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Statement of

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Chairman, Board of Governors of the Federal Reserve System,

before the

Committee on Banking and Currency

House of Representatives

on

Legislation to Repeal the Gold Cover Requirement

January 23, 1968

The Board of Governors of the Federal Reserve System recommends prompt enactment of legislation to repeal the statutory provisions that now require each Federal Reserve Bank to maintain reserves in gold certificates of not less than 25 per cent of its Federal Reserve notes in circulation. Some change in this requirement this year or next will be unavoidable as the volume of our currency grows in response to the demands of a growing economy. Its repeal now would help to make absolutely clear that the U.S. gold stock is fully available to serve its primary purpose as an international monetary reserve.

I want to emphasize that elimination of the cover requirement would in any event be needed in the relatively near future even if there were no further net sales of gold to foreigners. Federal Reserve notes in circulation increase each year with growth in our economy. The increase in 1967 was more than $2 billion, and this alone added more than $500 million to the amount of gold required under present law to be held as cover for Federal Reserve notes. Moreover, our domestic industrial and artistic uses of gold, over and above domestic production, amounted to $160 million last year, and such uses can be expected to be at least that large in the future. These two factors together would reduce our "free gold"--the amount of gold over and above that required as cover for notes--by about $700 million a year. At that rate, our "free gold," currently $1.3 billion, would be absorbed in less than two years, even in the absence of further sales of gold to foreigners. And it would be unrealistic not to allow for some additional foreign purchases. Thus, it is clear that a change in the cover requirement is unavoidable, and cannot be postponed for long.

It is true that Congress has given the Federal Reserve Board authority to suspend the gold cover requirement for a period of up to 30 days and to renew such suspension for 15-day periods thereafter. But this authority, granted at a time when Federal Reserve notes were convertible into gold domestically, was not designed to deal with present-day conditions. With growth in the economy the attendant need for steadily increasing currency in circulation will certainly continue. To provide the additional currency requires a permanent change in the law, rather than Board action every 15 days.

The primary function performed by gold today is not as a reserve against domestic currency but as a monetary reserve for use internationally. The major part of the United States international monetary reserve is in gold. Since mid-year, our gold stock has declined by more than $1 billion, and it now amounts to about $12 billion. In order to arrest this decline, we must achieve a major improvement in our balance of payments. That is the objective of the program announced by the President on January 1.

But while we are taking the fundamental steps needed to bring our international payments into equilibrium and stop the drain on our gold reserves, we should make it absolutely clear that all of our gold stock is available to serve its primary purpose, and thus discourage market speculation against the dollar or anticipatory takings of gold by central banks. Speculation against the dollar might be encouraged if the gold cover requirement were regarded as immobilizing part of our reserves; the labeling of only part of our gold reserves as "free" might seem to imply that the rest of our reserves are somehow unavailable to perform their primary function of maintaining the convertibility of the dollar. Any possible misunderstandings on this point should be put at rest. This legislation would do that.

Removal of this requirement would in no way reduce our determination to preserve the soundness of the dollar. To achieve our goals both domestically and internationally we must pursue sound and equitable fiscal and monetary policies.

Convertibility of the dollar into gold at a fixed price--$35 an ounce--is a keystone of the international monetary system and is a fundamental reason why foreign monetary authorities are willing to hold dollar reserves. The role of the dollar as the major international reserve currency, together with the readiness of private foreign residents to hold dollar assets, places the dollar in a unique position in international commerce and finance. Prompt enactment of legislation to remove the gold cover requirement would reaffirm to the world the convertibility of the dollar. At the same time it would meet the long-run requirements for an expansion in note circulation commensurate with steady growth in the economy.

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