole to producers of gold (largely foreign) and to foreign countries selling gold from accumulated stocks. (2) A corresponding addition (again with respect to gold purchases) would be made to bank reserves, which would provide the basis for a manifold expansion of credit that might be highly inflationary.

As to the first result, an increase in the price of gold would provide additional dollars to foreign countries without reference to the needs of the recipients. The extending of grants or credits, in such amounts as are in conformity with the real needs of the countries receiving them and are in the interest of the United States, is far better than increasing the price of gold as a means of providing any additional dollars needed. The United States is thus able to select the countries and the periods of time for which such aid would be given.

Concerning the second result, this country has no shortage of money. In fact, there is an abundance of gold reserves, on the basis of which additional money could be readily created by monetary and fiscal action. Increasing the price of gold is a deceptively easy, as well as potentially dangerous, way for the Treasury to provide more dollars for foreign aid (by buying foreign gold) or for domestic purposes (by buying domestic gold or by revaluing its existing stock) without having to raise taxes or to borrow. Such an arbitrary creation of more dollars is as inflationary as would be the arbitrary creation of an equal amount of "greenbacks" and more inflationary than Treasury borrowing of a corresponding amount from the banking system.

This country should not resort to such potentially harmful means of raising funds.

Any change in the dollar price of gold, either up or down, would have the following important effects: (1) Unless accompanied by a proportionate change in the price of gold in terms of all other currencies, it would dislocate the entire pattern of foreign exchange rates; (2) it would change the dollar value of existing gold reserves, both at home and abroad; (3) it would alter the profitability, and thus the level of production, of the gold-mining industry; (4) it would change the dollar value of this country's gold stock and all future additions to it, and thus be a basis for monetary expansion or contraction; and (5) it would constitute a major change in United States monetary policy, with unforeseeable psychological effects. In what follows each of these effects is discussed.

1. Unilateral changes in a country's price of gold have in the past been a means of altering exchange rates, and thus have served to adjust disparities between commodity price levels in that country and in the outside world. For example, if commodity prices and costs in a given country are too high in relation to those in the outside world, it might help to restore equilibrium by raising the price of gold in that country's currency, i.e., by depreciating its currency in terms of gold and also of such foreign currencies as remain unchanged in terms of gold. Conversely, if prices in the outside world were higher than in the given country, the country might reduce its price of gold in order to help bring about a better relationship.

During the spring and summer of 1949, price levels in many foreign countries were too high in relation to prices in the United States. To attempt to correct the disparity by a change in our price of gold (assuming that other countries made no change), would have called for a reduction in the gold price from $35 to some lower figure, that is, by an upward valuation of the dollar in terms of gold and of other currencies. This, however, would have caused serious dislocations in many foreign countries and would have had severe psychological consequences domestically. The needed adjustments were brought about in September by devaluations (in terms both of dollars and of gold) of a number of foreign currencies.

2. A change in the dollar price of gold would alter the dollar value of all existing gold reserves in direct proportion to the

change in price. Thus a 50 per cent increase in the price of gold would result in a 50 per cent increase in the dollar value of gold reserves, both in the United States and throughout the world.

In the case of the United States, it is clear that a rise in the price of gold is not needed to augment the value of domestic gold reserves, since these are more than adequate for present and foreseeable monetary needs. Under present legislation, the Federal Reserve System is required to maintain a reserve of 25 per cent against Federal Reserve notes and deposits, but the present ratio is actually about 55 per cent. Even if the latter ratio were to fall to the legal minimum, an increase in the gold price would not be an appropriate means of correction.

In the case of foreign countries, the situation varies. Many countries, because of postwar dislocations, are seriously handicapped at the present time by a domestic shortage of gold and dollar reserves. But a rise in the price of gold would help most those countries which already have large reserves. Every country which holds gold would automatically receive an increase in the number of dollars available to it, so that the largest increases would go to the largest holders, which are the Soviet Union and Switzerland as well as the United Kingdom. Under present and prospective circumstances, if the United States wished to make more dollars available for foreign reserves, it would be preferable to do so by extending stabilization credits to those countries whose reserves we wish to increase. Making dollars available to selected countries by means of credits would cost the United States less, in real terms, than trying to help these countries by making dollars available indiscriminately in exchange for gold.

3. A change in the dollar price of gold would alter the profitability of gold mining, and thus the level of gold production. Following the increase in the dollar price of gold in 1933-34 (from $20.67 to $35 per ounce), gold production, both in physical volume and even more in dollar value, was greatly stimulated all over the world. Because of the world-wide rise in costs of labor and materials which occurred as a result of World War II, the profitability of gold mining has sharply fallen, and production has contracted considerably from the peak level of 1940. Accordingly, proposals have been freely forthcoming from world gold-producing interests to raise the dollar price of gold. The dollar price of gold, however, is still higher relative to the general

level of commodity prices than it was in the 1920's, and gold production remains above the level of that period.

An increase in the price of gold would no doubt stimulate gold production. As for the United States, however, there is clearly no need for an increase in domestic gold production, since gold reserves in this country are far in excess of minimum requirements. An increase in the dollar price of gold obviously cannot be justified on the sole ground that it would increase the profits of gold mining.

In the case of foreign countries, those producing gold—which would be the immediate beneficiaries of a rise in the gold price—are not the ones whose need for assistance is greatest. While they might use the augmented value of their gold to pay for imports from Western Europe and thus enable Western Europe to do more towards balancing her trade with the United States, it would be much more to the advantage of the United States to accomplish this end by extending grants or loans.

4. As to the effects that an increase in the price of gold might have on our domestic monetary system, it is important to emphasize that this country's existing gold holdings, valued at the present price of gold, would support a far greater volume of money than needed for any likely future contingency.

The immediate monetary effect of an increase in the price of gold would be a "profit" from the revaluation of our existing gold stock. Expenditure of this "profit," which presumably would be within the discretion of the Treasury, would increase commercial bank reserves, and thereby foster a multiple expansion of bank credit, subject to the reserve requirements of banks in effect at the time. Increased bank reserves and resulting multiple expansion of bank credit would also be fostered by accelerated inflow of gold from foreign sources and domestic output. These developments would expose the economy to great inflationary dangers.

The Federal Reserve has no means adequate to cope with such a danger. In the absence of greatly expanded authority to absorb or immobilize the inflationary reserves thus created, the Federal Reserve would be incapable of performing its function of adjusting the credit supply to the needs of a stable economy.

Increasing the price of gold would be an awkward and dangerous instrument for this country to use, particularly in view of the fact that other more effective and far less risky means are

available or could readily be found to accomplish anything constructive that would be accomplished by changing the price of gold.

5. Lastly, it should be emphasized that any change in the price of gold would constitute a major change in the foreign economic policy of the United States. Since January 1934, the price of gold in terms of the dollar has remained unchanged at $35 per ounce. Thus, for over fifteen years, there has been a fixed relationship between gold and the dollar—one of the few elements of stability in an international economic situation that is only slowly recovering from the ravages and disruptions of extended world war. Changing the dollar price of gold would inevitably weaken the high confidence that this country's currency universally enjoys.

What would be the principal advantages and disadvantages of restoring circulation of gold coin in this country? Do you believe this should be done?

The advantages which might be gained by restoring the circulation of gold coin in this country are negligible and serious disadvantages would be incurred. None of the important domestic or international monetary problems now facing us would be appreciably helped toward solution.

Confidence in money, in our day, is based upon its internal purchasing power and the ability of a country to meet its external obligations, not upon internal convertibility of the money into gold. The currency of the United States is the most generally acceptable currency in the world today. Confidence in it is assured by the productive power of the United States economy. Gold is readily available and existing reserves are more than adequate to meet any conceivable international drain of funds. Since the chief argument for instituting a gold coin circulation would be the strengthening of confidence in the currency, it is clear that on these grounds no need for taking such a step exists today.

The argument that a return of gold coin circulation would bring about a desirable and automatic regulation of the domestic money supply and would assure the country a "sound" monetary system—in the sense that such a system would be "sounder" than the present one—is not valid. On the contrary, the adoption of a gold coin standard might actually hinder the maintenance of a stable and prosperous economy, since there is no automatic

relation between the demand for gold coin and the economy's need for money. The demand for gold for individual use, as contrasted with its use to balance international payments, reflects various speculative and capricious influences which should not affect monetary policy, and fails to indicate other conditions which ought to guide monetary policy. Thus a strong public demand for gold coin might arise in time of depression as occurred in 1931-33, imposing a restrictive monetary policy at the very time when the opposite policy is necessary. In time of rising prices, when shifts from money to commodities are likely, demand for gold might be small, so that the necessary restrictive action would not automatically occur. If during a wartime, moreover, heavy demands for gold should appear, free sales of gold would reduce our gold stock, stimulate speculation against the currency, and hinder the financing of the war. Furthermore, depletion of gold reserves resulting from private hoarding could conceivably impair our ability to meet extraordinary wartime expenditures abroad.

An over-riding reason against making gold coin freely available is that no government should make promises to its citizens and to the world which it would not be able to keep if the demand should arise. Monetary systems for over a century, in response to the growth in real income, have expanded more rapidly than would be permitted by accretions of gold. In the United States today, our gold stock, although large, is only 15 per cent of our currency in circulation and bank deposits, and less than 7 per cent of the economy's total holdings of liquid assets. The retention of a gold base is desirable in order to maintain *international* convertibility, and a gold standard system has therefore evolved in which the various forms of money and near money in the country are ultimately convertible to gold, where that is necessary to meet the country's international obligations. Return to a gold coin standard, however, would clearly expose the economy to the risk of drastic and undesirable deflation at times of high speculative demand for gold for hoarding, or else the Government would have to withdraw its promise of gold convertibility. Conjecture as to the possibility of such a withdrawal would stimulate a speculative demand for gold and might precipitate the event feared. The long run effect would be to weaken rather than to strengthen confidence in the dollar.

In regard to the international effects, it is often contended that if gold were made freely available by the United States, whether

in the form of coin or otherwise, one effect would be to eliminate the premium at which gold is quoted, in relation to the United States dollar, in black or free markets abroad. However, the present premium of gold over the dollar in foreign markets is a matter of very limited importance. It reflects chiefly the special suitability of gold for hoarding, its great familiarity, and its anonymous nature. It cannot even remotely affect the stability of the United States dollar.