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CONFIDENTIAL

Office Memorandum

TO : Mr. Volcker

DATE: March 10, 1969

FROM : William B. Dale

SUBJECT : Limited Gold Convertibility in a Cooperative Framework

I have become convinced that gold convertibility of the dollar cannot be maintained indefinitely. One of the reasons is the lack of discipline on surplus countries, and the fact that the medium-term outlook for the U.S. balance of payments appears very bleak in the absence of substantial appreciation of the currencies of surplus countries.

The question is thus when, in what circumstances, and to what purpose the United States will decide to alter the present unlimited full gold convertibility of the dollar at the initiative of others. I think there is a strong case to be made that this should be done sooner, rather than later. In the right framework, breaking the full-scale link to gold can, in my judgment, have quite limited cost to us and can play a very important role in forcing other countries to recognize the steps that are needed to create adequate reserves for the world and improve the adjustment process.

At present we have what I would call "pseudo" gold convertibility of the dollar. We do not formally turn anyone down when he asks for gold, but we make very clear we are unhappy if he asks. One of the reasons I would prefer to alter the existing gold convertibility is that I consider what we have to be a sham. There is a significant--if unquantifiable--cost to the United States in abiding by the letter of the law on gold convertibility when everyone knows that it is impossible for us, or them, to act according to the spirit which the law was intended to capture. I hate to have the United States leaning on legalisms, and other people snickering when we say we "freely" sell gold.

We have spoken quite a lot about the circumstances in which the United States might "break the link," but we have hardly considered at all what we would do afterwards. As regards the initial act of altering gold convertibility, I believe upon reflection, that the atom bomb analogy is not only wrong but misleading. It is true that breaking the link is an important act. But it is not necessarily destructive and disruptive. If done with cold logic, and followed up on the basis of a genuinely cooperative policy, I think it could earn us the respect of the world--in the same way a decision to devalue, or not to devalue, earns admiration when taken in the right conditions.

Robert Solomon uses that in his 3-16-70 memo to Volcker

I would like to see us earn the respect and admiration of the world by breaking the link in two ways:

1. Doing it on our own, as the result of a deliberate and statesmanlike decision for which we would take full responsibility, and not doing it by way of hiding behind some convenient crisis that happened to come up from one direction or another; and

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2. Replacing the existing "free" and "full" convertibility link (which we and everyone else knows is neither really free nor really full) with a conditional convertibility whose substance could be recognized by all as fair and reasonable.

It is clear, at least to me, that we must have some rule for limited gold convertibility after we break the link. Sales of gold at our initiative is not a satisfactory rule, unless we are clear under what circumstances we will sell, and when we won't. In fact, we must assume, as the most reasonable basis for policy, that the dollar will continue to be the reserve and vehicle currency. That implies that we will continue to have a passive market intervention policy and a passive conversion policy, rather than an active policy on either score. The task for us is to decide when we will convert at other peoples' initiative, and when we won't. The rules for conversion must be simple, quantitative (rather than qualitative), universally applicable, consistent through time, and such as to be everywhere recognized as sensible and fair, for ourselves, for other countries, and for the system.

I would suggest the following rule for gold conversion: The United States would sell gold for dollars at $35 (less charge) to any Fund member in an amount which did not bring that member's official gold holdings to a higher percentage of imports than was borne by U.S. gold holdings after the transaction. The import reference would be imports for the most recent 12 months for which statistics were available, provided the data were not more than three months in arrears. In the event of any dispute over the applicable data, the Managing Director of the Fund would be requested to make a determination, and the United States would accept his determination as final.

The attached table gives information on gold holdings and imports of countries. It shows there are eight countries to which the United States would not sell gold under the rule I have suggested, the major one being Switzerland.

Under this rule, on the basis of existing data, the maximum theoretical gold sales by the United States would be in the neighborhood of $7 billion--at which point U.S. gold holdings (about $3.8 billion) would be a little less than 10 per cent of U.S. annual imports, and no other country would hold any smaller percentage of its imports in gold. As a practical matter, I believe gold sales under the rule would be quite unlikely to exceed $2.5 to $3.0 billion at the outside.

The proposed rule focuses on gold in relation to imports. It would be better to have such a rule relating gold to total current payments, or even to total gross payments (current and capital), but statistical inadequacies make that out of the question. It is, in any event, preferable to focus on a relationship to imports, as a rough-and-ready indicator of gold reserve adequacy, rather than to base any rule on the percentage of aggregate reserves carried in gold. In this way, some added pressure is placed on

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countries with high over-all reserves that want to carry them in gold. It would also avoid the statistical problems of defining reserves and worrying about quasi-reserves.

Four other things about the proposed rule are worth mentioning:

1. It does not claim any special dispensation for the United States itself. We would step up and be compared to any and every country on the basis of substantive and exact criteria that can be applied to everyone. This is an important advantage in seeking to project the image of being reasonable and fair in breaking the link.

2. The incentives are in the right direction. If we were to restrict imports, the result would be a higher gold/import ratio, and we would be subject to greater gold sales than otherwise. If another country were to restrict imports, it would have a higher gold/import ratio, and would be able to buy less gold from us.

3. The rule is a dynamic one. It could apply to any situation at any time in the future. If our imports rise faster than someone else's, our gold/import ratio will fall and we will be subject to less gold sales. If someone else's imports rise faster than ours, his gold/import ratio will fall, and he can qualify for a larger purchase of gold from us. The rule could even continue to apply if the official price were to rise at some future time.

4. The rule would be consistent with the position of moving in an evolutionary way from the present dependence on gold as a reserve (especially on the part of the United States) to greater reliance in the future on SDR's.

The table shows some interesting things. Particularly interesting are the relative positions on this basis of Italy, France (even after large gold sales), Germany, the Netherlands and Belgium.

I urge that consideration be given to replacement of the present gold conversion policy by the gold conversion rule I have suggested. In my view, this should be done <u>immediately</u> and in the <u>absence</u> of a crisis atmosphere. It would, in my judgment, set the stage for a more successful cooperative negotiation to improve the international monetary system than any other option presently available to us.

Attachment

cc: Volcker Group

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Countries Grouped According to
December 1968 Gold Holdings as Percentage
of Imports (cif), based on Last Quarter of 1968
at Annual Rate

		Country	Gold	Imports	Per Cent
A.	High Proportion	1. Uruguay	133	150	89%
		2. Portugal	856	1,276	67%
		3. Burma	84	140	60%
		4. Lebanon	287	500	57%
		5. Switzerland	2,624	4,902	54%
		6. Iraq	193	409	47%
		7. South Africa	1,243	2,992	42%
		8. Saudi Arabia	119	400	30%
		Subtotal	5,539	10,769	51%
B.	United States		10,892	38,005	29%
C.	Other Countries with Gold/Import Ratios 10% or above				
		1. Austria	714	2,644	27%
		2. Italy	2,923	11,250	26%
		3. Venezuela	403	1,568	26%
		4. France	3,877	16,426	24%
		5. Germany	4,539	22,124	22%
		6. Spain	785	3,785	21%
		7. Kuwait	122	634	19%
		8. Jordan	30	163	18%
		9. Netherlands	1,697	9,943	17%
		10. Belgium	1,524	9,064	17%
		11. U.A.R.	93	604	15%
		12. Ecuador	26	200	13%
		13. Libya	85	656	13%
		14. Turkey	97	802	12%
		15. India	243	2,147	11%
		16. Greece	140	1,364	10%
		17. Iran	158	1,591	10%
		Subtotal	17,456	84,965	21%
D.	All Other Fund Members		4,778	101,820	5%
E.	Total - Fund Members plus Switzerland		38,665	235,450	16.5%

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