GOLD AND THE INTERNATIONAL MONETARY FUND

By Günter Wittich

Gold has been largely removed from the Fund's Articles of Agreement as a basis for transactions, and its role in the exchange system and as numeraire has been eliminated. This bare statement, however, fails to bring out the full implications of the changes in the role of gold brought about by the Second Amendment of the Fund's Articles. More important, it neglects the fact that gold remains an important asset among international reserves that must be taken into account in the Fund's mandated surveillance of international liquidity.

The breakdown of the par value system in the early 1970s led to a prolonged discussion of possible reforms of the system, including a gradual reduction in the role of gold. The main elements of the consensus on gold that eventually emerged in these discussions were:

* that there would no longer be an official price for gold;
* that the various obligations of member countries to use gold in transactions with the Fund would be abolished;
* that part of the Fund's gold holdings would be sold for the benefit of developing member countries; and
* that another part would be sold to all Fund members at the official price.

It was also agreed that there would be no action to peg the price of gold in the future and that the total stock of gold in the hands of the Fund and of the Group of Ten countries and Switzerland would not be increased. The latter agreement entered into effect in February 1976 for a period of two years; it was allowed to lapse in February 1978 in view of the then pending Second Amendment of the Articles.

The Second Amendment

As gold formed such a pervasive element in the original Articles of the Fund, the changes introduced by the Second Amendment were numerous. The most important of them are the following. Gold was eliminated as the common denominator of the par value system and as the unit of value of the SDR (special drawing right). Although there are now no par values, the amended Articles allow for the reintroduction of exchange arrangements based on stable but adjustable par values. Any new par values would, however, have to be expressed in terms of the SDR or of some other common denominator: as a legal matter, gold (or a currency) cannot be such a common denominator.

The Amendment also abolished the official price of gold of 0.888671 gram of fine gold per SDR by eliminating the definition of the value of the SDR in terms of gold. The value of the Fund's holdings of members' currencies is now maintained in terms of the SDR and the value of the SDR is based on a basket of currencies.

The elimination of the official price of gold also removed restrictions on dealings in gold among member countries. Before the Second Amendment, monetary authorities were not permitted to purchase gold at a price higher than that corresponding to the par value or to sell it at a lower price. Thus, in effect, when market prices differed from the official price, gold was unlikely to be used as a means of payment between monetary authorities. Under the amended Articles, there are no restrictions on the freedom of monetary authorities to enter into gold transactions among themselves or with the market, except for the general undertaking regarding world liquidity and the role of the SDR. Moreover, the Amendment explicitly forbade the Fund to restablish a fixed price for gold or to manage its price in the market. The Amendment, in addition, eliminated the obligatory use of gold as a means of payment to and by the Fund.

The use of the Fund's remaining gold holdings was regulated, and it was laid down that part of the Fund's gold holdings would be sold. For additional gold sales, the Amendment required a high majority (85 per cent) of the voting power. Subject to such a majority, the Fund can sell from its remaining gold holdings to countries that were members in August 1975 at the former official price in proportion to their quotas on that date or to members or others at a price based on prices in the market. The Amendment also specified potential uses for proceeds of the sales in excess of the former official price. These uses include temporary income-producing investments; assistance to developing members in difficult circumstances; and addition to the Fund's general resources for its normal operations, accompanied by a proportionate increase in quotas.

The concern that dealing in gold by the Fund might seem to establish a new official price gave rise to the circumscription that gold sales be made "on the basis of prices in the market" rather than "at the market price": this was intended to specify that in its transactions in gold the Fund should seek to follow rather than determine or even direct prices in the markets. But the Amendment went one step further and included an undertaking that members collaborate with the Fund and with other members with respect to reserve assets, so as to achieve better surveillance of international liquidity and to promote the role of the SDR as the principal reserve asset in the international monetary system.

Gold Sales Program

When the Fund was founded, gold formed the ultimate reserve asset and it was considered important for the financial strength of the insititution that member countries pay part of their subscription in gold. A number of other payments, such as charges or specified repayments to the Fund also had to be made in gold. The Fund also acquired gold in a variety of other ways, including purchases from South Africa after the introduction in 1968 of the two-tier gold market arrangement, which entailed the separation of official from private markets.

At the time of the discussions on reform and on the future role of gold in the monetary system, the Fund's gold holdings were equal to more than 150 million ounces, or 4,710 tons. The Fund was, in fact, the second largest official holder of gold in the world after the United States. As part of the consensus on the reform and as a contribution toward reducing the role of gold, it was decided in 1975 that one third of the Fund's holdings, or 50 million ounces, should be sold.

The gold sales were carried out over the four years from June 1976 to May 1980. During most of this period, gold prices continued to rise. The Fund held 45 auctions in all, at prices very close to London fixing prices. Proceeds of these gold sales amounted to US$5.7 billion, of which $1.1 billion represented the capital value of SDR 35 an ounce which was added to the Fund's general resources. $4.6 billion represented profits that were channeled to the Trust Fund, which was established in 1976 to make balance of payments (BOP) assistance available to eligible developing member countries.

The Fund's gold sales program was completed in May 1980, and its present gold holdings amount to about 103 million ounces. These holdings contribute to the Fund's financial strength and to its ability to borrow additional resources to meet its members's needs. The requirement that further gold sales by the Fund be agreed to by a majority of 85 percent in the Fund's Executive Board presupposes very wide agreement among the Fund's membership that such sales would contribute to the achievement of its purposes.

A number of proposals have been made to use the gold still held by the Fund. These include, to cite a few, the resumption of gold sales to member countries at the former official price; further sales to the market and use of profits from these sales to provide BOP support to developing countries on concessional terms; use of gold sales profits to subsidize interest rates on drawings on the Fund by low-income developing countries; and transfers to strengthen the financial base of a substitution account that was proposed to allow substitution of international reserves held in the form of foreign exchange into SDR-denominated assets. None of these (and other) proposals so far has found the required broad support among the Fund's membership.

Valuation, Role in World Liquidity

Gold continues to form a substantial part of the international reserve holdings of a number of central banks. Since gold holdings are very unevenly distributed, the importance of its share in an individual country's reserve holdings varies greatly. Almost four fifths of official stocks are held by the countries of the Group of Ten (industrial countries); holdings of other countries are generally small in absolute amount and in relation to other forms of international reserves.

Although gold remains an important part of international reserves, a large element of uncertainty attaches to the exact value of gold holdings. Two factors in particular have introduced substantial uncertainty: the abolition of a fixed and guaranteed price at which monetary authorities are assured they can buy or sell gold and the narrowness of the private gold market and consequent potential for sharp fluctuations in the market price if sales of substantial amounts should be found necessary.

Monetary authorities, hence, are no longer certain that they can mobilize their gold reserves for settlement or intervention purposes at a known price. Gold can be used as collateral for loans from other monetary authorities or from commercial banks, but the value that will be attached to it is not known in advance.

It is therefore not surprising to find a great diversity in the valuation of gold in official reserves. Of the 109 countries reporting official gold holdings to the Fund, 56 countries, which hold about 48 per cent of reported gold reserves, continue to account for their holdings at the former official price. Of the 35 countries that value gold holdings at market-related prices, 22 use the latest market price, or an average of prices over a recent period, and 13 use market or average prices reduced by a discount which ranges from 5 per cent to 35 per cent. The remaining 18 reporting countries use a variety of other methods to set the value of their gold holdings.

Finally, members of the European Economic Community have deposited 20 per cent of their gold holdings and their foreign exchange reserves with the European Monetary Cooperation Fund in return for an equivalent amount — valued at market prices — of European currency units (ECUs), which means at least a partial market valuation by countries that had not already done so.

For the Fund, the question of valuation of gold arises in a number of contexts. The amended Articles prescribe the manner of valuation of gold for some purposes but for others leave the choice of method to a later decision. The valuation of gold under the amended Articles is thus not a simple or unitary one but rather one that permits the application of different principles as the circumstances may require. In its financial statements, for instance, the Fund continues to value its holdings at SDR 35 an ounce. The same value is used in connection with the Fund's financial operations with member countries, which call for a consistent and independent valuation of members' reserve holdings: when it extends loans in support of stabilization programs, the Fund uses SDRs and the currencies subscribed by its member countries. Particular currencies to be used during given periods are determined on the basis of members' balance of payments strength and reserve holdings. But for this judgment gold has to be valued consistently and thus independently of the valuation attached to it by the member itself. The Fund uses the price of SDR 35 an ounce for this purpose.

Another difficult but important application of the valuation of gold is in the appraisal by the Fund of the adequacy of international liquidity. Such appraisals are undertaken periodically and published in the Fund's Annual Reports. They are also necessary in conjunction with decisions to allocate SDRs and in the quinquennial reviews of Fund quotas. Here the valuation of gold presents particularly difficult issues and rather than attempting to establish any general guidelines, the Fund has handled the method of valuation on an ad hoc basis depending on the purpose of the analysis. It has often been found useful to present more than one measure. In its Annual Reports, for example, the Fund in recent years has given data on gold holdings both in physical terms or at the constant value of SDR 35 an ounce and at market prices.

The valuation of gold in international reserves, whether for individual countries or in the aggregate, thus clearly has become more complex. It is also an area that is of great importance not only to individual countries, whether or not gold forms an important part of their reserves, but to the system as a whole. It is for this reason that one might expect it to be a question that will continue to be of concern to the Fund's member countries in order to promote a better international surveillance of international liquidity.

* This theme has been developed at greater length in an article by the author published in *Finance & Development*: September 1982/ Volume 19/ Number 3.

BARRY BRACEWELL-MILNES
Land and Heritage: The Public Interest in Personal Ownership
The Institute of Economic Affairs, London, England, 1982

> "The tax burden on heritage assets is a problem common to a number of industrialised countries. But it is aggravated in Britain by the exceptionally heavy structure of capital taxation ... In this country since the war a high-tax regime has been maintained, alleviated by reliefs for heritage assets too late and too grudging to prevent the destruction of buildings and the dispersal of their contents on a scale not experienced since the dissolution of the monasteries."

This damning judgement comes from Dr. Barry Bracewell-Milnes' new book which argues that there are strong public advantages in the *personal* ownership of land and heritage assets, compared with corporate or government ownership, apart from the intrinsic virtues inherent in private ownership of any form of property.

Dr. Bracewell-Milnes seeks to develop a welfare theory of ownership, stating that "Utility, the stuff of economic wellbeing in the traditional economic doctrine, is obtainable from ownership as well as consumption." He takes issue with the consensus among economists that ownership has value merely as "potential consumption" or the "power to consume." In contrast with consumption, ownership has more than one primary purpose: "Wealth is not valuable only as spending power ... The enjoyment of spending power provides a starting point; but other primary purposes, such as the perpetuation of the family name, may depend on this power's not being exercised."

Emphasizing the concept of wealth in terms of the basis of family security and psychological wellbeing, he continues: "Wealth can have utility even if the connnection with consumption is so attenuated as to disappear entirely." The author elaborates the concept of subjective illiquidity" to describe the nature of wealth invested in assets which for sentimental or other personal reasons the owner would be reluctant to sell