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"GOOD-BYE TO GOLD?"

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It was on St. Patrick's Day - Sunday, March the 17th, 1968 - that seven of the leading central bank governors of the world, who had hurried together in Washington, issued a statement which foretold a far reaching change in the world monetary system in general and in the role of gold in particular.

What had brought these gentlemen hurrying together? In brief, it was the imminent danger of a crisis in the world monetary system. Wild rumours were flying about: we were on the brink of an abyss like the nineteen-thirties, prices of stocks and commodities would tumble, values would be wiped out, incomes and purchasing power would shrivel, and international trade would be strangled as government after government once again resorted to restriction and protection.

This sort of talk was, I believe, vastly exaggerated. We have learned a lot since 1929 about how to keep business and finance on a reasonably even keel. The waves of boom and slump no longer toss us about helplessly, as they used to do. But, for all that, it was a very real emergency that brought these seven gentlemen speeding to Washington. They came, hot foot, because one of the important elements in the general pattern of post-war stability and expansion was in jeopardy. This was a

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system of international rules for exchange-rates and exchange dealings and gold purchases and sales. These rules had been embodied in the constitution of the International Monetary Fund in 1944 and had worked pretty well, although under increasing stress, until very recently.

Two pregnant sentences from the St. Partick's Day statement read as follows:-

"The governors believe 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."

What this means is that the central gold reserves of these seven countries, and of other co-operating countries including Canada, are now insulated from world gold markets. In effect these countries are saying: "What we have we hold - no more, and no less. We shall continue to play our international game, discharging obligations amongst ourselves, with the chips we hold already. We are not going to buy any more golden chips from the gold miners; we are not going to sell any more golden chips to the gold speculators and hoarders or even to industrial users. All these producers and consumers can play their own game separately, and

they can settle the price of their chips between themselves on the basis of supply and demand. But they can count us, the world monetary authorities, out of their game from now on."

Most of the rest of my talk this afternoon relates to the implications of this literally epoch-making departure. But before immersing ourselves in the gold problem we should, for a few moments at least, pay some attention to another issue with which the St. Patrick's Day statement was also concerned. This is the position, some would say the plight, of the U.S. dollar.

There is nothing novel, certainly nothing epoch-making, in the weakness of a particular currency especially when the nation concerned is heavily involved in war. Inflation in such a country is perhaps inevitable, and inflation always spills over national boundaries causing a weakness in the balance of trade, the balance of payments, and the national currency. Under domestic pressures the United States has for some years been spending and lending abroad more than it earns, and this over-spending tends not only to cause weakness in the U.S. dollar but also to produce inflationary conditions in other countries, high interest rates and tight money conditions all around the world, and not least in Canada.

Actually the Canadian dollar was, at the beginning of this year, unintentionally sideswiped by the American dollar. In his attempts to

keep on the road himself, Uncle Sam nearly drove us off. New American regulations on capital movements seemed destined to undermine the position of our dollar and started a run on it. Our authorities quickly persuaded the Americans that in hurting us they were not helping themselves and so our dollar quite quickly emerged from the flurry, the quite unnecessary flurry, in which it was temporarily embroiled.

This experience serves as an example of how disturbing to the rest of the world can be a disturbance in the U.S. balance of payments and in the strength of the U.S. dollar. And the pervasive influence of the U.S. dollar stems not merely from the fact that the United States is by far the largest trading country, capital-exporting country, international-banking country in the world but also from the particular way in which the agreed international financial rules are written. These rules, to which I have already referred, establish a formal, legal relationship between the United States dollar and gold which does not exist for other less important currencies. So it comes about that a disturbance of the U.S. dollar creates a disturbance of gold in a rather special, legal fashion.

In effect, the U.S. has been the basic, the central holder of the world's monetary gold reserves. These gold reserves had been falling at an alarming and accelerating rate before St. Patrick's Day. And the drain could be traced to two quite separate, quite distinct causes. One was the U.S. balance of payment situation; the other was a world shortage of the commodity gold.

Will this double drain continue? In part yes and in part no. The drain of gold from U.S.A. on balance of payments account can and will continue until the U.S. authorities solve their problems of inflation and of international financial deficit. Only a short time ago, with the U.S. commitment in Viet Nam still escalating, the solution of these problems seemed remote indeed; by the twin announcements of President Johnson a week ago yesterday appeared to give reason for relief and hope.

We may also take some comfort from the fact that, since St. Patrick's Day, U.S. exports of gold on balance of payments account can no longer disappear from the world's monetary reserves but will move from the vaults of the U.S. Federal Reserve System into the vaults of some other central bank abroad. There may be some "leakage" in the new system, but I do not expect it to be serious. Broadly speaking, while we can still anticipate substantial shifts from country to country in world gold reserves, we need no longer anticipate substantial losses.

The recent drain of gold from the United States has been caused, as I have already said, not only by a weakness in the U.S. dollar but also, since the U.S. holds the central world gold reserves, by the world shortage of the metal gold. This shortage, it was argued (wrongly) would inevitably cause the price of gold to rise. And from this price increase, it was anticipated, speculators and hoarders, perhaps you and I could make handsome profits.

Let us start at the beginning. How did it come about that gold, a particular metal with particular qualities, should be playing this monetary role? Really, I suppose, as a result of a series of anthropological and geological accidents. The anthropologists tell us that different races and tribes have used widely differing commodities for money. Some used scarce sea-shells, others used scarce stones, still others used scarce metals - particularly copper, bronze and silver. Such is the vanity of mankind - and womankind - that almost all of these things came into use as money because they had already established themselves as ornaments and jewellery. So we came to use bright, shiny, decorative, workable metals as money basically because our barbaric ancestors could make them into pretty bangles for their arms and legs or into rings for the ears and noses of their wives.

The metal gold only became widely used as a form of money in quite recent times. Usually, so the historians tell us, it was much too scarce. It gradually came into fairly general use in Western Europe after the Spanish galleons brought ship load after ship load from the newly discovered Americas. Gradually, over the next four centuries, it gained ground against its chief competitor, silver. And so, about 100 years ago, when Mr. David Niven suddenly bet that he could go "Around the World in 80 Days" he equipped himself with a money-belt full of British gold sovereigns. Sovereigns, like the Union Jack, were recognized and respected

everywhere.

But no sooner was gold clearly king of the monetary castle than his throne began to be undermined. Like many other nineteenth-century monarchs he could not face up to the twentieth century. He failed to measure up on the basis of at least two criteria: convenience and reliability.

As for convenience, none of us - at least none of us in a technically and politically advanced country such as Canada - would think of using gold coins today. For small payments, gold coins would have to be too small, too easily lost; for large payments, whether by businesses or individuals, coinage is hopelessly cumbersome. For small day-to-day payments we carry paper money and a little small change. As for larger payments, the sensible way to pay our bills is to have a chequing account in a bank. Recently credit cards have provided an even more up-to-date, even more mechanized method of payment. If David Niven were going around the world today he would carry, not a money-belt full of gold, but some credit cards and some travellers' cheques. Thanks to the progress of modern science, modern technology, and modern organization, we have learned to improve on gold as money; we have learned to do without it in our daily lives.

What is convenient for you and me as individuals is convenient for our governments as well. It is true that our Federal Government still

keeps about half of the national reserves in the form of gold. But it keeps the other half, the more active and useful half, partly in the form of working balances in bank accounts abroad and, the larger part, in readily convertible securities on which it earns interest. In short, like any prudent business operation, it keeps reserves partly in cash and partly in highly liquid but interest-bearing assets.

So much for the criterion of convenience; now what about reliability?

I have already pointed out that gold was not really a candidate as money for many centuries because it was too scarce. Gold scares, relating to real or apprehended gold scarcities, have from time to time swept the world like bush fires. Perhaps the most famous of all is identified with a political convention in the year 1896. Here is what happened (and I quote from the Cambridge Encyclopaedia):-

"When the Presidential convention of the Democratic Party met in Chicago in 1896, it was known that the issue would be joined between the gold standard Democrats of the East and the free silver forces of the West and South. William Jennings Bryan went to the convention as a simple delegate from the state of Nebraska. While the old experienced politicians were trying to agree on a Presidential nominee, Bryan upset all their plans and changed the currents of American political history by making one of the greatest speeches of his career. Of commanding

stature, handsome face, coal-black hair, with a rich beautiful voice, capable of making itself heard in even the largest assembly a natural-born orator and at that time only thirty-six years of age, he swept the convention off its feet by a speech for free silver in which he used his famous phrase: "You shall not crucify mankind upon a cross of gold!"

The gold scarcity which Bryan quite rightly foresaw in those days was dispelled by an unforeseeable geological accident. This was the discovery of gold in South Africa, almost at the very time that Bryan himself was speaking. And it has been the ample gold from South Africa, which still produces 75% of all supplies outside the communist world, that has allowed us to continue using gold, at least as international reserves, up to the present day.

However, within the last few years it became clear to all those who understood the issues that something was going wrong. Five or six years ago studies were put in hand both in the International Monetary Fund and also in the so-called "Group of Ten" which is made up of the world's leading industrial and financial countries including Canada.

During the period that these studies were in progress, the outlook for world gold reserves became darker and darker until, first in 1966 and then in 1967, there was no increase at all. On the contrary, world gold reserves actually declined. They declined because current supplies, whether from South Africa and other gold-mining countries, or from the

communist countries which export the metal to cover trading deficits from time to time, were all, more than all, gobbled up by the normal industrial uses of jewelry, dentistry, etc. and - most ominous - by a sharp increase of private hoarding. The shortage which had been becoming clear to the world monetary authorities for several years was by now becoming clear to the public. And so, whether for protection or for profit, the scramble for gold began.

While the international authorities were working away on their own plans, trying to hammer out a new agreement, there were many other plans put forward in public designed to remedy the growing shortage. We cannot discuss all of them; however, there is one that has had very wide popularity which we certainly must consider.

This is the proposal to remedy the shortage of gold by increasing its price. If, for example, the authorities in all countries agree (say) to double the price of gold the value placed on all existing world gold reserves will automatically be doubled. Moreover, the incentive to mine gold will have doubled and the immediate incentive to hoard gold against a further price-rise will have disappeared. So we will not only have a greatly enlarged stock of gold as a result of revaluation, we will also have laid the basis for increased production and increased flow of gold into world reserves and into other normal uses.

Why has this apparently simple solution been rejected by all the monetary authorities of the world save one, and by most disinterested economists, bankers and other financial experts? I think there are three reasons to which we should refer: a "basic" reason and a "market" reason and an "international-political" reason.

The "basic" reason for rejecting the proposal to juggle the price of gold as a means for remedying a shortage of world reserves lies in the simple fact that, in this day and age, we know how to do better. During this century of progress, progress in science and progress in organization, we have learned both how to measure and also how to satisfy our requirements for money and credit. National systems of currency and credit have, decades ago, been effectively detached from gold. Every country has its own central bank, reasonably insulated from irresponsible political influences, charged with issuing the amount of currency and credit its country needs. And what can be done for a single country can as well be done for a group. Once one accepts a business-like, scientific approach to the question how to create year by year sufficient international reserves, sufficient world money, to support the growth in employment, trade and investment it becomes fantastic to keep, as the sole foundation of the world system, a yellow metal that tickled the fancy of our barbaric ancestors.

Juggling the price of gold offers no escape from the political

dangers that are, of course, involved in running any sort of money system - national or international. Someone has to decide on the price just as someone has to run the system. Indeed, gold price juggling would introduce into a world monetary system commercial and speculative pressures that would be a serious impediment, not an aid, to those charged with its management.

This leads to the second, the "market" reason for rejecting an increase in the price of gold as a remedy for a shortage of world reserves. Once governments start to juggle the price there is no end to it. To establish a new price for gold is not to end speculation but to begin it all over again, and to begin it after giving assurance to the speculators that they really can force the price to be changed if they only try hard enough and long enough.

Thirdly, there is the "international political" reason against an increase in the price of gold. We must ask ourselves, which countries would stand to gain most from a world agreement to increase the price of gold? Of course Canada is a gold mining country and, as we would all agree, Canadians including our own gold-producers are all "good guys". But, unfortunately, the greater part of world gold production comes, if not from "bad guys", at least from guys to whom most of us do not want to give enormous and unearned bonuses. The leading producers are, of course, the South Africans and the Russians. Perhaps,

too, we would shy away from rewarding a country that has been persistently building up its own gold hoard at the expense of the stability of the world monetary system.

The intervention of General de Gaulle in world monetary affairs is not unlike his intervention in the affairs of the Province of Quebec. His cry "Long Live Gold" resembles his cry "Long Live Independent Quebec" and resembles it in three ways.

First, both cries are means to the same end - the aggrandisement of France and the dislocation and disarray of the position and policies of the Anglo-Saxon world in general and of the United States in particular.

Second, the General does not really care either about gold or about Quebec - except in so far as he can use the one or the other to further the immediate ends of France as he sees them. Those who heed his cries whether their special interest be in separatism or in gold, should beware of the day when the interests of de Gaulle's France cease to happen to coincide with their own.

Third, and most serious, he has given to two causes, both of which were wobbly and insecure, a new lease of life. French Canadian separatists found themselves no longer standing naked and alone in a corner of North America but instead warmly (if temporarily and dangerously) embraced in the comfortable neo-colonialism of de Gaulle's

francophone world. So too, the world's gold miners and gold hoarders suddenly heard an oracle booming from the Elysee Palace in Paris; many of them took heart, bought gold or gold stocks, and thus played their part in precipitating a crisis.

Fortunately for most of us, General de Gaulle made a monumental miscalculation. Instead of attaching the world monetary system more firmly to gold he has actually succeeded in detaching it and in ushering in the monetary system of the future. But we may be sorry for many people who were led to speculate on the metal or on the mines and who may now stand to lose.

In the St. Patrick's Day statement from which I have already quoted there was an arrow pointing to the future. Unfortunately, what the seven central bankers wrote on that arrow was in their own central banking shorthand. I don't suppose that one reader in a million really knew what it meant. May I remind you what they said:-

"The existing stock of monetary gold is sufficient in view of the prospective establishment of the facility for special drawing rights....."

What are these "special drawing rights"? This is a shorthand name for a new world reserve system - a system that is controlled by intelligence rather than by geological accident or market speculation. Nor am I speaking of pie in the sky, or a mere gleam in the eye. I am

speaking, as were the seven bankers, of a plan that was formally approved in outline at a meeting of world Ministers of Finance and Central Bank Governors which took place in Rio de Janeiro last September. These gentlemen, gathered at the annual meeting of the International Monetary Fund, approved a plan for establishing, as an affiliate of the Fund, an organization to create world reserves. The Fund itself, established more than twenty years ago, was designed to help countries meet international payments deficits by means of short-term lending operations. But it was not intended to create world monetary reserves or to exercise a controlling influence over the aggregate level of those reserves. It is this gap which the meeting in Rio decided to fill.

The term "special drawing rights" - SDR for short - has a certain technical significance. The word "special" simply distinguishes these drawing rights from the drawing rights already offered by the Fund to its member countries for the purpose of meeting their trade deficits. The term "drawing rights" simply implies that the system is to operate on a modern "line of credit" basis rather than by issuing some new form of metallic or paper money.

The plan that was approved in broad terms last Fall in Rio has now been worked out and agreed in considerable detail by the Board of the International Monetary Fund. Detailed proposals have also been approved, less than ten days ago, by the Group of Ten meeting in

Stockholm. As a final step, the detailed proposals are now to be approved by the Governments who form the membership of the Fund. The main governments (those in the Group of Ten apart from France) are already explicitly committed, and many others are warmly in favour of the new plan, so we may be quite confident of early action. Sometime in 1969 our new reserve system will be at work.

This will happen despite the fact that barriers and barricades are still being thrown up by the French, and the oracle of the Elysee Palace is still booming defiance. This causes the gold market to remain rather volatile and he would be a brave man who would want to predict - at least predict in public - what the price of gold is going to be next week, next month.

It has been rather widely suggested that the two prices for gold, the price at which the general public deals on the open market and the price at which central bankers hold and trade gold amongst themselves - that this two-price system cannot last for long. I would be inclined to hazard a guess that it can and will last for some years, perhaps even for decades. If, following the St. Patrick's Day announcement, the main central banks of the world are neither buyers nor sellers of gold in the open market, but merely pass their existing stocks around amongst themselves, they can and will put on this gold whatever price they choose, and I see no reason to expect that they

will ever change it. The free market, on the other hand, can go up or down on the basis of the forces of demand and supply spiced, of course, by the forces of speculation.

Last week Ottawa formally recognized the two-price system. After a temporary suspension, gold trading by the public is once again permitted. Of our 31 gold producers, three have for some years been selling on the open market for what they can get while the rest have been selling to the Canadian mint at \$35 U.S. per ounce plus the subsidy provided under EGMA (the Emergency Gold Mining Assistance Act). These arrangements continue unchanged. We the taxpayers may receive a small benefit because the mint will now resell its newly-mined, newly-refined gold on the open market, probably (although not necessarily) at a price somewhat above the official price of \$35 U.S. an ounce which is what it was getting before. Taken together all these arrangements appear to be stable and likely to be with us for some time.

While the short run outlook for the free-market price of gold is unpredictable, I would incline to be bearish on the longer-term outlook. The world monetary authorities have, apart from the past two years, been very substantial net purchasers. With these authorities withdrawing from the market, it will lack a normal source of support. I should be surprised if prices do not settle down at levels substantially lower than the peak prices achieved in free markets in recent

weeks.

One prediction that can be made with confidence is that gold will continue indefinitely as part of the international reserves of central banks and governments and that the price placed upon this gold will remain, as at present, \$35 an ounce. It is also possible to predict that, before the end of next year, a new element, consisting of the new "lines of credit" with the International Monetary Fund, will be added to those international reserves. Thus the new and stream-lined reserve of the future will take its place along side the historic reserve of gold.

And finally, people who delude themselves into believing that the world's monetary authorities are going to get back into the general gold-buying and gold-selling business, or are going to start juggling the price of gold, are surely doomed to disappointment. General de Gaulle may still try to turn back the clock and, in the words of William Jennings Bryan, to "crucify mankind upon a cross of gold"; but, quite predictably, he will fail.