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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

STRICTLY CONFIDENTIAL (FR) March 16, 1970.

TO: Chairman Burns

FROM: Robert Solomon Subject: U. S. Gold Policy.

If we ever find ourselves in a position where an increase in the official price of gold is a serious option, the following disadvantages would have to be weighed against the advantages as they appear at the time.

1. The international monetary system has been evolving away from dependence on gold as a source of reserve growth toward a multilaterally-managed system based on SDRs. The evolution away from dependence on gold follows the domestic pattern of gold use in every major country. It makes sense, since the supply of gold for international reserve purposes cannot be controlled in a deliberate and systematic manner. The evolution toward a multilaterally-managed system is the only alternative to a gold standard that is acceptable to our European friends, who will not accept a dollar standard. An increase in the official price of gold could reverse these evolutionary processes in several ways:

a. Creation of SDRs would either cease or be reduced to insignificant amounts, at least for the major countries.

b. The two-tier system would probably fall apart, as central banks would no longer be willing to abstain from purchasing gold from the market.

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c. As a result of these and other developments, gold would once again come to be regarded as the primary reserve asset.

d. We would be back to something very close to the gold standard, and the Europeans would be determined not to let official dollar balances grow again.

2. The distribution of gains would be perverse, in the sense that they would not further U.S. political and economic interests.

a. Those central banks that have maintained their reserves almost entirely in the form of gold would be seen to be vindicated. (This may help to explain why some central bankers are sympathetic to an increase in the gold price. If the gold price never rises, their policy of holding a non-interest-earning asset over the years will look more and more foolish.)

b. The biggest revaluation gains, relatively, would accrue to South Africa, Portugal, and some small European central banks. Those countries that have been most cooperative with the United States, politically and economically, would be among the smaller gainers. And in the private community, the gainers would be those who have consistently bet against the ability of men to manage the affairs of government rationally.

3. More broadly, the step would be interpreted as a political defeat for the United States.

a. We would have failed to fulfill a commitment, whether or not it was wise to make the commitment that an increase in the price is "unthinkable." (What choice does a bank have but to assure its depositors that they can withdraw their deposits on favorable terms?)

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b. Every other week the Financial Times (London) carries a column on the battle between gold and the dollar. At the moment the dollar is one-up. An increase in the gold price would be trumpeted as symbolic of the fall of the United States from its paramount position in the world.

4. The financial gain to the United States might be small and short-lived.

a. Just as the Netherlands Central Bank has never held uncovered foreign exchange in any significant amount since sterling was devalued in 1931, many countries around the world might cash in their dollar holdings (yes, even at the higher gold price). Thus much of the gain in the value of U.S. gold reserves might be eaten up by conversions of outstanding official dollar balances.

b. We would gain little in terms of exchange-rate adjustment. How many countries would fail to follow the dollar all the way in raising the price of gold in their own currencies? No more than a handful. The gold price increase would, in effect, be a bribe to these countries to accept a revaluation of their currencies relative to the dollar. If the points set forth above have any validity, it would be an expensive bribe. There are other ways to persuade surplus countries to revalue.

5. The possibility that the United States might suspend the convertibility of the dollar into gold is an important bargaining lever for the United States. Europeans understandably resent our possession of this powerful lever. And, like the nuclear deterrent, it is better unused than used. My own view is that we should respect the European desire to share in the management of the inter-

Good comparison → sheds light on U.S. power at the time

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national monetary system. But until we arrive at a stage where they also share the responsibility adequately (on many fronts, including exchange-rate flexibility, so that the United States can honestly take on the commitment to keep its payments position more or less in balance) we need a powerful bargaining weapon. If we ever increase the official price of gold, we can hardly use it.

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