

But the gold forces underestimated the resolve of the U.S. Treasury and the other members of the Group of Ten to hold the official price. They adopted Governor Carli's plan for a two-tier system. The crucial provisions of this plan are that the central banks would not buy nor sell gold in the private market. (It is hoped that, at the IMF governor's meeting next month, this agreement will be generalized beyond those countries that signed the Washington communique.)

When we look at events in this way, we arrive at a somewhat different interpretation of the sterling and gold crises. The formal breakdown of the system was not the important thing. It merely recognized fundamental changes that *had already taken place*. A palace insurrection. The revolution had already been won. The system would not collapse with the increase in the price of gold because it had already evolved into a new system over a year earlier. Fear of the consequences of the change in the gold market for the system were misplaced. Because now, in August, 1968, the cards are on the table for all to see. An ounce of gold is worth about \$40 in the private market—provided South African supplies are kept away from the market. Everybody knows the price will go down when South African sales are resumed in full force, bearing in mind that there are perhaps about 18,000 tons of gold in liquid hoards in private hands. What holds the price where it is is the gamble that the monetary authorities might yet raise the price; hope springs eternal.

VI. WHERE WE NOW STAND

The monetary facts, however, are that the world has virtually moved onto a dollar standard. Of course the U.S. may claim that it buys and sells gold freely; but everybody knows it does not. The dollar has become effectively inconvertible into gold, even for foreign central banks. All the big central banks know that if they try to cash dollars for gold in large amounts, the U.S. would simply stop selling it.

This means that other countries have to hold dollars or adjust. Their only alternative is to eliminate their balance of payments surpluses. But if they want surpluses because they want their external reserves to grow, they have to hold dollars or a new international asset.

One might ask, however, "Does not the higher price of gold symbolize the weakness of the dollar, rather than its strength?"

The answer is a paradoxical one: "Yes, but weakness is an essential attribute of an international money."

Gresham's Law states: Bad money drives out good—if they both exchange for the same price. If gold is worth more as a commodity than as a money, it will not be used as a money.

If a central banker knew he could always get \$40 for an ounce of gold he would never settle a monetary transaction with gold valued in official stocks at \$35 an ounce. This means that if gold was always worth at least \$40 as a commodity, central bank holdings would become completely illiquid. To the extent that this is true—to the extent that gold on private markets *is* worth \$40—gold would cease to be an international monetary reserve. Usable reserve assets of the gold-holding central banks would be reduced to the dollar component of reserves.

It is on this basis that the two-tier system should *increase* the demand for dollars, which, to the extent that dollars are softer than gold, become the only usable reserve asset, as well as the only important international currency. The rise in the price of gold in the private market illiquifies or "demonetizes" it.

Now in fact this is an exaggeration. Gold is not really worth \$40 as a commodity. Every central banker knows that if he dumps gold onto the private market to get dollars, the price will go down—and fast. So the argument I am making is only partly true. Some central banks will sell gold to others at \$35 an ounce, as France has been forced to do. To this extent gold has not been completely demonetized.

VII. THE FUTURE

Our system has now evolved, therefore, into a dollar standard, for good or bad. This system has some great advantages, but I would not want to claim that it is an ideal system, nor that it is permanent. Indeed, there are strong objections to it, from an international point of view, on both political and social grounds. Even in the U.S. there are objections to the system. Some of these objections are