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GOLD AND THE CENTRAL BANK SWAP NETWORK

HEARINGS

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL EXCHANGE AND PAYMENTS

OF THE

JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES

NINETY-SECOND CONGRESS

SECOND SESSION

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Monday, September 11, 1972

GOLD AND THE CENTRAL BANK SWAP NETWORK

MONDAY, SEPTEMBER 11, 1972

Congress of the United States,
Subcommittee on International Exchange and
Payments of the Joint Economic Committee,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 1202, New Senate Office Building, Hon. Henry S. Reuss (chairman of the subcommittee) presiding.

Present: Representatives Reuss and Conable; and Senator Javits.

Also present: John R. Karlik, economist; Jerry J. Jasinowski, research economist; George D. Krumbhaar, Jr., and Walter B. Laessig, minority counsels.

Opening Statement of Chairman Reuss

Chairman Reuss. Good morning. The Subcommittee on International Exchange and Payments of the Joint Economic Committee will be in order.

Today we begin 3 days of hearings on U.S. official policies regarding gold as an international reserve asset and on the swap network among central banks and how the Federal Reserve has used this network to intervene in the foreign exchange market.

In March 1968 the United States concluded an agreement with the other major industrial nations to divide world gold markets into two sectors—one official and one private. With the exception of limited purchases of gold from South Africa by the IMF, private and official dealings in gold have now for over 4 years been effectively segregated.

In the last 13 months, however, sweeping changes in the international monetary system have occurred which bring into question the relevance of the March 1968 agreement. First, the United States has stopped selling gold to foreign monetary authorities in exchange for dollars. Second, the price of gold in private markets throughout the world has increased until it is now approaching twice the official level. These events and other considerations which will be brought out in the course of this week's hearings suggest that the March 1968 agreement ought to be substantially revised.

Since 1962 the Federal Reserve System has entered into agreements with other central banks in which dollars were swapped for blocks of foreign currencies having an equivalent value. In many instances, foreign monetary authorities have used the dollars they obtained in this manner to buy their own currencies in exchange markets and thus prevent the value of these currencies from falling. Last year, however, the swap mechanism was used to reduce the foreign exchange risk foreign monetary authorities had assumed in supporting the dollar through massive purchases.

The initial rationale for the swap mechanism was to help central banks finance large international transfers of capital that were expected to be reversed in a matter of months. During the weeks immediately preceding August 15, 1971, on the other hand, the U.S. monetary authorities drew heavily upon the swap network. In effect, these funds were employed to help maintain an overvalued dollar exchange rate parity. On August 15, 1971, U.S. swap borrowings stood at over $3 billion. When exchange rates were realined last December, the Federal Reserve swap debt obligation increased by as much as $300 million, since these commitments included an exchange rate guarantee.

Immediately after the new economic policy was introduced last year, the Treasury vigorously insisted that it had been planning for some weeks to suspend dollar-gold convertibility and force dollar devaluation. At the same time, however, the authorities were drawing upon the swap network and using foreign currencies to prop up the same exchange rate that the Treasury believed untenable.

These are some of the issues we intend to investigate during these hearings.

Our first witness today is Representative Charles C. Diggs, Jr., from Detroit. Congressman Diggs is chairman of the House Foreign Affairs Subcommittee on Africa and will testify on the impact that U.S. official policies regarding gold have had on South Africa.

Our second witness later this morning will be Hon. Paul A. Volcker, Under Secretary of the Treasury for Monetary Affairs.

Mr. Diggs has prepared a very comprehensive prepared statement, which under the rules and without objection will be admitted in full into the record.

You may proceed in any way you would like to present your testimony.

STATEMENT OF HON. CHARLES C. DIGGS, JR., A REPRESENTATIVE IN CONGRESS FROM THE 13TH CONGRESSIONAL DISTRICT OF THE STATE OF MICHIGAN, ACCOMPANIED BY GOLER T. BUTCHER, CHIEF CONSULTANT TO HOUSE SUBCOMMITTEE ON AFRICA; AND BARBARA ROGERS, RESEARCH ASSISTANT

Representative Diggs. Thank you very much, Mr. Chairman.

I am accompanied this morning by Attorney Goler Butcher to my left, who is chief consultant to the House Subcommittee on Africa; and to my right, Barbara Rogers, who is a research assistant in connection with this special project.

Chairman Reuss. They are both very welcome. And they of course may join in at any point.

Representative Diggs. Mr. Chairman, I greatly appreciate this opportunity to appear before this subcommittee today, and particularly since it enables me to present some of the hard facts about gold mining—the industry on which this whole question of the monetary role of gold rests.

Unfortunately, when experts come together to discuss gold, they tend to theorize to the point where we forget what we are talking about. There are some very urgent human issues involved in gold mining. Specifically, South Africa currently has a virtual monopoly of the gold market. And the methods used to force South African Blacks to go down the mines and dig the metal out amount to a mere variation of the age-old evil of slavery. This may seem at first sight an exaggeration, but I hope you will see what I am talking about after the evidence is placed upon the record.

Mr. Chairman, I am in favor of any measures which will have the effect of reducing the price of gold, and in particular in bringing about its long overdue demonetization, and any other steps which would reduce the speculative demand. This is fully consistent with the official Treasury position. One specific action which I should like to see is the termination of the International Monetary Fund's agreement of December 1969 with South Africa, which provides South Africa with a floor price by allowing it to sell gold directly to the Fund either when the free market price drops below the official price, or to the amount of South Africa's balance-of-payments deficits, as well as on other grounds applicable to all IMF members.

This agreement with South Africa was supposed to insure the orderly marketing of gold, but it has obviously failed in that; for South Africa has recently been withholding large amounts of gold from the free market, formally justified by the favorable balance of payments which results from heavy capital inflow. It is therefore encouraging the speculative price to soar to the present unreasonable levels, almost double the official price. This benefits nobody but South Africa and the Soviet Union. Such tactics are harmful to the international monetary system, as I do not need to remind you; it is damaging to confidence in the dollar, and is increasing the difficulties inherent in an adverse balance of payments; it is very damaging to industrial users of gold, notably jewelers, many of whom are having to cut back production as well as raising prices; and I submit that it is very harmful to the people of South Africa.

The U.S. officials you will be hearing have been inclined to blame other countries for the failure to take decisive action to rationalize the role of gold in the international monetary system. They have tried to do so in the case of the 1969 agreement, although Mr. George P. Shultz has assured me that in this case they would be inclined to favor a review of it, and do not support the idea of a floor price for gold. I should like to insert, Mr. Chairman, my press release with the attached correspondence with Secretary Shultz in the record.

Chairman REUSS. Without objection, it will be received. And I would be very interested in seeing it right now if you have it with you, Mr. Diggs.

I say that because I have long believed that the United States should take the opportunity inherent in the 1969 agreement to open it up for review because of a change of circumstances, and what you say therefore is good news.

Representative DIGGS. I am glad to know that you concur, Mr. Chairman.

(The above referred to press release with the attached correspondence follows:)

PRESS RELEASE OF CONGRESSMAN CHARLES C. DIGGS, JR., U.S. HOUSE OF REPRESENTATIVES, WASHINGTON, D.C., JULY 24, 1972

WASHINGTON, D.C., July 24.—Congressman Charles C. Diggs, Jr., has released the text of a letter he wrote on July 20 to Treasury Secretary George Shultz to express his deep concern about the agreement of December, 1969, on the sale of gold by South Africa to the International Monetary Fund and the results of that agreement.

Congressman Diggs, Chairman of the House Subcommittee on Africa, accused the South African Government of taking advantage of the agreement, which allows South Africa to sell gold at the official price when the free market price is lower, or when their balance of payments is in difficulty. The way in which South Africa's marketing policy has worked has damaged the international monetary system—the speculative price rises tend to weaken the dollar and other international currencies.

The agreement with South Africa is tending to distort the two-tiered price system set up by the IMF in March, 1968. South Africa is the major beneficiary of the rising gold price, and it is withholding some of its gold production from the free market in order to drive the price up still further. Mr. Diggs points out that the 1969 agreement specifies renegotiation in the event of a major change of circumstances, and argues that the soaring price of gold on the free market justifies ending the agreement with South Africa.

South Africa's gold is produced by cheap, indentured and forced labor by rightless Africans; and it depends on the forced separation of workers from their families. Under similar exploitative conditions, the gold mines in the United States would still be working. Yet a recent attempt in the U.S. Senate to get the U.S. mines reopened by allowing individuals to purchase gold was decisively rejected as being against the national interest.

Mr. Diggs has challenged the Secretary of the Treasury to explain why South African producers should be given more privileged treatment than American producers.

Congressman Diggs also reiterated his call for the demonetization of gold, and pointed out that since U.S. official policy stresses a rationalization of the international monetary system away from a reliance on gold, South Africa should not be allowed to sell gold to the IMF.

Following is the text of Congressman Diggs' letter to Treasury Secretary Shultz:

TEXT OF LETTER, DATED JULY 20, 1972, FROM CONGRESSMAN CHARLES C. DIGGS, JR., TO SECRETARY OF THE TREASURY GEORGE P. SHULTZ

DEAR MR. SECRETARY: It appears that the present arrangements enabling South Africa to sell newly-mined gold to the International Monetary Fund, under the agreement of December, 1969, appear to be operating in such a way as to undermine the stability of the international monetary system, and in particular the interests of the United States in the strength of the dollar and the stabilization of commodity prices.

The March, 1968 agreement to create the two-tiered gold price would operate far better if there were so sales of newly-mined gold to official reserves, in unpredictable amounts and at irregular intervals. The 1969 agreement between South Africa and the IMF has had precisely this effect.

I understand that the negotiations for this agreement were originally bilateral, between the U.S. and South Africa, and were transferred to the IMF only at a comparatively late stage. I note with amazement that the Treasury's official announcement at the time of the transfer refers to the "Union of South Africa," a title which has been obsolete since it became a Republic in 1961. This does not add to one's confidence that the Treasury was fully aware of the issues at stake here.

It may be necessary to point out the obvious fact as to why South Africa is the major gold producer in the non-communist world. The gold mines there are economic only because of the abundant supplies of cheap, indentured and forced labor by rightless Africans from the reserves, new euphemistically called "Bantu homelands." It has been estimated that the real wages of African miners in South Africa are no higher today than they were in 1911, and possibly lower. In fact, a white worker in the mines earns twenty times more than a black worker. The system relies on increasing segregation of the miners from their families, who are confined to the reserves. Given similar labor conditions, there are plenty of uneconomic gold mines in the United States, as well as many other Western countries, which could still be in production profitably.

In an effort to reopen some of the U.S. gold mines, there was an attempt in the Senate recently to allow individuals in this country to own gold, which would have the effect of driving up the free-market price. This was decisively rejected by the Senate as against the national interest. Yet South Africa is following precisely this tactic: By withholding gold from the free market in recent weeks, the price is driven up and speculators are disturbing the international financial equilibrium.

The 1969 agreement effectively provides South Africa with a guaranteed floor price for its gold, while at the same time allowing it to offload gold even when the free price is above the floor, in order to boost the balance of payments. Yet when the balance is in surplus, as it is now, the Republic is taking full advantage by withholding gold. Particulary with the free-market price so high, there can be little justification for providing a floor price operating to our detriment and to South Africa's benefit, and none at all for allowing purely South African considerations relating to its own balance of payments—which tend to fluctuate wildly—to affect such a delicate international balance.

There is the additional fact that South Africa is reported to have violated the 1969 agreement by selling gold directly to the Swiss central bank, a transaction which is explicitly banned by the deal with the IMF.

To a few manufacturers, primarily in such non-essential fields as jewelry, gold, is an essential commodity. The interests of the manufacturers concerned are greatly harmed by the speculative price-rises, and many have been forced to cut back their output because of the exorbitant price of the raw material. Since gold is not subject to Phase II price controls, there is a strongly inflationary effect. It would clearly be in the interest of both manufacturers and consumers if the price of the metal were stabilized at a lower level, more nearly approximating the official price. This would be helped of course by the discouragement of speculation, and an end to sales of newly-mined gold to the official sector. This would return us to the system envisaged in 1968 where gold as a monetary reserve and gold as a commodity are kept separate.

It is the official view of the U.S. Treasury that gold should be demonetized; this is a policy which we wholeheartedly endorse, and I hope that you will follow through the implications of this in your approach to the complete exclusion of newly-mined gold from the official reserves.

The volume of gold production in South Africa is falling, and is likely to decline further in the medium and long-term unless there is a massive devaluation of the dollar in terms of gold. South Africa is not, therefore, a reliable long-term source, and with its accelerating inflation, due largely to its mismanagement of its human resources, the future is unpredictable. Official policy regarding the use of the 1969 agreement, the marked reduction in the proportion of gold held in its own reserves immediately after the devaluation of the Rand, as official reserves were sold on the free market, and now the withholding of newly-mined gold from the market, increase this unpredictability.

The 1969 agreement, by effectively subsidizing South Africa's foreign exchange reserves, helps to undermine the United Nations arms embargo on South Africa, to which we generally adhere, and allows it to disregard world opinion on its domestic race policies and also its illegal occupation of the international territory of Namibia. One of the major beneficiaries is France, which is selling highly sophisticated arms and equipment to South Africa in defiance of U.N. resolutions, including weapons capable of delivering an atomic bomb. South Africa, which has not ratified the Nonproliferation Treaty, has the world's third largest reserves of uranium, much of which it appears to sell without the "peaceful uses" safeguards of the International Atomic Energy Authority. With the recent discovery of a new enrichment process, South Africa poses a threat to the nuclear Nonproliferation Treaty, as a major source of unrestricted enriched uranium for the use of any country willing to pay for it. In South Africa, uranium is a by-product of gold mining, and subsidization of the gold mines therefore represents an indirect subsidy for uncontrolled nuclear proliferation.

I should, therefore, like to put to you the following questions:

Is there any reason why we should encourage South African gold production more enthusiastically than domestic production?

Specifically, what representations, oral and written, have been made to the South African Government over its decision to withhold gold from the free market, and what response was received?

Is there justification for a floor price for gold if there is no ceiling?

Why should we protect South Africa's balance of payments when this serves as the excuse to withhold gold?

The 1969 agreement specifies that in the event of a major change of circumstances, the agreement is to be reviewed. Would you agree that the wide gap between the official and the free-market price constitutes such a change?

I would appreciate receiving, at an early date, a response to each of the points raised herein.

Sincerely,

CHARLES C. DIGGS, Jr.,
Chairman, Subcommittee on Africa.

THE SECRETARY OF THE TREASURY,
Washington, D.C., August 9, 1972.

Hon. CHARLES C. DIGGS, Jr.,
Chairman, Subcommittee on Africa, Committee on Foreign Affairs, House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: In your letter of July 20 you make a number of comments on the arrangements made with South Africa concerning gold transactions with the International Monetary Fund. The letter concludes with several specific questions you would like answered.

Before turning to those questions, I would like to make some general comments. You are correct in stating that we would like to see the monetary role of gold diminished. We agree that wide price fluctuations, which derive in part from shifts in South African gold sales due to shifts in its balance of payments, are undesirable. Moreover, we believe that these movements in the gold price due to shifts in supply and the market's sensitivity to rumors simply provide further evidence of the need to build a monetary system not dependent on that commodity.

While agreeing that the shifts in supply increase the volatility of the gold price, I do not agree with any implication that the agreement reached with South Africa creates this problem. The opposite is the case; the agreement provides that South Africa cannot hold back more of its newly-mined gold from the market than that equal to its balance of payments surplus. In addition, its balance of payments position will not be artificially improved by unusual or nontraditional foreign borrowing or other special transactions. Thus, while fluctuations are not eliminated, they are limited and the agreement rules out shifts in supply that might be made for the purpose of influencing the market price, regardless of balance of payments conditions.

From this standpoint the present arrangement is clearly preferable to no arrangement at all. I would note that, in the absence of the agreement, there would be no means of forcing South Africa to sell gold or any other commodity it produces if it had no need to do so from the standpoint of its current foreign exchange requirements.

With respect to the "floor" price for gold, which appears to be your primary concern, this provision was operative for about two months in the first quarter of 1970. No gold sales have been made by South Africa to the IMF under that provision since that time. In fact, no sales to the IMF have been made for over one year under any provision.

It may be assumed that South Africa derives some comfort from the existence of the floor price for its newly-mined gold, which becomes available to it in certain situations and with certain limitations.

Truning to your specific questions, the answers are:

1. No, I see no reason why we should encourage South African gold production more enthusiastically than domestic production, nor do I see that in any practical way we do. Our gold producers can, and do. receive such higher market prices as may prevail. as do South African or other producers. In practice, our gold producers have not had to sell their gold below the monetary price even during that short period of time that South Africa did sell newly-mined gold to the IMF at ¼ percent below market.

2. We have made no representation to South Africa over its decision to withhold gold from the private market because such withholding as has taken place has been well within the limits that might have been withheld due to its present surplus balance of payments position. We have discussed with a Repre-

sentative of the South African Government in general terms the desirability of eliminating the floor price, a proposal they do not favor.

3. Conceptually, I see no justification for a floor price for gold whether or not there is a ceiling. I see no practical way in which a ceiling could be enforced through agreement with South Africa alone. Rather than moving toward adding a ceiling to a floor price the United States itself sees no need for a floor price but a number of countries do grow concerned if they believe the market value of an asset they hold in their reserves might decline below its book value. This in fact was the case as recently as late 1969. The continued concern over a floor price seems applicable only in terms of an expectation that experience could be repeated. The matter is consequently not one for a unilateral determination by the United States.

4. There is no reason why we should protect South Africa's balance of payments and the gold arrangements with South Africa are not directed to South Africa's balance of payments problems. In fact, South Africa had a sizable deficit during much of the period of the agreement.

5. As you state, the agreement with South Africa does permit the parties to review the arrangement in the event of a major change in circumstances. I think the developments beginning with last August 15 and the continuing developments with respect to monetary reform could be viewed as a major change in circumstances and the arrangement reviewed, should it be considered desirable to do so. I would emphasize that in important respects, the Agreement limits South African freedom of action. The floor price provision, which is of interest to South Africa, is not now operative. The provisions that limit the amount of gold that South Africa can withhold from the market are.

Sincerely yours,

George P. Shultz.

Representative Diggs. However, the claim that we cannot control the IMF is an evasion of this particular issue; it was the United States which initiated the negotiations with South Africa and other countries leading up to the agreement, as a bilateral issue. It was not until 2 weeks before the agreement was signed that it was handed over to the IMF to give it international respectability. Incidentally, an indication of the ignorance of the Treasury Department about the political and human issues involved is shown by the reference to "the Union of South Africa"—8 years after it had been forced out of the British Commonwealth because of its apartheid policy and changed its name to "the Republic of South Africa." That may seem to be a small point, but I think it is significant.

I should like to insert their press release on this in the record in order to make sure that those who read the hearing can further understand what I have reference to.

Chairman Reuss. Without objection, it may be received.

(The above referred to press release follows:)

Treasury Department Press Release

The Treasury today released the following statement:

"The question of the appropriate handling of newly-mined gold within the framework of the two-tier gold market has been reviewed by United States officials in contact over the past several weeks with financial officials of a number of individual countries in Europe and elsewhere including the Union of South Africa as well as with officials of international financial organizations.

"These discussions suggest that a basis for a satisfactory mutual understanding may be emerging.

"It is anticipated that these discussions will now be pursued in the framework of the IMF.

"(This statement was released simultaneously by the United States Embassy in Rome.)"

Representative Diggs. The IMF, incidentally, still treats South Africa in its grouping system as an "advanced British Commonwealth country." Since the United States initiated this commitment to South

Africa, it would be asking too much of our credulity to say that we cannot have a decisive voice in its termination. The voting system at the IMF is based on national quotas. The United States, with a $6.7 billion quota as of April 1971, is by far the most important member, its quota being almost 2½ times the next largest, the United Kingdom. This country is also in favor of an increased role for SDR's, and a diminished role for gold. France, the biggest "gold bug" has only a $1.5 billion quota. The U.S. taxpayer is therefore directly involved in the IMF's purchases of gold from South Africa, and our quota was increased by a record $400 million after the 1969 agreement.

There are many compelling reasons to terminate this agreement. Firstly, the agreement has not had the intended effect of dampening down speculative fluctuations in the free market gold price. Secondly, the agreement itself provides for review after 5 years or in the event of a major change in the circumstances. The disparity between the official and market prices would justify such a description. Mr. George P. Shultz has admitted in his letter to me referred to above that it could be viewed this way, "should it be considered desirable to do so." Thirdly, the agreement has been very one-sided—to the benefit of the South African Government. South Africa has used IMF facilities as a defense against balance-of-payments problems, and yet now with a favorable balance, South Africa is aggravating international instability. South Africa sold $672 million of gold to the IMF alone, immediately after the agreement, up to the end of April 1971. This was of vital importance to its balance-of-payments position at that time, and also helped to keep up the price on the free market, which it was using at the same time. Without these sales to the IMF or alternative outlets for the gold, the already serious balance-of-payments deficit would have been almost three times as large. But the South African Government has violated a key stipulation made by the United States in a letter from Mr. Paul Volcker to the managing director of the IMF, by selling gold directly to central banks—certainly Switzerland, and possibly some others. I should like to insert the text of Mr. Volcker's letter into the record, togehter with the text of the documents relating to the 1969 agreement.

Chairman REUSS. Without objection, it may so be inserted.

(The above referred to documents follow:)

[Extract from the International Monetary Fund Annual Report, 1970, App. I, pp. 184–189]

*   *   *   *   *   *   *

E. South Africa: Policy on Sales of Gold to the Fund

1. The Fund notes the letter from the Minister of Finance of the Republic of South Africa set forth [below].

2. In this letter, South Africa has stated its intention to offer to sell gold to the Fund only in the following circumstances:

(a) (i) when the price for gold in the market is $35 per ounce or below, up to an amount to meet South Africa's current foreign exchange needs for that period and

(ii) regardless of the market price, up to the extent that South Africa has a need for foreign exchange over a semiannual period beyond the need that can be satisfied by the sale of all of its current production of newly-minded gold on the market or by sales to the Fund under (i) above:

(b) when South Africa has been designated under Article XXV, Section 5, up to the amount for which South Africa has been designated; and

(c) from the stock held by South Africa on March 17, 1968 up to $35 million in each quarter, beginning January 1, 1970.

3. As a matter of policy, with the understanding that members generally do not intend to initiate official gold purchases directly from South Africa and without prejudice to the determination of the legal position under the Articles of Agreement, the Fund decides that it will purchase gold from South Africa when South Africa states that it is offering gold in accordance with the terms of its letter. When South Africa offers to sell gold to the Fund under this policy, the Fund will follow a procedure similar to the procedure for gold tranche purchases.

4. In addition, the Fund will accept gold from South Africa in accordance with the Fund's normal policies and practices under Paragraph 3 of Decision No. 7-(648) or under provisions of the Articles other than Article V, Section 6.

5. A charge of one-quarter of one per cent shall be levied on sales of gold to the Fund under Sections 2(a) and (c) of this decision pursuant to Rule G-7 and Rule I-8.

6. This decision shall be subject to review whenever this is requested because of a major change in circumstances and in any event after five years.

—Decision No. 2914-(69/127) December 30, 1969.

LETTERS TO THE MANAGING DIRECTOR OF THE FUND FROM THE MINISTER OF FINANCE OF THE REPUBLIC OF SOUTH AFRICA AND THE ACTING SECRETARY OF THE TREASURY OF THE UNITED STATES

MINISTRY OF FINANCE,
Pretoria, South Africa, December 23, 1969.

MANAGING DIRECTOR,
International Monetary Fund,
Washington, D.C.

DEAR MR. SCHWEITZER: As you know, for some time the Republic of South Africa has been discussing with the United States, with other members, and with you procedures for the orderly sale of newly-mined gold in the market and the sale of gold to the International Monetary Fund. I wish to inform you that as a result of these discussions, the South African authorities have adopted a policy with respect to gold sales and I would like to request that the Fund confirm that it will be prepared in the light of this statement of policy to buy gold from South Africa in the circumstances and under the conditions set forth below.

The following are the intentions of the South African authorities as to the handling of newly-mined gold and reserves:

(1) Without prejudice to the determination of the legal position under the Articles of Agreement of the Fund, the South African authorities may offer to sell gold to the Fund for the currencies of other members at the price of 35 Dollars per ounce, less a handling charge, as follows:

(a) During periods when the market price of gold falls to 35 dollars per ounce or below, at which times offers to sell gold to the Fund under this paragraph (a) would be limited to amounts required to meet current foreign exchange needs, and

(b) regardless of the price in the private market, up to the extent that South Africa experiences needs for foreign exchange over semi-annual periods beyond those which can be satisfied by the sale of all current new gold production on the private market or by sales to the Fund under paragraph (1)(a) above.

(2) (a) The South African authorities intend to sell current production of newly-mined gold in an orderly manner on the private market to the full extent of current payments needs. It is anticipated that new production in excess of those needs during a semi-annual period may be added to reserves.

(b) When selling gold other than in the private market, the South African authorities intend in practice normally to offer such gold to the Fund.

(c) The South African authorities may use gold in normal Fund transactions, e.g. in repurchase of appropriate drawings from the Fund, and to cover the gold portion of any South African quota increase, and to obtain currency convertible in fact to exchange against special drawing rights for which South Africa is designated by the Fund. Rand drawn from the Fund by other members would generally be converted into gold when Rand are included in drawings under normal Fund procedures. These Fund-related transactions, which may take place without regard to the market price of gold, will be reflected by changes in the composition of South Africa's reserves but will not affect the volume of sales of newly-mined gold in the market.

(3) Notwithstanding paragraphs (1)(b) and (2)(a) above, the amount of gold held by South Africa on March 17, 1968, reduced by sales by South Africa to monetary authorities (including Fund-related transactions) after that date and further reduced by such future sales to monetary authorities as may be made to finance deficits or as a result of Fund-related transactions, will be available for such additional monetary sales as the South African authorities may determine, up to 35 million Dollars quarterly beginning January 1, 1970. It is also contemplated that as an implementation of this understanding, the Fund would agree to purchase the amount of gold offered to it by South Africa in May 1968.

In order to determine whether South Africa has balance of payments surpluses or deficits as well as to indicate other operational and procedural points with respect to this policy, I enclose a memorandum which clarifies these particular matters.

It would be appreciated if, in light of these policy intentions, the Fund were able to decide that it would purchase gold from South Africa in the circumstances outlined above. I would expect that the Fund would review the situation at any time if there were a major change in circumstances and in any event after five years.

The South African authorities will work out with the Managing Director consultation procedures on the currencies to be purchased from the Fund with gold.

I hope that this announced policy, the implementation of which I believe will be a contribution to the stability of the International Monetary System, and my suggestion meet with the concurrence of the Fund. A copy of this letter has been sent to the Secretary of the Treasury of the United States.

Yours sincerely,

N. Diederichs,
Minister of Finance.

Operational and Procedural Points

A. For the present purposes, balance of payments deficits and surpluses will be equal to the change during the accounting period in the total of South African official gold and foreign exchange reserves, the net IMF position and changes in SDR holdings, and any foreign assets held by other South African banking institutions and public agencies under swap arrangements with the Reserve Bank. It is understood that changes in gold holdings outside the monetary reserves and in monetary banks' positions not covered by Reserve Bank swaps are normally not significant. If they should at any time become significant, further consideration will be given to their inclusion in the calculation. SDR allocations will not be considered as reducing a deficit or increasing a surplus as above defined. South Africa does not envisage unusual or non-traditional foreign borrowings or other special transactions that would affect the elements listed in this paragraph.

B. Addition of newly mined gold to South African reserves under paragraph 2(a) will take place when there is a surplus for an accounting period. It is envisaged that all new gold production, less domestic consumption, during the accounting period will be treated as a balance of payments credit item and that it will, in fact, be sold currently under paragraph 1(a) and paragraphs 2(a) to the full extent necessary to meet payments needs, except for the sales available under paragraph 3, apart from the Fund transaction initiated in May 1968.

C. Sales of gold by South Africa to monetary authorities under paragraph 1(a) may be made for any day when both London fixing prices are $35.000 p.f.o. or below, in an amount reasonably commensurate with one-fifth or weekly sales from new production required to be marketed to meet balance of payment needs.

D. Subject to paragraph 2(a):

1. Should sales to monetary authorities under paragraph 1(b), plus sales of SDRs and drawings from the IMF by South Africa, exceed the deficit defined under paragraph A of this memorandum, such excess will be deducted from the amount allowable for the first succeeding accounting period wherein a deficit is again encountered.

2. Should sales to monetary authorities under paragraph 1(b), plus sales of SDRs and drawings from the IMF, fall short of the amount allowable for an accounting period in which South Africa aims to finance its entire deficit by these means, such shortfall will be added to the amount allowable for the next succeeding accounting period.

3. It is expected that any discrepancies under 1 and 2 above will be minimal.

4. Should sales to monetary authorities under paragraph 1(b), plus sales of SDRs and drawings from the IMF, fall short of the amount allowable for an accounting period in which South Africa does not aim to finance its entire deficit by these means but chooses to sell more on the free market than it undertakes to do in paragraph 2(a), no correction will be made for any succeeding accounting period.

E. When the price criterion is operative, sales of gold to the IMF shall be attributed to the total deficit, if any, during the accounting period. The balance of such sales, if any, will be attributed to newly mined gold to the extent of gold production during the accounting period.

F. Sales or payments under paragraph 2(c) in connection with IMF-related transactions are expected to take place only within the criteria normally envisaged for IMF drawings by members, for use of members' currencies in drawings by other members and for SDR transactions.

G. Fundamentally, it is expected that the composition of South African reserves will not be greatly changed. In particular, it is understood that the ratio to total reserves will remain relatively stable. If South Africa should desire to make additional sales of gold or otherwise exchange assets for the purpose of achieving a basic change in the composition of its reserve hodings, further discussion would be held with a view to clarifying intentions.

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THE SECRETARY OF THE TREASURY,
Washington, D.C., December 24, 1969.

MR. PIERRE-PAUL SCHWEITZER,
Managing Director, International Monetary Fund,
Washington, D.C.

DEAR MR. SCHWEITZER: I have receive a copy of the letter dated December 23, 1969, sent to you by Mr. Diedrichs in which he sets forth the intentions which South Africa proposes to follow with respect to the handling of its newly-mined gold and reserves. This matter bears importantly on the continued effective functioning of the two-tier gold market which was initiated at a meeting on March 16–17, 1969, which you attended.

In view of the intentions of South Africa, and in view of discussions we have had with other Fund members, I should like to inform you that I have instructed the U.S. Executive Director to take the following position. The United States is prepared to support decisions of the International Monetary Fund to purchase gold offered for sale by South Africa in the circumstances and under the conditions described in that letter, assuming that there is an understanding among Fund members generally that they do not intend to initiate official gold purchases directly from South Africa. With this understanding, I believe that the policies to be followed will be consistent with the stability and proper functioning of the international monetary system.

Sincerely yours,

PAUL A. VOLCKER,
Acting Secretary.

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Representative DIGGS. The sale of gold to Switzerland is not the only way in which the South African Government's behavior has been unfortunate. We cannot be enthusiastic about South African officials traveling around the world, predicting confidently that the official price of gold is bound to rise, perhaps by double this time. At the end of August the Government of the South African Reserve Bank, Dr. de Jongh, announced that an increase in the official price of gold would prove to be unavoidable. This is an incitement to speculators who are gambling on a further slashing devaluation of the dollar. Meanwhile, when nobody was watching, the South Africans quietly disposed of a large proportion of the gold in its own official reserves, immediately after last year's devaluation.

The 1969 agreement with South Africa is not in the least necessary to the two-tier price structure set up in 1968. The system worked perfectly well for over 18 months before the agreement with South Africa. It is very unclear what our interest could have been in agreeing to this arrangement. In fact, by allowing the South African Government to manipulate its gold sales at will into either the free or the official market, the 1969 agreement undermines the principle of separating monetary gold from commodity gold. If the IMF were to sanitize official reserves by buying no more newly mined gold, and if the various central banks were to agree to the same, this would be more consistent with the two-tier principle of separating official reserves from the fluctuations of supply and speculative demand.

Mr. Chairman, the major piece of evidence I wish to put before your subcommittee to support this position relates to the inhuman conditions which prevail in the gold mines of South Africa. In the final analysis, it is here that the gold-based monetary system has been rooted, and I suggest that the highest priority should be given to the human factor which bears the entire weight of the system. Many observers have commented on how ludicrous it is that gold should be laboriously dug out of the bowels of the earth in South Africa, only to be buried again in the bowels of Fort Knox. If we were not so obsessed by the tribal mythology of gold, this ritual would be seen for what it is. But it is very far from a joke. For the people who mine gold, it is one of the cruelest and most unjust systems of exploitation known to man at the present time. And our support for the industry, which crucial to the economy and therefore lies at the heart of the apartheid system, conflicts with the expressed opposition to that system of the U.S. Government.

So let us look at the nature of this system. It is often argued that without the enormous supplies of cheap labor—labor without any human rights—the South African gold-mining industry would never have developed as it did. There was a great strike of African miners in 1946, which was ruthlessly suppressed by police attacks which killed and injured thousands of miners. At that time, the Chamber of Mines announced that to grant the demand of R1 per day (then worth $2) would put 35 out of the 45 currently producing mines out of operation. Since then no attempt at labor organization has been tolerated. If we compare wages and conditions in South Africa with those in the United States and elsewhere, many of which are now uneconomic to operate, it is obvious that South Africa's monopoly position as a producer of gold is a factor of the cheap labor system. If American mines employed labor under conditions operating in South Africa, many of them would still be working. The Soviet Union may be in a similar position to South Amrica and has certainly used convict labor in its gold mines; in this case, Soviet interests are very similar to South African interests, and both are very much in conflict with American and international interests.

The system in South Africa is controlled by the mining industry and the South African Government, working together to effect absolute control over the recruitment of African mineworkers, in South Africa itself, the so-called Portuguese territories of Angola and Mozambique, Malawi—which is really a satellite of South Africa—and Namibia, where South Africa is in illegal occupation, and the three countries within the South African customs union—Botswana, Lesotho, and Swaziland. The mines recruit through the monopolistic

Chamber of Mines, and have agreed among themselves to eliminate competition in wage rates, even at times of great labor shortages. Power is concentrated in a small elite group of companies with interlocking investments and directorates.

The State plays a vital role with bilateral agreements with Mozambique, the Portuguese African territory, and Malawi for the supply of a given volume of labor units, for which payment is made to the labor-exporting Government in the form of compulsorily "deferred" wages. Even more important is the system of influx control, whereby Africans in the labor reserves are prohibited from leaving without a contract and where a job in the gold mines is often the only alternative to starvation. It was in 1760 that slaves in South Africa were first required to carry passes in moving between rural and urban areas in South Africa, but it was the tightening of influx control after the 1930's that improved the mine labor supply from South Africa itself at a critical time, and still continues to be crucial to recruitment.

Africans are dominated by total government control in all aspects of their lives and work. Government policy restricts educational expenditure on Africans to less than one-tenth of that for whites, so that 65 percent of all African adults have never been to school, and over 70 percent of those who did dropped out before they could become functionally literate. This gives them a crippling handicap to start with. Then there is no right of residence in any urban area, which is where employment is available. Families and whole communities are arbitrarily broken up. There is no right of political participation, nor of political expression. Africans have no vote. They can be arbitrarily arrested and detained without charge or trial for any length of time if the police dislike their political views, and all their political organizations have been banned, and their leaders dead, in prison, or in exile. Special taxes together with acute poverty force people in the labor reserves onto the job market, where they usually have no choice of employer. Any attempt to go to the towns to find work freely is prevented by the complex network of pass laws, which are fundamental to the whole system of regulating Africans to serve the white economy as "labor units," and have been applied with increasing severity. Between 1936 and 1962 the proportion of convictions under the pass laws relative to the total African population rose from 1.9 percent a year to 3.4 percent. If there were a free labor market in South Africa, the mining industry would have to double its wages to compete with manufacturing industry. This competition is eliminated by the full machinery of a police state, forcing people to take the lowest paid jobs.

It is clear, then, that the South African legislation which forces Africans to stay in the reserves until they are needed on the mines is largely responsible for the fact that the international monetary system has the gold supplies that it does.

Equally vital is the supply of non-South African labor, which was the major solution evolved in the 1930's to the problem of attracting more labor without raising wages. The Portuguese colonial government in Mozambique supplies up to 80,000 Africans a year in terms of the 1928 Mozambique convention. Since 1910, this territory has supplied over a quarter of the Africans for the mines. Apart from the few employed in the towns, Mozambique Africans are faced with the alternatives of the South African mines, or conscription as forced labor, to work on coffee and other plantations, or into the colonial army. When there is a conscription drive in any area, the South African recruiting offices have ample supplies of labor. The system is obviously capable of great abuse; however, it is said that conditions here are nothing compared to the degrading scenes in Angola, another Portuguese colony.

Between 1936 and 1969 the total number of Africans employed in the gold mines rose from 318,000 to 371,000, while the number of black South Africans fell from 166,000 to 131,000, less than one-third of the total. Of the nominally independent African nations, it is Lesotho, entirely surrounded by South Africa and with very few natural resources, which is most dependent on the employment of its nationals in the mines. It provided 18 percent of the total labor force in 1961. Other independent countries have been trying desperately to reduce the numbers of their workers going to the mines.

Botswana had cut its contribution to 4 percent in 1961, and Swaziland 1 percent. Tanzania, then a United Nations trust territory administered by the United Kingdom, provided 16 percent in 1952, but after the massacre at Sharpeville in 1960 it cancelled the agreement providing 10,000 men a year. Tanzania is one of the poorest countries in Africa, but is setting a widely respected example in self-reliance.

It should not be assumed, of course, that the recruitment of foreign workers means that they are worse off than Africans in South Africa. In fact the labor reserves, or "Bantustans" of South Africa and Namibia are among the poorest areas in Africa in terms of income per capita, and even wages in nonmining sectors in South Africa compare unfavorably with a country like Zambia. There is of course a very high level of unemployment and underemployment throughout Africa, and throughout the third world generally, and much larger movements of foreign workers can be observed into the industrial centers of East and West Africa than into South Africa.

The main reason why black South Africans form a declining proportion of the total labor force on the gold mines is because this is deliberate Government policy. In the first place, foreign workers are easier to discipline, and so the possibility of labor organization, such as that which produced a general strike last December through February in Namibia, is reduced; and second, this is essential to the so-called outward policy, which consists of increasing the dependence of southern African on metropolitan South Africa, a classic case of neocolonialism. There is a very great and rapidly increasing unemployment among black South Africans, for which the Government feels it has to suppress the statistics but which may amount, according to one calculation, to 25 percent of the working population.

Mr. Chairman, the remainder of my prepared statement, of course, goes on to support further some of our basic arguments. I need hardly point out the historical importance of the gold mining industry to South Africa and the crucial role of that industry in its economic system. What we have been trying to get across here was indicated in one of our first sentences; namely, that of times when you become involved in this very complex and academic discussion there is a tendency to lose sight of some of the basic human factors that are involved.

And in addition to some of the technical references that we have made here, we wanted to make sure that this entire subject was being placed in a context so that this committee and those who are exposed to the testimony from this committee can have some idea about the relationship between these working conditions and the subject matter, and to the extent that the United States is involved in this entire setup, we are in complicity with their exploitation of the labor in their mines.

Mr. Chairman, I know you have a long day of testimony ahead, and you have a distinguished government witness who is due to testify at 10 o'clock. I do not wish to further elaborate here. The testimony so far and that which remains for the record speaks for itself.

(The prepared statement of Representative Diggs follows:)

PREPARED STATEMENT OF HON. CHARLES C. DIGGS, JR.

Mr. Chairman: I greatly appreciate this opportunity to appear before this Subcommittee today, and particularly since it enables me to present some of the hard facts about gold-mining—the industry on which this whole question of the monetary role of gold rests.

When experts come together to discuss gold, they tend to theorize to the point where we forget what we are talking about. There are some very urgent human issues involved in gold-mining. Specifically, South Africa currently has a virtual monopoly of the gold market. And the methods used to force South African Blacks to go down the mines and dig the metal out amount to a mere variation of the age-old evil of slavery. This may seem at first sight an exaggeration, but I hope you will see the point when you have considered the evidence available.

Mr. Chairman, I am in favor of any measures which will have the effect of reducing the price of gold, and in particular in bringing about its long-overdue demonetization, and any other steps which would reduce the speculative demand. This is fully consistent with the official Treasury position. One specific action which I should like to see is the termination of the International Monetary Fund's agreement of December 1969 with South Africa, which provides South Africa with a floor price by allowing it to sell gold directly to the Fund either when the free market price drops below the official price, or to the amount of South Africa's balance of payments deficits, as well as on other grounds applicable to all IMF members.

This agreement with South Africa was supposed to insure the orderly marketing of gold, but it has obviously failed in that; for South Africa has recently been withholding large amounts of gold from the free market, formally justified by the favorable balance of payments which results from heavy capital inflows. It is therefore encouraging the speculative price to soar to the present unreasonable levels, almost double the official price. (See for example H.B. Ellis in the Christian Science Monitor, August 10, 1972). This benefits nobody but South Africa and the Soviet Union. Such tactics are harmful to the international monetary system, as I do not need to remind you; it is damaging to confidence in the dollar, and is increasing the difficulties inherent in an adverse balance of payments: it is very damaging to industrial users of gold, notably jewellers, many of whom are having to cut back production as well as raising prices; and I submit that it is very harmful to the people of South Africa.

The U.S. officials you will be hearing have been inclined to blame other countries for the failure to take decisive action to rationalize the role of gold in the international monetary system. They have tried to do so in the case of the 1969 agreement, although Mr. George P. Shultz has assured me that in this case they would be inclined to favor a review of it, and do not support the idea of a floor price for gold. I should like to insert my correspondence with him in the record. However, the claim that we cannot control the IMF is an evasion of this particular issue; it was the United States which initiated the negotiations with South Africa and other countries leading up to the agreement, as a bilateral issue. It was not until two weeks before the agreement was signed that it was handed over to the IMF to give it international respectability. Incidentally, an indication of the ignorance of the Treasury Department about the political and human issues involved is shown by the reference to "the Union of South Africa"—eight years after it had been forced out of the British Commonwealth because of its *apartheid* policy and changed its name to "the Republic of South Africa." I should like to insert their press release on this in the record.

The IMF, incidentally, still treats South Africa in its grouping system as an "advanced British Commonwealth country." (New York Times, July 29, 1972). Since the United States initiated this commitment to South Africa, it would be asking too much of our credulity to say that we cannot have a decisive voice in its termination. The voting system at the IMF is based on national quotas. The United States, with a $6.7 billion quota as of April 1971, is by far the most important member, its quota being almost 2½ times the next largest, the United Kingdom. This country is also in favor of an increased role for SDR's, and a diminished role for gold. France, the biggest "gold bug" has only a $1.5 billion quota. The U.S. taxpayer is therefore directly involved in the IMF's purchases of gold from South Africa, and our quota was increased by a record $400 million after the 1969 agreement. (IMF Annual Report, 1970 and 1971).

There are many compelling reasons to terminate this agreement. Firstly, the agreement has not had the intended effect of dampening down speculative fluctuations in the free market gold price. Secondly, the agreement itself provides for review after 5 years or in the event of a major change in the circumstances. The disparity between the official and market prices would justify such a description. Mr. George P. Shultz has admitted in his letter to me referred to above that it could be viewed this way, "should it be considered desirable to do so." Thirdly, the agreement has been very one-sided—to the benefit of the South African Government.

South Africa has used IMF facilities as a defense against balance of payments problems, and yet now with a favorable balance, South Africa is aggravating international instability. South Africa sold $672 million of gold to the IMF alone, immediately after the agreement, up to the end of April 1971. This was of vital importance to its balance of payments position at that time, and also helped to keep up the price on the free market, which it was using at the same time. Without these sales to the IMF or alternative outlets for the gold, the already serious balance of payments deficit would have been almost three times as large. But the South African Government has violated a key stipulation made by the United States in a letter from Mr. Paul Volcker to the Managing Director of the IMF, by selling gold directly to central banks—certainly Switzerland, and possibly some others. (The TIMES, London, July 1970). I should like to insert the text of Mr. Volcker's letter into the record, together with the text of the documents relating to the 1969 agreement. The sale of gold to Switzerland is not the only way in which the South African Government's behavior has been unfortunate. We cannot be enthusiastic about South African officials traveling around the world, predicting confidently that the official price of gold is bound to rise, perhaps by double this time. At the end of August the Government of the South African Reserve Bank, Dr. de Jongh, announced that an increase in the official price of gold would prove to be unavoidable. This is an incitement to speculators who are gambling on a further slashing devaluation of the dollar. Meanwhile, when nobody was watching the South Africans quietly disposed of a large proportion of the gold in its own official reserves, immediately after last year's devaluation. (Financial Mail, Johannesburg.)

The 1969 agreement with South Africa is not in the least necessary to the two-tier price structure set up in 1968. The system worked perfectly well for over 18 months before the agreement with South Africa. It is very unclear what our interest could have been in agreeing to this arrangement. In fact, by allowing the South African Government to manipulate its gold sales at will into either the free or the official market, the 1969 agreement undermines the principle of separating monetary gold from commodity gold. If the IMF were to sanitize official reserves by buying no more newly-mined gold, and if the various Central Banks were to agree to the same, this would be more consistent with the two-tier principle of separating official reserves from the fluctuations of supply and speculative demand.

Mr. Chairman, the major piece of evidence I wish to put before your Subcommittee to support this position relates to the inhuman conditions which prevail in the gold mines of South Africa. In the final analysis, it is here that the gold-based monetary system has been rooted, and I suggest that the highest priority should be given to the human factor which bears the entire weight of the system. Many observers have commented on how ludicrous it is that gold should be laboriously dug out of the bowels of the earth in South Africa, only to be buried again in the bowels of Fort Knox. If we were not so obsessed by the tribal mythology of gold, this ritual would be seen for what it is. But it is very far from a joke. For the people who mine gold, it is one of the cruelest and most unjust systems of exploitation known to man at the present time. And our support for the industry, which is crucial to the economy and therefore lies at the heart of the *apartheid* system, conflicts with the expressed opposition to that system of the United States Government.

So let us look at the nature of this system. It is often argued that without the enormous supplies of cheap labor—labor without any human rights—the South African gold-mining industry would never have developed as it did. There was a great strike of African miners in 1946, which was ruthlessly suppressed by police attacks which killed and injured thousands of miners. At that time, the Chamber of Mines announced that to grant the demand of R1 per day (then worth $2) would put 35 out of the 45 currently producing mines out of operation. Since then no attempt at labor organization has been tolerated. If we compare wages and conditions in South Africa with those in the United States and elsewhere, many of which are now unecenomic to operate, it is obvious that South Africa's monopoly position as a producer of gold is a factor of the cheap labor system. If American mines employed labor under conditions operating in South Africa, many of them would still be working. The Soviet Union may be in a similar position to South Africa and has certainly used convict labor in its gold mines; in this case, Soviet interests are very similar to South African interests, and both are very much in conflict with American and international interests.

The system in South Africa is controlled by the mining industry and the South African Government, working together to effect absolute control over the recruitment of African mine workers, in South Africa itself, the so-called Portuguese territories of Angola and Mozambique, Malawi, Namibia, where South Africa is in illegal occupation, and the three countries within the South African customs union—Botswana, Lesotho and Swaziland. The mines recruit through the monopsonistic Chamber of Mines, and have agreed among themselves to eliminate competition in wage rates, even at times of great labor shortages. Power is concentrated in a small elite group of companies with interlocking investments and directorates. (Dr. Francis Wilson, *Labour in the South African Gold Mines*, 1911–1969, Cambridge University Press, U.K., 1972; p. 28).

The State plays a vital role with bilateral agreements with Mozambique and Malawi for the supply of a given volume of labor units, for which payment is made to the labor-exporting Government in the form of compulsorily "deferred" wages. Even more important is the system of influx control, whereby Africans in the labor reserves are prohibited from leaving without a contract and where a job in the gold mines is often the only alternative to starvation. It was in 1760 that slaves in South Africa were first required to carry passes in moving between rural and urban areas in South Africa, but it was the tightening of influx control after the 1930's that improved the mine labor supply from South Africa itself at a critical time, and still continues to be crucial to recruitment. Africans are dominated by total Government control in all aspects of their lives and work. Government policy restricts educational expenditure on Africans to less than one-tenth of that for Whites, so that 65% of all African adults have never been to school, and over 70% of those who did dropped out before they could become functionally literate. (Rand Daily Mail, Johannesburg, March 14, 1972; Wilson, p. 94; Mr. D. J. Marais, South African House of Assembly Debates (*Hansard*), April 11, 1972, col. 4576). This gives them a crippling handicap to start with. Then there is no right of residence in any urban area, which is where employment is available. Families and whole communities are arbitrarily broken up.

There is no right of political participation, nor of political expression. Africans have no vote. They can be arbitrarily arrested and detained without charge or trial for any length of time if the police dislike their political views, and all their political organizations have been banned, and their leaders dead, in prison or in exile. Special taxes together with acute poverty force people in the labor reserves onto the job market, where they usually have no choice of employer. Any attempt to go to the towns to find work freely is prevented by the complex network of pass laws, which are fundamental to the whole system of regulating Africans to serve the white economy as "labor units," and have been applied with increasing severity. Between 1936 and 1962 the proportion of convictions under the pass laws relative to the total African population rose from 1.9% a year to 3.4%. If there were a free labor market in South Africa, the mining industry would have to double its wages to compete with manufacturing industry. This competition is eliminated by the full machinery of a police state, forcing people to take the lowest paid jobs. It is clear, then, that the South African legislation which forces Africans to stay in the reserves until they are needed on the mines is largely responsible for the fact that the international monetary system has the gold supplies that it does.

Equally vital is the supply of non-South African labor, which was the major solution evolved in the 1930s to the problem of attracting more labor without raising wages. The Portuguese colonial Government in Mozambique supplies up to 80,000 Africans a year in terms of the 1928 Mozambique Convention. Since 1910, this territory has supplied over a quarter of the Africans for the mines. Apart from the few employed in the towns, Mozambique Africans are faced with the alternatives of the South African mines, or conscription as forced labor, to work on coffee and other plantations, or into the colonial army. When there is a conscription drive in any area, the South African recruiting offices have ample supplies of labor. The system is obviously capable of great abuse; however, it is said that conditions here are nothing compared to the degrading scenes in Angola, another Portuguese colony. (Wilson, pp. 128–9.)

Between 1936 and 1969 the total number of Africans employed in the gold mines rose from 318,000 to 371,000, while the number of Black South Africans fell from 166,000 to 131,000, less than one-third of the total. Of the nominally independent African nations, it is Lesotho, entirely surrounded by South Africa and with very few natural resources, which is most dependent on the employment of its nationals in the mines. It provided 18% of the total labor force in 1961. Other independent countries have been trying desperately to reduce the numbers of their workers going to the mines. Botswana had cut its contribution to 4% in 1961, and Swaziland 1%. Tanzania, then a United Nations trust territory administered by the U.K., provided 16% in 1952, but after the massacre at Sharpeville in 1960 it canceled the agreement providing 10,000 men a year. Tanzania is one of the poorest countries in Africa, but is setting a widely respected example in self-reliance.

It should not be assumed, of course, that the recruitment of foreign workers means that they are worse off than Africans in South Africa. In fact the labor reserves, or "Bantustans" of South Africa and Namibia are among the poorest areas in Africa in terms of income per capita, and even wages in non-mining sectors in South Africa compare unfavorably with a country like Zambia (See Barbara J. Rogers, *African Incomes in South Africa*, United Nations Unit on *Apartheid* No. 45/71, November 1971.) There is of course a very high level of unemployment and underemployment throughout Africa, and throughout the Third World generally, and much larger movements of foreign workers can be observed into the industrial centers of East and West Africa than into South Africa.

The main reason why Black South Africans form a declining proportion of the total labor force on the gold mines is because this is deliberate Government policy. In the first place, foreign workers are easier to discipline, and so the possibility of labor organization, such as that which produced a general strike last December through February in Namibia, is reduced; and secondly, this is essential to the so-called "outward policy", which consists of increasing the dependence of southern Africa on metropolitan South Africa, a classic case of neo-colonialism. There is very great and rapidly increasing unemployment among Black South Africans, for which the Government feels it has to suppress the statistics but which may amount, according to one calculation, to 25% of the working population. (Trade Union Council of South Africa, quoted in the *Rand Daily Mail*, April 12, 1972.) In the South African Transkei, which is a traditional source of mine labor, many applicants are being refused, while recruitment in Lesotho, Botswana and elsewhere is still aimed at attracting the maximum possible number. The removal of the cream of the labor force from such countries is very harmful to their rural development.

Any argument of the type which we hear so often from South Africa and its friends, that the South African gold-mining industry should be given favorable treatment by the international community in order to provide employment for recruits from South Africa, becomes absurd in the light of the facts. The development plans of the nominally independent African countries stress the goal of economic independence. The United States has acknowledged this priority by giving some aid to Lesotho, Swaziland and Botswana, especially the latter for mineral and transportation projects which should reduce its crippling dependence on South Africa, and create employment to reduce the outflow to the South African mines. What we are doing is negligible, compared with the effort we should be making. If we sincerely want to help the people of southern Africa, we should help them create their own employment opportunities, together with rural development programs. This will indirectly help the Africans of South Africa by releasing to them the employment opportunities generated inside their own territory.

Coming back to the gold mines, I should like to indicate briefly the conditions under which the African miners work. By the simple legislative expedient of defining employees so as to exclude Africans, these people are deprived of all their labor rights. Since 1911 it has been a criminal offense to strike or otherwise break the contract, which usually lasts about a year.

There have always been convicts used in the mines, but there is so little difference between the wages of regular laborers and convicts that for all practical purposes they could all be convicts. They have no paid leave at all, and a rigid discipline that means they are allowed to lose far fewer days through illness or family problems than the Whites. They also work longer hours, being underground for about ten hours a day, six days a week. One of the white miners' demands which has been consistently refused has been the reduction of the working week to five or five and a half days, since the Chamber of Mines fears that giving the Blacks spare time would create unrest. Any time that they do have is rigidly organized—hence the mine dances on Sundays, for tourists.

The men work two miles and more underground at very high rock temperatures, and the rock drilling creates almost intolerable levels of noise and dust. The result is a string of accidents, mostly from falling rock, and a number of occupational diseases, including heatstroke, deafness (for which the mines do not even bother to keep records), and silicosis of the lungs, which makes them more vulnerable to tuberculosis. Some mines contain highly explosive methane gas, and there is constant danger of the stope face bursting under pressure, or of flooding, as in the West Driefontein mine in 1969. The development stage of mining is especially dangerous, as in the Orange Free State mines in 1952–57.

Between 1936 and 1966 19,000 men, 93% of them black, died as a result of accidents in the gold mines, an average of three deaths per shift. This is almost half as many casualties as this country has suffered in the entire Vietnam war (45,855 since January, 1961), putting this industry on a par with the world's great war machines.

The black death-rate is almost double that of whites. There was also an enormous number of disablements from accidents. In 1968, a year when the fatality rate reached an all-time low, 491 blacks and 18 whites were killed, and 25,000 blacks and 2,000 whites were disabled for at least two weeks by accidents, 98% of which were estimated to have been due to the inherent danger of the work. The overall accident rate for 1968 was 64 per 1,000 persons in service. In addition to this are the huge numbers of slow deaths and disablement resulting from lung damage and other occupational hazards, for which there seem to be no records but which, from direct observation in the Bantustans, appear to be astronomical. In the Transkei, tuberculosis has reached epidemic proportions, affecting almost one-quarter of those surveyed as opposed to almost none 25 years earlier. (Study by Dr. Guy Danes, St. Lucy's Hospital, Transkei) This is also, of course, a result of chronic and increasing poverty in the reserves, which as early as 1914 were being described as little more than mining villages. If for no other reason than the enormous rate of deaths and disability, then, gold mining is a menace to the people forced to work there.

The color bar dominates every aspect of the industry, and unnecessarily aggravates the dangers in a way unimaginable in any free country, or even perhaps in the Soviet Union. For example, the collection of dust samples is an important safety measure, but although no Whites are available to do this job, the powerful Mine Workers' Union successfully opposes the employment of Blacks here. The color bar is so rigid that even the enlightened self-interest of white workers in having safety measures taken is ignored.

Apart from the mining companies and the Government, it is the white miners who benefit the most from the color bar in the gold mines. The white unions see the issue not as one "between white and black labor, but between free labor and slave labor", as a white strike committee expressed it in 1924. (Transvaal Strike Legal Committee, *The Story of Crime* (Johannesburg, 1924) p. 39.) They therefore seek to protect their jobs and very high salaries, to the total exclusion of the slave labor which threatens to undercut them. The gap between white and black wages has increased enormously over the last century, from a ratio of 7.5:1 in 1889 to 20.1:1 in 1969—probably the world record for wage differentials. Any situation where one class of people receives twenty times more than another is intolerably unjust. In the United States, where we still have a long way to go, the gap between white and black earnings fell between 1939 and 1953 from 2.4:1 to 1.7:1, and has been almost unchanged since then. In South Africa, real cash earnings for Africans are lower than they were in 1889, probably by over 25%, and as a proportion of total costs the wage bill for Africans has fallen dramatically, from 13.7% in 1936 to 8.9% in 1969.

Between 1936 and 1969, when the productivity of all workers rose by 39%, black wages fell. The benefits resulting from the increases in productivity go almost exclusively to the white miners, a minority of between 10% and 15%. An agreement in 1967 between the mining companies and white trade unions, for example, provided for the elimination of certain restrictive practices, and for the benefits resulting from the extra work of Blacks in these areas to go to the Whites.

The very low African wages are often justified by employers by the idea that it is not intended to support the worker's family, who are supposed to live off the land in the labor reserves. There is a conspiracy of silence about the actual conditions in these areas; where there have been studies made, the consistent conclusion is that they are totally inadequate to support the very great, and increasing population densities which have been forced into them, probably the highest population densities in Africa. This results in serious soil erosion and total exhaustion of natural resources. A Government commission reported in 1954 (Tomlinson Commission; Government Printer, Pretoria, 1955) that the reserves could only support half their current population at minimum subsistence levels, and since then the population has more than doubled. Contracts with the mines are therefore absolutely essential for a family's bare survival. The available evidence indicates that the reserves are becoming steadily more dependent on migrant wages as time goes on.

Since they are safely out of sight of the white community, however, the Government and mining industry can operate on the convenient assumption that they have no obligation to provide a wage adequate for the subsistence of a mine-worker's family, or for the worker himself in times of illness, unemployment and old age. In this way the system is even worse than the old slavery, where the victims were visible to those responsible. In South Africa, it is illegal for any non-African to go and see the reserves without special permission.

In line with the assumption that only the worker as a labor unit need be considered, the mines feed their workers as scientifically as modern cattle to make them fit for the gruelling labor underground. (Wilson, p. 55). For the same reason, to make them fit to work, they are given thorough medical attention, although there is no provision for their families—as there is for white families. On the other hand, housing is in bachelor barracks, with between twelve and ninety men to a room. Many of the older compounds have no beds and nowhere to eat except the dormitories. The system had been evolved for the Chinese indentured laborers used in the first decade of this century, and then applied to Africans whose families did not therefore have to be housed.

It is sometimes claimed that if fringe benefits are taken into account, the wage differential of 20 to 1 would not be so enormous. However, a comparison between the benefits available to Whites, and above all to their families, and those for Blacks shows enormous discrepancies, covering such benefits as bonuses and cost of living allowances, paid leave, unemployment, pension and provident funds, "active service allowances" for World War II veterans, and advanced educational assistance—all for Whites only; or medical care, educational assistance for children, subsidized housing (all with servants' quarters)—for the families of Whites only; or recreation, subsidized canteens, disablement allowances, compensation for lung damage, the rate of overtime pay, and numerous other advantages—all very much more generous for Whites than for Blacks. These benefits have not been quantified as an overall ratio of White to Black, but taken all together they add up to a picture analagous to that of the wage structure.

It is quite impossible to convey here the degree of suffering imposed by the system. It is not simply a matter of physical deprivation; it is a question also of the mental suffering which results from the tearing apart of the fabric of African society, just as in the days of the old slave trade. I was able to gain some idea of the human problems inherent in *apartheid*, as it effects people in the township ghettoes. But I was not allowed into the "Bantustans", which is where increasing numbers of people are being deported, by now over one million of them, mainly what the South African Government calls "surplus appendages"—the wives, children and other dependents of migrant workers. I should like to quote Dr. Anthony Barker, a doctor in the Zulu reserve for many years, on the effect of the system on African family life:

"Economic or even social analysis of migratory labor will fail to reveal the full picture of its cost in terms of human misery. To learn this you must listen to the lonely wife, the anxious mother, the insecure child . . . It is at family level that the most pain is felt, and we cannot forget that the African cultural heritage enshrines a broader, more noble concept of family than that of the West. The extended family has proved a marvellous security for those for whom, otherwise, there was no security at all.

". . . Deprived of their natural guides, children of migrants grow through an insecure, uncertain childhood to an adult life whose sole preoccupation may be to escape the system. There must be a harvest of aggression, with the weeds of violence growing rank within it."

(Dr. Anthony Barker, "Community of the Careless", *South African Outlook*, April 1970)

The details of the wages and conditions I have outlined here have been very carefully assembled in a book published last month by a South African economist, Dr. Francis Wilson, entitled *Labour in the South African Gold Mines*. In order that the facts should be available for anyone wishing to examine the issue further, I should like to insert into the record two chapters of Dr. Wilson's study. And to give an idea of some of the camps inside the Bantustans for the people of no use to the white economy, I should also like to insert the description of conditions in the Transkei and Ciskei, the major sources of mine labor in South Africa, from the researches of a Catholic priest in South Africa, Fr. Cosmas Desmond. As a result of this work, Fr. Desmond has been placed under a banning order by the South African Government—which means, among other things, that his writings cannot now be published, or quoted, inside South Africa.

In the light of these facts, Mr. Chairman, it is clear that South Africa's gold-mining industry operates on a basis of a labor force which is totally without rights, even the right to choose between employers; and that the international monetary authorities, by providing a guaranteed market at a guaranteed minimum price for South African gold, is in a sense subsidizing the industry and its neo-slavery system. This has the effect of aid to the South African Government, which has also subsidized marginally economic mines very heavily in times of difficulty because the industry is so crucial to the entire white-owned economy, and therefore to the entire structure of South African society.

The economics of South Africa's gold, where the grade of ore is distributed uniformly over a wide range, operate in such a way that any changes in the cost structure or the price of gold affects the amount of payable ore reserves. Increasing costs reduce the payable reserves, and an increase in price increases the reserves. Although the expected life of the mines is increased, however, current output is reduced, as is happening now with the deliberate reduction in the grade of ore processed, at Government instructions. With reduced output, of course, South Africa can reduce the supply to the speculative market without violating the letter of the 1969 Agreement with the IMF.

In the case of the heavily subsidized marginal mines, the high premium on free-market sales has been of enormous benefit recently. In fact, a guaranteed rising price is crucial, since costs are accelerating in South Africa, and once a mine is closed down it is virtually impossible to reopen. From this it is obvious that South Africa's 1969 Agreement with the IMF has been crucial to keeping some of the mines open. The prospect of an increasing gold price has also been essential in order to attract foreign capital for new investment in the industry, and to present a general impression of infinite prosperity for anyone interested in South Africa as an investment.

(See publications of the South Africa Foundation, and publicity materials available from South Africa's diplomatic posts; also the *Investor's Chronicle*, London, Supplement on "South Africa's Go-Go Economy", December 1969; and other newspaper supplements supported by advertising from South African interests.)

International support for the gold-mining industry—in the first place with an unlimited demand at the official price from the United States Reserve Bank, and now with a guarantee against falling prices and balance of payments problems for the IMF—has not been beneficial to the workers in the industry. The protection of an unlimited demand at constant prices encouraged the complete abolition of competition between the mining companies, which could therefore concentrate on matters of common interest, notably collusion to keep black wages down. The times of large increases in the gold price have never prompted increases in black wages. In fact a small increase in the early 1960s was prompted by international pressure against South Africa's *apartheid* system, resulting in the fear that independent African countries would follow Tanzania's lead in refusing to sell their workers under current conditions. (Wilson, p. 106) And as Dr. Wilson has pointed out, it is the margin of extra profit provided by international price guarantees that has been decisive in enabling the industry to avoid the pressures to ease the color bar, which is notable even in South Africa for its inflexibility and the inefficiency which results. The color bar reserves certain categories of jobs for Whites, and also limits the number of Blacks to be employed as a ratio of white employment. It was estimated in 1968 that a 70% replacement of white workers by Africans—who are in many cases at least as skilled as the Whites—would result in a saving to the gold-mining industry of R30 million a year (about \$40–\$45 million), approximately 6% of working costs. The saving would be greater now since the last series of white wage increases. A further result of encouraging South Africa's gold-mining industry has been the development since World War II of the uranium industry, uranium being a by-product of gold in nearly half the mines. South Africa already sells uranium without peaceful uses safeguards, and with its new enrichment process could become a real menace to the Nuclear Non-Proliferation Treaty. South Africa has not signed the Treaty.

I need hardly point out the historical importance of the gold-mining industry to South Africa, or its crucial role in the system which evolved to supply it, and later other sectors, with labor. The industry has long been the basis for South Africa's prosperity, and for the foreign exchange with which it buys arms and equipment for its massive armed forces and police. In 1970 output accounted for 10.5% of GNP. Sales of gold in 1971 amounted to \$1.5 billion—repeat, one and a half billion dollars—equal to all other exports combined. (Department of Commerce, Overseas Business Reports: Southern Africa; OBR 72–030, July 1972) Our support for these sales is in direct conflict with stated foreign policy, which is to abhor *apartheid* and support peaceful change in the system. The U.S. Government states that it favors the "constructive interplay of political, economic and social forces." (Statement by Secretary of State William P. Rogers of March 26, 1970.)

Since over a century ago, the whole white supremacy system in South Africa has been backed up by gold. The expropriation of the best land and crowding of all the Africans into tiny reserves, under 11% of the total area, was to provide cheap labor for the mines. This industry served as a model for all subsequent sectors of the white economy. Above all, gold has attracted foreign capital, and paid for the enormous wastefulness of *apartheid*, its armed forces, secret police, constant political surveillance, the mass deportation of Africans, the detailed administration of segregation in all its ludicrous aspects, and the propaganda machine that represents South Africa abroad as a bastion of anti-communism and therefore indispensible to the West. In fact, of course, South Africa is creating a mounting regional tension that is ideal for Communist subversion, and very dangerous to our key policy aim of international detente.

U.S. involvement in backing the gold industry in South Africa has been crucial. Private American sources have provided capital investment, but even more important have been unlimited Government purchases of gold over the last decades. It is over the last two or three years that our support has been of such vital importance, in allowing the IMF to use our huge and increased quota to buy South Africa's gold in enormous quantities, at a critical point in South Africa's economic life, then its balance of payments was moving deeply into the red and overseas confidence seemed to falter after the sudden fall in the Johannesburg stock exchange in April 1969.

For the U.S. Government to support so massively the minority Government of South Africa, to the tune of billions of dollars, and to do so even when this is contrary to our own economic interests and in conflict with our declared foreign policy objectives, simply boggles the mind. The situation amounts to more than complicity with *apartheid*; it is a massive subsidy for *apartheid*. It represents total hypocrisy which cries out to be rectified immediately. There is every reason why we should stop supporting the gold industry of these two totalitarian regimes, the Soviet Union and South Africa.

The gold industry is already in a natural decline in South Africa. In 1970, before the recent free-market premium, it was estimated that output would be cut by almost half over the next decade. There seems no prospect of new ore discoveries like those which produced the phenomenal growth of the industry in the 1950s and 1960s. Without further substantial rises in the official price of gold—which would be catastrophic from the point of view of the dollar—output will certainly fall appreciably as mines go out of production. Sooner or later, we shall have to find a rational substitute. Let us make it sooner rather than later, in order to dispel the international currency uncertainty which is doing everybody, except South Africa and the Soviet Union, so much damage.

It appears that the overwhelming majority of experts who have commented on this question of monetary reform are in favor of decisive measures to rationalize the role of gold in the international system. (See for example Hobart Rowen's review in the *Washington Post*, August 13, 1972) At the very least, they say that gold reserves should be sanitized, with no more purchases of gold for official purposes. The IMF has just stressed the need for a new system, in the report by the Executive Directors to the Board of Governors. (*Reform of the International Monetary System*, IMF, Washington, DC, September 6, 1972.) I am sure the witnesses you will be hearing later will be qualified to elaborate on the exact means of achieving this end.

So, to answer your own question, Mr. Chairman, we should not encourage the gold-mining industry of South Africa, any more than that of the Soviet Union; in fact we should do everything possible to bring the industry to an end as soon as possible. Any argument that it benefits the Africans who work there must be rejected, just as the arguments for continuing the old slave system had to be rejected. The system is rotten through and through, and can only survive on a basis of human suffering; and we want no part in it.

We should therefore terminate the IMF agreement with South Africa of December 1969. We should get an international agreement to stop buying the metal for official monetary reserves; sell some of the enormous U.S. gold stocks to *bona fide* industrial users; and demonetize gold as fast as can be agreed internationally, just as we successfully demonetized silver. In its place, we need further issues of Special Drawing Rights from the IMF, which should be based on rational economic factors and not the ability of one universally despised Government to exploit its people and those of the rest of Africa. We should, incidentally, insist that a special allocation of SDRs be made to the developing countries of the Third World, as resolved at the last meeting of UNCTAD, the U.N. Conference on Trade and Development, at Santiago, Chile. This is by far the most effective form of development financing, on which the United States has about the most pathetic record in the Western world; it would alleviate the international tension caused by world poverty, and also benefit us by giving developing countries the means to buy our products, and so boost our balance of payments and increase employment here.

Finally, we should compensate the independent African countries involved, and their people, by channelling additional assistance direct to them, not through the IMF via South Africa but through the international organizations of the United States system which were set up for this purpose.

Chairman REUSS. I want to congratulate you, Congressman Diggs, on presenting this committee with the most penetrating and comprehensive statement on South African gold and the manner of its mining that I have seen.

The general summary of your testimony is that since there is no sound international monetary reason why the United States should be a party to the purchase of South African gold—either directly or through the International Monetary Fund—therefore the humanitarian considerations ought to be dominant. We ought to do whatever needs to be done in order to prevent the further subsidization of the South African gold industry.

Representative DIGGS. That is the general thrust of my testimony.

Chairman REUSS. Occasionally one hears apologists say, well, if you do that, miserable though the life of the South African gold miner is, you will do him entirely out of a job, to the extent that you diminish gold production. Would you address yourself to that argument, which is sometimes heard?

Representative DIGGS. Mr. Chairman, I have been in all of these countries. I have talked to people who are still under the yoke of the colonial system in their countries and outside of their countries. And there is a general consensus that in terms of priorities, self-determination and freedom is more important to them than any temporary advantages or any temporary results that they might get from the continuing development of that particular economy as a matter of fact, in every country that I have been in, the economic development after independence, and after self-determination, after people were able to get their political rights and their economic rights, was much more rapid than it was under the circumstances which prevailed prior to independence.

Chairman REUSS. In your prepared statement you have this sentence: "International support for the gold mining industry—in the first place with an unlimited demand at the official price from the U.S. Federal Reserve bank, and now with a guarantee against falling prices and balance-of-payments problems, from the IMF—has not been beneficial to the workers in the industry." I want to ask particularly about the nature of the 1969 agreement. Where in that agreement—here you may want to ask your associates for some legal help—where in the 1969 agreement is a commitment by the International Monetary Fund to buy South African gold, for balance-of-payments reasons or for so-called kitty reasons under section 3 of the agreement, set forth?

I say that because Secretary of the Treasury Shultz in his letter to you of August 9, 1972, which has been made a part of the record, implies that the 1969 agreement was all to help the rest of the world and not to do anything for South Africa. And yet it is a fact that in 1970 the International Monetary Fund bought $208 million worth of gold under the $35 an ounce provision, it bought $262 million worth of South African gold under the balance-of-payments deficit provision, it bought $129 million under subsection 3, the so-called kitty provision, and it bought about $38 million worth of South African gold under various miscellaneous provisions. And then in 1971 it bought $127 million of South African gold under the balance-of-payments provision.

Was the IMF obliged to make these purchases under the 1969 agreement, or were they simply made gratuitously even though it did not have to be done? The effect is the same, even though legally I would be interested to know.

Representative DIGGS. With your permission, I would like to yield to Miss Rogers, my special consultant on this subject.

Chairman REUSS. Do you understand my question?

Miss ROGERS. Yes. I do.

Chairman REUSS. I have to say that as I read the agreement of December 1969 I can't find any language specifically imposing an obligation on the IMF to buy these hundreds of millions of dollars' worth of South African gold.

Miss ROGERS. Well, Mr. Chairman, my impression is that the agreement is very much behind the scenes, and if you like, a gentleman's agreement, but leaving out 99 percent of the gentlemen involved who are down the gold mines.

In fact, I agree with you that it is very unsatisfactory that there is no clear requirement on either party, and on the part of South Africa that it violated the agreement, if it can be called violation. In particular, in selling gold to Switzerland, this is a straightforward violation of the terms of the agreement. And in particular there is the one point that was stressed in Mr. Volcker's letter to the managing director of the IMF. I have correspondence here, which I hope will be inserted in the record, where he states his position on the agreement. I quote: "Assuming that there is an understanding among Fund members generally that they do not intend to initiate gold purchases directly from South Africa." This is one instance where South Africa has violated the terms of its understanding, if it is no more than that.

Chairman REUSS. For how much and when?

Miss ROGERS. Well, it was only reported in outline, and I don't have any amount. If one was reported, I have missed it. The whole question of gold sales is extremely vague, because in the case of the Soviet Union nobody knows what it sells and when.

But this is perhaps a technical point. South Africa has taken full advantage of the agreement, because between a year and 18 months after the agreement it salvaged its entire balance of payments by selling to the IMF. But since it has had a stable balance it took very great advantage, first by not selling any to the IMF. Particularly, it had been withholding about one-third of its entire gold from the free market. While this is in the letter of the agreement, it is violating the spirit of the agreement.

Chairman REUSS. Would you mind going over that again. I really could not hear it.

Miss ROGERS. My first point is that South Africa has violated the letter of the agreement and the provisions which Mr. Volcker made particular mention of, by selling gold to individual central banks.

My second point is that it has violated the spirit of the agreement by withholding one-third of its production from the free market at a critical time for the free market price.

My third point is that, to answer directly your question, there is no obligation as such on the IMF, because the agreement is so vague, but it has complied absolutely with both the letter and the spirit of the agreement on its side, in fact one might say that it has leaned over backward to act in a way favorable to South Africa. And it is for this reason—quite apart from our opposition to the gold-mining system in South Africa—it is for this reason that we oppose the 1969 agreement, because we think it to be one-sided. South Africa took advantage of it. And the IMF has complied absolutely with it, to no great advantage of the international system.

Chairman REUSS. However you arrive at it, the fact is that in the last 3 years, at a time when gold was supposed to be a diminishing asset in the world monetary system, the International Monetary Fund has in fact bought approximately $800 million worth of gold from South Africa. To the extent that it has done so, South Africa has been able to play its monopolist speculative game. Recently it has withheld gold from the market, and played its part in sending the price of gold up to $70 an ounce, which has scared the hell out of international monetary types, has it not?

Miss ROGERS. Yes. This is our point.

Chairman REUSS. Does it seem to you a rational way to run an International Monetary Fund, to give your antagonist a weapon which he can then use to do you in?

Miss ROGERS. Well, Mr. Chairman, it seems to me totally crazy to do a thing like that. Because South Africa's interests as a country are almost directly opposed to the interests of the international community, and in particular of the United States, because what we need is a rational, not a fluctuating, system of international payments, which will finance increasing trade activity in the international sphere—as the IMF in its basic charter at Bretton Woods points out. And South Africa's activity has been that of acting in its own best interests—which may not be the interests of its own people, but that is another question. But South Africa's interest is directly opposed to that of a rational monetary system.

Chairman REUSS. What specifically would you—either Mr. Diggs or Miss Rogers—recommend as a method of preventing further IMF purchases of gold or any other metals? Obviously because of the vagueness of the December 1969 agreement, tinkering with the agreement may not be enough to do it.

Miss ROGERS. Mr. Chairman, I understand that such Members of the Congress as were involved in 1969 were opposed to the agreement in the first place. And I don't see any reason why this position should change. I think it is a very simple matter, one simply terminates the agreement, as there is provision to do. It is unsatisfactory. And as you say, tinkering with it really won't help it. It is totally unnecessary to our purposes. In fact, we have searched for a good reason for the United States to enter into an agreement, and we honestly have not found one.

Now, it may be that the Treasury can come up with one. But on the face of it, it would seem far better to do away with the agreement.

This alone is not enough. Of course there has to be substantive reform in the monetary system, hopefully to diminish and perhaps finally abolish the role of gold as a monetary element. But our immediate purpose is to see the 1969 agreement ended.

Chairman REUSS. Mr. Conable.

Representative CONABLE. I must confess that I don't understand this development.

I would like to thank Mr. Diggs for a very comprehensive statement here that obviously should be studied by members of the committee.

What would be the immediate effect of terminating the agreement, Miss Rogers? What would it do to gold prices, for instance, in the short term?

Miss ROGERS. Well, sir, the immediate result would be nothing, speaking in purely international legal terms, because at the present time South Africa is not selling gold to the IMF.

Representative CONABLE. Yes. Obviously the price is far above the floor price.

Miss ROGERS. Yes. However, in terms of the general trend of discussion and the general atmosphere in a speculative market, I think that its effect—to what degree I can't say—its effect would be to diminish speculation, and to have a downward effect on price, which is what we are looking for.

Representative CONABLE. To what extent can South Africa move any gold it wishes to move into the unofficial market?

Miss ROGERS. It has absolute freedom to do what it likes, with the only provision that in a 6-month accounting period it cannot withhold more gold than the equivalent of its balance-of-payments surplus.

I would add that this surplus is not earned by an excess of exports over imports; it is earned entirely by the inflow of foreign capital, which is very much the result of the attraction of a high gold price. So you have a vicious circle, that South Africa is selling gold, and therefore it enjoys great prestige in the international money market, and therefore the capital flows in, and therefore it is in a very strong position to sell gold at the price it wants.

Representative CONABLE. Mr. Diggs, who owns the South African gold mines? Are they nationalized, or are they owned by some sort of international investors groups?

Representative DIGGS. They are privately owned.

Representative CONABLE. Is it domestically owned in South Africa, or by British interests, or by American interests, or by whom?

Representative DIGGS. I would say mainly foreign capital is involved in the South African mining industry. But there is domestic investment in there.

Representative CONABLE. Based on the labor practices that are enumerated here in considerable detail, they are obviously economic operations at this point, and you feel they would not be if gold were substantially lower, apparently. Has there been any movement in the direction of improving the working conditions in recent years, or is it absolutely rigid like most of the policies you have described here?

Representative DIGGS. The working conditions and general conditions affecting the majority in South Africa have deteriorated rather than improved.

Representative CONABLE. Including wages?

Representative DIGGS. In real terms and in relation to other elements in the economy, yes.

Representative CONABLE. So it is a purely exploitive operation both with respect to the reserves involved and the workers involved?

Representative DIGGS. There is no question about it, sir.

Representative CONABLE. And it is obviously, in your view, in the view of the studies you have made, resulting in very substantial economic benefits somewhere to somebody; is that correct?

Representative DIGGS. To those who are the beneficiaries of the investment.

Representative CONABLE. I must confess, sir, your statement is an eye-opening statement. And I hope it will have extensive study. Thank you.

Chairman REUSS. Thank you, Mr. Conable.

And I want to thank you and your associates, Mr. Diggs.

I would suggest that you may wish to prepare a letter and get the signatures of as many of your colleagues as you can—you can certainly get mine very readily—to the President saying that you are sick and tired of this behind-the-scenes conniving by the International Monetary Fund, and that you want the U.S. Governor and the U.S. Executive Director to promptly veto any further efforts to buy South African gold. To the extent that it is necessary to revise the December 1969 agreement, this should be promptly done. I would hope that you would undertake that. I think it would be a useful thing.

Representative DIGGS. Thank you very much for the suggestion.

Chairman REUSS. We are very grateful to you.

Without objection, all additional insertions will be received into the record.

(The following articles were subsequently supplied for the record by Representative Diggs:)

[Extract of Chapter 4 from "The Discarded People," by Cosmos Desmond (London, Penguin African Library, 1972)]

4. The Eastern Cape

The Eastern Cape Province is a vast area, encompassing a wide range of geographical and economic differences. It contains the busy industrial sea-ports of East London and Port Elizabeth, a number of fair-sized inland towns like Grahamstown and Kingwilliamstown, and sleepy rural hamlets dating back to the 1820 British settlers.

When the rains are good, which is not that often, the countryside is verdant and smiling. But the periodic droughts bring misery and suffering to many. As always, it is the poorest, the Africans, who suffer most. Around the sea-ports there is employment in the burgeoning industries, but in the rural areas and around the smaller towns the all-too-familiar spectre of unemployment, poverty, famine, malnutrition and stark starvation are to be found in the Black community.

Much as they desire apartheid, the Whites of Eastern Cape have a priceless economic asset in their impoverished Black neighbours, in terms of the vast labour pools of the adjoining Transkei, the most politically advanced and the only geographically consolidated of the Government's Bantustans, and the Ciskei, which exists as a scattered collection of seventeen separate pieces of land threading through the "White" areas of the Eastern Cape. The Ciskei does not form a coherent whole, but, in the words of the Tomlinson Commission, is merely an administrative unit.

The Transkei itself is of course crucial to the whole argument about whether the South African strategy of apartheid can be justified in any way. As the one African Reserve in the whole country which had a situation and history which lent itself to some form of territorial identity, it was made the showpiece of Dr. Verwoerd's new emphasis on "separate development". As a response to the shock to international confidence caused by Sharpville the separate development theory has served the Nationalist Government extremely well. But the Transkei today stands as evidence of what is meant by "development" and "self-government" in Nationaist practice.

The imposition of Bantu Authorities in the Transkei in the 1950s led, as happened in other parts of the country such as Sekhukhuniland, to widespread rebellion in 1960 and 1961 against the chiefs imposed or maintained in power by the Government. As the Secretary for Native Affairs told the Territorial Authority, 'Under the Bantu Authorities which you constitute you will be able to lead the people in a true sense. You will be able to tell them, not ask them, what to do.'

The rebellions were put down with considerable bloodshed and many were hanged in retribution. A state of emergency was declared in December 1960 which is still in force throughout the Transkei. Under Proclamation 400, the police and army have unlimited powers, and it is in these circumstances that 'self-government' was introduced in 1963. Even so the anti-apartheid party won an overwhelming majority in the first election, only to be submerged in the Assembly by a majority of Government-appointed chiefs. Since then the opposition has been systematically disrupted and crushed. Virtually all administration is in the hands of White South African officials and is rigorously enforced by the White police. All urban and administrative centres are in fact White enclaves within the Transkei in which apartheid is maintained without even a fiction of its being an African country.

Under its constitution, the Transkei Government has no say in its own defense, external affairs, internal security, postal and related matters, railways, immigration and frontier control, currency and banking, customs and excise. All legislation passed by the Transkei Assembly is subject to the assent of Pretoria.

After seven years of 'independence' and 'separate development' the Transkei is poorer than ever, and no less dependent on migrant labour. Out of a total population of some 1.4 million, 300,000 work as migrants in the Republic. Of the remainder, only 30,000 are in paid employment, and only 1,700 of them have jobs in industry.

The Tomlinson Commission in 1954 called for the redeployment of half the population of Transkei (then one million) in industry and in the urban centres, to relieve the extreme pressure on the land. Instead of this, the Government has swollen the population by its removals policy. The number of Xhosa 'repatriated' to the Transkei may be approaching a half million, according to estimates. Because of the state of emergency I was not able to visit any of these settlements or discuss conditions with the people, in spite of the fact that I have travelled through the Transkei during the last few years several times. Occasional reports reach the outside world of the desperate economic plight in the Transkei: queues of unemployed outside the labour bureaux; half the maize crop failed in 1969 and 1970; 20 per cent of the cattle died from drought in 1969; 40,000 infants died of malnutrition in 1967; an epidemic of tuberculosis affecting a fifth of the population in 1968—it is impossible to verify these reports, but all the evidence supports the view that conditions are deteriorating. There is no sign of a change in the insignificant number of jobs available in the Transkei; the Government-owned Xhosa Development Corporation has a total share capital of only R7 million, and approved loans of no more than R94,000 to Africans in 1968.

The Ciskei is backward, impoverished, little short of a rural slum, with an average population density of more than eighty per square mile (according to the Tomlinson Commission), which is considerably in excess of its carrying capacity. In figures, there are about half a million Africans crowded into the Ciskei's 2,185,000 acres.

The territory is further handicapped by the Government's policy of removing Africans from the Western Cape. Many of them have been resettled in the Eastern Cape, at Mnxesha, Ilingi and Sada. The first Government plan was to remove all Africans who were living to the west of 'Eiselen Line' (Kimberely/Humansdorp) near Port Elizabeth. The greater portion of the Cape Province lies to the west of this line, but later the line was drawn even further to the east and so the African inhabitants of Middelburg, Burgersdorp, Cradock and many other towns were doomed. This is known as the 'Kat-Fish Line'; it runs from Aliwal North, through Sterkstroom, to the Fish River. Beyond it, to the east, lies only a small corner of the Province, including the Reserves of the Ciskei.

The Government has in recent years become increasingly coy about furnishing statistics on the number of people being moved, so it is impossible to estimate how many new arrivals have been resettled in the Eastern Cape, particularly in the Ciskei.[1] The usual pattern that emerges is that the newcomers are unable to find work so they soon return to the Western Cape towns or go to the Rand as contract labourers, leaving the women, the aged and the children behind them for long periods to exist as best they can.

I presume that the reason for the special camps for 'redundant' people in the Eastern Cape is that people endorsed out from the Western Cape usually have no ties at all with any of the Reserves. Whereas in the less old established cities in other parts of the country it is possible to trace some tenuous connection for most Africans with a 'homeland', the majority of people in the Western Cape, and all their forebears, were born there.

In the Eastern Cape, with the notable exception of the Roman Catholic Diocase of Queenstown, I received more cooperation than anywhere else. I met a number of people who were fully aware of what was going on, were concerned about it and were trying to do something at least to ameliorate the conditions. The Border branch of the South African Council of Churches is very active and is doing excellent work in some of the settlements. A number of people were able to give me a lot of information, which they asked me not to publish. This was still very helpful in that when I went into the various places I knew exactly what to look for. Nevertheless I stress that I am only using information which I found, or confirmed, for myself.

MNXESHA

Limehill has become symbolic of the plight of Natal's rural Africans. In the same way Mnxesha has become a symbol for the Ciskei. As I travelled from Cape Town eastwards, the name kept recurring. Obviously conditions in this resettlement camp were more than usually atrocious.

When you have seen Morsgat, Weenen, Limehill, Stinkwater and so many others, it is difficult to be shocked or distressed by similar places. But one look at Mnxesha was sufficient to convince me that the reports I had heard had not been exaggerated and that here was grinding poverty, squalor and hardship equal to the worst places I had seen. There were the familiar, tiny one or two-room houses, many with a number of ragged, hungry-looking children or a bent old woman sitting outside. It was not quite true that I could no longer be shocked or disturbed. I was, in particular, by the sight of one tiny baby, a virtual skeleton, unable to move or even to cry and covered with flies. I have been through the children's wards in African hospitals throughout the country and over the past ten years have seen thousands of starving, dying children. But I doubt whether I

[1] See Appendix I.

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have ever seen anything worse than this. I cut short my tour to take the child to hospital.

Mnxesha is about ten miles from Kingwilliamstown, on the road to Alice. From the main road you can see that there is some kind of settlement, but the worst parts are not visible. The first people were 'settled' there in December 1967 with the aim of eventually accommodating 1,800 families (about 10,000 people). But by July 1968 there were only about seventy families. The main influx took place between December of 1968 and February 1969. This, I was told, was because once water had been laid on, the authorities in other areas pressed for the people to be sent to Mnxesha. The Minister of B.A.D. said in the House of Assembly on 4 March 1969 that 2,897 people, of whom 2,041 were children, had been moved there. Most of these had come from Middleburg (203 families), Burgersdorp (67 families) and Cape Town (39 families), with a few from a number of other towns. By May 1969, the official population figure was 3,400. My own estimate was much higher and seemed to be borne out by the numbers on the houses.

The first arrivals were put into wooden huts, with zinc roofs. The huts measured roughly 10 ft. by 16 ft. and 10 ft. high, with no ceilings or floors. There are ninety-nine of these which are still in use. In one of them, chosen at random, there were three adults and four children. I was assured that some of the others contained more. These people are mainly pensioners and indigents who do not pay rent. Obviously such huts are extremely hot in summer and cold in winter and the earth floors become very damp, even wet, in the rainy season.

The bulk of the houses are two-roomed, cement-under-asbestos structures with no floors or ceilings. Some stand alone, others are semi-detached so that they appear to be four-roomed houses, but are in fact two-roomed ones. The rent for these is R3.42 a month, including rudimentary sanitation services. In one of them there were thirteen children whose mother was working in Cape Town. Many, if not all, of the houses are grossly overcrowded. Because of the number of widows and pensioners, the majority (53 per cent of the total in May 1969) of the householders are women. There are a few four-roomed houses for teachers and Government employes.

An official of the Information Office attached to the Chief of Bantu Affairs Commissioner's Office in Kingwilliamstown was quoted in the *Daily Dispatch* of 16 January 1969 as saying:

Redundant people are being moved to Mnxesha. The township is the same as Ilingi near Lady Frere and Sada near Whittlesea. We house redundant people. The people would be of no particular age-group and could not render productive service in an urban area. Among such people were men who had lost their jobs and could not find new employement, old and infirm people and unmarried mothers. The Government would provide the children with one substantial meal a day and rations would be given to the old and infirm people. Able-bodied men would be able to enter into contracts for work on the mines, industries and other avenues of employment. The provision of employment in the new village is receiving the attention of the authorities.

How much attention they gave the matter we do not know, but they evidently decided against it. In the House of Assembly on 4 March 1969, the Minister of B.A.D. said that the Government was not contemplating establishing any industries in or near Mnxesha.

By May 1969, more people had arrived from Middelburg and others were still coming. These, and many of the others, were victims of the Government policy of moving all Africans to the east of the Kat-Fish Line. Since this had been the intention for some time it seems that little or no development of African locations in towns west of this line had been made. So, at Middelburg, the Government had built a large new coloured township, but had for many years done nothing about the African location where many people were living in tin 'pondokkies'. Conditions were thus far from satisfactory, but they did at least have better facilities than they found at Mnxesha. At Middelburg there were two established schools, a clinic with a permanent staff, lighting in some of the streets and a satisfactory water and sewerage system. Rents were R1.75 a month for a two-roomed house, R4 a month for a three-roomed house and R2 a month for a 'private stand'—at the time of the removal this was increased to R6 a month, presumably to encourage people to 'agree' to move. Many people at Mnxesha were quite adamant that they had been employed, reasonably housed and very much wanted to stay at Middleburg. But, as one said: 'You can't say no to a White man.'

They said they were told by an official that at Mnxesha they would have proper houses with a bath and a stove; there would be shops and other facilities and special bachelor quarters with their own kitchens and cooks. Others claimed they were told that if they did not move dogs would be set on them. Some were told to settle their families in Mnxesha and return to work in Middelburg. Those who owned their houses at Middelburg were promised compensation at the time of the removal, but some said they had received it several months after the move. The highest compensation that I heard of was R240 for a four-roomed house; others received between R25.25 and R80.

By the time of my visit the health facilities had improved considerably; previously, I was told, they were virtually nonexistent. A qualified nurse was appointed in May 1969 to run a free clinic, with a doctor visiting once a week. Until that time a nurse from Mount Coke had visited once a week. But the charge was 20 cents, so most people could not afford treatment. There was also a T.B. clinic once a week. Free medical treatment was available in Kingwilliamstown but the return bus-fare of 40 cents was prohibitive. There was (and still is) a free ambulance service. But the African superintendent has to drive four miles to the nearest telephone to call it and this telephone does not operate in the evenings or at weekends. The district surgeon ran a clinic about three miles away. He normally charged R1.50 for an adult and R1 for a child, which was well beyond the means of most.

The signs of malnutrition are obvious throughout the settlement and there have been many deaths. In May 1969 there were over ninety graves, of which over seventy were children's. The bulk of the population only arrived in December-February 1969.

There are now taps in the streets. These first appeared in February 1969. Until then water was brought in once a day Monday to Friday, twice on Saturday and not on Sunday. The people were told to boil the water before drinking it. Pit latrines are provided but they appear to be very shallow and are prone to overflowing.

Almost half of the men are migrant workers. The only employment in the area is on the building of houses in the settlement, for which men are paid R16.50 a month. Women are paid R6 a month for such work as planting grass in the settlement; this work is a form of poor-relief. In the beginning there was some employment in the settlement for one person from almost every house. But now there are many with no wage earner, who are provided with rations each month.

People complained that the rations were issued irregularly and that it appeared they were being cut down. Some said that the rations lasted them only two weeks: 'After that we have to pawn our clothes in order to buy food at the European store.' There are no shops in the settlement. The nearest one, which is White-owned, is about two miles away; there is another one and a Post Office about four miles away. The Border Council of Churches is subsidizing the sale of milk and soup powders. There is no fuel available in the area; I passed some children carrying wood four miles from the settlement. At first wood was being sold for 35 cents a bag and then for 25 cents. It is now being sold for 15 cents, the balance being paid by a relief organization. But even with this subsidy, wood was piling up with the distributor because the people could not afford it. A number of people have been fined R10 for trespassing while in search of fuel.

At Middleburg, and some of the other places from which they came, some of the people had been receiving maintenance grants of R5 a month for every child. But these grants are only applicable in urban 'Bantu areas', so they lost them on their removal to Mnxesha, which is a rural township. The Bantu Affairs Department in Zwelitsha had said that they would apply to Pretoria to make the grants applicable to Mnxesha.

A lower primary school was opened on 14 March 1969. Before that, the children had to walk about three and a half miles to school and often arrived exhausted, which was not surprising considering their undernourished state.

No matter how bad a settlement is there are usually some people, who have come from White farms, who prefer it; this is true even at Mnxesha. In general, the people from the towns did not want to move, but some said that, despite all the hardship, they were 'happy' because they felt that they had some security and were free from continual harassment about reference books. For example, at Middelburg many had to report every month to have their book stamped and they never knew when it would be the last time.

The sufferings of the people at Mnxesha are exemplified in the case of Mrs. E. M. She arrived at Mnxesha from Burgersdorp in December 1968, with her six children. By May 1969 two of the children had died; two others, aged thirteen and six years, had 'gross pellagra' according to a doctor; another younger child was in hospital with malnutrition. She is a widow and was supporting herself in Burgersdorp by doing domestic work; now she has no employment. She is only thirty-seven years old and so does not receive a pension. As Mnxesha is a rural area she cannot get a child maintenance allowance. Since she went to Mnxesha she has had no source of income apart from the few cents which she manges to earn by collecting wood from miles away and selling it in the settlement. She has taken her children to the nurse several times but because she did not have the 20 cents they were not attended to. She was receiving Government rations, which were obviously inadequate.

About one and a half miles from Mnxesha there is a growing settlement for pensioners and their families, called Emadakeni. In May 1969 there were sixteen mud huts, measuring about 10 ft. by 15 ft.; the roofs were also mud with a layer of tarpaulin in between. There were no windows, only two small openings. These huts housed more 'redundant' people from town locations. They did not pay any rent for the mud houses, which were certainly inferior to the normal farm house. There were no toilets provided and there was no sign of any having been built by the occupants of the sixteen huts. There was a water tank which was filled by a tanker. Some were building their own houses, for which they had been given doors and windows, a few yards away. Some of the people in the wooden huts at Mnxesha had been given plots at Emadakeni and told to build their own houses. A dozen or so wooden houses had recently been erected on this site.

ZWELITSHA

There are two big townships in the area, Zwelitsha and Mdantsane. Zwelitsha, which is three and a half miles from Kingwilliamstown, was started in 1949 and planned as a town in itself for 'landless Natives and full-time industrial workers from the over-populated Ciskeian Reserves'.[2] (Further evidence that the land shortage and overpopulation in the Reserves was recognized as long ago as 1949.) But for some reason the building was halted in 1958, after 993 houses had been built. Building recommenced in 1963 and since then the population has more than doubled with people endorsed out from towns in the Western Cape.

The township is on Bantu Trust property and so is classified as a rural township. This means, according to local informants, that the residents are not allowed to seek work in near-by Kingwilliamstown; the labour-force required there is drawn from the municipal location and the coloured population. There is a large factory just opposite the township, the Good Hope Textile Company. According to Professor Hammond Tooke,[3] the township was sited adjacent to the factory in order to ensure employment for the residents. I was told that the factory employs between three and four thousand people, but that many of these come from the rural areas of the Ciskei and the Transkei. My informants said that the wages were very low (starting at R3.15 a week), because the people from the rural areas were willing to accept anything. Every day there was a queue of about a hundred people from these areas looking for jobs. Therefore, they said, most of the men from Zwelitsha did not work there. Many of them return to the towns from which they were endorsed out, leaving their families at Zwelitsha. They become 'single' men living in a hostel, which satisfies the authorities because they are no longer residents of the urban area.

The rents are between R3.90 and R5 a month. If the residents fall into arrears with the rent, a policeman goes round and locks up the houses. They go to court and, if they cannot pay, are evicted. Many of them then look for a place in one of the rural Trust villages. For example, one such village about seven miles away, was planned for four hundred people; there are now about two thousand. On some plots there are four or five sub-tenants. I was told by a person who had at one time worked for the B.A.D. that the authorities turn a blind eye to this and to the development of slums which must inevitably follow.

MDANTSANE

Mdantsane is a large township about ten miles from the town of East London. It is by little more than a legal fiction that its residents conform with the

[2] Prof. W. D. Hammond Tooke, *The Tribes of the King William's Town District.*
[3] Ibid.

requirements of being outside a White urban area. The township is in a Reserve area but is almost surrounded by the East London municipal area.

In May 1969, the population was officialy 58,000. Unofficial but well-informed estimates put the figures as high as 120,000. All the people from Duncan Village, a shanty location near East London, are to be moved to this township. So far, about half of them (37,000) have already been moved. The residents from West Bank municipal location in East London have also been moved in. The others have come mainly from towns in the Western Cape, from which they have been endorsed out in furtherance of the Government aim of moving all Africans from the Western Cape, looking for employment. So many people have flocked in that it has not been necessary to compel people to go there. Many people have been evicted for non-payment of rent; they then move in with friends or relatives in the township, causing great overcrowding.

The people at Mdantsane find some employment in the industries of East London, which is conveniently situated as a "border area", with the advantages that this carries for industrialists. Some factory owners in East London say that a year ago they had an average of ten people a week looking for jobs; now they have forty a day.

There are the usual township facilities, but Dr. J. H. Moolman, M.P., in the "No Confidence" Debate in 1969, pointed out the deficiencies of the place. He said that there were thirty-two schols but more than half of them had no staff; there was not a single public telephone; there was no resident doctor or hospital and no pharmacy; there was no form of entertainment.[4] And of course there is the usual problem of increased rents (R6.75 and R8), and bus-fares 12–15 cents a day).

MOUNT COKE

At Mount Coke there is a big Methodist hospital and very little else. All around there are the usual Trust villages. But just a little way from the hospital there is a strange-looking settlement. It consists of about forty wooden huts, similar to those at Mnxesha, all huddled together. I was told that the African superintendent lived about three miles away at the Reformatory of which he was the principal and that I should go to see him to find out about the place. I went but he, very politely, explained that he had strict instructions not to give any information about the settlement. So I had to return and find out what I could for myself.

It appears that this settlement started off about five years ago as a transit camp. At first people stayed a year or two and then moved on. But for the last two years only a few people have moved on—to Sada. It now seems to have become a settlement for pensioners, some of whom have been there since the establishment of the settlement and presumably will stay there. In May 1969, about twenty-five of the huts were occupied, all by old-age pensioners or disabled people. There were also a number of small children; most of them are the illegitimate offspring of the inhabitants' children who either cannot afford to support them or cannot have their children with them in an urban area. The old people whose children could assist them were able to get a house in Zwelitsha.

These old or disabled people are mainly "rejects" from farms in the Karoo who were evicted when the "five labour-tenants law" was enforced; there are also a few "redundants" from urban location. The Secretary of the Farmers' Union denied that these people had been evicted from farms. However, one family was found living in an old motor-car and another in a cave, after having left a farm, and other people said that they were evicted, put on a train to Kingwilliamstown and then brought by lorry to the settlement.

They receive a pension of R5.05 every two months and rations every three months. The rations are in the form of a coupon, valued between R3 and R6, to buy food at the local store. They also receive skimmed milk when it is available and Pronutro (though they were not receiving the latter when I visited). Fruit from a Government farm, which is rejected at the market, is sometimes dumped there. About a ton of rotting pineapples was once dumped (so that the statistics can show that seventy-five people were given one ton of fruit in a year).

They do not pay rent for the huts and between them they have two taps. The people complained about the lack of food and general poverty but the general attitude was that experience has shown that it is no use complaining. One old person commented: 'Death is a release from such a place.' They said

[4] Hansard, No. 1, col. 144 et seq., 1969.

that they had been better off on the farms. Those at Sada said they had been better off here, which does not say much for Sada.

Malnutrition is widespread in the surrounding Trust villages. Some of the staff at the Methodist hospital said that this was due to a great extent to the ignorance and wilful neglect of the people, despite all the Government was doing for them. The hospital is 90 per cent Government subsidized.

KOMGA/MOOIPLAAS

There are also a number of Trust villages in the Komga-Mooiplaas area. Most of them have been established for some time and are of the usual pattern, which means that while the residents have a little land and a few cattle they are basically dependent on the income of migrant workers. When there are a number of Trust villages in an area you can generally assume that there will also be at least one 'closer settlement' for the 'left-overs'. In this area there is one called Sotho Township, seven miles from Mooiplaas. At the time of my visit, May 1969, there were about 150 houses. These people had been coming in, in ones and twos, over the past twelve years, mainly from White farms in the Queenstown, Kingwilliamstown and East London districts. An occasional one still joined them.

As a variation on the 'closer settlement' theme, they pay R1.50 a year for their 50 yd by 50 yd plots, instead of the usual R1. They have no land for grazing or ploughing. There is no employment in the area, except for a few White farms. The men work in East London and further afield; many of the women also have started going to East London to work. The bus-fare to East London is R1.30 return.

All of these people had to provide their own transport to the settlement and erect their own temporary shelters while they built their houses, which, in general, they have done very well. It is a common feature of such settlements that the people themselves make such efforts to build decent houses and to overcome the hardships imposed upon them that a casual observer might look upon them as prosperous rural villages. He might not realize that they have had to build this from nothing; he might not notice that there are no shops or other facilities; that they have no land nor cattle; that, most importantly, there are no men, because they are all migrant workers.

At Sotho Township a doctor visits once a week; the nearest hospital is in East London, thirty-six miles away. There is a dam and one borehole.

The nearby White farmers have complained that there is a lot of stock-theft and the Bantu Affairs Commissioner has assured them that these people will be moved again.

QUEENSTOWN

My main intention in going to Queenstown was to visit the notorious settlements of Sada and Ilingi, which were established to house people endorsed out of the Western Cape. On my arrival in Queenstown, I was virtually arrested and subjected to interrogation and a small dose of brain-washing—not by the police but by the clergy! I arrived a little tired and rather dusty and was immediately hauled off to the Roman Catholic Bishop, my request for the opportunity at least to be able to have a wash being brusquely dismissed. The Bishop, untimely aroused from his siesta, at first seemed just as bewildered by the whole affair as I was. But he soon warmed to his theme and argued that it was not fair to do any report or survey of Ilingi and Sada at that time because these places were still being developed. Actually, thousands of people had been living there for six years. He said that the Government was doing its best to rehabilitate the residents and that they were better housed than they had been on White farms. Some of the 'better houses' consist of one room, for ten or more people, about one-quarter of the size of the room in which the Bishop was speaking. I was eventually released, after having been warned that I would not be able to get into Ilingi anyway and that I was not to involve any of the local clergy in helping me. Before I had had time to leave the town, which I was in a hurry to do, the Vicar General was sent, in an enormous Mercedes, to repeat the warning that anything I did, I did on my own authority and at my own risk and that I did not have the Bishop's blessing—which I had not asked for in the first place.

ILINGI

Despite the Bishop's prediction, there was no difficulty at all about getting into Ilingi. I drove straight into the settlement and at every house I went to, or in any group I met in the streets, I found people only too willing to talk about their conditions.

Ilingi is about thirteen miles east of Queenstown, in a beautiful but bleak setting and far away from the public eye. It was started about three years ago and when I was there, in May 1969, there were about a thousand houses, stretching along the side of a valley completely exposed to the wind, the sun and the snow. The majority of the houses consisted of two rooms, one built of corrugated iron and the other of brick, each about 10 ft square; these were the more recently built ones. The first arrivals were housed in wooden huts, similar to those at Mnxesha, and later ones in one-roomed corrugated iron huts. These wooden and corrugated-iron structures were still in use. Rent for the one room was R1.50 a month and for two rooms, R2.40. Pensioners did not pay rent. A batch of two-roomed concrete houses, with iron or asbestos roofs, was being built.

The people of Ilingi have been evicted from farms or endorsed out of location in Uitenhage, Colesburg, Cradock, Cathcart, Molteno, and the Western Cape generally. The population is increasing all the time as more and more people from the Western Cape towns become 'redundant' or unwanted. Some of the people claim that they had been in employment in the towns from which they were endorsed out. They then leave their families in Ilingi and return to work. There are also about forty former political prisoners, mainly ex-members of the banned African National Congress, from Port Elizabeth, who have been virtually exiled to this settlement.

The first thing that everyone I spoke to complained about was the complete lack of fuel. There were no trees in the area and all fuel had to be brought in. A lorry-load cost R12 and was the most economical way of buying it, but few could afford to buy in such bulk. I was shown some sticks, about a foot long, for which they had paid one cent each. But this was only the beginning of their complaints. They said they had been cold throughout the winter, had insufficient room and were hungry. Most of the people I spoke to had come from farms and so complained of having no land or cattle. They said that on the farms 'saphila ngenyama'—'we lived on meat'. The signs of hunger and malnutrition were obvious. When a local missionary asked what he could do for them at Christmas, they replied, 'Bring us food.' Ilingi and Mpungamhlophe are the only two places I can remember where people came to me begging for food and clothes.

Some of the people said that they preferred to be there in that at least they were free from harassment, but they too agreed with the complaints of the others. Another complaint was that they no longer received rations, but one member of the family had to work in the settlement for R5 a month, if they were in need of relief. I had heard elsewhere that if there was no man or woman capable of working and the family was destitute, one of the children was forced to leave school and work in the settlement. I put this to a group of young people and they agreed that it was the case. The work they are given involves weeding and picking up stones, which appears to be intended just to give them something to do. While there is doubtless a lot to be said for providing employment rather than simply handing out rations, it still seems hard on women and children to have to work for a whole month for R5. It is hardly their fault that they or their husbands or fathers are not employed elsewhere; there is no employment for them.

About three hundred men are employed as drain-diggers and general labourers at R16.50 a month; about thirty-six as bricklayers at R24 a month, and seven as tractor drivers at R24 a month. The others have to apply for labour contracts as migrant workers in the industrial areas of the Republic. They are not allowed to seek work in Queenstown. Some of these people were endorsed out of Ilingi because they had lost their employment in the White urban area; now they have even less chance of ever finding a job.

Just prior to my visit a second primary school was opened; previously there had been one school with nearly a thousand pupils and nine teachers. A clinic was started at the end of 1968; a nurse and a midwife are on call and a doctor visits once a week. Many people said that, at the beginning, hospitals cases had to wait until there was a lorry-load. It was not clear whether this was still the case. There was a small shop, but it was a couple of miles from other sections of the settlement; people in some parts of the settlement said that there was no shop, presumably considering that the place where the shop is was not part of the same settlement. The nearest urban centre was Queenstown, to where the bus-fare was forty cents return. A Post Office had recently been opened, and there was a police station.

There were a number of pensioners in the settlement who were no longer able to work on farms, or were 'non-productive' in the urban areas. They were receiving a pension of R6 every two months. It appeared that they were the only ones receiving rations, which are much the same as those as Mnxesha.

I was told that there had been plans for a dam, but they seem to have fallen through. There were a few taps in the streets—one for about every forty houses. It was recently announced that a handicraft centre is to be built at a cost of R65,000, and also sports facilities, but there was no indication as to when these will be completed; nor was there any sign of industries being established in the area.

SADA

The conditions at Queenstown's other infamous settlement, Sada, have been known for some time. Before visiting there, too, I had to listen to a long lecture from the local Roman Catholic priest on the mores of the 'natives' and all the Government was doing to help them. I then went into Sada and found it to be a slightly larger edition of Ilingi—the same tiny houses, the same evidence of poverty and overcrowding. I went into Sada to visit the new Roman Catholic church, a large edifice standing rather incongruously among the shacks. But the superintendent had no qualms about letting me look around. He saw nothing wrong with the situation and obviously thought that he was doing a good job for the 'native', as I suppose he is according to his lights.

Sada is three miles from Whittlesea and twenty-four from Queenstown, in the midst of a rural area. The housing covers roughly two square miles. When I was there, about one thousand four hundred houses were occupied and a further three hundred were to be completed and occupied within the next three months. These people are mainly 'squatters' from White farms, but some also come from locations in the Western Cape, and even from the Orange Free State. There are a number of pensioners, widows and unmarried mothers. The population consists mainly of families with no income, though there are also a number of families of migrant workers.

The house-types are even more varied than at Ilingi. The first houses, erected about five years ago, were one-roomed wooden huts with mud floors, no ceilings and a small window at each end; they are still in use. Then a number of one-roomed asbestos huts with corrugated-iron roofs were put up; some of them are still in use. Then followed an attempt to mould walls from local earth. They cracked and were washed away; there are none still standing. After this, one-roomed corrugated-iron huts were used. Later one room of concrete or brick was added to these huts. The most recent houses are built of concrete or brick with either two or four rooms. But some of them have an outside door in each room so that a separate 'unit' can be accommodated in every room.

Very few of the people can afford to buy a stove, so many of them have to cook in the open; they usually build a mud wall as a shield against the wind. But on the day I was there it was raining and, in a number of the houses which we visited, the people were huddled around a brazier or an open fire in the middle of a room full of smoke. The thorn trees and dung from the surrounding countryside had by then been almost completely used up, so the people had either to buy wood or travel long distances to collect it. Farmers near by sell wood at R9 a load; three sticks, each a foot long, cost five cents.

People are said to go to Sada 'voluntarily' but, as we saw in the official statement about Mnxesha, Sada is one of the places for 'redundant' people. Some of its residents claim that they were led to believe that they were coming to a much better place; for others the choice was either Sada or nowhere; some, from White farms, do prefer it. My guide, a Roman Catholic missionary, explained that 'the native' liked to live in such placed with his own people and did not want to mix with Whites. He asked one woman, living in a four-roomed house, whether she preferred this place, and beamed with approval when she said she did. But he was rather taken aback when, asked why she preferred it, she replied, 'Because we are near to the White people.' I also noticed that he always phrased his question: 'You like it here, don't you?' To which almost any African would give an affirmative answer, realizing, quite rightly in this case, that it would be pointless to say anything else anyway.

Families entering or leaving the settlement require a permit from the magistrate at Whittlesea, who is also the Bantu Affairs Commissioner. Police patrol the settlement at night to prevent people from entering and settling illegally. The people who might try to enter are those who have been evicted from the White farms and have nowhere at all to go; it is not a question of leaving their homes in order to settle at Sada. It shows how desperate the plight of some people must be if they will try to settle illegally at Sada.

Many of the men are migrant workers and many are unemployed. About 120 are employed in the brickyard, and others on building houses and roads. The standard wage for those employed by the Bantu Affairs Department as labourers is R16.50 a month. Some seven hundred women are employed by the superintendent, in cleaning and weeding the settlement, for R5 a month. This wage, as at Ilingi, is in lieu of rations. A few work on the local White farm. When extra labour is needed by the Government forestry department, a few fortunate ones are employed at R10 a week, plus food. The brick factory was started by the superintendent primarily to make bricks for building at Sada. It can produce for more than needed at Sada but, since the nearest railhead is at Queenstown, twenty-four miles away, there does not seem much possibility of these being marketed. This would also seem to preclude the establishment of any other industry in the area. But, again, as at Ilingi, Mnxesha and many other settlements, many of these people were sent here because they were unemployed, and the intention seems to be either to keep them thus or to make them full-time migrant workers.

The Moravian Mission has started a sewing centre, which will be able to train some women and help them to gain an income. Having failed, after repeated attempts, to obtain a site for this purpose in Sada, the Moravians decided to build the centre on their own church site. The Department fo B.A.D. recently announced that it is to build a handicraft centre at a cost of R65,000; the building was being erected when I was there. As with the proposed centre at Ilingi, it is not clear whether this is to provide employment for the residents or is to be a training institution.

At the time of my visit about 45 percent of the people were living on Government rations. They were given monthly vouchers, valued at R1.70 for an adult and R1.40 for a child, by the superintendent and exchanged them at a shop in Whittlesea. There was then no shop at Sada, though the buildings had been completed and the prospective shopkeeper was there—living in the house which had been built for the nurse who had not yet arrived. People were attending the clinic at Shiloh, two miles away, where there was a doctor in attendance once a week. The superintendent called an ambulance to take urgent cases to the hospital in Queenstown.

There were the obvious signs of malnutrition everywhere. This was due partly to the poverty of the people and partly to their lack of education in nutrition and diet. Milk was available but it was not used very much. Some people spent what little money they had on more bulky but less nutritious foods; others could not afford it anyway. A soup kitchen was provided by the superintendent but only about half of those eligible made use of it. This may seem surprising in view of the high incidence of malnutrition. But many of the people having spent their lives on farms, are not aware of t he nutritive value of the soup. Also, the object to having to drink the soup on the spot; they would prefer to take it home and share it with the rest of the family. Another consideration is the apathy engendered by poverty and the whole social system. The plight of these people also illustrates one of the many contradictions in the practical application of the Government's policy. Officially the policy is to uphold the traditional African way of life. Yet what could be more untraditional than herding thousands of people together in a place like Sada? If people are to adapt to and survive in such an environment, they must firstly have employment and secondly be educated in the use of modern food products.

Water was pumped from the river into two concrete tanks each containing 20,000 gallons, near the camp and from there it was piped into the settlement, where there were taps every hundred yards or so. This seemed adequate for everyday purposes, but it was not sufficient to the allow the use of hoses for watering gardens. Most of the people attempted to grow a few mealies, pumpkins and other vegetables on their tiny plots; some kept a few chickens. They could have their plots ploughed for R1.

Two lower primary and one higher primary school had recently been opened. Previously the children had to go to Whittlesea or Shiloh, both about three miles away. The secondary school had been completed but it could not be used because the sewerage was not ready. The higher primary school had 340 pupils and six teachers; the total school-going population was about 1,200.

HERSCHEL

It was with some relief that I left the diocese of Queenstown and headed for Herschel, hoping to meet some clergy who would be more cooperative, though knowing that the Herschel Reserve is one of the poorest in the conutry and has more than its share of resettlement problems.

The whole of the magisterial district of Herschel, apart from the two villages of Herschel and Sterkspruit and a few Mission stations, is an African Reserve, which is obvious enough when you drive through it. It is approximately 514 square miles in area and has an estimated population of 75,000. A lot of the area is mountainous and most of the rest is badly eroded, so there is not much left for cultivation. What is left is not very fertile, since the whole region is very dry. According to the Tomlinson Report, the Herschel area is one of the most badly eroded in the whole country, yet at the time of its study had a population density as high as a hundred per square mile.

The people used to be spread out over the land, in particular on the mountain sides. But now they are grouped close together in Trust villages. The replanning of the area began in 1961–2. There are about twenty-one major residential areas and several smaller ones. The resettlement went smoothly, with a couple of exceptions. In one place, Jozana, the people repeatedly cut the fences as soon as they were erected. Their view was that once the land was fenced it was no longer theirs. Eventually police were sent to guard the fences and one man was allegedly shot by them when the people attacked the police. Nothing further happened about the matter and after the people gave way and "agreed" to move. In another place, the people were very much opposed to moving but the headman was in favour. They tried to persuade him to join them in opposing the resettlement. But he would not agree, so they burnt his house down.

The old people objected to moving because, apart from the great inconvenience and expense involved, they did not like to move away from the graves of their ancestors. This complaint is common to all resettlement areas. It has additional weight as an *ad hominem* argument, when it is remembered that the authorities who are implementing these schemes claim to be upholding the traditional way of life, in which the ancestors and their graves figure prominently. The younger ones felt that, while the official reasons were to prevent soil-erosion and make communication easier, the real reason was so that there could be greater control. Most of the new settlements are near the road.

The grazing and arable land is allocated by the headmen and councillors: the amount of arable land per family varies from nothing to six acres. The people complain that the headmen and councillors keep the biggest and best portions for themselves and that they have much less land than they had before. This is particularly true of the old and widows. In some villages the land is divided only into grazing camps, with no arable land available. Young men setting up home are given only a residential site, as are those who are endorsed out of towns. People also complain that the compensation they received for their houses was most unsatisfactory, for example R5 for a rondavel and R12 for a four-roomed house. Many had to borrow money to build their new houses. Sometimes, they say, the arable land is too far away to be of any practical use. The area is supervised by agricultural demonstrators and people are fined R10 if they plough without permission or if their cattle stray on the arable lands. Cattleculling, always a very sore point, was due to start shortly. There is a school and a water supply in each village. The people are expected to make their own pit latrines, which very often they do not do. There is a Mission doctor, a district surgeon and two Government-subsidized hospitals in the area.

A number of dams have been built but nobody has heard of any irrigation schemes. There is a very large dam near Sterkspruit, the main purpose of which, although it is within the Reserve, seems to be to provide boating facilities for the White people of Lady Grey!

There is virtually no work in the whole area. Herschel Reserve is merely a labour-pool for contract and seasonal workers, since only headmen and councillors can possibly make a living from the land. As in other Reserves, White farmers come from miles away to collect labourers for the harvesting season. In

Kuruman and Taung they come from the Western Transvaal, in Sekhukhuneland they come from Brits, and in Herschel they come from as far as Bethal and Standerton, a distance of about three hundred miles. I saw hundreds of people waiting in the village of Herschel for the lorries to arrive. As in other areas, some of them go along just for the adventure, but for most of them it is their only hope for food to see them through the winter. In some cases at least, they have to pay R5 for being transported to the farm and back and then 70 cents for every bag of mealies they bring back. In one case the people claimed that throughout their stay they received only black coffee and mealie porridge; most of them returned suffering from pellagra. They complained also of being beaten with sjamboks. Often men and women are housed in one barn—with the result that many of the younger women return pregnant. They also claimed that many people who go to Bethal do not return. I heard of one case in particular where a schoolboy went off on one of the lorries early in 1968; after six months he wrote to his parents asking them to find out where he was as he wanted to return home. They were unable to do so and, by May 1969, he still had not returned and nobody knew where he was.

Many of the men work on the diamond mines on the South-West African coast, or in Cape Town, Johannesburg and other cities, returning home only once a year. The local clergy say that this has caused many broken marriages and other problems. Many men, on returning home and finding their wives pregnant, dismiss them. The women then return to their parents, who already find difficulty in supporting themselves.

All forms of malnutrition are obviously a problem throughout the Reserve. The doctor at the Anglican Mission runs a kwashiorkor home, where malnourished children are admitted and their parents can stay with them. The parents are shown that the children can be cured without medicine at all but just by a proper diet. But one doctor can hardly hope to be able to spread her teaching to the many thousands of parents of hungry children.

ORANGE FOUNTAIN

Near the White village of Herschel there is a settlement that must surely be unique in the whole country. Unique, not in its conditions, but in the curious fact that it houses most of the sheep shearers in South Africa.

From the road you look down on rows and rows of tin huts on a flat open plain. There is absolutely nothing else for some distance around. There are some 200 huts, of which about 150 are occupied, each with its own smaller tin hut which is the latrine. The place is called, for some unaccountable reason, Orange Fountain. The huts are made completely of corrugated iron, with a row of small windows high up at the back; they measure about 10 ft by 10 ft and have no floors or ceilings or insulation of any kind. The residents are allowed to build additions, which must be the same shape as the huts and approved by the local magistrate, who is also the Bantu Affairs Commissioner. They have to obtain his approval before erecting any structure, even a chicken run. (But when I was there, in May 1969, none of the residents had built any additions.)

All the householders have the one thing in common, that they are sheep shearers, but they come from many different places. They were living on farms or in locations in Middleburg, Burgersdrop, Bethulie and Colesburg. The ones who were living on farms were told by Bantu Affairs Department officials, and those in the locations by municipal officials, that they had to move. Some of those from Burgersdrop say that they objected to going. They were then taken to the police station and told that if they did not move they would be sent to prison and then moved anyway. Their passes were confiscated and returned to them when they reached Herschel, with the registration stamp changed to Sterkspruit. Some of the men from Bethulie say that their families were moved while they were away working. There seems to have been some arrangement between the agents of the Sheep Shearers' Companies and the B.A.D. to put all the sheep shearers in one place, so that they could be more easily collected when needed. Officials told the people that they had to move, but the agents of the Sheep Shearers' Companies provided the transport. The families were first moved into the remnants of houses of people who had been resettled in Trust villages at Pelindaba, Sterkspruit and Qoboshane in the Herschel Reserve. That was in May 1967; six months later they were moved into the tin huts at Orange Fountain. Again they were transported by the Sheep Shearers' Companies.

There is one hut per family, which in some cases that I saw numbered eleven. The rent, for what is no more than a tool-shed, is R1.50 a month. The people complain of the coldness and dampness of the huts; they say that during the winter some children literally died of the cold. Some of them sleep during the day when there is warmth from the sun and huddle around a fire at night. Those with many children try to get friends to give some of the children a place to sleep. They explain, with some embarrassment, that they sometimes try to house all the children somewhere else for the night so that husband and wife can be alone. Sometimes whole families have to vacate their huts when it rains, as the water comes up through the ground; they move into the empty ones on drier land. Many say that they brought furniture with them, having been told that they were being moved into proper houses, but had had to sell it after arrival because there was no room in the huts. The cooking, of course, has to be done outside. They are unable to collect wood in the vicinity, as people usually can in rural areas, so they have to buy all their fuel. Coal costs R1 a bag and wood 50 cents a bag. Some claimed that fuel cost them R3–R4 a month.

There is a dam and a pump a couple of hundred yards away; but there are no outlets within the settlement—there is nothing in the settlement apart from tin huts. Some of the people are trying to grow vegetables on plots that are only about 50 ft square. Two doctors visit near by. They charge R1 per visit, plus 75 cents for an injection; though one doctor claims that he would not turn anybody away if he genuinely had no money. The district surgeon also visits. The children attend school in a near-by village where, the parents said, they have to pay 20 cents a term school fees.

The men work from about July to November or sometimes until January. They are paid 4 or 5 cents per sheep, or 1 cent if only the hindquarters are to be sheared; an expert can shear up to a hundred sheep in a day. They are also provided with food while they are away. But they are not guaranteed employment for the whole time they are away; sometimes they cannot work for three or four weeks at a time because the farmer is not ready for them or because of the weather. While the men are away, their families can buy food on credit at the local store to the value of R8 a month. Their rent is also paid through the Sheep Shearers' Companies. Some claim that after six months' work they were left with only R6 after their rent and accounts have been deducted. The usual amount seems to be about R20; a few of the real experts, if they have been paid the top rate and been fortunate enough to have been employed for the whole season, would have considerably more. They also buy on credit during the off-season; so their wages just about cover their expenses.

When they return from shearing, they can take other contract work, if they can get it, for a short period, provided they are back in time for the shearing season. Those who had previously been living on farms had had cattle, which they have had to sell, and usually their wives worked on the farm; they themselves, when they returned from shearing, either worked on the farms or in the near-by town. Those from urban locations say that they were always able to find temporary work locally during the off-season. So they were once reasonably prosperous people. Now they have to work simply to keep themselves and their families alive in a tin hut. Is it any wonder that they turn to drink, as the local clergy and others said they do?

Certainly on the Sunday when I visited the place, a number were "under the weather," but they were sober enough to speak with feeling of the inhuman conditions in which they are now forced to live—eleven people in a tin hut, 10 ft. square. Some spoke of returning illegally, to their old homes; others were just resigned to their position; others were blissfully unaware in their drunken stupor.

The local Minister's Fraternal provides some relief. But it is a situation that calls for far more than material aid. The settlement is administered by the B.A.D. and it is significant that the residents of Orange Fountain come from the same places as the people at Mnxesha. Obviously, although they were not "redundant" or "non-productive", in terms of general policy they were not wanted in those places, so they were dumped here, which is very convenient both for the B.A.D. and the Sheep Shearer's Companies. They are out of the Western Cape, which is the most important thing for the B.A.D., and the Sheep Shearers' Companies no longer have to collect them from their various homes. It does not seem to matter that the people have lost their decent homes, their cattle and their supplementary sources of income and simply exist in order to get enough money to continue existing. When I visited them, they had been living in these conditions for eighteen months and there was no sign of any attempt being made to improve them.

LADY GREY

Nineteen miles from Orange Fountain, at Lady Grey, there is a similar-looking settlement, with the same tin huts packed even more closely together. When I went into the settlement the first thing people asked me was whether I had a permit, as, they said, not even an African is allowed in without permission from the location office. They were therefore rather nervous throughout our conversations.

The settlement consists of about 250 huts; they are in two groups, separated by a large *donga*.[5] The larger part has about 120 plots. Most of these plots measure about 25 ft. by 50 ft; on each of which there are two tin huts and two latrines. In some cases both huts are rented by the one family. But in many cases there are two separate families, which means that their plot is one quarter of the size of a normal township plot and one thirty-sixth of a 50 yd "closer settlement" plot. The rent is R1.90 per month per hut; it has recently been reduced from R2. A few of the people were using three huts, two on one plot and one on half of another, and so were paying R5.70 a month. If a visitor, and this includes a son or daughter who works elsewhere, stays more than three days, an extra 20 cents is charged.

These people were previously living in the town of Lady Grey. They were told to move in February 1967; some said that they were given only two weeks' notice. They were called to the municipal office and told that they had to move because they were living in a White area. At least two of the families, and probably many others, had title deeds to the property on which they lived. The property of one of them had been valued at £890 by the municipality in 1966; it had been given the same valuation by officials from Port Elizabeth in 1963; the owner was paying R20 a year in rates. She had not yet received or been promised compensation, but it seemed that her land and five-roomed house had not yet been expropriated, since she was letting it to a Coloured family. But another person who had title deeds demolished her house in order to take the zinc and fittings with her. Some of the others had been tenants on land owned by Coloureds.

There are a few taps in the settlement, the water being pumped from the dam which serves the old location adjoining this settlement. There are no shops, clinic or schools, the nearest being in the old location or in the town of Lady Grey. No fuel can be collected in the vicinity; wood has to be bought at 50 cents a bag and coal at 73 cents.

Some of the residents are migrant workers, but many of them work in Lady Grey—at the garages, hotel or shops, or as domestics. The garage workers are paid R5.50 a week; garden workers R6 a month; domestics less than that—in some places in the area, at least until recently, domestic servants living out were paid R2 a month; others up to R10 a month.

On the other side of the *donga* there are about forty similar houses, housing people who had to move from the location because their homes had been condemned, plus a few who went of their own accord.

Some of these people were moved from very good houses, as could be seen from the quality and amount of furniture crammed into the tin huts. Now they are cramped, sometimes wet and cold, at other times sweltering hot, and are paying an exorbitant rent for a tin hut and a tiny portion of land. But they are out of the White area and one more town has been 'cleared'.

[Extract of chapters I and III from "Labour in the South African Gold Mines, 1911–69," by Dr. Francis Wilson (Cambridge, U.K., Cambridge University Press, 1972)]

CHAPTER I

FOUNDATIONS

The subject matter of economics is essentially a unique process in historic time. Nobody can hope to understand the economic phenomena of any, including the present, epoch who has not an adequate command of historical facts and an adequate amount of historical sense or of what may be desired as historical

[5] A gully or ravine caused by soil erosion.

experience . . . The historical report cannot be purely economic but must inevitably reflect also 'institutional' facts.

JOSEPH A. SCHUMPETER, *History of Economic Analysis.*

Labour problems go back a long time in South African history.[1] Within the first decade of his arrival at the Cape in 1962, van Riebeeck was faced with a labour shortage which he alleviated—temporarily—by importing slaves. But the existence of slavery was to give rise to other problems, not the least of which was the development of a colour consciousness which made whites unwilling to do menial work.

Nearly two hundred years later it was a combination of the abolition of slavery and a shortage of labour which sparked off the Great Trek from the eastern Cape into the interior.[2] And a central issue of South African politics for at least a hundred years before the National Party came to power in 1948 was the organisation of adequate supplies of black labour in such a way that it would not compete with white. 'Having pushed the native possessors off the soil,' writes Sir Keith Hancock, the whites 'felt the need of pulling native labourers back onto it.'[3] The discovery of minerals in the second half of the nineteenth century, while marking a new stage in the country's development, intensified the push-pull dichotomy. The perennial labour shortage, which Natal sugar planters had alleviated in 1860 with the introduction of indentured Indians, was aggravated. By 1874, only eight years after the discovery of the first diamond, the Kimberley diggings were employing no less than 10,000 blacks, and farmers throughout the country were complaining bitterly of the developments which were drawing off their labour.[4] But things were to become still more difficult for farmers when, with the discovery of gold in 1886, the demand for labour grew rapidly. By the turn of the century the black labour force on the mines of the Witwatersrand was little short of 100,000 men. Such radical changes in the economic structure over so short a period of time were not achieved without difficulty, and the restructuring of the labour market that took place during this period was to provide the pattern for much of the economy during this century. Of this structure there are four features which, because of their peculiar nature, and because they were to remain at the centre of the South African labour market for so long, need to be examined in some detail. They are the organisation of the supply of unskilled labour, the migrant system, the colour bar, and the pattern of industrial relations.

ORGANISATION OF LABOUR SUPPLY

The mineral magnates developed and refined two instruments to ensure adequate labour supplies: the law and recruiting organisation. Amongst the laws enacted specifically to push blacks into the service of white employers were those relating to taxation. Although they did not prove very successful in increasing the supply of labour they are significant as demonstrations of the power of the mining financiers to make laws in their favour.[5] For example, the Glen Grey Bill which incorporated a labour tax of 10s. a head on selected 'male natives' was introduced to the Cape Parliament by the chief of the magnates, Cecil Rhodes, who was also Prime Minister:

> You will remove them [the Natives] from that life of sloth and laziness, you will teach them the dignity of labour and make them contribute to the prosperity of the State, and make them give some return for our wise and good government.[6]

The bill was passed.

Legal curbs on the geographic mobility of labour in South Africa go back as far as 1760 when slaves were first required to carry passes in moving between urban and rural areas. Slavery was abolished in 1834, but during the nineteenth century numerous laws controlling movement well enacted in all parts of what was to become the Union of South Africa. The power of the mining

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[1] For the detailed historical background, readers are referred to Sheila T. van der Horst, *Native Labour in South Africa* (O.U.P., Cape Town, 1942) B.

[2] M. Wilson and L. Thompson (eds.), *The Oxford History of South Africa* (Clarendon Press, Oxford, 1969), I, 292 B.

[3] W. K. Hancock, *Survey of British Commonwealth Affairs* (O.U.P., London, 1942), II, pt. 2, 25 B.

[4] A. Trollope, *South Africa* (Chapman and Hall, London, 1878, 2nd edn.), I, 83–128, 146, 301; II, 80 B. M. Wilson and L. Thompson (eds.), *The Oxford History*, II, 117–20 B.

[5] van der Horst, *Native Labour*, pp. 133–4 B.

[6] Cape of Good Hope, *Hansard*, 1894, p. 362. Cited by van der Horst; see van der Horst, *Native Labour*, pp. 148–52, for an analysis of the various provisions of the Act.

magnates to push through legislation that would help control their black labour force was amply demonstrated by the Transvaal Volksraad's enaction, in 1895, of a pass law drafted by the Chamber of Mines.[7] The thinking behind the mass of nineteenth-century legislation which had been designed to dishearten cattle rustlers and to discourage labourers from breaking their contracts, took a new—and prophetic—turn in 1921 when the Transvaal Local Government Commission reported that:

The Natives (Urban Areas) Act of 1923 tightened white control over the the white man's creation, when he is willing to enter and to minister to the needs of the white man and should depart therefrom when he ceases so to minister.[8]

The Natives (Urban Areas) Act of 1923 tightened white control over the movement of Africans to the cities. The legislation was amended numerous times, tightened in 1936, consolidated in 1945 and again in 1952, until with the passage of the Bantu Laws Amendment Act in 1969 the whites had created all the machinery necessary to carry out the policy enunciated half a century before. The advantages which the pass (and passport) laws gave to the mining industry over other sectors of the economy will be explored in a later chapter.

A third arm of the law used to augment the supply of labour was that relating to land. The Glen Gray Act contained important provisions restricting ownership, but it was the Land Act of 1913 that was decisive. Although pressure for the legislation came primarily from farmers its effects were to prove even more beneficial to the Chamber of Mines which drew so large a proportion of its black labour force from the overcrowded 'reserves' created by the Act.

Besides legislation, the other weapon in the hands of the mining industry was the organization of recruiting. In 1893 the Chamber of Mines established a Native Labour Department with the two-fold objective of assuring an adequate and regular supply of black labour by opening up sources of supply within the Transvaal and by arranging for the recruiting of labourers from Mozambique, and of taking 'active steps for the gradual reduction of native wages to a reasonable level'.[9] However, the pass law of 1895 was ineffectively administered and failed to achieve its purpose of controlling the movement of black mineworkers; and so, towards the end of 1896, perturbed by the fact that 'a great deal of trouble and money were being thrown away by the competition for natives',[10] the Chamber formed its own recruiting organisation, the Rand Native Labour Association, to bring workers to the mines.

Countering criticism from mine managers about the costs of recruitment a spokesman of the Association, at the annual general meeting in 1898, pointed out that employment on the mines had risen from 14,000 in 1890 to 88,000 at the end of 1897. Were it not for the Association 'they would have had a continuation of the cut-throat competition which then existed, and they would have had each mine touting for its own labour'.[11] As it was the increase in employment by over 500% in eight years was achieved 'without any appreciable rise in wages'. The establishment of the Labour Association in 1896 was accompanied by an agreement to reduce wages and, unlike the agreement of 1890 which had succeeded only temporarily in reducing wages by 25%, this was enforced by means of inspection of wage sheets. Thus by 1899 the Chamber of Mines had succeeded in raising a black labour force of 99,000 men at a wage rate considerably lower than it had been ten years previously when the mining industry had only just begun. In 1900 the mining magnates approached the government of the Transvaal with a request that the recruiting of labour be a state enterprise, but the proposal was turned down.[12] And so, the employers reorganised their recruiting arrangements and formed the Witwatersrand Native Labour Association in order to monopsonise recruiting, by preventing mines from competing against each other for labour. At first it was planned that the W.N.L.A. should recruit all black labour for the industry, but it took a few years for the mines to stop competing for South African labour. Meanwhile the W.N.L.A. was the only body allowed to recruit in Mozambique.

The first decade of the twentieth century was a very difficult one for the mines. The Anglo-Boer war had disrupted production and then, when hostilities had ceased, the mines found themselves critically short of black labour. There

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[7] *Ibid.*, p. 133.
[8] Transvaal Province, *Report of the Local Government Commission* (Stallard) (T.P. 1, Pretoria, 1922).
[9] T.C.M., *Fifth Annual Report* (1893), p. 4 A.
[10] T.C.M., *Tenth Annual Report* (1898), p. 455 A.
[11] T.C.M., *Tenth Annual Report*, p. 462 A.
[12] D. J. N. Denoon, 'The Transvaal labourcrisis, 1901–6', *F.A.H.* VII (1967), 482 C.

were a number of reasons for the shortage, not the last of which was the fact that, in setting up the W.N.L.A., the Chamber of Mines had lowered the wage rate from the pre-war average of R5.00 to R3.00 a month.[13] Except for work on farms, where there were generally better fringe benefits, this was probably the lowest cash wage for black labour in the whole of Southern Africa.[14] Moreover working conditions were deplorable: the death rate of recruited workers in 1903 was 80 per thousand, and black workers were frequently assaulted by whites. Faced with a crippling shortage of labour, the mining industry began, in 1904, to bring indentured labour from the north of China where, due to the Russo-Japanese war, men who normally went to work as farm labourers in Manchuria were no longer able to do so.[15] The use of Chinese labour was controversial and, after the 1905 Liberal victory in Britain, pressure to repatriate the 50,000 men was exerted. Further recruiting was prohibited at the end of 1906. By 1910 there were few Chinese left on the Witwatersrand and, in 1912, the Chamber of Mines established the Native Recruiting Corporation (N.R.C.) to organize the recruitment of black labour from within South Africa and the three 'Protectorates' as the W.N.L.A. was doing in Mozambique. Because of the appalling pneumonia death rates, recruiting from any area north of latitude 22°S was prohibited in 1913. It was to be twenty years before the industry was to be allowed north again.[16] Despite the loss of these areas, the industry was by this time sufficiently well organised to maintain its monopsony power over the labour market by means of a maximum permissible agreement.[17]

OSCILLATING MIGRATION

Closely related to the organisation of supply was the second notable feature of the labour market; namely the pattern of oscillating migration whereby unskilled black workers came to the mines for a limited time and then returned to their rural homes. During the early stages of industrialisation in any country, the evidence suggests that many people, moving from rural areas to the new centres, do not commit themselves immediately to permanent residence in town, but that, after a good deal of movement between old and new homes, people gradually settle near their place of work. The common pattern at first repeated itself in South Africa; however the oscillations of workers backwards and forwards did not gradually diminish as elsewhere but became established by means of the compound system.

During the early years of diamond diggings it appears that, despite Trollope's rosy description of the effect of money on 'civilised kaffirs', Kimberley was a sordid place.[18] Robert Moffat of Kuruman describes it as it was in 1881:

It was a mining camp, in the process of solidifying into a town. It was a dangerous place to walk about after dark, drunkenness and violence were rampant. The mortality was portentous among natives. A dead 'nigger' lying in some nook or corner or on the open veldt at break of day was so ordinary an event as to be scarcely worth a paragraph in the newspapers. The native labourers herded in the vilest shanties and drank the vilest Cape dop, which they bought with the diamonds they stole during the day from the mines they worked in.[19]

The losses which employers incurred from illicit diamond buying and from absenteeism after week-end drinking led them to establish the closed compounds which by the late 1880s were a universal feature of the diamond fields and which were to remain essentially unchanged for the next eighty years. Despite Moffat's approval of the system which had saved thousands of [natives] from untold misery and degradation', the South African Native Races Committee stated in 1901 that, even when well managed, it regarded the closed compound system 'with very qualified satisfaction, and as exceptional and, in its present form, a temporary expedient . . . its application to gold-mining or other industries does not appear to be probable or desirable . . . The family life of the natives, however different from that of civilised white men, ought to be

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13 Denoon, *F.A.H.* (1967), p. 482 C.

14 B. Kidd, 'Economic South Africa', *Christian Express* XXII (1903), 58, 77 C.

15 Denoon, *F.A.H.* (1967), p. 490 C.

16 See p. 69.

17 van der Horst, *Native Labour*, pp. 166, 192–3 B. It was not until 1919 that the Robinson group of mines joined the N.R.C., thus giving the Corporation the complete monopsony of gold mine recruiting in South Africa and the 'Protectorates'.

18 Trollope, *South Africa*, II, 185 B.

19 The South African Native Races Committee (ed.), *The Natives of South Africa* (John Murray, London, 1901), p. 142 B. See also G. Tyamzashe, 'The Natives of the Diamond Fields', *Kaffi Express* (January, 1874), reprinted in F. Wilson and D. Perrot (eds.), *Outlook on a Century; South Africa 1870–1970* (Lovedale Press, 1972), p. 19 B.

treated with consideration and respect. It would be unfortunate if the breaking up of tribal organisations and the free movement of natives in search of work were to create a large mass of men without local or family ties.'[20] Despite this view, and despite the 'growing wish' of African workers to bring their families to the mines, the early pattern whereby men came to work for periods of eighteen months or less became entrenched on the gold mines.[21] On some of the coal mines, by contrast, as much as 50% of the labour force was, by the 1930s, housed in married quarters.[22] And in secondary industry compounds were the exception rather than the rule.

Why did the diamond and gold mines perpetuate the system? In a later chapter we shall analyse the economic forces which continue to undergird the pattern of migrant labour in the gold mines, but it is worth noting that the reasons for the establishment of compounds on the Witwatersrand were not the same as in Kimberley. On the diamond diggings the primary reason for the building of closed compounds which black workers were not allowed to leave during their entire period of contract was the prevention of illicit diamond buying. On the Witwatersrand, however, the possibility of miners finding ingots of pure gold was remote and so the system of *closed* compounds was never adopted. Unlike the diamond mines which seldom were short of labour, the gold mines went out to recruit men from all over southern Africa. And in doing so they were committed to housing them in bachelor compounds both because fewer men would have been willing to come without knowing that they would have somewhere to stay and because neighbouring governments were unwilling to let several thousand able-bodied men leave permanently. Compound housing was much cheaper for the mines than family quarters. Some of the earliest compounds were built for the Chinese indentured labour, and so were later available for black recruits.

COLOUR BAR

As we shall see in a later chapter, the pattern of migrant labour is reinforced by the colour bar. The use, by whites, of skin-pigmentation as a means of discriminating against potential competitors in the labour market did not originate in the gold mines nor, indeed, on the diamond diggings, but the mineral discoveries did much to entrench it in the South African economy. At first there were plenty of unskilled men able and willing to dig, but artisans were not so readily available. Those who were not willing to gamble their future on a lucky strike had to be enticed out of Europe by high salaries. Thus began the enormous differential between skilled an unskilled earnings. The situation was not unique but the peculiarity of the South African case was that the skilled men happened to be white and the unskilled happened to be black. What had begun as a classical example of the free interaction of supply and demand gradually hardened into a rigid caste system. This process of ossification as it took place in the gold mines is worth examining in some detail for it was to have far-reaching consequences in the country's political and economic development.

White miners saw themselves as a labour aristocracy: as early as 1893 the Volksraad enacted the first legal colour bar in the economy. A clause in the Transvaal republic's first mining law stipulated, in effect, that only white might do the actual blasting. Amended regulations in 1896 dropped this particular prohibition (although the *de facto* position did not change) but introduced two more. One of these was dropped at the insistence of the employers and the industry entered the Anglo-Boer war with one statutory colour bar which reserved the job of engine drivers for whites only. However, with the importation of Chinese labour in 1904, the regulations were tightened up again. The Chamber of Mines agreed that white labour must remain an aristocracy but the Imperial government, in endorsing the view, went a step further and insisted that before Chinese could be brought in white opinion in the Transvaal should favour such a policy. This proviso made it necessary for the Chamber to make elaborate concessions to the white artisans who opposed importation. The most important of these concessions was, as D. J. N. Denoon has pointed out: 'the prohibition of the employment of Chinese in an enumerated list of capacities, which obviated the risk of their ever competing with skilled or semi-skilled whites'[23] Denoon suggests that the mining magnates had not intended this legislation to be applied

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[20] South African Native Races Committee, pp. 145, 220 B. Cf. 'The Kimberley compounds' in Wilson and Perrot (eds.), *Outlook on a Century*, p. 297 B.
[21] van der Horst, *Native Labour*, p. 187 B.
[22] *Ibid.*, p. 188.
[23] Denoon, *F.A.H.* (1967), p. 490 C.

against Africans nor had they considered it to be final. However the prohibition on Chinese doing these jobs was seen by the artisans as reserving the jobs exclusively for whites. The timing of this enactment was important, for it came at a moment when the proportion of white workers in the mining industry was larger than usual. Had the line been drawn either five years earlier or five years later, the number of reserved jobs would probably have been considerably smaller.[24] Nor was it only the Chinese who were a threat to the white miners: in 1907 there was a strike to prevent blacks doing skilled jobs. Although the strike was lost it had the effect of 'causing the government to insist upon a definite ratio in mining of "civilised labour" to indentured natives'.[25] Thus in the troubled years between the ending of the Anglo-Boer war and the Act of Union, the white miners on the Witwatersrand were able to entrench themselves firmly in thier position of privilege. Their status was further reinforced by the Mines and Works Act of 1911. In terms of this law, the Governor General was empowered to make regulations requiring certificates of competency for the performance of different kinds of work. In the Transvaal and Free State such certificates were granted only to whites and by 1920 more than 7,000 white men in 32 mining occupations were protected by these regulations. The law itself was buttressed by the force of custom, backed up by trade union action: in 1920 a further 4,000 men were protected by the customary colour bar.[26]

INDUSTRIAL RELATIONS

It was the growing power, both relative and absolute, of the white colour-bound unions that formed the fourth institutional peculiarity of the labour market as it developed during the early decades of gold mining. In 1897 the Chamber of Mines attempted to cut the wages of all its employees. The white miners went on strike and were able to prevent a reduction in their rates of pay. Black wages however were sharply reduced. White miners struck again in 1907, this time to protect themselves against competition by their black fellow-workers, and in July 1913 the white miners came out on a massive strike. After riots and bloodshed they won recognition from the Chamber of Mines for their trade unions. As soon as this was accomplished there was another, larger, strike in January of 1914 whose purpose was, in C. W. de Kiewiet's words, 'to testify to the common purpose of all white labour to protect its interests'.[27] What was at issue was 'the whole immense problem of social and economic relationships between industry and labour, between skilled and unskilled worker, between white and black. Thus did the desire of the mines to make the most economical use of their labour become a problem that touched the life of the country at every point.[28] Nor was the unrest confined to whites. Following the successful strike in 1913, Africans on several mines 'rose in protest against their conditions of employment'.[29] Their fundamental grievance was, as the Commission appointed to investigate the disturbances found, 'the colour bar which blocks practically all opportunities of promotion'.[30] But nothing was done to remove the barrier. With the outbreak of the First World War there was an uneasy truce until 1918 when, under pressure from the white trade unions, the Chamber came to an agreement that the existing *status quo* on each mine, with regard to the relative scope of employment of white and black employees should be maintained.[31] The purpose of this agreement was to prevent any further crumbling of the colour bar which the legislation, in the fact of labour shortages, could not effectively prevent.

The post-war years saw an astronomical increase in the cost of living with prices rising by almost 50% between 1917 and 1920. As a result of pressure from the unions white wages were increased so that, in real terms, average earnings fell by only 4% betwen 1916 and 1921. The black workers, however, were not so

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[24] *Ibid.*

[25] I. L. Walker and B. Weinbren, *2,000 Casualties* (S.A.T.U.C., Johannesburg, 1961), p. 24 B. In 1903 it was estimated that, up until that time, the ratio of black-white employees on the mines had been approximately 8:1 (Kidd, *Christian Express* (1903), p. 76) C. See Appendix 26.

[26] van der Horst, *Native Labour*, p. 179 B.

[27] C. W. de Kiewiet, *A History of South Africa* (O.U.P., London, 1941), p. 168 B.

[28] *Ibid.*

[29] C. R. Diamond, *African Labour Problems on South African Gold Mines with Special Reference to the Strike of 1946* (M.A. thesis, Cape Town, 1969), p. 211 D.

[30] South Africa, *Report of the Native Grievances Inquiry* (Buckle) (U.G. 37, Cape Town, 1941), para. 280 A, cited by Diamond, *African Labour Problems*, D.

[31] It is worth noting that, on the outbreak of war, African mineworkers had pledged themselves to withhold all action to redress their grievances for the duration of the war.

successful. During eleven days in February 1920 some 71,000 men came out on strike for better pay, for lower prices in the compound stores, and against the colour bar.[32] From the beginning police and troops from the S.A. Mounted Rifles surrounded the striking compounds, arresting leaders and protecting strike breakers. There was one violent clash in which three men were killed and nearly 50 men (including about a dozen on the government side) injured. But, in general, the demonstration of force brought about a peaceful return to work. Apart from a reorganisation of trading methods the strike achieved nothing. In 1921 black wages, in real terms, were 13% lower than they had been in 1916. It was another quarter of a century before African mineworkers were to strike again. With the support of the state and backed up by the Native Labour Regulation Act of 1911, which made it a criminal offence for blacks, under contract, to strike, the employers were in a powerful position to crush any attempts at collective bargaining. But for white mineworkers, despite the Chamber's hostility, the strike was to prove a more potent weapon. Already, as we have seen, it had won recognition for their trade unions. But the main showdown was still to come.

In 1921 the Chamber of Mines, alarmed by the sharp drop in the price of gold from 130s. per fine ounce in February 1920 to 95s. per fine ounce in December 1921, took hasty steps to reduce working costs in the belief that if they failed to do so a further drop in the price to 84s. per fine ounce would render 24 of the 39 mines on the Witwatersrand unprofitable. On 10 December 1921 the Chamber brusquely gave notice to its white workers of the termination of certain wage agreements and of its intention to withdraw the *status quo* agreement as from the end of January. It proposed to increase the black: white employment ratio to 10.5:1. The white workers were equally alarmed; not only were they deeply suspicious of the Chamber's motives as a result of the long bitterness of previous strikes and the Chamber's uncompromising attitude in dealing with the unions, but also the time was one of great depression and the mineworkers were afraid of losing their jobs.[33] They went on a strike which developed into a full-scale rebellion. There were several days of fighting, property was destroyed, and between 230 and 250 people were killed.

In his study of the causes of the rebellion, Bernard Hessian places a great deal of emphasis on the mutual suspicion between the Chamber of Mines, whose attitude was "autocratic", and the labour leaders. The chances of a negotiated settlement were prejudiced 'because the Chamber of Mines' representatives were not prepared to accept the workers as equals in the negotiation room.[34] The motives on both sides were very confused. The Chamber saw itself not only as fighting for the very existence of the gold mining industry but also as trying to reduce racial discrimination caused by the white workers. These same workers on the other hand saw the issue not as one 'between white and black labour, but between free labour and cheap slave labour.[35] Both sides felt morally justified while the success of either would not have given blacks equal economic opportunities with whites: depending on which side won, blacks were to be faced either with the pass laws alone or with a combination of pass laws and colour bar.

Although the miners lost the battle, as the Chamber of Mines did in fact lay off a number of white workers and reduce white wages, they won the war. The impact of the rebellion entrenched the colour bar more firmly than ever before not only in the mines but in the economy as a whole. For fifthy years fear of provoking another Rand rebellion was to be a potent force in preventing employers from attempting to breach the colour bar. In 1923 the Mines and Works Act was declared *ultra vires* but, after a Mining Regulations Commission had 'reported alarmingly on the introduction of machinery capable of being worked by semi-skilled natives, a development which, unless checked, would lead to the "elimination of the European worker from the entire range of mining occupations" ',[36] the Mines and Works Amendment Act of 1926 was passed. In terms of this Act, blacks and Indians were specifically barred from jobs as mine managers, mine overseers, mine surveyors, mechanical engineers, engine drivers, miners entitled to blast, and various others. The Act remains the basis of the colour bar in the mining industry.

In 1924 the Smuts government, in an attempt to prevent any repetition of violence, rushed through the Industrial Conciliation Act for the creation of

[32] See Diamond, *African Labour Problems*, ch. 3. D. for details of the strike. The maximum number of men on strike at any one time was estimated to be 42,000.

[33] B. Hessian, *An Investigation into the Causes of the Labour Agitation on the Witwatersrand* (M.A. thesis, Witwatersrand, 1957), pp. 16–21 D.

[34] *Ibid.*, p. 112.

[35] Transvaal Strike Legal Committee, *The Story of Crime* (Johannesburg, 1924), p. 39 B.

[36] H. M. Robertson, '150 years of economic contact between black and white', *S.A.F.E.* III (1935), 21c.

machinery to deal with industrial disputes. Black mineworkers, however, were not amongst those declared to be employees within the meaning of the Act and were thus excluded from the industrial self-government which was to prove so successful in reducing conflict between employers and their white workers.

Another result of the rebellion was to bring to power a coalition formed between the National and Labour Parties. Together they adopted a 'civilised labour' policy whose objective was subsequently explained by the Secretary for Labour as being:

> to ensure that the class of workers described above [white unskilled workers] is not denied entry into unskilled occupations by reason of the fact that the lower standard of living to which the Native is accustomed has hitherto kept the rates of pay and their conditions of employement for work of this nature at a level which will not enable such workers to live in accordance with the standard generally observed by civilised persons. The policy is in no way associated with any question of racial segregation.[37]

The policy was applied primarily to state enterprises and in the case of the railways was most successful. Between 1924 and 1936 the proportion of whites employed rose from 9.5% to 28.9% while blacks fell from 75% to 57.8%. The proportion of Coloured people remained constant at 11.3% but Indians fell from 4.2% to 0.8%. In the depression year of 1933 it was the black railway workers who lost their jobs. They fell to 48.9% while whites rose to 39.3% of the total force.[38]

Besides the Mines and Works Amendment Act of 1926 and the civilised labour policy, there were no other direct measures to protect white workers; but there were several laws which indirectly limited the economic progress of non-whites. One of these which affected the Coloured people, particularly, was the Apprenticeship Act of 1922 which imposed no colour bar but in terms of which conditions for apprenticeship were set. By March 1939 in all 41 trades for which conditions had been laid down, the level of entry required was at least Standard VI, but as the majority of schools for Coloured pupils did not go beyond that level and many, indeed, not even so far, the effect of the Apprenticeship Act, subsequently re-enacted in 1944, was to bar Coloured people from the skilled trades which they had traditionally occupied in the Cape.[39] The educational barrier was reinforced by the tacit acceptance, by employers, that only white youths were to be trained.

Another law which indirectly barred the advance of blacks was the Wage Act of 1925 which was re-enacted in 1937 and 1957. Although it had been set up to improve the conditions in industries employing unorganised, unskilled labour, nevertheless during the 1930s the Wage Act was not used primarily to help black workers but rather to protect and improve the position of whites. Before the Second World War the Wage Act was an instrument of the civilised labour policy. However with the movement of whites out of unskilled occupations, and the disappearance of the poor-white problem, the Act has been increasingly used as a means of raising the minimum wage of blacks in various sectors of the economy.[40]

By 1936 the United Party government led by Generals Hertzog and Smuts was able not only to complete the Land Act of 1913 which effectively limited black land ownership to 13% of the country, but also to pass the Representation of Natives Act which removed the last black South African voter from the common voters' roll. Seen in its historical perspective, the election of the National Party in 1948 marked not so much a turning point in South African history as the intensification of a process which had been going on for three hundred years. The increased economic co-operation during the Second World War, when

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[37] Letter from the Secretary for Labour and Social Welfare to the Advisor of the Institute of Race Relations, 14 November 1935, *Race Relations Journal* II (1935), c.

[38] Hancock, *Survey of British Commonwealth Affairs*, p. 52 B. This was not the first time that black railway workers had been sacked to make room for more highly paid whites. A similar policy had been pursued twenty years before. Wilson and Perrot (eds.), *Outlook on a Century*, p. 330 B.

[39] Hancock, p. 53.

[40] W. F. J. Steenkamp, 'In quest of aims and norms for minimum wage fixing in terms of the wage Act (1925), *S.A.F.E.* XXXI (June 1963) c. D. E. Pursell, 'Bantu real wages and employment opportunities', *S.A.F.E.* XXXVIII (June 1968) c.

thousands of blacks moved into manufacturing industry, once again had its counterpart in the increased conflict made visible by ensuing legislation which, focusing on the colour bar and the supply of unskilled labour, added further barriers to occupational and geographical mobility.[41]

In the years that followed the four features which had been built into the structure of the South African labour market by the development of the gold mining industry became, as we shall see, yet more firmly entrenched. Indeed, for their labour policy in all sectors of the economy, the architects of Apartheid have taken the gold mining industry as their model.

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Chapter III

Earnings

Almost every student of the labor market complains at one time or another about the indaequacy of wage data and the ambiguity of their interpretation.

George J. Stigler, *Domestic Servants in the United States, 1900–1940*

The most striking feature of table 5, which shows the average annual cash incomes of blacks and whites working in the gold mines over the period 1911–69 is the evidence it provides of the extent to which the distribution of earnings in the industry has apparently become less equitable over time. We have already seen (p. 4) how, by means of monopsonistic recruiting, the labour organizations of the Chamber of Mines during the 1890s were able to lower the annual wages paid to the black mine workers from R78 in 1889 to R58 in 1897, notwithstanding the enormous increase in the demand for labour as the gold fields were opened up. During the Anglo-Boer war wages were reduced still further to R36 a year, but the shortage of labour became so acute that, despite the arrival of indentured Chinese, this level could not be maintained.[1] By 1905 cash wages for Africans had risen to an average of R54; Chinese wages however were considerably lower, R39 for the year. By 1911 the Chinese experiment had drawn to an end and the industry was reconciled to the fact that the major source of its labour force would be within Africa. Black cash wages had, by this time, risen from the war-time rate to R57 a year, a level that was slightly lower than it had been in 1897 and considerably below what it had been in 1889. Details of white wages are not available but the evidence suggests that they did rise between 1889 and 1911.[2] It seems likely that the ratio of average cash earnings between white and black widened from approximately 7·5 : 1 in 1889 to approximately 10·5 : 1 in 1898 and to 11·7 : 1 in 1911. Thereafter it continued to widen, particularly after the First World War, until it reached 15·0 : 1 in 1921. It was the size of this gap, combined with the fall in the price of gold, that induced the mining industry to try to make the colour bar a little less rigid. The attempt led (p. 10) to the Rand rebellion with its Pyrric victory for the Chamber of Mines. However, although it failed to crack the colour bar, the Chamber was able to reduce white wages substantially and the ratio between average cash earnings of the two colour groups narrowed to 11·2 : 1, the smallest it had been for a quarter of a century. For the next ten years the cash earnings of both white and black remained almost stationary, although in real terms, due to falling prices, wages rose during the 1930s. However, with the outbreak of the Second World War, the earnings gap started to widen again. By 1946 it was 12·7 : 1. Five years later it was 14·7 : 1, and by 1956 the gap was wider even than it had been at the time of the Rand rebellion in 1922. But things were not to stop there; five years later, in 1961, the gap had widened to 17·0 :1. And during the 1960s, a decade that had started with political unrest and a re-appraisal, by businessmen, of African wages, the gap continued to widen until, by 1969, it was no less than 20·1 : 1.

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[41] For the original analysis of South African economic history in terms of co-operation and conflict see H. M. Robertson, '150 years of economic contact between black and white', *S.A.F.E.* II (1934), III (1935) c.

[1] Monthly wage rates have been multiplied by twelve for purposes of camparison (sources, see pp. 3–4).

[2] T.C.M. Annual Reports.

TABLE 5.—ANNUAL CASH EARNINGS ON GOLD MINES, 1911–69

Date	Current rands [1] White	Current rands [1] Black [2]	Index of real earnings [3] (1936=100) White	Index of real earnings [3] (1936=100) Black	Earnings gap ratio W:B
1911	666	57	102	100	11·7:1
1916	709	59	94	90	12·0:1
1921	992	66	90	69	15·0:1
1926	753	67	85	88	11·2:1
1931	753	66	90	92	11·3:1
1936	786	68	100	100	11·5:1
1941	848	70	94	89	12·1:1
1946	1,106	87	99	92	12·7:1
1951	1,607	109	113	89	14·7:1
1956	2,046	132	119	89	14·5:1
1961	2,478	146	129	89	17·0:1
1966	3,216	183	149	99	17·6:1
1969	4,006	199	172	99	20·1:1

1 Divide by 2 to obtain the value of wages in pounds sterling for all years prior to 1968.
2 This category includes colored persons and, for 1911, a small proportion of Indians. For discussion about the wages of these groups see app. 6.
3 Using retail price index calculated from 1938 as the base year. Real earnings were then converted to an index taking 1936=100.

Source: GME, annual reports, 1911–61; Department of Mines, Mining Statistics 1966–69.

Another striking feature of the table is the fact that, in real terms, using 1938 as the base year, black cash earnings in 1969 were no higher and possibly even lower than they had been in 1911. For whites, on the other hand, real cash earnings increased by 70%. And, although there is no price index with which to adjust figures before 1911, it is worth noting that, between 1889 and 1911, white cash earnings probably rose whilst those for blacks fell by more than 25%.

However the above table provides an incomplete picture of the structure of earnings in the mining industry. It contains none of the substantial wages in kind that are provided to both black and white workers on the mines. Moreover the figures are averages which tell us nothing about the distribution of wages within each racial group; and they provide no information about possible changes in skill which might have affected the pattern of earnings. Thus before being able to determine the possible reasons for the massive shift in the distribution of incomes to which table 5 points, it is necessary to break down the overall averages into their component parts, to make due allowance for earnings in kind, and to consider the problems inherent in any comparison between black and white incomes.

CASH EARNINGS

The cash-earnings structure, over much of the period under consideration, was first established in 1927 by the Mining Industry Arbitration Board which was asked to examine certain wage demands made to the Gold Producers' Committee by the Mineworkers' Union and the Reduction Workers Association.[3] This Lucas award (named after the chairman of the Board) laid down the minimum rates of wages of employees in occupations covered by the two unions, and in the same year arbitrators laid down the minimum rates for mechanics, engine drivers, and associated workers. After 1927 there were considerable changes in the minimum rates, but much of the subsequent increase in white earnings was through the introduction and increase of allowances such as those for leave and the cost of living. White miners, the men responsible for supervising gangs of black workers at the stope face, were in a special position. Some of them were employed at daily rates of pay but others were paid by results.[4] The earnings of these contractors depend, as we have seen, on the amount of ore that the gang of men under them extracts on the frontiers of the mine.[5] The significance of the contractors lies in the fact that this method of payment-by-results has enabled them to capture

3 South Africa, *Conditions of Employment*, p. 3 A.
4 In stoping, development, and shaft-sinking, earnings per shift of contract workers in 1911 were 29%, 75%, and 102% higher, respectively, than earnings of day's pay men in similar jobs. By 1957 (the last year for which figures were published) the proportions were 20%, 48%, and −27% respectively. Numbers are not available for 1911 and 1957 but in 1936 89% of the 3,612 developers, stopers, and shaft sinkers in the gold mines were contract workers (sources: G.M.E., Annual Reports).
5 See p. 55.

the rewards of increased labour productivity without sharing them with the other (black) men who help to echieve the results. Furthermore, the earnings of the contractors set the pace for miners being paid at daily rates, and hence for all white in the industry. Less is known about the structure of cash earnings for blacks, but it too was built upon a foundation of minimum rates which varied, although less widely than white rates, according to a few broad categories of jobs. But the structure was far simpler than for whites: there were few of the allowances and other benefits which raised white earnings far above their minimum levels.[6]

Of the various allowances to white workers, that awarded for the cost of living was, during much of the period under consideration, the most important. Following the Rand rebellion in 1922, the cost of living allowance which had previously been paid to officials on the gold mines was withdrawn, with a few minor exceptions. In spite of repeated efforts by the unions no cost of living allowance was granted by management until 1941 when, following a request by the Mining Unions' Joint Committee (M.U.J.C.), the Gold Producers' Committee (G.P.C.) of the Chamber of Mines agreed that an allowance of one penny (0.8 cents) per shift qualifying for leave should be made for each six-point increase in the retail price index number for food, light, fuel, rent and sundries, on the Witwatersrand. The G.P.C. followed this up later in the same year by recommending that the cost of living allowance be paid to all mine officials in receipt of salaries between R30 and R170 per month at the rate of 25 cents per month for each six-point rise of the price index. Juniors, earning less than R30 a month, were to receive half the allowance. And in the same year, following a request by the M.U.J.C., the cost of living allowance was increased by 15%. Much of the increase in white earnings after that date was due to further increases in this allowance. By 1949, only eight years after it was introduced, it formed no less than one-fifth of white cash earnings. And in 1955, by which time the allowance formed more than a quarter of cash wages, part of it was consolidated into the basic wages. For black mine workers, on the other hand, despite the recommendation of a government commission in 1944, there is no cost of living allowance.[7]

Paid leave for white mine employees was first introduced with effect from the beginning of 1934. Underground workers on completion of 312 qualifying shifts (i.e. a working shift exclusive of overtime) were granted 18 week-days leave on full pay.[8] After 624 qualifying shifts their leave was 24 week-days; on completion of 936, and every subsequent 312 shifts, they were granted 24 week-days leave with pay for 30 days. Surface workers, except those in dusty occupations where pneumoconiosis was a danger, were granted 18 week-days leave for every 312 shifts completed. In subsequent years the annual amount of leave pay increased substantially, as did the length of leave. But the proportion of total cash earnings paid for leave remained fairly constant at approximately 10% throughout the period. For black mine workers, excluding only the tiny minority who are not migrant labourers, there is no paid leave.

Payments in the Witwatersrand Gold Mines Employees Provident Fund, which was established for white workers in 1934, are made only by employers, both in the form of occasional lump sums as well as by means of a monthly contribution according to the number of white employees in service. During 1938 a new branch of the provident fund was inaugurated whereby employers deposited, monthly, into the savings branch a sum of money that varied with the number of shifts worked by each employee. It was originally intended that the benefits paid out in lump sums by the provident fund should, as from 1939, be converted into pensions and the payout spread over the years of retirement. However, the unions opposed the Chamber's plan which was dropped, and in 1946 a pension fund for mine officials was established; both employers and employees agreed to contribute 5% each of basic salaries. Following the gold price rise in 1949 a second pension fund was established for all day's pay men on the same contributory basis. Once again, blacks are excluded from these advantages. Although it is organised somewhat differently, medical care for black mineworkers is in general as good as it is for whites, although in the case of Africans the care does not include their families left behind in the rural areas.[9] No medi-

[6] See Appendixes 7 and 18 for detailed statistics.

[7] South Africa, *Report of the Witwatersrand Mine Natives' Wage Commission on the Remuneration and Conditions of Employment of Natives on Witwatersrand Gold Mines 1943* (Lansdown) (U.G. 21, Pretoria, 1944) para. 287 A.

[8] For black mineworkers one year is generally taken to be 313 working shifts.

[9] It should be noted that much of the money accruing to the deferred pay interest fund is made over, in the form of grants, to hospitals working in the rural areas from which migrants come (see p. 136). Further details about the grants made by the fund are to be found in the *Report of the Witwatersrand Mine Natives' Wages Commission*, p. 61 A.

cal benefit allowance is paid but the cost of all treatment, both preventative and curative, is borne by the industry.[10] By law every mine has to have a properly equipped hospital for its black employees and there is, in addition, the W.N.L.A. hospital which deals with more serious operations and rehabilitation work of those crippled by accidents at work.

The medical benefit allowance was introduced in 1936 with the purpose of assisting white mine employees, including officials, to pay their subscriptions to the Mines Medical Benefit Society of which they were all members. This allowance (which was begun at the rate of R15 a year for each white employee) was equal to the cost of complete health insurance for employees and their families. In 1969, for example, the Chamber of Mines increased the allowance by a total of R1.3 million [11] and it has been raised several times to meet increased costs. Minor ailments are treated by one of a panel of private doctors. For more serious operations there is the Cottesloe hospital built just before the Second World War by the Chamber of Mines. After the sterling devaluation in 1949 and the rise in the gold price the medical allowance was consolidated into the minimum rate of wages. In 1955 the G.P.C. assisted the Medical Benefit Society by buying a nursing home at a total cost of R300,000. At the same time mines in the Orange Free State paid R10,000 for the additional costs of medical services during the year.

There had been some form of compensation for mine workers injured on the job ever since the first Workers' Compensation Act was passed in 1911. A new Act in 1941 formed the basis of subsequent legislation under which compensation paid to an injured man or his dependants was calculated according to his earnings at the time of the accident. Under the rules, compensation for an average worker totally and permanently disabled by a mining accident was a lump sum of approximately R1,228 if he was black and an annual pension (paid monthly) of R1,800 if he were white.[12]

A great deal of feeling amongst both white and black mineworkers was generated over the years about the industry's responsibility for one particular hazard of mining, pneumoconiosis. The disease is caused by dust getting into the lungs, which then become more vulnerable to tuberculosis. It was not until after the First World War that adequate steps were taken to reduce the amount of dust in the mines. Before the development of water-fed drills and the introduction of hoses to spray water in areas that had just been blasted, the concentration of dust was so high that the men working on the drills were likely to get bad silicosis within five or six years. The problem was aggravated for whites by the fact that many of the miners during the early years came from mines in Cornwall where they had already inhaled a lot of dust. During the first 25 years after Union no less than eleven Acts were passed dealing with pneumoconiosis compensation. By 1936 a total of 5,200 white miners had been granted monthly allowances for secondary silicosis or for silicosis with tuberculosis; 3,500 of these miners had already died by 1936; their average life expectancy from the time they received their certificates from the Phthisis Board being no more than five years. In addition to these monthly payments the Board also made lump-sum awards, varying between approximately R600 and R1,700 for ante-primary and primary silicosis.[13] To meet these costs the mining companies were, by this date, paying an annual levy of R2 million into the miners' phthisis compensation fund.[14] Black mineworkers at this time received some compensation for lung diseases caused or aggravated by their work. But in 1943 the Miners' Phthisis Acts Commission reported that the evidence it had received disclosed 'a disquieting state of affairs in regard to the compensation, the medical examination and the after-care of Native employees who have contracted compensatable lung diseases'.[15] The Commission recommended the immediate establishment of a country-wide system for the adequate compensation and medical treatment of all Africans suffering from such diseases. By 1967 the compensation fund was paying out an annual total of approximately R10 million, mainly in the form of pensions or lump-sum benefits. Of this total approximately two-thirds went to white (including some Coloured) employees or their dependants and the

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[10] See pp. 68, 95.

[11] *Star*, 20 October 1969.

[12] Figures, supplied by Rand Mutual Assurance Co., are based on average cash earnings for 1969. Whites might also be granted a constant attendance allowance; for blacks, once the compensation had been exhausted, there would probably be "a small extra-statutory allowance" for life.

[13] Department of Mines, *Report of the Miners' Phthisis Board for the Period 1st April 1935 to 31st March, 1936* (U.G. 18, Pretoria, 1937), pp. 13–15 A.

[14] *Ibid.*, p. 8.

[15] South Africa, *Report of the Miners' Phthisis Acts Commission, 1941–1943* (U.G. 22, Pretoria, 1943), p. 24 A.

remaining one-third to blacks.[16] Between 1964 and 1967 the average number of whites—working in all types of mines—who were certified each year as having a compensatory lung disease was 605; the average number of blacks was 5,930.[17] In 1967 the average compensation for men suffering from pneumoconiosis combined with tuberculosis was, in the case of whites, a pension equivalent to R1,230 a year, and in the case of blacks a once and for all payment of R576.[17a] In addition to the cost of compensation the Chamber of Mines bears approximately half the costs of the pneumoconiosis research unit which was established in 1956. During the three years 1966–9 the annual cost to the Chamber was R100,000.[17b]

It is diffcult to quantify precisely the relative extent of care which the industry took with regard to blacks and whites suffering from pneumoconiosis and from tuberculosis caused by it. For apart from differences in the amount of compensation paid, the method of treatment is not the same for the two groups. White miners who develop tuberculosis have access to the Springkell Sanatorium where they are looked after for several months until they are cured. The costs of maintaining the sanatorium, which rose from R40,000 in 1939 to R254,000 in 1962, are borne by the Chamber of Mines. Africans on the other hand used to be sent home as soon as the tuberculosis had been checked[18] but it was found that, with the lack of food at home, tuberculosis often recurred and the ex-miner infected others. Thus, Africans who develop tuberculosis on the mines are now kept in bed for three or four weeks before being sent home armed with antibiotics and the address of a rural clinic where they can obtain more. Unfortunately, however, many men fail to keep taking the antibiotics regularly and so tuberculosis recurs.

Another important fund—which has remained largely unused—was established in 1939 by the Minister of Labour to provide incomes for white mineworkers should they ever find themselves unemployed. Contributions were made both by employers and employees, but by 1969 the fund seemed to have lapsed. There was no similar fund for the black labour force.

In addition to the various allowances outlined above there were a number of *ad hoc* payments to whites. For example, in May 1943, the Mineworkers' Union submitted to the G.P.C. a demand for a 30% increase in wages. This was not granted but the following year an agreement was signed whereby the industry agreed to provide R200,000 a year for five years for housing and cooperative or other schemes designed by the union for the benefit of its members.[19] An additional sum of R50,000 was made immediately available to the union for use in connection with these schemes. However in 1948, a year before the 'lump sum payments' were due to cease, a new executive committee of the M.W.U. estimated that, because of corruption and maladministration, less than one-third of the R680,000 so far paid by the G.P.C. had been of any benefit to the actual rank and file members of the union.[20] As a result of this lump-sum agreement the M.U.J.C. requested the industry to pay to the individuals of the other unions a sum equivalent to that paid to the M.W.U.—but in the form of an additional medical benefit allowance to individuals. This allowance, was due to cease at the end of October 1949, but, in view of the sterling devaluation in mid-September, the G.P.C. agreed to continue paying it out on a month to month basis (to M.W.U. members as well) until the van Eck Commission, appointed to enquire into white conditions of employment in the gold mining industry, had submitted its report.[21] An 'active service allowance', introduced soon after the outbreak of the Second World War, was also applicable only to whites. After 1945 ex-servicemen who returned to the mines received a gratuity calculated at the rate of R60 for each year of full-time military service. For Indian and 'Eurafrican' (Coloured) employees the gratuity was calculated at the rate of R24 a year. For blacks there was nothing.

So much then for the breakdown of the component parts of the average cash wage. We must turn now to consider the distribution of wages about the aver-

[16] South Africa, *Report of the Pneumoconiosis Commissioner for the year ended 31 March 1987* (R. P. 20, Pretoria, 1968), p. 20 A.
[17] *Ibid.*, p. 10.
[17a] *Ibid.*, pp. 14, 20 A. Mine Labour Organizations (Wenela) Ltd., *Report of the Board of Directors for the Year Ended 31st December, 1967* (Johannesburg, 1968), p. 8 A.
[17b] T.C.M., *Seventy Seventh Annual Report* (1966), p. 33 A.
[18] That is, as soon as three sputa had been found negative.
[19] T.C.M. *Fifty Fifth Annual Report* (1944) A.
[20] See South Africa, *Reports of the Mine Workers Union Commission of Enquiry*, U.G. 36 of 1946 and U.G. 52 of 1951.
[21] South Africa, *Conditions of Employment* (U.G. 28, Pretoria, 1950). A.

age.[22] Full details of white cash earnings were published annually in the Reports of the Government Mining Engineer up until 1949. Thereafter, for one of those mysterious reasons known only to the keepers of statistical records, an invaluable source of information suddenly dried up. In 1936, when the mean white cash wage per shift was 252 cents the median wage was 225 cents. For officials alone the median was R78.8 a month (265 cents a shift) and for day's pay men it was 224 cents a shift. By 1946 the overall mean had risen to 354 cents a shift, and the median to just under 250 cents a shift. The reason for the wide difference between the mean and the median in 1946 was not due to a greater skewness in the distribution of white earnings as much as to the fact that the figures from which the means were calculated included all allowances, which the median figures did not. Between 1936 and 1946 white basic rates of pay did not increase very much but allowances became a substantial proportion of overall earnings. A measure of the internal changes in the white wage structure may be taken from table 6 which shows earnings for particular jobs between 1936 and 1956 when another source in the Government Mining Engineer's annual report disappeared. When measured in real terms it appears that, apart from apprentices, the incomes of all these workers actually declined slightly between 1936 and 1946. Thereafter they rose substantially.

Little is known about the distribution of black wages on the mines. Far less information than for whites was published, even before 1949, in the Government Mining Engineer's reports. The Chamber of Mines, although most helpful about other material, refused to make available unconditionally to me any information on this particular topic. Thus, only for 1943, when the Lansdown Commission was investigating the conditions of black mineworkers, is there any detailed information. In that year the mean cash earnings of the total black labour force of 300,000 men was 23 cents a shift and the median was 20 cents. In 1954 earnings for all underground workers other than 'boss-boys' varied from a minimum of 30 cents per shift to a maximum of 44 cents for underground police. 'Boss-boy' earnings varied from 36 to 59 cents a shift. In addition to these wage payments the average piecework bonus per man per underground shift varied from zero to 2 cents. There were other bonuses such as that for first aid (averaging 2 cents a shift). The total underground rate, including overtime and all bonuses but excluding the additional half shift for Sundays, varied from 37 cents on one mine to 40 cents on the highest paid mine.[23] By 1961 the mean had risen, in current terms,[24] to 47 cents a shift. On one mine for which figures were made available most of the workers earned a basic 32 cents plus a bonus of 7 cents, whilst for 'boss-boys' the basic rate was 42 cents and the bonus 22 cents.

There were two important changes in the wage structure during the 1960's. The first came as a result of the disturbances in Langa and Sharpeville in 1960 when one of the mining groups decided that it should raise black wages (see p. 106). Thus the group took active steps to raise the productivity of black workers in the mines under its control. Under the scheme, jobs were graded into five main unskilled or semi-skilled categories and four supervisory ones. On the three mines in which the scheme was first introduced the average skill distribution of the black labour force into the different categories was approximately as follows: unskilled 67%, semi-skilled 20%, supervisory 11%.[25] The new rates of pay for these jobs varied between 25 and 167 cents a shift; the median being 64 cents. These substantial pay increases (between 35% and 45% for most of the mines of the group) were not achieved in one jump but were introduced over a period of three years by means of successively higher scales.[26]

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[22] See Appendix 8.
[23] Based on a cross-sample of black workers in four mines. N.I.P.R.D., tables 4–6.
[24] 'Current terms' refers to the value of money on the specified dates.
[25] See Appendix 9.
[26] See Appendix 10.

TABLE 6.—WAGE RATES FOR SELECTED WHITE JOBS, 1936–56

	Current cents/shift		
	1936	1946 [1]	1956 [2]
Shift-bosses, underground [3]	351	366	731 (n.a.)
Contract miners machine stoping, underground	299	356	622 (738)
Fitters and turners, surface	233	243	451 (692)
Trammers underground	206	258	549 (722)
Clerks, surface [4]	202	237	446 (n.a.)
Apprentices, surface	56	93	178 (258)

[1] Including alloances but excluding overtime, savings fund allowances etc. To be more directly comparable with 1939 the figures for 1946 would have to be raised by about 10 percent to take into account various allowances which did not exist in 1936 and which were excluded from the 1946 figures.
[2] Excluding overtime, leave pay, medical benefit allowances, savings fund allowances, and cost of living allowances, but including bonus.
[3] Paid monthly: shift rate worked out by dividing by 26.
[4] Figures in parentheses include the components excluded under footnote 3.

Source: G.M.E., annual reports, 1936–56.

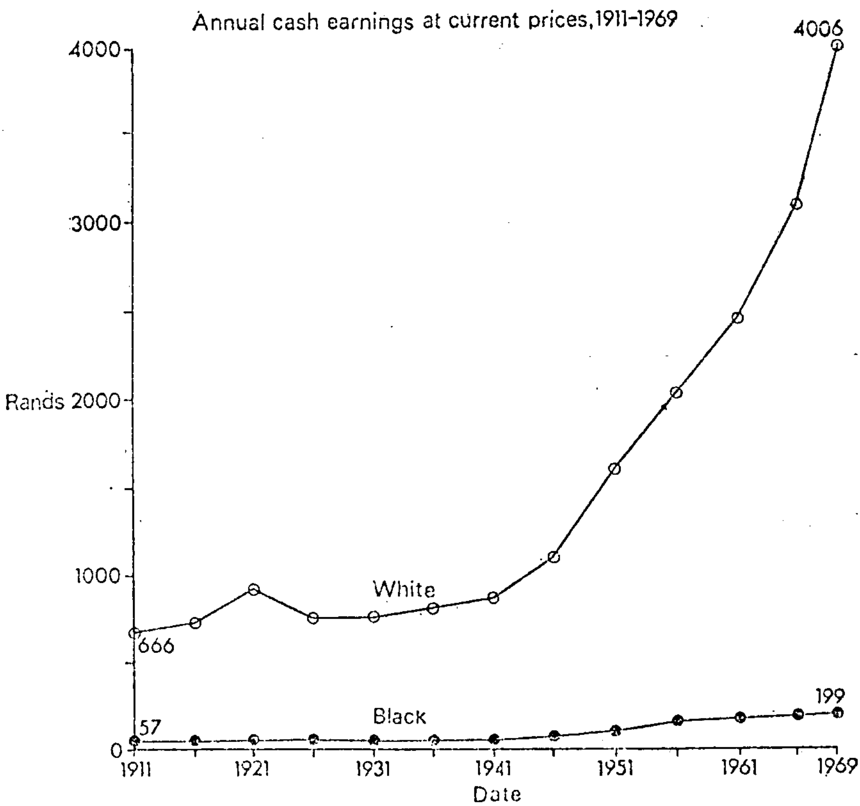

Fig. 4 Annual cash earnings at current prices, 1911–69
Source: Table 5, p. 46

The expectation that these increases would contribute to a narrowing of the gap between black and white earnings was not fulfilled, for in 1967 after prolonged negotiation and numerous strikes by white miners, the second major change in the industry's wage structure was introduced. This was the concept that all white wage increases be based explicitly upon improved 'productivity'. In terms of the new agreement the 22,000 members of the gold mining unions were upgraded from 'day's pay men' and put onto a monthly salary basis at a considerably higher rate than they had been earning before.[27] In return for an 11% increase in earnings the unions agreed to the elimination of various restrictive practices in order to allow better use of labour. The increases in productivity were to come not, as one might have expected, from harder work by those benefiting from the agreement, but from the fact that blacks were to be allowed to do jobs that they had not been allowed to do legally before. The white mining unions were in a unique bargaining position and the agreement of 1967 was a striking demonstration of their ability to use this power to obtain a high price for even the smallest upward shift of the colour bar (see p. 116).

One important service provided for blacks but not for whites is the system of deferred pay under which migrant workers are able to save part of their earnings until they get home where they can draw it from the local recruiting office. The system is voluntary for South Africans but in terms of the agreements with Mozambique and Malawi the workers from there are compelled to wait until they get home for up to one-half of their wages. The cost of administering the system is met out of the interest which accrues to the deferred pay interest fund from investment, at call, both of the deferred pay itself and money which workers deposit for safe-keeping with the compound managers. The bulk of the fund is given to hospitals and medical missions in the areas from which the migrant workers come. From the inception of the system in 1918 until 1943 the annual amount available for distribution was approximately R12,000. It has probably increased considerably since then.[28]

WAGES IN KIND

It has been argued by the mining industry that although the cash wages of black mineworkers might seem to be abnormally low, if one takes into account the wages paid in kind, the gap between black and white earnings is not as high as it appears at first glance.[29] To assess this claim it is necessary to examine in detail the earnings in kind of both blacks and whites.

Discussion about the cash equivalent of wages in kind has long been bedevilled by dispute as to the difference between the *cost* of such earnings to the industry and their *value* to the recipient worker. The figure used can so easily depend upon what one is wanting to prove. From an analytical point of view, however, it is clear that it is *cost* which is important when considering the demand for labour, and *value* which influences the supply. In practice the figures generally available are those relating to the cost to the mines of providing these wages; it is more difficult to obtain estimates of their value to employees. For example, it is argued that the cost of food supplied by the industry to a black worker is considerably lower (because of the difference between wholesale and retail prices) than the worker would have to pay for the same food in the market. This is true: but at the same time it is necessary to bear in mind that a man who has come to town to earn money to feed and clothe his family might, in order to save more, prefer to buy less food for himself. It is arguable that, faced with the choice of free food or the cash equivalent of its *cost* to the industry, men might choose the cash—provided that there were adequate food shops near the mines. It is worth noting that on the diamond mines, which have never found it necessary to recruit labour, African workers are not provided with food but buy it for themselves. In 1960 it was estimated that diamond workers spent an average of 13 cents a day on food compared with the 12 cents per man which it cost the gold mines to feed their men. Moreover the diamond workers saved or sent home 36% of their wage bill, compared with 18% by gold miners.[30] One of the main reasons why the gold mines feed their black workers rather than pay extra wages is to ensure that the men remain fit enough for the hard physical work involved in deep underground mining. Between 1936 and 1969 the cost of foodstuffs supplied free to black miners rose in current terms from 3 to 15 cents a day (including Sundays) for each man,[31] an increase in real terms of approximately 50%. Generally speaking very little food is supplied to white workers whose wages are high enough and whose wives live near enough to ensure that they are fed properly. However for officials,

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[27] The concept, of course, was not new. Implicitly it had been built into the white wage structure for years. See p. 47.

[28] South Africa, *Witwatersrand Mine Natives' Wages Commission*, pp. 32–3 A.

[29] T.C.M., *Gold in South Africa*, p. 25 A.

[30] E. J. B. Sewel, "Native labour and payment on Premier Diamond Mine', *Papers and Discussions of the Association of Mine Managers of South Africa* (T.C.M., Johannesburg, 1960–1), pp. 841 ff. A. Gold mine remittances exclude money not sent home through official channels.

[31] See Appendix II.

most of whom are on the surface at lunch time, some mines have subsidised canteens. No information is available as to the exact size of the subsidy but I have had a meal on one of the new mines at a price approximately one-third, if not one-quarter, the cost of a similar meal in a café. Also all mines provide tea, twice daily to white surface workers, and in unlimited quantities to underground workers when they come up from their shifts into the changing rooms.

Another major form of wages in kind is housing. The vast majority of black workers are housed in compounds or hostels where the men live in dormitories. For the 1% who are allowed to bring their families with them, small houses and gardens are provided until the men leave or retire. The pattern of compound housing for the migrant labourers differs little from mine to mine, although there is considerable difference in quality between the older and the newer mines. The number of men in a single compound or hostel varies from 2,400 to 7,000, and the numbers in each room vary from 12 (in mines built after the Second World War), to 20 on mines built during the 1930s, to between 60 and 90 in those mines developed before the First World War.[32] Washing facilities are available in the form of showers with hot and cold water, and there are large sinks for washing clothes. On the newer mines there are dining rooms and, in some mines, better quality bedrooms for more senior men. In compounds built before 1939, beds are not supplied and men either sleep on the concrete bunks or they have to make, or buy from their predecessors, wooden beds especially designed to fit the short bunks. In some compounds the bunks have concrete sides and tops as well so that men can only enter them by crawling in at one end. On the older mines there are no dining rooms and men eat either outside or in their dormitories which generally have a coal stove for heating purposes. The photographs between pages 38 and 39 give some impression of the difference in quality between the older 'compounds' and the newer 'hostels'. At the end of 1964, 51% of the black labour was living in hostels built after 1945 while 19% was living in compounds built before the First World War. By 1969 the proportions were 71% and 15% respectively.

To an outside visitor the most noticeable feature of the compounds, apart from the sheer number of men in each, is the fact that no women are allowed into them. An examination of the full social implications of the migrant labour system lies beyond the scope of this study, but a visit to any of the compounds impresses one forcefully with the extraordinary nature of an industry, whose demand for labour is not seasonal, and which has relied for many decades on workers who are not allowed to settle with their wives and children near their place of work.[33] Mining officials have been known to describe the method of organisation in a compound as one which preserves the traditional tribal pattern of authority. In reality it most resembles an all-male boarding school of the Thomas Arnold tradition with its system of housemaster (compound manager), prefects (indunas), seniors (izibondo) and boys ('boys').

The cost of the compound housing was estimated in 1943 to be 2 cents a man shift, exclusive of 0.8 cent for the capital cost of compound and hospital buildings.[34] By 1960 this had risen, for one group, to 5 cents; an increase in real terms of 45%. That fraction of the black labour force which lives in family housing on the mines works mainly in secretarial and administrative posts. Their housing was estimated, by one group in the 1960s, to cost R110 a year for each family. R86 of this was for the amortisation, over 20 years of the capital cost of R1,000, and R24 for the cost of fuel which is also free.

For whites the situation is somewhat different. In the older mines, the mining companies have never attempted to house all their workers, most of whom, except for a few key men, live in the surrounding suburbs. But in the newer mines, situated far from the main urban centres, the companies found it necessary to build houses—indeed whole towns—for their white employees. Subsidised housing is one of the juiciest carrots used in trying to entice qualified miners from the established areas into the more rural surroundings of the West Rand and the Orange Free State. The exact nature of the subsidy varies from group to group and from mine to mine, but it is generally true to say that all the mines in the areas developed after 1945 provide housing for the great majority of their white

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[32] T.C.M. and W.N.L.A., Annual Reports A. In 1968 the Johannesburg City Council agreed to lease the old compounds from disused mines (Robinson Deep and Crown Mines, No. 17 shaft) as a "temporary solution" to the problem of finding 10,000 beds for single African men working in Johannesburg (*Star*, 28 August 1968).

[33] See pp. 137–9. Cf. also D. Hobart Houghton, *The South African Economy* (O.U.P., Cape Town 1964), ch. 4; N. Robb, "Apartheid's labour system", *South African Outlook* XCVIII (July 1968), pp. 103–7; and F. R. Mohlabi, "Moral effects of the system of migratory labour on the labourer and his family", *Mapumulo Consultation*, 1971 C.

[34] South Africa, *Witwatersrand Mine Natives' Wage Commission*, p. 7 A.

employees at rentals far below the cost price. The quality of this housing was fully dscribed by Mr. Harry Oppenheimer when replying, in 1950, to an accusation by the Minister of Labour that, although the mining companies took particular pains to have a satisfied black labour force, they did not consider it so necessary to do that for their white employees. According to Mr. Oppenheimer none of the houses on the new mines of his group were less than 1,150 square feet in size, which compared with an average of approximately 800 square feet for workmen's low rental houses in Britain and the United States. No house stood in a plot less than a quarter of an acre; nor did it have less than three bedrooms, a bathroom, a separate w.c., a lounge, a dining recess, and a kitchen. Houses all had servants' quarters, an enclosed back yard, and a garage. And they were all supplied with built-in cupboards, an electric stove, and a geyser providing hot water to both kitchen and bathroom. The minimum cost of building such a house had been R5,000.[35] By 1965 this group provided six main types of houses for their white employees in the Orange Free State, with a tax-free subsidy which varied between R41 a month for the cottages and flats available to day's pay men, and R330 a month for the mine manager's house. Similar subsidies were available on the new mines of all other groups. Rents actually paid by those living in the houses varied between R10 and R20 a month.[36] At a conservative estimate, the average housing subsidy for all white employees on the mines developed after the Second World War was R512 a year tax free. An average of 164 cents a shift is a not insignificant perquisite for approximately half of all whites working in the industry.

The third major form of earnings in kind are the facilities provided for recreation. For whites there are club amenities available at heavily subsidised fees. In 1953, before many of the post-war mines had started production, there were 37 cricket fields, 63 football fields, 20 golf courses, 255 tennis courts, 83 bowling greens, and 38 swimming baths for the 46,000 white employed by the industry.[36a] For the 291,000 blacks the recreational facilities included a bar lounge in each compound and a total of 101 playing fields and 55 dance arenas. In addition, one or two of the newer mines had first-class cycle and cinder tracks on which some of the country's best athletes were produced. The most popular pastimes are soccer, cycling, athletics, and dancing, all of which draw crowds of spectators. For the select few with family houses on the mines facilities include tennis courts and, on a few mines, swimming baths. There are also voluntary literacy classes for one or two hours a week. In six mines of one group there were, in 1965, 1,000 pupils a week for a course which lasted three months. On the average some 60% of these men were expected to become literate in their own language. Having done this they were then allowed, if they wished, to become literate in English or Afrikaans. At this date it was estimated that between 40% and 50% of those who came to the mines were already literate in some language: this was considerably more than five years previously.[37] Once again it is difficult to quantify differences in the cost per man of recreational facilities provided by the mines for the two colour groups. But there is no doubt that the costs for whites are considerably higher than for blacks, not least because on the mines in the Orange Free State (which in 1964 employed 25% of the total labour force) recreational facilities for blacks are financed from the profits on the sales of sweets and cigarettes in the dry canteens in each compound.

Clothing issued either free or below cost price should, some might think, be included as part of wages in kind. However such clothing is more accurately classified as capital equipment without which men cannot perform their work efficiently. Indeed although boots, which in the 1960s cost the mines R2.50 a pair, were sold to workers for R1.45 (approximately one tenth of a month's salary), the subsidy was in fact doing no more than help the men to meet a cost that was primarily incurred during the course of their work.

PROBLEMS OF COMPARISON

Any attempt to compare the relative movement of black and white earnings in the gold mining industry involves a number of difficulties. At no stage in the production process do blacks and whites officially do the same jobs. Thus any comparison of earnings has to take into account the different skill distributions of the occupations filled by the two colour groups. This is more easily said than

[35] *S.A.M. and E.J.*, 18 November 1950.
[36] See Appendix 12.
[36a] T.C.M. (P.R.D. Series No. 34. Johannesburg, 1953) A.
[37] *Rand Daily Mail*, 4 August 1967.

done, for although it is in general true to say that whites hold skilled and semi-skilled jobs while blacks do semi-skilled and unskilled work there are nevertheless many blacks, particularly in the supervisory ('boss-boy') class, who are considerably more skilled than many day's pay men who rank above them. No detailed information has been made available to enable a comparison of the relative earnings of the less skilled white workers underground and the highly competent senior 'boss-boys'. Nor is one able to find out the relative earnings in those few occupations where black and white do almost identical jobs such as driving locomotives (see p. 116). Changes in the relative average earnings of the two groups may have been due partly to changes in the distribution of skills within each. Few figures are available to measure whether or not any redistribution of skill occurred. In 1940, officials (including secretarial staff) constituted 22% of the white labour force in the mines on the Witwatersrand,[38] by 1946 the proportion had risen to 30%.[39] On the other hand the development of the economy had so increased the opportunities for skilled employment that in 1957 the *S.A. Mining and Engineering Journal* pointed out that 'far too many South Africans artisans cannot measure up to their counterparts in the major industrial countries'.[40] Indeed, one of the barriers to the full development of the mines in the Orange Free State was the poor quality of the white miners.[41] This suggests that the skill capacity of white mine employees at the bottom end of the ladder may actually have fallen over time. However without more information than is yet available, it is impossible to determine whether the relative skill distribution within the two racial groups working on the mines altered over time or not. But in view of the developments in the training of black workers which took place after the Second World War (see p. 93) it seems likely that the difference in skill between the 'average' white and the 'average' black worker narrowed rather than widened over the period under consideration.

The second major problem encountered in comparing average earnings is that wages in kind vary widely from mine to mine depending on their age and geographical location. Whites on the old mines between Johannesburg and Springs are not provided with the subsidised housing that is offered to miners in the new, more isolated, areas of the West Rand and Orange Free State. Similarly blacks are far more comfortably housed on the newer mines. Paradoxically both blacks and whites in general prefer to work on the old mines. The reasons for this have not been deeply probed but the scraps of evidence available suggest that for whites the reason may lie in the social disadvantages of living in a small mining town as compared with the area around Johannesburg. As for blacks, a friend who was a migrant worker over the decade 1954–64 explained to me that the mines in the Orange Free State were far too dangerous for him ever to want to go there.[42] A compound manager of an older mine on the East Rand thought the reason for its popularity was due partly to the fact that it was a shallower mine and thus cooler to work in, and partly that it had only one basic shift a day compared with the Free State goldfields where there are three shifts but no night bonus. Whatever the reasons, the fact remains that mineworkers of both colour groups discount, fairly heavily, the perquisites offered in the newer areas. Moreover, the fact that these variations apply to both groups means that comparisons of average black and white earnings is not significantly distorted by them.

For the comparison to be meaningful, it is also necessary to ensure that the earnings relate to comparable units of working time. The annual average earnings discussed (p. 46) were obtained by dividing the total wage bill by the number of person 'in service'. But not all those in service were actually at work on any particular day. The reasons for this difference or wastage have remained much the same over the years.[43] For the blacks the chief causes of wastage are sickness and, in the case of newly arrived recruits, physical unfitness for work due to the change of climatic conditions. For whites on the other hand, a large proportion of the wastage is accounted for by annual leave which has increased over time. Of the 110 shifts (per 1,000 possible) lost by whites in 1956, 87 were for leave,

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[38] Jeppe, *Gold Mining*, p. 1734 B.

[39] G.M.E., *Annual Report including Reports of the Government Mining Engineer and the Geological Survey for the Year ended 31st December 1946* (U.G. 36, Pretoria, 1947) A.

[40] *S.A.M. and E.J.*, 23 August 1957.

[41] *Mining Journal*, 2 December 1955.

[42] See Appendix 13.

[43] Wastage is a measure of the proportion of the labour force that is absent from work. It is defined as follows:

$$\text{Wastage} = \left(100 - \frac{\text{No. of persons at work}}{\text{No. of persons in service}} \times 100 \right)\% .$$

13 due to absence with permission, and 10 due to absence without permission. Between 1936 and 1963 out of every 100 men in service the average number of whites at work was 88, and the average number of blacks was 98. In 1947 the number of shifts lost because of sickness was, for whites, 29 per 1,000 and for blacks 8.

Commenting on this difference, the Government Mining Engineer pointed out that the figures 'emphasise the benefits accruing to the industry from the control it enjoys over its native labour as a result of the "compound" system of housing'.[44] In addition to these differences is the fact that, in general, blacks worked longer hours than whites. By law each group is supposed to work a 48-hour week, but I was informed in 1965 that although this was true of whites, blacks spent approximately ten hours a day, six days a week, between the time they got into a 'cage' to go underground and the time they got back to the surface. Not all this time was spent actually at the face or getting there and back to the shaft, for when they arrived underground most blacks had, until the 1967 productivity agreement (p. 176) to spend an hour or more at the foot of the shaft waiting for a white miner to arrive and examine the scene of blasting in the previous shift to check that it was safe. Having to wait as much as three and a half hours after work for a cage to take them to the surface was a major complaint of black miners to official commissions both in 1914 and in 1943.[45] Despite numerous requests by whites for a reduction of the working week to five and a half or five days, this has been consistently opposed by the Chamber, not only on the grounds of cost, but also because it fears that such reduction would create unrest amongst the black labour force who would have too much idle time on their hands. 'One of the most important things in our welfare work', wrote one group in 1950, 'is to organise as much recreation for the African worker as possible in order to keep his mind occupied during his spare time.'[46]

Another factor to be taken into account is the distinction between what one might call consumption earnings and investment earnings. The former refer to all income which the employee receives for his own benefit; the latter refers to that part of income which, although it is part of the total earnings of an employee, may yet be regarded as a form of investment by the employer. For example, the free food supplied to black workers has long been regarded as a form of earnings in kind and is indeed an important factor in attracting labour to the mines. Nevertheless from the employer's point of view such expenditure may well be regarded as an investment, for better feeding of undernourished workers increases their productivity and, as we shall see in chapter 6, the rises in productivity are not necessarily followed by an increase in earnings but may accrue partly to the employers as a return on their investment. The same is true of education and training. Clearly it is impossible to draw a rigid distinction between consumption and investment earnings, but it must be realised that not all the earnings detailed in this chapter can be thought of as benefits accruing solely to the employees.

In correcting the comparative figures for these various differences, no account is taken of the fact that blacks generally spend longer underground than whites, nor of the fact that black jobs are considerably more dangerous and arduous than white. Also not taken into account are the costs of recruiting workers (see p. 73). Moreover it is impossible to make any quantitative comparisons over time of the costs of housing or of recreation. In 1969 the average cost to one group, a number of whose mines were new, of housing black mineworkers was 3 cents per shift worked. This figure included maintenance of compound buildings, cleaning, heating, sanitation, and assessment rates to local authorities. For whites the housing subsidy on the new mines worked out at approximately 164 cents a shift at this date. With regard to recreation there are no figures for comparative costs, even for one year, but as already noted (pp. 59–60) there is no doubt that, as far as the mines were concerned, the cost of helping each white to relax was much higher than for each black.

Between 1936 and 1949 whites, for overtime work, were paid at time and a half; thereafter they have been paid at double time. For blacks there was no overtime pay until 1944, after which date the rate has been at time and a half.

Despite the difficulties in quantifying the wages in kind and in allowing for the differences in risk and working hours it is none the less possible to get a

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[44] See Appendix 14.
G.M.E., *Annual Report* (1948) A.
[45] South Africa, *Witwatersrand Mine Natives' Wages Commission*, p. 29 A.
[46] Rand Mines, *A Survey of African Welfare on Mines of the Group* (Johannesburg, 1950) B.

fairly accurate picture of the relative earnings of the two groups. There are figures which show that in 1961 the average underground wage paid to a black worker was 59% of the total cost—including recruiting expenses—of hiring him.[47] For whites it was estimated that, on three new mines in 1963, cash earnings varied between 51% and 59% of the total labour cost.[48] Given the similarity of these proportions it seems that it would be not unreasonable to compare relative earnings by contrasting the cash incomes (including allowances) of whites on the one hand with the cash incomes plus cost of food supplied to blacks on the other. Table 7 shows the relevant figures.

TABLE 7.—EARNINGS PER SHIFT WORKED, 1911–69

Year	White (cash including allowances) (cents)	Black (cents)			Earnings gap			Index of real earnings [1] (1936=100)	
		Cash	Food	Total [2]	White (cash)	:	Black (cash and food)	White (cash)	Black (cash and food)
1911	217	20	4	24		9.0:1		92	111
1916	233	20	4	24		9.7:1		86	96
1921	348	22	6	28		12.4:1		88	77
1926	263	22	4	26		10.1:1		82	89
1931	266	22	3	25		10.6:1		88	91
1936	283	23	4	26		10.7:1		100	106
1941	301	23	5	28		10.8:1		93	90
1946	411	29	9	37		11.1:1		102	103
1951	587	36	9	45		13.1:1		114	90
1956	760	43	13	56		13.6:1		123	93
1961	876	48	14	62		14.2:1		127	97
1966	1,170	59	17	77		15.2:1		151	108
1969	1,488	65	18	83		17.9:1		178	106

[1] Using retail price index calculated from 1938 as base year. Real earnings were then converted to an index, taking 1936=100.
[2] Due to rounding of figures this column is not always exactly equal to the sum of the previous 2 columns.

Source See app. 15, p. 168.

Although the table does not include the considerable earnings in kind received by white mineworkers nor wages in kind other than food provided for black workers, there can be no doubt that the gap, or ratio, between average white and black earnings has always been large and that it increased rapidly during the 1950s and 1960s.

This movement is not only contrary to the pattern in other industrialised countries but was also quite different from what was happening in the South-

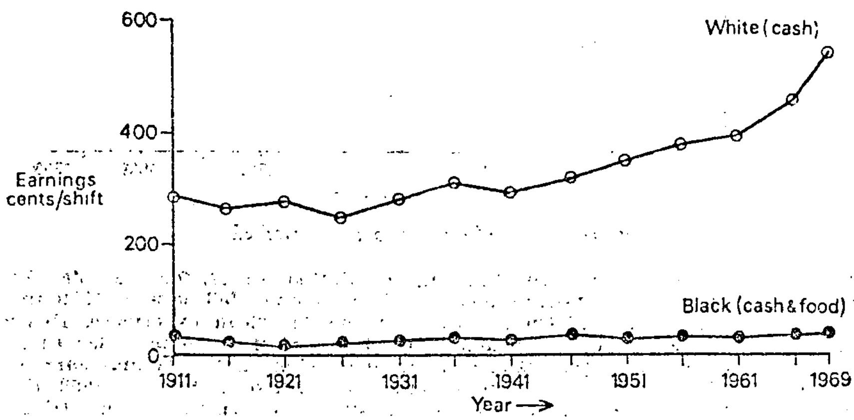

Fig. 5a Earnings per shift worked (at 1938 prices), 1911–69.

[47] In 1943 cash wages for black miners made up 68% of the total cost of hiring, including expenses of recruiting, housing, hospital and food. South Africa, *Witwatersrand Mine Natives' Wages Commission*, pp. 6–7.
[48] Figures kindly supplied by one of the mining houses.

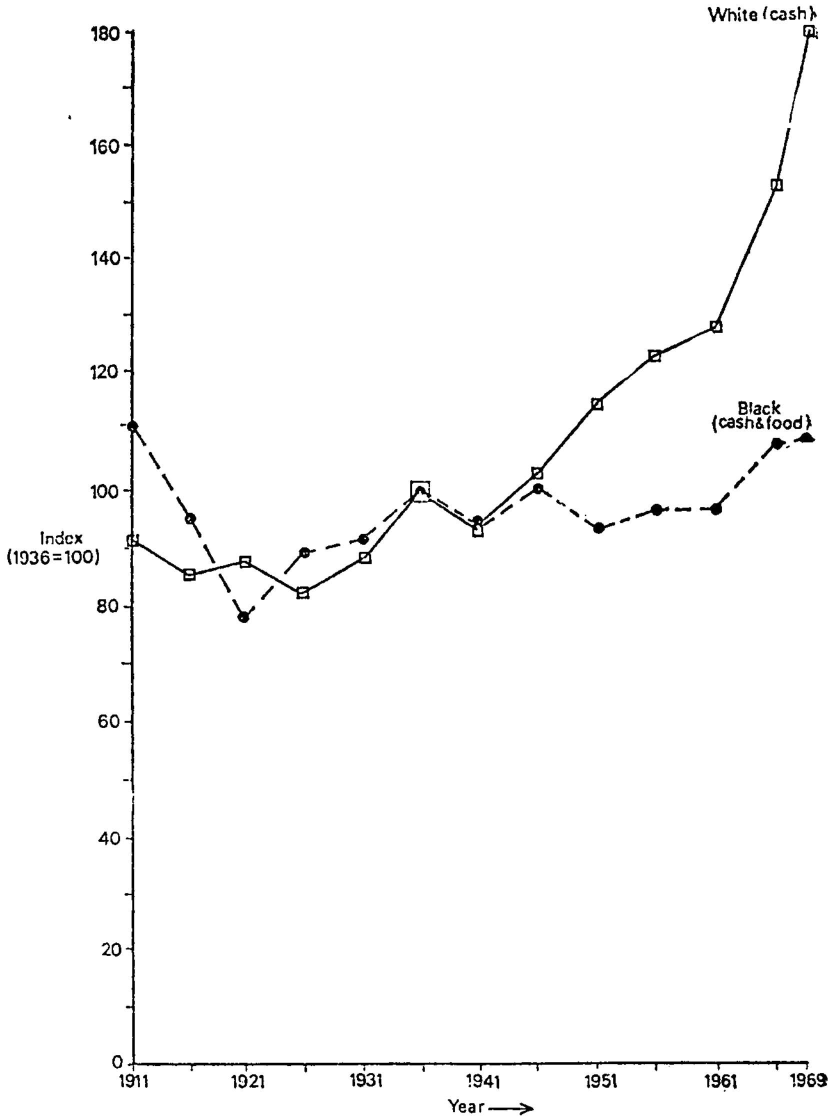

Fig. 5b Index of earnings per shift worked

African industrial sector at the time. In the United States, for example, the gap between white and non-white median salary earnings fell between 1939 and 1953 from 2.4:1 to 1.7:1.[49] On the basis of the American experience, Reder suggested that the gap (or 'skill margin') between skilled and unskilled earnings tended to decline in periods of general labour shortage.[50] A similar narrowing of the skill margin occurred in Britain where, between 1880 and 1950, the ratio of skilled to unskilled earnings fell substantially.[51] In the South African

[49] M. Zeman, *A Quantitative Analysis of White-Non-white Income Differentials in the United States* (Ph. D. thesis, Chicago, 1955), p. 25 D. The gap has not changed significantly since then. A. B. Batchelder, "Decline in the relative income of Negro men", *Q.F.E.* LXXVIII (1964) C.

[50] M. W. Reder, "The theory of occupational wage differentials", *A.E.R.* XLV (1955) C.

[51] K. G. J. C. Knowles and D. J. Robertson, "Differences between the wages of skilled and unskilled workers, 1880–1950", *Bulletin of the Oxford Institute of Statistics* XII (1951).

manufacturing sector the white–black earnings gap was not only much smaller than, but also moved differently from, that in the gold mines: between 1935 and 1946 it narrowed from 5·5:1 to 3·7:1 and then widened again to 5·5:1 in 1962. By mid-1970 the gap was 5.7:1.[52] In order to understand both why the gap between black and white earnings in the gold mines was so large, and why it widened so much after the Second World War, it is necessary to turn to a detailed analysis of the forces operating in the labour mraket of Southern Africa.

Chairman REUSS. We now are very happy to hear from Under Secretary of the Treasury Paul Volcker, who has a statement which has been submitted to us.

I am very grateful to you for appearing here so shortly after your return from some monetary discussions in Europe.

Your entire statement will under the rule be received into the record.

Would you now proceed in whatever way you like?

Would you be kind enough to introduce your associate?

STATEMENT OF HON. PAUL A. VOLCKER, UNDER SECRETARY OF THE TREASURY FOR MONETARY AFFAIRS, ACCOMPANIED BY PAGE NELSON, DIRECTOR, OFFICE OF FOREIGN EXCHANGE OPERATIONS

Mr. VOLCKER. This is Mr. Page Nelson with me, who is Director of our Office of Foreign Exchange Operations from the Treasury.

I will just read the statement, with your permission.

Chairman REUSS. Yes. It is an excellent statement, and responsive to our request. There are no wasted words.

Mr. VOLCKER. Mr. Chairman and members of the subcommittee, in these hearings the subcommittee is reviewing two issues of importance to U.S. international financial policy: First the role of gold in the international monetary system, and second, recent actions by the United States to intervene in the foreign exchange markets. I would like to briefly comment on these subjects and then to respond to any questions you may have.

With respect to gold, the United States has repeatedly expressed the view that the role of that metal in the international monetary system should and must continue to diminish. Such an evolution is, of course, fully consistent with the trend of monetary history over a period of many years. Governments around the world long ago reached the inevitable judgment that domestic monetary systems and policies could not safely be hostage to vagaries in gold demand and supply—the cost in terms of economic stability was simply too high. Internationally, gold 25 years ago accounted for about 70 percent of total national monetary reserves. By 1972, the ratio had declined to some 27 percent.

There are irresistible geological, industrial, and economic facts behind these trends. The physical supply of gold is both limited and, in the Western World, virtually entirely under the control of one producing nation. A point that Congressman Diggs was making here so eloquently. The supply reaching the market is not only subject to the policies and circumstances of that country, but is also increasingly

[52] Office of Census and Statistics, *Census of Industrial Establishments 1935–6* (U.G. 24, Pretoria, 1948), Bureau of Statistics, *Statistical Year Book 1968* (South Africa, Pretoria, 1969). See Appendix 16.

preempted by industrial, artistic, and dental uses. Gold is both an attractive and useful metal, but the residual supply is in no way related to the liquidity needs of the world community. Commodity uses inevitably compete increasingly with monetary uses as population and wealth rise.

Given these facts, I suppose there are some who would argue that additional liquidity in a gold-based system can be provided by increasing from time to time the price at which gold is traded among monetary authorities. But surely such an approach would make a mockery of any presumed "discipline" from a gold centered monetary system—the virtue sometimes still attributed to the use of gold. A system relying on gold price increases to regulate liquidity would be both continuously destabilizing to the monetary system and capricious in whom it benefits and whom it hurts.

The inadequacy of gold as the basis for an international monetary system seems to me amply reflected in recent history. Throughout the "Bretton Woods era," countries quite naturally sought supplements and substitutes, and this process was necessary to meet the needs of an expanding and integrated world economy. The two-tier gold system has been one means of coming to grips with destabilizing speculation in gold markets. The adoption of the SDR gave explicit international acknowledgment to the fact that new means needed to be found to provide an orderly and satisfactory means of assuring appropriate growth in world reserves.

None of this is new or startling. It has been common ground among the vast majority of economists for years—there are few issues upon which the profession is so united.

But within the general concept of diminishing dependence on gold in the monetary system, there are of course a number of questions concerning the role of gold that must be resolved in the course of negotiations on international monetary reform. As the IMF Executive Directors recently reported, a consensus among nations on what remaining role gold should still play in a reformed system does not presently exist. I do not think it will be easy to resolve differences on what to do about the precise role of gold. More than one approach may be available within the general context of avoiding dependence on gold for monetary purposes, but I would emphasize our belief that the historical trend toward substitutes and supplements will and should continue.

Among the detailed questions concerning gold's role in the system are the use of gold as "numeraire" for currency values, the existing requirement for using gold in certain transactions with the IMF, the relationship of gold to the SDR and other reserve assets, and the proper functioning of the two-tier system. These questions are obviously related to other aspects of the system and other issues of monetary reform; they cannot therefore be entirely resolved without consideration of other questions concerning SDR's, the nature of the exchange rate regime, the nature and use of alternative reserve assets, and the like.

I would suggest that during this interim period, when broad issues of the role of gold and structure of the monetary system are under negotiation, it would not be the appropriate time to end our long-standing restrictions on gold purchases by private U.S. citizens, thereby possibly injecting further speculative elements into an already volatile and artificial gold market. Certainly, it seems to me ironic that speculation in private markets whipped up by lingering hopes of an increase in the official price is itself cited by some as a reason to increase the official price. Such an approach would appear to abdicate all prospects for orderly control of international reserves. The time for sympathetic consideration to the elimination of our own restrictions is when the shape of the new monetary structure emerges, and the monetary system is fully insulated from instability in private gold markets.

As I have suggested, it is our wish to deal with the official role of gold in the context of an agreed cooperative global arrangement. I hope and anticipate that other countries approach the negotiations in the same spirit.

Changes in the present two-tier system will naturally be considered in that framework. I would not preclude any action in that respect prior to full-fledged reform, but I do think it is desirable to keep the overall objective in mind and to approach the question in a cooperative framework.

Finally with respect to the gold issue, I would observe that a few voices are occasionally heard that an increase in the gold price can somehow substitute for needed far-reaching monetary reform—that somehow the difficult economic and political issues of exchange rate adjustment, problems of achieving and maintaining balance of payments equilibrium, and the management of reserves can somehow be washed away or escaped by manufacturing a sea of new liquidity through an arbitrary adjustment in the official gold price. Surely, this is an illusion. It is a particularly dangerous illusion, for it would instead divert us from the urgent need to face up to and attack these real and fundamental problems with vigor and imagination, so that the evident problems of the past do not become a recurrent and damaging feature of the international economic landscape.

The second subject of these hearings is the recent U.S. intervention in the exchange markets, in accordance with a decision in July. This action is closely coordinated between the Treasury and the Federal Reserve, under agreed guidelines, regardless of which agency at a particular time may actually engage in the operation. Chairman Burns, who I understand will appear at a later session, will undoubtedly also wish to comment on this subject.

This decision to intervene more actively in the exchange markets, at such time and in such amounts—large or small—as we deem desirable, was taken from the primary purpose of helping to deal with speculative forces. Naturally we do not like to see turbulence and strains in the money markets. It creates problems for businessmen, our trading partners, and for us.

As you will recall, following a period of calm the exchange rate realinement so arduously worked out in the Smithsonian Agreement came under severe but unwarranted testing in early July in the wake of the British decision to float the pound. Speculative pressures growing out of this decision turned against the dollar. Foreign central banks intervened heavily in the exchange market to maintain their market rates, reaffirming their support of the Smithsonian Agreement. It was our view that the speculation arising from the unique situation of the pound should not affect the basic exchange rate structure. To help make this point crystal clear, and to signal an intent to help deal with speculative pressures in the future, intervention was undertaken by the Federal Reserve on July 19, using initially certain currency balances held by the Treasury. This decision was not inconsistent with, and indicates no change in, our basic policy approach to monetary reform and our efforts to achieve sustainable equilibrium in our balance of payments.

We have not embarked on any effort to artificially prop up the dollar counter to any basic balance-of-payments trends in the longer run. In the end, the strength of the dollar will rest on other policies to improve our balance of payments—policies we are pursuing with great vigor.

While the intervention action to date has been quite limited in terms of numbers of currencies, amounts and periods of intervention, we must of course be prepared to acquire needed foreign exchange to finance such operations. The existing swap facilities, or mutual credit facilities, long maintained by the Federal Reserve, provide a convenient vehicle for obtaining currencies as needed.

In contrast to usual practices before August 15, the present operation is one in which, while full consultation and cooperation is maintained with the foreign country concerned, the basic initiative will lie with the United States. Foreign exchange will be drawn not in a passive manner after intervention by other countries, but for use in the exchange markets by the United States in such amounts and at such times as we believe the market impact will be favorable and help to curb unwarranted speculative forces. Thus, the United States maintains full control over the usage of the lines. Drawings would not be made or enlarged to deal with what would be fundamental misalinements in our payments position. In normal and foreseeable circumstances, repayment could be anticipated from a reversal of market flows.

That completes my statement, Mr. Chairman. I will be glad to answer any questions.

Chairman REUSS. Thank you for a most excellent statement.

And with its two central propositions, I believe that you will find this subcommittee continues to be in harmony. Namely, gold should, as soon as possible, go the way of conch shells, stone wheels, and beautiful slave girls as a method of holding reserves, and second, that intervention in support of an exchange rate that is in basic disequilibrium is a poor idea, and should not be done. Those seem to me to be the two main points that you make. We find ourselves in perfect accord on them.

Mr. VOLCKER. I think those are the two main points. And I am of course glad to hear you reiterate your support.

I must admit that I had not thought of beautiful slave girls, and the Treasury officials might be in a somewhat prejudiced position if that was an international asset.

Chairman REUSS. In ancient Ireland, in the time of Patrick, they were the principal store of wealth, and highly regarded.

Representative CONABLE. A voluble reserve.

Mr. VOLCKER. The supply is large in this country, Mr. Conable.

Chairman REUSS. If I may, let me start with the South African business.

You were sitting in the back of the room, I think, when Mr. Diggs was testifying. Have you read, I presume, the letter of August 9, 1972, from Secretary Shultz to Mr. Diggs?

Mr. VOLCKER. Yes, I have.

Chairman REUSS. That letter says in effect that the December 1969 agreement isn't so bad because it at least makes South Africa place on the market that amount of her gold necessary to rid her of her current balance-of-payments deficit. Well, that is true. But I really don't think that is what Mr. Diggs was talking about. He was talking about the International Monetary Fund buying, as it has in the recent past, very large sums of South African gold.

Mr. VOLCKER. Not in the very recent past.

Chairman REUSS. Not in the last year, but I meant in the last 3 years, and all at a time when our general philosophy about gold was as you have described it today; namely, that it is an international reserve asset without much of a future.

The IMF purchases apparently were just made by the IMF out of the blue, and not as part of the December 1969 agreement.

I will rephrase that, in case that may be obscure. The December 1969 agreement, as I read it—and if I read it wrong, please tell me—does not oblige the International Monetary Fund to buy any South African gold. I used to think that it did, but on a more careful reading of it, I find that it simply sets forth what South Africa can sell and refuse to sell.

Am I right in that?

Mr. VOLCKER. I would say that certain agreed practices between South Africa and the IMF are in force. There is a legal question which I suppose goes to the issue of whether the IMF is obliged to do anything. And that legal issue was never fully settled.

Chairman REUSS. You know my views, because I have held them quite tenaciously both before and after the December 1969 agreement. I maintain that for the IMF to buy South African gold, or any other nonmonetary gold for that matter, is a miserable idea at a time when we want to phase gold out. Whether the IMF has bought the roughly $800 million worth of South African gold which it has purchased in the last 3 years as the result of a firm agreement with South Africa, or just on an ad hoc basis, it seems to me to have been equally harmful and wasteful in both cases.

Now, as a result of the testimony this morning, we have added to that the very deeply felt view of the distinguished chairman of the House Subcommittee on Africa. And I know that he is not alone in his view that it is simply outrageous for the United States to be a party, through our acquiescence, in an IMF action, in giving a wholly unnecessary economic boost to South Africa.

What can we do to set up an early warning system so that if the IMF is ever tempted to do this again, you can promptly let us know? We want to amass the maximum of public opinion to persuade the U.S. governor and executive director to use all of their powers, veto and otherwise, to prevent such action. Can you give us 30 days' notice in all cases before any IMF gold purchase from South Africa is attempted, so that we can do our best to stop it?

Mr. VOLCKER. I think it might be worth pointing out, Mr. Chairman, that these purchases to which you refer took place at a time when there were two developments and influences, one like the present period but the other way, the gold price was under pressure in the opposite direction, and the gold price was tending to decline below $35 an ounce at one point, and hover around that level for some period of time.

Chairman REUSS. That relates to $208 million of the $800 million purchase.

Mr. VOLCKER. And there was some special transitional arrangement which is now no longer effective as part of the agreement which also contributed to that total.

Chairman REUSS. I would agree that it is not likely that the IMF will be in a position to use the $35 an ounce excuse for buying South African gold.

Mr. VOLCKER. Well, they could again.

Chairman REUSS. But what about the balance-of-payments clause, which is still available?

Mr. VOLCKER. If South Africa has a balance-of-payments deficit under the terms of this agreement, they would be able to finance the deficit by selling gold to the IMF.

Chairman REUSS. If the IMF chooses to buy.

Mr. VOLCKER. Well, the IMF, I think, under the terms of this agreement, unless the agreement is changed, in effect says it does choose to buy. I think that is the nature of the agreement.

Chairman REUSS. I will admit that I always thought that was so. But I can't find anything in the agreement which says, "and the IMF agrees to buy." Presently, the IMF purchases are just due to some behind the scenes arrangement whereby they go and buy. And therefore one can repudiate, tear up, and throw away the December 1969 agreement, and the IMF could still go and buy.

Mr. VOLCKER. The agreement can be changed, unless there is no question about that.

Chairman REUSS. Where does it say—do you have it in front of you?

Mr. VOLCKER. I don't recall the precise nature of the Fund decision. There was an exchange of course with South Africa and with the United States, for that matter, to which Congressman Diggs referred. And there was, as I recall, an IMF decision taking note of this course of events. But I don't recall——

Chairman REUSS. Did it say, "And we will do the dreadful thing."

Mr. VOLCKER. That is certainly the implications of it. I cannot quote you the words. I have not got with me the formal IMF action in this respect.

Chairman REUSS. Let's do this. Would you, when you have an opportunity, perhaps aided by counsel, review the agreement, and if there is anything in the December 1969 agreement which actually binds the IMF to buy, call that to our attention for the record.

Mr. VOLCKER. I will be glad to supplement this. But in general my clear understanding is that this provided a basis for the IMF buying authority, but there is nothing in the agreement that says it can't be changed, of course. But it will take another decision by the Fund.

Chairman REUSS. I don't mean to be overlegalistic, and I confess that I had always thought, until the last couple of days, that the December 1969 agreement was the thing that bound the IMF to buy. But I can't find any language to that effect, and therefore it seems to me, unless you are going to set me straight on it, it seems to me that the IMF is just on its own initiative buying the gold.

Mr. VOLCKER. There was a legal question raised by South Africa and others as to whether the IMF was in fact not legally bound to buy. We never associated ourselves with that legal opinion, and do not now. But there was a difference of legal opinion. And the IMF has never in affect ruled on that legal point.

Chairman REUSS. Now, coming back to my point, while it is true, as you say, that the section 3, the kitty arrangement, was probably a one-shot operation, and while it is undoubtedly true that the $35 an ounce purchase is a thing of the past, nevertheless the balance-of-payments clause is still a sword of Damocles. So what arrangements can we now make for an early warning system, so that if the IMF feels the itch once again to buy South African gold, the Congress and the public can know about it and bring requisite pressures on the U.S. Governor to prevent it? Can we have at least 30 days' notice of such intention?

I see Mr. Dale, who is our man in residence, over there. Perhaps he could respond.

Mr. VOLCKER. There are two conditions under which the IMF can buy gold from South Africa. One is if the price is below the official price, which you can understand by looking at the paper, and as the price declines you can be so warned. The other is, of course, if South Africa is in a balance-of-payments deficit. Right now they are in a plus of some size. But as their balance-of-payments position changes, as it will inevitably some day, then of course the forecast of that could be presented to you and to others. This you would be interested in having. And those are the two conditions that could trigger a sale under the agreement as it now stands.

Chairman REUSS. South Africa could be in deficit, but that does not mean that the IMF is actually going to do the deed again. I think it is an outrageous thing. I would think that the IMF would think twice before doing it. But I want to help focus its thoughts on this when the time comes. So I would like to know——

Mr. VOLCKER. Apart from those two conditions, the IMF itself may not have 30 days' notice.

Chairman REUSS. Why? I would challenge that.

Mr. VOLCKER. If the price declines tomorrow——

Chairman REUSS. Below $35?

Mr. VOLCKER. Below the official price.

Chairman REUSS. If you are talking about that, for the "below $35" I will be content to read the papers on that. For the much more realistic balance-of-payments provision, how about giving the subcommittee 30 days' notice of any intention by the IMF to purchase nonmonetary gold?

Mr. VOLCKER. We can certainly try to give you some indication of when the South African balance-of-payments position changes so this may become a live issue.

Chairman REUSS. That will make me very happy.

But then I want to know, too, whether the IMF, apprised of that same fact, intends to do anything about it?

Mr. VOLCKER. I think unless there is a change in the agreement, the IMF would be prepared to buy some gold under those circumstances.

Chairman REUSS. Prepared. But are they going to?

Mr. VOLCKER. I would think they were going to if South Africa offered it to them.

Chairman REUSS. This depends, of course, on what you tell me about the agreement. As I have said just now, I can't for the life of me find in the agreement a commitment by the IMF to buy South African gold when South Africa finds itself in deficit.

Mr. VOLCKER. I will be glad to provide you some information which relates directly to that point.

Chairman REUSS. What action can the United States take to prevent such a purchase?

Mr. VOLCKER. Let me make two general points about the agreement, Mr. Reuss. First of all, it is an agreement entered into by a good many countries through the IMF, and all the members of the IMF. It is not a decision which therefore the United States can dominate or control in all aspects, as in many other areas of the system.

Chairman REUSS. Here again it becomes very important whether you are able to produce the wording of that agreement committing the IMF to make these purchases. I don't think it exists.

I have the agreement in front of me. If you can point it out now, or Mr. Dale or anybody else can point it out right now, wherein it says that the IMF is bound to buy, I will be educated.

Mr. VOLCKER. Unfortunately I do not have the precise language of the Fund agreement with me.

Chairman REUSS. We have got a chief counsel, Mr. Bradfield.

Mr. VOLCKER. We just don't have the Fund decision with us.

Chairman REUSS. I have got it right here. Maybe we can get it straightened out right now.

Mr. VOLCKER. If we may pass on while Mr. Bradfield is looking——

Chairman REUSS. Right.

Mr. VOLCKER. This was an agreement, I would say in general. As to every detail of it, I would just as soon some portions of it were written in a different way. I might like to write it your way rather than the way it is written. But it was an agreement that we had to enter into with a number of other countries. That is point No. 1.

And point No. 2, I think basically this is a side issue, this is an issue of some interest, but it is subsidiary to the general question as to the role of gold in the monetary system. And I don't attribute too much importance as to whether South Africa has got some opportunity at sometime in the future to sell some small amount of gold to the IMF or not. This should be reviewed and resolved as part of the general framework of disposing of the role of gold in the monetary system. I don't think this agreement in itself at the moment is perhaps as critical as some of this discussion might imply.

Chairman REUSS. But the whole gold issue is made up of a series of little parts, South African gold, the two-tier agreement, and the payment of gold as quotas, and so on.

Mr. VOLCKER. This is part of the total complex of policies and approaches. And it certainly will be reviewed in that connection. But I would not single it out as the heart of the matter.

The Fund decision was taken, as you know, on December 30, 1969. It reviews—I am just reading now from the decision—it reviews the letter which South Africa sent to the Fund stating its intention, under what conditions it would offer and sell gold to the Fund. There is a sentence here which was pointed out to me that I can just read: "As a matter of policy"—that is, stated as a matter of policy because of the legal obscurity to which I refer—"the Fund decides it will purchase gold from South Africa when South Africa states it is offering gold in accordance with the terms of its letter."

So it just seems to me that on the face of it the Fund has taken a decision here which would need to be reversed.

Chairman REUSS. Here is Mr. Shultz' writing on August 9 saying:

The agreement with South Africa does permit the parties to review the arrangement in the event of a major change in circumstances. I think the development beginning last August 15, and the continuing development with regard to monetary reform, could be viewed as a major change in circumstances, and the arrangement reviewed if it should be considered desirable to do so.

Why don't you promptly review the arrangement?

Mr. VOLCKER. There is no question in my mind that the basic agreement can be reviewed.

Chairman REUSS. Why not do it?

Mr. VOLCKER. The question is whether at this point in time a review and a change in this arrangement is useful in line with the purposes I think that you and I share. This agreement is not a one-sided agreement. As I suggest, there are elements in this agreement that from my particular point of view I would just as soon as not have. There are elements in this agreement from the South African point of view and the point of view of others which one would assume that they would just as soon not have.

The provision for ordinary marketing, I think, is valid, and not insignificant. South Africa happens now to have a very large surplus in their balance of payments. Under these conditions they have the inherent economic power in a sense to withhold gold from the market. They have done that to some extent, but to an extent far less than their balance-of-payments position itself would permit. I think that is one of the fruits of this agreement.

So it is not a totally one-sided agreement by any means.

I think it can and should be reviewed in the context of the evolution of the system as we move on. But if you ask me whether I think this is an urgent and critical matter today, I don't think it is urgent and critical today.

Chairman REUSS. I don't want to spend an undue amount of time on this, so I will conclude by saying, one, I repeat my urging, as I have numerous times in the past, that the U.S. governor promptly take steps to review and end that agreement insofar as there is any provision in there requiring the IMF to buy South African gold.

And secondly, until that is done, to notify this committee as soon as the South African balance of payments falls into deficit, so that we can do what we can to bring pressure on you to stop the IMF from purchasing South African gold.

Mr. VOLCKER. I don't think there is a fundamental disagreement here.

Chairman REUSS. Mr. Conable.

Representative CONABLE. Thank you, Mr. Chairman.

I understand your position.

We are talking about extremely unlikely possibilities here.

One thing I don't understand is that in the event of a balance-of-payment deficit, if IMF applies to buy gold, is it your understanding of the policy decision that has been made that they are obliged to provide gold at the then prevailing price?

Mr. VOLCKER. At the official price.

Representative CONABLE. At the official price. So they don't have to buy it at whatever price they want?

Mr. VOLCKER. No.

Representative CONABLE. I assume that the surplus of payments that South Africa now has are related to the price of gold to a certain extent, aren't they?

Mr. VOLCKER. That helps, I am sure. In assessing the South African payments position you always have to take account of the fact that the major export of South Africa is gold.

Representative CONABLE. So if the price is high they are pretty likely to be in good shape as to balance of payments?

Mr. VOLCKER. They were in pretty good shape as to balance of payments before the cyclical price of gold rose so high.

Representative CONABLE. What relation does that have to the supply of gold?

Have they been selling gold on the open market very recently?

Mr. VOLCKER. I have no firm information on that, Mr. Conable. I would doubt that any sales Russia has made have been very substantial. But I have no direct information on it at all.

Representative CONABLE. Apparently the Russians have substantial reserves they could use and put on the market if they wish.

Mr. VOLCKER. They unquestionably have some gold reserves. Again, that is not a figure they publish with great exactness. I don't know how big they are.

Representative CONABLE. Mr. Volcker, I notice your statement about not relaxing the prohibition of buying gold by American citizens at this point. Do we have a very short supply of gold for industrial and commercial purposes at this point?

Mr. VOLCKER. Are you talking about in this country or the world?

Representative CONABLE. In this country.

Mr. VOLCKER. We are a net importer of gold. I haven't got those statistics with me, but we certainly consume more gold in this country by a considerable margin than we produce.

Representative CONABLE. How do people who use gold for commercial and industrial purposes get it now?

Mr. VOLCKER. They just buy it in the market, in the private market.

Representative CONABLE. And apparently in the law there is no prohibition to their doing this?

Mr. VOLCKER. No; in the United States if you are a legitimate commercial or artistic user of gold, or medical user of gold, you can apply for gold under license from the Treasury.

Representative CONABLE. But the Treasury itself does not sell it.

Mr. VOLCKER. No. We did before the two-tier system; now they buy it in the private market.

Representative CONABLE. Would it be possible to install an auction system under some terms that would protect its abuse?

Mr. VOLCKER. Yes; that is conceptually possible. There is no prohibition in the law as to selling gold for industrial or other uses.

Representative CONABLE. Would such a device relieve some of the pressures upon prohibiting private citizens to buy their own gold?

Mr. VOLCKER. Certainly the industrial users would be very anxious for us to sell some gold in the market. The two-tier system as presently structured would suggest that we do not do that. It makes this distinction between the existing stock of monetary gold and industrial and other private uses. And the distinction is made clearly.

We would have to modify that kind of understanding should we sell gold to industrial users.

Representative CONABLE. Aside from the implications of the two-tier system, is there any legal impediment to doing that?

Mr. VOLCKER. No.

Representative CONABLE. Would it have any effect on our balance of payments?

Mr. VOLCKER. It probably would.

Representative CONABLE. Yes. We would presumably save some imports of gold from abroad.

Mr. VOLCKER. Right.

It would reduce our monetary stock of gold and save some gold imports.

Representative CONABLE. We are not now talking about a very large amount, are we?

What is our annual consumption of gold?

Mr. VOLCKER. Something over $200 million, as I recall; $200 to $300 million in industrial demand in the United States last year.

Representative CONABLE. If we were to do this, would it have the effect of further unstabilizing the dollar in some way because of the continuing relationship between gold and the dollar?

Mr. VOLCKER. I don't think so——

Representative CONABLE. Would it reduce our reserves?

Mr. VOLCKER. It would reduce our reserves. But I don't think it would have a major impact.

Representative CONABLE. In your view, Mr. Volcker, what has been our experience with the wider margins agreed on in the Smithsonian Agreement?

Do you think it has generally been favorable?

Has it been a success in your view, despite the recent swings that have taken place?

Mr. VOLCKER. In my view it has been, Mr. Conable. As in some areas, you cannot run a simultaneous experiment and do it another way at the same time. But in my view this has been an important and constructive factor in dampening speculation in currencies. Now, obviously we have had several instances of very pronounced speculation in currencies, despite the wider margins.

My judgment is that those incidents would have been more frequent, more prolonged and larger had the margins been narrower. That is a judgment I am disposed to make without having an opportunity to examine the opposite.

Representative CONABLE. Do you think it has the effect of dampening pressure for further monetary reform if we went these wider margins?

Mr. VOLCKER. I don't think so. We would see wider margins, prices fall——

Representative CONABLE. Do you think you would have more of a crisis?

Mr. VOLCKER. I suppose you might have had more of a crisis in that sense. But we have sufficient pressure, I think, and I am not looking for crises to produce more pressure.

Representative CONABLE. It would be your conclusion, then, that the wider margins have permitted a calmer search for further monetary solutions?

Mr. VOLCKER. I agree with that.

You might hear one source of concern about wider margins. The argument is sometimes made, and I think with some validity, that immediately following the Smithsonian, or some subsequent period, with a narrrower margin more money would have flowed back into the United States for expectational reasons, if the markins were narrower, because with the wider margins the dollar rate had to reappreciate in effect again a lot before you reached the point where the foreign central banks actually sold a lot of dollars into the markets. That is possible. In some periods you may have gotten more flow in that direction with a narrower margin. I think we might have paid a lot in a sense for that flow, because that is the other side of the coin. The flow might have gone more readily in the other direction too. And we are, of course, in a period when our basic balance-of-payments position is not strong, we are still running a very large deficit month after month on our underlying account.

So unless you get some tendency toward return flow, the money flows out. And most of the time we have had some tendency toward the return of short-term capital within these wider margins.

Representative CONABLE. My time is almost up. I have one last question.

When we repurchase dollars under a swap agreement, does the loss from such a repurchase show up as a budget transaction, a balance-of-payments transaction?

Mr. VOLCKER. There isn't necessarily a loss. But let's assume that there has been an exchange rate change which produces a loss.

Representative CONABLE. Isn't that very frequently the case?

Mr. VOLCKER. No. In most of the history of these swap transactions we tend to make a little profit, because you do this when the dollar is weak, and you tend to repay them when the dollar is relatively strong. We did take losses beginning last August 15, obviously, when there was a major exchange rate change.

Those losses will show up in one of two ways? If it is a Treasury operation, it will show up in the Exchange Stabilization Fund, and it has no direct budgetary impact. If it is a Federal Reserve operation it shows up in Federal Reserve earnings and has no direct budgetary impact, but in that case it may have an indirect one, because it reduces Federal Reserves earnings which eventually end up in the Treasury.

Representative CONABLE. From what you say, then, can I assume that the swaps have not cost us much that would show up anywhere?

What has happened since August 15?

Mr. VOLCKER. Not all of those transactions have yet been unwound. Some are still outstanding. We in the Treasury had no swaps outstanding on August 15. The Federal Reserve did. They estimate on the basis of current rates a net loss, somewhere under $200 million on all swap transactions they had then outstanding.

Representative CONABLE. So it has had in general a salubrious effect without costing us much?

Mr. VOLCKER. Well, you cannot say $200 million is nothing. Over the years they tended to make profits on these.

Representative CONABLE. In view of the swings that we have been having, $200 million not——

Mr. VOLCKER. I think that is a fair statement. There were additional losses to complete the picture. Technically it is a different type of operation. But the U.S. Treasury in this case had medium term foreign currency denominated securities outstanding, and still does. We will take some losses as these mature, or the Exchange Stabilization Fund will, in the area of $170 million from present estimates.

Representative CONABLE. We are not likely to have these losses, then, show up somewhere in a way that is going to be an embarrassment to us unless there is a dramatic change of some sort?

Mr. VOLCKER. That is right.

Representative CONABLE. Thank you. That is all.

Chairman REUSS. On this subject of the use of swap funds to intervene, I refer you to your sentence in your statement this morning:

> We have not embarked on any effort to artificially prop up the dollar counter to any basic balance of payment trends. . . .

I referred to that earlier when I applauded you for not having so embarked. And may I have your assurance that you will not so embark, to the best of your ability.

Mr. VOLCKER. Let me put it this way. We have not embarked on any effort through these operations to artificially prop up the dollar.

I think, as the next sentence suggests, we are embarked on a very large effort to correct the underlying imbalance.

Chairman REUSS. Of course.

Mr. VOLCKER. And in that sense prop up the dollar. And that is the essential core of our efforts. So I do not want your comment or my comment construed in any way to mean that we are not concerned with propping up the dollar. We are. But we have to do it through policies that affect the basic balance of payments.

Chairman REUSS. And not through using swapped currencies to maintain an artificial price for the dollar.

Mr. VOLCKER. Not to maintain an artificial price. But obviously we think they are helpful to deal with speculative influences and such kind of pressure, which may not at all be in accord with the basic trends.

We think it is a useful way to help stabilize the general psychology, the general atmosphere, pending the fruits of the most basic efforts.

Chairman REUSS. Now, on August 12 and 13, last year—and that was a Thursday and Friday before the Sunday, August 15—we undertook a very major effort to artificially prop up the dollar in the face of a fundamental disequilibrium which was, I read after the event, much on the Treasury's mind. In other words, on Thursday and Friday, August 12 and 13, the Treasury and the Federal together spent almost $3 billion propping up the dollar, attempting to maintain the existing parity: is that not so?

Mr. VOLCKER. I don't know exactly the kind of operations to which you are referring there.

I do not remember whether on those particular days we sold any gold or other reserve asset. We did manage in at least one sizable swap transaction at that time which exceeded the amount that you mentioned. But I would point out, I do not think I would characterize those as efforts to artificially prop up the dollar. We were then operating on the basis of convertibility in a passive manner with respect to these props. And when a country came in and, in effect, asked us to draw upon an existing swap, or asked us for reserves, the policy was of course to supply them. Until the decision was made to change that policy, we continued to do so, right through the Thursday and Friday prior to August 15.

Chairman REUSS. Didn't you have any inkling Thursday and Friday that the jig was up?

Mr. VOLCKER. I had a little feeling that the policy was under discussion, but the policy had not been changed.

Chairman REUSS. Well, $300 million, as you just pointed out, is a lot of money.

Mr. VOLCKER. That was not $300 million of loss in any sense.

Chairman REUSS. I don't want to be unpleasant about the past, but can we agree, never again when it is apparent that the dollar is in fundamental disequilibrium, are we going to commit the error of giving people guarantees against devaluation.

Mr. VOLCKER. That was a long time ago, Mr. Reuss, and I think the problem is looking ahead instead of looking backward, because you never quite know when you are in disequilibrium, and the amount of it, and when is the appropriate time to change a policy. Clearly on August 13 and 14 the U.S. Treasury was not going to preempt the President's decision as to whether he wanted the policy changed or not. And therefore the then current policies continued.

Chairman REUSS. I was so happy when I read in your report that you are not embarking on any effort to artificially prop up the dollar counter to any basic balance-of-payments trend, but now my joy is somewhat diminished, because you tell me that you cannot ever tell.

Mr. VOLCKER. I don't say that you can't ever tell. My joy is diminished only by the fact that in particular operating situations it is sometimes difficult to tell.

Chairman REUSS. But can you assure me of this, that as you have already said, the Treasury and the Fed have not in the last couple of months embarked on any effort to artifically prop up the dollar counter to any basic balance-of-payments trends. Can you assure me that from here on out, to the best of your ability to distinguish the basic balance-of-payments trend——

Mr. VOLCKER. I think that will certainly be correct——

Chairman REUSS (continuing). That that will be your motto?

Mr. VOLCKER. I think that when we think it is truly artificial, this kind of operation should not be engaged in, when we think it is truly an artificial situation. And that is sometimes difficult.

Chairman RUESS. It is interesting to know that on Friday, August 13, 1971, the Government of the United States was not aware that the dollar was in fundamental disequilibrium.

Mr. VOLCKER. I think what policy changes to introduce at that point were under active discussion, but they had not yet been agreed to.

Chairman REUSS. Switching to another subject, over the weekend the International Monetary Fund got out its annual report. And one of the interesting recommendations of that report was that the United States make an effort to secure an increase in short-term interest rates. Now, the Fed is currently pursuing a policy, as I understand Chairman Burns' statement of a few weeks ago before the Joint Economic Committee, of creating money at an appropriate rate to meet the national goals of maximum employment without inflation. It would seem to me not very good advice by the IMF that we depart from that guideline and artificially raise short-term interest rates.

So I hope it will be rejected.

How do you feel?

Mr. VOLCKER. I frankly had not read that report, Mr. Reuss, until I saw the newspaper report this morning. I had forgotten this report. I am sure it was written some time ago. And whether the sentences would be written just the same way today, of course, is problematical. In writing such reports the problem is that they are a little bit dated by the time they are issued.

But the thrust of your remark I do not think I disagree with. This is one of the real issues in defining a monetary system, I think, how much weight can one country give, can any country give, in the formulation of its domestic policies, to its balance of payments, to international financial repercussions.

I don't think you can say that any country is entitled to ignore the external implications of its policies.

On the other hand, you cannot ignore the imperatives of price stability and full employment at home that you mentioned. Sometimes there are opportunities for modifying policies in one direction or another of a little different mix of policies, to make it possible to help reconcile these goals more fully. But beyond that I think we need an international financial system that does not take a rigid stance on what can be done and should be done domestically, and permits international adjustments, international stability in the context of countries having a reasonable ability to pursue their domestic goals.

And I don't know that there is any major disagreement around the world on the kind of statement I just made, which is obviously in general terms. But when it comes to specifics, getting different shadings of emphasis, there is a question about that.

Chairman REUSS. I am glad you agree with my general point, which is simply this, that it seems to me that the best thing we can do for our balance of payments is to have full employment without inflation in this country. That will be the finest incentive for foreign investment, and other balance of payments rectifying.

Mr. VOLCKER. That has been a theme of mine for some years.

Chairman REUSS. But if we start again with a policy of stagnation and inflation, that to me is not only a disaster at home, but also ruin abroad.

Mr. VOLCKER. We cannot escape our problem through invoking a domestic recession. I think for both domestic and international reasons, I fully agree with that.

Chairman REUSS. One further question: Either at the IMF annual meeting to be convened in Washington in 2 weeks, or in the 2 or 3 months immediately ahead, a decision will have to be made on the distribution of a second round of special drawing rights. The first 3-year round resulted in $3 billion plus a year on the average. What is the U.S. policy on this? What do we think is a good amount to keep the exercise going, bearing in mind that we have created willy-nilly an awful lot of liquidity with our dollars? But SDR's are our darling, and we want to help them.

Mr. VOLCKER. When you look at the competing considerations here, Mr. Reuss—I think you have mentioned perhaps the two most important ones—it is not a crystal clear case one way or the other. I don't think this decision is necessarily a terribly vital one. The vital one is the role of SDR's in the future system, not whether we create some next year or the year following. You will find a good deal of emphasis around the world in other countries as to which approach on this particular decision is most helpful or harmful in terms of the longer run evolution.

We don't feel that there is an absolutely compelling case in one direction or another on this matter at this time. I think you will find us reasonably relaxed in terms of what this very short-term decision is.

Chairman REUSS. You wouldn't like to see no SDR's issued, would you?

Mr. VOLCKER. Oh, I think that probably would be a mistake. But you can argue a very small one, a token kind of allocation, could be argued against too on the grounds that maybe it is a token of some intention in the future to use them less actively than might be necessary.

On the other hand, if you argue the case for a very large allocation, you run into the fact that you mentioned, that the case for a shortage of worldwide liquidity at the moment is not persuasive.

Chairman REUSS. Senator Javits.

Senator JAVITS. Thank you, Mr. Chairman.

Mr. Volcker, there is an additional aspect to SDR's that I would like to ask you about. What is the position of the United States on the so-called link idea; that is, linking the SDR's to the problems of development either through changing the rations, or by any other means thereby giving LDC's the benefit of the new credit possibilities which the SDR's open up.

Mr. VOLCKER. The primary point I would make there, Senator, is somewhat analogous to the reply I had just made to Mr. Reuss, that I think the SDR question should be looked at primarily and urgently from the viewpoint of its long-term role in the monetary system.

That is the crucial question here concerning SDR's. If the use of SDR's for other purposes detracted from that primary role, it would be unfortunate, and we would not want to see a lot of discussion about using SDR's for any purpose if that detracted from their use as a monetary instrument, because that is the main ball game.

Senator JAVITS. If we do decide to use SDR's more extensively as a monetary reserve instrument, is it the U.S. position that we can or cannot crank in some element of a link between that usage and a greater credit for the developing countries through some change in the ratios or otherwise?

Mr. VOLCKER. I cannot answer that question. There is some danger, for instance, if trying to do the latter would mean that you couldn't do the former, then we obviously would not want that kind of result. I do not know whether in some theoretical sense there is a conflict between the two, but there may be a practical conflict. And I just do not know decisively the answer to that question, because it depends upon the attitudes of all the countries around the world.

Senator JAVITS. My assumption was that there would not be a conflict, and it would not invalidate the use of the SDR's in the now international monetary system.

Mr. VOLCKER. I do not think I can make that assumption at this point.

Senator JAVITS. You cannot. But is the position of the United States favorable enough to such linkage as to warrant our taking some leadership in the matter?

We are the most powerful financial figure on earth.

Mr. VOLCKER. I think this is a matter that will and should be under study as part of the total reform picture, but I would not want to go beyond that.

Senator JAVITS. Well, is it under study as part of the total reform picture?

Mr. VOLCKER. Yes, sir.

Senator JAVITS. It is.

Now, the United States has not yet made its reform proposals. Can you give us any ideas as to when it will make them, aside from the amendments the United States put forward to the IMF report? When are we going to make our proposals for the reform of the international monetary system?

Mr. VOLCKER. I do not know what you mean by proposals precisely, Senator, because we think in the past we have made a number of points that we think are fundamental to any reform.

They are certainly general points, point of principle, points of philosophy. I do not know whether you characterize those as proposals or not. I do not think I can, here this morning, describe or attempt to forecast in detail how our position might be developed in the period ahead, and just what might appear more desirable from all points of view.

Senator JAVITS. Mr. Volcker, that was not my question. I was not asking you for the details. If I did, you have a right to tell me what you are telling me. My question was, Is the United States preparing proposals to be made for a new international monetary system, and if so, when will they be submitted?

Here are the facts. The fact is that there is a new committee expressly for this purpose, to wit, the Committee of Twenty. And the fact is that the IMF-World Bank meetings will take place within 15 days. And the fact is that when the United States got the Smithsonian Agreement off the ground it put forward the proposition that it was going to be the base for a negotiation for a new international monetary system.

The fact is that we have not come forward with any proposals. The fact is that I have just met with a distinguished committee of Europeans in Canada this very weekend, and there is real feeling in Europe, the other main financial countries, about the fact that we do not show any signs of doing what we said we would do regarding the long-term reform of the system. So this is a very pertinent and very important question of policy for our country.

Mr. VOLCKER. I have done a little traveling in Europe myself rather recently, Senator, and I find the views quite varied on this point, including some feeling that it would be desirable if the United States is not too specific at this point in time.

Now, this is a question upon which I think reasonable men can differ. We have no reluctance to make proposals. I think the thrust of your question is whether it is desirable to come out with a fully integrated set of proposals for all aspects of the system in some detail.

Senator JAVITS. Mr. Volcker, that is not the thrust of my question, with all due respect. And you know, I have the greatest admiration for you. So if my tone seems to be categoric, it is not intended to be personal in any sense. I am only asking a question of fact, not a question of opinion, of fact. Is the United States preparing proposals for a new international monetary system? If not, the answer is "No." If "Yes," when do you expect to submit them?

Mr. VOLCKER. I think as a broad definition of proposals you can be sure that we have made some, and we will be making more. And we have a good many ideas in this area.

Senator JAVITS. But there is no concise set of proposals which will be, let us say, submitted to the new Committee of Twenty within a proximate period of time, days, months, or weeks?

Mr. VOLCKER. We will be making proposals, to use that term, to the Group of Twenty or elsewhere, as avidly as anybody else will be making them, probably more avidly.

Senator JAVITS. Mr. Volcker, obviously we are not going to get anywhere on this score. I take it, it is my own conclusion, that the United States is not yet either submitting or prepared to say that it will submit within a given period of time proposals for a new international monetary system to the bodies which are empowered to deal with such a question, to wit, one of them being the Committee of Twenty.

Mr. VOLCKER. I am absolutely certain you will find the United States taking a constructive rôle of leadership in those discussions.

Senator JAVITS. The judge will have to determine what your answer means, the judge being the people of the United States.

Mr. VOLCKER. I think that is right. And I will be glad to have you and the people in the United States sit in judgment on us as that discussion proceeds.

Senator JAVITS. I would not sit in judgment, but I hope to be very much a party to the dynamics of getting a good system. But I think there is a great interest in that question.

Mr. VOLCKER. I recognize that.

Senator JAVITS. Now, I have two specifics I wanted to ask you about. I am very interested in the position of Japan, which is certainly a very key factor in this growing situation. And in the opinion of our Government, if you wish to state it now—or tell us you do not wish to state it for diplomatic reasons, but I ask the question—in the opinion of our Government, the Treasury Department, are they taking as much action as they can reasonably be expected to take to correct the disequilibrium in their balance of payments? They are a major holder of foreign reserves, and their reserve position is increasing rapidly as compared to ourselves and other positions.

Mr. VOLCKER. Certainly a major source of disequilibrium in the world is the Japanese situation. You say, are they taking all the action which they reasonably can be expected to take? I suppose our point of view on that would be different than the Japanese point of view on that.

Senator JAVITS. Mr. Volcker, use your own definition. I am not trying to grill you.

Mr. VOLCKER. I would like to see faster and broader actions on that score. I would like to see this process speeded up to the maximum extent possible, because it is the major single source of disequilibrium in the world economy. You have to recognize that such a disequilibrium cannot be corrected overnight. But I would like to see it move faster, there is no question about it.

Senator JAVITS. As to the French attitude, I just wonder—I take this from an analysis which appeared only yesterday on the IMF in the New York Times authored by Robert Klein, in which it was indicated that there are major differences between ourselves and the French, indeed that they may stymie some of the things we may propose in respect to the new international monetary system.

Can you make any comment on the attitude of France toward this situation?

Mr. VOLCKER. I do not know that it is fair to single out any one country. There would certainly be differences of opinion. And I am not sure that the French Government or any government necessarily has a single opinion on those subjects. I think we will have to come to grips with these differences, which are quite evident in various countries in the course of these negotiations. And we have been trying to come to grips with these precisely, Senator Javits, that is what we have been trying to do really in recent months, pointing out that there are differences here that would have to be resolved. And some of the differences may be rather basic and fundamental points of philosophy or approach.

And we have to come to grips with these and find some way of dealing with them both in an amicable way and in a way that meets our legitimate need and their legitimate need.

Senator JAVITS. Mr. Volcker, do you see a time bracket in these negotiations, let's say from September 25, 1972, to September 25, 1973?

Mr. VOLCKER. I would certainly think what we should aim for is a general agreement on a basic approach, basic principles, by this time next year, so that we can go into the Fund meeting next year with this kind of basic agreement behind us. And that does not mean that you can write down all the details and get out the legislation and all the rest. But I certainly think we ought to aim for a basic consensus and a basic agreement by next summer.

Senator JAVITS. That is very heartening, and the answer is a good deal what I tried to get from you before. I have no desire, as I say, to stick you with some specific answers on future questions, but I do think it would be really assuring if that kind of a time bracket at least is before the world and the time bracket you have now indicated is roughly until very late in the summer of 1973.

Mr. VOLCKER. I agree with that. And that is the spirit in which we are approaching these negotiations. And I must say I find some of my foreign friends saying that that is too fast. But I do not think it is too fast. And I think that is definitely what we should aim at in a constructive spirit in that kind of a time frame.

Senator JAVITS. Mr. Volcker, with the permission of the Chair, I have one other question, and that relates to your own analysis of what we ought to do. You say at the end of your statement, when you knock down the idea that various interventions in the market, swaps, et cetera, are really going to do the job of increasing the price of gold, you say:

> In the end, the strength of the dollar will rest on other policies to improve our balance of payments, policies we are pursuing with great vigor.

Mr. Volcker, would you sum up for us as briefly as is reasonable—you do not have to detail the measures, you can give us the headings—what our Government considers to be the other policies which it is pursuing with great vigor to improve, not so much our balance of payments, if that is an element, but the "strength of the dollar," because on this all else is constructed. We still are the linchpin of the solvency and economic and financial security of the whole Western and industrialized world, including Japan. And I think we have to think and speak in those terms. So I think it is very important for you to restate—I know it has been stated many times—within this context on the event of the upcoming IMF meeting what are these policies.

Mr. VOLCKER. I would be glad to, Senator, because I think it is absolutely essential. You could go back, I suppose, to the effort which began on August 15, which followed August 13 and August 14 that Mr. Reuss was talking about, when we sought the fundamental exchange rate realinement to set a new basis, a new international framework for more competitive conditions for our industry, for our importers, and our exporters. But what too often gets overlooked, I think, is that the August 15 program had a very major domestic component. It is not overlooked in the purely domestic context, but what is overlooked is the favorable repercussion of that program internationally as well as domestically. And the record shows quite clearly that in the past year since August 15 our price performance has been really without parallel among the major industrialized countries. And this is the kind of fundamental medicine for which there is no substitute in terms of the long-term strength of our balance of payments. And, we manage to combine this with a growth record that stands out among industrialized countries. We still have too much unemployment. But we are making a definite move toward rapid growth, combined with greater price stability that Mr. Reuss was talking about earlier.

Now, we have supplemented that very basic effort, which I cannot overemphasize, with many more specific efforts to deal with our balance of payments.

We have made a concerted effort, for instance, to bring our export credit facilities into a position where our industry has the same kind of benefits and the same kind of opportunities that foreign exports have long had. We have been used to a government, and used to a national attitude, that has given a lot more attention to other matters. We have attempted to bring our tax system, through the different proposals, more into line with what is needed internationally so that our tax system does not inadvertently or otherwise become a drag on our exports, as it has been, for many years.

We have rather continuously engaged in a review of the defense area. And some progress was made there last December at the NATO meeting.

So in all these areas we have moved in more particular ways to support the basic effort, which is basically through competitiveness, price performance, and growth of the American economy, to improve our balance-of-payments position.

Senator JAVITS. Mr. Chairman, may I have 2 more minutes?

Thank you. I am very appreciative, and I will make it short.

I count, then, Mr. Volcker, five headings as what you call broad policy: Exchange rate flexibility; that is, the flexibility of the bank for us and for——

Mr. VOLCKER. I was thinking of the change in exchange rates since the devaluation of the dollar, and the measures——

Senator JAVITS. Accepted, and the other general headings include stability, growth, enhancement of growth, an effort to increase our surplus merchandise exports, defense budgeting, and I assume one would add also to that, an effort to reduce the budget deficit, which would be six.

Mr. VOLCKER. That is part of the total domestic program.

Senator JAVITS. That would be six major policy headings. Can you think of any others?

Mr. VOLCKER. I think these are the major areas. There are much smaller areas quantitatively in terms of improving our tourist facilities here for foreigners traveling in this country, and that sort of thing. But I think that basically covers the guts of the effort.

Senator JAVITS. Now, two questions: I give them both to you because they may have a relationship one to the other. The so-called multinational corporations are under great attack in this country on the ground of "exporting jobs." Nonetheless, the national production, the gross product for which they are responsible is enormous as is their domestic job creation effect. If memory serves me right, it runs into several hundred billions of dollars a year, three hundred, or something like that.

Now, the question: Has any effort been made in that regard to study and be sure of what is that contribution to the balance of payments?

And correlary to that, what efforts are being made to encourage investment in the United States, especially with this—I think it is something like $60 billion overhang which is a broad, to be utilized for domestic investment, like the acquisition, for example, by British Oil Co. and the American Oil Distributing Co.

Now, those are two questions.

Mr. VOLCKER. Certainly a good deal of study and effort is going into the general question of international investment and multinational companies in particular. It is an extremely complex area. And I think I would be less than candid if I said I had thought we had all the answers, even on an analytical level. But there is a good deal of effort going on in that general area, which seems to me quite appropriate.

Given the growth of these companies here and abroad, this is a major phenomenon on the economic landscape. We would certainly welcome more foreign investment in this country. This is an example of the kind of thing that most basically is affected by the health of our own economy. And that is one of the reasons why not only price stability here is important, but growth is important here. We have taken some more specific measures over the year to try to again simplify and improve the tax treatment in some cases of foreign investors, to avoid unnecessary regulation in that respect. And these efforts have had, I think, some success. But basically that flow of foreign investment is going to be a byproduct, I think, of the growth and competitiveness of the American economy.

Senator JAVITS. But we welcome it?

Mr. VOLCKER. We welcome it.

Senator JAVITS. We will facilitate it as best we can do it on an essentially nondiscriminatory basis with our own citizens.

Senator JAVITS. Is any report in preparation on multinational corporations?

Mr. VOLCKER. I do not think it would be fair for me to say that a report is under preparation. Certainly this area of international investment is receiving a lot of attention.

Senator JAVITS. In the administration?

Mr. VOLCKER. In the administration.

Senator JAVITS. I notice one thing that you don't—don't answer this if you don't wish to—but this little piece that I mentioned yesterday seems to indicate that the United States is going to oppose Schweitzer's reappointment.

Do you want to say anything about that?

Mr. VOLCKER. I don't think I would want to comment on that. His term isn't up for 1 year, as you know.

Senator JAVITS. Thank you very much, Mr. Chairman.

And I thank Congressman Conable.

Chairman REUSS. Just a couple of more questions.

Mr. Volcker, in March 1968, there was negotiated this so-called two-tier agreement under which, among other things, central banks and monetary authorities were enjoined against selling gold outside the system. I suggest that this provision of the two-tier agreement has now become academic and counterproductive. Permitting central banks once again, at their election, to sell gold in the free market, it would have several effects, all of them beneficial. It would tend, by increasing the supply, to drive down the free market price. Since the peak free market price at around $70 per ounce did give jitters to some people, a little more supply might not hurt.

And second, it would decrease the global stock of gold reserves. This is in line with our policy of phasing out gold.

And third, it would demonstrate once again, if additional demonstation is needed, that gold does not really have an immutable intrinsic value. A great deal of gold's value is due to the shortness of supply, and in some cases to speculative demand.

Do you agree with me that that provision of the 1968 two-tier agreement has outlived its usefulness?

If you do agree, why don't we bring that up at the IMF meeting—all the parties will be there—and see if we cannot get a meeting of the minds to abrogate the provision?

Mr. VOLCKER. This seems to me one of those areas that certainly should be discussed and considered as part of the monetary reform effort, and I am sure it will be considered in that context. It seems to me desirable to approach this as other matters in an area of cooperative discussion with our trading partners against the context of the role of gold in the system having no longer any future. It is certainly a very legitimate area of discussion.

Chairman REUSS. And we don't have to wait for Nairobi to fix it up?

Mr. VOLCKER. Not Nairobi.

Chairman REUSS. Why not make a good stab at it within the next couple of weeks?

Mr. VOLCKER. I suppose it is not impossible. But on the other hand, I am not sure you can make a perfectly persuasive case at the moment for great urgency in the matter.

Certainly this is a relevant subject of discussion. It does not have to be held for Nairobi.

On the other hand, as we have made the point with respect to many matters, other people might make the point with respect to this one, that it is a part of a total package.

Chairman REUSS. You testified in your statement today that on the proposition of the ownership of gold by private U.S. citizens, a change in our law, you suggested, would have to wait until "the shape of the new monetary structure emerges."

That will be at least a year, will it not, at the most optimistic?

Mr. VOLCKER. Yes.

Chairman REUSS. So those who in reading the Republican platform, particularly that sentence which says, "The right of American citizens to buy or hold or sell gold should be reestablished as soon as this is feasible," will have to wait a little while for the ship to come in?

Mr. VOLCKER. I would think that is correct, as the next sentence in that platform implied.

Chairman REUSS. Yes.

The next sentence says, "Review of the present policy should, of course"—and I will bet you are responsible for the "of course"—"take advantage of our basic objective of achieving strength in the basic monetary system."

Mr. VOLCKER. I had nothing to do with the platform, Mr. Reuss.

Chairman REUSS. Let me be the Republicans' advocate for the moment. Why mightn't it be a good thing to repeal that old 1934 law right away, not waiting for Nairobi? It would certainly show the United States sangfroid about gold, and so that it obviously would drive up the price a few dollars' worth, maybe. And that would simply show how ridiculous is the claim that gold is immutable and intrinsic. Why not make the Republicans happy, and do a sensible thing for the demonetization of gold, all in one stroke?

Mr. VOLCKER. Well, I suppose——

Representative CONABLE. I question the chairman's qualifications as the spokesman for the Republican Party.

Chairman REUSS. You doubt my——

Representative CONABLE. Your utter objectivity; yes.

Mr. VOLCKER. We should be a bit of a psychologist in this business, Mr. Reuss. I cannot give you anything other than psychological answers, as your question really implied. You read the psychology as a willingness to see gold out of the system. Other people might read it somewhat differently, there might be a source of some confusion and some uncertainty. And it seems to me that prudence is the better part of valor here, and this policy, which you can make a very persuasive argument for, provided the system properly disposes of the role of gold, should wait until the role of gold is indeed properly disposed of in a monetary system.

Chairman REUSS. I have one final question:

The present provision of the IMF agreement requiring the payment of 25 percent of quota subscriptions in gold has within the last few days produced some concern. Two or three Middle Eastern countries came in, and people had to scrounge around and find the gold for them somehow. Why shouldn't this vestige of days gone by be removed too, and why not attempt a quick pre-Nairobi amendment, if you can swing it, allowing SDR's, let us say, to be used instead of gold?

Mr. VOLCKER. Well, I think this is one of the provisions that should certainly go in a future system. But again it is one of these things that I see no urgency about. We have discussed this before, this could become a sizable problem at a time when quotas are generally being increased, and it amounts to something.

The only thing that gets involved now are fairly trivial payments by isolated countries either increasing their quotas or for some other reason having to make a quota payment. And these could be handled as the ones you referred to on an ad hoc basis, I am sure, without any damage to anybody.

And if you amend the IMF article, it is an elaborate parliamentary process, as you know. And I see no need to enter into that for this particular purpose at this time.

It is certainly a matter that should be taken care of as part of the total arrangements.

Chairman REUSS. Senator Javits.

Senator JAVITS. Thank you very much, Mr. Chairman.

The only other thing that occurred to my staff, while we have a minute, is the question of exchange rate flexibility. In view of the statement in the IMF report in that regard, I question, would the administration—I don't know if you can answer it now, but perhaps you can take it away with you and come back with an answer—would the administration favor or recommend giving the President any authority respecting changing the par value of the dollar, say, in 10-percent range, or something like that?

Mr. VOLCKER. I don't think that is a question I would want to comment on at this point. It is a relevant question to bring to the Congress, I think, again as part of the system that might be envisaged. But it is not a necessary action at this time.

Senator JAVITS. Finally, you know this two-tier gold price is kind of a baby of mine. I raised hob about the fact that gold is being drained away from us in a commercial sense. What do you think is the effect—if Congressman Reuss has already asked this, please just tell me—it just occurred to me that you might like to put in the record what you think the effect of the two-tier gold price is upon the policy of the United States to minimize the gold factor in the international monetary system and on the question of convertibility, which will face us? What is the relationship? Is there any relationship between our policy for or against the two-tier gold system and our policy on the use of gold today and in a new international monetary system?

Mr. VOLCKER. I think there is a relationship and an interrelationship among all these questions. The two-tier system was an effort, a legitimate effort, a useful effort, to come to grips with one aspect of instability of gold in the system. It could pass on to later stages, I think, as Mr. Reuss suggested, or in other directions in the future. I don't think that the two-tier system in its precise manifestation at this time is something that should be absent from review in these reform discussions. But I think it has been an element in the general reduction of the dependence of the world monetary system on gold. And it made it easier to manage in some instances, having that two-tier system in place, than not having it in place.

It helped deal, and still does, with one element of instability in the system.

Senator JAVITS. So you still favor our sticking with that policy?

Mr. VOLCKER. In its essentials, I think, at this moment, subject to the kind of review that Mr. Reuss was suggesting.

Senator JAVITS. Thank you, Mr. Chairman.

Chairman REUSS. Thank you very much, Mr. Volcker. This is one of your finer mornings, and we appreciate it. As always you have been very helpful. And I think Senator Javits and I would part with the hope that this will be a very important and productive IMF meeting, that the United States will not be diffident about forming constructive proposals, that you will aim at getting everything fixed up by Nairobi, and that a lot of things can be fixed up along the way.

Mr. VOLCKER. I would hope so. I accept that advice.

Chairman REUSS. We stand in recess until Wednesday at 10 o'clock in the morning at this place.

(Whereupon, at 12:05 p.m., the subcommittee was recessed until 10 a.m., Wednesday, September 13, 1972.)

GOLD AND THE CENTRAL BANK SWAP NETWORK

WEDNESDAY, SEPTEMBER 13, 1972

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON INTERNATIONAL EXCHANGE AND
PAYMENTS OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to recess, at 10:05 a.m., in room 1202, New Senate Office Building, Hon. Henry S. Reuss (chairman of the subcommittee) presiding.

Present: Representative Reuss.

Also present: John R. Karlik, economist; George D. Krumbhaar, Jr., minority counsel.

OPENING STATEMENT OF CHAIRMAN REUSS

Chairman REUSS. Good morning. The Subcommittee on International Exchange and Payments will be in order for a continuation of our hearings into two questions of U.S. international economic policy. We are interested in our official positions regarding gold as an international monetary reserve medium and regarding how the swap network among central banks has been used to support the dollar in exchange markets.

The panel assembled before us today is notable both for its expertise and for the diversity of viewpoints which it represents.

We have received four excellent prepared statements and under the rule and without objection they will be received in full in the record.

Our first witness will be Mr. Edward M. Bernstein, who is recognized throughout the world as an international economic expert. Mr. Bernstein is now a private consultant. But he served for many years as Director of Research for the International Monetary Fund and earlier, as a Treasury official, and was instrumental in the drafting of the Bretton Woods Agreement.

The second witness will be Prof. Daniel R. Fusfeld from the University of Michigan, who has recently written provocative articles on both international finance and domestic economic problems.

Is this your first appearance before the Joint Economic Committee?

Mr. FUSFELD. Yes.

Chairman REUSS. You are a very welcome addition to the pantheon.

As the third witness, we have our old friend, Fred Hirsch, who is currently a research fellow at Nuffield College, Oxford University. Mr. Hirsch was until very recently senior adviser on the research staff of the International Monetary Fund. Before holding that position, he for many years wrote on international monetary affairs for the highly esteemed journal, the London Economist.

Our fourth witness is Prof. Jacques Rueff, who is a former professor at the Ecole Libre des Sciences Politiques and at the Institut des Etudes Politiques in Paris. He is also a former Deputy Governor of the Bank of France and a longtime consultant of the French Ministry of Finance. He is a world renowned expert in the field of international monetary affairs.

I want to welcome you all here today and would like to express the committee's special gratitude to Mr. Hirsch and Professor Rueff for traveling all the way from England and France to testify in these hearings and to give us their views.

I will call first on Mr. Bernstein.

STATEMENT OF EDWARD M. BERNSTEIN, EMB, LTD.; FORMER DIRECTOR OF RESEARCH, INTERNATIONAL MONETARY FUND; AND FORMER U.S. TREASURY OFFICIAL

Mr. BERNSTEIN. Congressman, could I just put my prepared statement in the record?

Chairman REUSS. Fine. You will wait for questions?

Mr. BERNSTEIN. Yes.

Chairman REUSS. Fine. There will be some.

(The prepared statement of Mr. Bernstein follows:)

PREPARED STATEMENT OF EDWARD M. BERNSTEIN

The discussions on the reform of the international monetary system will take much longer than is generally assumed. One reason is that there are many complex problems on which large differences of opinion persist. Another reason is that the United States cannot in good faith accept the obligations that will be imposed on it in any new monetary system until the U.S. balance of payments has become strong and there is assurance that in the future adjustment of persistent deficits and surpluses will be made promptly. There is ample justification for the U.S. position. No international monetary system can function effectively unless there is complete confidence in the dollar. And prompt adjustment of imbalances is necessary if the international monetary system is to avoid a chronic tendency toward crisis.

One of the more difficult questions that will have to be considered is the future of gold. The Bretton Woods system was designed to retain some of the features of the gold standard, such as fixed parities, while adding a greater degree of flexibility in exchange rates. The characteristic of gold as the most liquid monetary asset was recognized in the Articles of Agreement of the International Monetary Fund which were intended to assure the Fund adequate holdings of gold. Subscriptions to the Fund had to be partly in gold, repurchases (repayment of reserve credit) had to be in gold as well as other reserve assets, and charges had to be paid in gold except under extreme conditions. The Fund was authorized to buy gold with currencies and to sell gold to replenish its holdings of currencies.

The Fund Agreement placed very little stress on gold in the obligations of members. Transactions in gold by monetary authorities had to be within prescribed limits above and below parity. Convertibility of official balances of a currency were to be made at the option of a country either in the currency of the country requesting conversion or in gold. The United States voluntarily assumed an obligation to buy and sell gold freely in international settlements, but that was the alternative to accepting responsibility for maintaining exchange rates within 1 per cent of parity. While the Fund itself did not regard gold as different from other reserve assets, many members of the Fund retained the traditional central bank preference for gold.

This preference for gold became stronger as time went on. One reason was that very little gold was added to monetary reserves until 1965 and no gold was added to reserves thereafter. Another reason was that dollar reserves increased steadily and ultimately became disturbingly large. Actually, without the steady growth of official dollar holdings, it would not have been possible to provide sufficient reserves for the expanding world economy. The amendment to the Fund Agreement authorizing the issue of Special Drawing Rights was intended to provide for the trend growth of reserves without depending on newly-mined gold and gold sales of the Soviet Union or on U.S. payments deficits settled in dollars. As events proved, it is impossible to operate an international monetary system with multiple reserve assets—gold, foreign exchange and SDRs—when there is a preference for gold.

The preference for gold has been heightened by the termination of the gold convertibility of the dollar and the sharp rise in the price of gold in the free market. Regardless of the changes that are made in a reformed international monetary system, the preference for gold will be disruptive if monetary reserves consist of several different reserve assets. One way of avoiding the disruptive preference for gold would be to demonetize gold. Another way, at least so it is claimed, would be to raise the monetary price of gold so high that it would no longer be preferred to dollars and other foreign exchange. Indeed, some advocates of a large rise in the monetary price of gold intend this to be the prelude to the restoration of the gold standard. Neither of these seems to me to be a practical way of dealing with gold in a new monetary system.

In discussing the role of gold as a common denominator for establishing parities in the International Monetary Fund, Lord Keynes said: "So long as gold is used as a monetary reserve it is most advisable that the current rates of exchange and the relative values of gold in different currencies should correspond. The only alternative to this would be the complete demonetization of gold. I am not aware that anyone has proposed that. For it is only common sense as things are today to continue to make use of gold . . . as a means of settling international accounts." I do not say that if Keynes were living today he would necessarily hold the same view regarding the role of gold. I do believe, however, that the considerations that led him to oppose the demonetization of gold in 1944 are valid today.

The stock of monetary gold outside the Communist group amounts to nearly $45 billion. Of that, $38.7 billion is held by national monetary authorities and $6.2 billion is held by international monetary institutions. The United States holds 27 per cent of the total gold reserves of these countries; and gold comprises 80 per cent of U.S. reserves. The extinction of such a vast amount of reserves is bound to have adverse consequences, not least for the United States. The practical problem, therefore, is not the demonetization of gold, but how to include gold in a reformed international monetary system without its being a disruptive factor. I understand that this is what is meant by the question: "How can gold be phased out as international money in an orderly way?"

The only way that gold can lose its independent identity as a monetary asset without depriving the world economy of $45 billion of reserves is either to exchange gold for another reserve asset or to incorporate it as in inseparable component of another reserve asset. Dr. Lawrence Krause of the Brookings Institution has proposed that countries exchange their gold reserves for a new issue of Special Drawing Rights. In my opinion, no country will agree to exchange its gold for SDRs, particularly if the gold is to be sold in the free market. Gold is the one reserve asset whose value does not depend on the credit-worthiness of a debtor country. Unless the new issue of SDRs were a claim on the gold acquired by the Fund in the exchange, in effect gold certificates, they would be a fiduciary reserve asset whose value ultimately depends on the credit-worthiness of other countries. That is not an exchange any country would be willing to make.

The alternative is to retain gold as a reserve asset, but to require that it be used jointly with other reserves. I have suggested that this could best be done by establishing a Reserve Settlement Account in which countries would earmark their gold, dollars and other foreign exchange, and SDRs in return for a balance in a Composite Reserve Unit (CRU). Transactions in reserves would thereafter be exclusively in CRUs. Countries would retain title to the precise reserve assets they earmarked, subject to implicit adjustment for changes in their CRU balance. A deficit country, by settling in CRUs, would be using its different reserve assets precisely in the proportions in which it earmarked them. A surplus country, whose CRU balance increased, would be acquiring the different reserve assets in the average proportions in which they were earmarked by deficit countries.

While the present stock of monetary gold would be retained in the Reserve Settlement Account, there could be no disruptive preference for gold. Whether a deficit country used gold or a surplus country acquired gold would be beyond its control. Nor would the composition of a country's reserves be affected by temporary fluctuations in its balance of payments. The position of a country in the Reserve Settlement Account would be determined on a cumulative basis. If a country had a deficit for a time that it offset by an equivalent surplus later, its balance in CRUs would be restored and the composition of its reserves would be the same as those it earmarked. No country would find it worthwhile to try to increase its reserves through a permanent surplus merely on the chance that the corresponding deficit countries would implicitly transfer to it some unknown proportion of gold in settlements.

If a Reserve Settlement Account were established, the International Monetary Fund would earmark its holdings of gold and SDRs in return for a balance in CRUs. Thereafter, any provision of the Articles of Agreement requiring gold payments to the Fund would be fully met by payment in CRUs. If the Fund found it necessary to acquire any currency for its General Account (reserve credit operations), it would do so by selling CRUs for that currency. Incidentally, if the Fund were to purchase gold from non-member countries, it could do so with currencies in its General Account. The gold would be added to its earmarked assets in the Reserve Settlement Account, thus increasing its CRU balance. The country whose currency was used to purchase the gold would in turn have a net improvement in its position in the Fund.

There are people who believe that the monetary system will be inherently unstable as long as the monetary price of gold is below its price in the free market. They say that it is necessary to raise the monetary price of gold to $70 an ounce or more. In a world abundantly supplied with reserves, it would be reckless to add another $40 billion to present reserves by raising the price to $70 an ounce. Nor is there any reason for believing that this would end speculation in gold. The higher monetary price would simply create a new floor for the free market. The risk of a decline in the price of gold would be negligible if countries bought the gold that was offered to them at $70 an ounce. Moreover, the fact that the monetary price of gold was raised to such an extent would create expectations of a still higher price in the future. There is no logic in such a massive increase in the monetary price of gold unless it is intended as a means of restoring the old-fashioned gold standard—a hopeless objective.

Some European countries have proposed that because of the inconvertibility of the dollar in reserve assets, the price of gold in all currencies be raised and reserve settlements among themselves be exclusively in gold—a kind of European gold standard. It is unlikely that the European countries would agree on exclusive gold settlements among themselves while continuing dollar settlements with the rest of the world. There is the practical difficulty that a country like the United Kingdom would have to depend heavily on reserve credit, with a gold liability, if it had to make settlements in Europe, despite its large holdings of dollars and SDRs. There is the psychological difficulty that a country like Germany would have to label the greater part of its reserves ($18.2 billion in dollars and other foreign exchange) as somehow not useable in Europe.

A system of gold settlements within the European Economic Community would divide the world economy into two segments—one based on gold and the other based on dollars and SDRs. Each member of the Community would have two balances of payments—one with Europe and another with the rest of the world. To separate these transactions, each country in the Community would have to impose exchange controls, although not necessarily restrictions, on every aspect of its balance of payments—trade and other current transactions as well as capital transactions. Furthermore, it would be compelled to maintain a balanced position in both its European payments and in its payments with the rest of the world. Otherwise, a country with a deficit in its European payments and an equal surplus in its payments with the rest of the world would find its gold reserves decreasing while its other reserve assets are increasing.

Such a division of the world economy would benefit no country and do great harm to all. It is inconceivable to me that the European Economic Community would agree to such a plan unless they came to the conclusion that the only alternative would be an international monetary system based on an inconvertible dollar. That is why it is essential to begin promptly with the discussions on the reform of the international monetary system and to proceed expeditiously in seeking agreement. As already noted these discussions will inevitably be prolonged. Moreover, even when agreement is reached on principles, it will not be possible to put the new monetary system into operation until U.S. payments are balanced or in surplus for an extended time and there is renewed confidence in the strength of the dollar.

If these assumptions are correct, the international monetary system will have to operate on the basis of the Smithsonian Agreement for at least two or three years. Every possible effort should therefore be made by the United States and other countries to see that the international monetary system functions effectively in this period. That will require international cooperation on the two major questions. The first is joint support for the central exchange rates that have been established as long as they are appropriate for restoring the U.S. balance of payments. The second is joint assurance that any country that holds dollar reserves will be able to use them for making payments in any currency and for settling balance of payments deficits with every country.

In my opinion, the countries that participated in the Smithsonian Agreement have an obligation to support the new central exchange rates as long as they are appropriate. Definitely, I believe that the United States has an obligation to support the dollar. As a practical matter, however, that obligation cannot extend beyond the capacity of the United States to fulfill it. With its limited reserves, it cannot undertake to provide gold or other reserve assets for the dollars that countries may acquire before the reformed international monetary system is operative. That limits the obligation of the United States in supporting the dollar exchange rate, but it does not absolve it from responsibility for doing all that it can. What is important is not how much reserves the United States uses in supporting the dollar, but the moral effect of recognizing its responsibility.

Obviously, the United States cannot afford to draw heavily on its depleted reserves in order to support the dollar exchange rate. If large-scale intervention in the exchange market is necessary from time to time to prevent the dollar from falling too low, it will have to be done by other countries through purchases of dollars with their own currencies. Within its capacity, however, the United States should also participate in such operations. That is not because the amount of resources it uses will be decisive, but because intervention by the United States is an indication that it regards the maintenance of the new central exchange rates as a commitment in which it shares. If the United States acknowledges this responsibility, other countries will be better able to do their part in supporting the dollar exchange rate. When this is clear, the exchange market will understand that speculation against the dollar is not a riskless operation.

Although the dollar was weak on several occasions this year, the United States did not intervene in the exchange market until mid-July, about three weeks after the last speculative outflow of funds from this country. All that was involved in these operations was actual gross sales of $31.5 million of foreign currencies for dollars. The effect on the exchange market, however, was dramatic. The backflow of funds was resumed and has apparently continued. The exchange rate for the dollar in terms of the currencies of the Group of Ten, excluding sterling, rose to about the same average rate that it was on June 15th. In terms of sterling, the dollar is about 6 percent higher than it was before the floating of the pound. There can be no doubt that the reserve position of the United States was helped considerably by the intervention in the exchange market to support the dollar.

There is another problem which requires consideration. Until the reformed monetary system is established, it is essential that every possible effort be made to see that the present monetary system functions effectively. The basic international characteristic of any monetary system is the interchangeability of currencies and particularly the convertibility of the dollar into all other curriencies. There are now about $55 billion of reserves held in the form of dollars. For many countries, their dollar holdings comprise nearly all of their reserves. These dollars can be used freely in making payments to the United States. They can be used in making payments to other countries by selling dollars for their currencies in the exchange market. There is no assurance, however, that Europe and Japan will continue to acquire dollars within the margins of the present central exchange rates. That is the principal source of uncertainty in the international monetary system.

This uncertainty would be removed if the United States were able to restore convertibility of the dollar in reserve assets. Unfortunately, it does not have the resources for meeting such an undertaking at this time. The United States has $13.1 billion of reserves. In addition, it has all of the $7.3 billion of the credit tranches of its quota at the International Monetary Fund and swap lines of $11.7 billion with 14 central banks and the Bank for International Settlements on which it has outstanding net drawings of $1,770 million. If these reserve credits were used in converting dollars they would have to be repaid by drawing down

U.S. reserves at a later date, unless the United States developed such a large surplus as to acquire reserve assets from other countries before the repayments were due. With the enormous reserve liabilities in dollars and with the U.S. balance of payments still in deficit, the reserves of the United States could be quickly wiped out if it undertook convertibility of the dollar in reserve assets.

Despite the importance of unrestricted use of dollars in international settlements, other countries understand that the United States cannot undertake convertibility of the dollar in reserve assets until two conditions are met:

1. The U.S. balance of payments must be strong and confidence in the dollar must be restored;
2. The United States must receive reserve assets when it has a surplus if it is to pay out reserve assets when it has a deficit.

The second condition cannot be met until there is a reform of the international monetary system under which existing dollar balances, although continuing to be used as reserves, cannot have an adverse effect on U.S. reserve assets. Convertibility of the dollar will have to be almost entirely through the exchange market until the new international monetary system is in operation.

Nevertheless, other countries must have assurance that their dollar reserves will be freely useable in all international settlements, even though the dollar is not convertible in reserve assets at this time. Such assurance can be given by the countries that participated in the Smithsonian Agreement. This could be done through interim arrangements, to remain in effect until the international monetary system is reformed, under which other countries would undertake, without qualification, to accept dollars in international settlements. The United States, in turn, would undertake to convert the net increment of official dollar holdings at the end of the interim period either in reserve assets, or currencies acquired from the International Monetary Fund, or in securities of the U.S. Treasury carrying a guarantee against depreciation in terms of SDRs. Alternatively, changes in official dollar holdings during the interim period could be included in any provision for dealing with outstanding dollar reserves in the new international monetary system.

In my opinion, such interim arrangements would be acceptable to other countries and would be in the interests of the United States. For other countries, the interim arrangements would be an indication that the United States favors a multilateral payments system in which all currencies will be convertible in accordance with provisions to be agreed in the reform of the international monetary system. At the same time, it would give them assurance that they would have no loss from any net increase in aggregate dollar reserves through a devaluation of the dollar. For the United States, the interim arrangements would have the benefit of assuring the *de facto* convertibility of the dollar without any risk of depleting its reserves. In fact, if the United States had a surplus on an official reserve basis, and this could happen if there is a large return of funds, it might be possible for it to acquire reserve assets. That would depend, however, on how the dollar holdings at the end of the interim period are integrated in total reserves under the reformed monetary system.

Chairman REUSS. Mr. Fusfeld, please proceed. Don't everybody do this.

STATEMENT OF DANIEL R. FUSFELD, PROFESSOR OF ECONOMICS, UNIVERSITY OF MICHIGAN

Mr. FUSFELD. I read my prepared statement on the plane coming in yesterday and decided that I wanted to reemphasize some of the basic points in it that may have been obscured by my difficulties in expressing myself.

One of the chief problems in our understanding and solving the international financial problems that face us is that very few people are willing to discuss some of the most fundamental of the political and ethical issues that underlie our problem. It is as if there were a ghost at the wedding that nobody is willing to recognize or talk about.

I tried to point that up in my discussion of the U.S. role in the international financial community. Fundamentally, the problem is that a persistent balance-of-payments deficit continued over many years results in a continued transfer of real assets into the hands of the citizens and corporations of the country that is running the deficit. Traditionally, this transfer of real assets into their hands was paid for by transfers of gold out of the Nation's monetary reserves and was consequently limited; but under the Bretton Woods Agreements, foreign central banks have been required to finance the U.S. deficit and the continuing transfer of real assets into American hands has been able to continue indefinitely and without any real limit. It was not until the unwillingness of foreign central banks to continue financing the deficit for a variety of reasons in the late 1960's and early 1970's that the system came to an end. The breakdown came in 1971, last year.

When we look at the recipients of those foreign assets, we realize that they have been primarily large American corporations and banks and the U.S. Government, which has used those resources to help finance its military posture overseas. You could put it, perhaps, in an unfavorable light by saying that the international financial system has been used for the purpose of aggrandizing American corporations and American military power. This is the ghost at the wedding that nobody is willing to talk about.

The question that the American policymakers have been wrestling with over the last year or so is, given the fact that foreign countries are no longer willing to accept this process, how can we continue the transfer of assets from foreign to American hands? The solution has been devaluation of the dollar. You will recall that last year Secretary of the Treasury Connally requested a devaluation large enough to provide $13 billion a year for American foreign investments and military commitments and $2 billion annually for emergencies.

This means that the burden of support for the continued transfer of assets into the hands of the American military and American corporations is being shifted onto the American public. A $13 billion balance of trade in our favor means that we are producing $13 billion worth of goods that are being consumed abroad and not here at home. We would be $13 billion per year poorer. It is a $13 billion tax on the American economy for the benefit of those into whose hands foreign assets normally come.

This, it seems to me, is the underlying reality that we now have to face. It makes our balance-of-payments deficit far more a domestic political issue and of far greater concern to the average voter and the average Congressman.

Well, I probably overstated my case. But you will have to pardon that because there is nobody else around who is stating it this way. I think that historians 500 years from now, looking back upon the troubled financial problems of the international community, will be writing it up in this way.

Basically, my conclusion is that there is not going to be any stable international financial system developed until the U.S. decides it does not want to live beyond its income in accumulating and using foreign assets; that is, beyond the income that we would normally get from foreign trade and investments. Thank you.

(The prepared statement of Mr. Fusfeld follows:)

Prepared Statement of Daniel R. Fusfeld

The Political Economy of the U.S. Balance of Payments

The American economy is the strongest in the world. It generates more than half of the world savings, which makes the United States the source of the bulk of the world's investment funds and New York the world's financial center. U.S. overseas investments are by far the greatest in the world: our annual net income from that source is six times as great as that of the next ten largest foreign investing nations put together. We consume close to half the world's manufactures and over half of its production of durable goods, forming the greatest market in the world. Our advanced technology and huge manufacturing capacity means that we are the world's largest supplier of durable goods. All of these elements combine to create in the dollar the most important key currency in the international economy, held by all important trading nations as the largest portion of their international monetary reserves.

Today, however, we find ourselves in serious trouble. The dollar is weak and weakening further. We have a huge balance of payments deficit. In the last few years our imports have exceeded our exports by many billions of dollars, reversing a relationship that had prevailed for over seventy years. How did we squander our strength? What is the source of our weakness? How could such an economic giant have been brought to its knees?

WORLD POWER AND THE U.S. PAYMENTS DEFICIT

The war in southeast Asia is widely recognized as the immediate cause of our current problems. It created the domestic inflation that wiped out the U.S. surplus of exports over imports. It also added substantially to overseas military spending, which further worsened our balance of payments difficulties.

The more fundamental cause, however, is that we pushed corporate foreign investment and military-related aid and spending abroad beyond the levels that our foreign earnings from exports and investments could support. We insisted on spending more for world power than we earned. The resulting payments deficit ran upwards from one to four billion dollars annually for a generation, and U.S. policy encouraged rather than discouraged those activities. For example, tax benefits and investment guarantees promoted corporate investment abroad. Foreign nations acquiesced, perhaps grudgingly, partly because of the importance of the dollar in international trade, partly because our favorable balance of trade made it possible to rescue the system if things got too bad, and partly for political and economic reasons of their own. But when domestic inflation, itself rooted in American militarism, changed our balance of trade to a deficit position, the game was up and the crisis of 1971 was precipitated. Even without the events of 1971, however, foreign nations would have ultimately rebelled, partly because it was senseless for them to accumulate excessive and unwanted dollars, and partly because the international financial system was being used for American economic and political aggrandizement at their expense.

BRETTON WOODS AND THE IMPACT OF U.S DEFICITS

The Bretton Woods agreements of 1945 required that central banks stabilize the value of their currencies within one percent of par. If the value of the dollar fell relative to the currency of another country, that nation's central bank had to buy dollars with its own currency. These purchases increased both the demand for dollars and the supply of the foreign currency, and were continued as long as necessary to bring the relative values of the two currencies back to within one percent of par value.

This method of sustaining fixed exchange rates had several effects:

1. The U.S. was able to maintain its payments deficit for an indefinite and unlimited length of time. The financing of the deficit was shifted to foreign central banks by the requirements of the system.

2. Because of the persistent U.S. payments deficit, foreign central banks gradually built up large holdings of U.S. dollars until they had far more than they needed or wanted. This was one price they had to pay to maintain the international payments system.

3. Inflation was fostered within the foreign country. Purchase of dollars by a foreign central bank has the same effect as any open market purchase. It increases the reserves of the banking system and encourages an expansion of the money supply. This inflationary effect could be countered by other fiscal and monetary policies, but they would have the effect of dampening domestic economic expansion while making funds for expansion available to Americans.

4. It promoted transfer of ownership of foreign-held real assets into the hands of Americans. Holders of dollars were able to exchange them for foreign currencies at a penalty of, at most, one percent. They were then able to buy foreign assets with those currencies. In this way the financing of the U.S. balance of payments deficit promoted the worldwide spread of U.S.-based international corporations. To the extent that some of those assets were used by the U.S. government for military expenditures, aid and offshore procurement, foreign central banks helped finance the maintenance of U.S. power and the Vietnam war. It is a well-recognized fact that an overvalued dollar enables American multinational firms to acquire assets throughout the world on favorable terms, and understates the real cost of U.S. military activities abroad. What is not usually recognized is that our balance of payments deficit brought actual transfer of assets from foreign to U.S. ownership, financed by the process of pegging currency values.

5. Finally—and this point is poorly understood in this country—these transactions helped create inflationary pressures *within the United States*. Americans obtained added purchasing power through creation of credit by foreign central banks. The resulting inflationary pressure cannot be held within national boundaries, but tend to spread everywhere in the world through international trade and investment. The effect on the U.S. was probably not large, but it helps to explain some of the persistent inflationary pressures that have affected the U.S. and the world in recent decades.

In this fashion the international financial system enabled the U.S., through its persistent payments deficit of upwards of $1 billion annually, to draw upon the assets and resources of other nations to maintain U.S. military power and promote the expansion of U.S. corporations. Inflation was one of the costs. More important, however, the fundamental conflict of interest embodied in these relationships undermined both the political system of world order that developed after World War II and the expanding pattern of world trade.

An historical analogy is appropriate here. When ancient Athens formed the Delian League in the 5th century B.C. to present a united front against Persian aggression its allies entered enthusiastically. But when Athens began to use the league for its own selfish benefit, opposition and revolt quickly followed. Much the same thing has happened with the postwar international financial system and its use by America for her own purposes.

THE INEVITABLE BREAKDOWN

The breakdown of this system had to come, particularly when foreign nations began to realize, as they did during the 1960s, that they were gradually turning the world over to the American international corporation and the U.S. military. Once that realization came it was more and more difficult for the U.S. government to get foreign central banks to finance our deficit. The French, in particular, were recalcitrant. U.S. gold reserves had to be used instead, until by the late 1960s they were sufficient to cover only a few years' deficit. Then, when inflation destroyed the U.S. surplus of exports over imports and made it necessary to finance a deficit that might run as large as $10–$20 billion, foreign central banks were no longer willing to support the dollar and the devaluation of 1971 followed. The Smithsonian agreements of 1971 provide some breathing space and time to work out new arrangements. The few indications we have indicate that the chief objective of the U.S. negotiators is to reestablish a system that would permit U.S. corporate investment and military expenditures overesas to continue unhampered by financial constraints.

EFFORTS TO PATCH UP THE SYSTEM, 1967–71

The Smithsonian agreements of 1971 made only a small change in the international financial system. The most important change widened the band of permissible fluctuations around par value for any country's currency from 2¼ percent. This wider band could increase the cost of foreign investment to U.S. corporations to a premium of 2¼ percent instead of one percent. But international differences in rates of return of that magnitude are by no means extraordinary. This change will not stop the financing of U.S. corporations abroad by foreign central banks, but will merely slow it down somewhat.

The system has also been modified in recent years by the introduction of Special Drawing Rights (SDRs) and by the use of currency "swaps" between central banks. The latter provides greater flexibility to the system, while the former enlarges the total of world monetary reserves. Both of these changes enable the

U.S. to finance its continuing deficit for an even longer period of time. As a consequence, the process of shifting foreign assets into U.S. hands is continued, and the inflationary pressures set in motion by the U.S. payment deficit are extended.

FEDERAL RESERVE SUPPORT OF THE DOLLAR

More recently, the Federal Reserve system has begun to actively support the dollar on the basis of the new par value established by the Smithsonian devaluation. This action contributes to deflation and reduced purchasing power in the U.S.

The process works, in essence, in the following manner. The Fed sells foreign currencies in the New York money markets to drive down their prices relative to the dollar. It receives payment by check, in dollars, drawn on a U.S. bank. Clearing of the check reduces the reserves of the U.S. banking system, just like any open market sale. The deflationary effects can be neutralized by countervailing open market purchases by the Fed, usually of Treasury bills, but this has an added effect of fostering lower interest rates. If open market purchases neutralize the deflationary effect on bank reserves of Federal Reserve support of the dollar, they create inflationary effects by promoting lower interest rates. It is extremely difficult to gauge these conflicting effects accurately and completely neutralize the effects of Federal Reserve support of the dollar.

But where does the Fed get foreign currencies to sell, when the U.S. has a persistent payments deficit? Initially, U.S. reserves at the International Monetary Fund can be tapped. Ultimately, however, the foreign currencies are obtained by purchase or swaps from foreign central banks. When that happens payment is made in dollars and command over U.S. resources passes to foreigners. Thus American assets are transferred into foreign hands, which has been the traditional way of settling a payments deficit.

The costs of Federal Reserve support of the dollar are borne by the average citizen, first through the destablizing effects of monetry policy, and second by the real costs of financing a deficit by transfer of assets to foreigners.

SHIFTING THE FULL BURDEN TO THE U.S. CITIZEN

U.S. policy has moved strongly toward placing the burden of financing the U.S. payments deficit on the American citizen. We have been moving away from the older system in which foreign central banks financed our deficit, to the detriment of their citizens. Federal Reserve support of the dollar is a major step in that direction.

Insight into the future was provided by former Secretary of the Treasury John Connally shortly before the Smithsonian Agreement was reached. He proposed devaluation of the dollar to the extent needed to create a favorable U.S. balance of trade of $13 billion dollars annually. He argued that this amount would provide adequate amounts of foreign currencies for both high levels of U.S. private investment abroad plus substantial offshore military procurement and aid, and still leave about $2 billion for emergencies. The actual devaluation under the Smithsonian Agreement amounted to about half that, at most (at price levels then prevailing). But whether the Connally proposal made sense or not is less important than the strategy it indicated. What Connally was proposing, in essence, was that the present U.S. military position in the world continue unchanged and that U.S. based international corporations continue to expand abroad, but that the costs be shifted entirely to U.S. citizens.

For a $13 billion U.S. balance of trade surplus is a $13 billion tax on the American economy. It represents $13 billion of goods and services that are produced here but consumed abroad. In real terms we would be $13 billion poorer. Devaluation makes the American worker pay for U.S. military adventures abroad and for the overseas expansion of U.S. corporations. Of course, U.S. jobs would be generated at the expense of unemployment abroad, but that is true only in the short run. In the long run any nation can maintain full employment at home by the proper mix of fiscal and monetary policies, and need not rely on its balance of trade for that purpose.

The strategy implied by the Connally proposals is to establish the value of the dollar, and stabilize it within relatively narrow limits, at such a level that the trade surplus to be generated would be large enough to adequately finance U.S. power and economic expansion. It also implied self-restraint on the part of U.S. policymakers not to exceed the limit imposed by the trade surplus. And there's the catch. For in the past American economic and military aggression has never been willing to accept that kind of economic limit. We were unwilling to stay within the limits imposed by our former balance of trade surplus. There is no reason to believe that we will be more self-disciplined in the future.

The problem arises because the benefits from American economic expansion and power accrue largely to a narrow group of corporate executives, families of great wealth, and military leaders, while the costs are borne by the average citizen in high taxes, rising prices, battlefield deaths and prisoners of war. The international financial system of the past even allows some of those costs to be shifted abroad. As long as a few with power reap the benefits while the many without power bear the costs, the self-restraint required for a workable international financial system will be swamped by the greed that ultimately brings down any favored elite. We have just witnessed the end of stage one, the growing reluctance of foreign nations to bear a part of the burden. We are about to enter stage two: a shifting of the full burden to the average American.

FIXED PARITIES VS. FLEXIBLE EXCHANGE RATES

The debate in the last few years over restructuring the world financial system has increasingly come to focus on the issue of whether fixed parities, such as those contained in the Bretton Woods and Smithsonian agreements, are more desirable than flexible exchange rates. Much of this debate ignores the realities stressed in this paper.

Fixed parties supported by foreign central banks enable part of the costs of U.S. expansionism and power to be shifted to foreigners through the financing of a U.S. payment deficit. The band of permissible fluctuations determines how much of the burden can be so shifted: the narrower the band, the more can be shifted; the wider the band, the less can be shifted. To the extent that the Federal Reserve System supports the dollar, the burden is borne within the U.S. It is not surprising to find the U.S. government supporting a new system of fixed parities.

Devaluation forces Americans to bear a larger share of the burden of U.S. expansionism. By increasing U.S. sales of goods and services abroad it makes more domestic resources available to promote U.S. interests abroad.

Flexible exchange rates place the full burden on U.S. workers and consumers. A persistent balance of payments deficit created by overseas investment and military spending would bring a continuing fall in the value of the dollar—in effect, persistent devaluation—to generate the exports necessary to finance the deficit. Indeed, in the absence of frictions there would be no deficit—only a continuing fall of the dollar. In this case, two effects are bound to be felt. First, foreign nations can be expected to retaliate with barriers to U.S. exports, starting a chain reaction that will diminish and hinder world trade. Second, the entire international financial system would be weakened by the deteriorating position of its most important key currency.

We are forced to the conclusion that no system of international financial institutions can long survive a continuing drive toward world power and economic dominance by the U.S. government and American corporations.

CONCLUSIONS

The sickness that afflicts the international monetary system is the same that afflicts the United States as a whole. As long as this country puts world power and economic dominance at the first priority in determining its policies there can be no stability in the world's financial institutions. The slogan of "maintaining the security of the free world" has become a cloak for a 20th-century version of the Medici motto in 15th-century Florence: "Money to get power, power to protect the money." It is those policies that have destroyed the post-war international financial system and will continue to undermine any successor. U.S. policy must ultimately come to terms with that reality.

As the burdens of U.S. policy come ultimately to be borne domestically within the U.S.—through devaluations and Federal Reserve support of the dollar, and perhaps flexible exchange rates—the average American will come to realize that he is paying the costs while giant corporations and banks and the military-industrial complex gain the benefits. When that understanding comes the U.S. international financial position will truly become a domestic political issue. This will be the third stage in the resolution of the problem. Perhaps then we will be able to discuss solutions that provide real benefits to the average American rather than arrangements which make him pay for someone else's wealth and power.

Chairman REUSS. Thank you, Mr. Fusfeld.

Mr. Hirsch, please proceed.

STATEMENT OF FRED HIRSCH, RESEARCH FELLOW, NUFFIELD COLLEGE, OXFORD, ENGLAND

Mr. Hirsch. Thank you, Mr. Chairman.

From a quick glance, it looks as though I have been guilty of submitting the longest prepared statement and therefore perhaps I should summarize it, although briefly.

First, on the question of gold, the general position that I have taken is as follows. As a matter of actual fact, the monetary role of gold is declining, and has been declining for 50 years; the pace has accelerated in recent years and the present role of gold has become quite minimal. This decline in the monetary role of gold which is evidenced by various criteria mentioned in my prepared statement is in my view a quite normal part of the processes that have been going on in the last two generations toward a greater degree of management of domestic economic affairs. Although it would have been possible, by taking certain steps—namely, deliberate increases in the price of gold—to still rely on gold and to have a certain degree of management in international financing that way, if that had been done—and I think this is a key point that is very often over-looked by those, particularly in Europe, who look to gold in order to preserve a measure of national independence—if one had attempted to maintain the role of gold, so to say, by making it a managed system, than those very advantages that gold does have in the international monetary system in its traditional form—which are basically advantages of an automatic system and an anonymous system that does not make great demands on the need for deliberate international agreement—and these advantages, of course, have been described by no one more clearly than by Professor Rueff—then those advantages will not exist any longer if you have a managed gold standard.

I would just like to emphasize that it is very important for those—and there are very many—in the international community who are reluctant to see a decline in the role of gold to really ask themselves precisely what function is gold still performing? The half-way house that we have at the moment, with the position of gold half accounting unit, half commodity—is a very different system than the one which is normally associated with the gold standard.

Now having gold in this position, rather in limbo, of being priced as a commodity at more than its monetary price, gives a number of difficulties for the international monetary system.

The difficulty we see at the moment is that since gold is priced as a monetary asset well below its value in the markets, countries are very reluctant to let go of the gold. It appears more like a growth stock with greater potential for appreciation and if you have a growth stock with potential for appreciation, you are not likely to use that freely, as in a checking account. Now, a further difficulty, because the value of SDR's is linked to gold, is that the freezing up we have in gold liquidity has extended to the SDR and IMF positions. So we have the paradoxical position that although statistically international liquidity has increased very greatly, indeed excessively, in qualitative terms, there has been a deterioration because countries are reluctant to use the reserves that they have.

Now, what are the solutions to these problems?

One possible solution which has been suggested is to try to force gold back into circulation, so to say, among central banks by requiring countries when they settle their deficits to settle them in some fixed package of assets—some dollars, some gold, some SDR's. The EEC countries, indeed, tried to operate such a system in connection with their recent settlement but they found that their member countries simply would not play. They were not willing to transfer gold at the monetary price.

I believe that this kind of solution to force gold back into circulation is really going against the grain of recent tendencies. I think that the long-run solution which is greatly preferable is to recognize the fact that in its official use now as well as in its private use, gold is functioning essentially as a nonmonetary asset.

Why are countries reluctant to give up their holdings of gold? Fundamentally because they feel that either the gold is going to appreciate over the long term, or else they have to have some basic strategic reserves just as countries may wish to keep official stocks of platinum or silver or copper. Both those kinds of uses are really quite distinct from monetary use that a country wants from reserve assets. Fundamentally, gold is getting into that kind of category; and since that is the need that it is fulfilling, in the long term, there are no technical difficulties in recognizing its change of function. One could stipulate, for example, that countries would be able, for some limited time period, to convert their existing gold holdings into newly issued SDR's, and then beyond some final terminal date, gold would simply be a commodity. Countries would then no longer have the possibility of making such conversions of their gold.

Such long-term demonetization, I want to emphasize, differs from many previous suggestions in that it does not attempt to force national gold into international hands; it just says to countries, you can keep what gold you like, but beyond a certain point there will be no fixed link with monetary assets.

Now, that is a long-term solution but I think one that ought to be pressed in the present round of international monetary reform. That still does not give us a solution at the moment, of course, because as is well known that is going to be quite a long, drawn out process, to get that reform.

Therefore, it seems to me that in the interim the solution is to try to change the way that gold is looked at in the psychological conditions of the market. Specifically, the unfortunate recent tendency that has resumed for gold to appear to have a one-way movement in the market, in having a floor price set at the monetary price, but without any ceiling as a counterport, that it is time to change that arrangement. This could be done by permitting and encouraging central banks and international financial institutions to sell gold in the marketplace at appropriate times with the deliberate purpose of driving down the premium price and of recreating a scope for a real two-way in that market.

I have made the specific suggestions in my prepared statement that the March 1968, Washington agreement should be amended to end the restraint against sales of gold by monetary authorities in private markets at premium prices. I have suggested that desirably gold should be sold in private markets through some central international agency such as the IMF, for example. This would be possible even under the present articles, provided it is done indirectly. The IMF would simply have to sell the gold through the central banks of member countries; and since the IMP itself is almost full of gold at the moment—it has almost $6 billion which is more than twice what it had 2 years ago—I suggest that a substantial sale be made by the IMF of something like $1 billion in the private market. I am quite sure that such action would have a very considerable and solutary effect in dampening down the speculative situation.

The second suggestion that I have made is that SDR's be made acceptable for all transactions with the IMF in which gold is now acceptable. This offsets, primarily, the 25 percent of IMF subscription payments which currently have to be paid in gold. To effect this reform in a tidy way, amendment to the IMF articles would be needed, but it would not be difficult in the next quota increase to use expedients comparable to those that have been used in the past for mitigation, even without amendment.

The third suggestion I have made is that the United States should declare formally on some suitable occasion that its efforts to restore official convertibility for the dollar, when the necessary conditions are met, are centered on convertibility in terms of SDR's, that the United States will never restore a fixed monetary link to gold, and that it intends in due time to transfer the treasury of gold holdings to the stockpiles managed by the General Services Administration or another agency competent in the management of valuable strategic materials.

Mr. Chairman, I will just take 2 minutes to summarize briefly my position on swaps. This is, generally, that I believe the committee would be right to take a guarded view of the resumption of swap activities. I think that swaps as they were used in the 1960's undoubtedly bore some responsibility for the long delays in exchange rate adjustment and that they encouraged the tendency to fight battles harder and harder and not to question whether the battles really ought to be fought at all.

I think that there is some safeguard against a repetition of that experience simply from the fact that countries generally are now more willing to countenance exchange rate adjustment; however, the change in attitude itself is not a sufficient safeguard from these dangers, simply because under the current exchange system it will be extremely difficult in practice, when one comes up against any particular exchange market pressure, to be sure whether such pressure relates to long-term disequilibria, in which case one could have a quick exchange rate adjustment, or else represents purely temporary pressure against which one can simply throw in all the defenses available.

I think that kind of dilemma is built into the way that balance-of-payments trouble come up. Therefore, the correct solution is to use the exchange rate not as a large, once and for all adjustment measure but as a more continuing and smoother process.

I have suggested that a large-scale extension and revival of swaps ought to be made to await the practical implementation of specific measures to smooth out the exchange rate adjustment.

Finally, I have suggested that when the time comes to revive swap activity, this might be more suitably done if the swaps were managed in a more comprehensive way and were related to refinancing on appropriate conditions, particularly relating to the need for exchange rate adjustments. I have suggested a specific new method of achieving this through the IMF; there would doubtless be many other possible forms of achieving the same object.

Thank you, Mr. Chairman.

(The prepared statement of Mr. Hirsch follows:)

Prepared Statement of Fred Hirsch

Gold Policy

The questions raised by the Chairman are highly pertinent. For a variety of reasons, questions concerning the role of gold in the international monetary system have tended to be skirted over in official consideration and public discussion. The time is now ripe for these questions to be brought more fully into the open.

My answers to the specific questions raised by the Chairman rest on the following broad view of the role of gold in the international monetary system at the present stage.

I. The monetary role of gold is declining rapidly

Judged by any of a variety of possible criteria, the actual role of gold in the international monetary system continues a decline that can be traced back to World War I; in recent years the pace of the decline has accelerated. First, the importance of *gold as a reserve asset*: in 1913 and again in the 1930s, gold accounted for about 90 per cent of total monetary reserves; between 1950 and 1970 the proportion declined fairly steadily, from 70 to 50 per cent; in the last two years it has plunged below 30 per cent.

The use of gold in *official international settlements* has dropped still more sharply; virtually the only remaining transactions are those connected with obligations to international organizations, and these are running into increasing resistance. This resistance is evident in the widespread questioning of the need for gold payments in subscriptions to IMF quota increases, to be referred to below; it was also reflected in the recent frustration of the intention of the EEC countries that settlements of debts in respect of mutual currency support should be in proportion to the composition of reserve assets of the debtor country—in the event, it proved impossible to persuade the debtors and potential debtors to include gold in this package.

The role of gold as the *standard of value* for currencies, although maintained in formal terms, has also been reduced in practical significance, by (i) the advent of Special Drawing Rights as an alternative measure of value or numeraire, and (ii) the weakening of the link between the official gold price used as numeraire and the price of gold metal as valued by the markets, The opening of a considerable gap between the official monetary price and the market price of gold, while it has a number of undesirable influences that will be referred to below, has unquestionably had the effect of giving the official gold price more of the characteristics of an accounting unit. This role can clearly be played as efficiently, and without the same undesirable side effects, by SDRs.

In the bargaining that took place last fall over the form that the realignment of currencies should take, an important element in the final agreement that this should include a formal devaluation of the dollar in terms of gold was that this step was necessary to help build up the role of the SDR as reserve asset and international numeraire. For under the existing IMF Articles, the SDR has a fixed link to gold, and if thte realignment had taken place wholly by way of appreciations of non-dollar currencies vis a vis gold and SDRs, this would have made the SDR an unattractive asset to hold, depreciating with the dollar against the other major currencies. This action on the price at which gold is accounted in its official monetary role was taken partly in order to achieve a desired effect in terms of SDRs.

II. The traditional role of gold is inconsistent with active economic management

The progressive decline in the monetary role of gold in the past fifty years has not been accidental or out of key with the main theme of economic and political tendencies. The international role of gold would probably have declined in any case in the twentieth century as a result of the spread of the principles of the banking process to the plane of international official statements. The decline has been hastened by the increasing extent of governmental management and intervention that has been found indispensable in national economies: for official management of national economies demands some accompanying degree of management in the international economy.

It is true that, in principle, certain ways could be found of maintainiing a major role for gold in the international monetary system while still exerting a degree of official influence and management over that system. This could be achieved, for example, through periodic increases in the price of gold in terms of currencies as a whole. But a managed gold standard of this kind would remove the automaticity and anonymity of the traditional gold standard; moreover, new elements of instability would be introduced by the necessity for periodic "price management". For in modern conditions of even creeping inflation, adjustments in the gold price would need to be made at recurrent intervals, and speculation on such adjustments would be a continuing disturbing influence.

III. AS A MANAGED RESERVE UNIT, SDR'S ARE SUPERIOR TO GOLD

At a time when it was still doubtful whether governments and central banks would have the sophistication or mutual trust necessary for management of an international unit such as has eventuated in SDRs, there was still a case for regarding a managed gold standard, operating through periodic increases in the price of gold, as a second best alternative to a perhaps unattainable managed paper standard. The technical success of SDRs since their introduction in early 1970 should have disposed of such doubts. Use of such a unit is both more efficient and less costly in real terms than use of gold metal as the managed reserve money of the system.

Moreover, while reliance on an international unit requires a working degree of international co-operation on an organised basis, this need not reduce the effective freedom of action of national authorities over the key aspects of their economic policy. Nor is there any sound basis for the belief that national control over the impact of international monetary influences is connected in a direct and positive way with the role of gold in the system. Thus, a system relying for its management on changes in the price of gold would be far less amenable to influence on the part of small or even middle sized countries than a system based on periodic and collective decisions on a managed supply of a unit such as SDRs.

The recent brief experience with SDRs, and a quiarter century's experience in the IMF's General Account, has shown that even wars—on the "local" scale experienced since World II—have not impeded access to IMF monetary claims. Large countries may well want to keep some strategic reserve of gold as financial insurance against a general conflict; but such a strategic reserve is essentially akin to strategic stocks of other commodities, and could in time logically be divorced from the monetary reserve—as was indeed done for the war chest kept by the German Imperial Staff before World War I.

IV. GOLD IS NOWADAYS DEMANDED MAINLY FOR NONMONETARY USE, BY OFFICIAL HOLDERS AS WELL AS PRIVATE HOLDERS

Because the risks of war and of other forms of excommunication from the world community are weighed differently by different countries, national authorities are likely in practice to wish to keep varying quantities of gold in their own hands. Naional authorities also differ in the extent to which they wish to hold gold with a view to its prospective financial appreciation, and they may differ on the views they take over the prospects of such appreciation. Thus one should not expect countries to maintain uniform amounts or proportions of gold in official hands.

Currently, a general tendency for official hoarding of gold has been encouraged by the wide gap that has opened up between the official price and the market price, as well as the remote possibility of a substantial rise in the official price. Since the value of SDRs is presently tied rigidly to the official value of gold, the same influence makes countries reluctant to part with SDRs and to engage in transactions with the IMF. This freezing up of a substantial proportion of global reserves has added to the difficulties of the international monetary system in the past year.

In principle, one possible remedy for this immobilisation would be to require countries to transfer reserves in a package containing all main reserve assets—

gold, dollars and SDRs—in some predetermined ratio. This has been suggested from time to time in the past; and such a requirement, as indicated above, was intended to govern settlements under the EEC's arrangements for mutual currency support. But such transfers of gold have been found impossible to enforce. The attempt to force gold back to an active role in monetary settlements goes against the grain of a long historical tendency for gold to become an inactive element in official holdings. Yet, the official hoarding of gold, and of SDRs and IMF positions along with it, plainly detracts from the function to be played by a good reserve asset.[1]

V. A STABLE INTERNATIONAL RESERVE SYSTEM MUST BE BUILT ON A SINGLE PRIME RESERVE ASSET SUCH AS THE SDR

The fundamental solution to the currently severe problem of uneasy co-existence between the several reserve assets lies in (i) recognising that national authorities have a varying demand for gold on grounds other than its characteristics as a reserve asset; and (ii) ending the strains produced by multiplicity of reserve assets of different characteristics. Gold is desired as a strategic reserve, as a long term investment, or as a medium term speculation, and as long as this remains so, attempts to harmonise the holdings or use of gold in some uniform proportion are unlikely to succeed—or to deserve to succeed. The conflicting pull between the reluctance of national authorities to release gold and the need to restore an active role to the monetary reserves frozen in immobile gold holdings stems partly from the current ambivalent position of gold as a reserve asset—half commodity, half accounting price. In a deeper sense, the conflict reflects the inherent instability that is involved in a system containing multiple reserve assets of differing characteristics.[2] A stable international reserve system may therefore be attainable only on the basis of a single main reserve asset. In present circumstances this would have to be the SDR.

This consideration argues for the replacement through newly issued SDRs of official holdings of dollars and other reserve currencies held in excess of immediate requirements for working balances; the same consideration makes it desirable that the role of gold as a separate monetary asset should eventually be ended. This does *not* require, as has sometimes been supposed in the past, that present national holdings of gold must be centralised in part or in full in international hands. Countries can be completely free to retain whatever gold they wish. All that is necessary is to disattach from such holdings, at a suitable time and in a suitable way, the provisions that involve a fixed link with (other) monetary reserve assets.

VI. FORMAL DEMONSTRATION OF GOLD CAN BE ENVISAGED UNDER CERTAIN CONDITIONS

Because gold holdings still constitute an important part of what are presently regarded as monetary reserves, explicit demonetisation of gold—which would merely be the formal culmination of a process that has already proceeded a long way—would have to be carefully prepared and phased. In particular, provision would have to be made for existing monetary holdings of gold to be exchanged into newly issued SDRs; it would also be important to ensure that gold withdrawn from the monetary system could be offset, in its deflationary effects on official international liquidity, by additional creation of SDRs to the extent considered necessary. With provisos of this kind, one may envisage the setting of a time limit for the exchange of gold into newly created SDRs and for the continuing acceptability of gold under present provisions in the IMF and elsewhere; beyond such a date, gold would no longer be eligible for either of these facilities, and would be replaced in its monetary functions by SDRs. Gold would thereafter be an entirely non monetary commodity.

A "final solution" of this kind would necessitate extensive changes in the IMF Articles: more important, its rationale would be dependent on acceptance by major countries, above all the United States, of the principle that the SDR

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[1] The characteristics of a good reserve asset are ready exchangeability into payments media used to meet current needs. An asset that appears potentially more valuable to the holder than the price at which it is accounted in current settlements is not a good reserve asset by this test.

[2] Because these characteristics are different, any one of these assets will at a given time appear unattractively weak, at another time attractively strong, vis a vis the other reserve assets on the basis of the fixed monetary relationship ruling between them at the given time (currently, 1/38 ounce of gold = \$ = 0.9 SDR). Thus a conflict between this fixed monetary link and the different relative valuation conferred by current expectations is bound to arise.

should be made the central asset of the monetary system. This would require that deliberate steps are taken to confine holdings of reserve currencies to the needs of working balances.

The treatment of monetary gold should logically be seen as part of this package. However, while acceptance of restraints on reserve currencies is an essential condition for a move to a true SDR standard, the same compulsion probably does not apply to formal demonetisation of gold. The reaosn is that natural tendencies, if properly channelled, might be sufficient by themselves to contain disruptive pressures arising from the remaining role of gold as a reserve asset.

VII. A LESS RADICAL SOLUTION THAN FORMAL DEMONETISATION IS TO CONTAIN GOLD PRESSURES BY A SERIES OF EXPEDIENTS, INVOLVING IMPORTANT CHANGES IN CURRENT POLICIES

"Containment" of the gold pressures, while less satisfactory than a solution on the lines indicated above, which is likely to be necessary in due time, could play an important part in easing current pressures. Such a policy of containment would involve at a minimum the following changes from present practice:

(1) *Acceptability of SDRs in all transactions with the IMF for which gold is presently required.* This would merely carry through a principle applied partially and without consistency in the amendment to the IMF Articles under which SDRs were introduced.

(2) *The 1968 Washington agreement should be amended to end the restraint against sales of gold by monetary authorities in private markets at premium prices.* Such sales should preferably be made through the IMF or an equivalent pool, and the profits on premium sales devoted at least in part to a common purpose such as allocations to the International Development Association (IDA). In addition, the IMF should make gold sales to the market on its own account (which would be possible even under the present articles if the sales were channeled through the central banks of member countries). The IMF has never been so full of gold—its current holdings are some $5¾ billion, more than twice their level two years ago. *A sale of say $1 billion of IMF gold into the market would have salutary effects.* The broad objective of open market gold sales should be to avoid excessive premiums in the market, and to create a pattern of two way movement in market prices so as to discourage short-term hoarding and speculation. An over rigid price policy such as that followed by the central bankers' gold pool in 1960–68 should be avoided.

Reductions in global monetary reserves arising from gold sales in private markets should be made good through additional allocations of SDRs.

(3) *The United States should declare formally that its efforts to restore official convertibility for the dollar, when the necessary conditions are met, are centered on convertibility in terms of SDRs; that it will never restore a fixed monetary link to gold: and that it intends, in due time, to transfer the Treasury gold holdings to the stockpiles managed by the General Services Administration* or another agency competent in the management of valuable strategic materials.

I now relate the broad approach outlined above to the specific questions posed by the Chairman.

1. Has the March 1968 two-tier agreement banning official gold transactions in the free market outlived its usefulness or should it be wholly or partially retained?

The March 1968 gold agreement should be substantially amended as indicated in VII (2) above. The 1968 agreement was essentially a holding operation, which stemmed the drain of global monetary reserves before SDRs were in place. The agreement was always open to ambiguous interpretation, concerning official reluctance to part with gold from monetary stocks. Moreover, this ambiguity became rather more marked following the end-1969 agreement on sales of newly mined South African gold to the IMF, which had the effect of again making the official gold price a floor to the market price. Without this agreement, the market price of gold in early 1970 would have fallen far below $35 an ounce (rather than marginally below as it did in fact).

The amendment of the March 1968 agreement should permit, and encourage, national monetary authorities to sell gold in private markets, both on their own account and on account of the IMF. An initial large amount such as $1 billion of gold should be sold from IMF holdings. Open market gold sales should preferably be channelled through a central pool, and the profits from premium sales should be allocated in part for a common purpose such as subscriptions to

IDA. A flexible price policy should be followed by the managers of open market gold sales. Such sales could offset, to the extent considered desirable, any sales of newly mined South African gold to the IMF.

A bold policy on open market gold sales would permit a relaxed attitude on purchases of gold by monetary authorities at premium prices, which would be unlikely in any volume. However, such purchases would infringe IMF obligations.

2. Is there any need to continue the IMF practice of requiring gold payments as part of quota subscriptions?

No. See VII(1) above. The 25 per cent of IMF subscriptions now payable in gold should be made eligible for payment in SDRs, and the same should be done for all other gold payments due to the IMF. Action should be taken before the next IMF quota increase, if necessary by making still more imaginative use of expedients in "mitigation" of gold payments than those used in the last two rounds of quota increases. Eventually, gold should cease to be eligible for such payments, which would then be in SDRs only.

3. What would be the effect on the rest of the world if the enlarged European Economic Community adopted a policy on gold differing from that of the IMF?

This would of course depend on the form of such a policy. If the EEC adopted an "independent" gold price to govern settlements among its members, this would be inconsistent with the official gold price underlying currency parities or central rates of IMF members, including those of the EEC countries themselves. Thus, such a move could be interpreted as a unilateral demonstration of gold of a rather original kind.[3] Unless the new EEC price acted as a magnet to which other major countries, and notably the United States, gravitated—and this seems inconceivable—the upshot would almost certainly be to hasten a formal break in the gold link at the global level. There might be no fixed relationships among different assets used as reserves, and the resulting confusion might easily eventuate in a breakdown of the IMF system in its broadest sense, involving floating rates between currency blocs and perhaps no generally usable reserve assets. The notion of a floating EEC gold price based on the market rate seems still more bizarre. I should add that I would be extremely surprised if EEC central banks were prepared, *as recipients*, to take settlement in gold valued at the premium price of the day.

4. (Dealt with together with 7 below.)

5. Should the statute prohibiting purchases and ownership of gold by private American citizens be repealed?

At least not until a bold policy on open market sales of gold has been adopted, and proved successful. After a more complete move to demonetisation of gold, free purchase by American citizens could cause no damage to the international monetary system. I would suggest, however, that the Congress might keep its eye on another aspect of such a liberalisation; its effect in adding another vehicle for fiscal evasion. Private ownership of gold has a time honoured function in this respect in France and other countries; and is a standing temptation to such evasion.

6. Are there any valid reasons why the rest of the world should support the Soviet Union's and South Africa's gold industry?

No. But the support of these industries has clearly not been the motive behind official gold policies (as concerns private interests, I would guess that a more significant role has been played by European watchdogs of the interests of private gold holders). It is indeed ironical that South Africa benefits from a more cast-iron commodity support scheme than any other primary producing country—with the price fully market determined on the upside, but protected from equivalent decline by the existence of the official floor price. But this asymmetry should be dealth with in its own right, first through an active official open market gold selling policy, and eventually through formal demonetisation.

4. Under a reformed international monetary system, to what extend would gold need to be replaced by special drawing rights?

7. How can gold be phased out as international money in an orderly way?

These questions have been discussed under V and VI above. In summary, gold should eventually be replaced by Special Drawing Rights as a monetary asset. But there is no compulsion to call in gold that countries wish to retain for non

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[3] This would not of course apply to the adoption by one or more EEC countries of a general commitment to freely buy and sell gold against their own currency; such a move would resuscitate a true gold link in the form of a Euro-gold system in place of the abandoned dollar-gold system. But it would be wholly out of character with the past practice of European countries if they were to risk any such action.

monetary use—either as a strategic reserve, or in expectation of long term capital appreciation or as a sheer hedge against the unknown. If possible, the next round of international monetary reform should set a terminal date to the use of gold as a monetary asset, permitting its replacement by SDRs, before that date, but not after. But a prior condition for such a reform is strict curtailment of the use of the dollar and other reserve currencies in official holdings. For without such curtailment, SDRs could not be expected to become the prime reserve asset of the system and to command the full acceptability which the replacement of gold by SDRs demands. Thus the replacement of gold and reserve currency holdings is part of the same package, in which the reserve currency element, as the most active, is also of overriding importance.

Federal Reserve Policy on Swap Agreements and Exchange Market Intervention

I will address myself to the general issues that underlie these questions, as others are more qualified than I am to deal with the operational issues. I shall not distinguish between use of swap agreements and Federal Reserve market intervention, since such a distinction is relevant only to highly technical and operational questions with which I am not concerned.

I. A GUARDED VIEW OF RESUMPTION OF SWAP ACTIVITY IS JUSTIFIED

I believe the committee will be right to take a guarded view of the resumption of swap activity. The development of central bank swaps has a long lineage, but entered a new phase in the 1960s, then experiencing what might be described as an explosive boom. Like many booms in the private sector, the business had a solid base but was seriously overextended by the enthusiasm of its protagonists. Swaps in the 1960s got out of control. The basic trouble was that they developed a life of their own, instead of being integrated with other aspects of the international monetary system, and specifically with the adjustment process.

A controlled use of swaps such as would be appropriate for the future cannot be attained, in my view, simply by the exercise of greater caution by monetary managers. These managers have to respond to the pressures which face them. Nor does it seem useful to say—as is the tendency among the officials concerned—that past excesses in use of swaps could be avoided with better government policies: such policies have to be accepted as they are for this purpose. I shall argue that a controlled use of swaps is integrally connected with functional improvements in associated monetary arrangements: and specifically in the mechanism of exchange adjustment.

II. PAST USE OF SWAPS HAS ENCOURAGED THE TENDENCY FOR MONETARY AUTHORITIES TO BECOME OVER-COMMITTED TO THE DEFENSE OF EXISTING PARTIES

Swap credits are short term credits between central banks or treasuries, carrying an exchange guarantee, and available without policy conditions on a reciprocal basis up to an agreed maximum, which can be raised or lowered by simple administrative action. In the framework of a system of stable but adjustable exchange parities such as has persisted hitherto, and with varying possible modifications is generally envisaged for the future, the appropriate role of these credits is in principle mainly twofold:

(i) to help finance transient disequilibria in external payments, e.g. those arising from seasonal or cyclical influences, disequilibria which it would not be appropriate to correct through adjustment of exchange rates or other measures with a lasting, and slow acting, effect; and

(ii) to help deter speculation on a change in parity in such situations.

In practice, however, it has not been easy to restrict the use of swaps for these purposes, and these alone. Temporary and reversible situations are easier to identify in prospect than in retrospect, nowhere more so than in external payments. A disequilibrium that turns out to be lasting will often show ambiguous signs in its early stages. Once the decision to defend the parity is made, this has to be done in a determined way; this in turn involves the commitment of substantial resources to defence of the parity, and if the parity is then abandoned, this will involve substantial monetary losses to speculators, and perhaps also a loss in terms of official credibility and prestige.

The additional resources mobilisable through swaps for currency support can therefore increase the tendency for monetary authorities to become over-committed to the defence of parities, and to continue their rearguard action at a time when an exchange adjustment is overdue. An important administrative element in this connection is that the availability and use of swaps tends to strengthen the the power and influence of the operational agencies in the official machine, and of the market operators within these agencies. Influence and leverage gravitate to those whose task is currency defence, at the expense of those officials who are concerned with wider aspects of economic and financial policy, including the full economic costs of currency defence.

These dangers were exposed at considerable economic cost in the experience of the 1960s. To be sure, a number of cases can be cited in which use of swaps and other short term currency defences achieved a valuable purpose in the intended manner: the most important such success was perhaps the prevention of a second devaluation of sterling in 1968.[4] But against these successes must be set the negative contribution made by swaps, along with other important influences, in delaying major exchange adjustments that are almost universally agreed in retrospect to have been justified and overdue, and that hard analysis could (and did) show to have been justified long before they were made. The belated devaluation of sterling in 1967 is one major example, and the belated devaluation of the dollar in 1971 is another.

As indicated, swaps were far from the only influence in these delays. In the case of the dollar, the role of swap credits in delaying the exchange adjustment was only marginal in direct terms—but in the wider context, the reliance placed on swaps and the tactics of which this formed a part bear a substantial responsibility for the delay, since a more restrained use of swaps and a lesser determination to prevent parity changes by other countries would have obliged the United States to confront the realities of its payments disequilibrium at an earlier stage.

III. MORE FLEXIBLE ATTITUDES ARE NOT ENOUGH

For the future, the danger of a repeat performance should be somewhat reduced by the lessons of recent experience. These lessons have contributed to a markedly more flexible attitude to adjustment of exchange rates and to a general agreement in principle that changes in par values should be made more promptly than in the past.[5] But a more sympathetic attitude to exchange adjustment will not prevent the emergence in the future, as in the past, of payments imbalances that cannot immediately be diagnosed as temporary or fundamental, involving the difficult decision of whether support should be given through use of swaps and other means, in the knowledge that this will increase the official commitment—financial and perhaps also political—in maintaining the parity. This problem tends to be skated over in official discussion. At the same time, a determination to abstain from support of parities in ambiguous situations would, under existing practice, quickly lead to excessive exchange adjustment—or else to a general drift towards floating rates, as may be the present tendency.

I believe there is no way of avoiding or significantly lessening this conflict without some change in the past institutional arrangements for exchange adjustment—considering these past arrangements as adjustments in parities at fairly lengthy intervals and then by substantial amounts, entirely at the formal initiative of only the country concerned, and in response to no general criteria; and with relatively narrow margins of fluctuation around parity—1 per cent vis a vis the intervention currency under the basic regime, increased to 2¼ per cent under the provisional arrangements made in the Smithsonian agreement of last December, but since limited in practice for the EEC currencies by the confines of the arrangements for limitation of margins between these currencies.

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[4] Another prominent example that is sometimes cited is the prevention of a devaluation of the Italian lira in 1964. But the deflationary measures by which the lira was "saved" exacted a cost in terms of employment and investment from which the Italian economy has in a sense never recovered.

[5] The shift that has occurred in the consensus view of officials of major countries on exchange rates can most readily be seen by comparing three reports. The current report of the IMF on reform of the system gives virtually unequivocal support for the principle of more active use of exchange adjustment (e.g. in the suggestion that countries might be expected to take positive action to adjust their parities when they were in "fundamental disequilibrium", and not merely, as at present, to refrain from exchange adjustment when they were not). In the IMF exchange rate report of two years ago, the possibility of more active resort to exchange adjustment was raised, but in a guarded and qualified way. But this report on "The Role of Exchange Rates in the Adjustment of International Payments" represented a clear advance in its title alone, as previous official doctrine was reluctant to concede that exchange rates were part of the adjustment process. In a report on the Adjustment Process issued in 1966 by the Organisation for European Co-operation and Development (OECD), exchange rates were mentioned in a single paragraph, and then in a backhanded way.

IV. THE PROCESS OF EXCHANGE ADJUSTMENT NEEDS TO BE SMOOTHED THROUGH WIDER MARGINS AND/OR SMALLER AND MORE REGULAR PARITY ADJUSTMENTS

A smoothing of exchange adjustment could be achieved through some combination of (a) effectively wider margins, e.g. to 3 per cent vis a vis the intervention currency; and (b) a systematic policy of reducing the size and increasing the frequency of adjustments in parities, if necessary through the stimulus of international criteria, guidelines or rules.[6] Without institutional changes to facilitate and promote a smoother process of exchange adjustment, it may be doubted whether sufficient exchange adjustment will be achieved, if only because national authorities will be thrown back on defence of their parities—indeed, this has already happened in a sense in the enshrinement of the Smithsonian exchange structure as a subject of worthy defence.

V. SWAP FINANCING WOULD BE SAFER AND MORE EFFECTIVE IN CONJUNCTION WITH MORE FLEXIBLE EXCHANGE RATES

If the swap network were to be revived on an extensive basis in advance of international agreement on the mechanics—and not only on the principle—of a smoother and more systematic use of exchange adjustment, two separate dangers would arise:

(i) the danger that the security given by the exchange guarantee element of swaps to surplus countries acquiring dollars would help deter such countries from stemming the dollar inflow by revaluing their currencies; such a tendency could again make it difficult to prevent or correct an overvaluation of the dollar, with the heavy costs this entails; and

(ii) in a different situation, for countries whose currencies were under downward pressure, extensive availability of swaps might again pose dilemmas as between large scale financng of the exchange market deficit or a possibly premature adjustment (or abandonment) of the parity.

Under a regime of smoother exchange adjustment, with greater scope for rates to move within margins, and smaller expected forced movements in rates as a result of (smaller) parity adjustments, use of swap financing would work together with a degree of adjustment in exchange markets. This would provide safeguards against undue cost of private speculation on a parity change, for such speculation would no longer always be profitable even if a small parity change occurred, as the lower margin of the old parity could "overlap" the upper margin of the new parity.[7] In addition, the scope for early adjustment of exchange rates, either in movements within the margins or in response to a small parity change, would provide an early corrective for the payments imbalance. Such a corrective would be on a modest scale and would be reversed if the disequilibrium turned out to be temporary, in fact, and if this were reflected in a turn-round in the exchange market. If on the other hand the disequilibrium proved more enduring, the way towards a larger adjustment would have been eased.

VI. EXTENSIVE REVIVAL OF SWAPS SHOULD BE MADE DEPENDENT ON SUFFICIENT PRACTICAL PROGRESS TOWARD SMOOTHER EXCHANGE ADJUSTMENT

For these reasons, I suggest that from the standpoint of both the United States and the working of the international monetary system as a whole, extensive revival of the swap network should be made dependent on sufficient practical progress in securing a working system of smoother exchange adjustment. It should be emphasised that implementation of such a system would require that the United States, as well as other major countries, would be willing to adjust parities more frequently, and virtually as a matter of routine.

Once a more flexible working system of exchange adjustment is in place, a revival of the swap network will be desirable as a complement to this system. Swap credits may also have an important new role to play in association with arrangements (referred to in the first half of this statement) to curtail the

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[6] I have discussed various possible methods of securig a smoother process of exchange adjustment in "The Politics of World Money" in *The Economist* of August 5, 1972, pages 55–68, and "The Exchange Rate Regime: An Analysis and a Possible Scheme", IMF Staff Papers, July 1972.

[7] Thus if the exchange margins were 3 per cent, and the market rate was 2 per cent blow par, then a downward parity change of 4 per cent would not necessitate a change in market rate, which would still be 1 per cent below the upper margin on the basis of the new parity.

accumulation of dollar balances in reserves of other countries beyond working needs. The question will then arise of the appropriate form and size of the new swap arrangements. This is a question for the future which can best be decided when the main features of the surrounding arrangements for reserve assets and the exchange mechanism are known. But some broad desiderata are already apparent.

VII. THE MOST APPROPRIATE FORM OF NEW SWAP CREDITS MAY BE A NEW FACILITY IN THE IMF ON SPECIAL TERMS

In general, it would probably be advantageous to make the swap facilities less haphazard in nature than they became in the 1960s, involving a complex series of facilities arranged on a bilateral or ad hoc basis among different groups of countries. Consideration should be given to channelling the facilities through a single organisation, such as the IMF. The IMF connection would have the advantage of (i) a ready made criterion on appropriate relative availabilities, in the form of the Fund quotas (though swap facilities should not necessarily be directly proportionate to quotas), and (ii) and "in house" facility for refinancing on appropriate conditions; this could help deter semi-forced rollovers in inappropriate circumstances.

Such credit facilities would have to be clearly separated from the regular IMF credit tranche. One possiblity would be to provide that, in circumstances where a member country represented that it had a payments need that appeared to reflect temporary pressures that it judged likely to be reversed within a maximum of one year, the member could draw a large amount—e.g. its whole quota [8] to finance such a need. Countries with more than a given amount outstanding in the credit tranches would not normally be eligible for the facility. Drawings on such an 'IMF-swap' would be made available without conditions about policies pursued by the member, and with minimum scrutiny concerning validation that the circumstances represented by the member existed. The ready availability of such funds would have to be balanced by an interest rate well in excess of the regular rate on IMF drawings; in principle, the rate should be close to short term rates within major money markets. This would help deter application for medium term finance being channelled to this facility in the first instance. In all these ways, the features appropriate to short term financing would be applied. Amounts outstanding after a year would have to be repaid or refinanced on the conditions appropriate to drawings in the IMF's higher credit tranches. These conditions already attach importance to adoption or maintenance of a "realistic" rate of exchange, and in credits granted to refinance swaps, this stress on exchange adjustment could be given particular emphasis. This would provide another connection between use of swap finance and exchange adjustment, a connection that is the best safeguard against new misuse of the swap mechanism.

Chairman REUSS. Thank you, Mr. Hirsch.

Mr. Rueff, please proceed.

STATEMENT OF JACQUES RUEFF, FORMER PROFESSOR, ECOLE LIBRE DES SCIENCES POLITIQUES; FORMER DIRECTOR OF THE FRENCH TREASURY; FORMER DEPUTY GOVERNOR OF THE BANK OF FRANCE; MEMBER OF THE ECONOMIC AND SOCIAL COUNCIL; AND CHANCELLOR OF THE INSTITUT DE FRANCE

Mr. RUEFF. Mr. Chairman, as you have already recognized, my English is very bad and I must ask you to excuse the way in which I will speak.

I want to say that I greatly appreciate the honor to testify before this committee.

I have tried to obey your command, Mr. Chairman, and to answer the various questions stated in your memorandum. These I have

[8] Currently $6.7 billion for the United States, $2.8 billion for the United Kingdom, and $1.6 billion for Germany.

written in my prepared statement; therefore, it is not necessary that I comment on them.

Chairman REUSS. That will be included fully in the record.

I would like you also to include in the record, Mr. Rueff, your June 24, 1972, statement, "A Marshall Plan for the United States" directly after your prepared statement of today. I notice you are going to talk about that today.

Mr. RUEFF. Yes; that is the main topic on which I should like to present some information. If you will permit me, I will speak freely on the subject of our discussion.

It seems to me that the main reason for all our problems and probably the main reason why we are here, is the permanent deficit of the balance of payments of the United States which is the origin of all kinds of problems of recent times.

Well, the first one, in which I think we ought to agree, is that this deficit is not fortuitous. It has been established as a necessary result of a certain international monetary system in which the United States had no responsibility. In other words—I insist on this point—you have no responsibility in this deficit which was imposed on you by the international monetary system which has developed in the world since 1950.

In 1961, I published a paper in which I tried to make clear the main character of the international monetary system. It was the fact that the central banks outside the United States had decided to alter the regime through which they create national currency. They create their own money not only against gold and claims expressed in national currency, such as commercial bills or treasury bills, but also against foreign exchange payable in gold, which meant dollars and dollars only. Therefore, money was created in Europe since 1945 against gold, claims in national currency and dollars. This system called the "gold exchange standard," as opposed to the "gold standard," was an exact repetition of the system which had been established in Europe in 1922 and which quite clearly was responsible for the great depression and resulted in this immense catastrophe.

According to this new regime, when foreign central banks received dollars as payment for any purchase outside the United States or aid or military expenditure abroad, they purchase these dollars and create against them national currency. But dollars have no use in Paris or Milan or Berlin; the same day they are received, these purchase dollars are invested in the New York monetary market in treasury bills or bank deposits and this money which has gone from the United States for foreign payments returns the very same day to the U.S. market; therefore, the United States never loses, in this regime, whatever amount they have paid to foreign countries.

Well, in 1961 I wrote three articles showing that this regime would have, inevitably, three consequences: (1) The permanency—is that an English word—the permanent existence of the deficit in the U.S. balance of payments—the deficit would be permanent so long as the regime exists; (2) the second consequence is inflation in the receiving country which has created money to purchase the dollars received in payment of the U.S. deficit; and (3) finally, necessarily, the collapse of the system because of the accumulation of foreign claims on the U.S. reserve of gold which was not to increase but to diminish.

Well, the least that can be said is that these three consequences have been observed and are still present before us, and have created the situation, which is probably the main reason why we are here. The U.S. balance-of-payments deficit still exists, inflation still exists in creditor countries, and, also, the collapse of the system is clear and undesirable since March 17, 1968, and August 15, 1971.

What is the way to meet this difficult problem of the deficit in the U.S. balance of payments? I want to be brief on this point. The only way is to create a situation in which the debtor country loses what the creditor country gains. As I said before, the main feature of the situation is that the debtor country, namely, the United States, because the dollar is a reserve currency, never loses the amount which is received by the creditor country.

What situation exists if you are not to pay for what you purchase? You purchase much more freely and your balance of payments tend to be in deficit.

What is the way to restore the situation? If you eliminate the floating exchange rates—of which I spoke in my prepared statement—the way is to restore a system in which the debtor country loses what the creditor country gains. This system is convertibility. There is no other way to establish such a transfer of wealth from the debtor country to the creditor country than convertibility and you can see that it is a matter of commonsense to recognize that when such transfers do not happen, the balance of payments, everything equal, tends to be in deficit.

Then what kind of convertibility? Well, the fashionable point of view today is convertibility into SDR's. But convertibility into SDR's is convertibility into something which is freely created, which is allocated and not obtained from real wealth. It is fiat money. So convertibility into SDR is only the appearance of convertibility because the debtor countries do not lose anything. They have received a gift which they use to pay and so SDR's will be the most efficient instrument for world inflation if it continues to be used in the present way.

What other kind of convertibility? Well, I want to be brief. Let me say that my view is that in the present world, the only real and practical solution which may be applied is convertibility into gold. For what reason? Because gold is not allocated; gold is gained and has a real value.

But then, if we say that, we must recognize that in the present conditions, the United States can't reestablish convertibility into gold because they have not enough gold; in case gold convertibility is restored, some dollar balances would be cashed in gold and the United States simply has not enough gold to repay them.

What are the figures? You have about $10 billion of gold. The amount of claims in dollars, foreign claims, is between 50 and 60; it is evident that if the repayment of part of these claims is demanded, you will not have enough foreign exchange or gold to do it. So if convertibility is restored, you will have to be provided with more foreign liquidities.

What are the possibilities? In 1961 I proposed that the price of gold not be increased, but reestablished at its place among the hierarchy of prices. As all prices in the United States had more than doubled since 1934, that meant approximately doubling the price of gold. I saw there the possibility of solving the immediate problem and restoring the convertibility of dollars into gold because the increase of the price of gold would have increased in the same proportion the value of your gold reserve.

At the end of 1960 you had a gold reserve of $17.5 billion and the amount of foreign dollar balances were approximately $13 billion. If you had doubled the price of gold, your reserve of gold would have been worth $35 billion. On that you could take $13 billion to repay foreign balances and remain with a gold reserve of $22 billion, a little higher than before. No risk of deflation nor inflation.

Well, now, that is no more the case. If you double the price of gold, your reserve of gold, which is about $10 billion, would be worth $20 billion. You would have a surplus value of $10 billion, it would be clearly insufficient to meet eventual repayments of $50 to $60 billion, which is now the approximate value of dollar balances in foreign hands.

Then I propose an international agreement in which every country, every member country, will agree to restore the same day the price of gold—not to change it—at its normal place among the hierarchy of prices.

Now it happens that this normal place is practically the price of gold on the market. It means approximately doubling the price of gold.

Well, that would give, as I said, approximately $10 billion for the United States and $31 billion for all non-American countries. Altogether it seems to me that it is only normal and fair that the foreign countries, having this surplus value of their reserve of gold, offer the United States a loan for a long period, 20 to 25 years, at a very low rate of interest, which would give the United States $31 billion in the foreign gold, which added to the increase of value of the American reserve means $41 billion, which would be, certainly, sufficient to restore the full convertibility of the dollar.

I call that a reversed Marshall Plan. Let me say that it seems to me that it is a fair and rational way to recognize the incredible and wonderful generosity of the United States when they have helped Europe after the war. That would be, as I said, be a reversed Marshall plan which would permit them to reestablish immediately the convertibility of the dollar and therefore to settle all our pending problems.

Let me say how this would appear to you. It is exactly what President Roosevelt did in 1934; he raised the price of gold and revalued the gold reserve of the United States. It is the only way to avoid and solve the very dangerous problems which are before us. I am sure it is practical.

Let me say one more thing, which is the last one: I am absolutely sure that this will be done in the future. It may not be done presently but it will be done in the future because it is the solution. There is no other solution. If we wait too long to apply it, we may have the renewal of crises like those to which we are accustomed. I notice that the Smithsonian Institute agreement has improved the balance of trade: but our problem is only to a minor degree a problem of balance of trade; it is a problem of balance of payments which has to be solved and must be solved. I hope only that we shall not wait too long to solve it.

Thank you, Mr. Chairman.

(The prepared statement of Mr. Rueff and the statement entitled "A Marshall Plan for the United States" follow:)

PREPARED STATEMENT OF JACQUES RUEFF

I greatly appreciate the privilege to appear before the "Sub Committee on International Exchange and Payments" under the learned Chairmanship of Representative Henry S. REUSS.

I suppose that if I have been invited to speak on U.S. official policies concerning gold as a reserve asset, it is because rightly or wrongly, I am considered as a champion of gold as the base for the international monetary system.

Let me say right away that this is not the right interpretation of my view. I am not the champion of gold as such; I am the champion of order in international relationships, which imply a certain degree of price stability, which is not existing in Europe, and a certain degree of balance in foreign payments, which is not attained—that is the least which can be said—in this great Country.

My position on gold is not a matter of orthodoxy—there is no orthodoxy in the field of money—but a desire of efficiency based on the conviction that something has to be made to restore more balance in our unbalanced world.

This being said, I will try to answer the questions asked in the memorandum of the Committee, trying on each point to make clear my own views, even and chiefly when they differ of the views of the majority.

This text has been written by me and unchecked by an experienced translator. Please excuse the bad English.

I.

1.—Has the March 1968 two-tier agreement banning official transactions in the free market outlived its usefulness or should it be wholly or partially retained?

At the present price of gold on the free market, there may be a temptation to sell gold at the free market price. If the arbitrary price fixed in the Smithsonian institute agreement is to be maintained and only in this hypothesis, the banning of such transaction is to be retained.

2.—Is there any need to continue the I.M.F. practice of requiring gold payments as part of quota subscriptions?

The answer is yes, despite the fact that the articles of agreement have been violated many times, by ingenius devices, in the last period.

In present circumstances the supply of gold to the I.M.F. permits to this institution to maintain the discretionary power to decide whether they will or will not give gold when required to do so.

Such arbitratory decision permit to solve exceptional situation after appreciation of the merits of the case.

3.—What would be the effect on the rest of the world if the enlarged European Economic Community adopted a policy on gold differing from that of the I.M.F.?

I suppose this question refers to a plan reported as having been discussed between the President of the French Republic and the Italian prime Minister in a recent secret meeting.

According to these unofficial gossips, the idea was to establish a price of gold nearer of the existing market price for the settlements between the members of the enlarged European Community.

Such a status would have the advantage to unfreeze the reserve of gold kept by these members, provided the free market price does not in the meantime attain higher levels.

Furthermore it would meet the objections of the Italian Government to settle in gold according to existing agreements a part of their debits towards the other members of the community, because they do not want to sell at the 38¢s an ounce, what is worth 65 on the free market.

The same result could be obtained more simply by authorizing the members of the enlarged Community to sell gold on the free market for purposes of settlement between themselves.

That would require an exception to the obligation contracted by Central Banks in the agreement of May 17, 1968, banning operations on the free Market by Central Banks.

Such exception, if agreed, could create a great attraction for the outside gold, and develop greatly the leaks and lags in the settlement of the international trade between the community and the rest of the world.

If applied, this discriminatory policy ought to be backed on very rigorous and complicated controls to avoid the renewal of great transfers of funds towards the enlarged community from the rest of the world.

4.—Under a reformed international monetary system, to what extend would gold be replaced by special Drawing rights?

The answer depends of the kind of reform envisaged.

Of course, despite the fact that it does not seem to meet the desires of the American policy. S.D.R. could be made convertible into gold. But it would raise very difficult problems with respect to the structures and roles of the I.M.F. The replacement of gold by S.D.R.—so called "papergold"—according to present practices would open the door to continuation of large inflation in the creditor counties, with the ensuing consequences of the renewal of large movements of capital towards them, as observed in the late months.

In such a case the main difficulty would be to find and impose a decisive criterion for the issue of this fiat money.

The experience of 1971 is very important. It was decided to issue 3 billions dollar of S.D.R. But in the mean time, the deficit of the U.S. balance of payments has created more than 22 billions of new dollars balances.

Nobody has had the will nor the strength to stop the allocation of S.D.R., which were clearly harmful in such circumstances as an addition to inflation.

5.—Should the statute prohibiting purchases and ownership of gold by private American citizens be repealed?

The answer is no, if the official price of gold is to be maintained in the U.S. much below the free market price.

It is only when the free market price coincides with the official price—which would be the result of convertibility of the dollar into gold—that the progressive repeal of the prohibition could be envisaged.

6.—Are there any valid reasons why the rest of the world should support the Soviet Union's and South Africa gold industry?

We, in France, buy a lot of American cars; it is not because we want to support American automobile industry, but because we find their cars useful and desirable. We buy them only to the degree of the need they present for us.

Such will be undeniably the case if a rational international monetary system, based on gold, is to be reconstructed. Gold will be bought from South Africa or Russia only in the degree required by the market and the amount of reserves wanted by other countries.

If not, we can play any game we like with the exports of countries we do not like. But it must be reminded that gold is not the only export of Russia and South Africa and that we want them to buy our own goods. Are we to refuse what we like or need to obtain from them, only to avoid to support their balance of payments.

Is it wise to harm one's self only to avoid to benefit other peoples?

7.—How can gold be phased out as international money in an orderly way?

The answer is that it can be excluded (I suppose with my ignorance of English that it is the meaning of "phased out") but I am convinced that it will never be in an orderly way.

The American experience, as previously the experience of other countries is decisive.

Since the early sixties, when the deficit of your balance of payments has been fully realized, you have first tried to restore the necessary balance by administrative action. On October 1962, in an article of "Foreign Affairs", my very good friend Robert ROOSA wrote: "The President's program, presented on 18 July 1963, demonstrates emphatically the determination of the U.S. to correct its own deficit".

In July 1965, the distinguished Secretary of the Treasury, my respected friend, Mr. FOWLER announced that the U.S. balance of payments deficit would be halved before the end of the year and completely eliminated in 1966.

On January 1st 1968, the President of the United States formulated at San Antonio, an ambitious program which was supposed to restore external equilibrium.

You know what result of all these attempts and their failure shows decidedly that there is no way to balance external payments by administrative manipulations.

Then remain only the monetary influences.

There are two possible kinds of monetary influences capable of controlling the balance of payments:

—floating exchange rates
—convertibility

(*a*) *Floating exchange rates*

Theoretically, floating exchange rates are perfectly efficient to balance payments between monetary area, whether national or regional.

So theoretically they can be perfectly efficient to "phase out gold as an international money".

But certainly not in an orderly way. Having been responsible of the management of a floating Franc in 1937, when I was in charge of the French Treasury, I can state without any hesitation that floating exchange rates create a general uncertainty for international trade, exclude any long term provision, generates either protection or subvention and is therefore totally incompatible with the desired expansion required by public opinion in modern States.

(*b*) *Convertibility*

Convertibility can be either in S.D.R. and various substitutes, such as dollar-balances or in gold.

As said before, gold is earned—either by extraction from the soil or more generally by an excedent in the balance of payment—whereas S.D.R. are "allocated".

The impact of this difference can be measured by observing the ensuing consequences for a country whose gold and foreign exchanges reserves fall too low.

Under the gold exchange standard the choice is simple. The country must either cease payments abroad or acquire the necessary means for international payments. If the second alternative is chosen, the country concerned either has to produce more gold or run a balance of payments surplus. In either case, means of payments abroad are obtained by giving up tangible goods, in other words by consuming less real wealth at home. The "foreign purchasing power" thus obtained is strictly limited to the extent of the sacrifice in domestic consumption consented to. No clever scheme or political pressure can change this one whit.

By contrast, with S.D.R., the restoration of purchasing power abroad is only the outcome of an unrequisited gift, which does not involve any sacrifice whatsoever on the part of the receiving country and depends on the discretion of the entity controlling the S.D.R., that is now the I.M.F.

For these reasons and many others, which would require more time than I can devote to this point in the present discussion. I am convinced that the only efficient way to restore balance in foreign payments is convertibility in something which is not freely created by the issuing institution, such as all possible kind of fiat money, but which is gained by production.

This being said, I must here state my conviction that in the present circumstances, taking account of the existing situation in the world, the only practical solution is convertibility in gold (which of course do not prevent the use of credit in domestic and foreign transactions).

Saying that, I don't want to be provocative. I know how deep is the antigold feeling in this Country. But you asked my views and I must be sincere to you.

I know also that many alternatives to gold have been proposed, such as a mixed standard of real goods. But all are impracticable.

On the other hand, I have many examples, in the past, which show that no foreign deficit resists more than a few months to convertibility in gold, provided there is no large internal inflation. I have written a small book in 1967 to demonstrate this conviction. I sincerely hope that in your great country, so much devoted to scientific researches, this question of the practical means of restoring balance in your foreign payments will be seriously and scientifically studied.

But if you accept temporarily my conclusion, it must be recognized that in the present situation there is no hope whatsoever to be able to restore the convertibility of the dollar in gold, as which existed until 17 March 1968 and survived conditionally until August 15, 1971.

The main reason is the huge amount of foreign claims which have been created on the American gold. If foreign payments in gold were to be resumed a large part of them would be cashed in gold, which is unacceptable, in the present situation.

To be practical, a large part of them has to be repaid or consolidated.

In 1961, observing the dangerous situation which the undue accumulation of dollar balances had created in the world, I proposed not that the price of gold would be increased, but restored approximately at his usual place among the hierarchy of prices, which meant—as all prices had more than doubled since the price of gold was fixed at 35 dollars an ounce in 1934 by President Franklin D. Roosevelt—approximately doubling it.

On January 1961, the gold holdings of the U.S. were still 17.5 billions when the amount of dollar balances held by foreigners were approximately 13 billions.

Fixing the price of gold at 70 dollars an ounce would have made possible to revalue the gold holdings—as President Roosevelt did in 1934—and take 13 million on the 35 billion gold holding at the new price, for repayment of the then existing dollar balance, which would leave a gold holding a little higher than before. The convertibility of the dollar in gold would have been fully restored.

But such a scheme was opposed by people who said "It is entirely unreal. Never, never, the American people will agree to a change in the price of gold".

I suppose that since the Smithsonian agreement of December 1972, this opinion is not so strong as it was before.

But since 1961, the structure has continued to deteriorate, through the application of the various expedients invented by the experts to prolong a system which in any case was bound to disappear.

End of 1961, the gold reserve of the U.S. had fallen to 10,206 millions of dollars. The amount of liquidities in the hand of foreign creditors has increased to more than 60 billion dollars.

The doubling of the price of gold, which would only mean the recognition of the price now practiced on the market, would only provide, if the previous plan were to be applied, approximately 10 billion dollars.

Even assuming that a part of the existing foreign balances would be willingly consolidated it is hardly, if at all probable, that an alleviation of 10 billions of the liquid foreign claims to the U.S. currency could make it possible to restore gold convertibility of the dollars.

For this to be achieved, I proposed on 24 June 1972 an adaptation of the old plan to the then existing situation. Through an international convention, including with the U.S. the main western countries, these participating states would undertake to raise simultaneously, in the same proportion, the legal price of gold in their own currency. Such an agreement would be of the same nature as the Smithsonian agreement.

If the price of gold were doubled—which means only the recognition of the free market price—the reevaluation would unfreeze—on the figures of 31 December 1971 10 billion in the U.S. 25,904 million "1934 dollars" in the western nations altogether and 5,097 million in the International Institution.

The international agreement would decide that the increment realized outside U.S.—namely 31 billion dollars—be offered to the U.S. through a long term loan—20 or 25 years—at a very low rate of interest.

Such a loan joined to the 10 billion increment obtained from the U.S. gold reserve would permit to guaranty the repayment of 41 billion dollars of foreign claims.

Viewed from the U.S., such an operation would appear as some sort of "Marshall Plan in reverse", a measure of fairness and gratitude in return for the incredibly generous contribution of the U.S. to the rehabilitation and reconstruction of the western world after the second world war.

I have not the slightest doubt that such a situation would make it possible to restore fully and immediately the convertibility in gold of the U.S. currency.

All precedents justify the statement that such an operation would bring on, throughout the world, the dishoarding of a large part of the resources at present withheld from the market.

Everywhere the decline in long term rates would be considerable and, without inflation, investment capacity would be increased fantastically.

It is an absolute certainty that, following such an operation, the world would benefit by a wave of prosperity unprecedented in its history.

But some will say: "If the solution is as simple as all that, how is it that it has not already been recognized and accepted by enlightened opinion in all western countries?"

The solution outlined above is simple because the problem it is intended to resolve is a simple one. But in present circumstances, its nature is completely hidden from the layman.

Official gold stocks at present available do not permit restoration for the gold convertibility of all Western currencies simply because their value is expressed in terms of the price for gold which President Roosevelt fixed in 1934, whereas all U.S. prices have more than doubled since that time. This absurdy low level for value determination results in more than half the real value of gold availabilities being masked.

It is to replace such hidden values, stupidly concealed in untruthful deceptive balances—I mean those of the Central Banks whose main asset is thus artificially understated—that all sorts of substitute liquidity schemes have been invented: increases in drawing rights with the International Monetary Fund, Swap agreements, SDR's, Euro-dollars. Reimbursement of such fallacious assets out of the proceeds of the revaluation of gold holdings would only result in what the fraud of a fictitious rate had done being undone.

But, some will say, if the problem can be solved to easily, how is one to account for the hostility which American public opinion shows towards any solution involving recognition of the rise in the dollar price of gold?

Those who raise this question forget that all solutions involving the devaluation of a currency—i.e. a return to the true price of that currency—have always been opposed by public opinion to the extreme limit of the possible.

If one recalls the preposterous opposition with which all french devaluations were met—the one that was proposed in vain by President Paul Reynaud in 1935 and the one which was carried through at the last minute in 1958 (and the necessity to achieve such devaluations at the time is now recognized by all), one cannot be surprised that American public opinion should be just as hostile to a proposed currency adjustment as public opinion in European Countries was, at the time, to similar problems of special concern to them.

One thing however is astonishing and that is the dimsightedness of non American experts in the face of a solution which was proposed more than ten years ago and which, if adopted at the time, would have spared the world all the monetary crises and substantially all the inflation that have never cease shattering the political and social structures of the West, right under your eyes.

But it is not a fact that circumstances have always demonstrated the narrow spirit of confirmity and the timidity of experts when faced with the demands of ill informed public opinion, in particular in such a rich and powerful country as the Great Republic of the United States?

What is now called for to implement this reversed Marshall Plan is, like for the first one, an international initiative at the highest level.

It seems that the eventual "Summit Conference" which is now being envisaged can be the occasion for such a move, if the principle were to be considered with sympathy by the American Government.

The Statesman who would succeed to bring about the reconstruction of an effective international monetary system on the ruins of the Bretton Woods structure would ward off the main danger threatening non totalitarian regimes

He would really save the western civilization.

May he do it before it is too late.

II.—SWAP AGREEMENTS

1.—How much was lost by the American taxpayers as a result of swap agreements made prior to August 15, 1971?

It is for the American Authorities to answer this question.

2.—How long did the present swap agreement run?

From what I know the SWAPS agreement have different validities: from 3 to 12 months. But when utilizated, the repayment may be delayed by agreement.

From what I know, on August 13, 1972, the amount of SWAPS available was 11,700 millions, $, of whom 3 billions had been utilized.

3.—What hopes is there that our payments situation will be reversed in a short time, so that the swap agreement do not simply enlarged?

The hope is very small. Sure the devaluation of the dollar compared to other currencies may improve the U.S. balance of trade.

But the problem is a problem of balance of trade only to a very minor degree. It is essentially a problem of dollar balances floating in the financial world without any tie of any sort.

The expected improvement of the balance of trade cannot in the better hypothesis permit to consolidate or repay the enormous balances of dollar and eurodollars which have been accumulated in foreign hands without any prudence.

Until they have been either consolidated or repaid there isn't any likeliness that new movements of short term money will develop and affect the foreign market.

Either they will be absorbed by foreign creditors such as Germany and Japan, or if they are not covered by new swaps, the dollar will fall severely on the foreign exchange markets.

That may open the door—as in 1931—to very dangerous measures of protection and isolationism.

4.—Is intervention by the U.S. Government likely to prolong support of another overvalued $ parity? Overvaluation hurts U.S. exports and the U.S. balance of payments generally by enabling American multinational corporations to buy up firms throughout the world at discount prices and by understanding the cost of U.S. monetary adventure overseas?

The answer is yes to both questions.

But I don't know if and to what degree the dollar is, after the Smithsonian agreements, overvalued. The figures of the balance of trade are no proof on this point because deficit of foreign trade is due more to an excessive aggregate demand at home than to simple disparities of prices.

The main responsibility for such excess of aggregate internal demand results chiefly from the reinvestment in U.S. of dollars purchased by foreign countries.

To solve the problem, the "gold exchange standard" has to be reformed in non-American countries for creating a situation in which the U.S. will loose really the purchasing power gained by foreign creditors.

But it must be said that the suppression of the gold exchange standard depends only on non-American countries. The gold exchange standard has never been asked by the U.S. It is for non-American countries to reform the way in which they create their own currency.

A Marshall Plan for the United States

(By Jacques Rueff)

I.—The mutation resulting from the price of gold in dollars

The rise in the dollar price of gold, which has increased from a theoretical figure of 35 dollars an ounce until 18 December 1971, and 38 dollars thereafter, to more than 60 dollars on 16 June 1972, has had a profound impact on the international monetary problem.

The solution which would consist in doubling the price of gold to 70 dollars an ounce—a solution I suggested in 1961 as a means of restoring convertibility to gold—has now been achieved in the proportion of nearly 75 percent. As a result of the increase in the nominal value of gold holdings an increase which remains a purely notional one so long as gold holdings have not been officially up-valued—this solution would generate a margin of readily available reserves which could contribute to the repurchase by the United States, of existing dollar balances.

It is clear that the United States will not resist indefinitely this attractive possibility and that one day—which is probably not far ahead—it will do what President Roosevelt did in 1934, what we, in France, have done on many occasions, and in particular in 1958, i.e. up-value their gold holdings to a level approximating the market rate.

One can safely assert that gold will be revalued, notwithstanding resounding statements to the contrary. There is no doubt that the United States will cull the ripe fruit offered them, unrequitedly, as a result of the rise in the market price of gold.

II.—The great alternative

But a change in the official dollar price of gold, i.e. in the legal par value of the currency, can be effected in two different ways:

Either singly by the United States which is the only huge dollar balances debtor;

Or simultaneously by all western countries.

Now, from the point of view of the general interest there is a considerable difference between the two solutions.

A.—*The first assumption: a change in the legal par value in the U.S. alone.*

For the purpose of analysing the consequences of a change in the price of gold bringing it closer to the market-price I shall proceed on the assumption that the 1934 price was doubled, thus raising the official price in the United States to 70 dollars an ounce.

The nominal value of the United States gold reserves which amounted to 10,206 million dollars by the end of 1961 would then be about 20 thousand million dollars.

Out of this amount, a quantity of gold equivalent to 10 thousand million dollars in terms of the new par value could be withdrawn from the reserves and used for the purpose of reimbursing a corresponding amount of dollar balances held outside the United States.

Such withdrawal would still leave in the hands of the United States gold holdings valued at exactly the same nominal amount as before the operation. Now, the way to assess the degree of liquidity of a given balance is in terms of monetary units rather than in terms of its gold weight.

As regards the liquidities in the hands of those countries that are in a creditor position vis a vis the United States, they would increase by exactly the amount reimbursed in gold by the United States but would be deflated by the (strictly equal) amount of the balances repurchased by the United States. As far as those countries are concerned, there would be no change whatsoever in the amount of resources backing the convertibility of their currencies.

Thus, in the United States and other countries as well, the situation would be virtually unchanged and the outcome would be no inflation and no deflation.

On the other hand, the reimbursement of dollar balances would deflate the volume of such balances by a corresponding amount. But the total amount of the dollar overhang has been estimated at 56–60 thousand million dollars and cannot be determined with greater accuracy. The burden of U.S. commitments vis a vis other countries would therefore be alleviated only to a minor extent, i.e. by not more than one fifth or one sixth of the total.

Even assuming that reimbursement could be completed as a result of a consolidation operation to which holders of dollar balances could agree, it is hardly, if at all, probable that such inconsiderable alleviation of liquid claims to the United States currency could make it possible to restore gold convertibility of the dollar.

For this to be achieved, other resources must be available.

However the lowering of the par value of the dollar would result in a down grading of dollar parity with the currencies of other countries which had not so altered their par values.

The competitivity of United States products would be strengthened in a corresponding proportion.

Such a change would generate profound disruptions in international trade. It would give rise to widespread requests for protection against what would then be termed "monetary dumping" by the United States. There would then be a reemergence of discriminatory tariffs and import quotas.

Inevitably, the United States would respond and tend to protect itself against such defensive measures. Isolationist trends would be greatly strengthened.

Under the impact of these two lines of action, the world would undergo a process of economic partitioning of the 1931–33 type.

The progress achieved through trade liberalization over the last decade would be lost. The economic expansion and the rise in the standard of living which it has brought about would be seriously impaired, perhaps beyond remedy.

B.—*The second assumption: par value in terms of gold are changed simultaneously in all major Western countries.*

If the price of gold was changed simultaneously in the United States and other major Western countries, monetary parities would not be affected. The conditions of competition would not be disrupted. There would be no grievances and no retaliatory measures. International trade would proceed unchanged.

However, the extension to all countries in the Western world, or at least to the most important of them, of the revaluation of cash holdings in terms of the gold price found to exist in the market would unfreeze the resources hidden in the form of gold reserves not only in the United States but in all the countries concerned.

Non U.S. countries could take advantage of the increments in the nominal value of their reserves thus generated without altering in any way their international liquidity position, and therefore without impoverishing themselves in any way. In particular, they could, if they so wished, offer them to the United States under long-term, low-interest lending arrangements.

Being thus provided with such additional resources, the United States could then use them towards the reimbursement of dollar balances still outstanding after reimbursements previously effected out of that part of their duly up valued gold reserves they had mobilized for that purpose.

Thus, in the world as a whole, revaluation of the gold holdings of non U.S. countries would generate no inflation and no deflation either, because the amount of resources lent to the United States would accrue to the countries whose dollar claims had been reimbursed.

By the end of 1971, the aggregate gold holdings of non U.S. Western nations amounted to 25,904 million "1934 dollars" to which one should add 5,097 millions held by International organizations (IMF, BIS, EEC), representing a total of 31,000 millions dollars. This revaluation as a result of an increase in the price of gold to 70 dollars an ounce would place at the disposal of the United States an equivalent additional amount of resources following the above mentioned operation. Together, with the cash availabilities resulting for the United States, from the revaluation of their own gold holding (i.e. about 10,000 millions dollars) such resources would make it possible to reduce the dollar overhang by about 41,000 millions dollars. There is no doubt that such reduction, coming on top of the amount involved in any consolidation operations agreed to by Central Banks and international institutions, and of the amount of dollar reserves that non U.S. countries would maintain for current settlement purposes, would make it possible to restore fully and immediately convertibility of the United States currency.

Thus, the reserve currency system would practically be a by-gone. There would no longer be any obstacle to the United States following an adequate credit policy so as to ensure the early elimination of its balance of payments deficit. By the same token, the main source of international inflation, that which arises out of the United States balance of payments deficit, would have dried up.

All precedents justify the statement that such an operation would bring on, throughout the world, the dishoarding of a large part of the resources at present withheld from the market. The decline in long term rates would be considerable and investment capacity would be increased fantastically.

It is an absolute certainty that, following such an operation, the world would benefit by a wave of prosperity unprecedented in its whole history.

But some will say, if the solution is as simple as all that, how is it that it has not already been recognized and accepted by enlightened opinion in all Western Countries?

The solution outlined above is simple because the problem it is intended to resolve is a simple one. But in present circumstances, its time nature is completely hidden from the layman.

Official gold stocks at present available do not permit restoration for the Gold convertibility of all Western currencies simply because their value is expressed in terms of the price for gold which President Roosevelt fixed in 1934, whereas all U.S. prices have more than doubled since that time. This absurdly low level for value determination results in more than half the real value of gold availabilities being masked.

It is to replace such hidden values, stupidly concealed in untruthful deceptive balances—I mean those of the Central Banks whose main asset is thus artificially understated—that all sorts of substitute liquidity schemes have been invented: increases in drawing rights with the International Monetary Fund, Swap agreements, SDR's, Euro-dollars. Reimbursement of such fallacious assets out of the proceeds of the revaluation of gold holdings would only result in what the fraud of a fictitious rate had done being undone.

But, some will say, if the problem can be solved so easily, how is one to account for the hostility which American public opinion shows towards any solution involving recognition of the rise in the dollar price of gold?

Those who raise this question forget that all solutions involving the devaluation of a currency—i.e. a return to the price of that currency—have always been opposed by public opinion to the extreme limit of the possible.

If one recalls the preposterous opposition with which all French devaluations were met—the one that was proposed in vain by President Paul Reynaud in 1935 and the one which was carried through at the last minute in 1958 (and the necessity to achieve such devaluations at the time is now recognized by all), one cannot be surprised that American public opinion should be just as hostile to a proposed currency adjustment as public opinion in European Countries was, at the time, to similar problems of special concern to them.

One thing however is astonishing and that is the dimsightedness of non American experts in the face of a solution which was proposed more than ten years ago and which, if adopted at the time, would have spared the world all the monetary crises and substantially all the inflation that have never ceased shattering the political and social structures of the West, right under our eyes.

But is it not a fact that circumstances have always demonstrated the narrow spirit of confirmity and the timidity of experts when faced with the demands of ill informed public opinion, in particular in such a rich and powerful country as the Great Republic of the United States?

III.—THE NEED FOR A POLITICAL INITIATIVE AT THE HIGHEST LEVEL

The operation which has been outlined above would require an international convention under which the participating States would undertake simultaneously to modify the legal definition of their national currencies, so that in each participating state the official price of gold would be raised in the proportion desired.

Viewed from the point of view of the United States, the reform would appear as some sort of Marshall plan in reverse, a measure of fairness and gratitude in return for its generous contribution to the rehabilitation and reconstruction of Europe after the second world war. The United States would no doubt welcome it with gratitude.

As regards non U.S. countries, holding dollar balances, the operation would turn an uncertain asset into a weight of gold having the same value but affording them an unquestionable international liquidity.

As regards non U.S. countries holding gold but no dollar balances to be reimbursed, the operation would not in any way alter their liquidity, but would turn what is a presumptive and concealed asset into an interest-bearing claim.

There is little likelihood that the prospect of such an operation should not be hailed with enthusiasm in a world which is yearning for stability.

But the negotiation of an international convention providing for parity changes to be affected simultaneously raises political problems which, one must say are very much akin to those that were resolved through the so-called Smithsonian Agreements reached in Washington, D.C. in December 1971.

These agreements could only be reached because they came in the wake of the Franco-American initiative of the Azores.

What is now called for is a new international initiative at the highest level.

It seems that the summit conference which is being proposed can be the occasion for such a move.

The Statesman who can bring about the reconstruction of an effective international monetary system on the ruins of the Bretton Woods structure will ward off the main danger at present threatening non totalitarian regimes.

He will really save Western civilization.

Chairman REUSS. Thank you very much, Mr. Rueff, and all members of the panel for providing us with all sorts of provocative material.

Mr. Rueff, I am particularly interested in your proposed Marshall plan for the United States. It is an intriguing idea. I took part in the Marshall plan of the United States 23 years ago when I had a very pleasant and also productive year in Paris at the Hotel Tallyrand. I would hope that you could perhaps head up a French mission over here and do the same.

We will try to improve the cooking.

Mr. RUEFF. It does not need a mission; it is so simple.

Chairman REUSS. It could all be done by a piece of paper.

Mr. RUEFF. I want to say, the only problem is to find the statesman who will take the initiative to propose that to the world in the same way that the Marshall plan was proposed to the world previously.

Chairman REUSS. Let me ask this question about how the Marshall plan in reverse would operate: As I read the proposal you are making, it would involve an approximate doubling of the price of gold to around $70?

Mr. RUEFF. Which would be only a recognition of the existing price of the market. It does not mean that it would be exactly $70 an ounce. It practically is the market price.

Chairman REUSS. How would you satisfy future needs for additional liquidity?

Mr. RUEFF. First, the gold standard does not prevent the development of credit, which is very elastic. All that exists in the present credit structure will, of course, continue and develop. But there is a point which is very important: Production of gold is much more elastic than people believe it to be. Let us imagine that you sell coal at the price of 1934. The production of coal will certainly not be sufficient to meet the needs of the world. It is exactly the situation with gold; it was sold at the old price of $35 an ounce. If we restore the price at the present level of the market, you can be sure that the production of gold will be greatly increased.

I have looked quite in detail at this question in the past. The production of gold, as every other production, was controlled by the variation of prices. Of course, for gold, the price never varies because it is fixed by a legal decision fixing the parity, but the other prices vary. When the aggregate level of prices were increasing, the production of gold diminished, and when the aggregate level of prices diminished the production of gold increased. And in the old years at the beginning of the century, the difference was between 1 and 7 percent in the production of gold when the aggregate level of price decreased or increased. So the production of gold is not different from any other production. It is controlled by the price mechanism.

Chairman Reuss. Under your regime, if, for example, industrial demand continued to grow at the rapid rate, and if the higher price for gold resulted in some expansion of production, but not very much, these developments would then, of course, increase the price of monetary gold, too, since it would be one single market. Is that true?

Mr. Rueff. No, Mr. Chairman; the price of gold in the regime of convertibility will not increase because it is fixed by the law defining the purity of the currency. But if gold is missing, if there is not enough gold, the aggregate level of price tends to decrease and it is the decrease of the aggregate level of price which will sustain the increase in production of gold.

Let me say you are a country of free enterprise. Your question would apply to every other production. There are two regimes in the world: There is either control by variations of prices or control by totalitarian measures. There is no in between.

Chairman Reuss. So you would envisage, at $70 an ounce for the official price of gold, a two-tier system such as we have right now?

Mr. Rueff. Not at all. In no degree. What I imagine is convertibility in gold at a fixed price and the price of gold will be stable, will not vary, unless there is a war or a large catastrophe such as a period of gold exchange standard.

But you must be clear about this: If there is not enough gold, enough purchasing power in the world, there will be a tendency of diminution of prices, which will stimulate the production of gold, then only gold sold at a fixed nominal price. It is just as for any other production with the only difference that the price of gold is fixed and it is the other prices which vary.

Chairman Reuss. Let me turn to another aspect of your plan. You speak of the use of the revaluation of gold to $70 an ounce as permitting the funding of a large part of the overhang of U.S. dollars now held by foreign central banks. I think your arithmetic indicates that foreign central banks other than the United States would be expected to lend $25 or $30 billion to the United States for 20 to 25 years at a very low rate of interest. Thus, the overhang would be largely removed; is that a correct statement?

Mr. RUEFF. That is quite correct, but I speak only of an offer. It would be offered to the United States if they want it; because I am quite sure that if the possibility to repay a large amount of the dollar balances would exist a large part of them would be freely consolidated and there would be no demand of repayment.

The figures are such. There are $10 billion now in the reserve of the United States. There is $26 billion in the—let us say—in the European central banks also including Japan, and there is $5 or $6 billion in the international organizations. All together, that makes $41 billion; that would be quite an amount compared with the amount of the existing dollar balances.

Chairman REUSS. You call this a Marshall Plan in reverse, the central element of it being a loan by the European countries to the United States, with interest, for 20 or 25 years, by which time it would have to be paid back. I suggest that that is a little asymmetrical. Under the Marshall plan the United States did not lend its money; it gave. Those were grants—no interest, no repayment—some $16 billion, or in modern dollars close to $30 billion.

Would you be willing to consider a real Marshall Plan in reverse? After all, the Marshall Plan philosophy was we should not expect these Europeans to be able to earn enough from balance-of-payments surpluses in the future to be able to meet a repayment obligation. We imposed an obligation in the 1920's and we will not do that again, we said. It turns out that we were too conservative and too generous.

But I am wondering if it would not be asymmetrical and fair play for the Europeans to make a grant rather than a loan?

Mr. RUEFF. I would greatly appreciate such a change to my proposal. I suggested a loan because I did not want to be too provocative. A loan at a low rate of interest, you know, for 25 years, is nearly a gift; but if it were a gift it would be much the better.

Chairman REUSS. If you make it a loan, that imposes Connally's views among the United States. We would have to have his $13 billion turnaround in our trade balance and possibly even more.

Mr. RUEFF. Mr. Chairman, do not be afraid; there is one point which I can guarantee—and I know the meaning of the word—I can guarantee that such a decision would imply an enormous wave of prosperity and development through the world. The very same day it is done, the long-term rate of interest will diminish; the amount of investment will extraordinarily increase; you will have a return of all the resources which are hoarded out of the market; you will have an enormous increase of employment everywhere and such a wave of prosperity in the world that all these questions will appear to be very small. That I can guarantee.

Chairman REUSS. I find myself in complete agreement with many of the pillars of your edifice—namely, the need for doing something about the enormous dollar overhang in foreign central banks, the need for providing a system of payments adjustment, and the desirability of European forgiveness of our debts as we have forgiven some of Europe's in the last 50 years. So regarding the mechanism which you use—an increase in the price of gold—I retain an open mind. As you know, I have had the other view; but I think you have made a real contribution in getting your plan on the table, which is why we are so delighted that you crossed the Atlantic.

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Mr. RUEFF. May I comment 1 minute on this last question—increase of the price of gold?

It is not something new, as I said. It is what President Roosevelt did in 1934, taking the price of gold from approximately $20 an ounce to $35 an ounce; and it has been the first step, then, to end the great depression. But, furthermore, it is not a change in the price of gold; it is recognizing the existing price of gold in the market. But what is even more important, it is only pulling the price of gold at its normal level among the hierarchy of prices, as all prices have doubled or more than doubled in the United States since 1934. If for any reason, whenever you maintain a price in no proportion with other prices, you have troubles. Returning to the normal level for the price of gold is the only way to avoid such troubles.

Chairman REUSS. Let me now turn to Mr. Fusfeld.

With much of your thesis also I found myself in agreement. Let me state what I think your thesis was, so you can tell me whether I have it right.

You are saying that in the last 10 years or so the United States has facilitated the takeover of vast assets by American multinational corporations—plant and equipment, oil wells, natural resources—all over the world. Part of these acquisitions were facilitated by the Bretton Woods system, and part were facilitated by our own maintenance of an overvalued dollar.

The second part of your thesis is that similarly we were able to conduct military adventures on the cheap, because, for example, we could buy up an airfiield in Greece at a 5- or 10-percent discount. Overvaluation made it easier for the Pentagon to perform its antics.

I think—well, let me ask you—is that about what you were saying?

Mr. FUSFELD. Approximately, yes. It is a good summary.

Chairman REUSS. All right. I am in rough accord.

Then, however, you get to how we work our way out of the present situation. Now, I would have thought that greater flexibility in exchange rates—leave aside the way of achieving it—would have removed a large part of the ability of the corporate-takeover people and military-adventure people to purchase of assets and to engage in military involvements on the cheap. Thus, if we have a realistic exchange rate instead of one that props up the U.S. dollar, it is no longer so advantageous for an American corporation to buy out a French company or for the Pentagon to conclude that a far-off war involving vast expenditures of foreign exchange can be conducted indefinitely. In short, I would have thought that a more flexible exchange rate might have had, in a gentle way and without destroying the United States, the same effect that payments deficits had on ancient Greece. As you mentioned, when they got in trouble in far-off Sicily, the strain on their external payments just would not permit the continuation of the wars there. That was part of the beginning of the end.

I am not suggesting that this is the most desirable way of doing it, but a system of exchange-rate adjustment which reflects real values would, I suggest, greatly reduce both of the evils you described.

To my surprise, however, you come down hard against greater flexibility in exchange rates and say that flexibility would be even tougher on the American worker.

Would you respond to my problems here?

Mr. FUSFELD. I think your analysis of the flexible exchange rates is quite correct as far as it goes. Clearly, a large American balance-of-payments deficit that is caused by international investment and military expenditures overseas could be eliminated entirely by flexible exchange rates. The value of the dollar on the foreign exchanges would decline and this would, among other things, create a balance of trade in our favor large enough to provide those foreign assets that the investment process and the military processes are demanding. In that case the burden of supporting expansionism is shifted away from foreign central banks and it is put on the American public.

So that is quite true; you solve the problem of the international balance of payments in the short run by creating an export surplus that creates or makes available those foreign assets at the expense of Americans. I do not like that either, because in this case we find the American standard of living being reduced a little bit in order to benefit the accumulation of assets by corporations and the use of assets for foreign military purposes.

Now, we add to that what I think is an even more subtle phenomenon. I do not see the foreign exchange equilibrium as stopping the drive toward the accumulation of economic and political power. It seems to me that these goals are rooted in something far more fundamental than balance sheets. When we in this country see an enemy overseas we do not ask ourselves how much it is going to cost in order to build up enough power to counter that enemy.

For example, look at our military and economic position in the Mediterranean. We have a fleet in the Mediterranean. One of the results of having it there is that it protects the line of supply of Near Eastern oil moving into the oil refineries of Western Europe. In other words, it protects the economic position of some large international oil companies whose securities would be riskier and consequently worth less than they are are now if that protection were not there.

Now, we do not put the fleet there in order to protect the value of those securities; we put the fleet there because there is an enemy in the Soviet Union, because we are trying to protect American interests and that means helping to protect the geoeconomic position of Western Europe by protecting the oil supplies that are essential to the European economy.

Now, when we stimulate and promote the investment of American oil supplies in north Africa and the Middle East, and put a fleet there and create balance-of-payments problems for the United States, we do not really put a price tag on it. We do what is necessary in order to counter the international political threat or military threat, or however we want to define it. In that kind of a situation we spend that money and make those investments—even if we have to subsidize the oil companies at home with tax concessions and guarantees and so forth in order to get them to make the investments—and we put the fleet there. The expenditures help create a payments deficit which pushes down the value of the dollar in a free exchange situation to create the balance of trade necessary to make the resources available.

So I see the drain continuing in the interest of pursuing international economic-political goals, with the burden imposed on the American citizen and the American economy. Even flexible exchange rates do not cause any real diminution of the ultimate sources of the drain, the shift of resources, and the aggrandizement of American economic and military power.

It is true that we will have to pay more for world power with flexible exchange rates than with fixed exchange rates and it is true that the burden would be shifted to the American rather than the foreign citizen; but ultimately the solution has to be some kind of restraint upon the international ambitions of American policy.

Let me give you another example of how important this ghost at the wedding really is. Mr. Rueff's proposal for the reverse Marshall Plan assumes that we can set up a world reverse system based upon gold. I would argue we cannot. As long as the United States generates half the world's savings and we are the largest buyer of durables and the largest supplier of durables to the world economy, the dollar is going to be a key currency. The central banks are going to hold dollars in their reserves. Whether it is legally defined that way or not, we are in an economic-political situation in the world in which the U.S. dollar is going to be a key currency and a reserve currency. That being the case, there is going to have to be some kind of accommodation in the international financial system for the dollar and its relationship to all the other elements of the financial system.

If the world economy were such that all the national economies were approximately the same size and there were not one nation dominating the flow of capital into the world economy; if you had a much more, if you wish, competitive model than an oligopolistic or monopolistic model, then Mr. Rueff's plan might have some opportunity of being successful. But if the dollar is that important, we are almost sure to have some kind of fixed exchange rates with bands of fluctuations and the problem of being able to shift some of the costs of our expansion abroad. The United States is in such a strategic economic position that we are able to take advantage of it to push for advantage at the expense of others.

Chairman REUSS. Well, let me ask you whether you agree with the following proposition, which I believe. In my view, a change in, improvement in the international monetary situation whereby, (1) the United States comes up with about the same powers to change its exchange rate when needed as anybody else, and, (2) exchange rates generally are made less sticky and more flexible would, at the margin, tend to discourage excessive, profligate American investment abroad and excessive, profligate American military adventurism abroad, and I think both things would be good for this country and the world.

Mr. FUSFELD. I think that is quite true, yes.

Chairman REUSS. You agree?

Mr. FUSFELD. Yes, and there would be some improvement—I do not think it is the whole answer, but it would certainly help.

Chairman REUSS. For example, on your point about the marginal effect of balance-of-payments considerations, if, let us say, Haiti, under Papa Doc, had ambitions to become a great military power and also to let its capitalists become great multinational operators, and if, to do that, it wanted to acquire bases and make leases and hire local personnel to develop those bases, they would not have been able to carry out such a plan due to balance-of-payments constraints. The Haitian international payments situation would not have permitted such an adventure, and Haitian currency would not have been accepted by foreign central banks in amounts necessary to permit these things. So at the margin—and the margin would be reached immediately in a situation like that——

Mr. FUSFELD. Right.

Chairman REUSS. Economic capabilities govern whether you proved or not. So until somebody comes up with some brilliant idea for changing the hearts and minds of men, eliminating the desire for political power by some, it seems to me the international monetary system has something to say for maintaining world peace.

Mr. FUSFELD. Sure. I think the chief disadvantage of a flexible international exchange system is that it is awfully easy for any nation to take advantage of it by sliding in some inflexibilities for its own currency to get temporary advantages. And this escalates until everybody is doing it. We all know that this is the chief reason why the so-called flexible exchange rates have never really worked in the past. The short-run selfishness of individual countries piled up one upon another makes everybody suspicious of it.

Chairman REUSS. Leaving philosophy, then, let me turn to Mr. Bernstein and ask about your reserve settlement account plan, which you explained today with great clarity.

In your prepared statement you talk about your composite reserve unit and the reserve settlement account, and you say—I will quote the sentence: "While the present stock of monetary gold would be retained in the reserve settlement account, there could be no disruptive perference for gold."

Can we be sure of that? After all, recently, the nations of the European Economic Community agreed to make their monthly settlements with each other in some sort of reserve settlement account—that is to say, in proportion to the various reserve assets that deficit countries held, and a distinct and disruptive preference for gold has developed. I do not bring this up to throw cold water on the CRU idea, because I think it is an excellent one. But how do you explain this development?

Mr. BERNSTEIN. I think we have to start with this proposition: About 4 years ago, at the time, actually, of the agreement for the two-tier system, I made a talk to the Council on Foreign Relations, in which I said the disruptive preference for gold is going to grow, and that some method of permitting gold reserves to be held in the system, but without disrupting its operations, must be found.

As Mr. Hirsch has well pointed out, there have been practically no gold transactions except for certain required transactions with the International Monetary Fund since the suspension of gold convertibility by the United States. The preference for other assets has moved to SDR's and claims and liabilities; that is, assets and liabilities, which have a fixed exchange value and are linked in one way or another to gold. That means that even transactions with the International Monetary Fund have been minimal, except when required by the rules.

I start with the proposition that you cannot tell countries that their asset preference is nonsense and you are not going to educate them to sell their gold. Even if they could, that would be one of the most disruptive things they could do—I will be glad to explain that—and contrary to our interests. What you have to do is to find a way in which countries, instead of burying gold as the national patrimony, never to be used except when they have to appease the gods in a great war, in fact, use them as reserves.

Now, all these plans for turning over gold to the International Monetary Fund in exchange for SDR's are, in my opinion, too simplistic.

Chairman REUSS. Too what?

Mr. BERNSTEIN. The plans to exchange gold for SDR's are naive. They assume that countries are going to turn over gold for a paper asset with uncertain rights. The only real assurance they get is that these SDR's can be used in payments to other countries, but even then only if the acceptance obligations are increased. I do not think countries will exchange their gold for SDR's. But I think they might be persuaded to put their gold on earmark where they keep title to it, but have to use it proportionately with other reserve assets. I think we would solve the dollar problem much more easily without trying to make long-term funding arrangements and exchanges for SDR's in substitution account. I would suggest instead, that like gold, the dollars be put on earmark in a reserve settlement account, where they would belong to the countries that hold them, but they would be used along with SDR's and gold in international settlements.

I believe two things happened in Europe. The first one, the fact that they proposed such a system to begin with is an indication that this is, in fact, a practical method of approaching the problem. If you get five countries with varying proportions of gold, the proportion of gold varies between, oh, some 18 percent of total reserves in the United Kingdom, to about 48 percent in some of the continental countries—I think that when you get these countries to agree that settlements among themselves shall be in what is, in effect, a composite reserve unit, proportionately in all their different reserve assets, far from being a nonstarter, it shows that practical men think this is a way of using all reserve assets without discrimination.

Why did it break down? It broke down for two reasons. The first, it was started in an era, in a period when Italy, itself, was practically the only deficit country because of massive movements of funds out of the country.

Second, it would not have worked in the long run in Europe alone for a different reason. I have tried to explain that in my prepared statement. You cannot divide the balance of payments of each country into two parts and say one part shall have settlements partly in gold and the other one exclusively in dollars. And this is what would have been necessary in Europe.

These countries are not all normally balanced in their European payments. There would therefore have been some structual surplus countries gaining the European CRU's, while the other countries that were paying them out were even though they were in overall balance because they were earning dollars elsewhere in the world.

Now, if the system were balanced, in the sense of overall balance, the system would have had a much better chance of working. That is the reason why I do not believe a gold standard for Europe itself will work. You cannot set aside a partial balance of payments for one area and say that that must be settled separately in gold and another with the rest of the world that can be settled in dollars.

I think most of the excitement about gold is really unnecessary. It has all been touched off by the fact that since the Smithsonian agreement, the price of gold rose from $42.75 an ounce to about $70 at full peak and is now around $67. It is interesting to note that between August 15, when the United States suspended gold convertibility, and December 18, when the Smithsonian agreement was made, there was no rise in the price of gold. There was none. As a matter of fact, if I am not mistaken, the price was a little bit lower on December 17—$42.75 an ounce, just before the Smithsonian, than it was on August 13, $43 an ounce. That is to say, the price of gold did not rise in this period even though everybody expected a big depreciation of the dollar, with less devaluation in gold. It is my opinion that the rise in the price of gold since December 1971 has been primarily due to the fact that we have put the national monetary system into limbo. We have suspended an international monetary system which had been working from the end of the World War until 1971, which had international sanctions. Well someday, when international monetary reform is agreed, we shall have another international monetary system with international sanctions. In between, we have an international monetary system in which there is no clear-cut responsibility for two essential elements. One is the interchangeability of currencies, and that is essential in the multilateral payment system. The second is the assurance that countries that hold dollars, now the largest component of reserves, will be able to use them in international settlements.

Who has responsibility for seeing that the international monetary system does function effectively until a reformed system is put into effect?

Now, if there is no responsibility, then I think people will, quite properly, say why trust the system? There is a greater probability, if you do nothing and nobody accepts resposibility, of winding up with Professor Rueff's suggestion. The only chance of ever restoring the gold standard is if all countries say they are not going to take any responsibility on the international monetary situation.

I feel that the responsiblity for the international monetary system never lapses. Even when the IMF does not have the power, someone does have the power and the responsibility. In my opinion, it is the participants in the Smithsonian agreement that have this responsibility. They have to make sure that the exchage rates that they agreed at the Smithsonian—the realinement of currencies—and actually maintain within the wider margins. They have to make sure that countries holding dollar reserves can use them in international settlements and these dollars reserves will be accepted by all countries that are parties to the Smithsonian agreement.

Now, if these countries have the responsibility, how do they share it? Well, I guess the answer is you can only take as much responsibility as you can carry out. And we have very limited powers and capacity at the moment to share in this responsibility. That is to say, we cannot undertake to support the dollar exchange rate without limit to anyone who comes along. We simply do not have the reserves for that purpose. If there is to be convertibility and stability in the system, most of the responsibility will have to be accepted by the other large industrial countries.

But within our limited capacity, we cannot escape that responsibility. And in my opinion, the importance of this was shown by the intervention of the Federal Reserve in the exchange market with a mere $31.5 million of foreign currencies. Between the end of June and July 15, there was an enormous outflow of funds from the United States. Nobody was taking responsibility for the dollar. In Europe there was great discussion of establishing capital controls or setting up dual exchange rates for capital and for current transactions. When the Federal Reserves intervened in the market, it found that once it was known it was intervening, there were hardly any takers. It was prepared to offer much more than it actually sold.

After July 7, the dollar became strong again. The backflow of funds since then, I think, on the basis of whatever available statistics there are, we can say that between the intervention of the Federal Reserve and early September, the backflow of funds to the United States was probably more than enough—but only just more than enough—to offset our deficit on trade and other current account and our net long-term capital outflow.

I want to make it clear, I am not in favor of using the $11.7 billion of swaps to support the dollar rate. If we use the swaps, we would have to find reserves ultimately to repay them. I am in favor, however, of showing that we care. It is the moral effect of the intervention of the Federal Reserve that counted in this turnaround in the exchange rate for the dollar. By early September, the value of the dollar—the weighted average value of the dollar—in the currencies of the Group of Ten, excluding the United Kingdom where the dollar appreciated by nearly 6 percent, was just about the same as it was before the troubles began late in June. At that time money was flowing into this country, and it is flowing in again now.

I am not in favor of massive interventions by us in the exchange market, especially on the basis of swaps. As Mr. Hirsch said, at least in principle, there is a contradiction between the concept that the United States will use billions of borrowed funds to support an exchange rate and, at the same time, argue that what we need is more prompt adjustment. I am not troubled about what we did. I do not think we are going to use the swaps on that scale.

Now, let me get back to gold. I have no more taste for gold than anybody else in this room, certainly much less than Mr. Rueff. I have always regarded gold actually as disruptive. Even when the gold standard was working best, it was very disruptive. But now you have a fact of life before you which is that there are $45 billion of reserves in the world in the form of gold. We hold $10.5 billion of those reserves in gold and the fund has over $6 billion. If you wiped out those $45 billion by demonetizing gold, you would be repeating the big mistake of the last quarter of the 19th century. You know, that was an era of great deflation in the whole world. And the principal reason was that the gold standard replaced the bimetallic standard and every country in Europe hastened to unload its silver reserves on the market to get gold.

Of course, nowadays, we know we cannot do that. Instead, we say we will turn it all over to the fund for a new issue of SDR's—disstinct, by the way, from the usual SDR's. Or if you prefer a reserve settlement account, have countries earmark the gold. In either case, there will be no diminution of total reserves in the monetary system.

But, they say, why not sell the gold in the free market? Now, it is quite true, this would not expose the world to the deflation of reserves that it had in moving from the bimetallic standard to the gold standard if reserves are created in another form—an equivalent amount of reserves, SDR's. But selling of gold has balance-of-payments effects, and I am thinking primarily of the United States. If gold is sold by monetary authorities in the free market, the question is what currencies would the buyers use to acquire the gold? What asset is the gold a substitute for by the private buyers? If they decide to hold less dollars on that account, we will be aggravating our balance-of-payments problem at the very time when we have a very large basic deficit.

Let me give you an historical example. At the beginning of the policy of keeping central banks out of the market, the first proposal to do that came from the United Kingdom. And they were quite right. The sale of gold by central banks in premium markets was getting to be a disgrace. From Latin America to the most sophisticated centers of Western Europe, central banks were selling gold in the free market in the late 1940's at premium prices. As the United Kingdom argued when they said, "After all, it is our gold," the question is who is buying it and what are they using to buy it with? What assests are they displacing the gold with? And, of course, they were displacing sterling assets.

So, in the end, official gold rates in the private market turned up as a deficit in the balance of payments of Britain. In my opinion, we ought to go very carefully with the business of selling off gold reserves.

I will make one large concession. When the international monetary system has been reformed, when there is an agreement that there will be a quanity of reserves in the system equivalent to present gold holdings—that is no reduction in reserves because of what we do with gold—then I would not object to cautious sales of official gold in the private market on two conditions. The first is that the U.S. balance of payments will have been restored before any such sales begin. The second is that continous supervision is made of these sales to see that they do not have adverse balance-of-payments effects, particularly on the United States. That would require the sales of monetary gold in the private market to be made by a monopoly—say, the IMF, which would be the agent for such sales on behalf of its members.

Now, that is my approach to how to deal with gold. You do not have to demonstrate gold or throw it out of the system. It is going to happen of itself. If you do nothing, it will disappear by going into a national patrimony that is never used. If you do something positive, it will no longer be a separable reserve asset. You do not have to make plans to demonetize gold to prevent it from being disruptive.

That is my feeling about the future of gold. I think it cannot be a separable reserve asset. It will always be disruptive if it is. We cannot surrender the amount of reserves in the system represented by the gold. Personally, I do not think any country will make an exchange of 35 SDR's for an ounce of gold. I do think they could be persuaded to earmark the gold, their dollars, and other reserve assets, and to agree that all settlements shall be in different reserve assets, proportionate to their holdings—that is to say, through a composite reserve unit. That is the farthest I can really see as a practical way of dealing with gold in the system.

Chairman REUSS. Thank you, Mr. Bernstein.

Mr. Hirsch, you have been listening attentively, as we all have, to what Mr. Bernstein has just been saying. Let me ask you to react to several of the numerous points that he made.

Would I be right in thinking that you agree very closely with what Mr. Bernstein had to say about the undesirability and unworkability of the Europeans having one system, maybe with a different use of gold, and the United States and the rest of the world having another system? That is the first point on which I think you agree with Mr. Bernstein, but I want to hear you on that.

And secondly, would you address yourself to the Bernstein point that it is impractical to expect the countries of the world at any foreseeable time to turn in gold for SDR's or a new issue of SDR's?

I did not misquote you, did I?

Mr. BERNSTEIN. No, that is exactly my view.

Chairman REUSS. All right. My hunch is you agree very much with one and disagree quite decisively with the other. Let's hear you.

Mr. HIRSCH. Well, Mr. Chairman, let me say I agree completely on the first one as indicated in my prepared statement. The notion of having two official values of gold, which in a sense is what this would amount to, the notion of a special price for EEC settlements, would mean that the very same country would formally have one parity with the IMF and a different settlement price with its partners. And that seems to me to be either a scheme that is almost deliberately not going to work, that is just going to expose its own weaknesses and possibly, land up in something quite different—that is, the hope that there will be a generalized increase in the gold price—or as I think more likely, it will provoke other countries into dropping the gold link altogether.

I frankly also doubt whether the central banks of the EEC countries concerned would, if it came to the test, accept gold as creditors at the market price at a time when, in the rest of the world, including the United States, that market price was not recognized for official settlement. So I completely agree with Mr. Bernstein on that.

On the second point, my qualifications are perhaps a little less than you imply, Mr. Chairman. I agree with Mr. Bernstein very strongly that one can't expect countries to commit themselves to exchange their gold into SDR's at the present stage, either in full—that is, to put their full gold holdings into the Fund in exchange for SDR's—or even as to some uniform proportion, let's say 50 percent or 25 percent. The reason for that, as I said in my statement, is that countries have a differing desire to hold gold for what are, in effect, completely nonmonetary purposes; strategic in some cases, insurance in other cases, a particular taste for gold in other cases. These different demands for gold, which are all very strongly felt, are therefore not amenable to international regulation, because as one knows, in international affairs, one can only get a common code accepted if it does not overstrain the real interest of the countries concerned.

So that I quite agree that it is impractical to require countries to exchange their gold for SDR's. But that is not what I have put forward. What I have suggested is something rather different. That is that countries should be given the facility within some time period—and I am talking now, I should emphasize, not for what should be done tomorrow, but for a reform in the longer term context of monetary reform—countries should be given the facility to exchange their gold into SDR's at the present monetary price. The importance of giving that facility, as Mr. Bernstein, I think, implicitly recognized, is to insure that any demonetization of gold would not have the same deflationary effects on the world economy as the move away from silver did in the 19th century, because the facility would mean that any country that expected the price of gold to fall below the current market price would have the incentive to take advantage of the exchange into SDR's on a voluntary basis within the given time period.

Now, as for the choice, and I think this will be the difference between Mr. Bernstein and myself, between an arrangement of that kind and an arrangement that he has put forward for some years now for the earmarking gold with the IMF or another similar authority, and then requiring that payments settlements should be in some balanced relationship—on this choice I do not want to make an absolutely definite judgment. I have not studied the latest version of Mr. Bernstein's scheme and it is very difficult to be dogmatic about this. I would say that in general principle, I feel that a scheme of that kind does suffer from one important weakness, and that is that it will involve a continuous strain, so to say, on cooperativeness among countries in seeing their gold being exchanged at well below the market price. I think this is the fundamental weakness as a long-term solution of the two-tier gold system. There is a real weakness in a system in which the monetary price of gold is below the market price. It frankly is upside down. The way the gold standard should work and did work was to set a monetary price that was so comfortably above the commodity value of gold that there was always a surplus of gold available for monetary use, and no question of the commodity value exceeding the monetary value.

Now, there were good reasons of expediency for organizing the split gold market on that basis in 1968. But in the long term, there will always be a continuing strain. There is an analogy of using a growth stock such as IBM money, and fixing a constant price relationship between this and other forms of money. The "monetary" price of the IBM stock will then lag further and further behind its market price, and no transfer at the monetary price is likely to take place. And that brings me to a point which I would like to reflect on, on Mr. Rueff's testimony.

How does one expect that relationship between the monetary price and the market price to move? I think it is fair to say that Professor Rueff expects and assumes that the working of the gold standard in itself will be made a sufficient discipline for the whole world economy that world prices will be held in check and will, if necessary, even be reduced, involving a falling world price level, according to the amount of gold one gets in the system. And as Professor Rueff explained even under the system of occasional increases in gold price that he put forward, if there were not enough gold coming into the system, it would be necessary for other prices to be adjusted downward.

Well, if one thought that that were feasible, then of course, there is no reason to expect the margin between the market price and the monetary price of gold in the system that we now have to increase, since the general price level would always adjust. But I do not make that assumption, because I think it is completely inpracticable to think that one is going to abolish even creeping inflation—that is, 2 to 3 percent inflation a year—simply for the needs of the world monetary system. I make the assumption that we will be doing very well to get back to 2 or 3 percent inflation a year. I think the real economic costs of trying to do more than that are probably excessive.

If we have a world inflation of 2 to 3 percent a year in general prices, then in the long run—and I completely agree with Professor Rueff on this—one has to expect that to be reflected in the valuation of gold. One will, in the long run, expect gold to keep pace with other prices. And that is going to mean an increasing margin between the market price and the official price.

Now, that will happen if one simply holds all the gold in official gold stock. In practice, the position of gold as a commodity is quite extraordinary in this one respect. The proportion of the stock available in the world, even of the official stocks alone and taking no account of private stocks, is uniquely compared to current production. The proportion is something like 25 to 1; world gold production and consumption is something like $1½ billion a year. The world official gold stock is something like $40 billion a year.

Now such a relationship is the dream of any buffer stock manager; in the case of tin or coffee, people think they are doing very well if they have 1 or 2 years supply of stocks. With a ratio of stocks to production as high as it is for gold then even the long-term tendency for a gradual increase in the price of gold is by no means certain to come about and may, indeed, be held down for almost a generation, as to some extent happened with silver, the United States holding and gradually selling off the silver stock.

Now, I conclude from this that it is both necessary and practicable to slow down, and in some degree to reverse, the rise in the market price of gold by official authorities being prepared to sell gold in the market. And, here again, I completely agree with Mr. Bernstein; it is desirable that it should be done, not piecemeal by each country acting independently, but in some collective, organized way by some sort of international pool.

Mr. Bernstein. May I make a statement?

Chairman Reuss. Yes.

Mr. Bernstein. First of all, the United States never sold a single ounce of silver that ever came into the Treasury at less than the monetary price until the war, when special sales had to be made to the silver users.

Second, I cannot understand the argument that countries will not be willing to see gold used in settlements where they pay out gold and get it back but, they will nevertheless surrender voluntarily any significant amount of gold for SDR's at 35 SDR's an ounce. I really can't see how one can have these two views simultaneously. If gold is too precious for a Reserve Settlement Account, it is far too precious to be exchanged for SDR's.

Mr. Hirsch. But I think the explanation is that under the arrangements that I put forward, it is not necessary that any gold should be sold—should be exchanged for SDR's. If it were the case that countries were of such a uniform view that they did not want to exchange any gold for SDR's; and if it were also the case that countries prevented the IMF, for example, from selling any gold in the market and from changing that expectation, taking that most unfavorable of assumptions, so to say, then I would say, well, one would simply move to the terminal date I have suggested. No gold would have been exchanged for SDR's, and beyond that point, gold would simply not be counted as a monetary asset and the world reserve structure would be isolated from the gold element.

I would agree with Mr. Bernstein that if one asks which is more likely, for the countries to exchange gold for SDR's or for them to earmark, of course, I agree with him that they are more likely to earmark. But I have put forward a system where one is not dependent on getting countries acting even that far againist their natural inclinations, and also where one could influence a country's inclination by managaing the world gold market in a more active way and using the enormous strength against speculators, which has never been used in any active way, the great strength the officials have against speculators by virtue of the enormous stock of gold as against the world gold production.

Chairman REUSS. We approach the end of the morning. I would like to take the remaining time to ask all the members of the panel—I will start with Mr. Bernstein and work over toward Professor Rueff—to comment on Mr. Rueff's rather specific proposal: Double the official price of gold, arrange for a generous forgiveness by America's creditors of much or all of the dollar overhang; restore dollar convertibility into gold and forget about SDR's.

Would the members, starting with Mr. Bernstein, react to that as an immediate action proposal?

Mr. BERNSTEIN. Well, first I want to say that we have all been assuming that the price of gold in the full market is going to remain at $70 an ounce. Put me down as differing from that proposition. The price of gold is near $70 an ounce because there is no international monetary system with international responsibility, and one of the potential end results of it is precisely the recommendation of Mr. Rueff.

Second, I do not have Mr. Rueff's great faith that the supply of gold will always be adequate because there will be a drop in prices and wages to assure enough production. I think instead what we will have is a series of crises because of inadequate gold production, though, at $70 an ounce, you will, for a considerable time, get lots of gold produced.

Third, I am not looking for any Marshall Plan. These countries have already lent us the money. They do not have to give us anything. We are rich enough to be able to work out our problem. We did not just incur a dead loss in using up our reserves as Europe did during the war. As my friend from Michigan has well said, we got some wonderfully fine assets in return for the dollars that they are holding and which they have lent us.

I think something must be done. I do not know whether the amount of the overhang is so big. I cannot estimate it myself. I think something must be done to make the dollar convertible. But my purpose in convertibility is not the same as Mr. Rueff's—which is to make all currencies convertible in gold. My purpose is to assure the interchangeability of currencies within a system of par values, with wider margins and more flexibility. That is the one purpose of convertibility, the interchangeability of currency, so a country can take what it earns in one country, and can spend in another.

All in all, I would thank Mr. Rueff for all of his contributions involving the rise in the price of gold and the restoration of the gold standard. I would thank him for that advice, but I would not accept it.

Chairman REUSS. Mr. Fusfeld.

Mr. FUSFELD. I think Mr. Rueff's plan would solve some of our present difficulties, which are very great, in particular the problem of the overhang, which has got to be settled somehow or other before there can be any remaking of the international financial system.

However, I see the general trend in exactly the opposite direction. As I interpret the present situation, we are essentially on a dollar exchange system for the international financial system. Gold has been immobilized. SDR's are too small in amount, and, by and large, reserves are held and international trade is carried on in terms of dollar reserves.

This, of course, puts the United States in a particularly strategic bargaining position for gaining all sorts of concessions on both international financial arrangements and trade. I suspect that we are going to be unwilling to move to a system which will demote the dollar from its present strategic position because of the short run advantages that we could bargain for.

And if I read the implications of our present bargaining position rightly, we are trying to delay as long as possible reaching any solution because the present system of dollar reserves permits us to continue our balance-of-payments deficit without any penalty or any significant halt.

I am very pessimistic. I do not see the United States agreeing on anything until we come right into the next crisis and we are forced to amend the present situation.

This is not a comment so much on Mr. Rueff's proposal as a kind of feeling that it is just out of the world that we are really dealing with. There is no real possibility of reversing the trend away from an almost exclusive dollar reserve standard. The United States is not going to want to do it and we are the big boy. It is to our advantage to delay and we are not going to be forced to do anything else until the next crisis comes. I am very pessimistic.

Chairman REUSS. Mr. Hirsch.

Mr. HIRSCH. Mr. Chairman, I think that Professor Rueff's plan serves a very useful function in sharpening up some very fundamental questions. I have just three comments to make about it.

The first one is simply to say that I agree fully with everything that Mr. Bernstein has said in his comments now, including why the gold price is high now; it is because there is this one possible option of a large increase in the gold price being adopted as an official policy and, while that possibility remains open, that obviously has important market effects and we should not interpret this as a necessary continuing influence.

Secondly, I also agree with Mr. Bernstein that one should not be so confident about the relationship of gold production with the monetary price. I did a study of this a number of years ago which suggested that while it had certainly been true, as I think Professor Rueff implied, that in the past there has been a very strong relationship between gold production and the monetary price of gold, that relationship has become much weaker since the 1930's. The fundamental reason is that the world is now so dependent for its gold production on one country, South Africa, and that in that country, gold plays such an important part in the country's economy and its balance of payments. Briefly, South Africa has to produce gold just like Brazil has to produce coffee. If the monetary price of gold is very high, if the world price is very high, that is very nice for South Africa's terms of trade. If the world price of gold is lower, that is not so nice for South Africa's terms of trade, but within limits, South Africa still has to produce that amount of gold because gold is the most profitable thing it can produce.

I have slightly overstated the case now, but it is certainly the case that nowadays, given this tremendous dependence on gold production in South Africa and the importance of gold in South Africa, world gold production is not closely related to the world price of gold.

My third comment follows on from this. We really have to decide whether the world monetary system is going to set the limits for what happens in the world economy on the one hand or whether the world monetary system is going to be able to accommodate existing main trends in the world economy.

Now, in my mind, the new world monetary system has to do the second thing; it has to accommodate the existing main trends in the world economy. That is what I believe the major countries and parliaments want from the system. But I think it is both the virtue and the drawback of a full gold standard system such as Mr. Rueff suggested that that system does not permit that, not if it works properly. Because as Professor Rueff pointed out, in that system, if there is insufficient gold, then the accommodation has to come on the side of the world economy and the reduction in prices and deflationary pressures within the world economy in order to make whatever supply of gold happens to be available in order to make that sufficient to go around.

And I do not think one can really say, well, credit arrangements are elastic and credit arrangements will adjust to that, because if that happens, then we have the gold exchange standard over again. I do not think Professor Rueff can have it both ways. If you are prepared to rely on the credit elements to let you out of insufficient gold, well, then, you must expect to happen what did happen in the past, and that is for a limited volume of gold to be supplemented by increased sterling, increased dollars, et cetera.

So I just want to finish by emphasizing that both the virtues and the drawbacks of a system such as Professor Rueff has put forward are really very different from a world monetary system based on a deliberately increased credit element.

Thank you.

Chairman REUSS. Thank you.

Mr. RUEFF. I must say that I am very interested by the comments of the panel. There are just two remarks which I want to make and then to answer your desire I will comment on the remarks of my colleague.

One point I want to make clear again. It is really impossible to admit that the huge balance-of-payments deficit of the United States for these last 20 years is fortuitous. Nothing of this magnitude and duration is fortuitous in this world. Such a continuance of this deficit has to be caused by something. I submit, and I think it is more or less admitted, that it has been organized by this venture of the gold exchange standard which has relieved the reserve countries from the obligation to pay their deficit abroad. But you must notice that the privilege of being a reserve currency has never been asked by the United States. The United States is the only country in the world which has no responsibility in the venture of the gold exchange standard. It has been adopted unanimously by the non-American central banks. Doing that they were restoring the system which had led in the twenties to the great depression.

That has not been a decision. It has just been a de facto situation and has imposed on this great country of the United States a deficit which is without precedent in entire history and which has been continuing, and which we have to explain. In this world which you have made so wonderful, in which, through scientific research and a beautiful organization you have been able to go to the moon. I suggest it would be useful to make clear for everybody why such a rich country as you are has such a deficit. It is easy to explain. It ought to be recognized and admitted by everyone. That is the first point.

The second point is that, in what I call the Marshall plan for the United States, I think I answer some remarks of my colleagues. There will be neither deflation nor inflation. It could not be. The only decision will be to offer to the United States, as I said, a loan which, if utilized, will be employed entirely to repay dollar balances. The United States will remain with the same reserve of gold as before and the same structure of credit. Therefore, no deflation whatever, no inflation whatever. All other countries having gold and no balances to repay will lose the increase of value of their gold reserve. There can be no inflation.

For the receiving country, they will lose the dollar balances, but those will be replaced by the amount of gold transferred from the United States. So there again, no inflation, no deflation whatever, no change in the credit structure. I think that is a very important point and can be demonstrated more fully if you want to go further into the question.

Then I come to the remarks of my colleague. Mr. Bernstein has said the most important thing which could be said with respect to this plan. I regret not to have said it before, because I think it is very valuable. He said you do not have to lend because you have already lent to the United States the amount of this foreign balance. They are, in fact, invested in the New York monetary market or in the American banks, they are already invested in the United States. So what is the change finally? The change will be the consolidation of claims which are outside, which can be demanded any moment, into a long-term loan or a gift. I do not know if I have been clear. My English is not good.

Mr. BERNSTEIN. Yes, it is clear.

Mr. RUEFF. So you are quite right. We will only create a situation in which the reimbursement of the existing dollar balances can't be demanded. I think it is a very important point.

The second point of Mr. Fusfeld is also very important. He said the United States is in a very strategic position.

Am I right? That is what you said?

Mr. BERNSTEIN. Yes, he did.

Mr. RUEFF. Well, I am convinced of that. I am convinced that if there were the slightest indication in the United States that you are ready to agree to such a gift, if I can use the expression, that there will be unanimity in the non-American countries to propose that to the United States. And I am convinced that if there would be any reason to believe that the United States approved such a plan, it will be applied very easily among non-American countries and to the satisfaction of everybody.

The curious thing is the tendency in this country to refuse those things which are offered to you. I remember something which happened to me about 5 years ago in this very building. I was received by a gentleman you certainly all know, Senator Paul Douglas. I had already proposed an increase in the price of gold. Senator Paul Douglas received my suggestion in a very unfriendly way. He said:

> Oh, I understand very well your position. You want to take all our gold from us and then you will double the price and make an enormous benefit against us.

I told him:

> My dear Senator, it is just the reverse. What I propose to you is to increase the price of gold when you have still gold and to pay to us against our dollar only half the weight of gold which you insist to pay us. So it is really an advantage for you, not for us.

Then Senator Paul Douglas said, "Oh, if it is so I must reconsider my position." I said, "Certainly you ought to do it."

It is not awkward that, being in a strategic position, you refuse the advantage to which you are entitled, which would be very easily offered to you and which would solve, without any doubt, the problem of the convertability of the dollar.

Mr. Fusfeld said, "It is difficult to reverse the trend." I am not so afraid of that. As I told you before, I have been in charge of the French Treasury a certain number of years, I have had a few opportunities—to make devaluation of the French currency. Well, that has reversed the trend. All the public opinion was absolutely against, absolutely opposed.

Well, we have done devaluation against unanimous will. And after the need was recognized by everybody and they were recognized as indispensible.

And you have said when I proposed to increase the price of gold that it was absolutely impossible: "No American opinion would ever admit any change in the price of gold." You have changed it in the Smithsonian Institution agreement and it has been accepted. And you will change it again and it will be accepted in the same way. So I am not afraid at all, as Mr. Fusfeld said, to reverse the trend. It is the duty of the statesmen to reverse the trend when they believe that there is reason to do it, that it will be good.

Mr. Hirsch said—I do not know if I have it clear—we have to accommodate the development of production, the progress of technique by an increase of the supply of gold. Well, I am not afraid at all of this need, because you must take account of the enormous amount of hoardings, not only of gold but of other means of payment in this world. If we follow the line of this reverse Marshall Plan for the United States, there will be an immense unhoarding of the world liquidities and return of resource which will permit a very, very great development.

Well, then, to finish, I take the word of, I think, Mr. Fusfeld, who said he was not very optimistic—am I right?

I am just the contrary. I am extremely optimistic. I am sure, and I do not speak lightly, I am sure that the plan I proposed will be applied. I am sure that there is no other way to solve our problems in the world. Of course, it can be delayed. It can be delayed a great many years, but during these years we may have very dangerous developments on the foreign exchange markets, as well as in the international trade. But I am sure that these dangers can be avoided. And I ame very optimistic, because I consider that it is impossible that the world will close its eyes for a longer period to a solution which is just before us, which could be applied very quickly, which would raise no problem, and which would solve all our difficulties.

Thank you, Mr. Chairman.

Chairman REUSS. Thank you so much, Mr. Rueff.

I want to express our gratitude to all members of the panel. It has been a remarkable panel, with some most helpful views. We are grateful.

The subcommittee will now stand in recess until 10 o'clock Friday morning for a continuation of the hearings. We shall then hear from Arthur Burns of the Federal Reserve.

(Whereupon, at 12:20 p.m., the subcommittee was recessed until 10 a.m., Friday, September 15, 1972.)

GOLD AND THE CENTRAL BANK SWAP NETWORK

FRIDAY, SEPTEMBER 15, 1972

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON INTERNATIONAL EXCHANGE AND
PAYMENTS OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to recess, at 10:02 a.m., in room 1202, New Senate Office Building, Hon. Henry S. Reuss (chairman of the subcommittee) presiding.

Present: Representatives Reuss and Widnall.

Also present: John R. Karlik, economist; George D. Krumbhaar, Jr., and Walter B. Laessig, minority counsels.

OPENING STATEMENT OF CHAIRMAN REUSS

Chairman REUSS. Good morning. The International Exchange and Payments Subcommittee will be in order for a continuation of our hearings inquiring into U.S. policy on gold as a reserve asset and into the manner in which the swap network among central banks has been used to intervene in the exchange market.

Our first witness today is Chairman Arthur F. Burns of the Federal Reserve Board of Governors. Mr. Burns entered public life after a long and distinguished career as an academic economist. He is an old friend of this committee and an illustrious exponent of the international monetary reform. We are most happy to see him again today.

Mr. Burns, you have submited a comprehensive statement which under the rules and, without objection, will be received to the record. Will you proceed by reading it or adding to it in any way you choose?

STATEMENT OF HON. ARTHUR F. BURNS, CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

Mr. BURNS. Thank you very much, Mr. Chairman.

Nine months have elapsed since last December when the finance ministers and central bank governors of the Group of Ten countries met at the Smithsonian Institution and reached an agreement on realining the rates at which major currencies are to exchange for one another. During this period, exchange markets have altered between calm and uneasiness.

The immediate reaction of the financial world to the Smithsonian agreement was one of overwhelming approval. After the turn of the year, however, the earlier enthusiasm gave way to more cautious appraisal.

Many market participants expected a large return flow of capital to the United States to materialize right after the December meeting. This did not happen. A decline of interest rates in the United States relative to those abroad was partly responsible for inhibiting the reflow of funds. Another factor was the initial low level of foreign exchange rates within the wider exchange margins agreed to at the Smithsonian meeting. With the major European currencies below their central values, temporary holders of those currencies sensed a possibility of making a larger profit by delaying a shift back into dollars until the dollar prices of foreign currencies approached closer to their upper limits. And once major European currencies strenghtened within the margins, fears developed that some governments would fail to defend the Smithsonian exchange rates.

But as successive speculative episodes occured in January, February, and early March, the foreign central banks intervened decisively. Their clear determination to uphold the new system of exchange rates had a reassuring effect on the market. Moreover, short-term market interest rates began rising somewhat in the United States while they declined abroad. This convergence of international interest rates helped to improve the atmosphere of foreign exchange markets. So too did prompt passage by the Congress of the Par Value Modification Act, known popularly as the gold bill. Confidence in the new system of exchange rates, therefore, improved and markets became more orderly.

Indeed, between mid-March and mid-June a sizable reflow of capital to the United States actually materialized. This reflow more than offset our continuing deficit on current account. Since the United States ran a surplus in its official settlements balance during this period, the dollar naturally strengthened in exchange markets.

This encouraging development ended abruptly in June as sterling came under increasing pressure. Today's hearing is hardly the occasion to discuss Great Britian's problems, except to note that sharp and persistent wage and price advances weakened the market's confidence in the ability of Britain to continue to defend its new exchange rates. On June 23, after suffering a huge decline of monetary reserves, the British Government announced its decision to float the pound.

In the weeks following the British decision, exchange markets were again in turmoil and the dollar again weakened. Most of the major European currencies as market participants sought protection against the possibility of tighter foreign restrictions on capital imports, a float of Common Market currencies, or some combination of both. Speculative waves buffeted the markets daily, and several countries responded by adopting new restrictive measures on capital inflows. By Friday, July 14, the sterling crisis, besides causing a shift of $2.6 billion from sterling into Common Market currencies, led to an additional flow of over $6 billion from dollars into European currencies and the yen.

A period of relative calm was finally restored after mid-July and has been maintained since that time. On July 17–18, the Common Market finance ministers and central bank governors met in London and reaffirmed their determination to maintain the Smithsonian pattern of exchange rates while discussions were proceeding on the longer term reform of the international monetary system. On July 19, the Federal Reserve System, acting in collaboration with the Treasury, resumed operations in the foreign exchange market. These two actions were entirely independent. Both played a major role in arresting disorderly speculation and in renewing market confidence.

Officials of the Federal Reserve and the Treasury had been considering for some time the advisability of renewed operations in the exchange markets that would involve—among other things—a resumption of Federal Reserve swap drawings which were suspended on August 15, 1971. Once a governmental decision to reactivate the swap network was reached, the Federal Reserve was ready to move.

The first of these exchange operations occurred on July 19 when the Federal Reserve Bank of New York made repeated offerings of sizable amounts of German marks on the New York market. I explained at the time that this operation was undertaken to help restore order in the foreign exchange markets, that the United States was simply doing its part in upholding the Smithsonian agreement just as other countries were doing, and that the operation would continue on whatever scale and in whichever currencies seemed advisable. As this committee doubtless knows, the American intervention in the exchange market was very favorably received by financial observers and participants both in the United States and abroad.

The New York Reserve Bank has recently intervened in the market for Belgian francs as well as for German marks, In all, the bank has intervened in the exchange markets on nine occasions and in the process sold about $32 million of foreign currencies. This amount, while relatively small, needs to be interpreted in the light of two major facts: First, the amount offered by the bank for sale was much larger; second, in view of the extensive swap facilities outstanding, their reactivation meant that the amount that could at any time be offered for sale was vastly larger. The second of these facts has been a matter of general knowledge, and it was sufficient to make even reckless speculators stop and think. As the dollar strengthened on the exchanges, all sales of foreign currencies by the Federal Reserve that have taken place since July 19, whether from balances on hand or from swap drawings, were later fully covered by market purchases.

The Federal Reserve's exchange operations started in 1962 and have been reported semiannually since then. The latest report, which describes operations through September 8, was released just a few days ago. With your permission, I would like to submit it for the record.

Chairman Reuss. Without objection, it will be received.

(The report referred to follows:)

Treasury and Federal Reserve Foreign Exchange Operations

This 21st joint interim report reflects the Treasury-Federal Reserve policy of making available additional information on foreign exchange operations from time to time. The Federal Reserve Bank of New York acts as agent for both the Treasury and the Federal Open Market Committee of the Federal Reserve System in the conduct of foreign exchange operations.

This report was prepared by Charles A. Coombs, Senior Vice President in charge of the Foreign Department of the Federal Reserve Bank of New York, and Special Manager, System Open Market Account. It covers the period March to September 1972. Previous reports have been published in the March and September Bulletins of each year beginning with September 1962.

The Smithsonian Agreement of December 18, 1971, was greeted with satisfaction and relief by the exchange markets. Rates for a number of European currencies settled at or close to their new floor levels, and sizable reflows of funds to the United States developed through the year-end. Following the turn of the year, however, market optimism shifted to an anxious and even skeptical mood as traders began to ponder the long negotiating path to a restructured international financial system. Market concern focused particularly on the risk that certain foreign central banks might suddenly withdraw from their Smithsonian commitments to defend their currencies at the new upper limits, and successive waves of speculation in January and February drove the mark, the guilder, the Belgian franc, and the yen close to or hard against their official ceilings.

The central banks concerned intervened decisively and without hesitation, however, and this demonstration has a reassuring effect. In early March, expeditious congressional action on a "clean" gold price bill removed another source of uncertainty that had been breeding unsettling market rumors. Simultaneously, the German Government took action to discourage borrowing abroad by German business firms, which had been a major source of buying pressure on the mark over the previous 3 years, while the Japanese Government reinstated controls on speculative buying of the yen. Finally, the interest rate gap between Europe and the United States began to be squeezed out from both sides, As recessionary tendencies continued in Europe, discount rate cuts were announced in Germany, Belgium and the Netherlands, while the U.S. Treasury bill rate rose significantly.

The dollar showed growing strength and resiliency throughout most of the spring months, as a return flow of short-term funds largely offset continuing deficits in other components of the U.S. balance of payments. This encouraging trend was abruptly reversed midway in June, however, as sterling was suddenly swept off its Smithsonian parity by a speculative wave that had been gathering force for many months past. In allowing sterling to float on June 23, the British authorities indicated that the defense of sterling during the previous 6 days had cost the equivalent of $2.6 billion.

Such official intervention to defend sterling was almost entirely conducted in Common Market currencies, in accordance with a British undertaking on May 1 to join with its prospective Common Market partners in maintaining a spread of no more than 2¼ per cent between sterling and any other Common Market currency. This European Community (EC) agreement had thus created a dual system of exchange rate limits in which the 2¼ percent Common Market band became colloquially described as the "snake in the tunnel" represented by the 4½ per cent Smithsonian band. A critical feature of the Common Market 2¼ per cent band was that intervention in dollars was to be confined to circumstances in which a weakening Common Market currency should decline the full distance to its Smithsonian floor or a strong currency should rise to its Smithsonian ceiling. Otherwise, maintenance of the 2¼ percent Common Market band was to be carried out by intervening in each other's currencies.

As sterling came under selling pressure in June, the Bank of England accordingly was called upon to offer marks and whatever other Common Market currencies were being quoted at rates 2¼ per cent above sterling, while its European partners bought sterling with their currencies. The general effect of such intervention to maintain the 2¼ per cent Common Market band was to brake the decline of sterling toward its Smithsonian floor of $2.5471, while simultaneously pulling down the stronger EC currencies well below their Smithsonian ceilings. In this strained pattern of rates, the markets may have sensed a two-way speculative opportunity to go short of sterling and long of continental currencies in the hope of profiting on both. Most of the outflow from London seems to have ended up in the Common Market.

On June 23 the British authorities announced their decision to float the pound, in effect temporarily suspending their participation in the Smithsonian and EC agreements. Following that announcement, other European currencies immediately rebounded to their Smithsonian ceilings, reflecting market fears of a severe tightening of capital import controls, a joint float of the Common Market currencies, or some combination of both. The European currency markets were then closed down, and an emergency meeting of the Community finance ministers was set for the following Monday in Luxembourg. At that meeting Denmark formally withdrew from the EC monetary agreement, while Italy secured a temporary authorization to keep the lira within the 2¼ per cent band by intervening in dollars rather than in European currencies. The finance ministers then reaffirmed their determination to defend both the Smithsonian parities and the Common Market band.

TABLE 1.—*Federal Reserve reciprocal currency arrangements*

[In millions of dollars]

Institution	*Amount of facility, Sept. 8, 1972*
Austrian National Bank	200
National Bank of Belgium	600
Bank of Canada	1,000
National Bank of Denmark	200
Bank of England	2,000
Bank of France	1,000
German Federal Bank	1,000
Bank of Italy	1,250
Bank of Japan	1,000
Bank of Mexico	130
Netherlands Bank	300
Bank of Norway	200
Bank of Sweden	250
Swiss National Bank	1,000
Bank for International Settlements:	
Swiss francs/dollars	600
Other authorized European currencies/dollars	1,000
Total	11,730

Despite this reaffirmation and subsequent drastic controls imposed by Switzerland and Germany to ward off unwanted capital inflows, rumors of a European joint float continued to incite heavy speculative selling of dollars against the stronger European currencies and the yen. By Friday, July 14, the sterling crisis had generated not only the previously noted flight of $2.6 billion of funds from sterling into other Common Market currencies but also additional flows totaling over $6 billion from dollars into various European currencies and the yen.

Meanwhile, the U.S. authorities had been considering the advisability of renewed operations in the exchange markets, involving, if necessary, Federal Reserve swap drawings that had been suspended on August 15, 1971. On U.S. initiative and with the approval of the German Federal Bank, the first of such exchange operations was launched on July 19 in the form of repeated offerings by the Federal Reserve Bank of New York of sizable amounts of German marks on the New York market. This intervention, which was continued briefly on the following day, was described by Chairman Burns as a move by the U.S. authorities to play their part to restore order in foreign exchange markets and to do their part in upholding the Smithsonian Agreement, just as other countries were doing. The Chairman also indicated that the operation would continue on whatever scale and whenever transactions seemed advisable. The U.S. Treasury also confirmed the intervention, stating in part that: "The action reflects the willingness of the United States to intervene in the exchange markets on occasion when it feels it is desirable to help deal with speculative forces. The action indicates absolutely no change in our basic policy approach toward monetary reform and the necessary efforts on all fronts to achieve a sustainable equilibrium in our balance of payments."

On August 10, the Federal Reserve Bank of New York intervened in a second European currency, the Belgian franc, which had remained pinned to its ceiling. In a series of daily operations in some volume, the Belgian franc rate was brought down appreciably below its ceiling and, in the process, some unwinding of speculation on the Belgian franc may have been set in motion.

Since July 19, the New York Reserve Bank has intervened in the market on nine occasions and sold in the process $31.5 million of foreign currencies; total offerings were, of course, much larger. All market sales of foreign currencies, either from balances or from small swap drawings, were fully covered by market purchases as the dollar strengthened on the exchanges.

As noted in the preceding report in this series, Federal Reserve swap debt, which had reached a peak of $3,045 million on August 13, 1971, had been reduced to $2,855 million by the end of last year. Since then, further net repayments of $1,085 million have brought down the total outstanding debt to $1,770 million (Table 2), a reduction of nearly 40 per cent from the August 1971 peak. The bulk of such debt repayments during the period under review was accounted for by liquidation of the remaining $715 million of an original $750 million drawing on the Bank of England. The sterling needed for such repayments was acquired in regular purchases during June, July, and early August, both through the market and in direct transactions with the Bank of England, plus a sizable direct purchase from the U.S. Treasury of sterling previously acquired in a U.S. Government drawing on the International Monetary Fund (IMF).

TABLE 2.—FEDERAL RESERVE SYSTEM ACTIVITY UNDER ITS RECIPROCAL SWAP LINES

[In millions of dollars equivalent]

Transactions with—	System swap drawings, Jan. 1, 1972	Drawings, or repayments (—) 1972: I	II	July 1–Sept. 11	System swap drawings, Sept. 8, 1972
National Bank of Belgium	455		—20	10.2——10.2	435
Bank of England	715		—52	—663.0	
German Federal Bank	50			—50.0	
Swiss National Bank	1,000		—300		700
Bank for International Settlements (Swiss francs)	600				600
Bank for International Settlements (Belgian francs)	35				35
Total	2,855		—372	10.2——723.2	1,770

In June, $300 million of swap debt to the Swiss National Bank was repaid through a direct purchase of $250 million of Swiss francs from the National Bank, supplemented by Federal Reserve purchases of Swiss francs in the market. In July, the remaining 50 million of swap debt due to the German Federal Bank was liquidated through a direct transaction with that institution. In May, swap debt in Belgian francs was reduced by a $20 million repayment to $470 million equivalent. Finally, in August, new drawings of $10.2 million equivalent were made on the Belgian swap line, but these were fully liquidated by early September.

In March and July of this year, the U.S. Treasury redeemed in two equal instalments a $153 million equivalent German mark-denominated note that had been issued to the German Federal Bank under the 1967 military offset agreement with Germany (Table 4). Other foreign-currency-denominated securities were renewed at maturity. As of September 8, outstanding U.S. Treasury foreign-currency-denominated securities amounted to $2.0 billion equivalent.

STERLING

In 1971 the United Kingdom had recorded a large payments surplus, with a substantial gain in official reserves. Meanwhile, however, the British economy had become afflicted by a wage and price spiral that threatened to weaken its competitive position in world markets. Moreover, a significant proportion of the 1971 reserve gain reflected hot money inflows that could be reversed in short order. Consequently, at the Smithsonian meeting the United Kingdom maintained sterling's gold parity, thereby limiting the appreciation of sterling against the dollar to the 8.57 percent increase in the dollar price for gold. A middle rate for the pound of $2.60571—commensurate with the dollar's devaluation—was established, and the Bank of England announced official buying and selling rates in conformity with the Smithsonian Agreement's provision for a band of 4.5 percent around the new middle or central rates.

TABLE 3.—DRAWINGS AND REPAYMENTS ON FEDERAL RESERVE SYSTEM BY ITS SWAP PARTNERS

[In millions of dollars]

Banks drawing on System	Drawings on System, Jan. 1, 1972	Drawings, or repayments (—) 1972: I	II	July 1–Aug. 31	Drawings on System, Aug. 31, 1972
Bank for International Settlements (against German marks) (total)		8, —8	6, —6	1, —1	

At the same time the British authorities relaxed the exchange control regulations they had announced in late August and early October to discourage inflows of nonresident funds. Spot sterling fell close to the new floor of $2.5471 in late December, as some speculative positions began to be unwound and year-end adjustments were made. Taking advantage of this development, the Federal Reserve acquired sterling in the New York market and repaid, just prior to the year-end, $35 million of the $750 million equivalent swap drawing on the Bank of England that had been entered into in August 1971.

After the year-end adjustments were completed, however, the initial post-Smithsonian euphoria in the markets faded. The outflow of funds from the United Kingdom dried up rapidly, and spot sterling moved away from the floor. Doubts about the durability of the new exchange rates quickly surfaced, and by mid-January most other major European currencies were bid up toward, or even above, their central rates. At the same time it became clear that the EC countries were approaching agreement on narrowing the margin of fluctuation between their currencies and that the United Kingdom probably would participate in the arrangements. Consequently, sterling was bid up into line with the continental currencies, rising by 4 cents to more than $2.59 before leveling off. In early February, following a further decline in Euro-dollar rates relative to money market rates in London, the pound advanced to its middle rate. Over the course of that month, sterling weakened from time to time, reflecting the market's pessimism over the long-term implications of a protracted coal miners' strike, but once the strike was settled the continuing general advance of other major European currencies had a buoyant effect on sterling.

On March 7, against a background of widespread market uncertainty and growing speculation about the readiness of individual central banks to absorb sizable new inflows of dollars, the EC countries announced agreement to narrow the margin of fluctuation between their own currencies to 2¼ per cent by July 1. The market saw this agreement as greatly increasing the likelihood of a concerted European attempt to stem further inflows of dollars—either through new controls or a joint float against the dollar—and there was a rush to stockpile currencies that might become more expensive or even unavailable later on. Although the buying wave was directed with particular force toward continental currencies, demand for sterling was also strong, and the spot rate shot up by almost 5 cents in 3 days to well over $2.65. The flurry soon abated, however, as the U.S. Congress acted on the gold bill, short-term interest rates in this country began to firm, and, following the March central bank meeting in Basle, it was made clear that there was continuing firm support for the Smithsonian Agreement.

Sterling, in particular, fell back sharply, especially after the release of British trade figures showing a swing into deficit in February. Thus, by the time the British budget was presented on March 21, sterling was down to the $2.61 level once again. The budget, which was expansionary, stressed the need for combating the sluggish trend in the domestic economy and the persistent high level of unemployment. In addition, there was a modest relaxation of exchange controls, primarily for capital outflows to the EC and candidate countries, and British firms controlled by residents of those nations were allowed to raise unlimited sterling finance for their operations in the United Kingdom. Following the budget announcement, forward sterling softened somewhat but, reflecting the general pressure against the dollar, spot sterling rose close to $2.62 by the end of March.

In April the sterling market was reasonably well balanced, with the spot rate fluctuating around $2.61. On April 28 the United Kingdom discharged the remainder of its debt to the IMF, thereby reconstituting its full drawing rights with the Fund for the first time since December 1964. The repayment required the cooperation of a number of countries. Under the arrangement that was worked out, the U.S. Treasury drew SDR 200 million equivalent of sterling from the IMF, thereby reducing the United Kingdom's repurchase obligation by a corresponding amount to SDR 950 million. The United Kingdom, in turn, discharged this residual commitment with SDR 500 million equivalent of currencies acquired from third countries against dollars, with SDR 50 million of gold and SDR's purchased from Canada, and with SDR 400 million out of British reserves. Then, on May 1, the United Kingdom formally began its participation in the EC narrower band arrangement that had been put into effect 1 week earlier. There was little reaction in the market, however, as sterling had been holding well within the 2¼ per cent band for some 2 months.

Spot sterling remained fairly steady through most of May. Nevertheless, an increasingly pessimistic atmosphere was developing in the market, as price and wage inflation and the continuing series of labor disputes threatened to cut further into Britain's competitiveness in world markets. The trade deficits, which had appeared in February and had continued in March and April, were taken as a sign that the huge current-account surplus of the past 3 years was already being eroded and might soon be erased. Market pessimism first showed through in a widening of discounts on forward sterling late in May, and in early June spot sterling began to soften as well. The pound was still trading above the middle rate for the dollar but had fallen close to the bottom of the EC band.

On June 8, the release of first-quarter balance of payments statistics for the United Kingdom, showing a sharp drop in Britain's current-account surplus, seemed to confirm market fears about the pound's prospects, and sterling came on offer, with traders beginning to switch into German marks, Swiss francs, and Dutch guilders. Then, on June 15, out of a growing morass of legal and jurisdictional controversies on the labor front, a wildcat dock strike triggered a new selling wave of both forward and spot sterling. With spot sterling now at the bottom of the EC band, the Bank of England and several Common Market central banks were obliged to intervene heavily in support of the pound against EC currencies. As the pound dipped to $2.58½ against the dollar on June 16, it tended to pull the whole band down vis-a-vis the dollar, thereby making the continental currencies appear relatively cheap.

Meanwhile sterling's prospects had become a subject of general debate in the United Kingdom, especially against the background of Chancellor of the Exchequer Barber's statement in the March budget address that "the lesson of the international balance-of-payments upsets of the last few years is that it is neither necessary nor desirable to distort domestic economies to an unacceptable extent in order to maintain unrealistic exchange rates, whether they are too high or too low." In parliamentary debate on June 19, an opposition spokesman stated that he did not see how a devaluation could be delayed beyond July or August of this year.

Over the next 3 days, enormous amounts of sterling were dumped on the exchanges. Forward sterling was driven to deep discounts (as much as 15 per cent per annum on 1-month deliveries), and spot sterling was pushed down to as low as $2.56½ against the dollar, even as EC central banks continued their massive support effort to maintain the 2¼ per cent band among their own currencies. In sum, over the six trading days June 15 to 22, such support amounted to $2.6 billion equivalent, financed by exchange transactions with the Bank of England that were to be liquidated by the end of July.

Early on the morning of Friday, June 23, with no end to the reserve losses in sight, the British authorities announced:

"H.M. Government has decided that, as a temporary measure, sterling will be allowed to float. This means that for the time being the market rate for sterling will not necessarily be confined within announced limits either in respect of the U.S. dollar or in respect of EEC currencies.

"It is the Government's intention to return as soon as conditions permit to the maintenance of normal IMF margins round parity and participation in the special EEC currency arrangements."

At the same time, the London market was closed through the following Monday and most of the exchange controls applying to nonsterling-area countries were extended to the overseas-sterling-area countries other than the Republic of Ireland.

The floating of the pound, and the subsequent withdrawal of the same day of the continental central banks from their respective markets, gravely weakened confidence in the durability of the Smithsonian Agreement and the EC intervention arrangements. On Monday, June 26, however, the EC finance ministers agreed in Luxembourg to continue to defend the Smithsonian rates and to retain the narrower EC band arrangements, while the pound continued to float.

TABLE 4.—U.S. TREASURY SECURITIES, FOREIGN CURRENCY SERIES

[In millions of dollars equivalent]

Issued to—	Outstanding, Jan. 1, 1972	Redemptions (−) 1972 I	II	July 1-Sept. 8	Outstanding, Sept. 8, 1972
German Federal Bank	612.0	−76.5		−76.5	459.0
German banks	153.0				153.0
Swiss National Bank	1,215.4				1,218.3
Bank for International Settlements [1]	164.8				170.9
Total	2,145.2	−76.5		−76.5	2,001.2

[1] Denominated in Swiss francs.

Note: Discrepancies in totals result from valuation adjustments and from rounding.

On June 27, when London was the only major European foreign exchange market to resume normal operations, the sterling rate dropped almost to \$2.47, but a sharp squeeze for balances developed later in the day as deliveries on earlier sales contracts had to be met, and the spot rate temporarily rebounded to \$2.51¾. Once the squeeze for balances had passed, sterling dropped off steadily, by a penny or two a day over the course of the next week, to as low as \$2.41¼ on July 4 in London. At that point commercial demand reappeared and the rate recovered to around \$2.45.

The revival of commercial demand was underscored by the release of trade figures for June, which had swung back into surplus and confirmed that in fact the United Kingdom was still in current-account surplus. Moreover, the continuing money market squeeze in London tended to support sterling in the exchanges. Even, so, new troubles on the labor front, culminating in a dock strike beginning on July 21, had a disturbing influence on the sterling market, occasionally pulling the rate down sharply. Over the remainder of July, sterling traded in the \$2.44 to \$2.45 range. On July 31, the United Kingdom settled its debts in connection with the defense of sterling in June, utilizing \$1,150 million of funds previously swapped out under special arrangements, \$634 million equivalent drawn under the U.K.'s IMF gold tranche position, and \$823 million from reserves that at the end of July still amounted to \$6,082 million (inclusive of Britain's remaining \$126 million IMF gold tranche position).

Meanwhile, as sterling began to decline sharply against the dollar in mid-June, the New York Federal Reserve Bank, acting in close consultation with the Bank of England, began to buy sterling in the New York market to repay the Federal Reserve's remaining swap commitment. By the end of June the System had been able to reduce its swap commitment by another \$52 million to \$663 million equivalent. After sterling was floated, the U.S. Treasury periodically bought sterling on days when the rate was declining in New York and by mid-July had purchased a total of \$41.5 million equivalent.

At that point the Federal Reserve, in order to repay the remainder of its swap commitment in sterling, initiated a program of daily purchases of sterling, mainly on a direct basis from the Bank of England but also in the market. These purchases, together with sterling acquired from the U.S. Treasury, including the pounds drawn by the Treasury at the time of the British IMF repayment in April, enabled the System to reduce its swap commitment by \$405 million equivalent to \$258 million as of July 31. The program of daily purchases continued through early August, and by August 14 the Federal Reserve had acquired sufficient sterling to liquidate the remainder of its original swap commitment of \$750 million.

Buoyed by a tight domestic money market and continuing commercial demand, sterling rose early in August to trade above $2.45. Announcement of an end to the dock strike and release of a second consecutive trade surplus gave additional support to the spot rate toward midmonth. Subsequently, the squeeze for balances eased, with British short-term interest rates declining abruptly, and spot sterling edged to below the $2.45 level in early September.

GERMAN MARK

Following the Smithsonian Agreement, the German authorities established a new central rate for the mark of $0.3103⅛, an effective appreciation of 13.58 per cent against the dollar, and set margins at $0.3034⅞ and $0.3174⅝ on either side of the central rate. None of the restraints against inflows of foreign funds introduced earlier in 1971 were removed, but the Government announced that it would not avail itself for the time being of its new power to impose deposit requirements of up to 50 per cent against German firms' borrowings abroad. When exchange trading was resumed, the mark settled well below its new central rate. Except for some modest outflows toward the year-end, there was no significant reversal of the huge speculative positions in marks that had been built up over the course of 1971.

Early in 1972 doubts began to spread in the exchange markets that a durable settlement of the international monetary crisis really had been achieved. Moreover, many Europeans were expressing concern over the further decline taking place in the U.S. interest rates. With the press and the markets focusing more and more on these issues, the atmosphere deteriorated progressively over the early weeks of the new year, and almost any news items or rumor was seized upon as a reason for additional selling of dollars. Funds were shifted into Germany particularly, and in heavy demand the spot mark rose through the new central rate by mid-January. Further waves of nervousness swept through the foreign exchange markets in February. Each time the mark rate was bid up sharply, and the pressures eased only after forceful intervention by the German Federal Bank.

Then, late in February, the German authorities announced new measures designed to lessen the inflow of funds and to defend the Washington agreement. These included cuts in the discount and Lombard rates of the German Federal Bank and a hike in the marginal reserve requirement against nonresident liabilities. More importantly, the Ministry of Economics and Finance imposed a 40 per cent deposit requirement (*Bardepot*) on most foreign borrowings of nonbanking enterprises, retroactive to January 1, moving for the first time to curb German corporate borrowings abroad. Following the announcement of these measures, the spot rate declined to almost 1½ percent below its upper limit by late February. Over the month as a whole, however, German official reserves had increased by $744 million.

The demand for marks soon built up again in early March, and the mark was driven up almost to its Smithsonian ceiling in reaction to the growing press discussion of a possible concerted European response to the continued influx of dollars—through either the introduction of controls or a joint float against the dollar. Following encouraging reports of the Basle meeting of central bankers on the weekend of March 11–12 and indications that United States short-term interest rates were beginning to firm, the mark backed off somewhat and traded around the $0.3150 level. The mark held at this level well into April, with little reaction to the announcement early that month that on April 24 the EC would implement its narrower trading band arrangement (the "snake in the tunnel").

By that time, and indeed throughout the second quarter, Germany's international payments position was undergoing a substantial readjustment. The domestic economy had leveled off, but wage and price pressures remained strong in Germany and the rise of the mark rate over the course of the previous year was beginning to exert an influence on the German trade balance. Thus the trade surplus, which had swelled to substantial proportions toward the end of 1971 and through the early months of 1972, showed a decline in March and subsequent months. Coupled with a further deterioration in service items and transfer payments, this moved the full current account from surplus to rough balance.

The continuing strength of the mark during the spring reflected, therefore, an increasingly heavy influx of capital. These inflows were mainly generated by the market's expectation that there might be a further rise in the value of mark-denominated instruments. At the same time, moreover, German corporations continued to seek funds abroad through a variety of means. To avoid the *Bardepot*, the corporations ran down their foreign market borrowings by $1.3 billion in March and April but at the same time were able to sell to foreigners a substantial volume of mark-denominated bonds.

The exchange markets were in better balance in May, but the general uneasiness over the international monetary situation showed through on a number of occasions. Such events as the intensification of the Vietnam war early in the month and Treasury Secretary Connally's resignation toward midmonth brought forth a spate of market and press commentary on their ultimate significance for the monetary system. Comments to the press by officials from either side of the Atlantic, or even rumors of what they might have said, were closely scrutinized for any hint of further moves to be made on the international monetary front. Thus, several times in May the German mark was bid up sharply in the exchanges, pulling several other European currencies along with it. These bursts of demand were short-lived, however, and each time the spot rate quickly retreated.

The mark was trading quietly around $0.3150 in early June, when swiftly moving events in the sterling market sent shock waves into other markets as well. The rush out of sterling was directed mainly toward the mark, which rose sharply against the dollar. By June 16, sterling had fallen to its intervention point against the mark under the EC arrangements and both the German Federal Bank and the Bank of England had to intervene massively (selling marks against sterling) to keep the spread between their two currencies from widening beyond 2¼ per cent. This heavy injection of marks into the exchanges tended to pull the mark down against the dollar, and the rate dropped to $0.3131 by June 22.

When the British authorities announced the floating of the pound on Friday, June 23, thereby dropping out of the Smithsonian and EC agreements, traders immediately began shifting funds out of dollars and into other European currencies as they feared a general abandonment of the Smithsonian rates. As a result, the German Federal Bank was flooded with nearly $900 million within the first hour of trading, after which it suspended operations and closed the exchange market. In trading later that day and on Monday, June 26, in New York, the spot mark jumped 15 points above its Smithsonian ceiling. Following the EC finance ministers' decision on June 26 to continue to defend the Smithsonian limits and to maintain the EC band, the German authorities announced they would reopen their foreign exchange markets on Wednesday, June 28.

When normal trading resumed that day, the spot mark traded just below its ceiling, but marks for future delivery were quoted at large premiums. The next day the German Government moved to back up the decision to support the existing international exchange agreements by announcing a series of measures to tighten controls. The *Bardepot* requirement was raised from 40 per cent to 50 per cent and was applied to a wider range of borrowings. Sales of domestic fixed income securities to nonresidents were made subject to the prior approval of the authorities, to be administered restrictively. The German Federal Bank again raised its reserve requirements against the banks' foreign liabilities, so that in effect reserves totaling between 90 per cent and 100 per cent would be required against any addtional foreign liabilities of the banks. Finally, domestic reserve requirements were hiked to absorb the liquidity generated by inflows of the nonbanking sector. This increase in domestic liquidity reflected the fact that Germany's official reserves, which had risen by $121 million in April and May, had been swelled by a further $2,763 million in June, largely as a result of the intervention to support both sterling and the dollar.

The tightening of controls by the German authorities did not immediately allay market anxieties and, in the generalized pessimism over the future of the Smithsonian Agreement, traders hastened to shift even more funds into Germany ahead of the possible imposition of additional controls. Consequently, the mark was in heavy demand early in July and the German Federal Bank was obliged to absorb dollars on a large scale.

The buying of marks, and of most major European currencies, continued until the Swiss authorities relieved some of the uncertainties by taking forceful defensive measures of their own on July 4 and 5. The German Federal Bank then intensified its efforts to tighten up the *Bardepot* and also asked banks to enter into a gentlemen's agreement neither to sell assets out of their own portfolios to nonresidents nor to arrange or guarantee any sizable foreign credits to residents. In addition, the German Federal Bank once again boosted its minimum reserve requirements against domestic liabilities to mop up the liquidity flowing directly into German corporations.

These various measures helped settle the markets briefly, but a new rush into marks and other currencies soon developed in the week prior to the scheduled July 17–18 London meeting of EC finance ministers. With the atmosphere still tense following the floating of the pound, there were reports in the European press suggesting that the EC finance ministers would plan a joint float of their currencies against the dollar, rather than stick to their announced agenda. The market seized upon these reports to mount a new drive out of the dollar and into the mark and other European currencies. With the mark pushed once again to its upper limit, the German Federal Bank had to absorb nearly $1.3 billion over the 2 days of July 13–14. On Monday, July 17, the EC ministers in London made clear their determination to maintain the Smithsonian exchange-rate structure and emerged with a general agreement on longer-term monetary questions, including the need for par values. The reports out of London gave pause to the markets, and the demand for marks let up over the two days of the meeting. The huge technical positions built up over previous days and weeks, short of dollars and long of marks and other currencies, nevertheless remained intact.

By Wednesday, July 19, the mark had edged slightly away from its ceiling and eased further after New York opened that morning, to around $0.3160 by 11 o'clock. Shortly thereafter, on the basis of a U.S. Government policy decision, the Federal Reserve Bank of New York placed large offerings of marks in the New York market. These offers were for System account, with marks made available by the U.S. Treasury on a swap basis. Such unexpected intervention generated an immediate market reaction, and traders quickly moved their mark quotations down. As the market backed away, the Federal Reserve's offering rate was subsequently lowered several times. The operation generated considerable market comment and, in response to press inquiries, Chairman Burns confirmed the System's intervention in marks, adding that such intervention would continue on whatever scale and whenever it was deemed desirable. The following morning in Germany, with the market fully alerted to the news of the U.S. initiative, the spot mark fell further, reaching $0.3152 (some ¾ per cent below the upper limit) by the time the New York market opened. The Federal Reserve followed up with a further offering of marks out of previously accumulated System balances. Over succeeding days, with additional favorable press and market commentary on the Federal Reserve initiative, the mark rate continued to decline. This tendency persisted into early August, with some unwinding of speculative positions, and the rate settled temporarily around $0.3140.

By midmonth a more favorable atmosphere developed for the dollar, following the release of improved U.S. balance of payments figures for the second quarter and indications of new efforts by the United States to negotiate a settlement of the Vietnam conflict. In addition, the various measures taken by the German authorities in July were beginning to bite. Consequently, the mark rate dropped further, reaching $0.3134 on August 16, and the Federal Reserve again sold marks to consolidate the dollar's improvement. These sales brought to $21.4 million equivalent the total of marks sold in market operations.

The shift in sentiment in favor of the dollar continued, pushing the mark rate to $0.3126¼ on August 21. On the next day, however, German commercial banks reportedly found themselves short of liquidity to meet their reserve requirements through the end of August. A squeeze developed in the Frankfurt money market, and the banks scrambled to buy marks in the exchanges, setting off a sharp rise in the mark rate before the banks' liquidity needs were met. When the July trade figures for the United States showing a narrowing of the trade deficit were announced on August 24, however, the mark eased once again.

In other operations during the period under review, the U.S. authorities, under agreements with the German Federal Bank, were able to liquidate certain German mark obligations entered into prior to the floating of the mark in May 1971. In March and July the U.S. Treasury purchased sufficient marks from the German Federal Bank to redeem in two payments a $153 million mark-denominated note. Moreover, on July 24, the Federal Reserve liquidated its remaining $50 million equivalent mark swap commitment, also purchasing marks directly from the Federal Bank. This repayment placed the $1 billion swap arrangement with the German Federal Bank on a fully standby basis and no new drawings have been made.

SWISS FRANC

Under the Smithsonian Agreement the Swiss authorities fixed a central rate for the franc of $0.2604⅛—in effect, an increase of 6.36 per cent against the dollar from the franc's previous parity and of 13.88 per cent from the parity in force prior to Switzerland's revaluation on May 10, 1971—and announced their new intervention points, 2¼ per cent on either side of the central rate. Actual trading conditions were little changed, however, since the banks had been allowed to deal throughout and because the restrictions imposed the preceding August remained in effect. Increases in the banks' net foreign liabilities over the July 31, 1971, levels continued to be subject to a 100 per cent reserve requirement, and interest payments on nonresidents' deposits made after July 31 were still prohibited. In the wake of the Smithsonian Agreement there were modest outflows from Switzerland, and the franc gradually began to ease toward the new floor of $0.2546¾. There was no substantial unwinding of speculative positions, however, and the Swiss banks remained highly liquid as the year-end approached.

Early in January, with the current account of Switzerland's balance of payments continuing in small surplus and the markets hesitant in the face of the many monetary issues still to be resolved, the franc rate remained slightly above the floor, even as domestic monetary conditions eased further. By midmonth the market was already beginning to question the durability of the exchange rate realignment, and the spot franc rose along with other European currencies. Over succeeding weeks, as traders grew increasingly jittery, several rounds of heavy buying pushed the franc up to as high as the central rate. At that time, in view of the continuing inflows from abroad, the Swiss National Bank instituted a requirement that 25 per cent of the proceeds of foreign bond issues in Switzerland (which were running at more than twice their volume of a year earlier) had to be converted into dollars by the central bank at the franc's lower intervention limit. Another wave of demand for francs developed in early March when, in the general strengthening of European currencies, the Swiss franc was rapidly bid up to some 1 per cent above the central rate. The tensions in the foreign exchanges eased abruptly at that point, however, and the franc rate fell back sharply. Since domestic liquidity remained extremely abundant in Switzerland, the decline was steeper in the Swiss franc market than elsewhere on the Continent, and after mid-March the spot rate was again below the central rate.

On April 5 the Swiss National Bank and the Swiss Bankers Association agreed on two measures to mop up some of the excess domestic liquidity. First, marginal reserve requirements ranging up to 20 per cent were introduced against the growth in the banks' domestic liabilities since July 31, 1971. Second, the already existing 100 per cent reserve requirement against increases in the banks' net foreign liabilities was considerably tightened through a more restrictive interpretation, even though the required ratio was halved. At first, there was little reaction to these measures in the Swiss franc market and the spot rate held fairly steady. But as the market came to appreciate the possible consequences of the restriction on the banks' net foreign currency positions, the franc weakened.

Late in April the Swiss banks began to transfer funds to the National Bank under the terms of the tightened reserve requirement against increases in net liabilities to foreigners. An alternative for the banks was to reduce their net external liability positions by purchasing dollars from the National Bank, and on May 2 the National Bank sold $150 million at the rate of $0.2577¼ (3.88 Swiss francs) for this purpose. The following day the National Bank announced that it would henceforth be prepared to sell dollars at this higher rate, rather than at the official lower intervention point of $0.2546¾, thereby reducing the effective range of fluctuation of the Swiss franc. In a parallel move, it lifted to the same level the exchange rate for conversions of foreign bond proceeds raised in Switzerland, while increasing to 40 per cent from 25 per cent the share of such proceeds that had to be converted at the central bank. These measures had no direct impact on the market but, over succeeding weeks, resulted in a further decline in the National Bank's dollar holdings.

The nervousness that broke out in the exchanges at the beginning of the second week of May pushed the franc somewhat higher, but there was never any severe pressure and the spot rate soon receded, declining until the middle of that month. Trading in francs then turned quiet, with the rate about ¾ per cent under the central rate and well below the EC currencies. Taking advantage of the relatively weak exchange rate, the Federal Reserve, with the agreement of the Swiss National Bank, initiated a program of moderate purchases of Swiss francs in the market to make a start on covering the System's swap commitments in that currency—$1 billion equivalent to the Swiss National Bank and $600 million to the BIS. By early June, such Federal Reserve purchases were sufficient, together with $250 million of francs bought directly from the Swiss National Bank to replenish its dollar balances, to enable the Federal Reserve to make swap repayments totaling $300 million equivalent to that bank. The System's Swiss franc swap indebtedness to the National Bank was thereby reduced to $700 million, while the additional $600 million equivalent Swiss franc drawing on the BIS remained outstanding.

Late in May the Swiss National Bank's sustained efforts to absorb domestic liquidity began to take hold and the Swiss franc strengthened. On May 30, an erroneous press report from Switzerland to the effect that Under Secretary Volcker had not absolutely ruled out the possibility of another dollar devaluation set off a particularly sharp reaction in the Swiss franc market. In heavy trading, the rate surged by ¼ per cent within half an hour. Although the wire service later admitted that it had transmitted its own interpretation of Mr. Volcker's response to questions and that the Under Secretary had in fact strongly supported the Smithsonian alignment, the market did not immediately recover from the initial adverse reaction, and the franc swung widely around the central rate over the subsequent days.

This misunderstanding was the first of a series of disquieting developments to hit the exchange markets in rapid succession in the late spring, and the Swiss franc became increasingly subject to speculative pressures. Early in June, free-market gold prices—which had already advanced sharply the preceding month—surged in a strong speculative outburst on rumors of an increase in the official price of gold. In response, the Swiss franc rose rapidly, moving through its $0.2604⅛ central rate.

Later in the month, the fever in the gold markets abated and the Swiss banks' concerns over their midyear liquidity positions were eased by the willingness of the National Bank to extend assistance through short-term swaps. (In fact, it granted a total of $923 million in swaps over the midyear period.) Nevertheless, demand for Swiss francs began to pick up, as funds were switched out of sterling on a progressively heavier scale. Since Switzerland is not a party to the EC currency arrangements, the franc rate was not pulled downward, as were many other continental currencies, by the rapid drop of sterling vis-à-vis the dollar. Instead, the spot franc was propelled upward by speculative positioning tc $0.2653 by June 22.

Following the floating of the pound on June 23, the Swiss National Bank announced that it would not intervene in the foreign exchange market until further notice. The Swiss banks were still free to trade, however, and the franc immediately rose above its ceiling. On June 26 the Swiss authorities took new and more drastic measures to limit the inflow of foreign capital, this time banning the sale to foreign investors of domestic securities, foreign securities denominated in Swiss francs, and mortgages on land and also prohibiting all sales of Swiss real estate to nonresidents. Following these steps, the franc rate moved back down toward its official ceiling. When other continental central banks reopened for business on June 28, however, the National Bank stayed out of the market to assess the situation further, and the franc continued to trade erratically above the upper limit in a thin market through the month end. During this period, the Federal Reserve sold out of balances small amounts of francs in the New York market, with most of the proceeds used to purchase German marks.

When the National Bank resumed operations on Monday, July 3, it warned that a negative interest rate penalty on increases in nonresident deposits in Switzerland would be imposed if the inflow of funds became too large. Nevertheless, there was a heavy demand for francs, and the bank was forced to intervene at the upper intervention limit. The Swiss authorities moved promptly, therefore, to impose a quarterly 2 per cent tax on any portion of foreign deposits with Swiss banks in excess of the balances held on June 30, 1972.

In addition, they extended the prohibition of interest payments on nonresident deposits made after July 31, 1971, to all banks (this ban had previously applied only to deposits with the larger banks), prohibited all banks from having net foreign exchange liability positions (including forward positions) at the close of business on any day, subjected borrowings abroad by Swiss citizens and corporations to the prior approval of the Swiss National Bank, and placed on a legal basis the previous gentlemen's agreement establishing the marginal reserve requirements against banks' net foreign liabilities. This barrage of measures halted the inflows, and the Swiss franc fell away from its upper limit, reaching as low as $0.2647 on July 5.

As the July 17–18 meeting of the EC finance ministers aproached, the Swiss franc again came into extremely heavy demand, and the National Bank had to absorb over $1 billion. Once the meeting got under way, however, the market concluded that the anticipated joint EC float against the dollar probably would not materialize, and buying pressure on the franc tapered off. When the meeting ended in a reaffirmation of official intent to defend the Smithsonian parities, some offerings of Swiss francs against dollars developed and the franc rate fell rapidly away from its $0.2664⅛ ceiling. The downward movement was accelerated by the news of the U.S. authorities' reentry into the exchanges on July 19 and by the favorable response that action received. The franc reached as low as $0.2641 before leveling off. On July 21, in order to absorb part of the franc liquidity resulting from the heavy mid-July inflows, the National Bank raised its marginal reserve requirements against increases in the banks' domestic and foreign liabilities.

The Swiss franc market, no longer fueled by a rapid succession of speculative rumors, then turned very quiet. In mid-August, when sentiment toward the dollar improved in response to the Federal Reserve's continuing market intervention and release of improved second-quarter U.S. balance of payments figures, the Swiss franc followed the German mark downward. By early September, the spot rate was fluctuating around the $0.2645 level.

BELGIAN FRANC

Following the Smithsonian meeting, the Belgian authorities announced that the franc's central rate would be set at $0.022313, an effective revaluation of 2.76 per cent against gold and a total appreciation of 11.57 per cent against the dollar. New intervention points were established at 2¼ per cent above and below the central rate. At the same time, Belgium and the Netherlands—which appreciated the guilder by the same percentage against the dollar—decided to maintain the close link between their currencies by continuing to intervene when necessary to keep the rate between the franc and the guilder within a 1.5 per cent spread. Moreover, the Belgian authorities maintained the two-tier market structure, with only current transactions going through the official market. When the Brussels exchange market was reopened on December 21, the Belgian franc was quoted well above the new floor and rose gradually thereafter. By the year-end, when Euro-dollar quotations fell below comparable Belgian domestic interest yields, the franc reached the new central rate.

Early in 1972, the Belgian franc joined other currencies in rising sharply against the dollar, and by February the National Bank had begun to take in dollars, both on a swap and on an outright basis. Moreover, in the separate market for financial francs, quotations had risen to a significant premium over the commercial rate. To a large extent, the run-up of the franc reflected relatively high interest rates in Belgium, as well as market fears over the prospects for the Smithsonian Agreement. For its part, the National Bank cut its lending rates three times between the first of the year and early March, with the discount rate reduced from 5½ per cent to 4 per cent in ½ per cent steps, but these actions served merely to bring Belgian rates down into line with comparable rates in other centers. At the same time, economic activity was only gradually recovering from a slowdown and Belgium's current-account surplus remained large. Once the spot rate began to rise, fears of a possible further advance led to a build-up of leads and lags in trade payments, which in turn generated additional demand in both spot and forward markets for commercial francs.

Early in March, when there was widespread discussion of a possible common EC response to growing dollar inflows, either through a joint float of their currencies or through administrative controls to bar these inflows, there was a jump in demand for several currencies, and the National Bank of Belgium again had to take in dollars at the Smithsonian ceiling. On March 9, in an effort to discourage short-term capital inflows, the authorities instructed the banks to avoid any further build-up in their spot liabilities to foreigners without a corresponding increase in their spot foreign assets. This tended to stem the tide for the time being, and the franc rate backed away.

With the Brussels money market now highly liquid, and with incentives having opened up in favor of moving into Euro-dollars, the Belgian franc continued to decline through mid-April. The generally improved exchange market atmosphere also encouraged some unwinding of the earlier leads and lags in favor of the franc. Nevertheless, the Belgian current account was still in surplus, and when the domestic money market turned tighter once again late in April while Euro-dollar rates declined, the Belgian franc began to advance. This tendency continued through May, when renewed nervousness in the exchanges led to a

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number of brief spurts in the Belgian franc rate. Late in May, when the Belgian Government needed dollars for current payments, the Federal Reserve purchased francs in a direct transaction with the National Bank and, using these francs as well as some balances on hand, repaid a total of $20 million equivalent of its swap debt to the National Bank. The System's Belgian franc swap commitments were thereby reduced to $470 million, including $35 million equivalent owed to the BIS.

When sterling came under speculative attack in mid-June, the Belgian franc was initially pushed up to its upper limit against the dollar. Sterling soon dropped to its middle rate, and the spread within the EC band thus reached the full 2¼ per cent. Consequently, as pounds continued to be dumped on the markets, the National Bank of Belgium joined other EC central banks in the support effort, buying sterling with francs in the market and making francs available to the Bank of England for corresponding intervenion in London. As the whole EC band was pulled down against the dollar by the pressure on sterling, the franc dropped to as low as $0.022537 on June 22, or 1.3 per cent below the ceiling.

The floating of the pound on June 23 released the downward pressure on the EC band, and the franc snapped back to its ceiling. After absorbing some dollars, the National Bank of Belgium quickly withdrew from the market along with the other continental central banks that had opened that morning. In the limited trading that followed, the franc rate immediately rose above its Smithsonian ceiling. After the EC Finance Ministers met in Luxembourg on June 26 and made clear their intention of upholding both the Smithsonian and EC currency arrangements, the Belgian exchange market was reopened on June 28. At first, the rate held just below its upper limit and there was no need for the Belgian authorities to intervene.

The grave uncertainties left in the wake of the floating of the pound soon led to new demands for continental currencies, however, and along with other European central banks the National Bank had to intervene heavily in early July, particularly on July 13–14, just prior to the EC finance ministers' meeting in London. Reports from that meeting tended to reassure the markets and, as with other currencies, the franc edged away from its upper limit. Nevertheless, although the German mark, the Dutch guilder, and the Swiss franc all declined fairly sharply over subsequent days, the Belgian franc hovered close to its upper limit. By late July it had moved back to its ceiling and held there into early August, with the National Bank again absorbing dollars almost every day.

In part, the relative strength of the Belgian franc reflected the continuing current-account surplus. In addition, the Belgian authorities had worked out a gentleman's agreement with the Belgian commercial banks to absorb some of the domestic liquidity created by the earlier official purchases of sterling and dollars, and the banks made sizable deposits with the central bank at the end of July and during most of August. Finally, it was clear that the speculative build-up of the previous month had not been unwound, and the longer the rate held at the ceiling the more entrenched became market expectations that the Belgian authorities might not be able to resolve the situation within the context of the Smithsonian Agreement.

In these circumstances, on August 10, following consultations with the National Bank of Belgium, the Federal Reserve initiated a probing action in the New York exchange market to see whether some shift of expectations could be generated that would pry the Belgian franc loose from its ceiling. As in the case of the operation in German marks in July, the Reserve Bank placed a large offer of Belgian francs in the market at the current rate. As the market backed away, the offer was subsequently moved down and a moderate amount of francs was sold over the course of the day. On the following morning in Europe there was not only some decline of the franc rate but also some sympathetic easing of other currency rates. To consolidate the gain, the Federal Reserve followed up with further offers on subsequent days, but, with the market continuing to back away, only a small amount of Belgian francs was sold. By August 14, the Belgian franc was clearly following the general downtrend of other European currencies, so that no further offers were made. As had been agreed at the inception of the operation, the Federal Reserve covered its franc sales by drawing on its swap line with the National Bank. These drawings totaling $10.2 million equivalent were repaid by early September, as improved conditions permitted the Federal Reserve to acquire the needed francs through market operations.

With the generally improved sentiment for the dollar, the franc continued to decline on its own through the end of August, reaching as low as $0.022743 before steadying in early September. As of September 8, the Federal Reserve swap drawings in Belgian francs remained at $470 million equivalent.

DUTCH GUILDER

At the conclusion of the Smithsonian meeting, the Dutch Government announced that the guilder would be revalued by 2.76 per cent against gold, thus producing an effective appreciation of the guilder of 11.57 per cent relative to the dollar. New intervention limits were set at 2¼ per cent on either side of the new central rate of $0.3082. There was little outflow of funds from the Netherlands when the Amsterdam market was reopened on December 21 and, with the Dutch current account strengthening against the background of sluggish domestic economic activity, the guilder rate began to rise during late December and early January.

With interest rates falling in foreign centers early in January, the Netherlands Bank reduced all its lending rates by ½ percentage point, the discount rate being cut to 4½ per cent. Domestic money market rates declined in response, but the exchange rate did not follow suit, as there were sizable new direct investment inflows and the underlying Dutch payments position remained strong. Even more important, the demand for guilders reflected the exchange market's growing concern over the viability of the exchange rate realignment negotiated in Washington, and the rise of the guilder followed closely the advance of other continental currencies, particularly the German mark.

Consequently, the guilder rate was ratcheted upward in several stages in January and early February, reaching almost to the upper intervention level. In February, the Dutch authorities moved to provide additional liquidity to the Amsterdam money market, first by open market purchases of Dutch Treasury bills and subsequently through exchange market swaps, and these operations relieved some of the upward pressure on the spot rate. Nevertheless, just after midmonth a new wave of exchange market uncertainty briefly pushed the spot guilder to the ceiling, and the Netherlands Bank had to absorb a modest amount of dollars. The market turned quieter through the end of February, and in view of the further decline in interest rates abroad, effective March 2, the Netherlands Bank cut its discount rate by ½ percentage point to 4 percent.

By early March, however, the debate in Europe over alternative means of dealing with dollar inflows was in full swing, with a further extension of capital controls appearing to be the most likely route. Consequently, there was an influx of funds into guilders by traders and investors who feared that new controls could render the guilder more expensive or even unavailable for certain kinds of transactions later on. The heavy demand pushed up the guilder rate, although the Netherlands Bank slowed the advance by entering into new swaps with its banks. Then, on March 7, the EC countries reached the decision to narrow the band of fluctuation between their currencies, and the market took the view that the community would now be in a better position to take common action against dollar inflows—perhaps through a joint float.

The demand for guilders thus swelled even further, pushing the spot rate to its Smithsonian upper limit, and over the course of 3 days the Netherlands Bank had to absorb $417 million. On March 9 the Netherlands Bank moved to curb inflows from abroad by prohibiting nonresidents from making new guilder time deposits or renewing such deposits when they mature and by banning the payment of interest on nonresidents' demand deposits. At the same time, the central bank restated its determination to maintain its Smithsonian buying and selling rates for dollars. Following these moves, the market turned much quieter and, as new inflows tapered off, the spot rate soon retreated from the ceiling.

The Dutch money market was now extremely liquid as a result of the earlier heavy influx of funds, and the guilder tended to drift downward through the second half of March and well into April, steadying only after dropping below $0.3100 in mid-April. Thereafter, the guilder followed the gradual updrift of the German mark and other continental currencies, and by early June was trading quietly around $0.3125.

The guilder was then caught up in the rush out of sterling. Although the guilder rate was bid up at first, the operation of the EC currency arrangements eventually resulted in a decline of the whole EC band vis-a-vis the dollar. As sterling weakened, it reached its support point against successive community currencies. By June 22, the guilder too was at the ceiling of the community band—now well below the Smithsonian upper limit against the dollar—and the Netherlands Bank was obliged to buy sterling with guilders. This additional supply of guilders tended to push the guilder rate still lower against the dollar, to 1.4 per cent below the ceiling at one point.

On June 23, following announcement of the floating of sterling, the Netherlands Bank along with other European central banks withdrew from the market. After the EC finance ministers' meeting on June 26, the Dutch joined others in reaffirming their commitment to the Smithsonian and EC arrangements. The Amsterdam market was officially reopened on Wednesday, June 28, with the guilder trading below its official ceiling. Over subsequent days, however, the dollar came under pressure in other continental markets and, with exchange controls in other countries deflecting funds away from those currencies, the guilder came into strong demand, obliging the Netherlands Bank to absorb substantial amounts of dollars. By July 7, stiff measures by the Swiss authorities had helped calm the European exchanges and the guilder edged away from its ceiling. The respite proved only temporary, as the prospective EC finance ministers' meeting on July 17–18 in London sparked new rumors of a possible joint float against the dollars that led to massive shifting out of dollars into most continental currencies. Along with other central banks, the Netherlands Bank had to absorb progressively larger amounts of dollars. In sum, from the time of the floating of sterling through July 17, the Netherlands Bank took in $543 million at the Smithsonian ceiling.

Demand pressures for continental currencies abated considerably when, during the course of the London meeting, the EC finance ministers reafirmed their determination to defend the Smithsonian Agreement, while focusing their discussion on longer-term issues of monetary reform. Also, on July 17, the Netherlands Bank announced additional measures to curtail capital imports, both through leads and lags in payments for merchandise trade and through intracorporate transfers by multinational firms. These steps helped calm the guilder market further, and the rate began to ease away from the upper limit. The Federal Reserve's reentry into the exchange market through offers of marks in New York on July 19 brought about an easing of the German mark against the dollar over the next few days, and the guilder rate too began to decline. Moreover, as the rate continued to soften through the end of July and into August, previous leads and lags on trade transactions began to be unwound. As a result of this decline, the spread between the guilder and the Belgian franc reached 1½ per cent. Under the terms of the Benelux agreement the Netherlands Bank was obliged to sell modest amounts of Belgian francs against guilders in order to prevent the spread from widening still further. By early September the guilder was trading below $0.3100 in a quiet market.

FRENCH FRANC

The French balance of payments had been in substantial surplus in 1971, and the franc had remained strong throughout the year. As part of the Smithsonian Agreement, the French Government agreed to keep the gold parity of the franc unchanged, thereby permitting the franc to appreciate relative to the dollar by 8.57 per cent. The new central rate for the franc was set at $0.1954–¾, with intervention limits set at 2–¼ per cent on either side. Although many of the exchange controls imposed in the second half of 1971 were eased or abolished following the Smithsonian Agreement, the French authorities maintained the basic structure of their two-tier exchange market. Under this system, which subsequently has been liberalized, the Bank of France defends the franc at the prescribed intervention points only in the official market (through which trade and most service transactions as well as governmental transactions are effected), while all capital transactions and some service transactions are strictly segregated in a financial market where the franc rate is allowed to find its own level.

Despite the strength of the franc during 1971, most market participants had not expected so large an appreciation of the franc against the dollar, and profit-taking brought the rate under heavy selling pressure as soon as the Paris exchange market was reopened on December 21. With leads and lags beginning to be unwound, the French authorities sold a considerable amount of dollars in the market as the spot franc edged downward almost to its new floor. Selling pressure on the franc let up in the last days of December and, as doubts began to develop in the markets over the durability of the Smithsonian Agreement, the franc rate early in 1972 started a long steady advance. The financial franc, in the meanwhile, had fallen below the official franc's floor on December 21 as speculative positions were unwound, but it subsequently converged with the official franc.

During the first quarter, the French current-account balance deteriorated. Furthermore, in January the French authorities took a number of steps to stimulate the domestic economy, including reductions by the Bank of France in its rates on discounts and secured advances of ½ percentage point to 6 per cent and 7-½ per cent, respectively. While the franc rate might have been expected to soften in consequence, there was simultaneously a general strengthening of European currencies against the dollar, and the spot franc quickly rose to a level only slightly below the central rate. In early February, an additional burst of demand, set off in part by open debate over measures to control short-term capital flows and rumors of growing official support in Europe for a joint EC flat, lifted the franc somewhat above the central rate. These speculative pressures continued through much of the month and, with the Bank of France on the sidelines, the rate rose steadily. At the same time, the financial franc was pushed up to a modest premium above the official rate.

The market atmosphere deteriorated further when, on March 3, French Finance Minister Giscard d'Estaing warned that the European response to continuing dollar inflows would be a further extension of exchange controls—perhaps at first on a piecemeal basis but later in concert. It was shortly thereafter that the EC finance ministers announced they would soon cut to 2-¼ per cent the maximum permissible spread among their currencies. In the general rush into all European currencies that followed, the commercial franc was pushed almost to its ceiling by March 9, and the financial franc, bid up not only by speculative pressures but also by heavy foreign purchases of French securities, surged almost 3 per cent above that level.

The flurry was short-lived, however, and the commercial franc quickly settled down to a rate well below its ceiling. The financial franc, although staying above the official ceiling, also eased. At first, the softening reflected a normal technical reaction to the preceding excessive sales of dollars. In mid-March, however, there was a perceptible improvement in market atmosphere following the regular central bank meeting in Basle, Switzerland, Secretary Connally's indication of willingness to discuss the forum for negotiations on international monetary reform, and President Pompidou's expression of optimism about the international monetary situation. Moreover, the French authorities acted at this time to ease domestice monetary conditions, cutting requirements against the banks' domestic demand and time deposits (the requirements against liabilities to nonresidents were, however, kept unchanged), reducing those longer-term interest rates directly controlled by the Ministry of Finance, and lowering the Bank of France's domestic money market intervention rates.

Further relaxations of monetary policy relieved buying pressure on the franc until late April. Then, heavy month-end conversions of export proceeds and, later, a temporary liquidity squeeze during the tax payment period exerted upward pressure on the franc, and the spot rate climbed close to its ceiling. Underlying liquidity conditions continued to ease, however, and, once month-end factors were out of the way, the franc traded quietly just below the upper intervention point until the end of May.

At that point the franc rose to its ceiling in response to an erroneous news report of Treasury Under Secretary Volcker's press conference on May 30. The pressure was especially heavy on June 2, when the Bank of France moved to restrain the growth of the French money supply by raising the reserve requirement against increases in bank credit from 2 per cent to 4 per cent. With interest rates in France already higher than in other major European countries, however, the authorities were confronted with a dilemma since they did not wish to draw in additional funds from abroad. Consequently, the Bank of France reduced its money market intervention rates on successive days to keep domestic interest rates below Euro-dollar yields. With each drop in the domestic intervention rates, the pressure in the exchange market subsided and the france temporarily edged below its ceiling. Meanwhile, the financial franc had advanced to a premium of over 3 per cent above the commercial rate, reflecting flows of funds into the French stock market and some switching of funds out of sterling.

The franc rate was again pushed hard against its ceiling in mid-June, when speculation against sterling began. As the flight from sterling gathered momentum, large-scale official intervention was required to keep sterling within 2¼ per cent of the franc. Both the Bank of France and the Bank of England had to intervene on a progressively heavier scale, supplying francs against sterling to an often hectic market. In the circumstances, the franc was pulled lower vis-a-vis the dollar until it reached \$0.1972½ by the morning of June 22, some 1.4 per cent below the ceiling.

With the announcement of the floating of the pound at the opening on June 23, the franc immediately rebounded to the ceiling. After absorbing a sizable amount of dollars, the Bank of France, in a joint move with the other EC central banks that were still dealing in the foreign exchanges that morning, ceased intervening and the Paris exchange market was closed. When the Bank of France reopened the exchange market on June 28, the franc hovered close to the ceiling, but the market was relatively quiet and there was little further official intervention. As a result of the inflows during June, French reserves rose by $921 million.

During the first half of July, strong speculative pressure began to build up against the dollar; with the franc rate hard against its upper limit, the Bank of France had to intervene almost every day, often in large amounts. The outcome of the EC finance ministers' meeting in London on July 17–18 had a calming effect on the market, however, and in line with the general firming of the dollar in mid-July the demand for francs eased to the point where official support tapered off. Nevertheless, the spot rate continued to bump up against the ceiling until news of the Federal Reserve's intervention in defense of the dollar on July 19 helped reduce pressure on the franc. Even then the franc continued firm by comparison with other continental currencies, as the French authorities maintained a relatively tight rein on domestic liquidity by raising the banks' minimum reserve requirements against both resident and nonresident liabilities by 2 percentage points, effective July 21. The franc remained close to the ceiling in early August, but a somewhat softer tone developed toward mid-month following market and press reports that the Federal Reserve bad been selling Belgian francs. Moreover the dollar was helped by subsequent news of improved second quarter U.S. balance of payments figures and reports of further U.S. efforts to find a settlement of the war in Vietnam.

The financial franc had been dropping more sharply, falling to a premium of less than 2½ per cent over the official franc's ceiling, as new issues of franc-dominated Euro-bond issues slackened during the vacation period and as conversions of franc bank notes sold abroad by French tourists swelled. Later in Augsut, both the commercial and financial franc rates firmed but trading remained orderly.

ITALIAN LIRA

Following the Smithsonian meeting, the Italian authorities established a central rate of $0.001719¾ for the lira, representing a 7.48 per cent appreciation against the dollar that was slightly less than the dollar's devaluation against gold. At the same time, they revoked the exchange control regulations introduced as of December 6, whereby the Italian banks had been instructed to refuse conversion of foreign currencies into lire unless the proceeds were required for normal trade or service transactions or for nonspeculative capital transactions backed by the appropriate documentation.

After the Italian exchange market was reopened on December 21, the spot rae soon settled near its new floor. A prolonged period of political uncertainty and the resultant delay in dealing with important social and economic problems generated some capital outflows. At the same time there were continuing prepayments of foreign loans. Consequently, even though the already large surplus in Italy's balance of payments on current account was expanding as the pace of domestic activity slowed, the spot rate held close to its lower limit through the second week in January. Then, with successive waves of speculation pushing many of the other EC currencies to their ceilings, the lira was pulled upward, eventually reaching some 1 per cent below its central rate where it traded through early March.

On March 7 the EC finance ministers announced their agreement in principle to narrow the margin of fluctuation between the Common Market countries' currencies to 2¼ per cent. With other EC currencies at or close to their ceilings, the market responded to this announcement by pushing the lira up into the proposed band. For some days the spot rate was, therefore, above the central rate. But the European markets soon turned quieter and, when the other EC currencies edged away from their upper limits, the lira—near the bottom of the 2¼ per cent band—dropped back to the central rate or just below, where it held through the end of the month.

A still softer tone developed in early April, especially when the Bank of Italy acted to help stimulate an upturn in economic activity by relaxing domestic credit conditions. Taking advantage of the tendency toward lower interest rates abroad, the bank cut its rates on discounts and secured advances by ½ percentage point to 4 per cent and 3½ per cent, respectively, effective April 10. (The additional 1½ percentage point penalty for banks making excessive use of central bank credit was, however, maintained.) Simultaneously, interest payments on balances held by commercial banks with the Bank of Italy were discontinued for deposits of more than 8 days, and were reduced from 1½ percent to 1 percent per annum for deposits of 8 days or less. The banks were thus induced to place excess funds in the market rather than with the central bank, and shortly thereafter they cut both their lending and deposit rates.

The spot lira rate declined until just before the EC currency arrangements limiting the maximum permissible spread between any two EC currencies were put into effect on April 24. At that point the spot rate firmed somewhat, fluctuating about 2 per cent below the strongest EC currency through the month-end. In early May, when the Belgian and French francs moved smartly higher, the lira held at the lower end of the band. But no official intervention was required to keep the lira within the band, as market arbitrage proved sufficient to do so in the absence of strong pressures. As other EC currencies rose during May, the lira rate was pulled higher and it hovered around the central rate until late May. Then, when formal consultation to form a new government in Italy were undertaken, the lira moved up to about 0.4 per cent above the central rate.

The accelerating attack on sterling that developed in mid-June brought with it heavy selling of lire and an abrupt shift in leads and lags against Italy. By June 22 the spot rate had been pushed to more than 1 per cent below the central rate. When the Italian exchange market remained closed on Friday, June 23, in the wake of the floating of the pound, reports circulated widely both in the market and in the Italian press that the lira would be devalued or that the Italian authorities were strongly considering withdrawing from the EC arrangements. In this atmosphere, the formation of a new Italian coalition government failed to allay the market's intense nervousness.

On June 26 the EC finance ministers, meeting in Luxembourg in the aftermath of sterling's float, confirmed their intention to maintain the EC arrangements and, to facilitate Italy's continued adherence to the scheme, permitted Italy to intervene for a 3-month period in dollars rather than in EC currencies to keep the lira within the EC band. (The EC arrangements normally permit intervention in dollars only when a currency is at its Smithsonian limits.) In addition, the Italian authorities took several other measures in an attempt to tighten control over foreign currency movements. They prohibited the crediting of lira notes to foreign accounts, thereby shutting down the export of capital through bank note conversion. They authorized the banks to assume net foreign liability positions rather than, as before, requiring balanced positions. And, finally, they reopened the door to nonbank borrowings abroad.

Fortified with these measures, the Italian authorities reopened the exchange market on June 28. The lira opened the day well outside the 2¼ per cent EC band, and sizable intervention was required to bring the lira back into the band at around its central rate. Despite this support, pressure on the lira continued as leads and lags remained adverse and Italian residents continued to repay their foreign borrowings. Consequently, the Italian authorities had to intervene in support of the lira well into July.

To help offset the cost of official reserves of this foreign exchange market intervention, the Italian Exchange Office required any bank that developed a net foreign asset position to use the surplus foreign exchange to repay outstanding dollar swaps with it, while public enterprises were encouraged to tap the Euro-dollar market for large amounts. By mid-July, Italian banks were repatriating funds on a large scale, state-owned entities were converting considerable amounts taken up in the international market, and tourist receipts were starting to build up. Consequently, pressure on the spot rate subsided, and the lira held just around its central rate through the rest of the month. Some of the foreign exchange inflows were added to official reserves, keeping the total reserve cost of the Italian support operations in June and July to around $100 million. This improved atmosphere continued through August, although the lira eased somewhat along with other European currencies as the dollar strengthened.

JAPANESE YEN

For several years prior to 1971, Japan had recorded progressively larger balance of payments surpluses, marked both by a burgeoning trade surplus and by increasingly heavy private capital inflows. As foreign exchange reserves mounted, the Government had moved to impede or offset the inflows of funds by tightening exchange controls, by promoting a shift in the financing of Japanese imports from foreign to domestic sources, by liberalizing some of the controls on imports and on capital outflows, and by depositing some officially held dollars with commercial banks.

While these measures had helped to relieve some of the immediate pressure, the markets became increasingly convinced that the yen was seriously undervalued. Therefore, when the U.S. Government suspended convertibility of the dollar in August 1971, there was a massive rush into yen that ultimately forced the Japanese Government to float its currency later that month. Over the following months, the yen rose sharply in the exchange market. But the authorities, concerned that a rapid run-up in the yen rate might impede the hoped-for recovery in the domestic economy, intervened heavily to moderate the advance.

Under the terms of the Smithsonian Agreement, the central rate for the yen was established at $0.003246¾, an effective appreciation of 16.88 per cent against the dollar. The Japanese authorities, in line with actions taken by other countries, immediately abolished some of the severe measures imposed earlier to block the inflow of funds. Then on January 5, with the yen settling near its floor and some reflows developing, the Government announced a further relaxation of exchange controls, eliminating among other things the requirement of prior official approval for any prepayment of Japanese exports. Not all of the control apparatus was dismantled, however, and certain measures limiting the foreign positions of Japanese banks were retained. Over the next 2 days a bunching-up of export prepayments gave rise to a burst of demand for yen, and the Bank of Japan absorbed a sizable amount of dollars, but the market then turned quieter.

By late January the exchange markets had become increasingly jittery. Most major foreign currencies began to rise sharply against the dollar, reflecting uncertainty over the viability of the Smithsonian Agreement and concern over declining interest rates in the United States. The yen, in particular, was in strong demand as the December 18 appreciation was seen by some as insufficient, given the size of the adjustment needed to bring the Japanese payments accounts into balance. Even with the Bank of Japan intervening to slow the advance, the yen almost reached its upper limit by February 24.

In view of this renewed show of strength for the yen, the authorities resumed their efforts to encourage the financing of Japanese trade out of Japanese reserves rather than with foreign credits, and the yen eased. The Ministry of Finance began to make deposits, totaling $200 million in February and $100 million in March, with the Japanese exchange banks to induce those banks to reduce their borrowings for U.S. banks. Deposits with the banks to facilitate the provision of export cover had been initiated in June 1971, and these new deposits raised the total amount transferred out of official reserves to $1.5 billion.

Then late in March, the Bank of Japan announced that, as an additional step to curb official reserve growth, it would increase its share of the financing of the country's imports from 30 per cent to 50 per cent over the 4-month period beginning in April; credits already extended by the central bank under this program totaled some $1.3 billion at that time. Despite these programs, however, Japan's official reserves rose by $1.2 billion during the first quarter, exclusive of the 1972 allocation of SDR's.

Early in April, the authorities decided to stimulate some demand for dollars by requiring repayment at maturity of a series of special dollar deposits made the previons fall in connection with provision of forward cover for small and medium-sized Japanese enterprises. Since the banks did not have the dollars available, they were forced to come into the market as buyers of dollars to repay the maturing deposits. Shortly thereafter, Japanese seamen began a prolonged strike, and subsequent work disruptions at the docks and in other industrial sectors curtailed Japanese exports for some time. As a consequence of these developments, the yen declined over much of April and remained easy in early May. By mid-May, the yen dropped to as low as $0.003282, and the Bank of Japan sold dollars to steady the market.

On May 23 the Bank of Japan announced that, as of June 1, the 1.5 per cent minimum reserve requirement against the foreign exchange banks' free-yen liabilities to foreigners would be replaced by a 25 per cent marginal requirement on increases in such liabilities. Also that day, the Japanese cabinet gave approval to a multi-faceted plan to stimulate domestic business activity and, at the same time, bring Japan's external accounts into better balance. The exchange market did not believe these measures would bring any early change in the basic situation, however, and the spot rate held steady through early June.

With the attack on sterling, the entire Smithsonian alignment appeared threatened and the yen was bid sharply upward. Following the floating of the pound, the Bank of Japan closed its exchange market while also announcing a reduction in its discount rate by ½ percentage point, to 4¼ per cent. Then, in an attempt to isolate the Tokyo market from a new round of short-term inflows, the central bank doubled the reserve requirement for free-yen accounts to 50 per cent and strengthened the regulations against advance payments of Japanese exports. When the Japanese market reopened on June 29, the Bank of Japan had to absorb substantial amounts of dollars through the end of June to hold the spot rate at the ceiling.

These inflows and the continuing basic payments surplus were more than fully offset by the various measures taken to push dollars out of reserves. By the end of June the special deposits with the banks, which had been increased in several stages, amounted to $1.9 billion, and the Bank of Japan's share in import financing amounted to some $2.3 billion. During the entire second quarter the Japanese authorities succeeded in pushing some $1.4 billion out of reserves through special operations, bringing about a reduction in reserves of $820 million for the quarter.

In early July, the exchange markets remained in the grip of uncertainties over the future of the Smithsonian Agreement, and with the yen at its ceiling, the Bank of Japan was obliged to intervene heavily. Although most European currencies eventually edged away from their dollar ceilings, particularly after the July 17–18 London meeting of EC finance ministers and the July 19 exchange market initiative by the Federal Reserve, the Japanese yen remained at its upper limit in Tokyo. Demand remained heavy as a result of the continuing large export surplus and renewed inflows to the Japanese stock market. The Bank of Japan, therefore, had to take in dollars almost daily, and sometimes in fairly substantial amounts, during July and August.

CANADIAN DOLLAR

As other major currencies rose strongly against the U.S. dollar late last year, there was also occasional upward pressure on the Canadian dollar. Heavy buying of Canadian dollars did not develop, however, until the conclusion in early December of the Group of Ten meeting in Rome. Thereafter, the Canadian dollar was pushed as high as $1.00½, and it remained strong until the Smithsonian meeting of the Group of Ten on December 17–18.

The communique at the conclusion of the Washington meeting noted that "Canada intends temporarily to maintain a floating exchange rate without intervention except as required to maintain orderly conditions." The Canadian dollar immediately rose to nearly $1.00¾, but expectations of a further appreciation dissipated rapidly, and the spot rate dropped back to below the $1.00 level in late December. After easing further early in January, the Canadian dollar settled at around $0.99½ by the middle of that month.

With the domestic economy expanding rapidly, the Canadian current account had slipped into deficit in late 1971 and the deficit increased in early 1972. Nevertheless, a step-up in loan demand in Canada put pressure on bank liquidity and in February interest rates began to rise, attracting funds from abroad. This influx of short-term capital, combined with continuing longer-term Canadian borrowings tended to offset the current-account deficit, and the Canadian dollar held relatively steady in the exchanges through late February.

At that point, substantial new Canadian wheat sales to the Soviet Union were announced, leading to a bullish reaction in the market. The spot rate for the Canadian dollar began to advance, and with rising interest rates in Canada still drawing funds from abroad, the rate soon rose above $1.00 once again. As it has done throughout the period of the floating rate, the Bank of Canada intervened intermittently on both sides of the market to moderate fluctuations in the rate, and with the Canadian dollar rising on balance, Canadian official reserves rose by $189 million over the first 3 months of the year.

During the second quarter the Canadian dollar came into strong, persistent demand. On occasion, this demand reflected the general uncertainties that were having such profound effect on other currency markets. Nevertheless, the growing strength of the Canadian dollar throughout the spring was more clearly traceable to developments in Canada's own payments position. Canada's current account improved sharply during the second quarter, with a swing of some $400 million away from the exceptional deficit of the first quarter. Moreover, the Canadian provincial governments and public utilities borrowed heavily abroad through bond issues, particularly in May. In addition, domestic credit conditions in Canada continued to tighten, and the chartered banks moved aggressively to attract funds. The consequent heavy demand for Canadian dollars drove the spot rate up by more than 2 cents from late April through early June, to about $1.02¼.

At that point, the squeeze for balances in Canada became acute, and the chartered banks, facing heavy loan demand but under pressure not to raise their prime rates above 6 per cent, had begun to offer certificates of deposit (CD's at yields of as much as 6½ per cent). This naturally drew in still more funds, pushing the Canadian dollar to almost $1.02¾. The Canadian authorities then moved to forestall a further rise in the exchange rate by prevailing upon the chartered banks to cut back their rates on CD's, effective June 12. Subsequently, other Canadian money market yields also dropped back, as loan demand eased somewhat. The Canadian dollar began to ease in the exchanges, reaching $1.01½ by the end of June. Over the second quarter as a whole, official intervention in a market that was rising on balance resulted in a substantial net reserve gain, $328 million.

Trading turned much quieter in July, and the Canadian dollar held fairly steady between $1.01½ and $1.01¾ throughout the month. With the onset of seasonal strength, a somewhat firmer tone emerged in August and the spot rate edged slightly higher.

EURO-DOLLAR

On the whole, Euro-dollar rates have been relatively stable since early 1972, although for brief periods speculative flurries and exchange market uncertainties have exerted upward pressure on the rate level. In sharp contrast to the extremely wide rate fluctuations during the preceding year, the weekly average of daily rates for the 3-month maturity remained within a relatively narrow range.

On the demand side the market has come increasingly under the influence of a wide variety of administrative restraints imposed by European governments and central banks over the past year. In several countries, access by corporations to the market has been severely curtailed in order to restrain further accretions to official dollar reserves. In Germany, in partciular, corporate borrowings in the Euro-dollar market were limited by fears of the impending imposition of compulsory cash-deposit requirements for nonfinancial enterprises, even before the actual implementation of the *Bardepot* on March 1. In addition, in many countries various barriers have been erected that prevent banks from converting Euro-dollar borrowings into local currencies, and these and other impediments to Euro-dollar borrowings were reinforced during periods of pressure on the dollar early this year and again following the currency crisis in June.

As a result of these constraints and of the decline in interest rates in European domestic loan markets, the demand for Euro-dollars in major European countries tended to be weak during most of the spring and summer. However, the contraction of demand from traditional sources was largely offset by a sharp rise of borrowings, mostly for distant maturities, by public and semipublic institutions in developing countries. Much of this expansion of loans to non-European borrowers reflected the aggressive efforts of major European banks that were flush with funds to find new takers for Euro-dollar loans. Eastern European countries also took advantage of the ample supply of Euro-dollar loans.

These various borrowings tended to cushion rate pressures arising from the disappearance from the market of some major Euro-dollar borrowers. Nevertheless, for protracted periods, notably during the April-June period, overnight Euro-dollar rates remained substantially below the Federal funds rate, providing some of the New York agencies and branches of foreign banks with opportunities for arbitraging between the two markets. Some U.S. banks also took advantage of the relatively attractive rates to borrow overnight Euro-dollars.

On the supply side, both U.S. residents and non-U.S. holders of dollars found the market increasingly attractive during the early months of the year, when short-term interest rates in the United States dropped much more sharply than 3-month Euro-dollar rates. Supplies from European official sources were held back as a result of the June 1971 agreement of the central banks of the Group of Ten countries not to place additional dollar balances in the market; however, supplies from non-European officials sources expanded further, as monetary reserves of many countries continued to rise. The relative attraction of the market to European commercial banks also increased, as the relaxation of monetary policy by several Western European countries during the January-April period reinforces a general trend toward lower interest rates.

Against this background, Euro-dollar interest rates tended to move downward in sympathy with U.S. domestic interest rates early in the year. Then, rates began to rise sharply in a belated response to the turnaround in U.S. interest rates in late February. This rise proved short-lived, however; when the usual quarter-end pressures failed to materialize and domestic European money market rates declined further, rates on all Euro-dollar maturities began to drift lower again.

In April, with U.S. interest rates moving up and with Euro-dollar rates remaining under pressure, the differential between the 3-month Euro-dollar rate and that for U.S. CD's narrowed appreciably. The spread between the two rates had been in excess of 2 per cent in the middle of January; it fell to less than 1 per cent in April. During the remainder of the spring, conditions in the Euro-dollar market were generally more comfortable. Thus, by early June the Euro-dollar/CD spread had narrowed further to only 40 basis points.

The run on sterling, which had developed in mid-June, at first had little direct impact on the Euro-dollar market. As sterling weakened, the central banks of the European Community intervened in the market by selling their own currencies. Several European currencies dropped to levels that the market considered unsustainably low in dollar terms. As a result, these currencies were bought heavily with dollars. The financing of these purchases brought about a new demand for Euro-dollars that, coupled with some midyear demand, pushed rates up once again.

On June 23, the day the British authorities yielded to the intense market pressure and allowed the pound to float, the 3-month rate rose as high as 6 per cent and 7-day Euro-dollars reached a peak of 7 per cent. Then, with the passing of the immediate effects of the speculative buying of continental European currencies and of the midyear pressures, the rates on most Euro-dollar maturities eased somewhat. However, the Euro-dollar market remained susceptible to the anxieties of the foreign exchange market, and during the period of heavy pressure on the dollar in the exchanges in early July there were periodic scrambles for funds to cover short positions.

When the exchange markets turned calmer after mid-July following the resumption of Federal Reserve operations in defense of the dollar, Euro-dollar rates began to edge downward. After a brief squeeze at the month-end, the market stabilized in early August, with the 3-month rate fluctuating narrowly around 5½ per cent per annum. The tone of the market was nevertheless fairly firm, as U.S. short-term rates tended to rise and some new demands came into the market. In particular, Italian public corporations resumed their borrowings of Euro-dollars in response to official encouragement, and the squeeze for sterling balances in London also tended to draw funds out of Euro-dollars.

Mr. BURNS. Let me call your attention now to a few salient facts concerning the swap facility—that is, the network of reciprocal currency arrangements that the Federal Reserve maintains with foreign central banks. This facility encompasses 14 central banks and also the Bank for International Settlements. The total amount that the Federal Reserve can draw on these institutions under outstanding arrangements is $11,730 million. By August 15, 1971, the amount actually drawn—that is, the Federal Reserve's debt to foreign institutions—had reached a peak of $3,045 million. Since then, substantial repayments have taken place, and the outstanding debt stood at $1,770 million on September 8 of this year.

Although profit considerations have never been the primary factor in the swap transactions, the Federal Reserve may either earn a profit or incur a loss in the course of using the swaps. A swap drawing by the Federal Reserve entails an obligation to deliver a specified amount of foreign currency at a future date. If the Federal Reserve acquires the currency needed for repayment of the swap at a dollar price that is lower than the price at which it was initially sold, a profit is made on the two transactions taken together. A loss results in the reverse case when the foreign currency appreciates between the time of the drawing and the time it is paid off and the required amount of foreign currency is, therefore, purchased at a higher price.

As already noted, the Federal Reserve's outstanding swap commitments on August 15, 1971, amounted to $3,045 million. Inasmuch as the dollar prices of the affected currencies—namely, Swiss francs, Belgian francs, pounds sterling, and German marks—have risen since then, the Federal Reserve has already incurred or will probably need to incur losses in liquidating these drawings. The total loss is presently estimated at about $160 million.

Two related facts have a vital bearing on this loss figure. First, from the inception of the swap network in 1962 until August 15, 1971, the Federal Reserve had a cumulative profit on its foreign exchange transactions of $25.6 million.

The second and more basic fact is that the expected Federal Reserve loss on foreign currency transactions undertaken prior to August 1971, is offset by the Treasury's incremental profit on gold account. Prior to the suspension of convertibility on August 15, 1971, foreign central banks taking in dollars could, under the Bretton Woods Agreement, convert such dollars into gold or other reserve assets. The swap transactions that were carried out in 1971 and earlier years served to defer or to reduce declines in reserve assets that would otherwise have occurred. Since gold was revalued in May of this year, the Treasury has profited substantially from the revaluation of the additional amount of gold that it now holds precisely because foreign central banks were willing to accept Federal Reserve swap drawings instead of demanding reserve assets from the Treasury.

All along, the primary purpose of the swap facilities that I have been discussing has been to serve at a first line of defense against disruptive speculation in exchange markets. Future foreign exchange operations by the Federal Reserve will continue to be guided by this objective. As in the past, operations in the currency of a particular country will be conducted only after full consultation with the central bank of that country.

In the new phase of operations, however, we shall not be confronted with the necessity of drawing on swap lines as an alternative to conversion by foreign central banks of dollars into gold or other reserve assets. In the new operations, market intervention will be on the Federal Reserve's initiative. It will be undertaken only to prevent or counteract disorderly market conditions and will be in such amounts and at such times as are judged likely to have a favorable market impact. Swap drawings will not be made for the purpose of providing medium or longer term financing of the U.S. payments deficit. Nor will they be used as a substitute for needed adjustments in basic economic policies.

Let me turn next to a brief discussion of recent balance-of-payments developments. The world payments situation continues to be plagued by large imbalances, despite the fact that the Smithsonian exchange rates are more appropriate than those that prevailed before August 1971.

The U.S. deficit on current account and long-term capital transactions—sometimes called the "basic" deficit—has continued to be disconcertingly large, reaching an annual rate of nearly $11 billion in the first half of this year. Meanwhile, other countries have been experiencing large payments surpluses—not only Japan and some industrial countries in Europe, but also many of the nonindustrial countries.

We knew, of course, at the time of the Smithsonian agreement that it would probably take 2 or 3 years for exchange rate adjustments to work out their full remedial effects. We also knew that business recovery in Europe and Japan was lagging behind the recovery of the United States, and that this divergence of business-cycle phasing would of itself delay restoration of equilibrium in our balance of payments. Under the circumstances, it would be entirely premature to reach a pessimistic conclusion about the longer run outlook for our international transactions. It should, however, be noted that the needed adjustments of payments imbalances, particularly in our merchandise trade, are taking place more slowly than had been hoped or anticipated.

One need not be a great optimist to argue that several forces are at last working in the direction of bringing about significant improvement in the overall balance of our international payments. These include, first and foremost, the better performance of costs and prices in this country during the past year than in other industrial countries; second, the impact of the exchange rate changes of last December, which in time should appreciably moderate the growth of our imports while stimulatig the expansion of exports; third, the cyclical recovery now under way in Japan and Europe, which should increase the demand for our exports; and fourth, the strong expansion of our domestic economy, which should—besides helping to attract foreign capital to this country—make American investors more willing to put their dollars to work at home rather than abroad.

Still another encouraging fact is the growing awareness—emphasized in the recent IMF report on international monetary reform—that the status of international payments imbalances requires continuing review by both deficit and surplus countries.

Finally, I want to comment briefly on the prospects for international monetary reform. The governments represented at the Smithsonian conference recognized that the agreement they had reached represented only the first step in rebuilding monetary order. Although the Smithsonian meeting—and conversations since that time—have set the stage for realistic international negotiations, they have done no more than that. The uneasiness and turmoil that have characterized exchange markets in recent months, the violent movements of short-term capital from one currency into another, the new capital controls which various governments established in reacting to these movements, the floating of the British pound—all these indicate the urgent need for early rebuilding of the international monetary system.

Fortunately, it now appears that substantive negotiations will get underway promptly. The committee of 20 in the International Monetary Fund will begin to function at the Fund-Bank meetings the week after next. The Deputies of the Committee of 20 should be able to meet frequently thereafter, canvass different approaches, and seek diligently to narrow the differences of view that presently prevail among national governments.

Many important issues will have to be resolved in the forthcoming negotiations. They include questions about the future monetary role of gold—a subject in which this subcommittee has indicated a special interest and on which Under Secretary Volcker testified earlier in the week. In general, I agree with the views that he has expressed. More specifically, I believe that the monetary role of gold will continue to diminish in the years ahead, while there will be a continuing increase in the importance of SDR's.

In discussing international monetary reform, we should guard against the tendency to be preoccupied with gold. Other issues deserve the greater part of our attention. Let me note some of them.

Ways need to be found, first of all, to assure a more prompt adjustment of payments imbalances than characterized the practical workings of the Bretton Woods system. Discussion of this objective and the means to attain it will in turn necessitate a thoroughgoing reexamination of the provisions of the IMF articles of agreement dealing with par values and exchange-rate flexibility.

Under the monetary system that prevailed before August 1971, there was a tendency to equate deficits with sin and surpluses with virtue. Moral as well as financial pressures were certainly much greater on deficit countries to reduce their deficits than on surplus countries to reduce surpluses. In fact, however, responsibility for payments imbalances can seldom be assigned unambiguously to individual countries. Moreover, the adjustment process is unlikely to work efficiently if surplus countries fail to participate actively in it. New means will, therefore, need to be devised for achieving a better division of responsibilities among surplus and deficit countries for initiating the correction of payments imbalances.

A number of vital issues will arise in connection with the convertibility of the dollar and future procedures for the settlement of payments imbalances. Decisions will need to be reached on the role of various reserve assets—not only gold, but also SDR's and reserve currencies. Major changes may be called for in the procedures governing the creation, allocation, and use of SDR's. Understandings will have to be reached about the desirability and feasibility of imposing limitations on the use of reserve currencies. Various proposals for the consolidation of reserve assets—among them, the substitution for SDR's for reserve currencies or gold—may need to be examined.

Moreover, since restrictive trading practices are a major factor influencing the balance-of-payments position of individual countries, it would be neither possible nor desirable to exclude the subject of trading arangements from the forthcoming negotiations. As a specific example, some consideration will have to be given to ways of amending trade restrictions that impede payments adjustment when exchange rates are altered.

Still other issues will come up, particularly those bearing on volatile capital movements, the transition from our present interim arrangements to the new reformed system, and the organizational structure of the IMF.

There are bound to be significant differences in national views on the issues I have mentioned, and practical difficulties will intrude as efforts are made to resolve the differences. Nevertheless, we can be moderately optimistic about the outlook. All countries have a strong interest in devising new rules to govern international monetary arrangements. Disagreements among nations exists, but they can be resolved once their representatives get down to the serious business of discussing them in a constructive and cooperative spirit.

The task confronting the conferees will be rendered more manageable if the major industrial countries, particularly the United States, meanwhile practice strict financial discipline. Indeed, I doubt if a viable international monetary system can be rebuilt without better control over inflation than we have as yet achieved. Fortunately, this need is increasingly understood in our country.

I look ahead to an extended period of challenging and rewarding negotiations on monetary and related trade issues. At the end of this process, we should have the foundations of a new and stronger international economic order.

Chairman REUSS. Thank you very much, Mr. Burns, for a most constructive presentation.

I have a number of questions, many of them suggested by your testimony.

On these swap agreements with various countries, are those written documents? Or are they oral?

Mr. BURNS. They are partly oral, partly written. There is an exchange of telegrams, I am quite sure, and there are informal conversations besides. These informal conversations are continuous between the central banks involved.

Chairman REUSS. Without asking for the whole chronology, would you, when you review your testimony, submit for the record the written documentation on, not necessarily all of the swap arrangements, but a representative of one of them so that we can, here on the committee, look at the words of it?

Mr. BURNS. I will be glad to do that, Mr. Chairman.

(The following information was subsequently supplied for the record:)

FEDERAL RESERVE SWAP ARRANGEMENT WITH THE DANMARKS NATIONALBANK

Cable message as follows:
To: Danmarks Nationalbank, Copenhagen.
From: Federal Reserve Bank of New York.

(*a*) Federal Reserve proposes a 12-month Danish krone/USdollar swap arrangement for $200,000,000 to be available on a stand-by basis from December 1, 1971 to December 1, 1972 subject to use by either party on two business days' notice. This arrangement may be renewed for further periods by mutual agreement.

(*b*) Drawings under the arrangement may be used in execution of spot and forward transactions concluded in consultation with the other party. Each drawing will have an initial maturity of three months, subject to renewal upon mutual agreement, and will be liquidated at or before maturity at the same rate of exchange as was applied to the respective spot transactions. Unless otherwise agreed, the rate of exchange to be applied to the drawing will be the spot rate in the market of the drawee two business days before the value date of the drawing.

(*c*) Proceeds of drawings will be employed as follows:

(1) The United States dollars are to be credited to an account designated "Danmarks Nationalbank Account A". It is understood that you may place the US dollars in whole or in part in a nontransferable certificate of indebtedness which the Secretary of the Treasury is prepared to issue to you, at par, to mature three months after date of issue. The certificate will be redeemable upon two business days' notice. It will bear interest at a rate based upon the average rate of discount at the auction of the last issue of three months US Treasury bills preceding the date of issue of the certificate. The rate will be quoted with two decimals. If the decimals are not a multiple of .05, they will be adjusted to the next higher multiple of .05. The certificate will be issued and redeemed at the Federal Reserve Bank of New

York, as fiscal agent of the United States, and will be held in a security custody account to be designated by you.

(2) The Danish kroner are to be credited to account "Federal Reserve Bank of New York Account A" under cable advice. It is understood that balances in this account will earn a return which is equal to a rate of interest based upon the average rate of discount at the auction of the last issue of US Treasury bills, as noted above. Such balances can be withdrawn by us upon two business days' notice.

(*d*) To protect each party against the remote risk of a revaluation of the other's currency we suggest the following procedure: we place with you a standing order to be executed when necessary for that purpose to purchase for our account kroner against dollars in an amount sufficient to replenish any earlier drafts upon our krone balance created by the swap. We shall accept from you a similar standing order to be executed when necessary for that purpose to purchase US dollars against kroner in order to replenish any earlier drafts upon your dollar balance created by the swap.

Chairman Reuss. You have testified that as a result of the events leading up to August 15, 1971, the Federal Reserve incurred a loss estimated at about $160 million. What was the total loss incurred by the Treasury as a result of its pre-August 15 operations? As opposed to the Federal Reserve.

Mr. Burns. I think the Treasury made a net profit.

Chairman Reuss. Leave aside the gold. If we did not have gold in the system that profit probably would not have been made. My impression is that their loss was about like yours and that together it was on the order of $300 million.

Mr. Burns. The Treasury did not engage in swap transactions.

Chairman Reuss. No; but the Exchange Stabilization fund was trying to support the dollar, I believe.

Mr. Burns. Yes. There was some loss by the Treasury. I do not remember the precise figure. I will be glad to supply it for the record. I am quite sure it was not large.

(The following information was subsequently supplied for the record:)

According to figures submitted by the Treasury Department to the House Committee on Banking and Currency (Background Material on Legislation Modifying the Par Value of the Dollar, February 15, 1972, p. 8) the Exchange Stabilization Fund (ESF) will have a loss, reflecting its liability for purchasing the additional foreign currencies to pay off U.S. foreign currency-denominated securities; this loss is estimated at $172 million.

In addition, the ESF gained $27 million from revaluation of its foreign exchange holdings. Thus, the net loss of the ESF is $145 million.

Chairman Reuss. If somebody loses, somebody gains, and I suppose the people who made off with the $160 million you lost, and the however many million it was the Treasury lost, are people who were betting against the dollar on those days leading up to August 15. If one does not like them, one calls them speculators. If one does, one has nicer words for them. That is what happens, is it not? Is that not the process?

Mr. Burns. Broadly speaking, I am not sure that can accept the general proposition that what one gains, the other loses. For example, in the case of the stock market, you buy a security and then you sell it to me and you make a profit. I sell it to Mr. Smith and I make a profit, and he sells it to Mr. Jones and he makes a profit. For a time we can have a merry-go-round and nobody loses.

Chairman REUSS. Well, unfortunately the August 15 merry-go-round ended with the taxpayers of the country losing several hundred million dollars.

Mr. BURNS. No, I do not believe that is true. I have reviewed for you the Federal Reserve's part and on the Federal Reserve's part there was a profit all around. Now——

Chairman REUSS. Excuse me. How is that? Are you counting in that gold revaluation?

Mr. BURNS. I have to count it.

Chairman REUSS. Well, I wish you would not. It really does not relate to—that just happens to be the Bretton Woods——

Mr. BURNS. I wish this whole business did not exist but it is there. We have got to consider it. Why were these swap transactions undertaken? The swap transactions were undertaken as a substitute for a demand for gold on the part of foreign central banks.

Chairman REUSS. Would a better substitute have been to close the gold window when it became apparent, as it now turns out it was to Treasury officials, at least, that the dollar was overvalued? Most of this—most of these hundreds of millions were lost on just a few days in August.

Mr. BURNS. No. There are not hundreds of millions involved. If we had closed the exchange window a week earlier, it is true that the loss would not have been what is now estimated at $160 million. It would have been significantly less. That is true. But you must recognize that it takes time even for very well-informed people to arrive at a judgment. With the benefit of hindsight, it perhaps would have been better to close the gold window a few days sooner. But the closing of the gold window was a part of a very comprehensive set of governmental decisions. It was the President's judgment that these decisions were best taken together, and I think that events have justified that judgment.

Chairman REUSS. Well, my purpose is not to suggest that anyone ought to restore the $160 million to the Treasury. That is water over the dam——

Mr. BURNS. No. I want to——

Chairman REUSS (continuing). As far as the Federal Reserve corporate picture.

Mr. BURNS. No. I must interrupt. The Treasury has not lost a penny on account of the swap transactions. On the contrary, the Treasury has made a good profit on balance because of the swap transactions. My statement on all this is actually an understatement. I have said nothing about the interest that we earned because of the swaps. I could tell you a dramatic story financially, but I prefer understatement. Precisely because of that, I must guard against the possibility of overstatement, even arising from a dialog with such an authority as you, Mr. Reuss, whom I respect greatly.

Chairman REUSS. I bring up the matter of the hundreds of millions, which failure to close the gold window caused, not so much to rake up the past but because this subcommittee desires to try to work out a clear understanding with you, as we did with Mr. Volcker the other day, on just when intervention will take place. Mr. Volcker in his testimony, was quite clear that the Treasury would not wittingly do another pre-August 15. He said, and I am quoting:

> We have not embarked on any effort to artificially prop up the dollar counter to any basic balance of payments trend in the longer run.

I think from reading your statement that that is also your view and the view of the Federal Reserve. Certainly, I found your July 1972, activities impeccable and applauded them; $31 million to quiet the market, which was disturbed largely by the sterling float, was an extremely good bet, it seemed to me.

Mr. BURNS. Incidentally, we made a profit on those transactions.

Chairman REUSS. Right. But what we want to be assured of is that under your administration or under anybody else's administration, if the time ever comes when the dollar is again in fundamental disequilibrium as it was last August 15, we do not get into the business of intervening massively to defend it. This is something that happens too frequently. While nobody can guarantee that he will be able to identify a basic disequilibrium and distinguish it from temporary disturbances, there certainly are two piles into which you can sort these phenomena and do your best to sort them properly. So I would ask you whether you would agree with what Mr. Volcker has said. Can you assure me that the Federal Reserve, just like the Treasury, does not intend, if it knows what it is doing, to spend good money supporting an unrealistic exchange rate?

Mr. BURNS. I give you that assurance without any qualification whatever.

Chairman REUSS. Good, and I will not complain about the $160 million.

As I understand it, sometimes the New York Federal Reserve Bank intervenes in exchange markets on behalf of the Open Market Committee and sometimes on behalf of the Treasury's Exchange Stabilization fund.

Mr. BURNS. That is correct.

Chairman REUSS. Is there any difference in the statutory obligations or the powers of the Open Market Committee and the Exchange Stabilization Fund as regards intervention in foreign exchange markets? Generally, how is the burden shared as between the Federal Reserve and the Treasury?

Mr. BURNS. The resources of the Exchange Stabilization Fund are very limited and, therefore, the foreign currency transactions that can be conducted for the Treasury are on a very limited scale. The Federal Reserve has larger financial ability to carry out these transactions and, therefore, if anything is to be done on a massive scale under present circumstances, the Federal Reserve has to do it. But, of course, we also work in these matters hand in hand with the Treasury.

Chairman REUSS. It is clearly established in the law or the precedents who is boss in these matters? Is the Federal Reserve included? Is the case the same as with internal monetary policy, independent but cooperative?

Mr. BURNS. As a matter of law, I think the answer is in the affirmative. As a matter of practice, we work together and we would never undertake a foreign currency transaction which the Treasury opposed. We have never done it, to the best of my knowledge. Certainly not during my period.

Chairman REUSS. In its annual report issued a few days ago the International Monetary Fund suggested that increasing domestic short-term interest rates might be a useful means of strengthening the United States balance of payments. In discussing this the other day with Mr. Volcker, I suggested that if this advice meant that our American monetary authorities were being asked to depart from an internal monetary policy designed to bring about full employment without inflation, that this was not good advice and should not be followed. He more or less, I think, agreed that domestic considerations should be paramount.

How would you view it? Have you seen that report yet?

Mr. BURNS. Yes, I have seen it. I have not studied it as I should. As you know, Mr. Chairman, we get advice from many people and we value the advice that we get. Then we do what we think is right. The Federal Reserve seeks to have interest rates in this country as low as they can reasonably be because of its great concern and responsibility with regard to the Nation's economic activity.

We in the Federal Reserve System subscribe fully to the Employment Act of 1946. We recognize our obligation under it, and we are not going to take measures to increase unemployment or to reduce employment if we can possibly help it. Therefore, while we appreciate the counsel by the International Monetary Fund, we will do what we think is right. We are not inclined, certainly at present, to take the advice of the Monetary Fund.

Chairman REUSS. In that connection, running down the various monetary indicators for the last 3 months, June, July, and August, I read your monetary activities as having produced extremely healthy growth rates in money—growth rates generally above the band suggested by this Joint Economic Committee. Specifically, narrowly defined money supply M–1, demand deposits and currency outside banks, have increased during that 3-month period at an average annual rate of 9.2 percent M–2, which is M–1 plus savings accounts, has increased by 10.5 percent. And reserves available to support private nonbank deposits have increased by 8.4 percent.

Would you agree that these are beyond the upper limit that you would like to see and that at some point you would hope to get them lower than that so you get within or closer to the band?

Mr. BURNS. I agree fully. Our control over the money supply over brief periods is limited. If you take a longer span, compare August 1972, with August 1971, you find that the narrowly defined money supply grew at an annual rate of 5½ percent. The rate of growth, as you point out, of the money supply and other monetary aggregates within the past 3 months has been on the high side, but please do not take that as an indication of Federal Reserve intentions. I think if you take a longer stretch you will find that the rate of growth will appear to be democratic, as it should be.

Chairman REUSS. If and when this happens in the months to come; that is, a less dramatic upward rate of growth than that in the last quarter, won't this happen at a time of rather high Treasury borrowing needs later this year and early next year? Don't we therefore face the possibility of a credit crunch and sharply rising interest rates?

Mr. BURNS. Well, the possibility is always there. My job is to try to prevent it and I think we will probably succeed. We can avoid over a longer span the high rate of growth we have had in the last few months without producing a credit crunch. I do not think the Federal Reserve ought to produce a credit crunch.

Now, circumstances may arise when one becomes unavoidable. I do not foresee any such thing, not at all.

Chairman REUSS. Well, I would bet on you to do as much as any man, I think, to avoid it, but I do have trouble with the three facts we are dealing with. One, extremely large increases in the money supply, however defined, in the last 3 months; two, despite this trend, rising short-term interest rates and some indications of a moderate spillover effect into the longer term market; and three, the likelihood of extensive Treasury need to borrow in the months ahead.

How do you cut that Gordian knot?

Mr. BURNS. Well, I am counting on the Congress to give us some assistance. Federal spending has been proceeding much too rapidly. In fact, I have the unseasy feeling that governmental spending is almost out of control. Sentiment has developed within the Congress, both in the Senate and the House of Representatives, for legislation on a rigid expenditure ceiling. I think if Congress passes such legislation promptly, this will have a very reassuring effect in the marketplace and that market expectations, which have been a very significant factor in moving Treasury bill yields higher in recent weeks, will change. This is our best insurance under present circumstances of keeping interest rates from rising unduly.

Chairman REUSS. Which brings us to fiscal policy, and why not? What is so magical about cutting, let us say, $5 billion of expenditures as opposed to cutting, say, $3 billion of expenditures and raising an extra $2 billion in revenues? Is not the one equally as good as the other in terms of inflation?

Mr. BURNS. Well, when you deal with magnitudes of the sort that you have described, I do not know that there is much difference between the two. If the figures were larger then a difference, I think, would emerge. I think this country is very heavily taxed, and I think the tax burden, if increased, could seriously impair incentives to invest. We will need a high level of investment to keep this economy of ours moving as you and I would both like.

Chairman REUSS. What percentage of our present plant and equipment are we now using?

Mr. BURNS. Statistics are published on that subject and——

Chairman REUSS. Something like 75 percent.

Mr. BURNS. I place no great store by those statistics, even though my shop publishes them. I think we probably ought to stop publishing them.

Chairman REUSS. Let us assume that Congress does a job gratifying to you in cutting out waste, eliminating extravagances, cutting down or back on programs that have lost their usefulness or never had it, all to your taste, whatever that may be. I think I know, but I want to put this question to you in a form in which you can manage it.

Do you believe that within the next 3 years a drive for additional revenues will be necessary, leaving to one side how that revenue increase is achieved, whether by plugging so-called tax loopholes, or by a new form of tax, or by raising the rates in the present tax structure? Will we need more revenues?

Mr. BURNS. This is such a difficult question, Congressman Reuss. So much depends on sentiment over the country. So much depends on sentiment within the Congress. So much depends on the thinking of the Executive establishment.

I believe that we have permitted Federal expenditures to proliferate. I believe that we could stabilize Federal spending at the present level. In fact, I believe we could cut it back and be just as well off or better off.

Now, I may be wrong in these beliefs but that is what I do believe. I have lived in this city for some time. I know a little bit about various governmental establishments. I think there is some extravagance everywhere. I think there are all kinds of programs we no longer need. I think we can have cutbacks in spending. I think we could live harmoniously, decently, well, without any increase in taxes over the next year, or two or three. I am giving you just my thinking. Of course, the thinking of the Congress, the thinking of people over the country, the thinking of the Executive establishment may be different.

Chairman REUSS. The following thought occurs to me. The Federal Reserve is independent and I have always supported that independence. Would it not be a valuable thing, a perfectly possible thing with your staff, to prepare for this committee, as you can, the same thing Charles Schultze and Brookings did? They prepared a counterbudget, heavily democratically flavored, perhaps, but a scholarly attempt. Why does not the Federal Reserve perform that great public service for this committee? I ask that very seriously. Of course, it means that you would have to put in your value judgments about what you should spend money on and how we should tax, but why not? What is the worth of being independent if you cannot do that?

Mr. BURNS. You know, Mr. Chairman, our abilities are limited. If we tried to do everybody else's job besides our own, I do not know where we would be. We have a little difficulty doing ours as well as we should. Now——

Chairman REUSS. Well, I would like to see you having to spend less time on bank regulation and some more detailed tasks and be able to turn your attention to what is really as important a subject as any I can think of regarding the future of this country.

Mr. BURNS. I appreciate your question. I appreciate the compliment to the Federal Reserve. But we have a great problem here. Your search for an answer, I think, is characteristic of your approach to economic and financial questions.

I have struggled with this question. I do not know how you men of the Congress handle the job; I honestly do not. I do not know how you vote on the legislation that you need to vote on. This Government has become so big that I do not see how any Congressman or any individual, no matter how well informed, no matter how diligent, could really evaluate what is happening in our Government.

Take our grant-in-aid programs. We have several hundred of them. How can the human mind grasp several hundred objectives of national economic policy? How can you evaluate it? Now, when I start thinking along these lines, I turn to other subjects. [Laughter.]

Chairman REUSS. Well, be aware that this committee would welcome whatever expressions and guidance the Federal Reserve now or in the future can find to give us on the whole budgetary problem.

I have just one more request. I notice in the press this morning there is a reference to not a Kinsey report but a McKinsey report of the Federal Reserve, which I hear is equally sexy, and I would like to have that report, if I may. Would you be able to make that available?

Mr. BURNS. I will make it available to you with an explanation. I ought to give you that explanation now.

Chairman REUSS. Would you, please?

Mr. BURNS. I learned about this study late yesterday afternoon. This is not a study by the Federal Reserve Board. This is not a study for the Federal Reserve Board. I am not sure that I would even describe it as a study. [Laughter.] This is simply a response that this firm made to an unofficial, personal inquiry by one of the Governors of the Federal Reserve.

Chairman REUSS. It will be received with that qualification.

Mr. BURNS. With that understanding, I simply will pass on to you a private communication from the McKinsey Co. to one of our Governors. I will be very glad to make that available to you.

Chairman REUSS. Thank you very much.

Mr. BURNS. And I will do so promptly.

Chairman REUSS. Thank you.

Mr. Widnall.

Representative WIDNALL. Thank you, Mr. Chairman.

Mr. Burns, my apologies for not being able to be here when you started your testimony today. I know through longtime friendship, and also through contact with you and your many appearances before the House Banking and Currency Committee and the Joint Economic Committee, how valuable your work has been and the great contribution that you have made to your country. We also appreciate your viewpoints, your views on the various matters that come before us.

Do you recommend, as does the recent IMF document on international monetary reform, greater flexibility for the exchange rate of the dollar?

Mr. BURNS. In principle, I think that would be desirable, yes. That does not mean that I want to see the exchange rate for the dollar changed with any frequency. I would hope for stability. But if a basic disequilibrium arises, we ought not to live with it and we ought to attend to it promptly. This is a point that Congressman Reuss emphasized early in this hearing and I am completely with him.

Representative WIDNALL. Do you have any comments to make on the significance and the effect of the widening of the margins which was agreed to in the Smithsonian Agreement? You do not mention margins in your statement.

Mr. BURNS. That is correct. Well, this is an experiment. I was in favor of the experiment at the time and I cannot yet be sure of the effects. I have the impression that the wider margins have been a little helpful in moderating capital movements. That was the great objective.

On the other hand, capital movements have been so large recently that I could not argue the point strenuously. Therefore, my answer to you is that we have undertaken an experiment and that I for one would like to see it continued. The time for proper evaluation I do not think has arrived. In any case, a reasoned, documented conclusion cannot as yet be given.

Representative WIDNALL. Could you explain in what way swap drawings influence the money supply in the United States? Is the present or anticipated level of swap drawings sufficient to have any direct influence on domestic monetary conditions?

Mr. BURNS. This has been studied very closely by the Federal Reserve staff and the conclusion reached is that it has no effect whatever.

Representative WIDNALL. That is a very direct answer. Thank you.

Could you give us your opinion on the various proposals to prevent U.S. citizens to hold gold and permit Treasury sales of monetary gold in limited amounts at auction prices to domestic industrial users?

Mr. BURNS. I would do nothing about gold at the present time. We are getting new international monetary conversations underway. If this country's gold policy were now changed, I think that would do some injury to the serious and delicate conversations that are about to get underway. Some countries would feel, and quite understandably, that we have acted on our own, without consulting others, thereby narrowing the area within which the international monetary conversations must proceed. Since I think it would injure these conversations, I would postpone that issue until we see where we get in our monetary conversations.

Representative WIDNALL. The recent report on our balance-of-payments situation indicates that it has improved and considerably improved but has quite a long way to go.

In your statement you note that the needed adjustments of payments in balances, particularly in our merchandise trade, are taking place more slowly than had been hoped for or anticipated.

Mr. BURNS. That is correct.

Representative WIDNALL. Do you see any indications at all that we are turning the corner on our merchandise trade deficit?

Mr. BURNS. I think that I must answer that question in the negative. As yet I do not see any indications that we have turned the corner.

Let me put it just a little differently. As yet I do not see any indications that I am willing to interpret in this manner. You can look for straws, but I want something that is a bit tangible. As yet it is not there.

Representative WIDNALL. Would you agree with a point made by Mr. Bernstein 2 days ago that the international monetary system will have to operate on the basis of the Smithsonian Agreement for at least 2 or 3 years?

Mr. BURNS. Well, I would only agree that it may take 2 to 3 years to work out the features of a new international monetary order. Beyond that I would hope that the Smithsonian Agreement could remain intact but I am by no means sure that each and every feature of it will remain intact. What happened to the British pound recently is a warning that the Smithsonian Agreement cannot be regarded as anything like a guarantee of stability.

Representative WIDNALL. In several places in your testimony you have alluded to forward-looking reforms that can and should be made in the international monetary system, changes in procedures governing SDR's, a better division of responsibilities among surplus and deficit countries, a more prompt adjustment of payments imbalances, a downgrading of gold in the international monetary system, and so forth.

From your conversations with foreign central bank heads, can you give us an idea of the prospects for international agreement on a significant degree of international monetary reform in the coming 2 or 3 years?

Mr. BURNS. I have the impression that there is an eagerness, strong desire, certainly on the part of central bankers, to move ahead. I have the impression that a willingness to accommodate one's views within reasonable limits is pretty widespread in the central banking community. I know less about the thinking of Finance Ministers, but my guess is that their thinking is not very different at the present time. Therefore, I think the atmosphere for these conversations is good.

Representative WIDNALL. In other words, what you are saying is that there seems to be a general awareness of the necessity in the situation and the urgency of the need to have some direct action taken together.

Mr. BURNS. I believe so, yes.

Representative WIDNALL. That is all. Thank you.

Chairman REUSS. Thank you very much for your usual great contribution to this subcommittee. We feel encouraged.

Thank you.

Mr. BURNS. Thank you, Mr. Chairman.

Chairman REUSS. We will now hear from Mr. Donald H. McLaughlin, on behalf of the American Mining Congress. Mr. McLaughlin has enjoyed a long and distinguished career as a mining geologist, a professor of geology, and a business leader and we are delighted to have you here.

You have presented a comprehensive statement which under the rules and without objection, will be received in full. Will you proceed in any way you like, sir?

STATEMENT OF DONALD H. McLAUGHLIN, REPRESENTING THE AMERICAN MINING CONGRESS

Mr. McLAUGHLIN. Mr. Chairman, members of the subcommittee, I feel very honored indeed to be asked to appear with this distinguished panel you have of scholars and great experts in the monetary field. I come as a representative of the gold producers.

I must say at the start, I feel that there are certain simplicities in these problems that are being overlooked. The technical complications are so very great that I think all of us, the American people and even the experts themselves, sometimes get bogged down in intricate technicalities and fail to recognize some of the basic simplicities of money.

I was tremendously impressed with the testimony that Jacques Rueff presented before the subcommittee this week. I wasn't present but I received a copy of it. He is truly one of the wise and distinguished men of our age. Chanceller of the Institut de France, member of French Academy, and a great friend of the United States.

Chairman REUSS. We think very highly of him, too, and I am glad to hear that statement.

Mr. McLAUGHLIN. I would like to call your attention not only to the testimony he gave but the article that he also submitted entitled "A Marshall Plan for the United States." In that article he says clearly and precisely what I have been trying to say in a fumbling amateurish way for the last 10 years. It pleased me very much.

My statement which I will try to present briefly is as follows.

The questions listed in the announcement of these hearings are fundamental in the confrontation that now exists between two very different concepts of money—namely. (1) a monetary system based on gold or (2) money that derives its value solely from the authority of a government or an international agency with comparable powers in the monetary field. Under the first concept, gold is recognized as the basic monetary commodity with worldwide acceptance by which all national monetary units and currencies are defined and measured. The second concept is best described as fiat or authoritarian money with its acceptance enforced by the edict of a sovereign power.

The subcommittee is to be commended for its recognition of the critical nature of these problems concerning the monetary function of gold and the need for their exploration before consistent policies can be formulated. The hearings are indeed most timely but I must point out that many volumes by scholarly authors have been written on these issues and that strong disagreement still exists among competent critics. The brief time available hardly permits more than statements that may sound dogmatic, but I hope that even this limited procedure may be of service in the great debate that is shaping up.

The position of the American Mining Congress, for which I am speaking as chairman of its subcommittee on gold, is expressed in the following resolution that was adopted about a year ago. I quote:

> In spite of continued opposition in Washington to a devaluation of the dollar and other major currencies in terms of gold, such a move will assist in restoring the desired degree of monetary stability while steps are taken to correct the worldwide inflation without creating a depression and excessive unemployment. The American Mining Congress urges that this means of resolving the current dilemma between continued inflation and a depression with excessive unemployment be given the thoughtful consideration it warrants.
>
> In the meantime, the demand for gold from sources other than central banks continues to hold the market price well above the official price even though Americans and citizens of several other countries are still forbidden to purchase the metal except for limited uses. Removal of these restrictions on ownership of gold would be consistent with the position of the U.S. Government that the monetary function of gold should be minimized. All would benefit by the demonstration of the intrinsic worth of gold on a free market. Whatever arguments there may once have been for prohibiting private ownership of gold, there are none today. Accordingly, the U.S. Congress should enact legislation to remove the restrictions on ownership of gold by American citizens.
>
> We commend the aggressive spirit of the President in his recent moves, but must express our concern over his failure to use gold more effectively in efforts to attain monetary stability.
>
> Bearing in mind the rapidly changing state of the economy, we urge that the dollar and other currencies be redefined in terms of gold and made redeemable in gold domestically and internationally at a rate substantially in excess of the current official price for gold in dollars.

A resolution along similar lines will be proposed and I confidently expect it will be adopted without change at a meeting of the American Mining Congress in San Francisco next Monday. It reads as follows:

> Under the two-tier system adopted in 1968, the price of gold has advanced to a level that more nearly represents its true value and also reflects the impact of inflationary influences on its cost of production. U.S. Government policy has wisely been amended to permit domestic gold producers to sell their output on the market. We believe this is a step in the right direction.
>
> We also believe the time has come to lift the restraints on private ownership of gold. Since the U.S. Government is abstaining from purchases of newly-mined gold, it cannot logically argue that private individuals or companies should be prohibited from acquiring the metal.
>
> Gold retains an important monetary function. It constitutes a major part of the present reserve of most central banks. It plays a useful role in settling inter-

national trade balances. It acts as a sobering check on government policies that otherwise might lead to unrestrained currency debasement and inflation.

The American Mining Congress feels that gold should not and, in fact, cannot be removed completely from its monetary role. Rather, it believes that the universal acceptance of gold as a common denominator of value must be carefully nurtured and continued.

These statements reflect the views of a wide range of the mining industry, not merely those of the gold miners, for we believe that wise monetary policies with regard to gold would benefit all.

My own convictions would lead me to go somewhat further than the Mining Congress resolution and to emphasize that stable money in the world is not likely to be regained until gold is again allowed to serve its traditional function as the common base of the world's money, with all currencies convertible into gold on demand, including those held by citizens as well as currencies in central banks and other agencies.

The following comments that I am submitting in response to the questions that you ask are in accord with the position of the American Mining Congress, but please regard them as my personal views if they seem to go beyond the words of the resolutions I have quoted.

Your first question was with regard to the March 1968 agreement—has it outlived its usefulness? My answer is that under the two-tier arrangement established on the Ides of March 1968, it has been demonstrated that gold commands a price for nonmonetary uses considerably above the official rate of $35 per ounce that existed when these steps were taken. Under its procedures a record of demand for gold has been built up that must be taken into account when rates are determined at which currencies can again be made convertible into gold. It continues to serve these useful purposes and should not in my judgment, be terminated until far-reaching agreements have been reached on the basic functions of gold in the monetary system.

No. 2 questions the need for continuing gold payments as part of the IMF quota. Under the procedures I would advocate, the function of gold in the IMF should be fully preserved with payments of all subscription quotas in gold itself or currencies redeemable in gold.

Your question 3—the effect if the European nations adopted monetary policies, particularly with regard to gold that would be different from IMF and Amerian policies—I would be inclined to say that if it is assumed in this question that the enlarged European Economic Community had adopted a common currency convertible into gold at specified rates and that the current monetary policies of the United States and the IMF continued with little change, it would provide a most interesting test, if Gresham's law still holds, of the relative status of the various components of the monetary system.

Question 4, concerning the displacement of gold by SDR's, leads me to comment that the device known as special drawing rights, in simple terms, is a form of fiat money established for the first time on an international scale.

If such a device could command worldwide acceptance and could be administered with avoidance of national frictions and inflationary abuse, it is perhaps theoretically possible that gold as money could be entirely eliminated. With the general inflation, with persistent domestic and international deficits, and with the intense competition that exists between nations today, it seems most unrealistic to think that this might happen.

In a system with national reserves composed of gold SDR's and dollars, experience under Gresham's law should again reveal which monetary element is the strongest. From the record to date, it clearly appears to be gold.

If gold were revalued at the proper levels in the major currencies, there would be an ample supply of gold and no need for SDR's.

Unless this is done, SDR's or something of similar nature, will have to be issued in increasing amounts with the gradual creation of a worldwide system of fiat money in which the discipline of gold would become more and more relaxed. I seriously doubt if such devices could gain the necessary confidence and general acceptance to give them stability and permanence. I trust that their weakness will be demonstrated in time to allow gold to be restored to its traditional monetary functions before the world has to go through a major crisis that could be socially disastrous.

Fiat money is not a new invention. John Law inflicted it on France about 250 years ago with unhappy results and I think the record is very clear what has happened since that time when similar schemes were tried.

Question 5, those who support fiat money surely have no logical grounds for objecting to the removal of the current restrictions on purchase and ownership of gold by American citizens. If, as the opponents of gold insist, the role of gold as money is to be minimized, if not eliminated, why should citizens be denied the right to own this commodity presumably so unimportant in the monetary system? On the other hand, under a truly convertible currency, restrictions on ownership of gold would be in opposition to the concept on which the system was based. Thus, the existing prohibitions on purchasing and ownership of gold seem indefensible from either position.

While the fiction was being maintained that dollars held by foreign central banks were convertible into gold at $35 per ounce—especially while the U.S. Treasury and agencies of other governments were involved in the costly speculation of attempting to prevent the market price of gold from rising above this figure—the reasons for maintaining restraints on purchases of gold by private individuals were at least understandable. And today, those who find it embarrassing to have a market price for gold far in excess of the official price are likely to oppose any move that would enlarge the demand.

By this time, however, the persistence of the relatively high market price for gold has made the official price—even at $38 per ounce—seem unrealistic and awkward to maintain as a measure of the value of monetary reserves of gold. Under these conditions, it is difficult to see any further objection to making the market as free as possible and taking note of what happens.

I might say here that we gold miners do have the privilege of selling our gold on the domestic market but only to people who have a license to buy specific amounts for specific purposes. The market consumes about four times the product of our domestic mines and around 6 million ounces of gold—worth $288 million at $38 per ounce—has to be imported to meet the demand. A mining company and a gold producer cannot sell, as you know, to individuals or organizations who do not hold such licenses.

The sixth question is why should the rest of the world support the gold industry of Russia and South Africa? It seems to me the question as worded is a bit slanted. The demand for gold that supports the world's gold mining industry everywhere is derived from free sources; namely (a) consumption of gold in jewelry, in electronics and other industrial uses, in biological services—including dentistry—and other applications in which the metal's unique qualities make it of special value; (b) the desire of people in all countries to own gold as a store of wealth, particularly as a protection against depreciation of paper currencies and securities expressed in such units, and (c) acquisitions by governmental agencies for stocks held in monetary reserves.

All three of these demands are significant and none can be disregarded in an appraisal of the demand for gold. The first two, which now consume the entire new production from the mines of the non-Communist world, result from causes quite unrelated to any desire to benefit or harm the Russian and South African economies.

I assume, therefore, that the question "why the rest of the world should support the Soviet Union and South Africa's gold industry," is concerned with the demand created by acquisition of newly mined gold for monetary reserves and the holding of gold in monetary reserves.

For the last few years, the nonmonetary market has taken practically the world's entire production at a price considerably above the official rate. Very little new gold from the mines has gone into the monetary reserves. This is likely to continue if the monetary price remains at its present levels. If the monetary price were substantially increased—even tripled if it were desired to compensate fully for the inflation since the price was fixed prior to World War II—it would, of course, benefit the two major gold producing countries, but the gain by other governments from revaluation of gold in monetary reserves (now some $41 billion at $35 per ounce) would be of far greater magnitude than the increased revenue on the annual production from the two largest gold producing countries.

The gold reserves of the United States, even at their present depleted level, are about equal to 10 years output from South Africa, and the European gold reserves are twice this figure. The increase in value of these reserves measured in dollars that these countries would gain from a revaluation of gold would far exceed the additional net revenues that the Soviet Union or South Africa would receive.

Opposition to a revaluation of gold is surely difficult to justify simply on the grounds that it would also benefit two nations whose political and social policies are in disfavor, particularly when specific effects of such a change within each of these countries are likely to be favorable in ways that would meet even with our approval. Failure to take wise steps with regard to gold because it would be helpful to Russia and South Africa seems to me to be as indefensible as to withhold the results of medical research from the general public because it might do some good to a few people with whom we happen to disagree.

The seventh question—how can gold be phased out as international money in an orderly way—is pertinent only to those who regard the elimination of gold as an entertainable and desirable end. This procedure would surely be extremely detrimental to our own welfare and also to the rest of the world if others could be persuaded to follow our bad example.

However, if we are bent on committing monetary suicide in this way, I suggest that the objective could be easily attained by reopening the gold window and making the gold in our reserves available at the current official rate to all holders of dollars. It might be even regarded by some as a particularly honest gesture, though perhaps a bit naive, if the metal were offered at $35 per ounce which would reflect the gold content of the dollar at the time the obligations to pay in gold were assumed. It seems quite probable that, if this procedure were followed, gold would be promptly eliminated from our reserves. It is a bit doubtful, however, if other countries could be induced to part with their gold and accept some form of fiat money in its place. It probably would be difficult to persuade any responsible governments to repeat the speculation that ended in March 1968, of trying to hold the price of gold at the official level by selling gold from national reserves.

Theoretically, perhaps, a worldwide system of fiat money would be possible, but surely it could not be established and maintained until the United States and each of the major countries succeeded in balancing their budgets, ending inflation and restoring a reasonable state of balance in trade and other transactions across borders. Then, perhaps, an international agency to which sovereign powers over currencies had been delegated and that could be kept in the hands of highly competent and dedicated men might make a system of fiat money work without the discipline of gold. As attainment of these ideals seems most unlikely, I expect that gold with continue to be held tenaciously, particularly by the hardheaded men who determine European policies.

I hope thatm y comments will at least serve to reveal the concern that many outside the ranks of economists and bankers feel about the need for retaining gold as the basic element in our monetary reserves and for utilizing our remaining stock more affectively and wisely than it has been in the recent past.

I know, Mr. Chairman, these views are very far from yours, which I respect very much, but I think I can honestly say they do reflect the views of the mining world.

Chairman Reuss. Well, you are right in saying that I am not for an international gold standard, but I cannot imagine a witness appearing before this committee who could have done a finer job than you in presenting your case. It is a real honor and pleasure to have had you with us.

I would ask one question of you, Mr. McLaughlin. It seems to me both the supply of and the demand for gold are very flexible things, which has pleased me very much. Industrial demand, jewelry demand, dentistry demand has gone up. I have nothing but good will toward the gold mining industry's ability to get business as a result of greater demand. It is also true that the demand of the French middle-class citizen, the sheiks of the Middle East, and wealthy people in India, and others throughout the world has increased. Over the centuries it has turned out to be a pretty good store of value, and these individuals' investment preferences demand depend on a lot of psychological factors. On the supply side, what South Africa and the Soviet Union and the other gold producing countries do is subject to many an "if".

My question, which I, of course, telegraphed, is, do not these considerations make gold a rather infirm and uncertain element on which to base a world monetary system?

Mr. McLaughlin. The demand for gold for the purposes that you stated is certainly going to continue. On the other hand, even with a great increase in the price of gold, I doubt if there will be any great surge in the production of ounces of gold. In fact, in South Africa there probably would be a decline for a while—and every place else where there are important mines—because lower grade ore that would then become profitable would be mined and milled, and until the capacity of the plants was increased, there would be a lower output of gold.

With a higher price, I think we could count on a fairly stable production of gold but unless we make more discoveries there will be a serious decline in output toward the end of the next decade. However, I am optimistic enough to think that with more intensive prospecting utilizing modern techniques, new ore bodies will be discovered that will offset the depletion of known deposits to a significant degree.

If the price were substantially raised, doubled or more, there would of course be a lot of changes. There would be some economies in the uses of gold though many commercial demands would continue unchanged because gold is so unique and the cost of the metal is not too critical a factor in the final price. There might be, however, some decline in industrial consumption, but I doubt if it would be very serious.

With a proper price, probably there would be a flow of gold from the large stocks presumably held in the Middle East and elsewhere that would be a very welcome supplement to the total amount of gold available for the markets, as well as for monetary reserves.

Chairman Reuss. An interesting point. Why should hoarders dishoard? Why would they not say, heavens, that which we have hoped would happen for so many years, namely, a doubling of the price of gold has occurred. Let us keep holding this wonderful commodity and wait for the next round of increases.

Mr. McLaughlin. Right. They would not dishoard unless they felt they were getting something for their gold that compensated them adequately for it.

Now, as you know, gold is in great demand for oil payments in the Near East and the recipients would certainly be looking for proper compensation before parting with it. I do not think that SDR's or other promises on paper would appeal to them as a good substitute for their gold.

If the notion persisted that we were going into a terrifying inflation, such as the German type after the First World War, I doubt if there would be any dishoarding of gold, but if we succeeded in regaining a stable monetary system with a revaluation of gold at a rate that would make convertibility possible, I am sure there would be such a great wave of confidence in the future throughout the world that the holding of gold simply as a means of protecting one's wealth would be less popular. In that case, a good deal of gold from private stocks might become available.

I was very much heartened by the conclusion in Jacques Rueff's article, "The Marshall Plan for the United States" when he pointed out how in his mind the changes he stated would lead to a period of great prosperity and sound prosperity in the world. I do hope you will study that article of Jacques Rueff very carefully. I know how concerned you have been about these problems of gold. I am sure that you will find his statements most helpful for they really present our position on gold better than any other recent papers I have read and far better than I can do.

Chairman REUSS. Well, you did very well. Both Mr. Rueff's presentation and yours, Mr. McLaughlin, will be seriously studied by us.

Thank you so much for being with us.

Mr. MCLAUGHLIN. Thank you very much and thank you for your kind remarks.

Chairman REUSS. The subcommittee will now stand in adjournment.

(Whereupon, at 11:40 a.m., the subcommittee was adjourned, to reconvene subject to the call of the Chair.)

APPENDIX

STATEMENT OF HON. PHILIP M. CRANE, A REPRESENTATIVE IN CONGRESS FROM THE 13TH CONGRESSIONAL DISTRICT OF THE STATE OF ILLINOIS

The Right To Own Gold

It has always been a proposition of free government that the burden of proof rests with those who seek to limit the freedom of the individual citizen, not with those who seek to preserve and enhance it.

Throughout our history there have always been those who sought to diminish our freedom, and many of the advocates of such limitations have had what they considered to be "good reasons" for calling for the intervention of state power.

The question of whether the individual citizen should have the right to own gold has brought forth many arguments by those who seek to limit his rights in this area. Rarely, however, has there been a consideration of the background of this question, and rarely have such "good reasons" for limiting our freedom been thoroughly examined.

Professor Milton Friedman, writing in Newsweek magazine of August 16, 1971, declared that, "There never was and there is not now, any valid reason to prohibit individuals from owning, buying or selling gold. Individuals should have the same right to trade in gold as they have to trade in silver, copper, aluminum or other commodities."

The initial nationalization of gold by President Franklin Roosevelt has been characterized by Professor Friedman as, "An act of expropriation of private property in no way different in principle from Castro's nationalization of U.S.-owned factories and other properties without compensation or from Allende's nationalization of U.S.-owned copper mines in Chile at a price well below market value. As a nation we do not have a leg to stand on when we object to these acts of expropriation. We did precisely the same thing to residents of the United States."

At the same time that our own Government prohibits Americans from owning gold, it is interesting indeed that the other countries in the world which have adopted a similar policy of prohibition are primarily totalitarian dictatorships, such as Albania, Bulgaria, Cuba, East Germany, Hungary, Rumania, Red China and the U.S.S.R. The only non-Communist states with such a prohibition are Ceylon, India, Libya, Mali and Rhodesia. Even Great Britain, which followed our own policy for years, restored the right to ownership of gold coins last year.

When the Bretton Woods International Monetary Fund was established, foreign central banks were allowed to convert their paper dollars into gold at \$35 an ounce, but the prohibitions against American citizens' doing so, or even holding gold, was continued.

Economist Henry Hazlitt notes that, "The excuse continued to be that if American citizens were allowed this right, they might drain the Treasury of so much gold that it could not fulfill its solemn obligation to convert into gold for foreign central banks. But now the United States government has repudiated and defaulted even on this pledge, the last excuse for depriving private citizens of the right to own gold or hold gold has been wiped out."

Yet, while the last excuse for such a policy has been eliminated, the policy continues, and continues to be supported. In addition, faced with a government policy of inflation, deficit spending, and currency devaluation, citizens have no safeguard. With the right to own gold, states Mr. Hazlitt, "American citizens would have a major way, prohibited to them now, of protecting their savings against the further erosion in value of an irredeemable dollar."

The basic question involved is clearly that of the freedom of the individual. The "Milwaukee Sentinel" of June 24, 1971, notes that, "Americans are just as free and surely have as many rights as Canadian, West German, or Mexican citizens. Right? Not quite. The citizens of these other countries can own gold. Americans can't."

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One reason which seems to motivate those who urge the continuation of the prohibition against the private holding of gold is that they wish none to be free to escape the inflationary management of money which has become a preserve of government administrators.

Discussing this point, Henry Hazlitt points out that, "If individuals all over the world were legally free to hold, buy or sell gold they would be able to protect themselves against being ruined by their money managers. Under such conditions gold, whether 'monetized' or not, would soon become the de facto international currency, in terms of which international transactions would increasingly be made."

It has been stated that providing citizens with such a right would be damaging to the governmental policy of "reducing the monetary role of gold."

The fact is that the reduction of the monetary role of gold, begun in the New Deal has now been completed. Gold reserve requirements for Federal Reserve notes and deposits have been abolished. Even the attempt to maintain the world market price of gold at $35 an ounce has been abandoned. Today, there is a free market in London where, in August, 1971, the price of gold was $40 an ounce. Since that time the price has risen dramatically. From a year-end price of $42 an ounce, gold by this past February had risen to over $49, one of the sharpest rises on record and a 20-year high. By summer the price of gold hit an all time high of $72 per ounce in European markets.

Discussing this point at a meeting of the International Monetary Conference of the American Bankers Association in Montreal in May, 1972, Professor Milton Friedman declared that gold is "thru" as an international medium of exchange. He stated that, "The role of gold is being played out like a Greek tragedy. The world is now on a dollar standard, and there is not the slightest chance the United States will make the dollar convertible into gold again."

In addition, all indications are that irrespective of a change by the United States in its policy of denying American citizens the right to buy, sell, or hold gold, the world price of gold will continue to climb owing to significant increases in industrial demand for the metal. The Washington Post of February 14, 1972, had an article dealing with the industrial demands on the world's gold supply: "Free world production, now thought to be at its peak, stands at 1,262 metric tons a year—a figure which some estimates suggest will barely meet industrial demands within a year or two. Purely industrial consumption (excluding jewelry) of the gleaming metal has increased by as much as 17% a year in the past and is expected to level off at around 6% in the future."

It has been said by critics of the right of citizens to own gold that this matter should be considered at a later date, when the monetary role of gold has been settled as part of an overall monetary reform.

In such an eventual settlement, gold can play only one of three roles: First, we demonetize gold; second, we retain fractional gold backing, but not enough to again permit convertibility; or third we restore convertibility.

Let us consider briefly each of these situations.

If all gold backing is removed, there can obviously be no objection to immediate restoration of the lost right to own it.

If we retain fractional backing, there can be no objection to immediate restoration of the right to buy, sell or hold gold since—at present—there is no connection whatsoever between the official price of gold, $38 per ounce, and the world price, $68 per ounce, and convertibility is impossible.

Convertibility is only feasible when the world market price and the official price are in harmony. Since soaring industrial demand keeps pushing the market price higher, annual devaluations would be required to achieve this which has been called totally unacceptable to foreign bankers and contrary to U.S. determination to diminish the role of gold, and which trigger reciprocal devaluations throughout the world.

If private ownership were immediately restored and the market price of gold doubled, it would have no impact upon an ultimate settlement of the role of gold restoring convertibility because: First, governments will arbitrarily decree the official price of gold; and second, the percentage of devaluation—even at the present market rate, $68 an ounce—will trigger reciprocal devaluations throughout the free world, a consequence that is unavoidable.

Another objection raised in opposition to private ownership, sale or purchase of gold is that it would benefit speculators. On the basis of the recent Washington

Post article, it seems that unless the United States reopens the rich gold mines in our Western States and Alaska and adds to the world's gold supply, we can anticipate that the rising industrial demand for gold will produce just such a windfall for speculators because, as the Post article observes: "The non-monetary demand for the metal proved far higher than any one in industry had thought possible. Industrial uses (all forms of fabrication) consumed 1,050 tons in 1968. This combined with the 570 tons taken up by speculators, exceeded the free-world production that year by 260 tons."

The article continues: "By 1973–74, say some estimates, industrial uses for gold alone could equal the non-Communist world's annual production figures. All this suggests a dramatic rise in the price of free-market gold during the next decade, unless the Soviets choose to release some of their holdings. . . ."

What this also suggests is that investment in gold in the world market is going to secure handsome profits for speculators, regardless of what nations or central banks do about the role of gold in the international monetary system, because of the growing industrial demand with rather constant production. Further, the Soviet Union, which for years has engaged in gold mining activities, will benefit enormously from these market conditions. Why should the Soviet Union enjoy this kind of privileged position when the United States possesses enormous quantities of gold in the ground, which at the present time cannot be mined because of U.S. efforts to hold down the market price of gold?

Prior to 1934, thousands of Americans were employed in the mining industry. There are still thousands of potential jobs available in the mining industry if the price of gold reaches a level profitable enough for the mining companies to go back into production. There are a number of benefits to the American economy if we do so.

First, it would contribute positively toward remedying unemployment. Second, the United States has sufficient gold reserves underground to make this country one of the foremost exporters of gold in the world. Since it is our policy to seek to remedy our balance-of-payments deficit, surely becoming a major exporter of gold would help to meet this objective.

If our policy is to diminish the role of gold in the international monetary system, the basis upon which a number of spokesmen have opposed the right of citizens to own gold, then exactly the opposite conclusion would logically be in order. If American citizens once again had the right to buy, sell, or hold gold as they do any other commodity—be it pork bellies, or soy-beans—then the goals of those who oppose this right would actually have a better chance of taking place. As long as there is a continued denial of this right, people will continue to put a special premium on the role of gold—for this reason, if for no other.

During the next session of Congress, I intend once again to introduce legislation urging that the right of the citizen to own gold should be restored. It should, I think, be the fundamental right of every American to invest in gold, just as every American has the right to invest in precious gems. The United States is almost unique among free world countries in prohibiting this right.

It must be remembered that gold reserve requirements for Federal Reserve notes and deposits have been abolished and the reduction of the monetary role of gold that President Roosevelt began has now been completed. In addition to restoring a fundamental right to all of our citizens, the adoption of the proposal which I have introduced during the present session and will re-introduce during the next session, would also create a boom in the mining industry, providing thousands of jobs and once again making the United States a major gold exporter, thereby reducing our balance-of-payments deficit.

It is an old legal maxim that when the reason for a law ceases to exist that the law itself should be eliminated. If there ever was a valid reason to prohibit American citizens from holding gold, that reason does not exist at this time. Since that is the case, the prohibition should also cease to exist.

In a free society the presumption of the law should always be on the side of freedom, not of governmental coercion and limitation. Those who want to prevent American citizens from the right to own gold have themselves to meet a burden of proof on behalf of that limitation upon individual freedom. Thus far, they have failed to do so. Parliamentary avoidance of the real issues cannot, for long, substitute for meeting that burden of proof. I am confident, when all of the facts are clearly set forth, that the issue will be resolved in the terms discussed here.

STATEMENT OF HON. JAMES A. MCCLURE, A REPRESENTATIVE IN CONGRESS FROM THE FIRST CONGRESSIONAL DISTRICT OF THE STATE OF IDAHO

Mr. Chairman, I appreciate the opportunity to present this statement in behalf of one aspect of our gold policy which may not receive the attention it deserves in these hearings. I refer to the ban on private ownership of gold.

The ban was imposed during the Roosevelt Administration, and the President took the position at that time that gold "leads to hoarding and tends to a possible weakening of national financial structures in times of emergency." While we may all dispute the wisdom of President Roosevelt's depression policies, surely all of us can agree that the conditions which prompted the ban in the first place have long since gone.

A lot of other things have passed on as well—the gold cover, for one. While I opposed lifting the cover, once the decision had been made, it seemed to me that all arguments for denying Americans the right to own gold had ended.

So, I took two actions. I introduced the first bill in recent years to repeal the ban. And I wrote to Secretary Fowler, requesting his views on it. Fred Smith, Mr. Fowler's General Counsel, replied that private gold holdings lead to "destabilizing speculation and hoarding and would contribute to our balance of payments problem . . ."

But then came devaluation. It was an inevitable action, and one that seemed to end the reasons why the Johnson Administration clung to the ban on private ownership of gold.

Last February, I wrote to Secretary Connally. Was the Nixon Administration to perpetuate this outmoded policy? The answer, unfortunately, seemed to be yes. Paul A. Volker replied to my inquiry in this fashion: ". . . the lifting of restraints on the individual ownership of gold at this time would severely disrupt the gold market, substantially increase world money market uncertainties, and delay progress toward reform of the International Monetary System."

Mr. Chairman, the reform about which Mr. Volker wrote, is a monetary system based upon the good faith and mutual confidence among nations. Yet, the strongest and the richest nation in the world lacks sufficient faith and confidence in its own citizens that it will not permit them to buy, own, and hold gold. It is an irony not lost on other nations around the world.

What could better illustrate the stability of the American monetary system than visible proof that gold is a precious commodity desired by many Americans? The Republican Platform Committee sees nothing wrong with it and last month they adopted the following plank on gold:

> Since the 1930s it has been illegal for United States citizens to own gold. We believe it is time to reconsider that policy. The right of American citizens to buy, hold, or sell gold should be reestablished as soon as this is feasible. Review of the present policy should, of course, take account of our basic objective of achieving a strengthened world monetary system.

With the opening this week of the world's first market in gold futures, the question now becomes whether or not the law prohibits the holding of a gold futures contract. The Treasury says it does, and that's par for the course.

Time magazine has had the courage to see through all of this for what it really is. The Treasury, Time notes, fears that any form of U.S. ownership of gold might lead to an alternative "and possibly preferred" form of tender. But instead of weakening the dollar, the very threat of this would undoubtedly spur government officials to make more responsible monetary policy in the first place.

I hope that this Committee, concerned as it is with the role of gold in international finance, will not forget the role that gold plays in our own economy. Indeed, if that economy is as free as we all like to say that it is, there can be no reason remaining for continuing the gold ban. My bill, H.R. 5978, has as its purpose the termination of that ban. A statement of support by this committee would constitute a big step in the right direction.

STATEMENT OF HON. JOHN G. SCHMITZ, A REPRESENTATIVE IN CONGRESS FROM THE 35TH CONGRESSIONAL DISTRICT OF THE STATE OF CALIFORNIA

Mr. Chairman and Members of the Committee, last spring during the House and Senate hearings on the Administration's devaluation bill, several witnesses testified in behalf of gold, including myself, but any consideration of the gold-freeing bills as amendments to this bill was ruled out because the proponents of the devaluation measure, at the President's insistence, wanted to secure passage of it at the earliest possible date without attachments. However, the Senate Banking and Currency Committee Chairman announced that following the hearings on the dollar devaluation bill, it was agreed to hold hearings exclusively on the gold-freeing bills later in the year. And it was also understood in the House that further consideration would probably be given to the gold issue later in the session.

But six months have passed and although national attention has been focused on the importnace of restoring gold-ownership rights to the American people, following the introduction of several bills for this purpose by legislators in both the House and Senate, no gold hearings have been held and none are scheduled.

Therefore, I welcome the opportunity thus afforded by the hearings of the Joint Economic Committee on the over-all monetary situation to make the case for gold, to reiterate the strong position which I have maintained throughout my term in Congress; in fact, throughout my years of public service, i.e., the absolute necessity of returning this nation to a solvent state which the restoration of gold-ownership rights and a subsequent sound currency would enable us to do.

While the anti-gold propaganda has been rife in American since the manipulation of the currency was made an instrument of State policy following the abandonment of the Gold Standard and confiscation of private gold-ownership rights, there are still monetary economists of the highest competence who have never been deceived about the means being employed to destroy Western Civilization. It was Lenin's admitted device for the conquest of this hemisphere—debauch the currency and ridicule gold in order to banish it from the minds of people as a monetary unit of surpassing quality. But the indisputable fact remains that the use of gold as a monetary standard has been essential in the advancement of civilization.

And why? Because since the first gold bars formed during the reign of King Menes aided him so tremendously in uniting the peoples of the upper and lower Nile into one kingdom, that known as Egypt—over 3,000 years before Christ—gold has been recognized and appreciated for what it is—that repository of rarest value, of proven worth, by which all other standards of economic value are measured. And wherever it has been permitted to perform its function as only a unit of gold convertibility can, it has ensured a high degree of economic stability and engendered pride and a sense of security among the people, giving strength to the character of the nation itself because it embodies the priceless element of integrity, without which no nation can lay any just claim to leadership or true greatness.

Yet, in spite of the consistent preference for gold by the most advanced civilizations on earth, as a great economist, Dr. Walter Spahr, said: "Today we are writing another chapter in the awful book of human folly." We can see that this is all too true when we realize that although we emerged from the shock of World War II owing no one abroad a dime and with well over $24 billion in gold bullion in the Treasury, we are now on the verge of international bankruptcy with a further devaluated dollar, no longer convertible into gold by anyone, and a national debt—with many of our creditors in other countries—so large it all but defies finite comprehension. And this is not by accident. It is the direct result of government-mismanaged economy, of unrestrained government spending of unsound fiscal policies—socialistic measures which gravely injured the character of the United States. They have radically altered our pattern of living because, as Dr. Spahr further observed, "Socialism is based upon fundamental fallacies and therefore points toward social degeneration."

But those responsible for the chaotic state of our economy today, in order to perpetuate the destructive policies that have brought us so low, continue to argue that gold is "scarce"—this in spite of the fact that reliable Western mining engineers inform us that California alone still has the gold potential of South Africa, and also in spite of the fact that according to the late Dr. Theodore Macklin, over 73,000 tons of gold have been recovered from the earth in the last 477 years. So it is quite obvious that the only scarcity of gold is an artifically induced scarcity. Then we hear occasional whining that "you can't turn the clock back," but those of us who are fighting for a return of this country to a position of strength and honor among the nations of the earth have no intention of turning the clock back. The clock ran down long ago. What we propose to do is to rewind the clock and reset it on Standard Time—Gold Standard Time. As a staunch advocate of sound money, I am committed to that course of action.

At these hearings we are being asked to consider ways and means for monetary reform, but in view of the goldless money confusion which pervades the atmosphere today, it is difficult to understand how any substantial progress can be made toward reform on a global basis until the participating countries represented make a determined effort to restructure their own monetary systems on the basis of a sound currency. Certainly, the siphoning of the wealth of any country into some gigantic central bank and the subsequent issuing of what is commonly referred to as SDR's is not the answer. Regardless of the color, a paper note is only as good insofar as it is redeemable. As one eminent financial analyst observed, SDR's have no value whatever other than what they take, directly or indirectly, from gold, and their continued use will inevitably intensify inflation on a worldwide scale. In other words, there is no substitute for a sound currency, convertible into gold on demand. As the former Foreign Minister of Rumania, Prince Michael Sturdza, sadly reflected in his memoirs, "The source of the economic damage and social disorganization of the Continent was the appearance on its Eastern borders of a menace (Russia as a Communist nation), the equivalent of which it had never known before.

"Among those damages, one of the most destructive was the deterioration, sometimes to almost nothingness, of the worth of so many European currencies. . . . For the countries involved, the disappearance of the metal covering meant inflation, paralysis of the economic exchanges, insolvency of governments, reduction of the salaries of state employees to an unbearable minimum, rampant speculation and profiteering, unavoidable corruption of moral standards, and the fateful devaluation of social and patriotic values."

Will we never learn from the tragic experiences history records? Surely there can be no peace in the world until respect for true worth, for intrinsic value, is restored and reflected in the strength of our monetary systems. Money, which is necessary to ensure the peaceful and profitable exchange of goods and services and the fulfillment of contracts, must, if standards mean anything, be a unit of exchange of the highest quality, of universal validity. That means gold.

STATEMENT OF PROF. DONALD L. KEMMERER, URBANA, ILL.

Should gold play a major role in a modern monetary system, and particularly our own?

I would like first to raise the question, "What are the most important functions that money has to perform?" It should serve as a medium of exchange, as a measure of value, and as a store of value. But how can it serve satisfactorily as a medium of exchange unless it is generally acceptable, that is unless it is trusted? How can it serve as a measure of value if its buying power is constantly changing, say shrinking? How can it serve as a store of value if its purchasing power withers with the passage of time, usually from government overspending? Clearly the central theme to the answers to all three of the above questions is that the monetary unit must have integrity and credibility. The absence of these will discourage trade, encourage cheating and make people hesitate to enter into long term contracts. How does one go about devising a reliable money, one that will stimulate economic growth? The answer depends on the school of thought to which one belongs.

In this respect monetary economists seem to fall into two categories. On the one hand are those who subscribe to the ancient adage, "We have gold because we cannot trust governments". They believe that the gold coin (notice, not the gold exchange standard) standard, fashioned after countless experiments in the social scientists' laboratory, historical experience, is the best monetary system man has yet been able to devise even though it has its faults. They will stress that the near-century from the end of the Napoleonic Wars to the outbreak of World War I saw more price level stability than our 20th century has since the end of World War I. During the period, 1820–1914 the English pound, the French franc and the American dollar, plus the German mark and its immediate predecessors were most of the time remarkably stable, and all these monies were either on the gold standard, or the bimetallic standard or the silver standard, i.e., all on some kind of precious metal standard. Bank notes or other paper money had to be redeemed on demand in specie. This requirement limited credit expansion to a considerable extent and kept inflation from getting out of hand (it got out of hand only when a nation suspended specie payments as we did during the Civil War) History has much to teach us.

The other school of thought believes that modern man with his refined technical and analytical skills can devise a better monetary system than the gold standard, that "barbarous relic" as Keynes called it. But just about all such systems that members of this second school propose are paper money standards whose notes are not redeemable in gold or even in silver. Proponents of these systems have great faith in the ability of governments to make their money standards work, that is to protect the new unit's buying power and credibility. I have little doubt that man can devise a more appealing money system than the gold coin standard. But will it work? Such systems seem always to be predicated on man's behaving in a manner that is not characteristic of him. It supposes that Congressmen won't vote to spend more than the tax collectors can collect. It supposes that businessmen won't raise their prices when the supply of money outruns the supply of goods. It supposes that if price and wage controls have to be imposed, they will work, and if debt ceilings have to be enacted, they will not have to be raised repeatedly. It supposes that all the lessons of the past, each one illustrating how paper monies have lost their value fairly rapidly, are not relevant and the new fiat money or paper gold is going to be different and will work. Obviously I do not subscribe to the second school of thought.

Why then do we so badly need a dollar based on gold and redeemable in gold (preferably both at home and abroad) if we are to restore the integrity and credibility of the dollar? The answer is to let the public test the value of the dollar and prevent the government from causing it to depreciate. Until March of 1933 the right to demand gold for paper money was the public's economic audit of government financing just as our system of holding elections every two and four years is the public's political review or audit of Congress' and the President's performance. Our government should restore that economic audit to the people. Instead, since 1960 the government has deprived the public of the right even to own gold as a commodity, both at home and abroad. But back to my main line of thought. Gold redeemability can (it has in the past) keep Congress from overspending and even provides Congressmen with a strong reason for resisting public pressures to overspend. In this regard let me quote from a congressional colleague of yours, the late Howard Buffett of Nebraska, who wrote in 1948 as follows:

"There is a parallel between business and politics which quickly illustrates the weakness in political control of money.

"Each of you is in business to make profits. If your firm does not make profits, it goes out of business. If I were to bring a product to you and say, this item is splendid for your customers but you would have to sell it without profit, or even at a loss that would put you out of business—well, I would get thrown out of your office, perhaps politely, but certainly quickly. Your business must have profits.

"In politics votes have a similar vital importance to an elected official. That situation is not ideal but it exists, probably because no one gives up power willingly.

"Perhaps you are right now saying to yourself: 'That's just what I have always thought. The politicians are thinking of votes when they ought to think about the future of the country. What we need is a Congress with some 'guts.' If we elected a Congress with intestinal fortitude, it would stop the spending all right.

"I went to Washington with exactly that hope and belief. But I have had to discard it as unrealistic. Why? Because an economy Congressman under our printing-press money system is in the position of a fireman running into a burning building with a hose that is not connected with the water plug. His courage may be commendable but he is not hooked up right at the other end of the line. So it is now with a Congressman working for economy. There is no sustained hookup with the taxpayers to give him strength. When the people's right to restrain public spending by demanding gold coin was taken from them, the automatic flow of strength from the grass-roots to enforce economy in Washington was disconnected." [1]

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[1] "Commercial and Financial Chronicle," May 6, 1948.

STATEMENT OF KURT SOLMSSEN, FINANCIAL CONSULTANT, 1500 WALNUT STREET, PHILADELPHIA, PA.

I understand that your Committee is about to hold hearings on the question of gold and the Federal Reserve Board's decision to intervene in the exchange markets in support of the dollar. In this connection I wish to make the following statement.

I.

If any proof were needed that gold is not a proper basis for an international monetary system, the gyrations of the free gold market in recent months have supplied it. Therefore,

1. I approve of the U.S. policy of reducing gold to the status of a commodity. The quickest way of achieving this against the opposition of European nations is to destroy the present gold preference of foreign central banks by breaking the gold price bubble skillfully created by the South African Government in co-operation with Swiss banks. In order to do so the March 1968 agreement among central banks which at present governs our policy should be abrogated or modified to permit the sale of gold from U.S. reserves in the free market. The sale of 1/10th of 1% of our reserves would already do wonders.

2. The difficulties of the dollar would have been greatly lessened if the U.S. resistance against the agreement permitting South Africa to sell newly-mined gold to the International Monetary Fund under certain conditions had prevailed. Gold presumably would have fallen below $35/oz. in the free market and the mystique of gold would have ended. This agreement between South Africa and the International Monetary Fund should be terminated.

II.

The Federal Reserve Board's decision to support the dollar by the use of U.S. reserves was a useful and proper gesture to indicate that this country acknowledges its responsibility for the maintenance of the dollar's external value, but it was not and cannot be more than a gesture. As long as this country continues to have a balance of payments deficit anywhere near its present size the U.S. reserves are totally inadequate for a real protection of the dollar. This gesture in no way eliminates the basic quandary in which foreign central banks find themselves; namely, either to accept seemingly unlimited amounts of dollars or to let their currencies move upward against the dollar or to institute exchange controls. Consequently, the elimination of the U.S. balance of payments deficit must be achieved if a workable international monetary system is to be constructed. No such system can operate successfully as long as any nation pours huge amounts of its own currency into the world.

It will not be possible to eliminate the deficit by a further adjustment of the external value of the dollar. There are three reasons:

1. A devaluation of the dollar in terms of the "strong" currencies means revaluation of those currencies. This is politically unacceptable in the strong currency countries.

2. The impact on the foreign exchange market of what might be called legitimate supply and demand for trade purposes has frequently been overshadowed by huge movements of speculative funds. Any external valuation of the dollar low enough to discourage such movements would be totally unrealistic for trade purposes: It would make American exports ridiculously cheap and enormously increase the cost of vital imports. A "crawling peg" would diminish but not eliminate the danger of a dollar rate unacceptable for trade purposes.

3. The events of the last twelve months have shown that the American trade balance is less sensitive to dollar devaluation than was expected by many.

Since it appears impossible to improve our balance of trade to the necessary degree and to eliminate speculative short-term capital flows merely by an adjustment of the external value of the dollar, and since the necessary stimulation of the domestic economy prohibits the establishment of domestic interest rates high enough to encourage long-term capital flow to this country, one must conclude that the free market mechanism is incapable of restoring our balance of payments. It will be necessary to resort to qualitative controls.

Such qualitative controls have already spread around the world. Almost all strong currency countries have limited the access to their own currencies by a great variety of exchange controls. Rather than add to their dollar reserves or accept the depressing effect of the upward revaluation of their currencies they have curtailed the purposes for which their currencies may be acquired.

Meanwhile the United States has not gone beyond the by now old established Interest Equalization Tax and Foreign Direct Investment Regulations which have been insufficient to balance our payments. Thus the United States is standing by idly while the dollar loses the only convertibility which matters; namely, the convertibility into goods, services and investments. Furthermore, this limitation of convertibility being due to foreign regulations, it is the foreign governments which decide what is permissible and when such limitations are to be lifted. It would be far better for the United States itself to do the inevitable and limit the flow of dollars from this country to what the world is willing to accept.

The dollar, in the long as well as in the short run, has preserved its purchasing power better than almost any other currency. The elimination of speculative transactions directed against the dollar would make it possible for the inherent strength of the dollar to show itself. This country would then have a firm basis for its negotiations with the rest of the world. Once this stance is achieved it will become evident that the necessary restrictions may not have to beim posed for any great length of time because the world will again become hungry for dollars.

Until at least near-equilibrium in our foreign transactions is reached, there is also no point in negotiating about even limited convertibility of the dollar as demanded by the Europeans. A "funding" of the existing central bank holdings of dollars will be of little help. Everyone knows that they are inconvertible anyway; and as long as this country continues in deficit in amounts close to the present ones, our reserves could become exhausted in short order even by future accumulations of dollars in official reserves.

The necessity to act will rapidly become more urgent because reliable forecasts of this country's deficiency in energy sources show that within three or four years we may have to import approximately an additional $2½ billion worth of oil products and by the end of this decade an additional $8 billion. If this country has to find sums of this magnitude in addition to the billions required to eliminate our present trade deficit, not only a fundamental restructuring of our export trade but also import controls will be required. These additional sums cannot be created by changes in the exchange rate or tax incentives.

The measures required to restore our balance of payments are quite alien to established thinking in this country, but I am afraid inevitable and preferable to the chaos which may result before long in their absence. I suggest the following:

1. The carrying out of foreign exchange transactions should be limited to licensed banks. Banks should be given guidelines as to what transactions should be carried out, such as normal trade demand and what transactions should be refused, in particular, obviously, speculative movements of funds either in anticipation of currency devaluation or for the purpose of profiting from higher interest rates abroad. In the beginning all banks in this country and the foreign branches of domestic banks should be licensed, but licenses should be withdrawn from banks violating the guidelines.

It should be remembered that the circle of those who benefit from speculative transactions in rather small and that the upheaval created in the foreign exchange markets by these transactions in one way or another damages most of the population. The barrier erected between domestic and foreign money markets will make it possible to carry out a productive domestic monetary policy without always looking over one's shoulder at the foreign markets.

2. The exemptions from Foreign Direct Investment Regulations should be greatly reduced, and in particular the exemption authorizing unlimited investment of funds borrowed abroad should be done away with.

A great deal has been written about the question whether Foreign Direct Investment is beneficial for the balance of payments, but there seems to be no doubt that in most instances the results are an out-flow which over a number of years may be more than counterbalanced by an in-flow of profits. Whatever the benefit of Foreign Direct Investment may be in normal times, these are not normal times. Right now an out-flow of anything like $5 billion per annum for Foreign Direct Investment cannot be justified. Moreover, since the beginning of the restrictions, in excess of $10 billion has been borrowed. The service charge on these loans must now exceed $1 billion a year. Some of the principal of the earlier borrowings is falling due. The interest on dollar investments held by foreign central bank reserves is on the order of $2 billion per annum. If we continue the present policy we will approach the situation of some Latin American countries where just the service charges on the foreign debt have become an unmanageable item.

For a limited period of say two or three years, no Foreign Direct Investment, not even with funds borrowed abroad, should be permitted except where the prospective investor can show either

(*a*) that the investment will be offset by increased foreign exchange inflow within two years; or

(*b*) that the money is required for an addition to working capital or inevitable and non-deferrable capital investment for the purpose of an already-established type of business of an existing subsidiary.

3. With somewhat less urgency the Government should prepare the mechanism required to curtail non-vital imports.

This of course would be a big step away from the long-established principles of free trade. There are grave doubts in my mind whether under present conditions free trade is really more beneficial to the nation as a whole than a policy of using this country's purchasing power for bargaining purposes.

4. At the present time U.S. exports constitute only 4% of the Gross National Product. Only 4% of American business is active in exports. Germany, on the other hand, exports 18% of her Gross National Product. A 1% increase in the exported percentage of Gross National Product would do wonders for our balance of payments. I suggest that alongside with our strict adherence to the principles of free trade we jettison our doubts and the contractual obligations which at present prevent us from an outright export subsidy. This may lead to retaliation, but I believe when it comes to that the United States has the longer breath.

In the last few years the Government of the United States on various occasions has had the courage to break with long-established policies when the good of the country required it. I hope it will not hesitate to do so in order to re-establish the respect for our currency.

Statement of Henry H. Wilson, President, Chicago Board of Trade

Mr. Chairman, Members of the Committee, I welcome this opportunity to inform you of the Chicago Board of Trade's position as you continue hearings on Gold and the Federal Reserve Bank's intervention to support the American dollar. I speak today in behalf of the right of United States citizens to conduct transactions and own Gold, a freedom which has not been in existence since the passage of the Gold Reserve Act of 1934 under the administration of President Franklin Delano Roosevelt. The recent diminution of the role of Gold in monetary affairs in the United States associated with the elimination of reserve requirements for Federal Reserve notes and deposits represents the removal of any obstacles for domestic ownership of Gold. There is no longer any reason for not permitting a free market to operate.

The traditional benefits associated with a more efficient allocation of resources as a result of the free interaction of supply and demand provide the rationale. These allocation benefits are potentially enormous. A result may be in the operation of marginal U.S. mines thereby increasing employment and the gross national product. The Chicago Board of Trade has written a contract in Gold futures and trading will commence once this prohibition is repealed. Futures trading in gold would play the same vital role it does in other markets such as soybeans, silver, etc., which are currently traded on the Chicago Board of Trade. This consists of providing an alternate market to producers, aiding in the dissemination of prices and industrial data and facilitating hedging. The latter is simply a mechanism for efficiently transferring risks associated with price changes. The futures market should also stabilize prices. It seems reasonable to conclude that an elimination of the prohibition on the private ownership of Gold coupled with the establishment of a futures market should be of value to the Gold industry in particular and the United States economy in general.

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