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The IMF and Its Phantom Gold Sales

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The IMF as the linchpin of the fixed exchange rate regime

The International Monetary Fund (IMF) was set up in 1944 by the victorious allied powers at Bretton Woods, N.H. It was designed to serve as the linchpin of the post World War II international monetary system based on fixed exchange rates. It was well-understood that there could be no fixed exchange rate system without a gold anchor. Thus gold was retained as a bedrock, but multiple credit expansion was permitted, even encouraged. The U.S. dollar was to be treated as equivalent of gold. This meant that gold was double-counted in the system. Member countries were called upon to subscribe their quota of IMF capital in gold, called the first tranche, which set the limit of each member's line of credit with the IMF called drawing rights. A second tranche was also available to members in good standing in case of emergency (read: in case of a run on the central bank).

The system worked tolerably well for some 25 years. But it was flawed on the strength of double-counting the gold reserve. Every time a government imposes on the market two different standards of value to be enforced as equivalent, the market hits back through the operation of Gresham's Law. The postwar international monetary system was no exception to this rule. The bad penny (the dollar) drove the good penny (gold) out of circulation. Gold hoarding by governments and individuals snowballed. By 1968 the dollar was being dumped all over the world in anticipation of a dollar devaluation (the favorite bet was the doubling of the statutory price of gold from $35 to $70 per oz. which was supposed to pacify the market at the time.) It should be noted that the original IMF Charter provided for the devaluation of the dollar in terms of gold (with all foreign exchange rates remaining unchanged) in case of "fundamental disequilibrium".

On August 15, 1971, in a surprise move President Nixon, instead of devaluing the dollar, defaulted on the obligation of the U.S. to pay its debt to foreign governments and central banks in gold at a fixed statutory rate of exchange. In turning the dollar into an out-and-out fiat currency Nixon ignored monetary history and logic. The dollar became vulnerable to open-ended debasement and depreciation. Nixon also ignored moral considerations, as well as the long-standing commitment of the U.S. enshrined in a number of international treaties, including the IMF Charter, to keep the dollar convertible into gold on demand. Reneging on this solemn commitment was in shocking disregard for international rights and obligations. It released the genie of world-wide inflation from the bottle, never to be able to put it back. Worse still, interest rates were destabilized world-wide, a development without precedent. Like the wrecker's ball, swinging interest rates were to demolish productive capital. The U.S. and world economy were now sailing in uncharted waters with no compass, no rudder, and no anchor; while the sea was growing stormy.

Nixon was badly advised. His mentor was Professor Milton Friedman, the high priest of monetarism, a man who would completely ignore things like good faith behind promises and the honor of governments in signing international treaties, in a single-minded pursuit of his obsession with the Quantity Theory of Money. This theory teaches, falsely, that the value of the dollar can be maintained by a “quantity-rule” in the face of chicanery, default, and reneging on promises, by means of keeping the annual rate of increase in the stock of “high-powered money” at a moderate 3 percent. Apart from the fact that it may not be possible to fix the rate at 3 percent because of the tendency of debt-accumulation to accelerate under the regime of irredeemable currency, the idea that the value of dishonored promises can be maintained through the stratagem of restricting their quantity is preposterous. If it were true, poverty could be abolished by training the poor to ration lies.

Time has proved other theories of Friedman wrong, too. His theory of equilibrating the balance of trade through the floating exchange rate mechanism is utterly wrong. Friedman asserted that there is such a mechanism which works analogously to that of the gold standard. According to him, if the foreign exchange value of the dollar falls, that will automatically decrease imports to the U.S. as well as increase exports from the U.S., and the favorable balance of trade will soon stop the fall of the dollar. Alas, that’s not what has happened. The exchange value of the dollar has kept falling ever since 1971, with the greatest part of the fall still in store, and the only observable increase in exports being the export of the well-paid industrial jobs due to outsourcing. Entire industries such as steel-making and TV-manufacturing have been closed down, with auto-making likely to be the next extinct industry in the U.S. The ordeal of American manufacturing is the handiwork of Friedman. The fact is that the value of dishonored promises cannot be artificially upheld by a “quantity rule”. Predictably, the *floating* dollar turned out to be a *sinking* dollar, an insurmountable handicap on producers trying to compete in the world market. Their terms of trade is deteriorating while that of their competition is improving. Incredibly, mainstream economists and financial journalists still find it possible to treat the suggestion with respect that the weak dollar is a prop to the export industry, even after the devastation of America’s export industry through the disastrous experiment with the falling dollar.

The IMF as the anti-gold war-horse in the Treasury’s stable

In 1971 the question arose what to do with the IMF which had been conceived as the antithesis of floating. With the advent of the New Brave World of flexible exchange rates the IMF lost its *raison d’etre* as the mainstay of the fixed exchange regime. The obvious course of action would have been to dismantle it and to return the subscribed quota of capital, gold, to the rightful owners, the member countries. However, it is easier to create a bureaucracy than it is to dismantle it.

Policymakers at the U.S. Treasury (which still controlled the world’s largest hoard of gold ever assembled) were girding up their loins to keep the gold price in check. The demand for gold was increasing by leaps and bounds after the American default and there was a clear and distinct danger that the dollar would in short order go the way of the Assignat of 1790 France and the Reichsmark of 1923 Germany. Policymakers thought that it would be a shame to dissipate the IMF gold by returning it to members. The IMF gold could come handy in suppressing the price of gold. After all, the IMF gold hoard was the second largest ever assembled in the world and the threat of dumping it could be formidable.

The U.S. Treasury started dropping broad hints that the scrap metal at the IMF should be auctioned off without further ado. Soon it became clear that members did not have a stomach for the Treasury’s plan. They argued that the IMF gold belonged to them and was not available, even for such a noble effort as to save the face of the dollar. The dispute was not allowed to continue in public and a compromise was reached. Member countries agreed not to press their claim to ownership. Instead, they agreed to extending the life of the IMF under a modified Charter, against U.S. commitment to auction Treasury gold instead of IMF gold, after a one-shot deal of auctioning off a token amount of the latter with part of the proceeds being restituted to members. By the new Charter members had the right to sell gold to the IMF at the official price of $42.22 per oz, but they were forbidden to buy gold in the market at prices higher than the official price “at which the U.S. Treasury and the IMF was committed *not* to sell gold”. An exception was made in the case of South Africa, a pariah member of the IMF, which was deprived of its right to sell gold to the IMF at the official price. Thus South Africa was forced to dispose of its huge gold production in the market. This was done to scare the wit out of gold bugs threatening them with the prospect that the gold price could fall below $42.22, or even below $35. Needless to say that this was an empty threat based on the idiotic notion that the price of gold could permanently fall below $35. The financial annals fail to show a single instance in which the dishonored paper of a banker went to a premium, instead of a discount!

Apparently, the compromise is still in effect. Treasury-inspired hints are occasionally dropped about future IMF gold sales trying to placate the stirring gold market, but no actual sales are conducted. At one point the Clinton administration asked Congress to approve an IMF gold sale, but it was voted down. In vain was the proposed sale couched in the language of a grant to developing countries, an odd combination of banking and charity. The puerile idea that "barren" gold reserves ought to be replaced by "productive" interest-bearing dollar reserves has been floated from time-to-time, but did not fly, in view of a negative return to capital after inflation is taken into account.

The old Treasury war horse of looming IMF gold sales is trotted out from time to time more as a scare-tactic to threaten gold bugs than a serious proposal. A public showdown with the membership over the ownership claim is to be avoided at all cost. The latest episode was the announcement in early February, 2008, that the IMF plans to sell gold from its reserves. Another announcement from the G-7 meeting in Tokyo confirmed that the sale may come as early as April. It was not mentioned where the authority to sell would come from. These announcements are hardly credible. The established pattern shows that the IMF is maintained strictly as a paper tiger to prey on jittery gold bugs. However, while the G-7 can press for the restitution of gold, the minority of members have a veto power on the G-7 proposal to sell it. As the gold price climbs, selling IMF gold becomes less and less appealing to members. It appears that the U.S. Treasury is again flagging a dead horse for its propaganda value. It is time again to plant fear into the hearts of the gold bugs. But neither the probability that the sale plan will ever be approved, nor the actual size of the proposed sale (13 million ounces worth about $12 billion) justifies fears that the price of gold will be shoved back down to the $500 level by these announcements, as suggested by Mike Bolser in an interview published in the *World Net Daily*.

When on Monday, February 25, the Bush administration announced that it would give approval to the plan "to sell gold bullion in order to stabilize the IMF's shaky finances", the knee-jerk reaction of the market was to push down the gold price by $20. However, the lost ground was more than recovered in the space of two days' trading. It is also revealing that the Bush administration made its support conditional upon down-sizing the functionless IMF, such as reducing the number of its executive board members from 24 to 20, and its $900 million annual budget by more than 10 percent to $ 800 million. The IMF is sinking further into limbo as its lending activities keep shrinking. Many of its former clients have repaid their debts and spurned IMF offers of further aggressive tutelage as they found IMF meddling in their internal affairs intolerable.

Quite clearly, the only reason the expensive IMF apparatus is maintained is the dubious proposal that gold bugs can be kept in check forever with threatened periodic gold sales, even if these sales never materialize. It is hoped that after a decent period of time the threat can be repeated, will be believed, gold bugs will retreat and, above all, the gold hoard will remain intact and could be used again and again for intimidation purposes.

On the subject of Treasury gold sales, they seem to be blocked by the top brass of the U.S. military, who know something about the sinews of war. They are fully backed by remarks uttered by Alan Greenspan while he was still in charge at the Fed reminding the forgetful that Nazi Germany could secure war materiel from abroad only against payment in gold after fortune has forsaken its armies in the field.

The U.S. Treasury is at the end of the rope of its anti-gold crusade. It painted itself into a corner: whatever it does will help gold and hurt the dollar. Its only way to escape from the trap of its own making is to come clean and admit the foolishness of its gold policies for the past 35 years, and open the U.S. Mint to the unlimited and free coinage of gold and silver on customer account. It would be a coup that would forestall the challengers of the U.S. monetary hegemony, the Russians and the Chinese among others, provided that it was pulled off before they did it. In this way the U.S. could retain its monetary leadership in the world. Time also seems to be propitious in this election leap-year when Congressman Ron Paul offers a sound and convincing blueprint to the electorate about fiscal and monetary reform.

Still, I am not holding my breath. There does not seem to exist a grain of intelligence or wisdom in the Treasury how to meet the current financial and banking crisis, not even to the extent of keeping a contingency plan on file for the mobilization of Treasury and IMF gold in a reconstruction of the international monetary system on the basis of fixed exchange rates.

Friedman's floating exchange rate system has served the U.S. and the world badly. It's been an unmitigated disaster. A return to the regime of fixed exchange rates should be considered most seriously, in order to fend off the collapse of the international monetary and payments system. The idea is resisted by a reactionary alliance between the policymakers at the Treasury, the Fed, and mainstream economists in academia, as such a plan would put gold back right into the center of the universe. These reactionaries have vested interest to hang on to their usurped power, enriching themselves and their friends in the process at the expense of the public at large.

However, there is silver lining to the IMF gold saga. It does have some effect in slowing down the meteoric rise in the price of gold. In my opinion this effect is positive. A sudden death of the dollar is not desired by any serious observer, nor is it in the interest of the savers and producers of the world. A more controlled decline may spare many innocent people from utmost economic pain, and give a chance to latecomers to the gold party to gear up for the ultimate showdown.

And, who knows, it may give a little extra time to policymakers at the Treasury to wake up and prepare a contingency plan at the eleventh hour, to open the U.S. Mint to gold and silver, the only way to avert the coming of Armageddon.

Reference

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GOLD STANDARD UNIVERSITY LIVE

Session Three has just concluded in Dallas, Texas. The subject of the 13-lecture course was *Adam Smith's Real Bills Doctrine and Its Relevance Today.* (Monetary Economics 102). The titles of the follow-up conferences were: 1. *The Economics of Gold Mining* and 2. *Gold Profits in Troubled Times:Putting the Basis to Good Use.* Course material will soon be available in print and in DVD format to all interested parties.

Session Four is planned to take place in Szombathely, Hungary (at the Martineum Academy where the first two sessions were held). The subject of the 13-lecture course is *The Bond Market and the Market Process Determining the Rate of Interest* (Monetary Economics 201). Tentative date: June 27-30. For more information please contact GSUL@t-online.hu . Further announcements will be made at the website www.professorfekete.com .

March 1, 2008