GOLD AND THE DOLLAR

Remarks by

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Today I'm going to talk about gold and the dollar. Because of the limitations of time this noon, and the breadth of the subject to be covered, I will dispense with the usual amenities, and proceed to the first of three parts of this short talk. For those of you who want to keep score, these three parts will be: (1) what has happened in the last two or three weeks; (2) why did it happen; and (3) what may have been accomplished.

About three weeks ago the tempo of trading in the London gold pool started to accelerate, after a period of about six weeks of relative calm. Then, commencing about the first of March, private gold buyers started a wave of buying that gathered momentum in almost geometric ratio, until on Thursday, March 14, the sales reached about 200 tons.

Just a word about the pool might be helpful. It is - or was - the product of an agreement among the nations of western Europe and the United States. Its objective was to contribute to monetary stability by providing a place for private persons to buy and sell gold, thereby indirectly assuring the indirect convertibility of all currencies into gold at about $35 an ounce. As an operating mechanism, it was lodged in the Bank of England, with periodic reimbursement of gold losses by the partners in accordance with their agreed shares. France withdrew last year, and after picking up her share, ours was increased to 59%.

On Thursday night, the seven remaining partners suspended the pool operation and agreed to meet in Washington to determine a new course of action. And meet they did on Saturday. Present were the Governors of the central banks of Belgium, Switzerland, Germany, Italy, the United Kingdom, the United States and the Netherlands. Also attending were the heads of the International

Monetary Fund and the Bank for International Settlements. They agreed to these points:

(1) The private market for gold will be completely isolated from the existing monetary gold stock. The price of gold in the London market will fluctuate in response to supply and demand, without intervention by governments. The price of gold may rise above $35 an ounce, or it could conceivably fall below this price.

(2) The United States will continue to buy and sell gold at the existing price of $35 an ounce in transactions with monetary authorities. The Governors agreed, however, that they will not hereafter sell gold to other monetary authorities to replace gold taken from their reserves to be sold in private markets.

(3) The seven countries will cooperate in maintaining the existing parities and orderly conditions in the exchange market. To achieve these objectives, the United States will strengthen its balance of payments through fiscal and credit policies and the United Kingdom will eliminate the deficit in the U.K. balance of payments and move to a position of large and sustained surplus.

(4) Available credits to the United Kingdom were increased to $4 billion, including the IMF standby. The United States increased its swap limits with central banks and the BIS by $2,275 million to a total of $9,355 million. Swap lines, or credit packages, enable central banks to adjust short-term pressures against their respective currencies by borrowing foreign currencies, and have proven to be very useful.

(5) To facilitate the return to a better balanced pattern of international payments, most of the European governments intend to follow expansionist monetary and fiscal policies. In particular, they will avoid as far as possible increases in interest rates or a tightening of money markets.

Concurrently, the International Monetary Fund issued a statement calling on all members to conduct gold transactions consistently with their obligation under the Bretton Woods Agreement, "to promote exchange stability and to maintain orderly exchange arrangements."

According to Edwin Dale of the New York Times, the free translation of this means that every member nation of the IMF must either stop all buying and selling of gold to private citizens, or be left out of the system. A second penalty would be the automatic refusal of the U.S. Treasury to buy any gold from the offending nation.

On Tuesday the U.S. Treasury amended the gold regulations in these principal ways:

(1) The Treasury will no longer purchase gold in the private market, nor will it sell gold for industrial, professional or artistic use.

(2) The prohibition against private holdings by U.S. nationals was reaffirmed.

(3) Domestic producers were given the right to sell their production in foreign markets freely, as well as the unrestricted right of sale to authorized domestic users. Authorized domestic users may continue to import gold or purchase it from domestic producers within their licensed limits.

In the Federal Reserve System, an increase in the discount rate was voted by the boards of directors of eleven of the twelve banks. As some of you may know, the banks must originate the discount rate changes, which subsequently, however, must be approved by the Board of Governors.

The principal result of these steps has been to set up a two-price system for gold. The first of these will be a floating price for gold viewed as a commodity; a market-determined price which will reflect levels of supply and demand. The other is a fixed monetary price of approximately $35 an ounce for settlement of international balances among central banks.

Why did this happen? The principal reasons are these:

The deepening loss of confidence in the British pound over the last three or four years, characterized by recurrent crises in sterling, and culminating in the devaluation last November.

Gradual loss of confidence in the U.S. dollar, caused by continued deficits in our balance of payments and in our domestic budget.

Mounting liquidity pressures in the structure of the international monetary system caused by the role of gold in central bank reserves. These reserves are composed of three elements: gold, convertible currencies, and the gold tranche position of each country with the IMF. Of the components, convertible currencies (also known as reserve currencies -- these are the pound sterling and the U.S. dollar) have played the principal role in recent years in meeting the demands for expansion of reserves to meet the needs of a rapidly growing world economy. This has been so for these reasons: the United States made an expanding volume of dollars available in the free world during the 50's and early 60's by aid programs, overseas investments by U.S. corporations, military spending, and a number of other ways involving both the public and private sectors of this country. During this period we ran an increasing deficit in our balance of payments. It is fortunate that the dollars were available, for in recent years the production of gold in the free world has not expanded in any significant way; more seriously, the monetary stocks have not been able to compete with hoarders and speculators for the gold that has been mined. In the last three years, monetary gold stocks have not increased. In fact, the pressure from speculators has been such through the gold pool that monetary stocks have actually declined. Quite obviously, under these circumstances, a loss of confidence in the two reserve currencies has slowed the growth of central bank reserves in the free world.

Finally, there is the irrationality of man. In an extraordinarily complicated world, the simplicity and immutability of a single metal have enormous emotional appeal. You can see it, lift it, feel it, and even bury it without fear of deterioration -- assuming your government permits you to hold it in the first place. In a world beset with tensions and doubts over not only the continuation of financial and political institutions as we have known them, but of man himself, rumors have a very fertile medium indeed in which to spread and multiply at incredible speed. These rumors have been translated almost overnight into enormous speculative pressures against the dollar, the pound, and gold in the last eight years.

I am reminded of the story of the Montana prospector who wasn't going to be allowed into Heaven by St. Peter because of the destruction being worked upon the golden streets by others of his occupation. Only when he promised to find a way to stop them did St. Peter agree to let him in. In a few days his success became obvious, for a stream of prospectors passed through the gate headed in the other direction, each with his pick and shovel on his back. At the end of the line, though, came our friend. St. Peter stopped him to congratulate him on the success of his move. In response to a question as to how he had accomplished it, the prospector said it was easy, he had simply started a story of a gold strike in Hell. St. Peter nodded his head in approval, and said, "Well, it certainly did the job, but where are you going?" The prospector looked a little shamefaced and said, "Well, I thought I'd go down and see if there's any truth in it!" I suspect that most gold rumors are generated in about this same way.

This brings me to the final part of this review. What has been accomplished by these moves? Well, first of all, as I have said, the two use streams of gold have been separated. The ground rules for use of monetary gold and its price are quite clearly set out. Less clear are any clues for the price trend of gold as a commodity. Not the least of the factors affecting this price are these:

First of all, there is somewhat more than $2 billion of gold overhanging the market; gold acquired since November. This is gold acquired by speculators anticipating an increase in the monetary price. Gold as an investment has several disadvantages, not the least of which are the costs of storing it and the loss of income. Not all of this gold has been bought by oil sheiks to bury in the Middle East. A substantial part of it was bought by aggressive international investors as part of hedging operations. Presumably these people, who are interested in keeping all their assets fully invested and earning, will be moving some of this gold back into the market, thereby increasing the supply.

The second major unknown is the effect of the restriction placed by the U.S. Treasury and the IMF on sales of gold by central banks to private buyers. It will affect South Africa especially, but also Canada, for both of these countries have had a policy of bringing gold into their central bank reserves and then selling from these reserves to private buyers.

The second accomplishment has been to strengthen the case for the special drawing rights. This is the white hope of the future for an orderly, planned expansion of international banking reserves through the IMF. On March 29, the member countries of the IMF will be voting on the recommendation of its Board of Governors, which they passed last fall in Rio to authorize an amendment of the IMF agreement permitting the orderly creation of a form of new money known as special drawing rights. The amendment, if passed at this meeting, must then go to the legislatures of the various countries for approval, with activation probably not possible until sometime in 1969. Obviously, one of the major uncertainties will be the attitude of France. But the need has been demonstrated so dramatically in the last two weeks for something like SDR's that it is the fervent hope of most responsible people that the General will moderate his position.

The third objective has been to make the British austerity budget announced Tuesday somewhat more palatable than it otherwise might have been to the British people. These steps taken to bolster the British economy and the pound were essential, but a terrible dose of salts to a free people.

The fourth accomplishment has been to force upon western Europe a realization that their fiscal and monetary policies must be a mirror image of our own. If our balance of payments program is successful, that success will be a deflationary force of major proportions in the free world. To mitigate this effect, western Europe will have to accept a decline in their surplus trade positions and pursue expansionary measures in their own countries as offsets.

The fifth accomplishment has been to demonstrate once more the extraordinary cooperation among central banks that is a phenomenon of recent years. When the pressure is on, most have been able to work together in the common interests of their various countries.

Finally, it may have forced the United States Congress, the administration and the U.S. citizen to think a little more seriously about our own national aspirations and responsibilities. Unless we take significant heroic measures to correct our two deficits -- that is, the balance of payments and the budget -- the events I have briefly outlined will be only a temporary paliative, and we could face another dollar crisis. We are fighting two wars, one in Vietnam and one at home, neither one of which lends itself easily to budgetary containment. This is a dilemma which has to be resolved in major part with a tax increase, because of the inherent difficulties of realistically imposing limits on national commitments already made. Perhaps the nature of these commitments will now be critically examined to determine the priorities in a plan of national survival. Anything less than such an examination will be the cruelest of deceptions. In the real world of international credit, like the personal world of you and me, there is a limit to the patience of creditors. In the world of human relationships there is a similar limit to the credibility of promises. In neither world should we promise more than we are willing to deliver. It is the costs attached to extending or not extending these promises that must be critically appraised; because once made, the promise must be kept if we are to maintain our integrity as a nation.