cies defined in terms of gold at the present official price of $35 an ounce. The private markets for gold will be isolated from the monetary gold stock. The amount of gold and foreign exchange reserves will remain fixed at about their present level, and the growth of monetary reserves will take place through the issue of SDRs. Currencies will remain convertible, as they now are, with gold, foreign exchange, and SDRs all used together in balance-of-payments settlements. Such a gold standard is a natural evolution of the international monetary system in response to the needs of the world economy. Some of the problems that could arise because of a difference between the monetary price and the private market price of gold or because of a preference by some countries for gold rather than SDRs and dollars are discussed below.

II. PRIVATE GOLD MARKETS UNDER THE NEW GOLD STANDARD

Premium Gold Prices and the Gold Standard

Under the classical gold standard as it existed prior to 1914, national currencies were redeemable in gold coin. As people were free to use gold coin for any purpose—to export it, hoard it, or melt it—there was complete equivalence of gold and money at the mint price. Such an equivalence is not essential under a modern gold standard. It is true that except for a brief period, the price of gold in the leading private markets was about $35 an ounce from November 1953 to March 1968. But this 15-year stability in private gold markets was exceptional. From 1940 to 1953, the price of gold in private markets was always at a premium—sometimes at a very high premium. Furthermore, from 1961 to 1968, the price of gold in private markets was kept close to $35 an ounce only by large-scale intervention of the gold pool.

On October 20, 1960, a brief burst of speculation in gold was touched off by rumors, during the U.S. presidential campaign, of a possible change in U.S. gold policy. As a consequence, the price of gold in the London market rose to $40.60 an ounce and then quickly subsided. Some central banks regarded the premium price for gold as a serious reflection on the stability of currencies and therefore a strong encouragement to gold speculation. In February 1961, the gold pool was formed by the central banks of eight countries (France was in the pool until June 1967) to keep the price in the London market at not more than $35.20 an ounce. While sales of the gold pool did not ordinarily exceed purchases, except for brief periods, the gold pool had to support the market almost steadily during the past two years. On March 15, 1968, the London gold market was closed and the remaining members of the gold pool agreed to isolate the private market entirely from the monetary gold stock. This, in effect, means a two-price system—a fixed monetary price of $35 an ounce and a fluctuating price in private gold markets.

There are some who hold the view that a two-price system for gold is inherently unstable. They fear that some central banks will sell gold from their reserves at premium prices. They even see a possibility that some central banks will act as arbitrageurs, selling gold for dollars at premium prices and using the proceeds to buy gold from the U.S. Treasury at $35 an ounce. These fears are unfounded. A two-price system for gold is not a novelty. It existed all through World War II and for eight years after the war. The London market was not reopened (March 1954) until the premium on gold had been eliminated several months before.

It may be helpful to analyze the factors that determine gold prices in private markets. There is a steady demand for gold for industrial purposes and for hoarding in those areas in which gold is a customary form of investment for savings. In addition, there is a highly volatile speculative demand for gold that reflects the state of confidence in currencies. Until the formation of the gold pool, changes in the speculative demand for gold were manifested mainly in higher or lower prices, subject to the limitation that the price could not fall much below the monetary value of $35 an ounce. As would be expected, the price of gold (in U.S. dollars) was close to the postwar peak in July and August 1949, just before the devaluation of sterling and other European currencies. At that time, American smelting companies quoted an export price of about $50 an ounce, FOB New York, for foreign gold sold by them on consignment. Once the European currencies were devalued, the dollar price of gold for export to private markets began to fall and by April 1950 it was down to $38 an ounce, FOB New York. Except for a brief period at the start of the Korean war, prices continued to fall and by November 1953 the premium in private gold markets, except in the Far East, had virtually disappeared (Table I). Prices fell and remained at $35 an ounce from 1953 to 1960 because of the greater confidence in currencies, particularly the European currencies.