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The Russian Gold Ruble

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There has recently been an increasing amount of comment in the world press about the possibility that the U.S.S.R. may introduce a gold ruble, and widespread speculation about the effects of such an action. The anticipated effects have on the whole been described in gloomy terms. They have included such fears as that the introduction of a convertible ruble may tend further to weaken the U.S. dollar, open the way for speculative "bear" attacks on the dollar and major European currencies, upset world commodity markets and prices, and touch off widespread disturbances of trade. As a recent news report put it,

> "The experts say there is little doubt a sudden, well-planned dumping of large amounts of new gold into the delicately-balanced world economy could work havoc.
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> "Trade payments would be upset. Prices in the free world could skyrocket. Banks might have to close their doors against a runaway demand for cash. Currency systems could be fatally debased by a galloping inflation."1/

Fears of this kind have been summarized in the phrase that a convertible ruble would be a monetary sputnik.2/

It therefore appears interesting at this time to investigate Russian gold production and stocks, to determine what meaning and significance can be attached to the "Russian gold ruble," and to consider what conditions

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1/ New York Herald Tribune, July 14, 1959.

2/ Perspectives Economiques (Paris), No. 164, June 25, 1959, in supplement dated June 27, 1959. A rather guarded statement on this point was made by Robert Triffin in a recent article, "The Return to Convertibility," in Banca Nationale del Lavoro, Quarterly Review, March 1959. This article assumed that prospective Soviet sales of gold would be about $200 million per year and noted that "the conclusions of this paper would, I must admit, be thoroughly upset if the USSR decided to use agressively its vast gold stock in world markets, for economic or political purposes. Depending upon the policies adopted on both sides of the famed iron curtain, this could either save or definitely wreck the gold standard as an international monetary mechanism." (p. 53.)

or advantages might lead the U.S.S.R. to make the ruble convertible. It should be noted explicitly, however, that there have been no official statements that describe the characteristics of such a gold or convertible ruble in any detail, or even that definitely promise the introduction of such a ruble.

Soviet Gold Production, Sales, and Stocks

Russian gold production

There has been a great deal of speculation in the postwar period about the amount of gold currently produced by the U.S.S.R. As noted in an earlier paper,1/ estimates of Soviet gold production have varied widely, although even the lowest estimates would put the Soviet Union in the ranks of major producers of gold. Estimates of current production range from $70 million per year to $630 million per year.2/ Samuel Montagu & Co. estimated 1958 production as more than 17 million ounces (about $600 million), while Alec Nove expressed the opinion that Russian gold sales are "perhaps equal, or nearly equal, to the gold currently being mined" (i.e., perhaps $250 million).3/ Other recent articles estimate production as 12-15 million ounces ($420-520 million).4/ The U.S. Bureau of Mines has estimated current production at about $350 million. The Northern Miner5/ recently reported "the word of a British intelligence agent in Russia that Russian gold production is not anywhere what propagandists have made it out to be. At the most, he declared, it would be six million ozs. a year" ($215 million). The Soviet authorities have themselves published no data on gold output since 1937, when they reported production as $190 million.6/

1/ O. L. Altman, "A Note on Gold Production," Staff Papers, April 1958, pp. 281-82.

2/ Barclays Bank (London), Overseas Survey 1959, section on gold.

3/ Respectively, Annual Bullion Review, 1958, and "Soviet Trade and Soviet Aid," Lloyds Bank Review (London), January 1959, p. 11.

4/ The Times (London), June 23, 1959.

5/ May 28, 1959.

6/ According to one estimate, output in 1928 was about one million ounces ($35 million at the present price of gold), while output in 1955 was about 12 million ounces ($420 million). "This increase has come about through the growth of the forced labour system and not due to any technical improvements. Apparently little mechanical equipment is used, extraction being accomplished by hand panning." (South African Mining and Engineering Journal, April 6, 1956, p. 469.) The discovery of new gold fields in Kolyma in the early 1930's and the increase in the price of gold in 1934 must also have had some effect upon gold production.

The trend of Soviet gold output in recent years has been the subject of similarly conflicting estimates. A 1957 news report stated that "there are indications that Soviet gold production may have dropped in recent years because of a cut in manpower."1/ A 1958 news report described gold output as having been falling since 1953.2/ On the other hand, a German study in 1959 estimated that gold production increased from 70 tons (about $70 million) in 1950 to 310 tons (about $310 million) in 1956 and again in 1957.3/ In 1957, the Soviets, for their part, announced that the organization concerned with gold mining was being reorganized, and the new head responsible for operations stated that by 1960 he hoped to achieve a sharp increase in output and a 25 per cent reduction in costs of production.4/ Whether or not these objectives were achieved, the fact is that in 1959 there were a number of references to the necessity of reducing production costs, but no statements that costs had been reduced or that production increased.

Recent commentaries have noted once again that Soviet gold production is largely the result of placer mining in Siberia. Some gold is obtained from deep mining, but little is known of the geologic strata that are mined for this purpose and there has been nothing to suggest that the Soviet Union has gold bearing ores which can compare with those of South Africa in either quality or quantity. About 75-80 per cent of Soviet gold production is said to be concentrated in the sub-Arctic Far East area where costs of transportation are very high and working conditions severe. The sources of Soviet gold production are interesting for two reasons. First, production of gold from underground mines is likely to be more stable from year to year, and more susceptible to long-run operations, than placer mining. There are deep mines in the United States and South Africa which have been producing gold continuously for 50 years or more. Placer operations may yield spectacular results but these results tend to be relatively short-lived. Secondly, it would appear on the average that there are systematic differences in production costs and conditions between deep mining and placers. The former requires a much larger capital investment but this investment, if applied to productive orebodies, can result in lower production costs.

Gold is also obtained as a by-product of mining nonferrous metals. Since the output of nonferrous metals is large and expanding, that of by-product gold cannot help but be significant. In periods of prosperity by-product gold is 35-40 per cent of total output in the United States and about 13 per cent in Canada. According to some estimates, it is 10-15 per cent in the U.S.S.R.

1/ New York Times, July 19, 1957.

2/ The Times (London), August 15, 1958.

3/ Ferdinand Friedensburg, "Der Aufsteig der Sowjetischen Bergbauleistung," Vierteljahrshefte zur Wirtschaftsforschung, November 4, 1959, p. 376. Fortune magazine stated in March 1954 that production had recently fallen to $70 million per year because of the diversion of labor to the production of uranium. (p. 159.)

4/ New York Times, August 17, 1957, and Northern Miner, August 15, 1957.

Recent discussions of Soviet gold mining have advanced the thesis that the costs of production are very high. It has recently been estimated that the cost of production of Soviet gold is equivalent to at least $165-190 per ounce at the official rate of exchange.1/ There is, of course, no way of determining the extent to which the calculations of the cost of production in rubles are correct. They are obviously "guesstimates" on a grand scale. The conversion of ruble costs into dollars at the official rate of exchange raises additional difficulties, and this would not be the first occasion that the use of the official rate led to questionable results. Furthermore, direct cost calculations of this type, even when accurate, are not necessarily good guides to export-import policies. Costing procedures in the U.S.S.R. are very different from those in other countries, and there is dissatisfaction within the U.S.S.R. about items to be included in costs and methods of calculating costs. It is not the absolute cost of gold production in the U.S.S.R. that determines whether it is advantageous to produce gold for export, but rather the cost of producing gold relative to the cost of producing some other commodity. If the cost of producing gold (by Soviet methods of costing, converted at the official rate) is five times, and the cost of producing timber is six times, the selling price in the free world, it will still be more economical for the U.S.S.R. to buy imports with gold rather than timber.

What is clear from the welter of conflicting facts and considerations is that the U.S.S.R. appears to place substantial emphasis upon the expansion of gold production, the reduction of production costs, and the accumulation of gold reserves. Indeed, it has been suggested (not without a certain wry humor) that the current Soviet attitude toward gold, anchored to the rock of Karl Marx, is actually more Victorian than the attitude of the West itself.

Russian gold sales

The U.S.S.R. has sold substantial amounts of gold, particularly in recent years, in London, Zurich, and other financial centers, but has never released any data on the amount of these sales. These have been estimated in the West from and by a number of different sources. As

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1/ This estimate was reported in The Times (London), June 22, 1959, and is based upon only two cost components. (1) The cost of the three tons of goods and supplies required to produce one ton of gold is 9.3 million rubles, of which perhaps 60 per cent represents the costs of transporting these goods to the mining area. (2) The cost of labor per ton is 12.0 million rubles, based upon average monthly pay of 1,000 rubles per worker.

Thus labor and materials alone come to 21.4 million rubles per ton, or $5.4 million at the official rate of exchange. This is equal to $189 per ounce. (This figure was apparently incorrectly reported in the article as $166 per ounce.)

might be expected, these estimates vary widely and have been subject to large retrospective corrections, both up and down. The largest sales in any one postwar year are thought to have been made in 1957, when 7 million ounces were sold, valued at $245 million. Gold sales in 1958 are estimated at $210 million.1/

The U.S.S.R. sells gold to cover deficits in its balance of payments. Sales are concentrated in a few months at the end of each calendar year, and they may extend into the first few months of the next year. The U.S.S.R. has consistently met its current foreign financial obligations promptly, and gold is an admirable medium for assisting toward this end. Sales of gold can be made quietly, and they do not call attention to shortfalls in the Soviet balance of payments or to particular events which may have caused them. This advantage of gold is mirrored by the fact that estimates of Soviet sales vary widely. Gold sales can be made quickly, without significantly affecting the market price. They do not affect established commodity market relationships or trading channels, so they do not elicit political outcries on the part of countries or producers whose products are affected. Public reaction to Soviet sales of aluminum was thus completely different from its reaction to sales of gold, even though the former were a much smaller percentage of world production than the latter. Sales of aluminum were widely regarded as unfair competition or economic warfare, whereas sales of gold as large as $250 million per year--almost 25 per cent of free world output--tend to be accepted in rational, economic terms, and may even be considered helpful.

Incomplete tabulations for the period 1931-43 suggest that gold sales by the U.S.S.R. to official buyers, excluding sales in gold markets to nonofficial ones, averaged about $70 million per year. These sales were equivalent to 7 per cent of average annual world gold production. In the 13-year period 1946-58, the U.S.S.R. probably sold gold to the extent of $1,100 million to $1,300 million, equivalent to 10 per cent of gold production in countries outside the Soviet bloc, but sales were negligible in some of the earlier years. Average sales in this period were therefore about $100 million per year. In the last three years, 1956-58, gold sales totaled more than $600 million, equivalent to 20 per cent of gold production outside the Soviet bloc, and average annual sales were $210 million.

These estimates of Soviet gold sales give perhaps a misleading impression of the importance and growth of gold exports in the Soviet balance of payments. In 1957, when gold sales were almost $250 million, total Soviet exports were $4.4 billion at the official rate of exchange, and exports to countries outside the Soviet bloc were about $2 billion. Gold exports were a much more important element in the balance of payments in the prewar period. In 1938, for example, exports to all countries were $250 million, whereas gold sales in 1931-43 averaged $70 million.2/ Furthermore, the purchasing power of gold has fallen sharply.

1/ It is possible that some sales in some years were for the account of satellites.

2/ Trade data are as reported by the U.S.S.R. in Direction of International Trade, Annual Issue, 1958, pp. 161 and 163.

Between 1938 and 1957, for example, export prices of industrial countries increased 130 per cent, those of nonindustrial countries increased 200 per cent, and those of all countries increased 160 per cent. In terms of purchasing power over imports, Soviet gold sales in 1946-58 were much smaller than they were before the war, and even the high level of sales in 1956-58 was only about 15 per cent above the prewar level.

As a major exporter of gold, and as a high-cost producer, the U.S.S.R. would, of course, be interested in seeing that the price of gold was increased. Usually the U.S.S.R. is noncommittal upon this point, and indeed it may well feel that any argument on its part might prejudice the case against raising the price of gold. Nevertheless, in 1958, it argued that the price of gold should be increased, stating that the present price of $35 per ounce was an "artificially established" one, and that "the difference between this price and the one that should exist amounted to tribute paid by the countries that sell gold to the United States."1/ Needless to say, this tone and approach were designed not only to further the self-interest of the U.S.S.R. but also to foster discontent among other countries.

If the U.S.S.R. were interested in forcing the United States to increase the price of gold, it should withhold gold rather than sell it. If it really believed the many arguments that the continued economic expansion of the non-Soviet world depended upon an adequate supply of gold reserves, and that the present production of gold was inadequate, the obvious policy for the U.S.S.R. would be to reduce its sales of gold. This would be economic warfare on a grand scale. By this reckoning, to increase its sales of gold would be to strengthen the financial system of the non-Soviet world and to help keep the price of gold at $35 an ounce.

Russian gold holdings

The gold holdings of the U.S.S.R., according to a number of estimates, have been put in the range of $7-8 billion; one or two estimates put them considerably higher, and others put them at only a fraction of this amount.2/

1/ A statement by Deputy Premier Mikoyan, reported in the New York Times, August 3, 1958. The timing of this statement is not without some interest, since in the first half of 1958 the United States sold $1.9 billion of gold to foreigners at $35 per ounce. These sales must have been made at a substantial loss, according to Mr. Mikoyan's analysis.

2/ Samuel Montagu & Co. (London) reported gold reserves at $7 billion in 1955; and The Times (London) stated (August 15, 1958) that 1958 reserves must have passed the $8 billion mark.

As of June 30, 1947, Soviet gold holdings were estimated at $2.5 billion by the National Advisory Council, Report on Activities of NAC, April 1-September 30, 1947, p. 37. On this basis, holdings could not possibly be larger than $6 billion at the present time--and they could be much smaller.

The Times (London) reported on August 15, 1958, that "the heavy expenses incurred abroad during the first Five-year Plan apparently exhausted Soviet gold reserves. . . . Therefore, 1932, the last year of the first Five-year Plan, can for practical purposes be considered as the 'zero point' of the Soviet gold reserves, which then began to increase."

The size of gold holdings has never been reported by the U.S.S.R. and, in the nature of the case, any estimate is a guess. Nevertheless, the U.S.S.R. must have substantial gold holdings, which would include some gold taken over from the Czarist regime, the gold received from Spain during the Spanish Civil War, and the excess of production over sales for more than a generation. Gold has been produced practically continuously since the Russian Revolution, even though the amount of this production is not known, and there were many years when there were few, if any, sales. Stalin reportedly attached great importance to gold production and reserves, and these reports would be consistent with his peasant background and general suspiciousness, and with the fact that the production of gold was continued and even expanded during World War II.1/

Recently, on a number of occasions, the U.S.S.R. has linked expansion of trade with the free world to the grant of substantial lines of credit. This point came up during recent discussions on increasing trade between Great Britain and the U.S.S.R., and is reported to have been discussed by Prime Minister Macmillan and Premier Khrushchev, with the former stating that he would be glad to accept gold in payment for goods, and the latter saying that the U.S.S.R. didn't have any gold. The denial, of course, is to be interpreted figuratively. The U.S.S.R. has a substantial quantity of gold, even if this is likely to be much less than the large amounts often mentioned; Khrushchev's denial certainly cannot mean that the Soviet gold holdings are very small. His views were stated in more rounded fashion during a press interview in 1958, as follows:2/

> Question: "We understand, Mr. Khrushchev, that your policy consists in balancing export and import so as to get by without the purchase and sale of gold."
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> N. S. Khrushchev: "You won't get very far on gold reserves alone, there is always a limit to them, whereas the development of the economic potential and the production of commodities is the capability of the nation, the capability of the people, and all this is always richer than gold reserves. Economic relations between countries should be

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1/ In this connection, the prophecy of Dr. Ernest Jones in 1917 (quoted for economists in Keynes' Treatise on Money, vol. 2, p. 290n.) may be recalled: "The ideas of possession and wealth, therefore, obstinately adhere to the idea of 'money' and gold for definite psychological reasons. This superstitious attitude will cost England in particular many sacrifices after the war, when efforts will probably be made at all costs to reintroduce a gold currency" (from Papers on Psycho-analysis, p. 172).

2/ From a stenographic transcript of a conference between Mr. Khrushchev and two members of the staff of the Journal of Commerce on March 22, 1958, as reported in that newspaper on March 27, 1958.

> developed mainly on the basis of exchange of commodities, in other words, on the basis of purchase and sale. We do not deny that gold does play its part in trade and we are not advocates of sitting on sacks of gold."

This answer is clear but, given the complexities of the Soviet situation, it is necessarily incomplete. The U.S.S.R. does wish to increase its exports of certain types of goods, but it would like to increase its imports even more; it wishes to accumulate gold if it possibly can against uncertain contingencies, but it knows that some gold will have to be sold; and finally, it would prefer to pay for additional imports with credits, which would ease the strain of exporting. The U.S.S.R. may also be of the opinion that it might receive easier and somewhat less suspicious treatment if it became a debtor on a substantial scale.

Ruble Coins and Deposit Balances

The ruble as a gold coin

Soviet references to a convertible ruble backed by gold have been neither clear nor consistent. Thus Mr. Mikoyan hinted in 1958 that a convertible ruble is a goal of Soviet policy,1/ but Mr. Khrushchev is reported to have said this year that "he had not even heard of the question of a convertible ruble discussed," and "to have expressed doubt that he would favor any such proposal."2/ Any discussion of the characteristics of a convertible ruble, or of a gold ruble, or of a convertible ruble backed by gold, is essentially speculation. This speculation must start from the basic fact that the significance of the word convertible is quite different in the Soviet system from its significance in the capitalist one.

Whatever the Soviets may mean by the term gold ruble, they obviously cannot mean that they will coin any substantial amount of gold into rubles and pay for imports with these rubles. This would be practically equivalent to paying for imports with gold. There may be a premium market for gold in the form of rubles, in the same way as there is a premium for gold in the form of napoleons and other gold coins, so that the U.S.S.R. could probably obtain a higher price for its gold by selling coins rather than bars. However, the market for gold coins is relatively limited. Any determined effort to exploit it would drive the premium down and make continued coinage uneconomic. In fact, the objective of a gold ruble could hardly be to sell more gold than the U.S.S.R. is presently selling.

1/ New York Times, August 3, 1958.

2/ New York Times, April 16, 1959.

Ruble deposit balances

It follows from this that if the U.S.S.R. wishes to make the ruble convertible, the reason must be to provide an incentive for foreigners to hold deposit balances in rubles. The ruble would not be made convertible into gold if it were expected that rubles would in fact be converted, for this would be the same as having sold gold in the first place. The expectation must be that the rubles will not be converted.

Ruble balances could be created if the U.S.S.R. ran a balance of payments deficit with the rest of the world on current account, paying with ruble deposits. The U.S.S.R. would be able to secure some genuine advantages if it could persuade foreigners to build up a substantial volume of deposit balances denominated in gold rubles. It would obtain foreign funds by a process equivalent to borrowing at short term, with the prospect of paying little interest on the amount borrowed. In this way, the U.S.S.R. could increase its imports without increasing its exports, or, alternatively, reduce or eliminate its sales of gold while maintaining its exports unchanged.

Foreigners can be expected to hold ruble balances willingly for essentially the same reasons as they can be expected to hold dollar or sterling balances. Such balances could be a way of investing in interest-earning assets funds not immediately needed for international trade. Foreigners could build up working balances which will be drawn upon when receipts from exports do not exactly match payments required for imports, either to pay for future imports or to buy other currencies. It is unlikely, for reasons discussed below, that either of these reasons will be operative in the near future.

Despite this, one immediate incentive to hold ruble balances arising from the balance of trade should not be overlooked. The U.S.S.R. has a substantial volume of trade. It offers the ever present attraction that it may greatly increase its volume of foreign trade, and the ever present threat that it can sharply redirect it. Soviet trading is highly centralized on a state basis and hence is conceived in bilateral terms. Bilateral negotiations do not necessarily imply that the U.S.S.R. will pay Country A the same price for a commodity as it will pay Country B, nor do they imply that the U.S.S.R. will export a given commodity to both countries at the same price. A recent study showed that there were substantial differences between prices paid by or to satellites and those paid by or to the countries in Free Europe; and, furthermore, that there were large differences among the countries in each group.1/ The terms

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1/ Horst Menderhausen, "Terms of Trade Between the Soviet Union and Smaller Communist Countries," Review of Economics and Statistics, May 1959, pp. 106-19. For example, in the case of wheat exports by the Soviet Union in 1957 prices, in terms of rubles per ton, ranged from 245 for Holland to 375 for Albania. (p. 111.)

of trade in any particular situation may be made so favorable that Country A may be induced to hold "swing balances" in rubles as part of the quid pro quo. This is, of course, impossible with many commodities which are bought on world markets, and for which little if any bilateral trading is possible. On the other hand, there have been a number of occasions on which the U.S.S.R. bought a commodity widely traded in world markets and paid more than the world price--or more than the country thought it could realize by selling at the world price--in accordance with some bilateral arrangement.1/

Ruble balances could also be created as a result of short-term capital movements if foreigners bought rubles with gold or convertible currencies. Conceivably, deposit accounts denominated in gold rubles could be attracted by paying a competitive rate of interest and/or by offering more security against devaluation than the United States and the United Kingdom. This would put the U.S.S.R. into the short-term banking business, and make Moscow a competitor of the money markets in New York, London, Switzerland, and other places. If the U.S.S.R. already has substantial gold reserves, it could even sell the gold deposited with it, invest the proceeds in world money markets, cover

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1/ Whether any seller benefited from such a higher price depended of course upon how the other half of the transaction was arranged, i.e., what prices eventually had to be paid for Soviet goods. But until this other half of the transaction had been completed, the partner country would hold a ruble deposit balance. The article by Horst Mendershausen showed that in 1955-57 the satellites on balance were disadvantaged with respect to both exports from and imports to the U.S.S.R. as compared with Free Europe. (Op. cit., pp. 111-16.)

its obligations with future production, and make a profit into the bargain.1/ On the other hand, if the U.S.S.R. did not invest the equivalent of its ruble deposits in money market securities, but rather spent these funds, it in effect would be the recipient of a short-term loan at an effective rate of interest that consisted of the rate it paid its depositors and its own handling costs. This type of combined operation may sound fantastic now, but it is by no means impossible at some future time.

Convertibility of rubles into other currencies and into goods

The currencies that play an important role in international finance are convertible not only into other currencies but also into goods. As far as the U.S.S.R. is concerned, currency convertibility can be achieved much more easily than goods convertibility.

The ruble will be externally convertible if it can be used without restriction to buy other currencies. It can be convertible at some predetermined rate, or within predetermined margins on either side of a parity rate. It can be convertible even if there is no parity, as the fluctuating rate of the Canadian dollar testifies. But if a currency is to be widely used even though it has no parity and its range of rates is not determinate, there must be some assurance that its rate is not officially "manipulated." Fluctuations determined by market forces are to some extent predictable--or at least, persons operating in such markets operate on the idea that they are predictable.

The ruble has had a par value for many years, and is formally equal to 0.222168 grams of fine gold; its circulation is restricted to the U.S.S.R. and it is not traded on any international market. Given the conditions under which the U.S.S.R. might make the ruble convertible, and the doubt that the U.S.S.R. would not "manipulate" external values not tied to a parity, there is little doubt that a convertible ruble would continue to have a stated parity in terms of a quantity of gold.

There is really little reason why the ruble cannot be made externally convertible, given the control that the U.S.S.R. has over its balance of payments and over its internal prices. The floating supply of rubles can be easily controlled by bilateral trading deals, and the ruble could be made convertible because, in fact, no one had rubles to convert.

1/ The demand for, and the possibilities of, this type of operation were clearly demonstrated by the substantial increase of BIS deposits in 1958. The BIS covered its spot sales of gold received against time deposits by purchases of futures. Since the U.S.S.R. is a producer of gold, it would not have to do this, but it might stop selling forward. Einzig recently stated that "the most important seller of forward gold is the Soviet Government. Evidently Moscow does not anticipate an early devaluation of the dollar and is prepared to take a risk, such as it is, for the sake of obtaining a somewhat higher price for its gold exports." ("The Forward Market in Gold," The Banker, April 1959, p. 229.)

A country can develop substantial holdings by foreigners of its own currency if it can compete for short-term funds by offering favorable interest rates, but it must provide the assurance that the original transaction of (say) buying rubles with dollars at a given exchange rate can be reversed on the decision of the foreigner by buying dollars with rubles at some predetermined rate(s). If the Soviet authorities were prepared to maintain a dollar-ruble rate at par, without margins, funds could flow into or out of ruble balances solely on the basis of interest differentials plus the cost of making the switch. On the other hand, if the exchange rate fluctuated between predetermined margins, the interest rate differentials required to attract and retain funds would be larger. It is likely that a substantial volume of funds would move only if there were some guarantee as to the rate at which transactions might be reversed. This might imply the development of forward quotations for dollars in terms of rubles.

The establishment of goods convertibility for the ruble is another and much more difficult matter. This is basically the question of what goods a foreigner can buy with rubles, and what prices, terms, and conditions will be applicable to such purchases. Capitalist states conceive of themselves as free economies. They strive to give purchasers maximum freedom of choice and employ a high degree of competition to make this choice effective. With economies that already produce high standards of living, and that have considerable flexibility, they have large reservoirs of capacity and investment to meet any reasonable demands in a reasonable period of time. Subject to some limitations applicable to goods having strategic or defense importance, citizens and residents with domestic money can use such to buy anything they wish; and what is more important in this connection, foreigners can buy the same goods and at the same prices. When there are limitations, most of them apply to all alike. When the export of a commodity is forbidden, it is generally forbidden to all.

These conditions are not present in the U.S.S.R. The U.S.S.R. has expanded rapidly in the face of considerable shortages, and it is always pushing hard against capacity in one important field or another. Over very long periods, it has employed rationing, differential pricing, "expediting," and just plain standing in queues to allocate short supplies. There are any number of commodities which a Russian holding rubles cannot buy at any price; and there are an even larger number which a foreigner cannot buy, let alone buy at a reasonable price or within a reasonable delivery period. Given the number of tight spots and bottlenecks in the Soviet economy, execution of central plans could be disrupted by withholding part of the production of many commodities. If failure on the part of a Soviet citizen to produce an assigned quantum of goods is often severely punished (and has not infrequently been considered sabotage), the purchase of scarce goods by a foreigner might easily be considered as a type of economic warfare.

There is thus a very great difference between what Soviet goods a foreign holder of rubles can buy and what United States goods (for example) a foreign holder of dollars can buy. A holder of rubles can buy only what the government wishes to sell; a holder of dollars can buy anything by paying the prevailing price for it. Since the prevailing practice is to make Soviet bilateral deals balance, any country left with a ruble balance at the end of such a deal is in a worse position for the next deal than if it had come out even.1/ The reason is that, with respect to any trading negotiations, the U.S.S.R. prefers to have payment for its exports in imports rather than in balances of its own currency, since these result, so to speak, in "unrequited exports."

The nonavailability of goods in general, and the fact that the U.S.S.R. cannot permit foreigners to have free choice of the goods that are available, indicate why the ruble cannot be convertible into goods in the near future. But there are two other difficulties that should be mentioned: ruble prices, and the ruble exchange rate. Domestic ruble prices may be reasonable in terms of each other without being reasonable in terms of outside prices. The relationship of the price of one good to the price of another may function more or less satisfactorily for internal pricing2/ without indicating the relationship at which the U.S.S.R. will trade one or the other to foreigners. Relative prices reflect all the singularities of Soviet policy with respect to costing and pricing, and they present oddities that the U.S.S.R. is trying to cope with.3/

1/ The situation was recently stated in these words: "In 1955 the USSR imported 93 million dollars more than it exported. . . . In 1956 imports were 112 million dollars more than exports and in 1957 imports exceeded exports by 139 million. Some of the amounts were paid in transferable currencies, as in the case of Cuban sugar. Many countries, however, are tied to the USSR by trade and payments agreements which specify bilateral balancing of trade (except for Soviet credit) and payment by adjustments in the volume of trade. Hence, some of the export surplus of underdeveloped countries is short-term credit granted unwittingly by them to the USSR. Argentina felt this acutely when in early 1958 a delegation, hat in hand, toured the USSR and Eastern Europe to try to buy enough goods to settle accounts." (R. L. Allen, "Soviet Economic Trends and Prospects-Discussion," Proc. Am. Econ. Assn., 1958, p. 47.)

2/ Thus, Khrushchev stated in the Journal of Commerce interview already referred to that "as is known, the cost of production consists of many elements. Our domestic prices do not always and for all goods correspond to the cost of production. In our home trade there do not exist the two aspects as you understand them. We sell some goods at prices exceeding their cost of production. But some goods are sold below the cost of production. They are sold at a loss but their production is necessary from the viewpoint of the development of our country's economic potential. . . ."

3/ The situation is in fact much more complicated than this. There are a series of prices applicable to industrial and other goods, with each series serving a different function. See Gregory Grossman, "Soviet Economic Planning: Industrial Prices in the USSR," Proc. Am. Econ. Assn., 1958, pp. 50-64.

External prices contain an additional distorting element, namely, the overvaluation of the ruble. The present rate of four rubles to the dollar is not a realistic one, but this is not important to the U.S.S.R. The exchange rate does not have to yield realistic world prices, since it is not designed to move exports nor to equilibrate foreign receipts and payments in terms of a price mechanism. If the U.S.S.R. wishes to export goods, it is not bothered by calculations of the domestic price converted at parity--it simply sells on the basis of the world price. The extent to which it shades the world price depends upon the stability of that price and how anxious the U.S.S.R. is to sell quickly.

When the U.S.S.R. wishes to sell, the world price is controlling. When the U.S.S.R. does not wish to sell, the domestic price converted at the official rate is controlling. Apart from the nonavailability of goods, the latter may result in an impossible export price.

A recent speech by K. V. Ostrovityanov to the 21st Congress1/ described parts of the above argument in the following words:

> "The growth of international socialist division of labor and economic connections between socialist countries inevitably will call forth growth and development of monetary-exchange. On the other hand, monetary exchange relations will develop into interrelations between countries belonging to the two different systems--socialism and capitalism. . . .
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> "The development of monetary-exchange relations in the economic interrelations between countries of the socialist camp will call for, of necessity, a single standard for the comparison of costs of production in a given country with costs in other countries of the world system of socialism and also for comparison of competitive totals of the two systems--socialism and capitalism. . . .
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> "At the present time the countries of the socialist camp are concluding trade agreements between one another based on world prices which have been corrected suitably2/ in order to give them great stability. . . ."

1/ Reported in Pravda, February 6, 1959.

2/ One explanation of what the term "corrected suitably" may mean is given by Mendershausen, op. cit., p. 106: "Official statements make it appear that the problem of finding tomorrow's true market price can be solved by subjecting yesterday's observed market price to some corrective manipulation. They emphasize the need to eliminate 'undesirable fluctuations' due to business cycles, 'speculation,' or 'sharp competition' and contend that in this fashion the fair price can be determined objectively and impartially. The existence of bargaining among communist traders is usually denied. But bargaining undoubtedly takes place. The trade negotiators of the various countries are known to bring a variety of 'world market prices' to their meetings. So there are alternatives to choose from. The choosing is done by haggling."

The goods convertibility of the ruble at the present time is limited to the point of being virtually nonexistent. This is certain to be the situation for many years to come. Even if all the countries in the Soviet bloc are considered as one currency area, the situation is not really changed. Trade between any two countries in the bloc is on a barter basis; and trade between one country in the bloc and another outside it is also on a barter basis except for a few commodities. Introducing a third country into any transaction does not eliminate the element of barter--it simply makes the trade trilateral. Thus, when Burma earned a ruble balance with the U.S.S.R. by selling rice, and wanted to buy goods in Czechoslovakia with this balance, it engaged in three-cornered negotiations to bring the deal off. The same sort of problem would arise if, for example, Poland wished to spend ruble balances in Czechoslovakia. This is not to deny that a formal, if limited, convertibility could be established in the Soviet bloc.1/ But its effectiveness would depend upon whether, in each country, another Soviet satellite could obtain the goods it wanted on fair terms with funds obtained through conversion. If it could not do this--and it is quite unlikely that it could--the bloc might set up something that looked like the EPU but that functioned quite differently.

In short, the U.S.S.R. could easily make the ruble convertible into other currencies in a technical, banking sense within the Soviet bloc, or in a considerably wider area. The strict controls that the Soviets exercise over imports, exports, and the balance of payments guarantee that such convertibility would never impose any real drain on the U.S.S.R. On the other hand, such convertibility would not bring any real economic advantages, though it might have some propaganda advantages. If the U.S.S.R. became a center for short-term capital movements by accepting ruble deposits denominated in gold, and if it paid interest on these deposits, it could enter the banking business in competition with other centers, scoring certain economic and propaganda advantages. But there is no possibility at the present time, or for years to come, that the U.S.S.R. can, in any meaningful sense, make the ruble convertible into goods. This deficiency will severely limit the use that other countries will make of the ruble, even if it were made technically convertible. The U.S.S.R. itself has

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1/ A recent report in the BIS Press Review, July 27, 1959, based on information in East-West Trade News, July 23rd, stated that "speculation among international observers on the future convertibility of the rouble has gathered strength recently. The Economic Commission for Europe has stated that the trading problems of the Soviet bloc would be eased somewhat if the rouble were made effectively convertible or transferable within a limited area, in the sense that 'at least any eastern European trading partner of the U.S.S.R. had the possibility of earning surpluses in trade with that country which could be used to finance deficits elsewhere'. The possibility of a rotating fund for credit, to lubricate the wheels rather like the old E.P.U., has been voiced from time to time. According to the paper, there is more evidence for this possibility than for outright rouble convertibility."

recognized that the ruble can become an international currency only when it is responsible for a much larger share of the world's production and international trade, and when prices in the communist countries are made more competitive than they now are with those in capitalist countries. As Ostrovityanov put it:1/

> "In proportion to the growth of the economy of the world system of socialism, the increase of labor productivity, the lowering of costs of production and increase of the proportion of the world system of socialism in international trade the socialist countries will more and more change over to their own basis in the matter of price determination basing prices on costs of production of goods in the socialist camp. It may be assured that in proportion to the further successes in communist construction the Soviet ruble will begin to go out into the arena of the world wide market, gradually squeezing out the dollar."

This not only requires the adjustment of relative prices in the U.S.S.R. but the adoption of realistic exchange rates.

The Threat of Soviet Gold Reserves

Soviet gold and the structure of exchange rates

The fear has been expressed that the large gold reserve of the U.S.S.R. constitutes a "sword of Damocles" over the free world. It is held to threaten the structure of exchange rates and that of world prices. As related to exchange rates, the thesis has been stated as follows:2/

> "The suggestion that, in possession of a large gold reserve, the Soviet Government would be in a position to direct a major attack on the dollar or other Western currencies cannot be dismissed so easily. In possession of large liquid financial resources represented by her gold reserve, the Soviet Union would always be in a position to build up a large balance in any currency and to throw its holdings of that currency on the market at some awkward moment when the currency concerned is already under pressure and is vulnerable."

It follows that if the U.S.S.R. is to acquire sizable holdings of foreign currencies, it must do so either by selling gold or by running a sizable surplus in its balance of payments or both.

1/ Loc. cit.

2/ Paul Einzig, "Gold Policy of the Soviet Government," Optima, June 1959, p. 63.

The gold policy in the last two generations has consistently been oriented about two propositions: first, it is important to build up a sizable gold reserve against unforeseen contingencies; and secondly, goods are so important that gold will be sold only to pay for goods. The proposition that the U.S.S.R. will sell gold to acquire currency balances which will, at some appropriate moment, be used to attack other currencies or the structure of exchange rates is quite unrealistic. It is also self-defeating. When the U.S.S.R. acquires foreign balances by selling gold, it simultaneously provides the means by which foreign countries can defend themselves against Soviet raids. The monetary management required to provide this one-to-one defense is not difficult. Thus, for example, if the U.S.S.R. buys dollars with gold, and then sells dollars for sterling, the United States will support the sterling-dollar rate with the gold it bought from the Soviets. Similarly, if the Soviets wish, dollar balances can be converted back into gold. The advantages that might accrue to the U.S.S.R. from this type of operation would be negligible or nonexistent, while the costs, in terms of goods whose purchase was foregone, would be substantial. This type of operation might well be economic warfare in reverse.

If the U.S.S.R. were willing to run a large balance of payments surplus and thereby acquire holdings of dollars or other Western currencies, it would be able at some time of its own choosing--which might be awkward from the point of view of the country concerned--to convert one currency into another or into gold. But the fact that this is possible is quite different from thinking it is at all likely. The U.S.S.R. has such a great demand for goods that it is inconceivable that it would consent to be paid in currency balances or in gold. Furthermore, the acquisition of currency balances on the scale required to attack individual currencies or damage the structure of exchange rates would effectively nullify any Soviet prospects for credit from abroad.

Soviet gold and world prices

The threat of Soviet reserves to world prices is a completely different matter, and it has been stated as follows:1/

> "It seems probable that one of the main objects of the Soviet financial policy of building up a formidable gold stock is to possess a 'strategic' financial reserve with the aid of which Russia is in a position to effect large buying operations in any part of the world. If, for no matter what reason, the planners of Moscow deem it advantageous to buy commodities or industrial products, securities or currencies, the possession of a large gold stock well in excess of current requirements makes this possible. Such operations may pursue economic or political or military ends. In given circumstances, they are liable to be harmful to the free world."

1/ Ibid., p. 64.

There is no doubt that the U.S.S.R., with large and growing demands for many different goods and services, and with large financial resources, could materially affect the world demand for, and price of, any item it really wanted. If this additional demand occurred during a depression, it would be welcomed; if it were added to a demand already expanded by prosperity or inflation, it would make the task of price and monetary control much more difficult, and it might even cause considerable dislocation. But it is hard to imagine that, in peacetime, this dislocation could be more than temporary, or that it could be created simultaneously with respect to a great many commodities. The U.S.S.R. might, for example, charter a large proportion of the world's tanker fleet if it developed a substantial exportable surplus of oil and decided to invade world oil markets. It might attempt preemptive buying of selected strategic materials. Such actions might cause trouble and additional expense for capitalist countries. But this cannot mean that the U.S.S.R. will find it profitable to so act. The Cold War has already lasted for more than a decade, during which the U.S.S.R. has reputedly greatly increased its gold holdings, but not engaged in economic warfare of this kind.

It has not done so for probably one or more of the following considerations: (1) it has wanted to build up its gold holdings, for both rational and irrational reasons; (2) it exported gold or other commodities to pay for specific goods and services imported to meet its own needs or those of its satellites, but it could not afford the luxury of buying things it did not need; (3) it recognized that the United States and other capitalist countries also had great financial resources, resources probably greater than its own, and that their retaliation could create great countervailing costs and difficulties; (4) it realized that it could not obtain any substantial or permanent dislocations or create long-term damage, even if it spent substantial amounts; and finally, (5) it believes in the Marxist-Leninist doctrine of imperialism that the advanced capitalistic countries continually suffer from lack of markets, so that it would hardly undertake actions to provide these markets and thus bolster these countries.

It should be re-emphasized that the U.S.S.R. has large gold holdings, and that it may at any time decide to reduce them. This decision could significantly affect world demand for, and prices of, a substantial number of commodities. But similar results could be accomplished by withholding commodities from, or by dumping commodities on, world markets.

The additional demand that might result from a reduction in the gold holdings of the U.S.S.R. must be kept in perspective. Even if the U.S.S.R. has gold reserves of $8 billion, which is highly unlikely, it would not willingly spend more than a fraction of this in a kind of economic warfare which might well be useless. In comparison, India alone reduced its reserves by $1.1 billion in 30 months (January 1956–June 1958); and the

United States had a balance of payments deficit of $3.5 billion in 1958 without upsetting markets.1/ If the U.S.S.R. had a large balance of payments deficit, it would add to the world's reserves--as the United States did in 1958--and if this increased the reserves of the United States, it would strengthen the position of the dollar.

1/ Any additional spending by the U.S.S.R. out of its existing gold reserves can also be viewed in the light of what would happen if (as has been urged) the price of gold were to be raised to $70 or to $100 per ounce. If countries spent only a quarter of their gold revaluation profits following an increase in the gold price to $70, the increase in demand would be equal to the present value of Soviet gold holdings at their maximum estimate; correspondingly, at $100 an ounce, one quarter of the revaluation profits would be almost twice as large as the maximum value of these holdings. The annual increase of free world demand alone, with gold raised to $100 per ounce, would be equal to 25 per cent of the maximum estimate of Soviet gold holdings.