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CHAIRMAN OF THE BOARD OF GOVERNORS
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

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~~STRICTLY CONFIDENTIAL~~ (FR)

MEMORANDUM FOR THE PRESIDENT

FROM: Arthur F. Burns AFB

In preparing for the June 10-11 meeting of the International Monetary Fund's Interim Committee, the Treasury and Federal Reserve have agreed on all aspects of a U.S. position except for one point. But that one point is of fundamental importance. The manner in which it is resolved may well determine the shape of the world's monetary arrangements, and therefore affect our economic and political interests over the next generation.

The broad question at issue is whether central banks and governments should be free to buy gold, from one another or from the private market, at market-related prices. (Market prices have recently been in the range of \$160 to \$175 per ounce; the official price is \$42.22 per ounce.) The Treasury is willing to accept a large measure of freedom for such transactions. The Federal Reserve is opposed.

The specific point of controversy is whether to allow individual governments to increase their gold holdings above a specified ceiling (for example, actual holdings as of May 1, 1975). The Treasury is willing to agree to the position, taken strongly by the French Government, that there should be no ceiling on the gold holdings of an individual government. The Federal Reserve believes that individual country ceilings are essential, and that the United States should not agree to any new international arrangements on gold unless they incorporate such ceilings.

The January 1975 communique of the International Monetary Fund's Interim Committee, an internationally agreed document, stated that freedom for national monetary authorities to enter into gold transactions should "ensure that the role of gold in the international monetary system would be gradually reduced." Individual country ceilings on gold holdings, which the Federal Reserve favors, would contribute to this objective. The Treasury's position, on the other hand, will be interpreted by many as a withdrawal from the January understanding.

There are four basic elements in the Federal Reserve's stand on gold:

First, there is no compelling practical problem that requires early action on gold issues. Sizable borrowing facilities exist to help countries tide over emergency needs for balance-of-payments financing. Countries needing to use their gold holdings can either sell some gold in the market or arrange to use their gold as collateral for loans. Hence, there is no economic reason for being concerned about deferring a resolution of outstanding gold issues.

Second, until we and other countries have forged a genuine consensus on the desired shape of the future world monetary system, we should not isolate the gold question and deal with it apart from other critical issues of monetary reform. Moving ahead on gold in the absence of such a consensus may inadvertently and dangerously prejudge the shape of the future monetary system.

Third, early removal of the present restraints on inter-governmental gold transactions and on official purchases from the private market could well release forces and induce actions that would increase the relative importance of gold in the monetary system. In fact, there are reasons for believing that the French, with some support from one or two smaller countries, are seeking such an outcome. Countries such as France that are opposed to ceilings on their individual gold holdings undoubtedly want the freedom to buy in the private gold market so as to support the market price. It is an open secret among central bankers that, at a later date, the French and some others may well want to stabilize the market price within some range. In my judgment, therefore, there is a significant risk that the Treasury's recommended position would inadvertently foster, or at least permit, an increase in the relative importance of gold in the monetary system.

Fourth, a large measure of freedom for governments to trade in gold at a market-related price may easily frustrate efforts to control world liquidity. For example, such freedom would provide an incentive for governments to revalue their official gold holdings at a market-related price. (France has already done so.) This in turn could result in the addition of up to $150 billion to the nominal value of countries' reserves. Liquidity creation of such extraordinary magnitude would seriously endanger, perhaps even frustrate, our efforts and those of other prudent nations to get inflation under reasonable control. This is a matter of great concern to Mr. Witteveen, the head of the IMF, and to many other financiers.

As our government's policy on gold has evolved, the Federal Reserve has sought to avoid taking a rigid position. I have gone some distance to try to conciliate the French view:

> First, I have reluctantly agreed to a partial return of the International Monetary Fund's gold holdings to member countries; this action, strongly desired by France, would augment the gold stocks of France and other countries, but would weaken the IMF itself.
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> Second, I have proposed the important concession that a government may buy gold from another government, irrespective of its established ceiling, if the purchase will accommodate an emergency need by the selling government to mobilize its gold holdings; also that a government which had made a sale under emergency conditions could repurchase that amount from another government without involving the emergency provision.
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> Third, in view of a desire to come closer to the French view, I have suggested some lifting of the ceiling that would apply to an individual country's gold holdings (e.g., from 100 per cent to 105 per cent of the actual holdings as of May 1, 1975).

Indeed, I have even been willing to go further. I have consulted Henry Kissinger as to whether there is some political quid pro quo we might want to extract from the French in exchange for acceding to some part or all of their desired position on gold. But Henry tells me there is none at this time. Resolution of gold issues in their preferred manner is very important to the French, and they will probably be willing to pay a lot to get their way. If we do ever accede to French views on gold, we should at least use our bargaining leverage to achieve some major political advantage.

If the United States took a stand on the gold question that failed to satisfy the French in current international negotiations, would there be adverse economic or political consequences? I doubt it, for two reasons. First, some other European countries (most importantly, the Germans and the British) are unlikely to participate with the French in a European, go-it-alone policy on gold. I have a secret understanding in writing with the Bundesbank -- concurred in by Mr. Schmidt -- that Germany will not buy gold, either from the market or from another government, at a price above the official price of $42.22 per ounce. Second, there is in my judgment a reasonably good chance of a "successful" negotiation in Paris next week, even if it proves impossible to win French acceptance of individual country gold ceilings and other aspects of the U.S. position on gold issues. The political pressures to reach agreement on increases in IMF quotas are great. A package that included these quota increases and some other relatively un-controversial matters, but did not include agreement on gold, seems feasible and should be an acceptable outcome for the United States.

All in all, I am convinced that by far the best position for us to take at this time is to resist arrangements that provide wide latitude for central banks and governments to purchase gold at a market-related price. It is my understanding that this position is supported by Japan, the United Kingdom, by some other developed countries, and by most if not all developing countries. This position also commands strong support in our own country among those of the financial and academic communities that are sensitive to these issues. Severe criticism on the part of prominent and influential financiers would inevitably follow if the Treasury's present position prevailed.

Finally, I must point out that the Treasury's position on gold will have to be aired in Congressional Hearings when changes in the IMF Articles of Agreement come up for approval. In my judgment, Mr. Reuss, who is a leader on issues of this type, will denounce the Treasury's position on gold once he understands it. This is one more reason why you should ponder the gold issue very carefully.

Copy to:
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