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# OPENING ADDRESS TO THE WORLD GOLD CONFERENCE

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I take particular pleasure in returning to the World Gold Conference three years after the last meeting here in Venice. It is a privilege for me to deliver this opening address and the number of presentations and the quality of the panelists promise a discussion of considerable interest. As on previous occasions, the Conference will cover a broad spectrum of issues concerning prospects for commercial gold and specific aspects of the market. It will also consider the role of gold in the world financial system.

Compared with 1987 the price of gold is down by more than 20 per cent, having dropped sharply in the past few months to about 350 dollars a ounce, the lowest price in four years. The prospects are uncertain, but there continues to be interest in gold as a reserve asset. In my introductory remarks today I will concentrate on the outlook for gold in the international

financial system from the standpoint of a central banker. In doing so, I shall recall some of the issues I drew attention to at the 1987 Conference; I shall also assess the impact of recent events on the attitudes of central banks towards gold.

The thrust of my argument three years ago was that gold could no longer serve as the linchpin of the international monetary system. Economic analysis suggested that it could not perform such a task and experience provided irrefutable confirmation. I shall not retrace the events that led from the gold standard to the Bretton Woods system and to the creation of the SDR in 1969 as a "paper gold" instrument to underpin the international monetary system and regulate official liquidity; but there has been a clear trend to "demonetize" gold and to move away from systems in which gold was predominant to one based on multi-currency reserve assets.

I would nonetheless submit that official attitudes to gold have not changed significantly of late, despite the vagaries of time and the natural transience of moods and intellectual fashions.

Gold still accounts for nearly 40 per cent of the official foreign reserves of the industrial countries, which hold some 85 per cent of the total stock of gold. The share of gold in countries' reserves varies widely however: it is 10 per cent in Japan and 20 per cent in the United Kingdom, and on the order of 70 per cent in France and Belgium as well as the United States. Since gold has the peculiar property of being part of a country's net wealth and not a claim on any foreign nation, and its value is not contingent upon any one country's discretion, monetary authorities and international financial institutions will continue to perceive gold as the ultimate store of value.

This is confirmed by the fact that some central banks that historically did not have very much gold have recently shown interest in building up their holdings. Japan is one instance, and among the developing nations, Taiwan. Roughly 10 per cent of their reserves are in gold and both countries have large dollar assets. Taiwan, in particular, acquired substantial amounts of gold between 1987 and 1988, and is reportedly seeking to increase its share still further.

By contrast, some industrial countries' central banks have been reducing their gold reserves. Canada disposed of more than 5 million ounces during the eighties, with the result that the gold share of its official reserves fell from about 80 per cent to below 30 per cent. Belgium, whose gold holdings still accounted for about 60 per cent of its official reserves at the end of 1988, has since sold about 10 per cent of its gold.

Looking ahead to the 1990s, one can reasonably expect some other central banks with large gold reserves to become net sellers; more generally, there may be a gradual shift of official gold from Europe and North America, which hold more than 80 per cent of the total, to other countries in both the industrial and the developing world.

One problem still facing official holders of gold in an international system increasingly based on multiple-asset reserves is how to exploit this non-interest-bearing and highly illiquid asset efficiently. One successful mechanism has been the partial mobilization of EMS member countries' official holdings through the creation of ecus against gold

deposits. This has permitted a considerable increase in their official liquidity, further enhanced by the provisions for the mobilization of official ecus introduced in 1985. This arrangement shows that it is possible to mobilize gold, and hence to create liquidity, at least temporarily, without recourse to outright sales.

Central banks have occasionally managed their gold more actively through loans at market rates or swaps with private investors: Canada, Switzerland and the Netherlands, for instance, have made "Location swaps". To my knowledge, however, only the Bank of England has regularly conducted profit-oriented operations in the market by making short-term deposits of gold with recognized market makers in London.

Proposals have recently been put forward to sell part of the IMF's large gold holdings (over 100 million ounces) to finance the arrears of member countries. The US suggested that the IMF should sell about 3 million ounces for this purpose. Other countries were concerned about the institution's financial integrity and objected to such an "up-front" sale. As an alternative they proposed that the gold be used as

collateral for ESAF resources to be loaned to low-income countries in arrears.

Apart from this, I do not expect gold to be called upon to play a greater role in the international financial system in the future, although I am not prepared to rule such a development completely out.

Specifically, gold cannot serve as the benchmark for fixed exchange rates or official liquidity. The scale of the divergences in "fundamentals" between the leading countries, and the conflicts between domestic priorities and external objectives do appear to preclude a return to fixed exchange rates worldwide and more actively "managed" liquidity creation.

A difficult middle way will thus have to be found between discipline and flexibility. The experience of recent years has shown that the key to greater exchange rate stability is closer economic policy cooperation between the leading countries. Exchange rate agreements of the Louvre type are, in fact, useful only insofar as they succeed in bending domestic policies to the requirements of international adjustment. In the

present system, as under the gold standard, exchange rate stability is only possible if countries are willing to subordinate their domestic policies to its achievement. The role of any standard is thus revealed as secondary if such willingness is there, ineffective if it is not.

A return to gold would not solve the problem. If an official price for gold were to be restored, strains in the payments system would follow; the growth and freedom of trade would be hampered if the price were irrevocably fixed, while speculation would be fueled if the price could be changed according to circumstances. As for international liquidity, historical experience with gold has shown that it is difficult to set a price that would result in exactly the right amount of gold being produced while avoiding inflation and recession.

On a related point, I remain very skeptical about the idea of a gold or commodity standard serving as an anchor for domestic monetary policy. In some quarters it has long been argued that price stability is more likely to be achieved by automatic mechanisms than by the exercise of central bankers' discretion, but in my view the traditional counterarguments are still

valid. In the first place, a gold standard would unnecessarily divert resources from the private sector to official reserves; secondly, changes in the relative price of gold could have adverse short-run effects on aggregate output and employment; and thirdly, a gold standard could bring international politics considerations into domestic monetary management in view of the concentration of world supply in South Africa and the USSR.

Although some issues and doubts remain to be settled, I find greater appeal in the proposals put forward in recent years for a commodity price index, including gold, to be used as an information variable, or as an indicator, in making judgmental assessments of national and international economic performance and in shaping economic policies.

This point was forcefully argued in 1987 by Robert Heller of the Federal Reserve Board. He stated that "focusing on commodity prices as an early and sensitive indicator of current and perhaps also future price pressures, the monetary authorities may take such an index into account in making their policy decisions"; he further stated that "if other central banks would use

the same global commodity price index as a consideration in their policy decisions, there would tend to be a congruence of domestic monetary policy actions across countries. As a result, exchange rate stability might be enhanced."[1]

A similar suggestion was made by Treasury Secretary Baker at the IMF-World Bank meetings in September 1987; the United States was prepared to use a commodity price indicator including oil and gold to provide early warning of potential price trends in the G-7 coordination exercise. This proposal was endorsed by Ministers and Governors of the Group of Seven in April 1988 and such an indicator has indeed become a standard analytical instrument in the box of tools used to monitor economic developments, though it was decided to exlude the gold price.

Gold's international monetary role could possibly be enhanced by the dramatic changes unfolding in the countries of Eastern Europe. Their previously stagnant and largely insular economies are now

1. Robert Heller, Anchoring the International Monetary System, The Heritage Foundation, Washington, March 24, 1987.

undergoing reform and seem poised for a transition towards market systems with convertible currencies and a larger measure of integration in world trade. One could thus envisage a situation in which gold would acquire renewed prominence. In particular, the large supply of gold held by the USSR could be used to back the move towards a convertible ruble or as collateral for loans and lines of credit in world financial markets. Cases of the latter have been reported recently in the specialized press and this use appears to be gaining momentum.

In this context, Governor Angell of the Federal Reserve recently suggested that a gold standard might provide a monetary anchor for the Soviet Union during the transition from central planning to a market-oriented economy. He argued that "two unique features of the Soviet situation might make the gold standard a suitable means of providing monetary discipline. First ..., during the transition there would be a great deal of uncertainty about policy and even about the exact nature of fundamental economic relationships. A monetary anchor of gold, with its implied discipline and historical association with long-run price stability, might reduce these uncertainties. ... Second ..., the

country's prominent position in the world gold market in terms of reserves as well as volume of production. This position would seem to impart extra credibility to the ruble-gold convertibility".[2] Governor Angell has also suggested that the Soviet Union issue "gold-backed ruble development bonds" to attract foreign capital to finance its economic restructuring. The USSR's ample supply of gold would make such a guarantee credible and the rate of interest on these convertible rubles might turn out to be quite low.

Despite their appeal, these proposals are nonetheless open to some of the same objections I raised earlier. First, it would be very difficult to set the initial price of gold; if it were "wrongly" priced, there would be money supply shocks. Second, even if the "right" price were to be found, prices and interest rates around the world would not remain stable, giving rise to international flows of gold and thus to undesirable fluctuations in the domestic money supply. Lastly, in the longer run the low price elasticity of gold output might cause it to be inadequate to the needs

2. Wayne Angell, Monetary Policy in a Centrally Planned Economy Restructuring Toward a Market-Oriented Socialist System, The Institute of the USA and Canada, Moscow, September 4, 1989.

of a fast-growing economy.

This brings my introductory remarks to a close. Other eminent participants will discuss some of the issues I have touched on at greater length and I shall be most interested to hear to their views. Thank you.