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THE PEDIGREED GOLD SYSTEM: A GOOD SYSTEM—WHY SPOIL IT?

REPORT

OF THE

SUBCOMMITTEE ON INTERNATIONAL EXCHANGE AND PAYMENTS

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

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LETTERS OF TRANSMITTAL

December 12, 1969.

To the Members of the Joint Economic Committee:

Transmitted herewith for the use of the members of the Joint Economic Committee and other Members of Congress is a report of the Subcommittee on International Exchange and Payments entitled "The Pedigreed Gold System: A Good System—Why Spoil It?"

The views expressed in this subcommittee report do not necessarily represent the views of other members of the committee who have not participated in the hearings of the subcommittee or in the drafting of this report.

Sincerely,

Wright Patman,
Chairman, Joint Economic Committee.

December 11, 1969.

Hon. Wright Patman,
Chairman, Joint Economic Committee,
Congress of the United States, Washington, D.C.

Dear Mr. Chairman: Transmitted herewith is a report of the Subcommittee on International Exchange and Payments entitled "The Pedigreed Gold System: A Good System—Why Spoil It?" This report has been approved by a majority of the members of the subcommittee and without dissent.

The subcommittee wishes to express its gratitude and appreciation for the guidance it has received from the administration officials and the international monetary experts who appeared before it as witnesses.

Sincerely,

Henry S. Reuss,
Chairman, Subcommittee on
International Exchange and Payments.

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THE PEDIGREED GOLD SYSTEM: A GOOD SYSTEM—WHY SPOIL IT? [1]

Introduction

A number of recent developments—the proposed IMF quota increase, the decline in the free market price of gold, and reports that the March 1968 two-tier gold marketing agreement was being or was about to be circumvented—prompted the Subcommittee on International Exchange and Payments to schedule hearings on November 13 and 14, 1969, to examine the implications of these developments. At the 1969 annual meeting of the International Monetary Fund, the Governors adopted a resolution instructing the Executive Directors to submit by the end of the year a recommendation specifying an appropriate increase in Fund quotas. A quota increase could affect the U.S. reserve position because, in the past, other countries without sufficient gold to make the required subscription payments have purchased the needed gold from the United States. Reports that the provisions of the March 1968 two-tier agreement were in some cases not being observed, and a marked decline in the free market price of gold also suggested a re-examination of the usefulness and vitality of this agreement. The following presents the subcommittee's conclusions derived from its hearings.

1. The March 1968 two-tier gold marketing agreement has succeeded beyond initial expectations and should be maintained in its present form. The United States could gain nothing from any "compromise" with South Africa producing a resumption of official gold purchases from that country. Consequently, the U.S. Treasury should under no foreseeable circumstances agree to support—either directly, through the IMF, or by sanctioning the purchases of other industrial countries—the free market price of gold.

The separation between official and private gold markets was established as a means of ending the heavy gold losses that the nations participating in the London gold pool were suffering in early 1968. These countries had for several years intervened in the London gold market in order to maintain the price at which gold was traded there within a narrow range of the official value of $35 per ounce. However, as the consequence of a surge in speculative demand for gold following repeated exchange crises, the gold pool members found themselves in early 1968 supplying intolerably large amounts of gold to private hoarders and speculators. Since the United States had assumed the

[1] Representative Richard Bolling states: "Since other responsibilities prevented my participating in the hearings on which this report was based or evaluating the arguments presented therein, I am unable to take a position on this report."

Senator Stuart Symington states: "I support recommendations 1 and 2, but withhold judgment and take no position on recommendations 3 and 4."

Senator Charles H. Percy states: "I support recommendations 1 and 2. However, I believe that recommendations 3 and 4 raise questions about the nature of monetary reserves which I believe were not adequately covered in the hearings, and thus I reserve judgment on these recommendations."

largest proportionate share of the burden in transactions conducted by the gold pool, these official gold losses fell most heavily upon the United States.

On March 16, 1968, representatives of the monetary authorities of the nations then actively contributing to the gold pool—Belgium, Germany, Italy, the Netherlands, Switzerland, the United Kingdom, and the United States—met in Washington to discuss techniques for dealing with the crisis. The following day they announced their agreement in a communique which stated in part, "that henceforth officially held gold should be used only to effect transfers among monetary authorities and, therefore, they decided no longer to supply gold to the London gold market or any other gold market. Moreover, as the existing stock of monetary gold is sufficient in view of the prospective establishment of the facility for special drawing rights, they no longer feel it necessary to buy gold from the market. Finally, they agreed that henceforth they will not sell gold to monetary authorities to replace gold sold in private markets."

Following the announcement to reorganize the international gold market on a two-tier basis splitting official from private transactions, a test of wills ensued between the United States and South Africa. The agreement was reached primarily to conserve the U.S. gold stock—an important psychological bulwark in protecting the international reserve-asset value of the dollar. By contrast, South Africa, as the largest producer of gold and supplier of the metal to Western European markets, had consistently urged an increase in the official value of gold and a corresponding decrease in the reserve-asset value of the dollar relative to gold. After the introduction of the two-tier gold marketing system, South Africa continued to work for this objective. The chief tactic of that country in attempting to bring about an increase in the official value of gold was to withhold current production from Western European markets and therefore to increase the differential between the higher private market price and the official value. In March 1969 the price of gold in both the London and Zurich private markets reached a peak of nearly $44 per ounce.

With the passage of time, it is becoming increasingly evident that this conflict is being resolved in favor of maintaining the reserve-asset value of the dollar and of international monetary stability. The U.S. gold stock fell to its postwar low in May 1968 and since that time has increased by over $700 million worth. The dollar remained strong in exchange markets throughout the repeated crises centering around the French franc and the German mark from May 1968 through to the eventual devaluation of the franc and upward revaluation of the mark. More importantly, the agreement has succeeded in obliging South Africa to sell the bulk of her gold output in the private market and thus reduce the differential between the private and official price. Most members of the International Monetary Fund have agreed voluntarily to abide by the March 1968 accord; consequently, official purchases of South African gold have been minimal since the establishment of the two-tier marketing arrangement.

Examination of the structure of South Africa's balance of payments immediately reveals that country's inability to suspend gold sales for any extended period. Excluding gold sales, South Africa typically has a deficit on current account (line 5, Table 1) that has in recent years been only partially offset by private and official capital inflows (line 8). In fact, it is only since 1965 that the capital account has registered annual surpluses, rather than deficits. The consequent deficits on current and capital accounts together (line 9) are reduced by gold sales (line 10). But even with the benefit of gold exports, net surpluses and deficits (line 11) tend to be small. Moreover, the net position—including gold sales—has shifted from surplus to deficit, or vice versa, every year or two.

TABLE 1.—THE SOUTH AFRICAN BALANCE OF PAYMENTS

[In millions of South African rand]

	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969 I	1969 II
1. Merchandise exports, free on board	879	931	952	1,017	1,083	1,064	1,199	1,298	1,495	388	353
2. Merchandise imports, free on board	−1,127	−1,022	−1,048	−1,302	−1,595	−1,823	−1,678	−1,974	−1,930	−479	−537
3. Net service payments (−)	−256	−282	−247	−281	−314	−351	−367	−360	−357	−75	−109
4. Transfers (net receipts +)	−5		19	26	34	41	65	77	113	23	25
5. Balance on current account, excluding gold sales	−509	−373	−324	−540	−792	−1,069	−781	−959	−679	−143	−268
6. Private capital movements, including errors and unrecorded transactions	−165	−83	−64	−74	−41	162	160	235	372	22	−2
7. Central government and banking capital	12	−13	−56	13	8	96	−11	−66	74	11	39
8. Balance on capital account (net inflow +)	−153	−96	−120	−61	−33	258	149	169	446	33	37
9. Balance on current and capital accounts, excluding gold sales	−662	−469	−444	−601	−825	−811	−632	−790	−233	−110	−231
10. Gold sales	573	490	491	595	775	881	618	811	301	129	263
11. Surplus or deficit on above transactions, including gold sales	−89	21	47	−6	−50	70	−14	21	68	19	32
12. Newly produced gold absorbed in reserves	−43	86	141	93	−39	−106	150	−38	468	87	−73
13. Change in total reserves	−132	107	188	87	−89	−36	136	−17	536	106	−41

Note: Conversion of the above data from South African rand to U.S. dollars would enlarge all figures by 40 percent.

Source: South African Reserve Bank "Quarterly Bulletin," September 1969.

Introduction of the two-tier gold marketing system produced a decline in South African gold sales during 1968 to less than half of the previous level. The quantity of newly produced gold absorbed by the government as part of South African reserves (line 12) consequently jumped in 1968 to three times the greatest previous annual increase. In the second quarter of 1969, however, gold sales returned to the previous rate—about 800 million rand or $1,100 million annually. (See Table 2 for quarterly amounts in dollars.) In both the second and third quarters of this year, South Africa has sold all of its newly produced gold and, in addition, substantial amounts from its existing reserve holdings. Sales in the second quarter totaled $369 million. Gold sales in the third quarter are estimated at approximately $440 million. Thus, South African gold sales in the third quarter of this year were apparently larger than throughout all of 1968.

TABLE 2.—QUARTERLY SOUTH AFRICAN GOLD PRODUCTION AND SALES SINCE MARCH 31, 1968

[In millions of dollars]

	1968				1969		
	I	II	III	IV	I	II	III
1. Level of South African gold reserves	742	974	1,069	1,243	1,367	1,264	1,093
2. Net South African gold production		276	273	279	302	266	[a] 275
3. Change in gold reserves		232	95	174	124	−103	−171
4. Sales=Production—Change in reserves		44	178	105	178	369	446
5. Cumulative sales since Mar. 31, 1968		44	222	327	505	874	1,320

[a] Assumed.

Source for lines 1, 2, and 3: South African Reserve Bank "Quarterly Bulletin," September 1969, and "Internationa Financial Statistics," November 1969.

The marked rise in South African gold exports during the second and third quarters of 1969 reflects, at least to some extent, that country's inability to suspend gold sales indefinitely. With net external expenditures in the absence of gold sales normally ranging each year from $700 to $1,100 million and with foreign exchange reserves worth from $150 to $300 million, South Africa could permanently suspend gold sales only at the expense of massive deflation and domestic industrial dislocation.

Of the approximately $1.3 billion worth of gold sold by South Africa from April 1968 through September of this year, about $1 billion worth has apparently been to private purchasers. During this period, member nations making drawings from the IMF purchased slightly more than $100 million worth of gold from South Africa. (See Table 3.) This gold was obtained with South African rand included in the packages of various currencies lent by the Fund.

TABLE 3.—IMF DRAWINGS IN RAND, MARCH 1968–DECEMBER 1969

[Millions of dollars equivalent]

	Drawing country	Amount
1968:		
April	Peru	10
June	France	23
June	United Kingdom	19
November	Peru	10
1969:		
March	Peru	6
September	France	24
September	United Kingdom	10
Subtotal		102
November	West Germany	25
December	West Germany	20
Total		147

Source: U.S. Treasury Department.

Nations in balance-of-payments difficulties need dollars with which to buy their own domestic currencies and support them in exchange markets. Thus, when such countries borrow money from the Fund, they typically exchange all other currencies for dollars with the monetary authorities issuing these other currencies. As it is permitted to do under the convertibility provisions of the IMF Articles of Agreement, South Africa opts to offer gold instead of dollars for any rand offered for conversion by foreign monetary authorities. Consequently, rand lent by the IMF to countries making drawings are subsequently used to buy gold from the South African Reserve Bank.

In addition to these gold purchases resulting from the loan of South African rand by the IMF, the monetary authorities of some smaller countries have perhaps also purchased gold directly from South Africa. Apparently the nation of this type purchasing the largest amounts is Portugal; acquisitions by that country since March 1968 would now appear to total approximately $160 million worth of gold. Total official gold purchases from South Africa since the introduction of the two-tier system and through September 1969 may therefore amount to slightly more than $300 million.[1]

The temporary period during which South Africa was able to withhold gold from the private market has expired, and the resumption of South African gold sales at about the previous rate—reinforced by a long-awaited realinement of exchange rates in Western Europe—has brought the private market price of gold down until it is once again virtually the same as the official value. The intended objectives of the two-tier gold marketing agreement have therefore been realized. The United States could gain nothing from any kind of compromise with South Africa to modify the March 1968 accord and sanction the resumption of even limited official gold purchases from that country.

The United States would, in fact, lose substantial ground and pay a stiff price for any compromise with South Africa. For example, reintroduction of a fixed floor under the private market value of gold could divert South African supplies into official coffers and would assure speculators that the price of gold would not be permitted to slip below a stated minimum. Both of these factors would tend to encourage

[1] Including the $50 million of gold paid by South Africa to the IMF as partial reimbursement for that country's gold tranche drawing earlier this year.

a resumption of speculation and a renewed upward trend in the private market price of gold. The higher is the private market price of gold above the official value, the greater is the temptation for foreign monetary institutions to rush to the U.S. Treasury and demand conversion of their dollar reserves into gold. With liquid liabilities to foreigners totaling approximately $39 billion and U.S. gold reserves of slightly more than $11 billion, the United States could hardly withstand such an attack without substantial modification of the international monetary role of the dollar.

Supporting the private gold price could become a political embarrassment and undoubtedly would constitute a serious economic waste. We would be supporting the price of a good that is the primary export commodity of South Africa and the chief store of value of the Soviet Union. The United States has failed to enter into agreements effectively stabilizing the prices of the primary products that are the chief source of export revenues for poor nations; to extend a similar kind of aid to South Africa and the Soviet Union would constitute a political absurdity.

A decision to support the private market price of gold could delay complete acceptance of the SDR facility as a permanent feature of the international monetary system, since gold acquisitions might to some extent substitute for SDR distributions. Moreover, continued expansion of gold reserves would forgo the economic savings derived from the newly established ability of the IMF to create internationally acceptable fiduciary reserve assets in the form of special drawing rights. Instead, we would be expending real resources to dig gold-bearing ores deep from the earth, to refine these ores, to ship the refined metal around the world, and finally to bury it again in bank vaults. The resources devoted to such activities could, for example, much more reasonably be employed to help speed economic growth in developing countries.

Finally, the Secretary of the Treasury is not compelled by law to purchase gold from U.S. residents or foreigners at $35 per ounce or any other specific price. The Gold Reserve Act of 1934, as amended, states "With the approval of the President, the Secretary of the Treasury may purchase gold in any amounts, at home or abroad, . . . at such rates and upon such terms and conditions as he may deem most advantageous to the public interest; any provision of law relating to the maintenance of parity . . . to the contrary notwithstanding."

Supporting the private market price of gold would not be in the public interest and would entail budgetary expenditures or economic policy consequences requiring the approval of the Congress. Any budgetary expenditure would obviously require congressional consent, but even if Treasury gold purchases were monetized through resale to the Federal Reserve System, the consequences of such transactions would necessarily come under congressional review.

Given the existence of the SDR facility, monetization by the Federal Reserve of gold purchased to support the private market price would involve the creation of money to benefit special interests—South Africa, the Soviet Union, and gold speculators—rather than to assure general international monetary stability. Any such use of the power of the central bank to create money to benefit special interests—rather than to maintain general economic stability—would require, as in the past, the explicit authorization of the Congress.

The same Gold Reserve Act of 1934, referred to above, permitting the Secretary of the Treasury to "purchase gold in any amounts, at home or abroad, . . . at such rates and upon such terms and conditions as he may deem most advantageous to the public interest," could be availed of as a conscience-pricker for any foreign central bank that felt tempted to violate the spirit of the March 1968 two-tier agreement by purchasing gold on the private market—particularly if the price fell below $35 per ounce. The Secretary of the Treasury could condition his purchase of gold from a foreign monetary authority on the latter's assurance that it had not obtained "bootleg" gold, whether newly mined or hoarded, from the private market. This Treasury "condition" would be intended to, and in all likelihood would in fact, discourage foreign official purchases of "bootleg" gold because of the knowledge that to do so would cause the withdrawal of any U.S.-financed floor.

The rationale behind such a refusal to let U.S. gold purchases encompass our own destruction was well set forth by Senator Jacob K. Javits and Representative William B. Widnall as endorsers of the 1962 Joint Economic Committee Annual Report:

> One step which might be considered to help stem the outflow of gold would be for the United States to terminate its guarantee to *buy* gold from foreigners at $35 per ounce or at any other predetermined price. At the same time, we believe that the United State must avoid devaluation by continuing to *sell* gold to foreigners at $35 an ounce.
>
> The guarantee to buy gold at a fixed price encourages speculation in gold against the dollar. The belief that the United States facing balance-of-payments difficulties, may devalue the dollar in terms of gold, leads speculators to sell dollars for gold in the free gold markets overseas. They hold the gold in the hope of selling it to the U.S. Treasury after devaluation, thus reaping a large profit should devaluation occur. If the dollar is not devalued, their loss is negligible, since almost all risk has been removed by the U.S. guarantee to buy the gold at $35 an ounce. Eliminating this guarantee to buy gold at a fixed price would dampen speculative fevers by introducing a new element of heavy risk in speculative operations.
>
> There is considerable reason to feel that some of the U.S. gold loss in recent years has been to replace gold that the Bank of England has been paying out to speculators for the purposes outlined. We think termination of the guarantee to buy at a fixed price would be likely to sharply reduce such speculation and, at the same time, stimulate a return of sizable amounts of gold to the United States.

2. The member nations of the IMF should be urged in transactions with monetary authorities to guarantee collectively at $35 per ounce the value of all gold held as legitimate monetary reserves on March 31, 1968.

The recent decline in the private market price of gold has raised the possibility of a further drop in the private price to below the $35 per ounce official level. In this event, some foreign monetary authorities might request the reintroduction of a minimum price in the free market to assure that there could be no misunderstanding about the value of their own gold reserves. Rather than agree once again to "make a market" for gold sold by South Africa or dumped by speculators whose expectations have turned sour, the United States should urge the member nations of the IMF to guarantee formally under the aegis of that organization the $35 per ounce official value of gold legitimately held as monetary reserves at the introduction of the two-tier system. Given such a guarantee, there would be no question about the continuing value of these gold reserves. Any ostensible need to intervene in the private market to assure the stated value of official assets would be avoided.

3. In the event that "mitigation" arrangements cannot be devised to furnish nations without gold the quantities they require to meet their subscription obligations under the proposed IMF quota increase, the U.S. should allocate gold from its own stock rather than agree to a renewal of official purchases from South Africa.

When the 10 major industrial powers agreed in July 1969 on the amount and rate of an initial SDR distribution, the same countries—including the United States—agreed also to consider favorably an increase in IMF quotas. Consequently, during the last IMF–World Bank annual meeting, from September 29 through October 3, the Governors of the Fund instructed the Executive Directors to submit by the end of 1969 a proposal on an appropriate set of quota increases. The Executive Directors must submit a recommendation not only on the size of a general expansion in Fund quotas, but also on whether the growth rates of some countries have been sufficiently faster than the average to warrant especially large increases for these exceptional performers. Since each country's proportionate voting strength in the IMF is closely tied to the size of its quota, and also since SDR's will be distributed in proportion to quotas, a number of countries have applied for special increases. To the extent that special increases are granted, the nations receiving them will acquire greater powers to determine the activities of the Fund and will obtain greater proportional amounts of the new reserves that will soon be distributed.

Under the IMF Articles of Agreement, each country is obligated to make gold subscriptions to the Fund equivalent to 25 percent of its quota. The remaining 75 percent of its subscription is paid in its own currency. Current expectations are for a 33 to 37 percent general increase in Fund quotas, or a $7 or $8 billion absolute expansion. Consequently, gross member gold subscriptions consistent with a quota increase of this size would range from $1.75 to $2 billion.

Each time the members of the IMF have agreed to a general increase in quotas, a few of them—generally less-developed countries—have not held sufficient gold reserves to make the required gold subscription payments. Such members were then obligated to purchase gold from some other country and then turn it over to the Fund. In former years, these gold purchases for the purpose of meeting subscription obligations were usually made from the United States. But when the last general quota increase was approved in 1966, mitigation procedures were devised to enable Fund members to meet their gold subscription obligations and also to curtail U.S. gold losses.

Under a mitigation arrangement described by Under Secretary of the Treasury Paul A. Volcker in his testimony, a nation needing gold purchases it from another Fund member whose currency is in demand by the IMF. The purchaser then remits the gold to the Fund. The IMF in turn uses the gold to purchase an additional amount of the currency issued by the initial seller of gold. The net effect is to enable gold-scarce nations to satisfy their subscription obligations and to permit the Fund to acquire more of those currencies desired by borrowers. There is no net change in the ownership of gold.

Depending upon the extent to which mitigation procedures are applied when gold subscriptions are paid in compliance with the forthcoming quota increase, U.S. gold sales to other countries for subsequent payment to the IMF might total no more than $60 million, or might range as high as nearly $800 million (see Table 4). Other industrial countries, with the exception of Japan, are apparently willing to make their gold subscription payments from existing stocks and without purchasing additional amounts from the United States. The Japanese gold subscription, which presumably will be obtained from the United States, may amount to no more than $60 or $70 million. Thus, the bulk of mitigated gold payments would be to enable nonindustrialized countries to meet their gold subscription obligations, which would total an aggregate of some $600 or $700 million.

TABLE 4.—ESTIMATES OF POSSIBLE U.S. GOLD LOSS RESULTING FROM IMF QUOTA INCREASE

[In millions of dollars]

	Low	High
Total anticipated quota increase	7,000	8,000
Total gold subscription required	1,750	2,000
Estimated maximum U.S. gold outlay (no "mitigation"):		
Gold subscription payments of other industrial nations [1] (36.1 percent of total)	632	722
U.S. subscription (24.3 percent of total)	425	486
U.S. sales to other countries for payment to IMF	693	792
U.S. outlay	1,118	1,278
Estimated minimum U.S. gold outlay ("mitigation" applied for all nonindustrial countries):		
Gold subscription payments of other industrial nations [1] (36.1 percent of total)	632	722
"Mitigation"	633	724
U.S. subscription (24.3 percent of total)	425	486
U.S. gold sales to Japan (3.4 percent of total)	60	68
U.S. outlay	485	554

[1] The 13 member nations the IMF designates as industrial, excluding Japan and of course the United States: Austria, Belgium, Canada, Denmark, France, Germany, Italy, the Netherlands, Norway, Sweden, and the United Kingdom. Other industrial members, with the exception of Japan, are apparently willing to make gold subscription payments without purchasing additional amounts from the United States.

Note.—The above calculations assume no special quota increases. Such special increases, if approved, would not substantially change the estimates.

Although mitigation procedures are certain to be applied to some extent, it is unclear at this time what will be the total amount of mitigation. In his testimony before the subcommittee, Under Secretary Volcker stated, "In the end, the Fund will be adequately supplied with usable currencies, or perhaps SDR's, without impairing the reserve position of any country." This statement implies that the U.S. gold stock will decline as a result of the Fund quota increase by little, if any, more than the amount of this country's own gold subscription.

Regardless of whether the amount of mitigation is relatively modest or such arrangements cover virtually all gold subscription payments by nonindustrial countries, the United States should be prepared to offer to other countries the gold they need to meet subscription obligations and which cannot be obtained through mitigation arrangements. Sales by the United States are preferable to modification of the two-tier gold marketing arrangement because of the undesirability of renewed official gold purchases from South Africa and because the United States is likely to be able to easily afford such gold sales.

The U.S. gold subscription cannot be considered a reserve loss resulting from an IMF quota increase because any such U.S. gold payment to the Fund increases our automatic borrowing privileges by the same amount. Given even a very modest application of mitigation arrangements, U.S. gold sales to other countries for subsequent payment to the IMF would be less than the $700 million of additional gold reserves acquired since the May 1968 low. Thus, there is virtually no likelihood that the U.S. reserve position could deteriorate to the point it reached last year when the dollar was in a more tenuous position than it is currently. The United States has nothing to fear from any decline in its gold stock resulting from quota increases and should not hesitate to offer gold to other countries needing it to meet their subscription obligations. To do otherwise would encourage the resumption of official gold purchases from South Africa.

4. The splitting of official from private transactions in gold is consistent with the unanimous views of witnesses before the subcommittee that the dependence of the world monetary system upon gold will lessen significantly over time. This fact calls into question the requirement in Article III: 4 of the IMF Articles of Agreement that 25 percent of quota increases be paid in gold. The United States should therefore propose an amendment to the Articles of Agreement permitting gold subscription obligations also to be paid in SDR's or currencies specified by the Fund.

This proposal reflects realistically the increased international role of major currencies in addition to the dollar, the guarantees which IMF members have extended to assure the value of SDR's, and the relatively declining importance of gold as a reserve asset. This suggested reform would also eliminate the fiction that presently exists, through mitigation procedures, whereby the 25 percent gold contribution requirement is bypassed.

The figure of 25 percent for the gold contribution was not entirely arbitrary in 1945. The gold contribution in the initial subscriptions plus the U.S. dollar subscription was equivalent to approximately half the total initial quotas, and Dr. Bernstein informed the subcommittee that this initial composition of Fund assets was intentional. At that time, however, the dollar was the only major currency that was freely convertible. Members wishing to make repurchases from the Fund did so with dollars.

The reinstitution of external convertibility for the European currencies at the end of 1958 made it possible—if not necessarily advisable at that time—to consider whether in the long run the Fund should continue to adhere rigidly to the 25 percent gold subscription formula under future quota increases. This question is even more appropriate now, when strong currencies are exchanged freely in world trade. Repurchases from the Fund to date, for example, have been made with 14 currencies other than the United States dollar, including Mexican pesos and Australian dollars.

One of the mitigation procedures adopted in 1966 illustrates the increased maturity of the world monetary system and the need for a new look at the 25 percent gold contribution. Under the mitigation procedure, borrowings which were used to purchase gold were to be paid back in part in currencies acceptable to the Fund, i.e., not gold.

In effect the gold contribution was lowered in certain instances in addition to the very limited ones spelled out in Article III: 4. A country making its gold contribution in this manner could theoretically obtain a "gold tranche" borrowing privilege—that is, a virtually automatic drawing right—without contributing gold. But this fact was not recognized in the IMF charter itself. The International Monetary Fund should accept this reality and eschew the fiction that what is not gold, really is gold.

This reform could be accomplished by allowing "gold" subscriptions to be paid in SDR's or currencies acceptable to the Fund in addition to gold. An amendment to this effect would get around the complicated accounting which was used in the mitigation procedure, but would have the same mitigatory effect.

Since this reform would entail amendment of the IMF Articles of Agreement, it should not affect negotiations currently underway on IMF quota increases. Adjustment of the 25 percent gold subscription requirement should be discussed without the pressure of deadlines prior to the next quota increase. At that time the world should be prepared to effect further constructive developments in the world monetary system.