The present inflated demand for gold rests upon persistent belief in the possibility of dollar devaluation and the confident expectation that, in any event, gold can always be converted into dollars without limit at no less than $35 an ounce. A change in asset preferences can be effected only by changing these expectations. Only in this way will the actual demand for dollar assets be brought into line with the underlying character of the dollar's international role.

Despite repeated official statements of the U.S.'s determination to defend the dollar and the steps which have been taken for this defense, belief in the possibility of dollar devaluation underlies the bulk of the private speculative demand for gold and probably exerts some influence upon the decisions of central banks and monetary authorities with respect to the composition of their reserves. So long as we stand ready to convert gold into dollars without limit at $35 per ounce, the holding of gold becomes a safe potential source of dollars, risking little more than the interest foregone. The desirability of gold as a monetary reserve asset depends upon the fact that the conversion of gold into dollars is universally taken for granted. If convertibility of gold into dollars were convincingly limited, gold not eligible for purchase by the United States would lose its usefulness as an international monetary asset. International settlements between foreign countries are largely carried out in dollars, not in gold, and it is scarcely conceivable that foreign central banks and monetary authorities would agree to use in settlements among each other an asset not freely exchangeable for dollars.

The kinds of steps which, in my judgment, the United States should take to alter prevailing asset preferences are given below:

1) The present 25% gold reserve requirement against Federal Reserve notes should be repealed and it should be made more explicitly clear than at present that all the monetary gold which the United States holds would be used if necessary in defense of the dollar. Gold should be treated not as a last line of defense to be conserved and husbanded but as a readily available reserve to be employed alongside swap credits and forward exchange operations and IMF drawings and other newly developed financial devices. Although we have reiterated our determination not to devalue, continuation of the existing reserve requirements against Federal Reserve notes together with U.S. zealousness to avoid gold losses whenever possible has created a widespread impression that in the face of persistent gold losses, the U.S. would resort to devaluation long before its 13 billion dollars of monetary gold had been exhausted.

It is widely accepted that if a devaluation of the dollar should occur, this would be accompanied or immediately followed by a general devaluation of other currencies. Consequently, devaluation of the dollar would do nothing to improve the competitive position of the U.S. in world markets, even if such an improvement were desired for balance-of-payments reasons. The chief effect of a devaluation of the dollar would be the change in the U.S. liquidity position through a writing up of the dollar value of monetary gold holdings. If a 50% devaluation were undertaken with a 13 billion monetary gold stock, the new value of that stock would be 26 billion dollars. This is the only advantage, if it be deemed an advantage, to be gained from dollar devaluation. (Since devaluation would greatly weaken the rest of the world's willingness to hold dollars and dollar claims, even this advantage would be illusory.) It should be noted that devaluation would be utterly pointless even in terms of the liquidity position of the U.S. if it were deferred until our gold holdings were exhausted, since with a monetary gold stock of zero, there would be nothing to write up. A general devaluation of currencies at a time when U.S. gold reserves were exhausted would only increase the dollar fetching power of foreign gold holdings and of newly mined South African and Russian gold. Although exhaustion of the U.S. monetary gold stock would doubtless necessitate a suspension of gold payments, it would not necessitate devaluation, which is a very different thing, and would, in fact, render devaluation pointless, except as a means of providing massive windfalls to foreign monetary authorities and gold speculators and mining interests. It is well understood, of course, that the U.S., without gold of its own, would not find it attractive to supply such a windfall to others. Belief in the possibility of dollar devaluation rests squarely, therefore, on the assumption that there is some floor to United States gold reserves not far below present levels and that if this floor is reached, the United States would feel "forced" to devalue. This belief would be greatly weakened if convincing evidence were provided that there is no such floor. Elimination of Federal Reserve requirements against Federal Reserve notes, together with greater use of gold along with swap credits and other financing devices for day to day international payments purposes would go far to destroy belief in the possibility of devaluation.