



Department of State

TELEGRAM

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E.O. 12958, Sec. 3.6

NLJ 95-167

By *is*, NARA Date 3-18-97

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1. THIS TELEGRAM CONTAINS TEXT MEMORANDUM HANDED TO US BY KESSLER OF NETHERLANDS BANK. PLEASE INFORM URGENTLY ROBERT SOLOMON AT FEDERAL RESERVE.

2. COVER NOTE, DATED MARCH 4, READS AS FOLLOWS:

BEGIN TEXT

TO MESSRS: DAAN, DEMING, EMMINGER, VAN LENNEP, MORSE, OSSOLA, RICK-

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ETT: AS A CONTRIBUTION TO OUR CONSIDERATIONS I ENCLOSE A PAPER ON THE URGENCY TO REACH INTERNATIONAL AGREEMENT ON CERTAIN RULES OF THE GAME WITH RESPECT TO THE RELATION BETWEEN GOLD AND THE NEW ASSET.
END TEXT

3. MEMORANUM, ALSO DATED MARCH 4, FOLLOWS:

BEGIN TEXT

THE GLD PROBLEM

(1) THE GOLD POOL HAD A DEFICIT OF NEARLY \$2000 MILLION IN 1967 OF WHICH MOARE THAN \$1600 MILLION IN NOVEMBER AND DECEMBER. IN JANUARY AND FEBRUARY 1968 THE DEFICIT WAS MUCH SMALLER BUT STILL IN THE ORDER OF \$1400 MILLION PER YEAR. THE DECLINE IN MONETARY GOLD STOCKS OF NON-COMMUNIST COUNTRIES IN 1967 WAS SOMEWHAT SMALLER THAN THE DEFICIT OF THE GOLF POOL; IT CAN BE ESTIMATED AT NEARLY \$1700 MILLION.

(2) THE GOLD LOSSES IN 1967 AND 1968 WERE ENTIRELY DUE TO SPECULATION. WITHOUT SPECULATION GOLD SUPPLY WOULD BE IN THE ORDER

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OF \$1600 MILLION PER YEAR INCLUDING \$250 MILLION RUSSIAN SALES,
AND GOLD DEMAND FOR NON-SPECULATIVE INDUSTRIAL AND SAVINGS PURPOSES
IN THE ORDER OF \$1200 MILLION, LEAVING A POSITIVE MARGIN OF \$400
MILLION. THIS POSITIVE MARGIN, HOWEVER, IS LIKELY TO DISAPPEAR AND
TO TURN INTO A NEGATIVE ONE WITHIN FOUR OR FIVE YEARS, DUE TO THE
UPWARD TREND OF 7 TO 8 PER CENT. PER YEAR OF NON-SPECULATIVE GOLD
DEMAND.

(3) IT IS UNLIKELY THAT THE INTERNATIONAL MONETARY SYSTEM COULD
STAND ONE OR TWO MORE SPECULATIVE CRISES LIKE WE HAVE HAD LAST
NOVEMBER AND DECEMBER DURING WHICH GOLD LOSSES WERE MORE THAN
\$1600 MILLION. THIS IS SO BECAUSE THE POINT MAY BE REACHED AT
WHICH THE SPECULATION WOULD REINFORCE ITSELF IN A CUMULATIVE WAY.
APART FROM THIS IT IS UNCERTAIN THAT MEMBERS OF THE POOL WOULD BE
WILLING TO GO ON SUPPORTING THE MARKET FOR SUCH BIG AMOUNTS.

(4) IT IS IRREALISTIC TO ASSUME THAT THE SITUATION PREVAILING IN
JANUARY AND FEBRUARY OF RELATIVELY MODERATE GOLD LOSSES OF, SAY,
\$1250 MILLION PER YEAR, WILL CONTINUE FOR AN INDEFINITE PERIOD OF
TIME WITHOUT, SOME DAY, DEGENERATING INTO A CRISIS:

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(A) UNCERTAINTY ABOUT THE FUTURE GOLD PRICE IS BOUND TO PERSIST
SO LONG AS INTERNATIONAL ARRANGEMENTS DO NOT MAKE IT CRISTAL-
CLEAR THAT THE INTERNATIONAL MONETARY SYSTEM IS "MMUNE" TO
ANY AMOUNT OF GOLD LOSSES TO THE MARKET (SEE PAR. 7);

(B) THIS UNCERTAINTY IS BOUND TO INCREASE AS LONG AS BALANCE OF
PAYMENTS DEFICITS OF THE RESERVE CURRENCY COUNTRIES PERSIST.
COMPLETE AND SUSTAINABLE DISAPPEARANCE OF THESE DEFICITS IS,
HOWEVER, UNLIKELY IN THE ABSENCE OF AN ADEQUATE CREATION OF
NEW RESERVE ASSETS SATISFYING INCREASES IN GLOBAL RESERVE
NEEDS AND OFFSETTING NET REDUCTIONS IN WORLD MONETARY GOLD
STOCKS (SEE PAR. 7(B));

(C) EVEN ASSUMING THAT THE BALANCE OF PAYMENTS DEFICITS OF
THE RESERVE CURRENCY COUNTRIES WOULD COMPLETELY DIAPPEAR--
AS THEY SHOULD-- (THE UNITED KINGDOM EVEN GRADUALLY IMPROVING
ITS RESERVE POSITION) AND THAT LEGITIMATE TOTAL RESERVE
REQUIREMENTS WOULD BE MET BY DELIBERATE RESERVE CREATION,
THE UNCERTAINTY ABOUT THE FUTURE PRICE OF GOLD IS LIKELY TO
INCREASE BECAUSE:

(1) U.S. GOLD LOSSES WOULD PERSIST DUE TO DEFICITS OF THE

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GOLD POOL RESULTING FROM SPECULATIVE FACTORS AND FROM
THE UPWARD TREND OF NON-SPECULATIVE GOLD DEMAND (SEE
PAR. 2).

(II) THE GOLD COVER OF U.S. LIABILITIES TO OFFICIAL HOLDERS,
THAT CAME DOWN FROM 157 PER CENT. IN 1960 TO 95 PER
CENT. IN 1964 AND 63 PER CENT. IN DECEMBER 1967, WOULD
SHOW A FURTHER DECLINE DUE TO GOLD LOSSES REFERRED TO
UNDER () AND TO POSSIBLE INCREASES IN DOLLAR LIABILI-
TIES TO DOLLAR HOLDING COUNTRIES RESULTING FROM
CONVERSIONS OF NEW RESERVE ASSETS. IN ADDITION,
CONVERSIONS OF DOLLARS INTO GOLD BY GOLD HOLDING
COUNTRIES COULD NOT BE EXCLUDED.

(5) HAVING REGARD TO PAR. (3) AND (4) THE CONCLUSION CANNOT BE
OTHERWISE THAN THAT THE POSITION IS VERY VULNERABLE EVEN ASSUMING
THE BEST POSSIBLE RESULTS OF THE ENDEAVORS TO BALANCE THE ACCOUNTS
OF THE RESERVE CURRENCY COUNTRIES. THE BEHAVIOUR OF THE GOLD MARKET
SINCE FEBRUARY 29 CONFIRMS THIS VULNERABILITY. IN ORDER TO HAVE A
CHANCE TO MAINTAIN THE PRESENT SYSTEM OF FIXED EXCHANGE RATES AND

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A GOLD PRICE OF \$35 PER OUNCE IT IS A MATTER OF URGENCY TO REACH
INTERNATIONAL AGREEMENT ON THE "RULES OF THE GAME" THAT COULD MAKE
THE SYSTEM OF S.D.R.'S IMMUNE TO GOLD LOSSES.

(6) THESE RULES WILL HAVE TO BE MORE BASIC THAN JUST A "HOLDING
OPERATION". THEY HAVE TO BE SO SIMPLE AND CONVINCING THAT IT
BECOMES CRISTAL-CLEAR TO SPECULATORS THAT THERE IS NO POINT ANY
MORE IN SPECULATING ON AN INCREASE IN THE PRICE OF GOLD. IT IS
ONLY THEN THAT THE SPECULATIVE DEMAND FOR GOLD WILL SUBSIDE AND
THAT, VERY LIKELY, DISHOARDING WILL TAKE PLACE, WHICH FOR A WHILE
MAY OFFSET THE GRADUAL APPEARANCE AND GROWTH OF A DEFICIT ON
NON-SPECULATIVE ACCOUNT.

(7) IN ORDER TO ESTABLISH BEYOND DOUBT THAT THE SYSTEM IS IMMUNE
TO GOLD LOSSES TWO CONDITIONS HAVE TO BE MET:

(A) THE NEW RESERVE ASSETS SHOULD BE EFFECTIVE NOT ONLY TO
"SUPPLEMENT RESERVES" BUT ALSO TO SUPPLEMENT AND REPLACE
GOLD;

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NOTE: HANDLED AS NODIS PER S/S-0 3/6/68



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(8) SUCH NEW RESERVE ASSETS SHOULD BE CREATED "ACROSS THE BOARD" NOT ONLY TO MEET AN INCREASE IN LEGITIMATE GLOBAL RESERVE NEEDS BUT ALSO TO COMPENSATE NET REDUCTIONS IN WORLD MONETARY GOLD STOCKS DUE TO GOLD SUPPLY LAGGING BEHIND GOLD DEMAND.

(8) IT IS IRREALISTIC TO ASSUME THAT THE CAPACITY TO REPLACE GOLD WILL QUICKLY ENOUGH EMERGE SPONTANEOUSLY FROM THE GOLD-LIKE PROPERTIES WITH WHICH THE NEW RESERVE ASSET WILL (OR SHOULD) BE ENDOWED. EVEN IF IN THE LONGER RUN SUCH A DEVELOPMENT COULD BE EXPECTED, WE HAVE NO TIME TO WAIT FOR IT. WHAT, THEREFORE, IN ADDITION TO THE GOLD-LIKE PROPERTIES OF THE ASSET, IS NEEDED, IS AN "ORGANIZED

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EQUALITY TO GOLD", I.E. RULES OF THE GAME THAT ENSURE THAT GOLD AND THE ASSET ARE TREATED BY THE MONETARY AUTHORITIES ON THE SAME FOOTING WITHOUT A BIAS IN FAVOUR OF GOLD.

(9) THE MOST SIMPLE AND DIRECT WAY TO ENSURE THIS WOULD BE AN AGREEMENT AMONGST GOLD-HOLDING COUNTRIES TO HARMONISE THE RATIO BETWEEN GOLD HOLDINGS AND (GROSS) ASSET HOLDINGS BY MEANS OF MONTHLY OR QUARTERLY RESHUFFLES. THE GOLD AMOUNTS INVOLVED IN THESE RESHUFFLES WOULD IN THE BEGINNING, WHEN CUMULATIVE ASSET CREATION STILL IS VERY SMALL COMPARED TO TOTAL GOLD STOCKS, BE ONLY MINOR. GENERALLY SPEAKING, COUNTRIES LIKE THE MEMBERS OF THE COMMON MARKET WITH RELATIVELY HIGH GOLD HOLDINGS IN RELATION TO THEIR QUOTA, WOULD HAVE TO TRANSFER SOME GOLD (AGAINST NEW ASSETS) TO COUNTRIES WITH RELATIVELY LOW GOLD HOLDINGS LIKE JAPAN, UNITED KINGDOM, SWEDEN AND CANADA (SEE ANNEX, WHICH ALSO SHOWS THAT UNDER CERTAIN ASSUMPTIONS WITH RESPECT TO THE MEMBERSHIP OF THE RESHUFFLE CLUB--SEE PAR. 11-- THE UNITED STATES WOULD BELONG TO THE GROUP OF COUNTRIES THAT WOULD RECEIVE SOME GOLD).

(10) THE TECHNIQUE OF PERIODIC RESHUFFLES DIFFERS FROM A FIXED LINK

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BETWEEN THE NEW ASSET AND GOLD IN THAT IT IS FAR MORE FLEXIBLE AND ALSO MORE CONVINCING IN BRINGING HOME THAT THE NEW ASSET IS A FULL SUBSTITUTE FOR GOLD. GOLD MARKET INTERVENTIONS AND GOLD TRANSACTIONS OR RESERVE ASSET TRANSACTIONS WITH COUNTRIES THAT DO NOT PARTICIPATE IN THE RESHUFFLES OR WITH THE MONETARY FUND EASILY FIT IN WITHOUT GIVING RISE TO SPECIFIC PROBLEMS. TRANSACTIONS IN GOLD OR IN RESERVE ASSETS BETWEEN PARTICIPATING MEMBERS WOULD, AS LONG AS TOTAL GOLD HOLDINGS AND TOTAL RESERVE ASSET HOLDINGS OF THE CLUB REMAIN UNCHANGED, BOIL DOWN TO TRANSACTIONS IN GOLD PLUS RESERVE ASSE IN A FIXED RATIO AS DETERMINATED IN THE RESHUFFLE. IN THE BEGINNING THE GOLD CONTENT OF THIS RATIO WOULD, OF COURSE, BE VERY HIGH.

(11) SPECIAL ATTENTION HAS TO BE GIVEN TO THE EXTENT OF THE MEMBERSHIP OF THE RESHUFFLE CLUB. A SIMPLE AND EFFECTIVE RULE PROBABLY WOULD BE THAT COUNTRIES WITH ASSET HOLDINGS THAT ARE HIGHER IN RELATION TO THEIR GOLD HOLDINGS THAN THE RELATION THAT IS OBTAINED AMONGST RESHUFFLING COUNTRIES ARE FREE NOT TO PARTICIPATE IN THE RESHUFFLES. (SEE FOOTNOTE (1) BELOW.) ON THE OTHER HAND, COUNTRIES WHOSE ASSET HOLDINGS ARE RELATIVELY LOW (AND WHOSE GOLD HOLDINGS, THEREFORE, ARE RELATIVELY HIGH) SHOULD BE OBLIGED TO SUBMIT THEMSELVES TO THE RESHUFFLES. INDEED, THIS OBLIGATION SEEMS SO ESSENTIAL THAT IT WOULD

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HAVE TO BECOME PART AND PARCEL OF THE NEW RESERVE ASSET SCHEME. (SEE FOOTNOTE (2) BELOW.)

(12) IN PRINCIPLE, THE NOTION OF PUTTING GOLD AND RESERVE ASSETS ON THE SAME FOOTING AND "ORGANISING" THIS BY WAY OF RESHUFFLES, RUNS COUNTER TO THE IDEA, AGREED UPON IN RIO, THAT CERTAIN SPECIFIC RECONSTITUTION OBLIGATIONS SHOULD BE ATTACHED TO THE NEW ASSET. TECHNICALLY, HOWEVER, THE TWO NOTIONS NEED NOT CONFLICT, SINCE COUNTRIES THAT IN VIEW OF THEIR RECONSTITUTION OBLIGATIONS WOULD HAVE TO BECOME "HIGH ASSET HOLDING COUNTRIES" (SEE PAR. 11) WOULD BE FREE TO STAY OUT OF THE RESHUFFLES.

(13) IF WE WANT TO HAVE A CHANCE TO REMAIN THE MASTERS OF GOLD AN INTERNATIONAL AGREEMENT ON THE RULES OF THE GAME AS OUTLINED ABOVE SEEMS TO BE A MATTER OF URGENCY. WE WOULD FOOL OURSELVES IN THINKING THAT WE HAVE TIME ENOUGH TO WAIT AND SEE HOW THE S.D.R.'S WILL DEVELOP. IN FACT, THE CHALLENGE REALLY SEEMS TO BE TO ACHIEVE BY INTERNATIONAL AGREEMENT WITHIN A VERY SHORT PERIOD OF TIME WHAT OTHERWISE COULD ONLY HAVE BEEN THE OUTCOME OF A GRADUAL DEVELOPMENT OF MANY YEARS.

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(14) IT GOES WITHOUT SAYING THAT THE RESHUFFLE RULES WOULD CERTAINLY NOT SOLVE ALL PROBLEMS CONNECTED WITH THE PROPER FUNCTIONING AND THE MAINTENANCE OF THE STABILITY OF THE INTERNATIONAL MONETARY SYSTEM

PROPER ADJUSTMENT POLICIES WOULD REMAIN AS IMPORTANT AS EVER. FURTHERMORE, THE POSITION OF THE DOLLAR AND OF GOLD IN A WORLD IN WHICH THERE WOULD NO LONGER BE UNCERTAINTY ABOUT THE STABILITY OF THE PRICE OF GOLD WOULD REQUIRE SPECIAL ATTENTION. IN THIS RESPECT CERTAIN UNDERSTANDINGS BETWEEN GOLD-HOLDING COUNTRIES AS TO THE MINIMUM GOLD CONTENT OF RESERVES MIGHT BE CALLED FOR. THESE OTHER RULES, HOWEVER, ARE OF SECONDARY IMPORTANCE COMPARED TO THE OVERRIDING URGENCY OF ENSURING THAT THE NEW RESERVE ASSETS WILL REALLY BE AN EFFECTIVE SUBSTITUTE FOR GOLD. END TEXT

5. FOOTNOTES REFERRED TO IN PARA (11) OF MEMO AS FOLLOWS:
FOOTNOTE (1) "IT IS CLEAR THAT COUNTRIES WITH RELATIVELY LOW GOLD HOLDINGS RECEIVING GOLD IN THE RESHUFFLE WOULD BECOME NET DEBTORS IN THE NEW ASSET SCHEME. AS THIS WOULD IMPLY THAT THEY WOULD HAVE TO PAY INTEREST, THEY MIGHT PREFER TO STAY OUT OF THE RESHUFFLE."

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FOOTNOTE (2) "ASSUMING THAT ALL 10-COUNTRIES WOULD TAKE PART IN THE RESHUFFLE PRACTICE THE FOLLOWING-NON-O 10 COUNTRIES WOULD HAVE TO JOIN: SPAIN, SOUTH AFRICA, AUSTRIA, PORTUGAL, URUGUAY, BURMA, LIBYA AND LEBANON (SEE ANNEX)."

6. ANNEXED ATABLE, REFERRED TO PARA (1) AND FOOTNOTE (2), BEING TRANSMITTED SEPARATE TEL.

GP-1. BROWN

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