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Is the End of the Gold Era Nigh?

by Dr Wolfgang Schömb, Bad Harzburg

Gold as a major element of currency systems has gone through a wildly fluctuating history. A new chapter of this history is at present being written. The gold market has become particularly interesting, since the Central Banks came into being, for these decline to provide supplies for stilling private gold demand. Which were the reasons for this refusal, and how will gold's history continue? Have the most recent events—the division of gold markets and the decision to establish special drawing rights—already set up a final situation, or is this only an intermediate stop on our way towards a complete separation of gold from international currency relations?

Underlying Causes of the Gold Rush

There is no gainsaying that the persistent imbalance from which the British and the US international payments situations have been suffering was one of the underlying causes, though in different measure, of the turmoil into which world currency relations were recently plunged. However, as the imbalance has been a perennial problem for a long time this cannot have been the only motive for gold speculation. There are reasons for suspecting that, in March, 1968, the ultimate aim of the speculators was to enforce an increase in gold prices, which has been in the offing for many years past. It is clear that a strong pressure group of interested parties, consisting of gold holders and of speculators in gold, invaded the gold markets in force. They were joined by the opponents of the dollar, who saw their appointed hour approach when their secret desire for devaluing the US currency seemed to be on the threshold of fulfillment. However, there are signs for justifying the assumption that the main motive imbuing gold speculators with zest was the chance to make a financial cut and not the deliberate aim to topple the dollar from its pedestal.

Even the least informed observer must see clearly now that an increase in the price of gold need not inevitably cause dollar devaluation. It is possible to visualise a devaluation of the dollar which changes only the dollar's gold parity but leaves unaffected the gold prices expressed in all the other currencies. Conversely, a general increase in gold prices would mean a general devaluation of all currencies, not only of the dollar, provided that their mutual rates of exchange, as well as their dollar value, are not affected. The French apparently did not see these interdependencies quite clearly, for a long time. Dollar devaluation in isolation, of course, would have

satisfied the French intentions, but at the same time, the competitive power of all the nations participating in world trade, including that of the French economy, would have been adversely affected by it. During the days of the storm, this was realised but only just in the nick of time.

On the other hand, a general increase in the price of gold would profit all the holders of this precious metal greatly. Among such holders, the most important one is, of course, the United States. It is hard to see why France should be so keen on raising the price of gold, as dearer gold would immediately enable the US to provide full for cover its exchange commitments once again by gold. France could not possibly reach, in this way, either of its two possible objectives—neither could it interfere in the United States' economic policies nor would it be capable of casting the dollar down from its throne. There is, in fact, no better support conceivable for the dollar, in its role as reserve currency, than doubling the nominal dollar value of US gold holdings.

It will probably never be possible to find out with sufficient certainty who were the decisive vested interests that caused the rise in gold demand. It is virtually certain that different groups with different motives took part in the push to upvalue gold. The spark that fired the engine was probably supplied by gold speculators who intended to utilise for their own purposes the difficulties into which the world currency system had been plunged by the devaluation of sterling and by the crisis in the US balance of international payments. It is highly likely that pressure was reinforced by those who want to see gold cost more, for reasons of their own currency policies. And finally, it may be assumed that gold producers supported the speculation directly or indirectly. It is easy to see why those that process and that use gold, once the ball got rolling, also started to hoard gold, for a potential purchaser who lets time slip by until he may have to pay more for the same commodity needs to have his head examined. It may be taken for granted that many holders of dollars and sterling, at the time under discussion, became apprehensive lest further devaluation be inevitable, and therefore tried to hedge against such dangers by getting rid of their holdings. There was nothing more advisable than to swap dollars and pounds directly for gold. It is probable that dealers, in individual markets for gold, tried to hypnotise potential buyers into believing that gold prices had already risen

higher than they, in fact, had done, and a run on gold had become unavoidable.

Gold Price Developments

What will be the future effect of splitting the gold markets, following the decisions taken during the crucial days of March? The focal question is whether the gold price in the free market will climb and thus become a fluctuating variable in the future.

Turning to the side of demand, any rise in the price of gold, caused by whatever influences, ought to be followed by contracting demand. As in the case of gold speculation is of particular importance, it is impossible to predict exactly the price level which must be reached for demand to decline. Much will depend on the time when bearish forces will gain mastery over the market. However, the proposition seems virtually unacceptable that a group might be formed which is as strong as the Gold Pool and strong enough to stabilise the price of gold at a firm level well above US \$ 35 per troy ounce. This means that on any level above \$ 35 per ounce, the price of gold would be exposed to strong fluctuations, which must probably deter private investors from sinking large funds in gold, since changing prices make gold holdings risky to private purchasers, once their illusions about a practically perpetual stability of gold values have been shattered. It is not to be expected that any Central Bank will buy gold for more than \$ 35 per ounce, as long as the US Federal Bank System continues to supply other Central Banks with bullion at a price of \$ 35. Only if the price of gold should slip below \$ 35 per ounce, would it be interesting to Central Banks as before to buy bullion in the free market. Neither will industrial demand for gold be able to push up the price of gold beyond \$ 35, since gold is subject to substitution in numerous forms in which it is used industrially. From the side of supply, there are also many signs that higher gold prices will not be tenable for long, even without the intervention of Central Banks. Gold producers have already announced that they will reopen former gold mines which had been closed, and that they will use existing capacities more closely to their limits. All this will exert pressure on gold prices.

And eventually, it may also be expected that all the gold hoarded by speculators will return to the market and place it under pressure once the situation has become completely clear again.

All this means that the hopes of gold speculators have proved, and will prove, vain. It is much more likely that demand for gold will drop than that it will rise, and on the other hand, gold supplies are likely to grow rather than to contract. Though it is impossible to make firm quantitative forecasts, since many unforeseeable influences come into play here, it may be safely assumed that the gold price in the free market will show moderate fluctuations and eventually come to a virtual rest on official parity. Seen from this angle, splitting the gold market was a very clever move of the Central Banks. It may even be conceivable that they can cover their gold requirements more cheaply in the free gold markets from now on than they could in the past.

Gold as a Tool of Currency

The tug-of-war for the gold price, at any rate, has damaged the reputation of gold as the stable foundation of the world currency system. Public opinion is now probably aware of the fact that the dollar's value as a reserve currency kept by Central Banks does not depend on how big the United States' holdings of gold are, but principally on the immense economic power of the North American Continent. What private holders of dollars had to learn ought to be much easier to be memorised by governors of Central Banks. This leads to the question whether there is still any need for gold as an instrument of the currency system.

Holding on to gold as an instrument of their currency policies, Central Banks behave in a way which is difficult to explain, except that they have not yet succeeded in finding a substitute for gold. Special drawing rights which are to be established as a new instrument of currency policy are no substitute either, and the difficult problem is not soluble in this manner, as drawing rights are not reserves but only additional credit lines. Therefore it is not possible to "invest" surpluses of a country's balance of payments in such rights. Yet this is the crucial question in the discussion as regards reserve instruments.



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