

in prices and costs inhibits the growth of reserves by discouraging gold production and diverting more of the gold output to private uses instead of monetary reserves. Under these conditions, the traditional gold standard could be restored and maintained after a great war only through a deep and prolonged deflation, such as that of the 1930's.

The Second World War is unique in having escaped a destructive postwar deflation, but only because the gold standard itself has been gradually freed from the rigorous restraints it imposed in the past. Countries no longer regard the amount of their gold reserves as an acceptable measure of the appropriate money supply. When gold reserves are not adequate to permit the growth of the money supply required by the economy, the reserve requirements are changed. Countries no longer regard the maintenance of the historical gold parities of their currencies as the primary objective of economic policy. When a country cannot correct its balance of payments at the existing parity, it no longer deflates the economy, it changes the parity with the approval of the International Monetary Fund. But gold still remains the most important form of international monetary reserves, and countries are only now beginning to make a rational adjustment to the effects of war on the growth of reserves.

The Second World War had the usual effect on gold production and gold reserves. In 1940, the gold production of all countries, excluding the Communist countries, was \$1,283 million. Gold production fell sharply during the war, and although it recovered after 1945, the prewar level of output was not reached again until 1962. There was a modest increase of gold production between 1962 and 1965, when it was at a peak of \$1,440 million, but production fell in the two following years, although it may rise slightly in 1968. Thus, gold production this year will be only 12 percent higher than it was 28 years ago. In every country except South Africa, production is substantially lower than it was before the war. In South Africa, production has increased because of the opening of new mines with high grade ore. But operating costs are rising, and there is no assurance that gold production in South Africa will continue to increase. At best, the growth of gold production hereafter will be very slow and it may, in fact, stay on a plateau or possibly decline.

Furthermore, as gold became cheaper relative to goods, and as money incomes rose sharply, more of the newly-mined gold was absorbed in industrial uses and private hoards instead of going into monetary reserves. In the 30 years since the end of 1938, the monetary gold stock of the world, excluding the Communist countries, increased from just under \$26 billion to just over \$40 billion, including the gold holdings of the IMF and other international monetary institutions. This is equivalent to an average annual increase of less than 1.5 per cent. Most important, the rate of increase has declined sharply. From 1938 to 1948, the monetary gold stock increased at an average rate of 3 per cent a year. From 1948 to 1958, it increased at an average rate of 1.4 per cent a year. In 1968, the monetary gold stock was virtually the same as at the end of 1958, although this was mainly because of the large sales by the monetary authorities of the gold pool countries to private holders in 1967 and 1968. In any case, as the members of the IMF will no longer sell monetary gold to the private market and as little or none of the newly-mined gold will be sold to the monetary authorities in the future, the monetary gold stock may be expected to remain frozen at about the present level of \$40 billion.

Foreign exchange reserves and reserve credit

A system of fixed parities, defined in terms of gold, cannot function satisfactorily unless there is an adequate growth of monetary reserves. In fact, international trade and payments have expanded at an unprecedented rate in the postwar period and the world economy has prospered, despite the very small increase in gold reserves. The international monetary system, although based on the gold standard, was able to adapt itself to a minimal growth of gold reserves because the need for additional monetary reserves was met in other ways—primarily through a steady increase of foreign exchange reserves and secondarily through the development of very large facilities for reserve credit.

Foreign exchange.—The enormous growth of foreign exchange reserves during and after the war was a once-for-all phenomenon that cannot be repeated. In 1938, the foreign exchange reserves held by all countries amounted to about \$1.8 billion. During the war, the United Kingdom financed a considerable part of its overseas military expenditures by the sale of sterling for local currencies to the monetary authorities—mainly in the Far East and the Middle East, but also in Europe and other regions. After the devaluation of sterling in 1949,