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An Analysis Of The Gold Crisis: Its Development And Proposed Remedies

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AN ANALYSIS OF THE GOLD CRISIS:
ITS DEVELOPMENT AND PROPOSED REMEDIES

SUBMITTED IN PARTIAL FULFILLMENT
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M. E. H.
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CHAPTER I

MONETARY HISTORY

The gold problem can only be understood in the light of history. Gold is the only universal form of money, and has been so for thousands of years. The scarcity of gold pushed mankind to develop the whole complex money system we have today --- paper money, checks and credit, now the chief form of money used in daily business transactions.

Throughout time gold has remained the ultimate security for all forms of money. By the 19th century the system crystallized as the gold standard operated, in the main, by the Bank of England, a private institution. By giving the British pound a constant value in terms of a specific quantity of gold, the Bank of England established the pound as universally accepted substitute for gold.¹

Other countries similarly guaranteed their money in gold, with the result that almost the entire world had, in effect, a single monetary system. This was literally free enterprise's golden age because of the convertibility of virtually all nations' money into gold, capital flowed freely from country to country. Under this system, world industrial output expanded by nine times in a century and the United States grew from a puny colony to a great world

power.

The system broke down during World War I. The war reduced Britain's commercial and banking power and unleashed forces of revolutionary change. In Russia the Communists took their people off the gold standard and Lenin vowed to build public latrines of the precious metal to show the revolution's contempt for it as a symbol of capitalism. Hitler and Mussolini went off gold as soon as they came to power. Britain gave up redeeming the pound in the old gold value in 1931.

Then, Franklin D. Roosevelt made sweeping monetary changes in the United States. In 1933-34, he (1) seized the gold in the Federal Reserve banks; (2) compelled individuals to surrender all gold coins or bullion; (3) repudiated the clause in government bonds promising repayment in gold; and (4) devalued the dollar internationally. From 1792 to 1934, the United States had paid $20.67 for an ounce of gold; now it paid $35.00. It was argued that this would stimulate U.S. exports, since other countries, getting more dollars for their gold, could afford to buy more goods here --- but history proved otherwise.

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2 "The Coming Crisis in Gold", Reader's Digest, September, p. 143.

3 Ibid.

4 Thomas, op. cit., p. 62.

5 Ibid., p. 61
During the 30's there was a chain reaction of currency devaluation as other countries also strove to increase their exports and reduce their imports. In the United States an incipient comeback shriveled. Unemployment deepened and recovery did not begin until the late 30's --- and then under the stimulus of the approaching war.  

By then the flight of gold to the United States as Hitler marched over Europe caused the Treasury's gold stocks to rise from 6000 tons to 19,000 tons on the eve of World War II.  

This unequal distribution of the free world's gold quickly put the United States on the spot. Foreign countries needed to buy more from us than they could sell. When they had no more gold to cover the gap, our first choice was to make them borrow. But before long we realized that there were grave risks of winning the war and losing the peace, if we saddled the Allies with an impossible debt burden. The alternative was not to require the foreign country to repay. Since somebody had to pay the domestic dollar costs of such exports, the U.S. taxpayer was nominated to carry the load. 

This forgiving of gold payments began with pre-Pearl Harbor lend-lease to Britain. During the war it was broadened to include all the Allies except Canada; after the war it was turned into the United Nations Recovery and Re-

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6 Ibid., p. 59.

7 Reader's Digest, op. cit., p. 144.
construction Act, then into the Marshall Plan, which became Mutual Security, International Cooperation and other names now forgotten.\textsuperscript{8}

By being continued after the fantastic recovery of Europe's export trade, these varied and often worthy plans have had a common effect: to transfer gold or title to gold away from the United States. Some transferring was certainly in order. But a continuation of this process has helped to create a chronic U.S. balance-of-payments deficit leading to a drain of gold and an increase in potential claims against gold.\textsuperscript{9}

Within the United States the chief effect of the monetary upheaval of the 1930's has been to abolish the automatic and impersonal control exercised by gold and, in effect, to make Congress the final judge of the value of the U.S. dollar.\textsuperscript{10} Congress exercises this enormous power through its control of taxes and spending. Congress's bias toward deficits, visible in the growing national debt, has produced a phenomenon that could never occur under the old money system. The name of this phenomenon is inflation.

For the first century and a half of this country's existence the government in borrowing expected to repay its


\textsuperscript{9} Reader's Digest, op. cit., p. 144.

\textsuperscript{10} Ibid.
debts in gold. The one time it did not was when it financed the Civil War with the notorious greenbacks.\textsuperscript{11} This expectation of repaying in gold discouraged going into debt and passing one generation's obligations along to others unborn. Since 1933, however, the government has been under no such restraint. It has met every real or fancied emergency by borrowing. The acknowledged debt of the United States today stands at 290 billion dollars.\textsuperscript{12}

The United States today faces its most difficult decisions involving money. The choice is between continuing to inflate at home --- and thus precipitating an international crisis if foreign holders of gold claims should lose faith in the dollar --- or stopping the inflation by prudent budgetary and credit controls. Fortunately there is a growing awareness of this problem. Recent anti-inflationary measures have arrested the gold drain but the underlying problem of an alarmingly high balance-of-payments deficit remains.\textsuperscript{13} Unless this situation is solved, no one can predict how long foreigners will be willing to keep accumulating dollars instead of gold.

In an election year the American public can make its own contributions to sound fiscal policy by supporting

\textsuperscript{11} Thomas, \emph{op. cit.}, p. 57.

\textsuperscript{12} Reader's Digest, \emph{op. cit.}, p. 146.

\textsuperscript{13} "Can U.S. Head Off A Crisis in Gold", \emph{U.S. News and World Report}, November 28, 1960, p. 49.
candidates who favor real economic growth with stable prices, and by listening skeptically to politicians who seek the kind of false expansion purchased with more government debt and more inflation. The first line of defense is a domestic anti-inflationary policy. Clearly we cannot go on for very long exporting, as we did in 1958, over two billion dollars worth of gold a year.\footnote{Reader's Digest, \textit{op. cit.}, p. 146.}
CHAPTER II

GOLD PROBLEM: 1958-1960

In a pit cut out of the granite bedrocks of Manhattan Island, five stories below the street floor of the Federal Reserve Bank of New York, lies a treasure of pure gold of such concentrated weight that if it were not resting on mother earth it would plunge floor by floor through any building yet designed. In this elaborately guarded steel --- and concrete --- cased vault are 10,000 tons of brightly gleaming brick-shaped gold bars, worth ten billion dollars. (Only Fort Knox contains more --- 12,500 tons.)

Why all this gold got there is a story vitally affecting the lives and fortunes of the American people.

For, unlike the gold at Fort Knox, this gold does not belong to the United States. Much of it was once ours, but it now is owned by other countries; the Federal Reserve stores it as a matter of convenience. In its huge vault are 96 heavy-steel cages, each containing the amount of gold owed to a foreign country or an international financial agency such as the World Bank or the International Monetary Fund.

In addition to this supply, foreigners and international institutions are credited with more than 19 billion dollars

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1 Ibid., p. 140.

2 Ibid.
in claims directly or indirectly convertible into gold. These claims amount to 19,000 tons of gold. By a sobering coincidence, this is almost as much gold as the United States still has!

Only ten years ago, as a result of the flight of foreign capital to the United States to escape World War II, plus the post war demand for U.S. goods, this country had about 25,000 out of 35,000 tons of the free world's gold. At that time foreign dollar claims against gold amounted to 800 tons, leaving 17,000 tons which were ours alone. Only 11,000 tons were needed as legal backing for our currency; 6,000 tons were surplus.

Today, we have almost no surplus gold. Every banker in the world clearly understands that if all the foreign claims against U.S. gold were presented simultaneously, and honored, the United States would be left with barely enough gold to prop open the gates of Fort Knox.

What has caused such a drastic reversal in the U.S. Gold position?

In order to understand the answer to this question, one must first understand certain basic international economic principles. The only apparent reason for our losing a huge segment of our supply of gold through the course of a few years, can only be attributed to the fact that we have been

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3 Ibid.

4 Ibid.
running a continual deficit in our balance of international payments. By definition, a balance-of-payments is a summary statement of all the transactions between the residents of one country and the rest of the world. These transactions are the determinate in whether a country repletes or depletes its gold supply. When these transactions involve more imports of goods and services than exports of goods and services, there occurs a deficit in the balance-of-payments.

Truly, the gold problem is one of an export-import question. The U.S. balance-of-payments deficit hit an all time rate in 1960 of $4.3 billion. The U.S. gold stock has dropped since 1949 from $25 billion to $18 billion. U.S. dollar securities owned by foreigners amounted to $20 billion.

How had all this happened?

During the election campaign, some Democrats blamed it all on Republican bad management. The dollar is in trouble, they said, because the Eisenhower Administration led the U.S. into a recession, then neglected to stem the dollar outflow until after the election was over. Republicans, in turn, blamed it on the Democrats. Kennedy's promises, they said, had weakened the dollar by raising the specter of inflation.

Both these arguments worried foreigners. But nobody

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5 Ellsworth, op. cit., p. 230.

6 Ibid.

7 "Is the U.S. Dollar in Danger", Newsweek, December 5, 1960, p. 49.
went to the heart of the matter --- which is, in brief, that in a changing world, the U.S. is trying to do more than anybody else is.

For ten years the United States has been sending more dollars abroad as payment for imports, as foreign and military aid, as tourist travel and as private investment, than came back as payment for U.S. exports, as dividends on private investment, as repayment of foreign loans and as foreign investment in the U.S. economy. At first, the annual deficits were hardly noticed, but by 1958 we had an alarming deficit of three and a half billion dollars, which rose in 1959 to a staggering five billion.

To most Americans it comes as a shock to realize that there are two utterly different kinds of dollars: the dollar one U.S. citizen gives to another, which is a piece of green paper or a scrawl on a check; and the dollar given to a foreigner, which can in one way or another be converted into gold at the U.S. Treasury. Most of us think that we have not been on the gold standard since 1933, when the government made the dollar inconvertible at home while leaving it convertible internationally.

The U.S. is committed to support the cause of freedom everywhere. But the cost is astronomical. With missiles

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8 Reader's Digest, op. cit., p. 141.
9 Ibid., p. 142.
10 Ibid.
costing more than their weight in gold, the U.S. annually spends three times as much on defense ($40 billion) as the whole government spent in 1940.\textsuperscript{11} The U.S. is also by far the largest contributor to the United Nations, NATO and SEATO; it meets the entire army payrolls of South Korea and Laos; it is building up the strength of India ($676.7 million in economic aid in fiscal 1960), Turkey ($120.2 million), and Peru ($16.5 million).\textsuperscript{12}

At the same time, the U.S. commitment to freedom means freedom to its individual citizens and its corporations to spend their dollars where they please. Goodyear, for example, in 1960 opened a $7.5 million plant in France; and the Ford Motor Corporation offered $359 million for all outstanding shares of its British subsidiary.\textsuperscript{13} These investments are striking evidence of the vitality of U.S. business but they still cost the U.S. a temporary loss of dollars. The average yearly export of U.S. private capital: $3 billion.\textsuperscript{14}

Individual Americans are also strewing their own largess round the world. Average tourist spending abroad: $1.6 billion.\textsuperscript{15}

\begin{itemize}
  \item \textsuperscript{11} Newsweek, op. cit.
  \item \textsuperscript{12} Ibid.
  \item \textsuperscript{13} Ibid.
  \item \textsuperscript{14} Ibid.
  \item \textsuperscript{15} Ibid.
\end{itemize}
Not all these U.S. outlays — on defense, economic aid, investment, and tourist purchases — are lost to the United States. A large per cent is returned, in the form of foreign purchases or investments. But a significant proportion of it does put a drain on our gold reserves.

On November 16, 1960, the Administration became conscious of the evergrowing drain on our gold reserves and has set out since then to remedy the situation.

President Eisenhower laid down a series of orders to the military services and other agencies that spend large numbers of dollars abroad. The purpose — to check their rate of spending. About 1 billion dollars a year was expected to be kept from flowing abroad through a recall of 284,000 dependents of U.S. servicemen residing overseas, and by a shift in buying policies that resulted in smaller purchases of foreign goods and larger purchases of U.S. goods in the Government's foreign transactions.16

At this time, Treasury Secretary Robert B. Anderson and C. Douglas Dillon, Under Secretary of State, made a trip to Europe to try to get other countries to cooperate with the United States in measures to strengthen the dollar.17

An announcement had been made on November 14 that West Germany was prepared to undertake a foreign-aid program of 500 millions to 700 million dollars a year. The American

17 Ibid.
officials also persuaded West Germany to pay a larger share of the cost of maintaining U.S. troops there.\textsuperscript{18}

Why all this diplomatic policy and persuasion? The outside world was flooded with dollars. Where the world had complained about a dollar shortage after World War II, it suddenly was worried about a dollar surplus.

Foreigners can demand payment any time they choose on claims which total more than 20 billion dollars. That is more than this country's gold stock on November 9 --- 18.2 billion dollars. In the following week in 1960, the gold stock fell further, to 18.1 billion.\textsuperscript{19}

The reason for the President's action was found in the rising demand in that year for gold from the U.S. Treasury. The gold outflow came to 50 million in the first quarter of 1960; 96 million in the second quarter; then it jumped to 637 in the third quarter and amounted to 569 million between October 1 and November 9.\textsuperscript{20}

Once it was realized by experts and the public that the gold crisis was growing into a destructive monster of magnified proportions, attention was turned to the capability of our reserves to meet the situation. Our reserve adequacy and its proposed growth or depletion, as the case may be, is examined in the following chapter.

\textsuperscript{18} Ibid., p. 49.
\textsuperscript{19} Ibid.
\textsuperscript{20} Ibid.
CHAPTER III

RESERVE ADEQUACY

Radical changes in the international and national monetary and banking systems have fundamentally altered the role of monetary reserves and other capital movements in balance-of-payments adjustments.

Reserve requirements stress primarily the role of reserves in the cushioning of balance of payments deficits, and rely for an approximate, and admittedly very rough, measurement of reserve adequacy on the ratio of a country's overall reserves to annual imports or exchange sales.¹ Legal prescriptions on monetary reserves and monetary issues vary widely from country to country. In the past reserves never made any reference to a country's export or import levels.

The radical changes imported to monetary institutions and policies by the first World War and the world depression have completely revolutionized the role of monetary reserves and have consequently brought about fundamentally different views as to their measurement and adequacy.²

The universal disappearance of gold coin from active monetary circulation has deeply modified the significance of central bank liquidity. Reserves need no longer be held to

² Ibid.
convert bank deposits and paper currency into legal gold
tender for purposes of domestic circulation. Reserve drains
are now associated exclusively with external deficits in the
balance of payments of the country. In a closed economy,
central bank liquidity would be fully assured by its mere
ability to print notes. Excessive issues would be reflected
in inflationary pressures upon prices, but would not affect
the bank's liquidity.4

International flows of private capital can no longer be
relied upon as a major source of cushioning for current ac-
count disequilibria. Fears of currency depreciation and ex-
change restrictions often indeed tend to stimulate private
capital flows from deficit countries to surplus countries,
and to aggravate, rather than cushion, the impact of current
account imbalance.5 On the other hand, the unprecedented
development of official loans and grants provides today vast
amounts of cushioning capital, which substitute in part for
the private capital flows of the gold standard era.

The International Monetary Fund, the International Bank
for Reconstruction and Development, the European Payments
Union, the European Fund, the European Investment Bank, the
Colombo Plan, etc., were specifically set up for capital re-
quirements.

3 Thomas, op. cit., p. 62.
4 Ibid.
5 Triffin, op. cit., p. 33.
The Marshall Plan and other U.S. foreign aid programs completely dwarfed the rather modest flows of private investments abroad and still account today for about half of the United States total capital exports. Countries of today must look to their own monetary reserves as their first and most important line of defense against temporary deficits in their balance of payments.

The main function of monetary reserves is no longer to preserve the overall liquidity of individual central banks, but to permit the financing of short-run deficits in the country's external transactions. An insufficient level of reserves will force the deficit country to resort to otherwise unnecessary measures of deflation, devaluation or restrictions to keep its payments in closer and more continuous balance with its receipts that would be called for by the need to preserve long-run equilibrium in its international transactions.

One fact stands out in any study of reserve levels. Reserves at the end of 1957 were at an all time low in relation to the last hundred years, and have been declining at a rather alarming pace since the end of 1954. This fact received little public notice as long as the drain on

7 Triffin, op. cit., p. 34.
8 Ibid.
our reserves took the form of an increase in our short-term dollar liabilities abroad rather than in a loss of gold from Fort Knox. From 1949 to the end of 1957, our gold stock decreased only by $1.7 billion, or about 7 per cent, while our dollar liabilities more than doubled, from $8.2 billion to $16.6 billion.\footnote{Ibid.}

The United States gold losses of 1958 began to create some concern about the continued deterioration of the country's net reserve position. The excess of gold reserves over short-term liabilities to foreign countries has declined continually from $18.2 billion at the end 1949 to less than $5 billion at the end of 1958, that is, at an annual rate of more than $1.3 billion over the years 1950-1957, and by nearly $3 billion in 1958 alone.\footnote{Ibid., p. 11.}

Such a movement obviously could not continue indefinitely without ultimately undermining foreigner's confidence in the dollar as a safe medium for reserve accumulation. The time will certainly come, sooner or later, when further accumulation of short-term foreign liabilities will either have to be slowed down or substantially matched by corresponding increases in our already bloated gold assets. If this were not done on our own initiative, foreign central banks would do it for us by stopping their own accumulation of dollar assets and requiring gold payment instead for their overall

\footnotesize{\begin{itemize}
\item \footnote{Ibid.}
\item \footnote{Ibid., p. 11.}
\end{itemize}}
surplus with the United States.\textsuperscript{12}

Thus, the question must be asked, is the prospective development and supply of reserves over the next few years likely to alleviate or intensify the present reserve shortage for the United States?

The International Monetary Fund's study on "International Reserves and Liquidity" calculates the growth of reserves which would appear necessary over the next ten years to prevent a further decline of world reserves in relation to world imports. The Fund bases these calculations on the assumption of an average growth rate of 3 per cent a year. For the ten years 1962-72, world reserves would have to increase by $19 billion, as against roughly $7 billion expected from the monetization of new gold production. The minor gap thus left between the required growth of reserves and the amounts expected from new gold production should not cause any serious worry, as it may easily be bridged, and indeed more than bridged, by a further growth of foreign exchange reserves and by a possible decline in private gold and dollar holdings.\textsuperscript{13}

Although our reserve balance at this time was still in good shape, remedies had to be proposed in order to restrain any further depletion in our reserves. Remedies came from

\begin{flushright}
\textsuperscript{12} Triffin, \textit{op. cit.}, p. 63.
\textsuperscript{13} World Reserves and Liquidity (Washington: International Monetary Fund, 1958), p. 6.
\end{flushright}
various individuals and groups, but the most important of these are contained in the next chapter.
CHAPTER IV

PROPOSED REMEDIES

How can the strain on our gold reserves be reduced?

There is no real original advice to offer regarding the policies which we should follow to plug up the persistent and growing deficits in our overall payments balance.

Our main problem is not to retrench, but to advance, not to cut our imports and our capital contribution to economic development abroad, but to restore our exports to levels sufficient to enable us to pursue in the future, on a sounder and more durable basis, policies which have abundantly proved their worth and which are indispensable both to our own internal growth and to the maintenance of our economic and political position in the world of tomorrow.

We must, first of all, strengthen, or recover, our competitiveness in world trade, by arresting inflation here, while stepping up our rates of growth and productivity by appropriate investments in research and technology.\(^1\)

We should, secondly, continue to press more and more vigorously for the elimination of remaining discrimination on dollar goods and the further reduction of other obstacles to trade and payments by foreign countries, and particularly by prosperous Europe.\(^2\)

Thirdly, the liberalization of foreign obstacles to American exports should stimulate our own producers to devote more attention than they do now to prospecting foreign markets and expanding their sales abroad.\(^3\)

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1 Triffin, op. cit., p. 7.

2 Ibid.

3 Ibid.
Fourthly, we should do everything to prod European countries to assume their fair share of development financing abroad, particularly through multilateral assistance programs rather than through bilateral, tied loan, procedures.

Last but not least, the current relaxation of world tensions may possibly enable us to reduce the terrifying and disproportionate defense burdens --- internal as well as external --- which probably account, more than any other single factor, for the revolutionary shift which has taken place in the international dollar balance from pre-war to post-war days. This, however, is only a hope, and one which is totally incompetent to hazard any guess or suggestion.

Two problems are inescapable.

The first is that the elimination of our overall balance of payments deficits would, by definition, put an end to the constant deterioration of our monetary reserves and thereby deprive the rest of the world of the major source from which the international liquidity requirements of an expanding world economy have been met in recent years, in the face of a totally inadequate supply of monetary gold.

The second is that the huge legacy of short term foreign indebtedness already inherited by us from the past is likely to place a heavy handicap on sound policies for economic growth and stability in this country. Refugee capital has flown here in large amounts after the second world war,

\[\text{Ibid.}\]
as it had flown to London after the first world war. Some of it may return home, as currency conditions become definitely stabilized in Europe, just as it left London in the late 1920's. Our huge gold losses in 1959 were due in part to such a repatriation of foreign capital at a time when interest rates had fallen here well below the rates available in Europe. They were slowed down in 1960 by an extremely sharp rise of interest rates in this country, prompted by our domestic concern about inflation. In this case, external and internal interest rate policy criteria happily coincided, but they may diverge tomorrow. "If and when we feel reassured about our internal price and cost trends we may wish to ease credit and lower interest rates in order to spur our laggard rate of economic growth in comparison not only with Russia, but with Europe as well." "We may then be caught, however, exactly as the British were in the 1920's, between legitimate and essential policy objectives and the need to retain short term funds here in order to avoid excessive gold losses." 

Is there a way out of this dilemma? Yes, the problem

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6 Ibid., p. 205
7 U. S. News and World Report, op. cit.
8 Triffin, Europe and the Money Muddle, p. 218.
9 Ibid.
lies, in both cases, with the absurdities associated with the use of national currencies as international reserves. It can be met, most directly and simply, by the internationalization of the foreign exchange component of world monetary reserves.¹⁰

Let the United States, the United Kingdom, and other major countries bar the use of their national currency as monetary reserves by other countries. Give all countries, instead, the choice of keeping in the form of international, gold-convertible, deposits at the International Monetary Fund, any portion of their reserves which they do not wish to hold in the form of gold. Attach to these reserve deposits at the Fund exchange rate guarantees that would make them a far safer medium for reserve investment than any national currency holdings, always exposed to devaluation, inconvertibility, blocking, or even default by the debtor country. Let them, finally, earn interest at a rate to be determined, and varied from time to time, in the light of the Fund's earnings on its own loans and investments.¹¹

In order, however, to take account of initial diffidence and inertia, and to guarantee the system against the sudden and unpredictable shifts between gold holdings and Fund deposits, all countries should undertake to hold in the form of International Monetary Fund deposits a uniform and agreed proportion of their gross monetary reserves. They would be entitled, but not compelled, to convert into gold at the Fund any deposits accruing to their account in excess of this minimum requirement.¹²

A minimum deposit ratio of 20 per cent would probably be ample to initiate the new system, and would substitute for the present, exceedingly complex and rigid system of national quota contributions to the International Monetary Fund capital. This ratio might have to be increased in time,

¹⁰ Triffin, Gold and the Dollar Crisis, p. 10.
¹¹ Ibid.
¹² Ibid., p. 11.
however, in order to provide adequate lending power to the Fund, and to insure beyond any shadow of doubt the full liquidity and convertibility of Fund deposits into gold or any currency needed for settlements.\textsuperscript{13}

On the other hand, prudent management of the system would, in all likelihood, make it unnecessary to resort to compulsion for that purpose, as the member countries own interest would lead them to maintain with the Fund, rather than in gold, a much larger proportion of their total reserves than the minimum percentages imposed by the Fund.\textsuperscript{14}

The only major objection to this proposed reform in the Fund's operations would be the same as that raised against the Keynes plan for an International Clearing Union. Such a system would endow the Fund with a lending capacity which, if improperly used, might impart a strong inflationary bias to the world economy. "This danger, however, can be guarded against most effectively, simply and directly by limiting the Fund's annual lending authority to the amount necessary to preserve an adequate level of international liquidity."\textsuperscript{15}

Various alternative criteria could be retained for this purpose. The simplest one might be to limit the Fund's net lending, over any twelve months period, to a total amount which would, together with current increases

\begin{footnotesize}
\begin{itemize}
  \item \textsuperscript{13} Ibid.
  \item \textsuperscript{14} Ibid., p. 20.
  \item \textsuperscript{15} Ibid.
\end{itemize}
\end{footnotesize}
in the world stock of monetary gold, increase total world reserves by, let us say, 3 to 5 per cent a year.¹⁶ The exact figure could not, of course, be determined scientifically and would, in any case, depend in practice upon the compromise between divergent national viewpoints which would emerge from the negotiation of the new Fund Agreement. A reasonably conservative solution would be to retain a 3 per cent figure as definitely non-inflationary, and to require qualified votes.¹⁷

The Fund's lending operations, moreover, should be no more automatic than they are at present, and this discretion should enable it to exercise a considerable influence upon members to restrain internal inflationary abuses.¹⁸

A new and different category of Fund lending, however, would arise from the reform proposed here. This would consist of open-market investments in the financial markets of member countries, undertaken at the initiative of the Fund itself.¹⁹

The first investments of this character would result automatically from the initial absorption by the new Fund of the outstanding national currency reserves transferred to it by members in exchange for Fund deposits. "The bulk of these reserves would be in the form of bank deposits, acceptances and Treasury bills previously held by the

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¹⁷ Ibid.

¹⁸ Triffin, Gold and the Dollar Crisis, p. 21.

¹⁹ Ibid.
central banks themselves in New York and London."

The Fund would have no immediate need to modify the pattern by these investments, but should be empowered to do so, in a smooth and progressive manner, insofar as useful for the conduct of its own operations. "This purpose would be served by giving the Fund an option of liquidating such investments at a maximum pace of 5 per cent annually."

In the absence of any specific planning and policies, the growing inadequacy of world reserves would be most likely to lead, in the near future, to a new cycle of international deflation, devaluation and restrictions, as it did after 1929. Such a cycle might possibly be triggered by unfavorable economic developments outside the center countries themselves, but its international spread would begin with the difficulties which the United States or the United Kingdom might experience as a result of any considerable slow-down or reversal of the inflow of foreign funds to their markets. The lessons of the 1930's and the radical changes which have taken place since then in governmental attitudes and policies would probably rule out any widespread recourse to, or acceptance of, internal deflation as a method of adjustment. Devaluation and restrictions would be the most

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20 Ibid., p. 25.
21 Ibid.
22 Thomas, op. cit., p. 63.
23 Triffin, Europe and the Money Muddle, p. 200.
likely outcome of such a situation.  

Fortunately, a sufficient number of people are now alert to these dangers, and we have witnessed during the last few years some modest beginnings toward advance planning in this field. The proposed expansion of the International Monetary Fund's quotas by 50 per cent, and of the International Bank's capital by 100 per cent are steps in the right direction. A less publicized, but important feature of the European Monetary Agreement is the exchange guarantee provided by it on all balances held by any participating country in the currency of any other participating country. Finally, the implementation of the provisions of the European Economic Community Treaty relating to coordination of economic and monetary policies and the adjustment of balances of payments within the Community may also lead to fruitful developments in the future.

The future is still unclear to most observers on how to deal most effectively with a reoccurring gold problem, but remedies such as those put forth above may be the answer the world has been looking for. Nevertheless, as the world changes we must always be on the outlook for more and better methods to deal with balance-of-payments deficits

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24 Ellsworth, op. cit., p. 329.
26 Triffin, Gold and the Dollar Crisis, p. 71.
27 Ibid.
between nations. Our gold must be preserved and protected! If this idea is always in the minds of legislatures and international dealers in money, America will continue to be the leading industrial and monetary nation in the international world.
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