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Statement by

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before the

Subcommittee on International Finance

of the

House Committee on Banking and Currency

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I am pleased to appear before this Committee to give you the views of the Board of Governors of the Federal Reserve System on H. R. 17475. This bill seeks to postpone the date, now set by Public Law 93-373, when citizens of the United States can again "purchase, hold, sell, or otherwise deal with gold."

I respect the views expressed by the Secretary of the Treasury in opposing H. R. 17475, and I also recognize that there is considerable opposition in the Congress to any change in the provisions of Public Law 93-373. In the latter part of my testimony, I shall therefore address myself to measures that can and should be taken to limit the risks and minimize some of the adverse consequences that may flow from implementation of this law. With good management, I believe that we shall be reasonably successful; but it is my duty, nevertheless, to point out that prompt removal of present restrictions on private trading in gold could complicate a financial situation that is already beset by strains and stresses.

In recent debates on the gold problem, members of the Congress took the position that gold has ceased to serve as the foundation of our monetary system, that indefinite continuance of the prohibition of private gold holdings can no longer be justified, and that the time has therefore arrived for restoring the right and freedom of our citizens to buy or sell gold. As I understand the proposal of H.R. 17475, it in no way questions the objectives of Public Law 93-373, but merely seeks to delay the date for making this legislation effective. That is also the Board's position.

The Congress has set December 31 as the outside date for ending the restrictions on private ownership of gold. However, the President was given the authority to end these restrictions sooner, if he found that the international monetary position of the United States would not be adversely affected by such action. The language of Public Law 93-373 clearly indicates that although the Congress wanted the prohibition on private ownership of gold to end in the near future, the Congress was also concerned about the adverse consequences that could result from an abrupt ending.

It is difficult to foresee with any confidence the effects of removing the ban on private ownership of gold later this month. True, there is considerable interest in the reopening of the private gold market on the part of some businessmen and financiers; but there is also great uncertainty about the extent to which our citizens will actually want to acquire and hold gold.

Historically, gold has been regarded by many people as a hedge against inflation, or as a means of protection against a decline in the exchange value of a country's currency. At present, some individuals also regard gold as an asset whose value is more dependable than that of common stock or other financial investments. In the climate of uncertainty that now prevails, with fears of inflation continuing to spread, the opportunity to own gold might seem attractive to large numbers of people in the United States.

There is fragmentary evidence supporting this view. As already noted, a lively interest has developed among banks, stock brokers, currency and metals dealers, and commodity exchanges in preparing for private gold trading. Also, the recent runup in the price of gold in European markets suggests that market participants abroad anticipate the development of an active market in the United States.

Some sources close to the gold market have attempted to estimate the potential demand for gold in this country. We at the Board have no estimate of our own and are skeptical of the guesses being bandied about. But we as well as others recognize that when the gold market is reopened, people might rush in with funds transferred from savings accounts, common stocks, or other financial assets. The financial wealth of households, personal trusts, and nonprofit organizations in the United States is enormous. Although we can be quite sure that the transfer of accumulated savings to the gold market will not be more than a tiny fraction of this total, the diversion of funds from customary financial channels could still come to an uncomfortably large sum in dollars.

The resulting disturbance of the money and capital markets -- especially in the period immediately following removal of the ban on gold ownership -- would tend to have adverse effects on the sectors of the economy that are most heavily dependent on credit. Thrift institutions and commercial banks have only recently begun to experience improved deposit inflows. Any sizable withdrawal of funds from savings accounts would, of course, dim the prospects for a larger supply of mortgage credit in coming months. Recovery of the homebuilding industry might therefore be retarded.

Money flows to the equity and debt markets may also be reduced as investors move to acquire gold. At present, prices of common stocks are severely depressed. The corporate and municipal bond markets, meanwhile, are handling a huge volume of new issues. Borrowers in these markets are counting on an ample supply of funds to refinance maturing debt and to raise capital for new business ventures or new public undertakings. To the extent that the public's savings are diverted from these markets to gold, business firms and other borrowers would find it more expensive and more difficult to carry out their capital expenditure programs.

Besides these effects on credit flows, early removal of the prohibition on gold ownership could lead to excessive speculation in the gold market. Since annual world production of gold is rather small, and the gold market abroad has typically been rather thin, changes in demand have often led to wide swings in the price of gold. Given these characteristics of the market, removal of the ban on gold ownership might lead for a time to exceptionally large movements in the price of gold, and therefore encourage widespread speculation. Speculative forces originating in the gold market may spread to the markets for silver and other precious metals, and from there to other commodity markets. Eventually, a reversal of such a speculative development would be practically inevitable, so that many investors in gold and other commodities would suffer losses. If events took such a course, our economy could be injured.

The risks associated with a reopening of the gold market extend also to the exchange value of the dollar in international markets. Apart from sales by the Treasury, any substantial demand for gold by our citizens would have to be met by gold imports. The consequence might be a worsening of our international balance of trade and downward pressures on the dollar in foreign exchange markets.

These pressures on the dollar could, of course, be checked by sales of gold from our nation's monetary reserves. But there are risks associated also with this course of action. Since the precise role of gold in the international monetary system is yet to be determined, it would hardly be desirable to dispose of any sizable part of our reserve assets.

Clearly, therefore, various adverse consequences for our financial markets and our economy may stem from a reopening of the gold market at the end of this month. No one can now say with any confidence how serious these consequences are likely to be. The risks associated with private ownership of gold are, however, postponable, and I see no material advantage to the nation in incurring these risks under present circumstances. The prudent course of action would be to delay the reopening of the gold market until a more propitious time. In the Board's judgment, therefore, the proposal of H. R. 17475 goes in the right direction.

At the same time, the Board recognizes that the bill presently before this Committee may not be greeted with enthusiasm by the Congress, and that the development of plans for implementing the provisions of Public Law 93-373 must go forward.

It will be important to do what we reasonably can to minimize the risks associated with that statute. I expressed doubts earlier about the wisdom of disposing of any large amount of gold at the present time. We should be ready, nevertheless, to make prudent use of the Treasury's holdings if demands for gold threaten to have adverse economic or financial consequences. For example, if large imports of gold exerted significant downward pressure on the exchange value of the dollar, prices of imported products would rise, and this would tend to worsen our inflationary problem. Sales from the Treasury's gold stock could lessen this difficulty, and I therefore endorse the Treasury's intention to auction 2 million ounces of gold early in January.

Moreover, we will need to bear in mind that the proceeds of any gold sales by the government would enable the Treasury to reduce its borrowing compared with what it otherwise would be. This reduced borrowing in turn would tend to lower interest rates on government securities, and thus mitigate the adverse effects on money and capital markets that would result from large private purchases of gold.

Over the long future, however, it would be best for the government to avoid frequent or sizable intervention in the market. A principal reason for abandoning the existing prohibition on gold ownership is the fact that it infringes on the freedom of our citizens. Periodic sales or purchases by the Treasury to influence the price of gold would hardly be consistent with return to a free market for that commodity. All in all, it would seem better to let the gold market find its own level, and to let the cost of any excesses be borne by those investors or speculators who choose to enter that market.

I would like to conclude with a brief comment on the regulatory status of gold transactions by banks. Since 1968, banks have been able to buy and sell gold for industrial or artistic uses under a Treasury license. At present, only two banks are actively engaged in such transactions. If private gold ownership goes into effect on December 31, 1974, banks will no longer require Treasury licenses to deal in gold, and many banks may become involved in gold transactions or in providing gold-related services to their customers.

In anticipation of this possibility, the Federal Reserve has been working jointly with the other bank supervisory agencies to clarify the regulatory status of gold transactions. It is expected that the results of this effort will be made available to banks in the near future.

The Federal regulatory authorities agree that our nation's financial institutions must proceed cautiously in participating in gold transactions. Because of the risks inherent in gold trading, some banks may prefer to act only as agents. In cases where a bank decides to trade in gold for its own account, it would be appropriate to do so only in such amounts as may be required to satisfy the needs of customers. It will be particularly important that banks offering gold for sale avoid promotional efforts that could lead to unrealistic expectations by bank clients or to adverse effects on public confidence in individual banks or the banking system.

The bank examination process must play a role in assuring that banks are not exposed to undue risks because of gold transactions. Examiners will have to be concerned with a bank's accounting practices in regard to gold, with its record-keeping for the accounts of customers, with its management expertise in this area, and with the additional risks that the bank undertakes in relation to its capital. Banks will need to understand that excessive involvement in gold transactions, including concentration on loans collateralized by gold or otherwise related to gold dealings, could constitute an unsafe or unsound banking practice and therefore become subject to the cease-and-desist provisions of the Financial Institutions Supervisory Act of 1966.

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