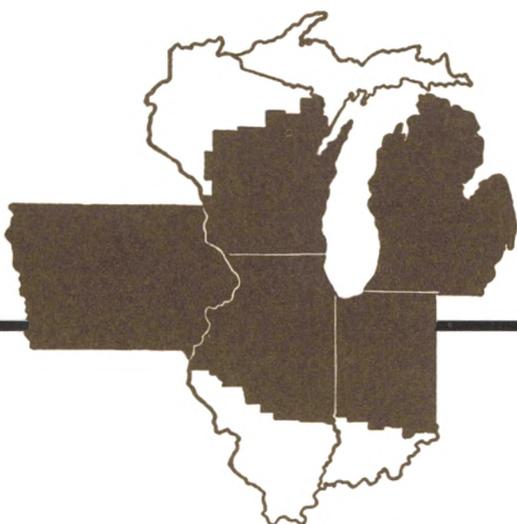


A review by the **Federal Reserve Bank of Chicago**

Business Conditions

1964 March



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The state of the economy —the problems before us

As man continues his quest for more and better goods and services, he inevitably encounters the restraints imposed by limited resources, including his own limited ability to use these resources efficiently. There is hope, of course, that by studying how resources are used, ways can be found to produce greater supplies of useful products and thereby provide higher standards of living for more people.

The Employment Act of 1946 provides for a Council of Economic Advisers to assist the President in maintaining a continuous study of the performance of the economy and in proposing changes in laws and Government programs to improve performance in both private and public sectors of activity. Each year the Council prepares an Annual Report to the President that is made available to the public in January.

In its Report for 1964 the Council noted that the "American economy has recorded nearly three years of solid expansion" since the current rise in activity began in the first quarter of 1961. The Council concluded that there was no evidence to indicate an early recession but contended that the tax cut, then

pending before Congress and subsequently signed into law by the President on February 26, was "urgently needed" to accelerate economic growth toward "full employment."

Big problems

The major function of the Council is to call attention to conditions that are hampering or are likely to hamper the optimum use of resources and to propose possible remedies. The current report, therefore, comments upon a number of major problems which the Council believes are retarding achievement of maximum output and efficiency of the nation's economy.

These problems include (1) reducing unemployment of men and facilities to acceptable levels; (2) reducing the proportion of the nation's population with family income below the amount needed to provide a decent minimum standard of living; (3) accelerating advances in technology—the basis for all economic progress—and cushioning the hardships created for some individuals and communities as a result of this progress; (4) restraining any tendency toward excessive price and wage increases as activity rises in

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1964, and (5) reducing the deficit in the nation's international balance of payments and maintaining the value of the dollar in world trade.

Idle resources

Almost everyone agrees that the United States economy could produce goods and services in greater volume than it is at present. Unemployment is relatively large compared with past periods of prosperity and surveys of manufacturing firms indicate that most industries have unused capacity.

How large is the difference between actual and potential output? At best, this must be a fairly rough estimate and this theoretical "gap" will vary depending upon judgments of achievable minimum unemployment levels, rate of gain in efficiency and the ability to adapt the idle resources to production of needed goods and services and for other reasons. Judgments differ also on the extent to which output could be raised from present levels without reawakening excessive inflationary pressures. In fact, some believe that these pressures were undesirably strong in 1963 when the Bureau of Labor Statistics' consumer price index rose 1.5 per cent although its index of wholesale prices continued relatively stable.

The Council estimates that there was an output gap in the fourth quarter of 1963 equal to an annual production of 30 billion dollars of goods and services. In other words, had the actual performance during the quarter matched the potential envisaged by the Council, output would have been at an annual rate of 630 billion dollars or 5 per cent above the actual rate of 600 billion.

Even if there were no margin of unused capacity, output could be increased by elimination of impediments to efficiency. For example, any monopolistic practices of busi-

ness and organized labor would come under this heading as would Government programs that help to maintain prices above competitive levels or to promote investment that tends to maintain production of certain kinds of goods in excess of current requirements.

Production also can be stimulated under most circumstances by expanding the supply of money and credit, by stepping up Government spending without a corresponding boost in tax revenues or by reducing taxes without an offsetting reduction in Government spending. The Council endorses tax cuts as the most important means of stimulating faster growth of production in the current circumstances to boost both consumer demand and private investment.

The tax cut is expected to reduce Government revenues about 8 billion dollars in 1964. There can be no serious question that the effect will be expansionary. Consumers and business will tend to spend and invest more if their after-tax incomes rise. But increased dollar income is not translated automatically into increased production.

Many analysts are apprehensive that the most serious economic problems are misallocation of capital investments and lack of proper training of the unemployed and that these may not yield readily to measures designed primarily to increase aggregate dollar income. To the extent this may be the situation, with the economy already in an upswing, the stimulation provided by the tax reduction could cause additional upward pressure on prices well before full employment is reached. To help guard against this possibility the Council reiterates its earlier proposal for wage and price restraint.

Price-wage "guideposts"

Although "the price stability of 1961-63 has resulted in part from persistent slack in

the economy . . .,” the Council states, “another major factor has been the responsible action of most union and business leaders in making noninflationary wage and price decisions.” Since the tax cut and other current or pending Government programs are intended to largely eliminate the “slack” in the economy, continued price stability during 1964 presumably will depend even more heavily than in the recent past on “responsible action” by union and business leaders.

It is argued that in a competitive society an “unseen hand” guides economic decisions toward the general good even though particular actions are motivated by the hope of private gain. Many observers believe, however, that this condition no longer holds as a result of the great market power wielded by large business firms and industrywide unions. In the words of the Council: “Either management or labor, by unrestrained pursuit of its own near-term advantage, could reactivate the price-wage spiral that has remained quiescent for several years.” The Council considers wage increases to be noninflationary if the annual percentage increase in total compensation per man-hour does not exceed the national trend output per man-hour, calculated as the average rise in output per man-hour of all goods and services produced in the private sector of the economy during the most recent five-year period.

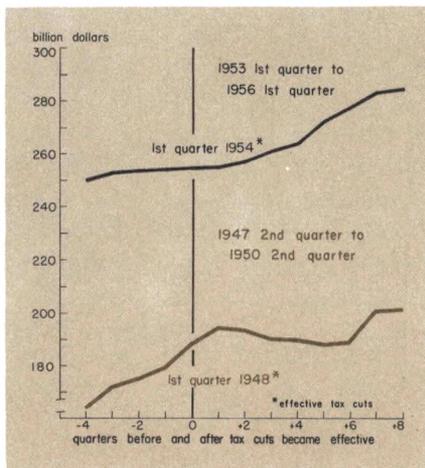
In setting prices individual industries are asked to compare their own changes in trend productivity with that of the entire private economy. It is appropriate, the Council believes, to raise prices to accommodate deficiencies between an industry’s and the economy’s trend productivity. On the other hand, if an industry’s trend productivity exceeds the national average, “product prices should be lowered enough to distribute to the industry’s customers the labor cost savings it would make under the general wage guidepost.”

For the entire period 1947-63, the annual average increase in output per man-hour for the entire private economy is estimated to have been 3.2 per cent. Trend productivity for the five years ending in 1963 also averaged 3.2 per cent compared with 2.3 per cent in 1960.

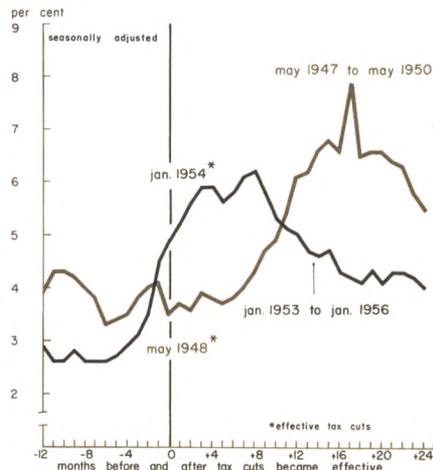
Despite difficulties in measurement, estimates of trend productivity constitute a useful

The impacts of earlier postwar tax cuts varied . . .

disposable personal income



unemployment rate



yardstick for judging whether or not private decisions on wages and prices are noninflationary according to the Council. If wage increases exceed trend productivity, prices will tend to rise.

Individuals involved in decisions that will result in changes in prices or wages clearly are confronted with considerable difficulty if they attempt to apply the Council's suggestions to specific cases. Nevertheless, the Council believes adherence to the price-wage guideposts "not only would make for overall price stability but would be generally consistent with the tendencies of competitive labor and product markets."

Thus, where wages and prices are set in competitive markets, it would appear that wage-price decisions will automatically approximate the guideposts. Where competition does not bring this result, wage and price negotiators are asked to police themselves

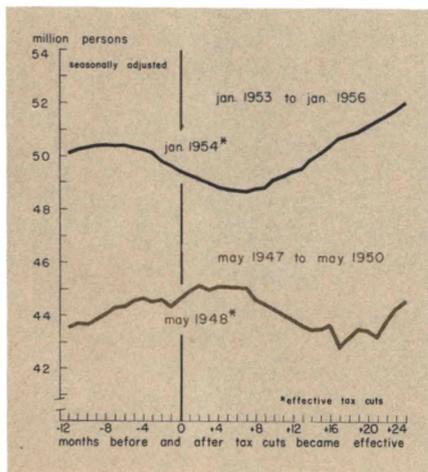
much as public utilities are policed by regulatory commissions.

Widespread differences of opinion exist about the extent to which the present American economy offers buyers and sellers truly competitive markets. It can be maintained that the failure of prices and wages to decline in the period since 1957 despite significant amounts of unused resources implies the existence of rigidities associated with excessive concentration of market power. If it is desired that conditions more nearly approximate those of competition and if those who determine prices and wages do not respond to the suggestion that they make decisions similar to those that would be made in a competitive environment, a reduction in the extent of such market power may be the only remedy.

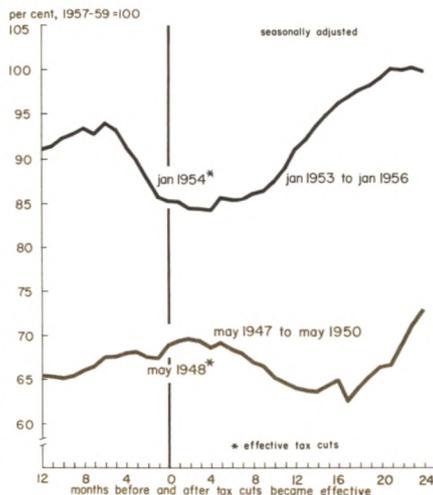
There are a number of ways in which Government reduces market competition and

as indicated by general economic measures

nonagricultural employment



industrial production



substitutes administrative decrees for the decisions of many buyers and sellers. Examples are found in the agricultural programs, tariffs and import quotas, regulation of transportation, price maintenance laws and quotas restricting production of crude petroleum. For the most part these programs reflect successful attempts of interested groups to obtain legislation that helps insulate them from competitive market forces. Elimination or reduction of such governmental aids to

monopoly clearly would allow competitive forces to operate in a broader area and would lead to more efficient use of resources and larger total production. But such improvements may be purchased at the expense of some other objectives of public policy.

Challenge of technological change

Innovation, which can help reduce costs or pave the way for new or improved goods and services, is looked upon by the Council as "the great reconciler." Technological change permits the satisfaction of apparently conflicting desires—higher wages and larger output along with increased leisure and stable prices. It also improves the nation's competitive position in world markets.

Last year the nation's output was seven times as great as in 1900. This gain was accomplished with a rise of only 80 per cent in man-hours worked while output per man-hour increased 300 per cent.

The tax credit on the purchase of new machinery and equipment and the accelerated depreciation permitted in 1962 are helping to encourage investment. The tax cut is expected to further stimulate investment by increasing profit potential through increases in sales, reduction in corporate tax rates and rates on the upper brackets of personal income and a broadening of the investment tax credit.

These factors encourage business to make additional investments in new equipment already developed by producers of capital goods. Government and business also are stimulating technological change by making large expenditures for research and development. In 1963 total expenditures on research and development exceeded 16 billion dollars, more than three times the total of 1954.

"Growing sophistication in the use of economic policy, particularly fiscal and monetary

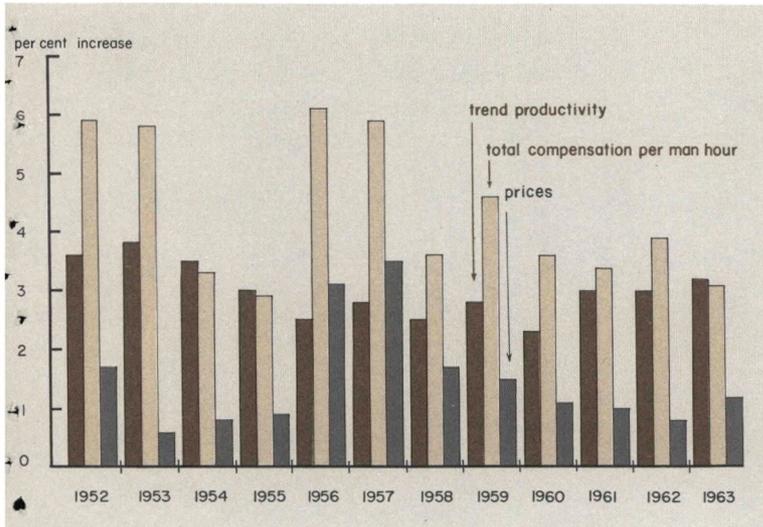
policy," the Council maintains, "is capable of righting the balance whenever job-destroying effects of technological progress outweigh its job-creating effects." Nevertheless, additional Federal aids are advocated to help retrain or relocate workers displaced by changes in technique.

The degree to which technological change is accelerating and the extent to which, on balance, it may be eliminating or creating jobs is unknown. But it is clear that the process called "automation" is really a continuation of the centuries old process formerly known as "mechanization." It will be aided and the impact upon men and capital will be eased by a maximum flexibility of movement and utilization of workers and other resources. Future problems will be aggravated by any attempts to impede this development.

If employment can be boosted and technological progress maintained at a high or even accelerating rate, average income will continue to rise. In 1947 the incomes of United States families ranged above and below a midpoint of \$4,117 in terms of 1962 prices. By 1962 the midpoint had risen to \$5,956. During this period the proportion of families with current incomes of less than \$3,000 declined from 32 per cent to 20 per cent. Despite this substantial progress, about 9.3 million American families, including 30 million persons still had incomes of \$3,000 or below in 1962 and were classified by the Council as "poor."

In general, measures that improve the efficiency of the economy and enable it to operate closer to optimum capacity will improve the environment in which the poor as well as others find jobs. But measures that help to increase the flexibility and skills of the labor force could have a more direct effect in boosting incomes at the lower levels. Measures to reduce discrimination in employment, cut

Since 1961 productivity gains have been close to increases in worker compensation



down the incidence of illness, expand educational and job training facilities and strengthen job placement services could help many persons of ability and determination to raise their status. Programs to accomplish these goals exist. The need is to improve and expand activities that are insufficient.

Balancing the balance of payments

In recent years no broad survey of the national economy has been complete without a commentary on the deficit in this country's balance of payments. The Council points out that the nation has continued to have a surplus of exports as compared with imports of goods and services and this "favorable" balance appears to be improving. (The difficulty in balancing the totals relates largely to capital, aid and defense transactions.) Moreover, total United States assets in other countries

probably have been increasing faster than total liabilities to foreigners. Nevertheless, the "deficit," defined as the increase in foreign short-term liabilities plus the outflow of gold, has averaged more than 3 billion dollars per year since 1957 and rose from 2.2 billion dollars in 1962 to an estimated 2.6 billion dollars in 1963.

The United States balance of payments deficit worsened substantially in the first half of 1963 mainly because of an increased outflow of long-term capital. A number of steps were proposed or taken to deal with this development, of which the following were most important: (1) higher short-term interest rates to reduce the incentive to purchase higher yielding foreign obligations; (2) reduced military spending abroad;

(3) further "tying" of foreign aid to United States exports; (4) arrange for borrowing from the International Monetary Fund; (5) an interest equalization tax to be made effective retroactive to the day following the President's July 18 message, and (6) an intensified campaign to expand exports and promote tourism in the United States.

No one believes that the balance of payments problem will be resolved permanently in the immediate future. Nevertheless, there is ground for hope along the lines set forth by a Brookings Institution study undertaken at the request of the Council, the Treasury and the Bureau of the Budget. Assuming an acceleration in the nation's rate of economic growth, the study projected that the nation would have a basic payments *surplus* (exclusive of short-term capital flows, unrecorded transactions and special Government trans-

ment for the direction and control of economic activity?

The foregoing discussion is presented here to indicate the nature of the basic economic problems that business, labor and Government leaders must resolve. The problems are not unique or even solvable in the sense that an adequate corrective today will remain

effective tomorrow. Instead, these and similar problems are inherent parts of the environment in which man seeks to raise his standard of living. There is fairly wide agreement on the ends, but a great diversity of views on the most effective means of achieving these desired ends, reflecting our imperfect knowledge of the world in which we live.

Gold in the world's monetary machinery

The role that gold plays in the world's monetary arrangements gradually has become more specialized and probably less important overall. Nevertheless, gold retains a position of prestige: many people automatically think of gold—and its erstwhile companion, silver—whenever the word “money” is mentioned.

Although important, these metals provide only a small part of the world's money; the proportion is especially small in countries where most payments are made by check. For example, probably no more than 2 per cent of all financial transactions in the United States are made with coins—and gold is not included in these at all.

While gold and silver have a variety of uses in industry and arts, these are largely irrelevant to their use as money. Instead, these metals came into widespread use as money centuries ago because of their particular characteristics: durable, easily shaped and resistant to corrosion. But most impor-

tant, these “noble” metals are relatively scarce and the total supply does not vary greatly from year to year as do supplies of many other commodities that might otherwise be satisfactory as monetary mediums. Because of these characteristics, they can serve as a combination “yardstick and warehouse”—that is, a measure of relative value and store of wealth.

In a country with a stable government and established customs, however, these functions can be provided better by “paper and ink.” The weight is less; the flexibility is greater. Paper money, checks and various accounting arrangements that minimize actual transfers of money or in some instances avoid them altogether have gained popularity.

The supply of money in most of the industrially advanced countries has long been detached from, and largely unrelated to, the amount of available gold. Thus, it has been insulated against the effects of shifts in the stock of gold available for monetary use as

well as shifts in private demand for gold to serve as a store of wealth. In the United States, for example, the private holding of monetary gold has been prohibited since 1933 and the holding of gold abroad by American citizens has been prohibited since 1961.

For international financial transactions, too, it is more convenient and efficient to use paper and ink and associated "promises to pay" than to incur the expense and nuisance of constantly moving monetary metals around the world and providing for their security against loss or theft. Thus in the international as well as the domestic financial arena, the allure of the yellow metal may be less strong than in some former periods.

Currently gold's major role is that of providing one form of linkage between the various national currencies and the economies of the countries that engage extensively in world commerce. It is largely because of this international linkage that developments such as the following attract widespread attention:

In 1963, the monetary gold stock of the United States declined an additional 461 mil-

lion dollars—about half as much as each of the two preceding years.

Soviet sales of gold in European markets rose to more than 400 million dollars—up from about 200 million in 1962.

Estimated free world production of gold in 1963 amounted to 1,365 million dollars, 75 million above 1962. The increase of production has been relatively large since about 1958 even though inflationary pressures have continued in evidence through much of the world.

The gold stocks held by central banks and governments in Western Europe and the International Monetary Fund rose between 700 and 800 million dollars last year, more than twice the increase in 1962. The relatively large rise reflects the lessened demand for private hoarding, increased sales of gold by Russia to obtain exchange used to purchase wheat and other commodities and sales by the United States.

Gold in the U. S. monetary mechanism

The U. S. Treasury stands ready to purchase and sell gold at the official price of \$35 an ounce, thereby fixing the value of the dollar in terms of gold. But since banks and the public in this country are not permitted to hold monetary gold or gold certificates, it is not possible for shifts in domestic private demands for gold to cause fluctuations in bank reserves and money supply.

The par value of most currencies that are not themselves defined by statute in terms of gold are stated to have a par value relative to the United States dollar of 1944 gold content. In this way most of the world's currencies are anchored to gold.

So long as foreign monetary authorities have confidence that the United States will be willing

Gold and dollar reserves of foreign central banks and governments

Year-end	Gold	Short-term dollar claims (million dollars)	Total	Per cent gold in total reserves
1958	17,448	8,665	26,113	66.8
1959	18,373	9,154	27,527	66.7
1960	20,226	10,212	30,438	66.4
1961	21,908	10,940	32,848	66.7
1962	23,178	11,958	35,136	66.0
1963*	23,916	12,359	36,275	65.9

*September

Source: IMF, International Financial Statistics

Required holdings of gold and foreign exchange

Central Bank	Liabilities requiring gold or foreign exchange reserves	Required reserves		
		Gold	Gold or foreign exchange	
		(per cent)		
Belgium	Notes and demand liabilities	33 $\frac{1}{3}$	—	In effect
Canada	None	—	—	—
France	Notes and other demand deposits	35	—	Suspended since September 1, 1939
Italy	Notes and other demand liabilities	—	40	Suspended since 1935
Japan	None	—	—	—
Netherlands	Notes, drafts, deposits and other current account balances	—	50	In effect
Switzerland	Notes	40	—	In effect
United Kingdom	Notes in excess of 2.35 billion pounds sterling	100	—	In effect
United States	Notes and deposit liabilities	25	—	In effect
West Germany	None	—	—	—

ment is obsolete since private holding of monetary gold is prohibited in this country. Moreover, the President has declared that this nation's entire stock of gold is available, if needed, to redeem foreign dollar claims. Many of the advocates of abolition of the gold reserve requirement believe that such action should only be taken at such time as the United States balance of payments deficit has been greatly reduced or eliminated.

and able to continue to maintain the official dollar price for gold, countries can treat dollars as the equivalent of gold. It is stipulated in the Bretton Woods Agreements Act of 1945, through which the United States became a member of the International Monetary Fund, that any change in the value of the dollar relative to gold shall require legislative action by Congress.

Federal Reserve Banks are required to maintain reserves in gold certificates (representing gold held by the U. S. Treasury) of not less than 25 per cent of their deposit liabilities and of their notes in circulation. This requirement can be changed by Congress, as it was in 1945, and it may be suspended by the Federal Reserve Board provided that the deficient Reserve Banks pay a tax graduated according to the amount of the deficiency.

There has been widespread discussion for some years whether the gold reserve require-

into and out of United States monetary reserves still increase and decrease bank reserves, the effects on domestic money supply and credit conditions can be offset by appropriate action of the Federal Reserve System and is offset if this is deemed advisable from the standpoint of the System's overall policy goals. Through purchases and sales of securities in the open market, changes in Federal Reserve Bank discount rates and changes in member bank reserve requirements, the Federal Reserve System can control the supply of reserves available to commercial banks and hence the amount of bank deposits and credit in the United States. The potentially inflationary or deflationary effects of gold inflows or outflows can thus be offset.

Gold in other countries

The role of gold as a reserve currency and as a part of domestic money supply varies

widely among countries. There are only a few (not all are shown in the table on page 11) where the statutory reserves must be held exclusively in gold; elsewhere reserves consist of gold and foreign exchange. Nevertheless, the desire of monetary authorities to hold gold is still generally strong. This is true even of central banks whose statutory requirements have been suspended or which have never been subject to such requirements.

Most countries allow the private domestic holding of gold, but nowhere do the monetary authorities undertake to sell gold to their nationals at a fixed price or in unlimited quantity for this purpose. Practically all countries buy gold freely from individuals and banks at a fixed price, paying the seller in currency or check, but Switzerland also mints some gold coins. In some countries, for instance the United States, the buying rate is specified by law while in others it is set by administrative decision. Many permit private trading of gold, a smaller number permit free import and fewer still permit free export.

London is the world's most important bar gold market while coin markets are dominated by Paris and Zurich. Quoted prices in gold markets tend to reflect the public moods of optimism or pessimism about the economic or political future to the extent they are not offset by official transactions. In addition to France and Switzerland, Germany, Italy, Belgium, the Netherlands, Greece and Turkey have played a rather important role in European gold dealings.

On the Asiatic Continent, Bombay despite prohibition against gold imports played a leading role as a gold importer until November 1962, when the Indian government made gold transactions illegal and called in the metal. Since then, trading in black markets is reported to have developed. Bombay's decline allowed Beirut (Lebanon) to become

Asia's ranking gold trading center, followed by Kuwait, Hong Kong, Macao, Bangkok, Singapore, Rangoon, Tokyo, Manila, Taipei and Seoul. In Africa, Dakar, Djibouti and Casablanca are the leading centers, and in the Western Hemisphere, Mexico City, Toronto, Montevideo, Panama City and Rio de Janeiro are of some importance.

No precise measure of the amount of private dealings in gold in recent years is available but it probably totaled several billion dollars annually. When confidence in certain currencies declines, some wealthy persons may shift a portion of their assets into gold bars while the "little man" under similar circumstances may seek refuge in gold coins.

Among the most popular coins are the French napoleon, once equal to 20 francs; the British sovereign, once equal to 20 shillings; and the United States double eagle, once equal to \$20. These and other popular coins trade at a substantial premium above the value of their gold content, but premiums vary sharply from time to time reflecting changes in demand and the limited supply of these coins. Some of the popular gold coins are reported to command premiums about 25 per cent above the gold content.

Although Paris and Zurich are the chief centers for gold coin trading, there is no single marketplace for them in either city. Instead, the major commercial banks act as agents for buyers of gold coins and do much of the trading, storage and shipping.

Demand from collectors has come to play an increasingly important role in the gold-coin market. Another source of demand is from jewelers, who use gold coins to make pendants, cuff links and other objects of personal adornment. The pre-Christmas demand from both of these sources causes a seasonal variation in gold-coin prices.

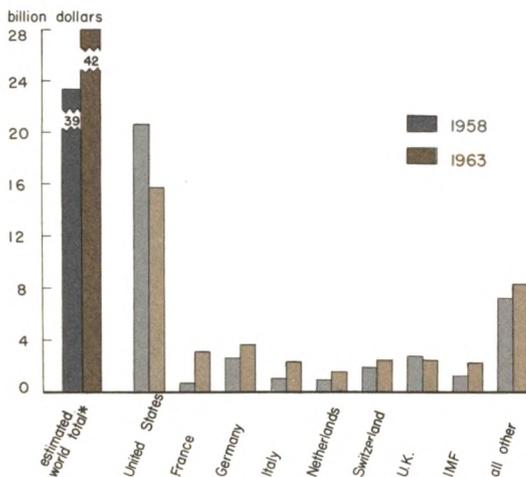
While gold continues to have a limited

circulation throughout much of the world, its role in *national* money mechanisms clearly cannot be described as a dominant one and there is a growing tendency to consider gold as primarily, if not exclusively, an “international money.”¹

Gold in the international mechanism

Most international commercial transactions are “cleared” in the exchange markets through offsetting entries on the books of commercial banks and private traders. The balances remaining are for the most part settled by the use of United States dollars and British pounds sterling. Reflecting the importance of these currencies in international transactions, the central banks and treasuries of many countries keep a part of their monetary reserves in these so-called reserve currencies. Most or all of their remaining reserves are held in the form of gold bullion at home or abroad.

Gold reserves of central banks and governments



*Excludes holdings of the USSR, other Eastern European countries and China Mainland.

The non-gold portion of international reserves is held largely in the form of dollar balances with American banks or in short-term investments, for example, Treasury bills. Second in importance as a supplement to gold holdings are balances in sterling in the London market.

There are wide variations between countries in the composition of the non-gold portions of their international reserves. The United States carries its reserves entirely in the form of gold. Western European nations generally hold much larger amounts in gold than in dollars while Japan has followed the opposite practice.

Since the end of 1958—the year of the largest gold outflow from the United States—foreign central banks and governments have maintained an almost constant ratio of gold to dollar reserves (about 2:1), using only a portion of newly acquired dollars to purchase gold from the U. S. Treasury. From December 1957 to September 1963, foreign gold reserves increased about 9.5 billion dollars while the United States monetary gold stock decreased about 7.2 billion dollars—from 22.8 to 15.6 billion. The remainder came from other sources—Russian gold sales and new production.

Gold outflow reduced

Declines in the United States stock of monetary gold were smaller in 1961 and 1962 than in each of the preceding three years and the drain was reduced further in 1963. This welcome change reflects in part new forms of international cooperation, in particular the sale by the Treasury of special securities denominated in foreign currency.¹

The willingness of foreign central and commercial banks and individuals to increase

¹See *Business Conditions*, July 1963.

monetary reserves and working balances in the form of dollars depends largely on confidence in the ability and determination of the United States to maintain the exchange value of the dollar in terms of their domestic currencies. This in turn is closely related to the success in achieving and maintaining an approximate balance in the United States international payments.

The United States in recent years has been more successful than most of its trading partners in arresting domestic inflation; there also is some indication that this country's merchandise export surplus is being further enlarged and will contribute even more to a reduction in the deficit in the international balance of payments than it has in the past.

Meanwhile, the dollar, as some of the other major currencies, is likely to be in large supply in the foreign exchange markets from time to time, with resulting pressures on the exchange rate. In order to moderate such temporary pressures, the Federal Reserve System since early 1962 has entered into a number of currency swap arrangements with foreign central banks and the Bank for International Settlements. It also expects to derive continuing benefit from the "gold pool," an arrangement closely connected with the operation of the London gold market.

London gold market

The London gold market was reopened in 1954 after being closed for about 15 years. There are two principal differences between the London market and the purchase and sale of gold by the U. S. Treasury: 1) Any nonresident of the sterling area can buy gold in London from bullion dealers, but only monetary authorities can buy gold from the U. S. Treasury. 2) The London price is allowed to fluctuate in response to supply and demand while the U. S. Treasury's buying

and selling prices do not change.

The arrangements for gold purchases and sales in London and New York are integral parts of the international payments mechanism, with central banks, treasuries and stabilization funds channeling their gold transactions mostly through London and New York. Gold traded in other places is related predominantly to private supply and demand, although Russia is known to have frequently sold gold in these markets in recent years.

Five men representing firms which together constitute the London bullion market meet every weekday morning in the offices of one of their members. The first order of business is to "marry," as far as possible, the buy and sell orders for gold previously received and arrive at a "fixing price." These dealers are in telephone contact with the Bank of England, which largely controls the supply of newly offered gold.

While the fixing price is quoted as the official price for the day, business is often done later between banks and dealers at different prices. At the fixing the bullion dealers are normally acting as brokers (agents) only but later may be buying or selling also as principals.

During the first five years of operations since the reopening of the market in 1954, dealers were authorized to conduct only spot transactions (delivery and payment within two working days). The restriction on forward dealing was removed in 1959, but future prices may not be made public and thus forward deals are of minor importance.

South Africa, traditionally the world's largest gold producer, is a major factor in the market, but the basis on which the Bank of England sells South African gold and the amount it actually handles are not published. Important sources of demand in the London

Ratio of gold in official holdings of gold and convertible foreign currencies of selected countries

Year-end	Belgium	Canada	France	West Germany	Italy	Japan	Nether- lands	Switzer- land	United Kingdom	United States
				(per cent)						
1958	85	55	71	60	52	6	82	93	93	100
1959	93	51	75	58	59	19	85	94	92	100
1960	82	48	79	44	72	14	83	94	87	100
1961	75	46	72	56	65	19	92	93	69	99
1962	84	27	72	59	65	16	91	93	93	99
1963	76	31	71	54	77	15 ^a	84	95	92 ^b	99

^aJune ^bSeptember Source: IMF, International Financial Statistics

market are European commercial banks and Eastern dealers buying metal for resale in the Middle and Far East.

The basic trading unit is a gold bar of approximately 400 ounces, equivalent to something over \$14,000 at recent prices. There may be a surplus of buy orders at the fixing, in which case the Bank of England will be informed of the excess demand. The Bank then decides whether to supply gold and in what amount and whether the dealers' bids are acceptable. In general, the bank's objective is to maintain a relatively stable price for gold, but if private supplies are large or private demand is exceptionally strong, the bank may permit sizable price swings. In order to maintain relatively stable prices, it may at times have to draw on its Exchange Equalisation Account—in which all of Britain's gold and foreign exchange reserves are held—and purchase gold from the United States.

London "gold pool"

A gold pool was formed among the West's leading central bankers toward the end of 1961 for the purpose of providing joint action and support to the Bank of England in its

efforts to stabilize the London gold market.

The pool is managed by the Bank of England and includes as additional members the United States, Germany, France, Italy, Switzerland, Belgium, and the Netherlands. Its monthly surpluses or deficits are settled at the close of the following month according to each member's quota, but activities are not publicized.

Relatively small fluctuations in the London market price of gold since the inception of the pool suggest that it has been quite successful in checking potentially large speculative price movements. The willingness of member central banks to channel their own demands through the pool and to refrain from buying in the market at certain times may also have helped to prevent wide swings in the market price of gold with resulting speculation against certain currencies.

Conclusion

The current international monetary arrangements are often described as the gold exchange standard. While their origin antedates World War I, their main features were set forth at the end of World War II in the

Articles of Agreement of the International Monetary Fund.

Although the role of gold in the world's monetary machinery has gradually diminished, gold still appears to many people as the essence of wealth. This popular preference for a commodity that has tended to remain stable or to increase in value relative to the world's major currencies—though its purchasing power relative to goods and services has declined—is reflected in many of the world's markets in which gold in one form or another is still actively traded. As a determinant of the domestic money supply, however, gold plays a minor role at best in economically advanced countries.

On the other hand, there are few indications so far that gold will soon lose its importance as a medium in which most nations carry at least a portion of their international reserves. Although gold's share in total reserves has declined in the postwar period of rapidly expanding world trade, it still constitutes the hard core of international liquidity.

Whether it will continue to do so for a long time to come depends on many factors—gold production, the price at which gold is bought and sold by monetary authorities, the balanced (or unbalanced) growth of world trade and coordination of national economic policies, to name just a few. For years, private economists have offered proposals for reform of the international monetary system. Some of these envisage a freeing of the international payments mechanism from dependence on gold, while others would strengthen

Gold production

	World production*	South Africa	Canada	United States	Aus- tralia	All other
		(million dollars at \$35 a fine ounce)				
1954	895	462	153	65	39	176
1958	1,050	618	159	62	39	212
1959	1,125	702	157	57	38	171
1960	1,175	748	161	59	38	169
1961	1,215	803	157	55	38	162
1962	1,290	893	146	55	37	159
1963 ^P	1,365	962	140	50	37	176

*Estimated; excludes U.S.S.R., other Eastern European countries, China Mainland, and North Korea. It is estimated that the Sino-Soviet bloc has produced about \$350 million of gold annually in the last 10 years.

^PPreliminary estimates.

gold's position as an international reserve currency.

At the annual meeting in September of the International Monetary Fund, two comprehensive studies of the international payments system were initiated. One is being conducted by the IMF staff, the other by Treasury representatives of the 10 major IMF members that participate in the Fund's General Arrangements to Borrow. The latter study group includes the United States, Britain, France, West Germany, Italy, Belgium, the Netherlands, Sweden, Canada and Japan, with combined holdings of about two-thirds of the world's reserves of gold and foreign exchange. The only ideas ruled out from the agenda of the meetings are a change in the present gold price of \$35 an ounce and freely fluctuating exchange rates among currencies. Results from these studies are expected during the latter part of this year.