REPEALING CERTAIN LEGISLATION RELATING TO RESERVES AGAINST DEPOSITS IN FEDERAL RESERVE BANKS

HEARING

BEFORE THE

COMMITTEE ON BANKING AND CURRENCY
HOUSE OF REPRESENTATIVES

EIGHTY-NINTH CONGRESS

FIRST SESSION

ON

H.R. 3818

A BILL TO ELIMINATE THE REQUIREMENT THAT FEDERAL RESERVE BANKS MAINTAIN CERTAIN RESERVES IN GOLD CERTIFICATES AGAINST DEPOSIT LIABILITIES

FEBRUARY 1, 1965

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REPEALING CERTAIN LEGISLATION RELATING TO RESERVES AGAINST DEPOSITS IN FEDERAL RESERVE BANKS

MONDAY, FEBRUARY 1, 1965

House of Representatives,
Committee on Banking and Currency,
Washington, D.C.

The committee met, pursuant to notice, at 10:05 a.m., in room 1301 Longworth House Office Building, Hon. Wright Patman (chairman) presiding.

Present: Representatives Patman, Multer, Barrett, Reuss, Ashley, Moorhead, St Germain, Gonzalez, White, Gettys, Ottinger, Cabell, McGrath, Hansen, Annunzio, Widnall, Harvey, Brock, Talcott, Clawson, Johnson of Pennsylvania, Stanton, and Mize.

The Chairman. The committee will please come to order.

Today the Banking and Currency Committee takes up for consideration legislation to "eliminate the requirement that Federal Reserve banks maintain certain reserves in gold certificates against deposit liabilities." I have introduced H.R. 3818 to accomplish this end by request of the President and the administration.

As we know, the United States has gold reserves valued at some $15 billion. Present law requires that we maintain a gold reserve of 25 percent against both the total of Federal Reserve notes in circulation and the deposit liabilities of the Federal Reserve banks—which consist almost exclusively of member bank deposits.

At the end of the year there were about $35.4 billion in Federal Reserve notes outstanding and deposits amounting to $19 billion in Federal Reserve banks. These liabilities and deposits require gold reserve covers of $8.9 and $4.7 billion, respectively, for a total of $13.6 billion. By simple subtraction, since our total gold certificate reserve at the end of 1964 amounts to $15.1 billion, this leaves us with a free margin of only $1.5 billion.

Trends and actions of the last several months indicate that we may well have a further reduction in our free gold reserves.

If changes in existing law are not forthcoming immediately a number of severe repercussions can result. Most important, in my opinion, would be the fact that we would have to forgo any increase in the money supply. If this were to happen, economic activity would be strangled and we would immediately be on the road to recession and depression. Also important is our posture in the world of nations. We must provide the flexibility needed to maintain the international value of the dollar and the stability of the international monetary system—which, of course, is based upon the stability of the American dollar.

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There are those who argue that the 25-percent reserve should be eliminated on both the deposit and the note side, and others who advocate removal, at this time, of the requirement on only the deposit liability side. Certainly, there are valid arguments on both sides.

Economists argue that the entire requirement is the vestigial remains of a dead system, and certainly they are right. But others argue that there are valid psychological reasons why the reserve requirement should be maintained behind the Federal Reserve notes, and they too are right. Further, those who argue for partial elimination on the deposit liability side take the position that after the public has been properly educated on this entire gold reserve matter and when there is further need for elimination of gold reserve requirements, the Congress can so act.

At any rate, in a few words, this is the problem we have before us for analysis, debate, and action.

I would be remiss, however, if I did not at this time point out what is to me a very important matter. To be sure, part of the problem we are to discuss today stems from the high levels of economic activity which we have fortunately had over the last several years. But in large part, too, the problem is created by the adverse balance-of-payments problems our country has been experiencing since 1949.

The U.S. balance of payments has been in deficit every year since 1949, except 1957. This certainly has caused pressures on our gold reserves, resulting in several instances in a reduction in U.S. gold holdings.

Currently, my analysis and information indicate that a substantial cause of our balance-of-payments problems stems from the substantial amount of loans which U.S. banks have made to foreign entities. I am aware of the fact that the interest equalization tax has been successful in abating in small part our balance-of-payments problems, but I am also aware of the fact that the President has standby powers which can further alleviate the situation.

I trust that during the formal presentation of the witnesses and during the discussions that will follow we shall be able to explore this matter.

(H.R. 3818 follows:)

[H.R. 3818, 89th Cong., 1st sess.]

A BILL To eliminate the requirement that Federal Reserve banks maintain certain reserves in gold certificates against deposit liabilities.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the first sentence of the third paragraph of section 16 of the Federal Reserve Act, as amended (12 U.S.C. 413), is further amended by striking out "reserves in gold certificates of not less than 25 per centum against its deposits and".

SEC. 2. The eigthteenth paragraph of section 16 of the Federal Reserve Act, as amended (12 U.S.C. 467), is further amended by substituting a period for the comma after the word "notes" and striking out the remainder of the paragraph.

The CHAIRMAN. Mr. Dillon, we are glad to have you here as our first witness. As the Secretary of the Treasury we value your testimony.

Mr. BARRETT. Mr. Secretary I am very happy you are here this morning. Every time you appear before this committee we gain much from your testimony. I have a meeting with the mayor of Philadelphia and I must leave now, but I did want to be here to pay my respects.

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Secretary DILLON. Thank you, Mr. Barrett.

The CHAIRMAN. You may proceed in your own way. You have a prepared statement?

Secretary DILLON. Yes, Mr. Chairman.

The CHAIRMAN. Proceed as you desire.

STATEMENT OF HON. DOUGLAS DILLON, SECRETARY OF THE TREASURY

Secretary DILLON. Mr. Chairman and members of the committee, I welcome this opportunity to discuss H.R. 3818, which would implement a recommendation by the President in his economic message to adapt the gold reserve provisions of the Federal Reserve Act to the realities of present and prospective monetary requirements. This would be achieved by eliminating the provision of existing law that the Federal Reserve Bank hold gold certificates equivalent to at least 25 percent of their own deposit liabilities. The similar requirement that a gold certificate reserve of 25 percent be maintained against Federal Reserve notes in circulation would not be affected in anyway.

The need for this legislation does not arise from any sudden emergency or crisis, nor does it signal any prospective change in the economic and financial policies of the administration or of the Federal Reserve System. In the future as in the past, our domestic monetary policies will be directed toward meeting the basic needs of our economy for adequate, but not excessive, amounts of money and credit. Gold will continue to be made freely available, at the fixed price of $35 per ounce, to meet the legitimate demands of foreign monetary authorities—a policy that is the basic foundation of the international monetary system. The purpose of this legislation is simply to eliminate any unnecessary questions or doubts about our ability to discharge these two fundamental responsibilities with full effectiveness over the years ahead.

Sustained, healthy growth at home—marred neither by inflationary excesses nor by widespread unemployment and wasted resources—must necessarily be supported by orderly growth in the volume of money and credit. This monetary expansion will, in turn, require a larger base of bank reserves, which are held largely in the form of deposits by the commercial banks at the Federal Reserve. It will also mean larger amounts of currency in circulation—currency consisting almost entirely of Federal Reserve notes—as the rising volume of trade generates additional demands for cash.

Under the provisions of present law, these expanding Federal Reserve note and deposit liabilities will in turn require that increasing amounts of our gold be set aside as part of the Federal Reserve Banks' gold certificate reserves. But, the present operating margin of so-called free gold over and above existing requirements is already relatively small. The normal growth of our domestic money supply will exhaust this margin within a year or two, even without the outflow of a single ounce of gold.

Clearly, the capacity of the Federal Reserve to accommodate the monetary and credit needs of a strong and growing economy with stable prices must not be jeopardized. Equally clearly, our pledge to maintain the convertibility of the dollar into gold at $35 an ounce must not

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be cast into doubt by fear that our gold stock available for that purpose may be inadequate.

True enough, the emergency provisions of present law can be invoked if needed to suspend the gold cover requirement, but these provisions clearly are framed for temporary use rather than for long-range needs of growth. H.R. 3818 would meet this problem simply and straightforwardly, for as long ahead as anyone can now foresee, by immediately freeing almost $5 billion of gold presently held as reserves against Federal Reserve deposits. It will also permit us to avoid the present necessity of automatically setting aside additional gold as the growth of our economy enlarges the volume of bank deposits.

At the end of 1964, the volume of Federal Reserve notes in circulation—which make up over 95 percent of our basic currency—totaled $35.3 billion. At the same time, Federal Reserve deposit liabilities amounted to $19.5 billion. Together, these Federal Reserve liabilities required a gold certificate reserve of $13.7 billion, absorbing for that purpose all but $1.4 billion of the gold certificates issued to the Federal Reserve against the Treasury gold stock. And since January 1 the Treasury gold stock has declined by $200 million as a result of sales to foreigners, with further losses to be expected.

In terms of ratios, gold certificate holdings had fallen to 27.5 percent of the note and deposit liabilities on December 31, 1964. This represented a decline of 2.2 percentage points in the ratio in the space of a year—and during that year our loss of gold amounted to only $125 million. The decline in the ratio during 1964 was thus almost entirely accounted for by the needs of our domestic economy for additional money and bank credit and by the expansion in currency that is a normal reflection of growing trade and business turnover.

Looked at over a longer period of time, it is true that declines in our gold stock, as well as increases in Federal Reserve notes and deposits, have contributed to the declining ratio. These losses of gold to foreigners are, of course, closely connected to the balance-of-payments deficits we have run over the past 15 years.

It is essential that the vigorous effort launched in 1961 to reduce and eliminate that deficit and to stem the gold loss be continued and reinforced until equilibrium is restored. The administration, as you know, attaches the highest priority to that effort, and the President will shortly review our entire balance-of-payments program in a special message to the Congress.

However, it is abundantly clear that the United States cannot expect to support its own long-term monetary expansion—an expansion that will inevitably be associated with the continued growth of our domestic economy—by attracting to this country a disproportionate share of world gold reserves. The fact is that, even after the large gold outflow of the past decade or more, the United States still holds some 35 percent of the monetary gold of the entire free world. Certainly, it is essential that this country, with the dollar playing a key role as a world reserve and trading currency, continue to hold a large gold stock, and our policies are directed toward that end. Moreover, as our balance-of-payments deficit is ended, some reflux of gold from abroad could be a normal and healthy development. But, it would be shortsighted and self-defeating to attempt deliberately to draw

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in from abroad the billions of dollars of gold that would be necessary over the years simply to meet the mechanical requirements of present law as our economy grows.

During the past year, Federal Reserve notes in circulation increased by $2,466 million. Of this increase $662 million resulted from a decline of the same amount in the circulation of silver certificates. Meanwhile deposits of member banks, representing their required reserves, also grew $1,037 million during 1964. Thus, disregarding the temporary, one-time impact of the retirement of silver certificates, it was necessary under present law to add over $700 million of gold to the reserves required against Federal Reserve notes and deposits. This amount is more than the average annual increase over recent years in monetary stocks of gold in the entire free world.

If we attempted to drain gold from abroad year after year in the amounts needed to meet the essentially arbitrary and outmoded gold cover provisions of present law, the only result would be a drive by other countries to protect their own gold by controls and restrictions that would sacrifice all the progress that has been made toward freer trade and payments among the nations of the free world. Far from looking toward future increases in our gold stock adequate to meet the gold cover requirement, the hard fact is that until our own balance of payments can be brought into equilibrium, we must be prepared for further outflows.

The current gold cover requirement is an outgrowth of a much earlier period in our monetary history, and can be fully understood only in the context of circumstances that have long since vanished. Prior to the establishment of the Federal Reserve System in 1913, the several kinds of paper currency then in use circulated alongside gold coins domestically, and were freely convertible, directly or indirectly, into gold. In an effort to protect this convertibility, a variety of devices was used at various times to maintain the note circulation in a fixed relationship to gold and to provide assured redemption facilities. One result was that the supply of currency was not responsive to the changing needs of the economy, and this so-called "inelasticity," combined with deficiencies in the banking structure, helped make the economy prone to recurrent bouts of inflation and panic.

The Federal Reserve System was designed to eliminate these defects by providing a means for adjusting the supply of currency, deposits, and credit flexibly to the needs of commerce and business. At the same time, however, our currency, including the new Federal Reserve notes, remained convertible into gold. Under these circumstances it was entirely natural that those framing the Federal Reserve Act included a provision that the Federal Reserve banks maintain certain minimum reserves of gold in relation to their note and deposit liabilities, even though the passage of the Federal Reserve Act clearly recognized that the supply of money and credit should be adjusted to the needs of the economy rather than set in some fixed relationship to gold. These minimum requirements were apparently considered desirable largely to encourage full public confidence in the new institutions; to assure acceptability of the newly introduced Federal Reserve notes alongside gold; and finally to provide some ultimate limit to the expansion of Federal Reserve credit.

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It is also worthy of mention that the original Federal Reserve Act treated reserves against deposits in a different manner than reserves against Federal Reserve currency. In the first place the reserves against deposits were originally set at 35 percent while those against notes were set at 40 percent. Possibly more significant is the fact that the original Federal Reserve Act provided for reserves against notes to be held only in gold but permitted either gold or "lawful money" to serve as reserves behind deposit liabilities. Only since 1945, when the current 25-percent requirement was established, have note and deposit liabilities been treated in the same fashion. Thus there is clear precedent for treating deposit liabilities in a different fashion from Federal Reserve notes as far as reserves are concerned.

I believe the record of the past half century makes it amply clear that the provision of Federal Reserve credit, and the associated increase in its note and deposit liabilities, has, quite properly, been related to the needs of the economy rather than to the reserve requirements specified by law.

During the first two decades of the Federal Reserve System, when our currency was still redeemable in gold domestically, the level of Federal Reserve bank deposits and currency typically fluctuated far below the limits set by the gold reserve requirement. As shown by the table attached to my statement, this remained the pattern during the 1930's and early 1940's, after the convertibility of our currency into gold by American residents was ended. At one time, in 1940, the ratio actually rose as high as 91 percent.

Toward the end of World War II there was concern that the vast expansion of money and credit required by wartime financing might exhaust the "free gold" held in excess of legal requirements, thus hampering the war effort. Congress consequently reduced the reserve requirements set by the original Federal Reserve Act to the present uniform requirement of 25 percent in gold against both notes and deposits. As it turned out, of course, the war was soon over, and the actual ratio remained over 40 percent until 1959. This experience clearly demonstrates that the release of gold from the legal requirement in excess of the needs that actually materialized did not become a basis for an unwarranted expansion in Federal Reserve credit.

Today, the strong probability that the present margin of gold over the 25-percent requirement will be exhausted within a relatively short time no more indicates a need for domestic monetary restriction than the existence of a wide margin of "free gold" in the past provided a useful signal or excuse for monetary expansion. The fact is that the Federal Reserve, in discharging the fundamental responsibility delegated to it by the Congress for regulating the supply of money and credit in accord with the needs of the economy, must not be constricted by an arbitrary formula designed for another time.

While the desirability of eliminating the gold reserve requirement against Federal Reserve bank deposits appears to me beyond dispute, I recognize that the purpose of any change in a requirement of this kind that has lingered on for many years can easily be misunderstood and misconstrued. There may be some, for instance, who fear that this action may in some fashion imply a departure from the administration's firm policy of maintaining the stability of the dollar both at home and internationally. Let me, therefore, make it crystal clear

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that I am most keenly aware of the dangers that can come from an undisciplined expansion of credit. The proposal before you does not carry this danger.

In the future, as in the past, the best assurance we can have that the supply of bank reserves will be neither so little as to stifle growth nor so large as to fuel inflation lies in a responsible and independent Federal Reserve System, functioning within a framework of responsible government. For our part, this administration has and will continue to work in close cooperation with the Federal Reserve in developing an effective financial programs, while fully respecting its unique place within our structure of government and its special responsibility for developing informed, independent judgments concerning monetary policy.

President Johnson has recently reiterated the fixed policy of the United States to defend the present gold value of the dollar "with every resource at our command." The Chairman of the Federal Reserve Board has repeatedly made it clear that the existing gold reserve requirement need be no bar to our making good on that pledge. Present law provides that the gold requirement can be suspended—initially for 30 days, and subsequently for intervals of 15 days. It should be clearly understood by all that that provision of law could and would be invoked if required to meet foreign demands, and that the suspension would be renewed as long as needed.

It would clearly be incongruous, however, to fall back on special and easily misunderstood powers for temporary suspension at a time when we are dealing with basic long-term problems rather than with a passing emergency. Reliance on a temporary arrangement can give rise to totally unwarranted doubts at home and abroad over the extent of our commitment to the international stability of the dollar, and over our ability fully to support that commitment. Without question, prompt passage of the measure before you, unequivocally releasing some $5 billion of gold from the present requirement, will reinforce confidence in the stability and strength of the dollar by placing beyond any doubt the willingness of both the executive and legislative branches to make our gold fully available in its defense.

In this connection, it is worth emphasizing that almost all industrially important foreign countries have long since abandoned any rigid tie between their gold holdings and the domestic monetary system. One relatively small country—Belgium—fixes a minimum legal ratio between gold and central bank note and deposit liabilities. One other country—Switzerland—has retained a link to the note issue (as would H.R. 3818), but it has no requirement against other central bank liabilities. In the Netherlands, the comparable reserve requirement can be met by holdings of foreign exchange as well as gold. South Africa, which accounts for 70 percent of the free world production of gold, also, and understandably, has a gold reserve requirement very similar to our own present requirement. In every other instance, among the leading financial powers of the free world, gold holdings are unequivocally available for international use.

H.R. 3818 represents an essentially modest step to bring our gold reserve requirement into line with present needs. Its implications for our economic well-being are, however, important.

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You will find, I am sure, that this bill has broad support among informed banking and financial circles in this country. As a further indication of our firm intent to defend the gold value of the dollar against any potential pressure, it will help reinforce confidence in the dollar abroad, and I am certain it will be warmly welcomed by foreign monetary officials. I urge that you promptly report the bill favorably to the House and speed its passage.

(The table entitled "Ratio of gold certificate reserves to deposit and Federal Reserve note liabilities combined " follows:)

Ratio of gold certificate reserves to deposit and Federal Reserve note liabilities combined

Yearend:	*Percent*	Yearend—Continued	*Percent*
1932	62.9	1949	54.7
1933	63.8	1950	49.4
1934	70.8	1951	46.4
1935	77.6	1952	46.2
1936	80.1	1953	44.5
1937	79.9	1954	45.1
1938	83.7	1955	44.4
1939	86.7	1956	44.6
1940	90.8	1957	46.3
1941	90.8	1958	42.1
1942	76.3	1959	39.9
1943	62.6	1960	37.4
1944	49.0	1961	34.8
1945	41.7	1962	31.8
1946	43.5	1963	29.7
1947	48.3	1964	27.5
1948	48.9		

Source: Federal Reserve bulletin.

Office of the Secretary of the Treasury, Office of Debt Analysis, Feb. 1, 1965.

The CHAIRMAN. Thank you very much, Mr. Dillon.

We announced that it was our plan to have Mr. Martin, Chairman of the Federal Reserve Board testify tomorrow, but since he was unable to be here tomorrow we have made arrangements for an afternoon session and we hope to hear Mr. Martin this afternoon at 2:30 o'clock. After his testimony I see no reason why the committee should not be in a position to pass on this legislation. At least, we are inclined to do what we can to expedite it.

There are several points that I would like to raise on the gold reserve cover question, Mr. Dillon, and I will read them out to you.

Obviously, there will not be time enough to read them all and receive your answers, so I would like to get them in the record in this way.

I do not want to take up any more time than the other members are given. Therefore, I think that I shall read these questions and ask you to answer them in the record when you get your transcript, if you will and furnish for the record your answers.

First. Every year since 1949, except for 1 year (1957) the United States has had an adverse balance of payments of substantial magnitudes If this had not been the case, if our balance of payments hadbeen in balance or favorable instead of unfavorable, would there stll in your opinion, be a need to consider adjustment of the gold reserve requirements under discussion today?

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Second. Economists argue that gold reserve requirements on both deposit liabilities and Federal Reserve notes are merely vestigial remains of a foregone system. True though this may be, does the administration believe there are reasons, psychological and otherwise, which cause you to request removal of the reserve requirement on only the deposit liability side at this time?

Mr. WIDNALL. Mr. Chairman?

The CHAIRMAN. Yes.

Mr. WIDNALL. Mr. Chairman, will you yield at this point?

The CHAIRMAN. Yes.

Mr. WIDNALL. I think that the subject matter which we are considering today is extremely important. It seems to me that before we finally act this afternoon that the committee should have the benefit of the answers to those questions, which are very splendid. Otherwise it would only be a part of the record and it would not be very helpful to us.

The CHAIRMAN. May I finish them and then we will return to that, if possible. Would it be possible, Mr. Dillon, for you to be here this afternoon?

Secretary DILLON. I think that we can get the answers to those two, at least, relatively rapidly.

The CHAIRMAN. We will put them in the record. I agree that they are very important.

Third. Our balance-of-payments problems seem to have been severely accentuated in the fourth quarter of 1964. Further, I gather this was caused by substantial capital outflows of both a short- and long-term maturity.

(*a*) Is it still true that of the four causes of our balance-of-payments problems—foreign aid, military payments, tourists, and outflow of capital—the latter, outflow of capital, is as important, if not more so, than the other three combined? What are the amounts involved currently?

(*b*) What recourse, under existing authority, such as the interest equalization tax, does the administration have to correct this matter?

(*c*) We are told that capital outflows, which adversely affect our balance of payments, are of two categories, short and long term. Of the short term, how much is longer than 1 year; how much is really disguised long-term outflow due to the fact that such so-called short-term outflows are continually rolled over from short period to short period and therefore in effect constitute long-term lending abroad?

Fourth. There have been reports that Treasury was conducting an intensive investigation on the causes of the fourth quarter balance-of-payments deterioration.

Fifth. During hearings previously conducted on balance-of-payments problems you, Mr. Secretary, supplied the record with some information on U.S. portfolio capital outflows involving U.S. investment houses and U.S. commercial banks. As we know there are only a handful of banks and investment houses involved in these international transactions. To what degree have the banks and investment houses caused our most recent increase in our unfavorable balance-of-payments situation? In other words, what percent of our balance-of-payments problem is caused by these two types of financial institutions?

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Sixth. I would appreciate your supplying for the record information, by year and geographic area the following information on capital outflows by U.S. banks and investment houses:

(*a*) Portfolio outflows for 1962–64 accounted for by banks, long and short term.

(*b*) Portfolio outflows accounted for by investment houses, long and short term.

(*c*) A distribution of the number of banks which account for specific percentages of our portfolio outflow. In other words, how many banks are involved, and what percentage of the total involvement do each of them have. I realize that possibly individual bank names cannot be divulged, but certainly the number and percentages can be supplied.

Seventh. Since 1958 the interest cost on 3-month Treasury bills has increased over 100 percent (103 percent). Since as recent as 1961, the interest cost on this class of Government security has increased by almost two-thirds (62.7 percent). As we know, the administration has by concerted action increased this rate in the name of stopping the outflow of dollars. Several studies have been made to attempt to determine whether or not high interest rates on short-term Governments really do or do not stem the outflow of dollars. Of all those studies I have seen, none arrive at any flat conclusions to prove this assumption. Only one study done by the New York Federal Reserve Bank indicates that a "reasonable"—whatever that means—increase in interest rates would improve our balance of payments by $500 million or more. On the other hand, an analysis by none other than a member of the Federal Reserve Board of Governors strongly challenges the position that high rates can stem the outflow, let alone do so without hurting the domestic economy.

What has been the beneficial effect, in dollar measurement, of this determined move to raise interest rates on short-term issues? How many dollars have we kept at home or attracted to this country?

And, on the other hand, what has been the cost to the American people? In other words, taking the interest rate in effect, say, in 1961 on 91 bills, how much more have we paid in interest costs to date on this class of securities as a result of the increase in interest rates?

I am of the opinion that the result of raising short-term interest rates has not had the effect of stopping the outflow of dollars from this country in any significant way, or attracted any appreciable amount of foreign funds into this country. I would like statistical proof to the contrary, if this is the case.

And even if it is the case, which I seriously doubt, I firmly believe that the cost on the domestic scene in terms of higher interest costs across the board here at home—decreased investments and increased consumer interest costs—far outweigh any small advantages we may have achieved in our balance-of-payments figures.

I know that the information you can furnish in answering these question will be very important to this committee, Mr. Dillon. If possible, as Mr. Widnall suggested, we would like to hear from you this afternoon before passing on the bill. We will appreciate your comments. I assume that you would not have time to go into them in detail now, so you may forgo responding to them at present. Mr. Widnall?

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Mr. WIDNALL. Thank you, Mr. Chairman. Mr. Secretary, we always welcome you when you come before this committee—you are very forthright as a witness.

Is it not true, what was actually said 20 years ago by the then Chairman of the Federal Reserve Board, at a time that when the Congress reached the minimum goal reserves of 40 percent, they reduced it? The one Chairman explained the reason for the uniform treatment of both minimum gold reserves in these words:

> Since the two liabilities are convertible at the option of the owner the same requirements should apply to both.

Secretary DILLON. That was the statement that was made by the then Chairman of the Federal Reserve Board. I think it has a certain advantage of simplification which was noted at that time in congressional reports. They pointed out that the term "lawful money" was one that was difficult to decide exactly what it meant; and, therefore, for simplification purposes they put the two requirements together. The fact of the matter is that the two requirements have never been the same. And the requirement today is treated entirely differently for each. Should we go through the 25-percent limit we would not go through the 25-percent limit on both deposits and notes. The way the Federal Reserve handles this cover, the entire shortfall would be assessed first against deposits until that was exhausted to zero, and not until after that time would there be a shortfall against notes, so that shows that at present they are treated differently. The first shortfall that occurs is against deposits, and therefore, logically ought to be attacked by legislation.

In addition, the law is quite different in the penalties that it provides. The law, for a short fall in deposits, provides no specific penalties for that. The Federal Reserve may apply a tax of some sort. It could be set at any figure, a minimum figure that does not really have any impact.

On the other hand, in the case of notes, the law is very specific. It allows leeway to the Federal Reserve down to 20 percent, but thereafter it provides that the discount rate be increased by 1½ percent—a very big increase—for every 2½ percent that the cover falls below 20 percent—almost a prohibitive increase. So these matters have been treated quite differently.

I think they are looked on by the people of the country quite differently and always have been. And that is the reason we suggested that deposits be treated first.

Mr. WIDNALL. If the reserve requirements on both were reduced to 15 percent, would you not accomplish exactly what you are trying to do, and, actually, have about $1,100 million more?

Secretary DILLON. In money terms that is correct. A reduction would accomplish the same purpose. It would give us the same extra amount of dollars, but I rather doubt myself that the psychological benefits, which are important, would be as good. I am not sure what the result would be in this country because there has always been, as the chairman pointed out, a psychological feeling on the part of many that a gold reserve against notes was very important. When you get down to 15 percent there does not seem to be really much use of having such a small reserve. It might as well be nothing, and for that reason we felt that it was better to leave it at a substantial figure, a figure that

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the public is used to, which is 25 percent. But you are quite correct that if the Congress did decide to do the latter it would give us the freedom in handling our gold stocks that we would have the other way, and it would give us more in dollars.

Mr. WIDNALL. I know there is quite some pressure in the other House to eliminate any requirements on both, that is, reserve requirements. And I had in mind the psychological factors. I feel that serious consideration should be given to them. I believe the reserve requirements should be reduced somewhat at this time and not entirely removed. I think that from a technical point of view that it would be a little more honest than what we are doing and that the automatic gold check on the expansion of money supply would be preserved, and I quite agree with you that public confidence might be better served by such an approach, rather than by eliminating it all on one and not on the other. I think that is all at this time.

The CHAIRMAN. Mr. Multer?

Mr. MULTER. Thank you, Mr. Chairman.

Mr. Secretary, it has been my pleasure to welcome you over the years. I, along with our chairman and many others, regret the newspaper announcement that you may be leaving Government service shortly. For myself I want to express on this record publicly that I think you have been one of the best Secretaries of the Treasury we have ever had in this country. We always welcome your appearance here and your testimony. It has always been most helpful.

Mr. Secretary, with reference to the bill before us, I would like first to touch upon that which appears in the latter part of your statement, as follows:

> In the future, as in the past, the best assurance we can have that the supply of bank reserves will be neither so little as to stifle growth nor so large as to fuel inflation lies in a responsible and independent Federal Reserve System, functioning within a framework of responsible government.

I believe that it is presently not only your own opinion, but that of the administration and if I am wrong, please correct me, Mr. Secretary—that while the Federal Reserve System has been set up as an independent agency of Government responsible to the Congress, this does not preclude a cooperative effort on the part of the Federal Reserve System with the Secretary of the Treasury, nor does it mean that the Federal Reserve System or the members of the Board should not cooperate. Responsibility to the Congress does not mean taking direction from a Member or even from a committee of Congress but responding to the mandate of Congress duly enacted.

Is that not a fair statement, Mr. Secretary?

Secretary DILLON. Well, I agree that we have worked very well with the Federal Reserve System. I think that the Federal Reserve Board, while it is independent—and that independence, I think, should be maintained—that independence should be exercised within the framework of responsible government. It should take into account the policies of the President, the executive, and I think that it does. At least, in the last 4 years it has very much. And I think probably if we go back even before these 4 years, the same thing was true in the preceding 4 years—that the policy of the Federal Reserve Board at that time, probably, reflected the views of the then administration on monetary matters.

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Mr. MULTER. Mr. Secretary, the bill as introduced, which is, I believe, administration bill H.R. 3818, goes part way, so far as the reserve is concerned. And as has already been indicated, the other body may desire to go all the way to remove the reserve entirely. Do you not think that we ought to have some additional statement, either at this moment or at a later time for the record why we should not go all the way? I anticipate what may happen even though I have no right to indicate what the other body will do. We may pass this bill in its present form and the other body may then go all the way and then we go into conference and as the result of the conference we may get a bill that is quite different than that which is presently before us. I think it would be well for this committee to anticipate that possibility and consider the entire problem, whether or not we should not take the reserves off entirely.

Secretary DILLON. Well, I think that economically speaking there is no good argument for a gold requirement of any sort either against notes or deposits. Certainly, this is the general practice in the world today. As I said, among the countries that are in the IMF General Agreement to borrow, only four, including the United States, have any such clause at all and they are, except for the United States, the smaller ones. Certainly I know that a few years ago Per Jacobsson in a speech stated his view that, since gold was only used now in international monetary transactions, it would be better if it was clearly available entirely for these transactions.

Going further back, it is interesting to note that it was largely a psychological concern that in 1913 made the Congress put this requirement in. There is an interesting paragraph from a report of the House Committee on Banking and Currency in the 63d Congress on H.R. 7837, which was the original bill which became, in 1913, the Federal Reserve Act, and the committee stated, "In a general way the committee believes that requirement of a fixed reserve is not a wise or desirable thing as viewed in the light of scientific banking principles. It believes, however, that in a country accustomed to fixed reserve requirements, the prescription of a minimum reserve may have a beneficial effect."

Obviously, the committee was paying attention to the psychological side. We feel that that side is still very strong in the country, and it might come as an unnecessary shock and disturb confidence if we requested the removal of the entire gold reserve cover. For that reason we have not done it—not for any reason of economics or even sound banking principles.

I cannot state it any other way to say that we have to weigh these questions of confidence and psychology, which are so important in matters of finance—matters having to do with currency. We felt that we should take account of that; and, therefore, we did not perceive any necessity for going all the way at this time. There is clearly proof of the necessity for making some change, but you cannot prove the necessity for going all the way, even though it may be a logical thing to do on a scientific banking principle.

So, therefore, we ask to go part of the way, and ask for the removal of the reserve against deposits.

Mr. MULTER. My time has expired. I do hope that before we conclude with the Secretary I will have an opportunity to ask him some

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other questions, particularly in reference to a bill which I introduced on January 4, 1965, which is, in part, the same as the chairman's bill now before us.

The CHAIRMAN. Mr. Harvey.

Mr. HARVEY. I wonder for a moment if you would refer to the table at the end of your statement which you submitted to us this morning. Let me call to your attention, sir, the year 1940. In that year we had the highest ratio in the amount of 90.8 percent, and then in the years following that ratio rapidly diminished down to 1945 when we had a ratio of 41.7, and in 1945 the percentages, I believe, were changed to the 25-percent figure that we have right now.

Now, my question to you, Mr. Secretary, is, is it not also a fact that during those years from 1941 to 1944—those same years—to 1945, for that matter—that we had considerable wartime deficit financing and that we had a tremendous expansion in our monetary supply in the country? As a matter of fact, all of that planning changed our monetary supply, and was it not for that purpose?

Secretary DILLON. Not necessarily in the same relationship, because if you sell the bonds of the Government to savers and do not create new money with it, it does not increase the monetary supply.

Mr. HARVEY. The banks buy the bonds?

Secretary DILLON. Yes, that is right—the banks buy the bonds.

Mr. HARVEY. They would buy more bonds during wartime than during peacetime, perhaps, but at the present time, certainly, most of these bonds find their way into the Federal Reserve System, do they not?

Secretary DILLON. No; in the last 4 years the Federal Reserve purchases have gone up about $2 billion or so a year, something of that nature. And commercial banks, which also create the money supply, have not increased their holdings at all of Government bonds. They may be a little lower than they were 4 years ago. So all of the rest have been sold in one form or another to the general public and have not increased the money supply.

Mr. HARVEY. Let me ask you this, would you not say that during those years that the wartime deficit financing as well as our lend-lease program at that time were both factors in the decrease of our gold ratio?

Secretary DILLON. Oh, yes; certainly. In those years it is very clear that during the wartime financing, which was so tremendously far above anything that we now have, we could not possibly do anything except to sell bonds, which represented part of our deficits, to the banks, and they created new money with that. There was just not enough savings around to do otherwise.

These interesting figures here—I happen to have the figure for 1935, before the war started—the reserves of commercial banks in the Federal Reserve banks were only $5½ billion, and in 1945 they had $16 billion. So there was a tremendous increase in that area, and that was certainly a result of what was going on during the wartime. You are quite right.

Mr. HARVEY. And then, as I look at these figures, they seem to climb up to a high in the year 1949.

Secretary DILLON. The high reserve ratio was in 1949. What happened there really was that after the war our gold supply grew for

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a few years because the rest of the world was virtually bankrupt; they were recovering from the war, and they had nothing with which to purchase from us except gold, and that is what led to the Marshall plan. That was a time of dollar shortage. At that period our gold supply steadily increased until it reached a high in 1949.

Mr. HARVEY. To what extent has deficit financing since that time contributed; that it, since 1949, to this problem?

Secretary DILLON. I do not think it has contributed very much. I do not have the figures on commercial bank ownership of Government debt back that far. I know, as I said, in the last 4 years it has not increased at all. So the deficit financing has not had that effect.

I do have some figures on the money supply which show, since 1950, that currency, for instance, has increased from $25 to $34 billion. That is a difference of $9 billion, which is just a result of the growth of the economy. I do not think it had anything to do with the deficit financing.

Mr. HARVEY. Thank you, Mr. Secretary. My time has expired. I, also, welcome you as being a very fine witness and wish you well.

Secretary DILLON. I can answer one thing further. The total ownership of Federal securities held by commercial banks in June of 1950 was $65½ billion and in November of 1964 it was $63.5 billion. So there has been no increase in Government security holdings by commercial banks, which is the thing that does make new money and could be inflation creating. The whole deficit has during that period, apparently, been financed in a relatively noninflationary manner.

Mr. HARVEY. Thank you.

The CHAIRMAN. Mr. Reuss?

Mr. REUSS. I want, with my colleagues, to extend my praise for your administration of the Treasury. You should be very proud of it.

You appear here today to suggest that we now take a whole new fresh look at the gold cover problem, that the administration's position is that the gold cover should be removed on the deposits, but retained on notes, thus reducing our $15 billion to about $5 billion, but keeping a mortgage on the remaining 10.

I want to call your attention to a statement in the President's Economic Report of last Thursday at page 105 where the following statement was made:

> Monetary policy is formulated by responsible officials with a view to the public interest, and the presence of a mechanical limit on monetary expansion is inappropriate. Such a limit is either irrelevant—when the gold stock is far above the legal minimum—or harmful—when the gold stock acts as an arbitrary restraint. Consequently, the President has proposed that the Federal Reserve Act be amended to require gold cover only for Federal Reserve notes and not for deposits in Federal Reserve banks. This will assure continued opportunity for monetary growth and for needed flexibility in the operation of monetary policy. In addition, it will emphasize the full availability of our gold stock, at its fixed price of $35 an ounce to defend the dollar in international markets.

I would like to ask you three related questions, and I will put them to you so that you may answer them together. They are suggested by that statement from the President's Economic Report.

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If your proposal is adopted and we remove the cover on $5 billion but keep it on about $10 billion, is it not a fact that in this next year the Federal Reserve could under such a law expand bank credit almost without limit, and thus is not the proposed legal limit irrelevant?

Second, since under your proposal, with the normal annual expansion of the currency, with foreseeable requests for our gold, we would be bumping against the ceiling again as we are now in just a very few years, perhaps at a time when it would not be propitious to change the ceiling, is not the limit harmful? And, finally, if Congress should in its wisdom decide to remove the mechanical limit on the gold cover entirely, and thus place our full gold reserves behind the dollar, would the administration object to this? I would like to get your answers to those questions.

Secretary DILLON. As to the first one, I agree with you that there is no inducement to the Federal Reserve—they are responsible people. There is no mechanical restraint—they could increase credit, as you say, almost without end if they desired. They have been able to do that for many years, and they have never done that. And they have not been bound by this gold cover restriction on the deposits. And I think again it is relevant to go right back to what the original committee that studied this so carefully said in 1913—that this reserve, from a scientific banking point of view, was a bad procedure. So I think that the answer to your first question is what the latter part of my statement said, that our safety in this area—our safety—is a responsible Federal Reserve System.

I agree entirely with the statement in the Economic Report that you read to me.

Now, for the second question regarding currency—assuming that the gold stock remains constant, and assuming that our economic growth continues at about the present rate and assuming that that growth requires an appropriate growth in the currency—we would in 10 years, roughly, be in the position where we would be approaching the gold cover requirement of the Federal Reserve notes. Certainly a very important part of this, as the chairman pointed out in his opening statement, is the question of the balance-of-payments problem. We have not been able to put an end to the deficit as soon as we would have liked—it has proved more persistent and more difficult than we would have liked—certainly, and that problem still remains.

The administration's intention, and thus our national objective, to restore equilibrium is spelled out in the economic message and the Economic Report. If that is done, it may well be—in fact I think it should be—that the United States would begin to attract not only a fair portion of newly mined gold—in fact, being a reserve currency, probably, at that time it ought to attract the major portion that goes into monetary reserves. It might even attract some gold from certain other countries who are not reserve currency countries who have gold reserves that are possibly larger than they have any real need for. So there is a real possibility that we will be able to attract gold to these shores in an amount that would not be large enough, as I pointed out, to cover both the requirement on notes and deposits, but which might be large enough, or very nearly large enough, to cover the supply of notes and put this problem off for quite a long time to come—20, 25 years, in any event—which is so far away that I do not think there is any reason that we have to face it now.

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As to your third question: if the Congress decided to remove the entire requirement, would the administration accept it? Well, I think there is no doubt that if that was the Congress will, since the Congress represents the feeling of the people and since the reason for retaining some of the cover is, primarily if not entirely, psychological—not any banking reason—I think that the administration would, of course, accept the action of the Congress.

Mr. REUSS. Thank you. My time has expired.

The CHAIRMAN. Mr. Brock?

Mr. BROCK. Thank you, Mr. Chairman.

Mr. Secretary, pursuing the same line of thought, it is true, I believe, as Mr. Reuss implied, that monetary expansion comes through deposits rather than currency.

Secretary DILLON. At the moment, the last 2 years, the bulk of our growth has been in currency more than through Federal Reserve deposits. You see, the bulk of the drain on our gold stock has come that way. A factor over the last years, say the last 15 years, is that the Federal Reserve from time to time has reduced the reserve requirements on member bank deposits. If they had not made those reductions that they did make in the last 15 years we would have been through the 25-percent limit today.

Mr. BROCK. That is correct. Speaking in terms of the expansion of the economy, that expansion might have come through the deposits.

Secretary DILLON. The deposit reserves at the Federal Reserve banks the last 2 years have not increased anywhere near as much as the currency. There have been rather complex factors. Maybe the Chairman of the Federal Reserve System can speak to it better than I can. The general impression of monetary students is that one reason for this is that corporations during recent years have made great progress in economizing on their cash balances that do not pay interest and they have been investing them instead in short-term governments and in all sorts of interest-bearing paper.

There is some indication that this process during the last year about reached the end of the road—that non-interest-bearing demand deposits of corporations got about as small as they could get, in comparison to their business, and that they even started to grow. This growth in reserve requirements here of a billion dollars against deposits, as compared to practically no rise in the 3 or 4 years preceding may be largely due to growth in corporate deposits. So I think that in the future we will have a greater growth in the deposits than we have had.

Mr. BROCK. Well, again, in the same area, you mentioned that there was a difference today in the reserve requirements from those before.

Secretary DILLON. That is right.

Mr. BROCK. That there is a difference insofar as the penalty is concerned, is there not, that it is negligible at least, on the deposits where it is not on the notes?

Secretary DILLON. Yes; the Federal Reserve can set the penalties on deposits anywhere it wants. And, presumably, it would set it at a negligible amount which would have no effect on the economy. The Federal Reserve can, also, set the penalty on the shortfall of notes at any rate that it desires, so long as that shortfall does not get below 20 percent. After 20 percent it is a very high tax, 1½ percent, begin-

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ning when you go to 20, and another $1\frac{1}{2}$ percent for every $2\frac{1}{2}$ points that it drops.

Mr. BROCK. Is it 20 percent on notes?

Secretary DILLON. Yes; but not on deposits.

Mr. BROCK. Not on deposits?

Secretary DILLON. No specified rate on deposits. And the Federal Reserve cover on deposits would have to be entirely exhausted before there is any shortfall on notes at all. These requirements are separate and the Federal Reserve could apply the shortfall of the Reserve banks against either notes or deposits as they wished. The shortfall would be applied against deposits first.

Mr. BROCK. As a matter of fact, you almost could say that you have about $7 billion worth of gold available today that we don't think we have.

Secretary DILLON. That is exactly right. That is what the Chairman of the Federal Reserve has always pointed out—that in an emergency under the present law, using this emergency procedure, we could in effect waive these penalties and would waive them. They wouldn't really begin to take effect until our gold reserves had shrunk to something less than $6 or $7 billion.

Mr. BROCK. Even if you didn't waive them the penalty would not be substantial.

Secretary DILLON. The penalty depends on what the Federal Reserve sets. At the moment they set it at one-half of 1 percent, which was done way back 20 years or more ago, and there is no doubt they would set it at a much lower penalty if they actually went through the requirement.

Mr. BROCK. One final point. Mr. Reuss asked you would you favor the abolishment of the reserve requirements on both notes and deposits, if the subject were brought up in Congress.

Secretary DILLON. He asked what would the administration position be if Congress actually did it. I said the administration naturally would accept what Congress did.

Mr. BROCK. Thank you. The point is that your answer would be somewhat different I assume if we passed some of the proposals limiting the independence of the Federal Reserve System.

I notice on page 11 you mentioned and reiterated with Mr. Reuss, the requirement for a responsible and independent Federal Reserve System.

Now if we were to prepare certain measures, for example, the measure limiting the yield on Government bonds to $4\frac{1}{4}$ percent, this would put a definite change in character on their ability to control monetary expansion. Your answer, I assume, would be quite a bit different if that were true, would it not?

Secretary DILLON. I don't know whether it would or not. But my answer would be that I certainly think the Federal Reserve has to keep full flexibility, and should not be bound by any directives or requirements such as one that would force them to buy Government bonds at a particular level.

Certainly if there were such a requirement, the Federal Reserve couldn't function as well as it has in the past, and couldn't, I think, do what might be required for the economy. But I think that is really a separate question from this, although it is tied into the extent that

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removal of this requirement does emphasize the importance of a properly functioning independent Federal Reserve System.

Mr. BROCK. It can't be separate since this committee is considering them both.

Secretary DILLON. That is right, the same committee. It has to do with banking problems.

The CHAIRMAN. Mr. Moorhead?

Mr. MOORHEAD. Thank you, Mr. Chairman.

First I would like to join with my colleagues in expressing admiration, Mr. Secretary, for your administration of the Department of the Treasury, and your handling of domestic and international fiscal matters during the past 4 years.

Mr. Secretary, on page 7 of your testimony you describe our domestic monetary situation before the Federal Reserve System was established, and as I read that, it reminds me of the world monetary system today. In other words, in 1912 domestically there were several kinds of currency convertible directly or indirectly into gold, and today we have that on the international scene. Reading your testimony and thinking of the world situation:

> One result was that the supply of currency was not responsive to the change in needs of the economy, and the so-called inelasticity, combined with deficiencies in the banking structure, helped make the economy prone to recurrent bouts of inflation and panic.

Is that not the situation we face potentially in the world or international monetary system today?

Secretary DILLON. When you say "potentially," certainly it is a problem we may face. We haven't faced it because of the fact that we have been operating on the gold exchange standard, whereby the dollar also serves as an international reserve, and there has been an adequate supply of dollars available to the world to finance all the trade that there may be.

However, that raises a potential problem in meeting increasing world needs. The world, under the present system, seems to be in need of a steady increase in dollars—which means dependence on a permanent deficit in our balance of payments—and that doesn't seem logical and is not accepted by a number of other countries.

Everyone agrees that the probabilities are that at some time in the future the supply of new gold will not continue to be adequate to take care of growing international needs. Therefore there are a number of studies underway to try to find a new method or a new system that might be able to handle this need over a long period of time.

Unfortunately, these studies have some difficulty in coming to grips with the problem because a number of countries, particularly those in Europe, are more concerned about the immediate problem of the dollar deficit than they are about the long-term problem of financing world trade 5 or 10 years from now. They are looking, in their studies, for ways and means of forcing a rapid decline in the American payments deficit rather than looking to some means to finance world trade over a long period of time, and those two objectives are not always the same.

So we haven't been able to make as much progress as I think we will have to make. Luckily we have I am sure a few years to go before there is a real problem.

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Mr. MOORHEAD. Wouldn't it be a fair statement to say that part of the purpose of the legislation we are considering today, is to enable us to have a few more years in which to come to grips with the real problem which is, our balance-of-payments deficit, and two, a new and more flexible international monetary system.

Secretary DILLON. That is correct.

Mr. MOORHEAD. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Talcott?

Mr. TALCOTT. Yes, Mr. Chairman. Thank you very much. Mr. Secretary, I would like to join in the accolades that my colleagues have paid to you personally and to your administration.

In your statement you indicate that passage of this bill would have no effect on the reserves for Federal Reserve notes. You said at least it would not be effective now. And then later you indicated that it would meet the problem that we have now for as long ahead as anyone could foresee.

But in your answers to Mr. Multer and Mr. Reuss, you indicated that as soon as possible, or as soon as you could make it politically palatable to the people, that you and the administration would probably want to eliminate the reserve requirements on both the deposits and the Federal Reserve notes, is that right?

Secretary DILLON. No, I didn't mean to give that implication. In answering them I merely meant to say that there did not seem to be any very good banking or financial reason for maintaining it, but there was a very strong psychological reason because the gold reserve has been part of the background of the American people since the beginning of our country. Therefore, it is certainly a shock to move away from it, and I don't see any reason why we have to subject ourselves to that, unless it is proven to be necessary.

I hope and would expect that we would get our payments into balance relatively rapidly, and then, as I pointed out to Mr. Reuss, there should be some inflow of gold which would enable us to offset all or a major part of the requirements for increased currency in circulation. So we might not face any further action on this for as long as a generation, 20 years, something like that, if then.

Therefore there is no reason to do it at this time or to even worry about it or be concerned about it at this time. There will be, as Mr. Reuss pointed out, if we do not get our payments into balance, and if we continue to lose gold to foreigners over the next 3, 4, or 5 years, in substantial quantities. Then it is quite correct that we would, in a matter of 5 or 10 years, be approaching 25 percent cover on the currency alone.

Mr. TALCOTT. I have no further questions.

The CHAIRMAN. Yes, sir. Mr. St Germain.

Mr. ST GERMAIN. Thank you, Mr. Chairman. Very briefly I too would like to join my colleagues in thanking you for your services, and commending you for your efforts.

Remaining on the same question here, I think that it mainly stems, the same question stems around the chairman's question, No. 2. That reads that:

> Economists argue that the entire gold reserve requirements on both liabilities and Federal Reserve notes are merely vestigial remains of a dead system. True though this may be the administration believes, there are reasons psychological

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and otherwise which cause you to request removal of the reserve requirement on only deposit liabilities at this time?

Now subsequent to the chairman's propounding this particular question, I think we can agree that you have now boiled it down to a point where it is mainly psychological. I have not heard you state any other reason to date.

Secretary DILLON. No.

Mr. ST GERMAIN. Other than the psychological.

Secretary DILLON. But that is very important.

Mr. ST GERMAIN. Right. Here we have something that certainly, when we get into these areas, and it seems that recently we get more and more testimony wherein we hear and oftentimes we agree that certain actions are taken for psychological reasons. That being the case, we are all becoming amateur psychologists after a fashion, and I want to propound this theory of psychology to you.

Taking little quotes from you, in fact this most recent one, "There is no reason to do it now," is that correct? Well, if we are going to be psychologists, isn't it better than to do it now when we can say to the people, "There is no emergency, there is no real reason. We are not acting out of panic or necessity. We are just doing it because there is no other reason other than psychological to maintain it."

Therefore why not get it over with? Why not face it now? Wouldn't that make things much easier for the Congress in session 20 years from now or 10 years from now or 15 years from now when there will be a reason other than psychological, for it?

Secretary DILLON. It certainly would make it easier for a future Congress, unless the general thinking of the country on this matter changed over the next 10, 15, or 20 years. It might perfectly well be the case.

Everything that we have seen indicates that there is a very strong feeling that some reserve requirement should be maintained. Certainly the American Bankers Association apparently is in favor of a reduction in the requirement, but not its complete elimination. That is an example.

Mr. ST GERMAIN. Could I ask one question at this point, Mr. Secretary?

Secretary DILLON. Yes.

Mr. ST GERMAIN. I am not familiar with their reasoning in taking that stand. Is this psychological also or is it other than that?

Secretary DILLON. I think it reflects the feeling of their membership. You can guess as well why they have that feeling as the next person. Certainly some of the heads of the major banks in New York, or the Bank of America in California, which deal worldwide, have favored complete elimination. But other members who are representatives of smaller banks all across the length and breadth of the country have not come to that point yet.

Mr. ST GERMAIN. Thank you, Mr. Secretary. I guess it all revolves around this, for many of us, to decide which psychological answer is the more accurate one at this point.

The CHAIRMAN. Mr. Clawson?

Mr. CLAWSON. Thank you, Mr. Chairman.

Mr. Secretary, in light of the day's discussion, do you believe that we could be successful in working toward an international agreement

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to completely demonetize gold, and let it become merely a commodity upon the free market?

Secretary DILLON. I would doubt that, because the basic studies that have been made so far have reached agreement: that the present system, based on gold, has to be or should be the foundation of any future system; that it has worked very well; that there obviously are certainly problem that one can foresee lying ahead; and that what is needed are improvements in the present system rather than to demolish it and set up an entirely different system.

If you don't have some tie to gold, you would have to be tied to something, and the only something that you could think of is some value that will be internationally created, and that therefore would be over and above the national sovereignty of any one country.

Of course that is the great difficulty in moving ahead to say an international Federal Reserve Bank, because it would then have authority over the whole international monetary mechanism the same way as the Federal Reserve has over our entire monetary mechanism.

We aren't dealing in a world of states which are all part of one country. We are dealing with independent nations. It may be a good analogy internationally.

It is a difficult thing to see quite how it could be achieved because countries do not want to give up their own sovereignty and ability to decide how much credit they need internally for their own domestic purposes.

Mr. CLAWSON. So the monetary system is tied very closely with gold then?

Secretary DILLON. Yes.

Mr. CLAWSON. Throughout the international monetary system?

Secretary DILLON. Oh, yes.

Mr. CLAWSON. May I change from this line of thought to another. Are there other avenues of action that might be available to the Federal Reserve Board for changing the disparity between the cover and the deposits?

Secretary DILLON. There is one other avenue that is open. Of course it has been used over the last 10 or 15 years, but only for monetary reasons, not for the gold reasons. That avenue is that the Federal Reserve still has considerable leeway, if they so desired and thought it was wise, to reduce the reserve requirements of the banks. That would reduce the amount of deposits of the banks in the Federal Reserve, and therefore reduce the amount of gold that would be required.

I think they probably could save about $2 billion of gold in that way, if they wanted to do that.

Mr. CLAWSON. If they went down to the legal minimum.

Secretary DILLON. Yes, to the legal minimums. But they do not feel that that is the type of thing to do, for this reason, and therefore they have not done it. Of course, it could have all sorts of effect on the banking system.

Mr. CLAWSON. So you feel that this wouldn't be a proper solution to the problem?

Secretary DILLON. No. I don't think it is a solution at all, and I am sure the Federal Reserve, which has responsibility for this, feels very strongly that it isn't a solution. We have talked with them from time to time about this, and they feel that.

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Mr. CLAWSON. Thank you, Mr. Secretary. I have no further questions.

The CHAIRMAN. Mr. Gonzalez?

Mr. GONZALEZ. Mr. Chairman, most of the questions I have or did have have been asked. My colleagues have demonetized my stock of questions at this time.

The CHAIRMAN. Mr. Johnson of Pennsylvania?

Mr. JOHNSON of Pennsylvania. Thank you, Mr. Chairman.

Mr. Secretary, I am a new member of this committee, and it is with great trepidation that I try to ask any questions about gold, but I will ask a few questions that a layman might ask. I notice that in the magazines it says our debt now to foreign nations, the foreign claims against our gold are $26 million-plus. Is that about correct?

Secretary DILLON. Approximately, yes.

Mr. JOHNSON of Pennsylvania. And your statement says that our gold that we have available to meet that demand is only $1.4 billion, according to your statement.

Secretary DILLON. That is the "free gold" that is available. The last two Presidents, President Kennedy and President Johnson, have always maintained that our entire gold stock is available for that purpose, and the Federal Reserve has always said that it would waive requirements of the gold cover to make this additional gold available, which it can do under the law. So from the point of view of the foreigner, there is far more available than the $1.4 billion. But that is all that is available without breaching the 25 percent gold cover.

Mr. JOHNSON of Pennsylvania. Yes. Now of course it has been written up in the newspapers in the last couple of weeks how France, so let's say cleverly, just last week they had $200 million and demanded gold for the $200 million. I want to ask you this question.

How much money does France owe us today? Would you have any idea what their debt to the United States is?

Secretary DILLON. Their post-World War II debt, which is a real debt which they are paying on currently, is about $600 million. In addition they owe about $60 million to Canada.

Mr. JOHNSON of Pennsylvania. Would you have any idea how much foreign aid we have given to France since the Marshall plan was put into effect?

Secretary DILLON. I don't have the figure with me, but several billion dollars.

Mr. JOHNSON of Pennsylvania. Several billions of dollars?

Secretary DILLON. Yes.

Mr. JOHNSON of Pennsylvania. Don't you think that countries like that, that have been the recipient of our largesse, shall I say, and owe us upwards of $1 billion, that when they have $200 million in currency to surrender or to convert, that they should be invited to apply it on the debt they owe us rather than embarrass us by demanding gold? Have you ever thought of that?

Secretary DILLON. Well, there are two points that I can make. In the first place the value of the dollar depends on our willingness at any time to exchange it for gold, so we cannot indicate that the dollar is inconvertible in any way. It is not. We are ready to do that.

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Secondly, so far as repayments of these debts are concerned, we have been quite successful in obtaining advance repayments in debt from countries that are able to make them.

The French themselves have repaid a substantial amount, probably as much as they still owe us. They repaid about half of it I think.

They are the largest country that still owes us a debt, and of course I would be very happy if they would repay it in advance, and we do talk to them from time to time about it.

But this time they determined that they—for monetary reasons, or they didn't give any reasons—preferred to not repay the debt, and to convert some of their excess dollars to gold.

Mr. JOHNSON of Pennsylvania. Now another question. Apparently the witnesses who are going to be in front of us are going to be those in favor of this, and we naturally would like to hear from somebody who will give us the other side of the picture. I want to ask this.

Isn't it true that the business community in this country has had kind of a comforting and reassuring position in the Nation, feeling that in back of the banking deposits there has always been this 25 percent backing in gold, and that if we now remove it, we are taking away something that we possess and enjoy now in our business community, and won't that have a destruction of confidence on the part of the business community when this Nation has to do away with its gold coverage?

Secretary DILLON. Well, there we get again into this question of psychology, which is a very difficult one to measure.

The only organization—it is not entirely business but it has a lot of businessmen in it—that I know of that has taken a position on this outside of the position that I expect the American Bankers Association will take is the Committee on Economic Development, the CED. They have taken a strong position as far back as 1961, and which they reiterated now, that this gold cover should be entirely abolished, since it is now an anachronism.

If you ask my own opinion, my own feeling would be that as far as the bulk of our own businessmen are concerned—some of them might feel concerned, some might not—but I think whatever concern they felt will be overcome by their interest in running their own business affairs.

They would see that this didn't have any real effect on their business, and they would just keep on tending to their own knitting and doing the good job that they have been doing over the past years.

Mr. JOHNSON of Pennsylvania. Thank you. My time has expired.

Mr. MULTER. Mr. Chairman, will the gentleman yield?

Mr. JOHNSON of Pennsylvania. My time has expired anyway.

Mr. MULTER. May I have a half minute to ask a brief question, Mr. Chairman.

The CHAIRMAN. Without objection it is so ordered.

Mr. MULTER. I think up to this moment the gentleman is the first member of the committee who has indicated that there may be some opposition to this bill. Has the gentleman received any communication from anyone opposed to the bill?

Mr. JOHNSON of Pennsylvania. No; I haven't. The bill was just put in recently.

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Mr. MULTER. Actually the principle of this bill has been before the committee for more than 4 years.

The CHAIRMAN. Mr. White.

Mr. WHITE. Thank you, Mr. Chairman.

I might say in answer to the question of the gentleman from New York, I read several places in the press, and I have people in my district that are of course in opposition to the removal of the gold cover from both deposits and from the Federal Reserve notes.

First of all, to get back to the basic question that is before us, Mr. Secretary, and it has been propounded to you many times, I think the question I want to ask you first is your statement here in support of H.R. 3818. You are asking for the removal of the gold cover from behind deposits. Your statement today goes to that point and that point alone.

Secretary DILLON. That is correct.

Mr. WHITE. I listened, however, to your testimony, Mr. Secretary, and I find first this is what we are going to ask for, and you indicate there is the possibility that the administration may make a second request for removal of the cover for the currency. Is this in the plans of the Treasury Department at the present time?

Secretary DILLON. No; it is not in the plans at all, and I do not mean to give any impression that that may be done.

All I pointed out, in answer to questions, was if we get our payments into balance, as we must, and then newly mined gold and other gold begins to flow to some extent to this country and adds to our overall gold resources, as it should, that then I don't see why, in the foreseeable future, there would ever be a problem regarding the notes.

I said that if, on the other hand, we continue to run a very heavy balance-of-payments deficit for the next 4 or 5 years, and our currency continues to expand, we will find ourselves sometime in the next 5 to 10 years in a position where we will be up against the 25-percent cover on notes. That is merely an exercise in arithmetic.

It is something that is obvious, but it is something that I certainly would hope and expect would not happen, because I would hope and expect that we would succeed finally in getting our payments into order, so that the other track would be what we would follow.

Mr. WHITE. As I understand your request here today that is to provide gold for two purposes: to satisfy foreign calls on our gold, should they develop, and also to provide under the 25-percent cover additional area for expansion of our credit for note issuance as required by the expansion of our economy and needs for that additional currency.

Secretary DILLON. That is exactly right.

Mr. WHITE. And you state on page 3 that—

> H.R. 3818 would meet this problem simply and straightforwardly, for as long ahead as anyone can now foresee, by immediately freeing almost $5 billion of gold presently held as reserves against Federal Reserve deposits.

You also state on page 4 that you anticipate further losses to be expected along with the $200 million that has been drawn down by, as you say here, "sales to foreigners."

Now what further losses do you expect, and what part of the amount of gold made available, if this legislation is enacted, would you anticipate might be called on by foreign governments?

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Secretary DILLON. That is impossible to predict in an amount. All I meant there was that for a number of reasons our gold loss last year to foreigners was minimal. Actually the outflow of gold from the United States to foreigners last year amounted to about $36 million.

Mr. WHITE. Mr. Secretary, isn't this more or less the idea we are going to stop the run on the bank by making available the gold, and therefore give——

Secretary DILLON. Oh, no; not all. Making it available by changing this law won't at all influence the requests by foreigners. I think it will make them feel more confidence in us, because we will be able to supply them gold in the regular procedure without having to go through the temporary procedure that the Federal Reserve has.

I think that their demand for gold will depend in the long run on two things, on worldwide gold supplies and on our balance of payments, but primarily on our balance of payments. We have to get that into balance.

Mr. WHITE. One last question I would like to ask you, Mr. Secretary, is at present we have entered into expansion of the International Monetary Fund, and we have shored up the currencies of Italy, and we have participated in England in shoring up the pound, and we have done this by involving short-term credits in substitution for gold.

If this legislation is passed, will we have gold and would it be the policy of the Treasury Department to use gold in these instances for the 25-percent cover?

Secretary DILLON. No, our policy will not change.

Mr. WHITE. For expansion of IMF, or would we still be in the area of substituting short-term credits for those involvements?

Secretary DILLON. We will do the same as we would in the absence of this legislation. As far as the International Monetary Fund is concerned, there is a proposal, which was agreed to in principle by the Governors of the Fund last September—the details are still being worked out by the executive directors and it should be completed some time this month—to expand the Fund by about 25 percent.

That would mean an increased quota of 25 percent for each member country, including the United States. Of that increased quota, 25 percent has to be paid in gold, and we would have to pay that 25 percent increase in gold, just as every other country would.

We have worked out special arrangements though, so that other countries will not on balance take our gold away from us—thus reducing our gold stock—in order to make their own payments, which is what happened last time the Fund was increased. This time that will not occur.

Mr. WHITE. But we would put up 25 percent in gold.

Secretary DILLON. Yes.

Mr. WHITE. If we are involved in the expansion of IMF.

Secretary DILLON. Yes. That is irrespective of this legislation.

Mr. WHITE. My time is up.

The CHAIRMAN. Mr. Stanton?

Mr. STANTON. Thank you very much, Mr. Chairman.

Mr. Secretary, you might have answered my question in regard to France. You stated that much of the money going out of the country has gone to France, and that in your conversations with them, if for

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no other reason this has been embarrassing to the present administration.

In your own mind do you believe this money is being used for their immediate economic benefit, or do you believe that De Gaulle has something else in mind?

Secretary DILLON. No. I think that the French just felt that they wanted to keep a slightly greater percentage of their overall reserves in gold rather than dollars.

I think there is a feeling generally in continental Europe—the French possibly are one of the leaders, but they are not alone—that it is time our balance-of-payments deficit was brought to an end.

A number of Europeans feel that this deficit, by allowing American dollars to pile up in their country, stimulates internal inflation in their country. I don't think that is true. But nevertheless they feel that way, and I think maybe the French were emphasizing their feeling by making this conversion.

It wasn't so unusual, because in 1962 and 1963 they did the same thing, and it didn't receive much comment. In each of those years they accompanied their conversion by an advance repayment on their debt. This time they didn't. So there was a difference.

The other difference was that for reasons of which I am not aware, and I don't know that they are, this was discussed at some length in the British, the French, and then all the continental press and our press before they finally acted. So it took on a much more important coloration than it ever did before when they just treated it as a simple financial transaction, and made it without talking about it.

Mr. STANTON. Thank you very much.

Mr. ANNUNZIO. Mr. Chairman?

The CHAIRMAN. Yes?

Mr. ANNUNZIO. I would like to ask the Secretary a question.

The CHAIRMAN. You will be called on in just a very few minutes if you don't mind. We are alternating from side to side. Mr. Gettys is next.

Mr. GETTYS. Mr. Chairman.

Mr. Secretary, as a new Member of this Congress and of the committee, I would like to join in expressing to you my admiration for you and your work, and, if it is true that you are leaving the Government, which I hope it is not, to say that it will be a real loss to the administration and to the country. Thank you.

The CHAIRMAN. Mr. Mize?

Mr. MIZE. I join with everyone else, Mr. Secretary, in expressing congratulations.

Your answer to one of Mr. White's questions partially answered mine. You said on page 2 gold would indeed remain available to meet legitimate demands of foreign authorities. That is the basis of the international monetary system.

The administration apparently feels that if the gold assigned to our money were made available, foreign holders of dollars would feel assured and not demand gold. Is that not correct?

Secretary DILLON. No, I don't feel that this would have any great effect on the demands for gold. I think their demands for gold will be regulated by our balance-of-payments results primarily.

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I do think that they would feel that we were operating in a more reasonable way if we made gold available to them when they asked for it—and it is theirs to get and we have to make it available to them—if we did it without having to utilize what was obviously a procedure that was set up by the Congress for emergencies, which allows the Federal Reserve to waive this 25-percent requirement. Therefore, the straightforward thing to do is to change it instead of to do that.

So I think to that extent they would think we were acting responsibly, but I don't think it would have any great effect on the size of their demands for gold, at least not immediately.

Mr. MIZE. In other words, then generally you feel that foreigners who do hold dollars look to the general fiscal strength of the United States more than anything else?

Secretary DILLON. That is correct, absolutely.

Mr. MIZE. In other words, what causes a run on gold is a lack of confidence?

Secretary DILLON. That is right.

Mr. MIZE. Thank you, sir.

The CHAIRMAN. Mr. Ottinger?

Mr. OTTINGER. Mr. Secretary, I would like to add to the expressions of my colleagues my admiration of your performance. Perhaps on a more positive note than any expressed, I hope that you will be with us for many years to come.

As a relative laymen, and as a new member of the committee, I want to ask you a question. You stated that future gold drain would be reduced by purchases of newly mined gold which would help prevent reaching the cover requirements that would be left after this bill removed the cover on notes. Why isn't there available for this purpose the gold that is mined today? Why can't the United States go out and buy gold?

Secretary DILLON. Well, it is, and if our payments are in balance, it will be available.

The only problem is now that even though we do buy and received last year through the operations of the London gold market a substantial proportion of the newly mined gold, all of that gold and a little bit more we had to then use to sell for artistic and industrial purposes or to other foreigners who wanted to dispose of excess dollars.

So when I was talking about the future, I was talking about the time when we had a balance in our payments, and were not generating dollars that were more than some countries wanted to hold. Then we would, as we did during the last year, be able to acquire a substantial volume of the newly mined gold, and keep it, because nobody else would want to buy it.

Mr. OTTINGER. So our practical limitation on going out to buy gold is the fact that to do so today would further aggravate our balance of payments?

Secretary DILLON. There is no limitation on buying the gold, but we have this policy of being ready and willing to sell gold to anyone who prefers it to holding dollars. The problem is that people have wanted more gold than we have been able to buy ourselves out of newly mined production.

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Mr. OTTINGER. The other question I had, Mr. Secretary, is the effect on this problem of I suppose a very vastly increased commercial demand for gold.

Secretary DILLON. That has increased very substantially, but it is very small compared to world production.

Last year, for instance, we had a deficit in the United States of $90 million. By that I mean we consumed in the industry and the arts $90 million more of gold than we actually produced in this country, and we have produced something over $50 million. So our uses for industry and arts were about $140-odd million.

To go back only as far as 1955, 1956, 1957, and 1958, those same uses were only about $40-odd million. So there has been a very substantial increase.

But that $141 million has to be looked at against free world production, not counting Russian production, of about $1,400 million. So it is only about 10 percent of that, so still the great demand for gold is for monetary purposes.

Mr. OTTINGER. Thank you, Mr. Secretary.

The CHAIRMAN. Mr. Cabell?

Mr. CABELL. Thank you, Mr. Chairman. No questions. I yield to those who have questions.

The CHAIRMAN. Thank you. Mr. McGrath?

Mr. MCGRATH. Thank you, Mr. Chairman. I have no questions.

The CHAIRMAN. Mr. Hansen?

Mr. HANSEN. Mr. Chairman, no questions except to reiterate some of the statements that were made a little bit ago as a lay person, to express my sincere appreciation for the ability that Secretary Dillon has shown during his service, and I hope that LBJ is able to hold on to him.

The CHAIRMAN. Mr. Annunzio?

Mr. ANNUNZIO. I, too, Mr. Chairman, would like to join my colleagues in commending Mr. Dillon for a job well done.

Mr. Dillon, as you were reading your statement, I underlined "to stifle growth nor so large as to fuel inflation lies in a responsible and independent Federal Reserve System."

I recognize that this statement "independent Federal Reserve System" is a matter of debate. But I also know that the American Bankers Association among others have said that they would back the gold cover legislation if the administration will not back the Federal Reserve reform bill (H.R. 11).

Now, Mr. Secretary, what was your reason for including the independent Federal Reserve statement in your testimony? Is it pertinent to the particular issue under discussion at this time?

Secretary DILLON. I think a lot of people think it is, because if you remove the gold cover from deposits, you remove a restriction, albeit an arbitrary one, on the Federal Reserve in the creation of credit. With that removal, there is no restriction whatsoever left, except their good judgment. So therefore I think it is very appropriate to this committee.

Mr. ANNUNZIO. Thank you.

The CHAIRMAN. It is time for the House to meet, and we would like to ask you, Mr. Dillon, if it is not asking too much of you, to return

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at 2 o'clock and answer the questions I asked you, so that there will be no delay in our consideration of the bill. Will that be satisfactory?

Secretary DILLON. Certainly.

The CHAIRMAN. Then we will resume with Mr. Martin at 2:30. Thank you very kindly. The committee stands in recess until 2 o'clock.

(Whereupon, at 12 noon the committee was recessed, to reconvene at 2 p.m. on the same day.)

AFTERNOON SESSION (2:10 P.M.)

(Present: Representatives Patman (chairman), Multer, Barrett, Reuss, Ashley, Moorhead, Stephens, St Germain, Gonzalez, Weltner, Grabowski, White, Gettys, Ottinger, Cabell, McGrath, Hansen, Annunzio, Widnall, Brock, Talcott, Clawson, Johnson of Pennsylvania, Stanton, and Mize.)

The CHAIRMAN. The committee will please come to order.

Mr. Dillon, it is nice of you to return to answer questions.

If you will just take them up one by one and give us the answers that you would like to give, it will be appreciated very much.

STATEMENT OF HON. DOUGLAS C. DILLON, SECRETARY OF THE TREASURY—Resumed

Secretary DILLON. I will be glad to do that, Mr. Chairman.

The first question was:

> Every year since 1949, except for 1 year, 1957, the United States has had an adverse balance of payments of substantial magnitude. If this had not been the case, if our balance of payments had been in balance or favorable instead of unfavorable, would there still, in your opinion, be a need to consider adjustment of the gold reserve requirements under discussion today?

The answer to that is, if there had been no deficit in the balance of payments since 1949, it would be reasonable to assume that our gold stocks would have remained unchanged.

Our gold certificate reserves at the end of 1949 amounted to $23.2 billion. This would have provided a ratio of 42.3 percent against the present deposit and note liabilities of the Federal Reserve. Thus the ratio would have declined by approximately 12½ percentage points from the peak 1949 ratio of 54.7 percent, but with this decline it would still have been some 17 percentage points above the 45-percent ratio.

The second question was whether there were special psychological or other reasons that the administration felt that we should request the removal of the reserve requirement on only the deposit liability side at this time. I think I answered that at some length this morning. We do believe there are psychological reasons that have to do with general confidence, and it was for that we limited our request to the removal of cover on Federal Reserve deposit liability.

The third question had to do with the balance-of-payments problem and mentioned that the outgo had been accentuated in the fourth quarter of 1964. And it was asked whether this was caused by substantial capital outflows of both short- and long-term maturity. And the answer to that is "Yes"; that it was largely that which was responsible for the increase.

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And in subdivision (a) it is asked:

Is it still true that of the four causes of our balance-of-payments problems, foreign aid, military payments, tourists, and outflow of capital—the latter, "outflow of capital" is as important, if not more, than the other three combined, and what are the amounts involved currently?

We are still trying to sort out that data to get it as well up to date as we can, but it is clear that capital outflow of all kinds is larger than the other three. In 1964, the seasonally adjusted annual rate of capital outflow for the first three-quarters was approximately $5.7 billion, and similar figures for dollar outlays abroad for the military and foreign aid were under $4 billion, something of that nature.

And the next subdivision (b) is:

What recourse under existing authority, such as the interest equalization act does the administration have to correct this matter?

I do not know if it is a complete correction, but we do have the authority of the so-called Gore amendment which allows the President to apply the interest equalization tax to certain bank loans if he finds that the loans are causing the equalization tax to be ineffective in some degree. In other words, if there is a certain amount of transference from longer term securities to bank loans.

And subdivision (c) is:

We are told that capital outflows which adversely affect our balance of payments are of two categories, short term and long term. Of the short term, how much is longer than 1 year; how much is really disguised long-term outflow due to the fact that so-called short-term outflows are continually rolled over from short period to short period and therefore in effect constitute long-term lending abroad?

The answer to that is that, for the purpose of balance of payments accounting, the word "short term" in the question means 1 year and under. So none of what we call short term is longer than 1 year. There have, however, been large increases in medium-term bank loans, perhaps as much as $1 billion in 1964.

And as to the further part of the question as to—

how much of this is really disguised as long-term outflow, due to the fact that such so-called short-term outflows are continually rolled over—

it is difficult to tell in the short-term area. In that area I think it is largely trade financing. In the medium-term area, where much of the increase has been, this is the subject of an analysis at this time to see how much of that could reasonably be regarded as disguised longer term outflow. Depending on that answer when the study is completed—it means analyzing these transactions loan by loan—the decision would then be taken by the President whether or not he would invoke the Gore amendment. That study has not yet been completed. So we cannot give any figures. But our impression is that there has been, particularly during the second half of the year, a good amount or a fair amount of substitution of these medium-term bank loans for what otherwise would have been long-term security issues subject to the interest equalization act.

And question No. 4:

There have been reports that the Treasury was conducting an intensive investigation on the causes of the fourth-quarter balance-of-payments deterioration.

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I mentioned the fact that we will shortly have reasonably accurate overall figures for the deficit. Detailed breakdowns in those figures are not available for at least another month, so we do not have that data available and will not until that time.

The CHAIRMAN. Mr. Widnall?

Mr. WIDNALL. Mr. Secretary, as to the balance-of-payments situation, do I understand that the President is going to send up a special message on that?

Secretary DILLON. That is what he stated.

Mr. WIDNALL. And with possible recommendations in that area?

Secretary DILLON. Oh, yes.

The next question, No. 5 is:

During hearings previously conducted on balance-of-payments problems I supplied the record with some information on U.S. portfolio capital outflows involving U.S. investment houses and banks in the United States. As you know, there are only a handful of banks and investment houses involved in these international transactions. To what degree have the banks and investment houses caused our most recent increase in our unfavorable balance-of-payments situation? In other words, what percent of our balance of payments is caused by these two types of financial institutions?

We have not been able to get complete figures for the first three-quarters. So all I have at this time, to be accurate here, is 1963 figures which show that total bank credit, foreign borrowing, and security transactions together led to a net outflow of $2,600 million approximately, as against a total recorded outpayment of about $36 billion so it was about 7 percent of our total payments. On the other hand, our deficit on regular transactions was about $3¼ billion, so if you credited it just against the deficit, it was a very substantial part of that deficit.

(Subsequently, the following paragraph was supplied for the record:)

Using seasonally adjusted figures for the first three-quarters of 1964, our net outflows from bank credit and securities transactions together amounted to $1,826 million, which was about 6 percent of our $28,950 million total of recorded outpayments. Our deficit on regular transactions for those three-quarters was about $1½ billion.

Secretary DILLON. The next question was, by year and geographic areas, information on capital outflows by U.S. banks and investment houses.

We have not been able to break that down by geographical areas, but we have been able to answer some of the other questions.

Subdivision (*a*) of the question is "Portfolio outflows for 1962–64 accounted for by banks, long and short term."

The bank outflow overall for 1962 was $451 million, which was divided $324 million short term and $127 million long term. And "long term" means everything over 1 year. So it includes medium.

In 1963, bank capital outflow was $1,481 million of which $742 million was short term and $739 million was long term. (See table inserted hereafter.)

The 1964 figures we have available now are for the first three quarters, and they shown bank capital outflow in that first three quarters, seasonally adjusted, of $1,645 million, of which $1,077 million was short term and $568 million long term.

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Now, the next part of the question, subdivision (*b*) is, "Portfolio outflows accounted for by investment houses, long and short term."

That practically all would be long term. It would be mainly new issues. And the transactions in foreign securities which presumably were handled by the investment houses in 1962 led to a net outflow of $969 million, which was composed of an outflow into new issues of $1,076 million, an inflow of $203 million on redemptions, and an outflow of $96 million on outstanding security transactions.

In 1963 the overall figure for foreign securities was a net outflow of $1,104 million which was made up of an outflow of $1,250 million in new issues and an inflow of $195 million in redemptions and an outflow of $49 million in outstanding issues.

For the first three quarters of 1964 the net figure is an outflow of $181 million, which is made up of an outflow in new issues of $482 million, an inflow of $130 million in redemptions and an inflow this time in transactions in outstandings of $171 million.

Capital outflow through banks and through transactions in long-term securities, by area, 1962 through third quarter 1964

[In millions of dollars; capital outflow (−)]

	1962	1963	3 quarters [1] 1964
Total capital outflow reported by banks	−451	[2] −1,481	−1,390
Total short term	−324	−742	−852
Western Europe	−110	−41	−122
Canada	+30	−85	−34
Japan	−212	−431	−267
Australia, New Zealand, South Africa	(3)	−12	−3
Latin America and other Western Hemisphere	[4] −70	−109	−321
Other countries and international	+38	−64	−105
Total long term	−127	[2] −739	−538
Western Europe	−84	−488	−338
Canada	−30	+29	+8
Japan	−51	−155	−33
Australia, New Zealand, South Africa	(3)	+30	−22
Latin America and other Western Hemisphere	[4] +46	−120	−104
Other countries and international	−8	−35	−49
Total net U.S. purchases of foreign securities	−969	−1,104	−181
New issues of foreign securities	−1,076	−1,250	−482
Western Europe	−195	−272	−11
Canada	−457	−693	−317
Japan	−101	−164	
Australia, New Zealand, South Africa	(3)	−17	
Latin America and other Western Hemisphere	[4] −102	−36	−83
Other countries and international	−221	−68	−71
Redemptions	203	195	130
Transactions in outstanding securities	−96	−49	171

[1] Not seasonally adjusted. Seasonally adjusted breakdown by areas not available. Comparable seasonally adjusted total for bank capital is $1,645,000,000 and for long-term securities is $181,000,000. Third quarter figures preliminary.
[2] Includes approximately $150,000,000 of receivables acquired by purchase from U.S. corporations.
[3] Included in "Other countries and international."
[4] "Other Western Hemisphere" included in "Other countries and international" for 1962.

Source: Based on balance-of-payments data as published in Survey of Current Business.

Then the next part of the question, (c), was—

the distribution of the number of banks which account for specific percentages of our portfolio outflow.

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As to how many banks there were, there were quite a few banks involved in this business; probably as many as 60 or 70 altogether contributed in significant amounts, but during the first three quarters of 1964, nine banks accounted for 73 percent of the net increase in outstanding long-term loans to foreigners and 81 percent of new long-term commitments. So the bulk in figures is rather concentrated in a few of the larger banks.

Then there was a rather long question on interest costs on 3-month Treasury bills, their increase and what it has amounted to, and then what effect it might have.

I think it is very difficult to quantify what the effect of this increase in short-term rates has been in balance-of-payment terms largely because it is dependent on what in other conditions would have been a much larger dollar outflow of short-term funds. There is probably something over $2 billion in corporate and other nonbank liquid funds on deposit abroad and obviously placed there to get somewhat higher interest rate returns—if those interest rates had been relatively much higher abroad it would have, undoubtedly, meant a larger volume of corporate funds abroad. There is no way to measure that. We have known and we know this last year that there was an increased outflow of short-term banking funds to Europe during the second quarter—that was the period in which the gap between the Eurodollar rates and our own rates was somewhat wider than it had been in either the first or the third quarters.

As to the cost of this increase in bill rates here, we have made a number of computations. There were $37.4 of Treasury bills outstanding at the end of 1961. We took those, and at the 1964 rates on that $37.4 billion there would have been an increase of 40 percent, or $400 million in interest. The interest charge on those bills at 1961 rates was $1 billion. It would be $1.4 at the present rates.

Another way of doing this is to take the 1964 figure—at the end of 1964 there were $52.4 billion of Treasury bills outstanding. We issued $15 billion additional bills in the period from 1961. And if we took that $52.4 billion and applied the 1961 rates to it, the cost, which would have been $2 billion under the current rates, would have been reduced by $600 million during the year. It would have been reduced to $1.4 billion. So on either amount there would have been an increase of about 40 percent. There would have been a decrease of 30 percent in our current charges if there had not been any change in the bill rates during that period.

Mr. BROCK. May I ask a question here?

The CHAIRMAN. Yes, sir.

Mr. BROCK. Did you say that if the 1961 rates were in effect today we would have had a cost of $600 million a year less?

Secretary DILLON. Yes, less for the balance of the Treasury bills that we now have outstanding.

The CHAIRMAN. Mr. Martin has arrived. You have just about finished the questions, I believe; have you not?

Secretary DILLON. Yes.

The CHAIRMAN. One thing came up this morning on page 11 of your statement about an independent Federal Reserve, "functioning within a framework of responsible government. For our part this administration has and will continue to work in close cooperation with

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the Federal Reserve in developing an effectual financial program," and so forth.

Is there any particular reason why that was presented in that particular phrase as "independent Federal Reserve System?"

Secretary DILLON. No, that has been the regular policy right along and within the framework of that it just seemed something useful to say. There is no particular reason.

The CHAIRMAN. In other words, you were not capitulating in regard to statements made by any big organizations to the effect that the administration——

Secretary DILLON. No, none whatsoever. [Laughter.] Never even thought of that.

The CHAIRMAN (continuing). Who would otherwise not support this.

Secretary DILLON. No.

The CHAIRMAN. You had no reference to that at all.

Secretary DILLON. No, sir, none whatsoever.

The CHAIRMAN. It was not for the purpose of catering to any groups in opposition to this?

Secretary DILLON. Certainly not.

The CHAIRMAN. To give them a bonus——

Secretary DILLON. No, sir.

The CHAIRMAN. Thank you.

Mr. MULTER. May I address a few questions to the Secretary?

The CHAIRMAN. Yes.

Mr. MULTER. Mr. Secretary, if we kept our international accounts on an accrual basis, the impact of these bank loans and securities would be very small. The deficit in our balance of payments would substantially be lessened if not be wiped out if we had kept our books on an accrual basis?

Secretary DILLON. Yes. Our assets overseas every year have gone up—the net assets overseas have gone up more rapidly than our balance-of-payments deficit—the increase has been larger than our balance-of-payments deficit. So actually our balance sheet position overall has been improving for a long time. The problem we think is one of short-term liquidity, not of the overall assets.

Mr. MULTER. Mr. Secretary, you are familiar with H.R. 625 which I introduced on January 4, 1965, which is the same as the bill I introduced 4 years ago. It goes further than the current bill. I would like to address a question to sections 11 and 12 of that bill and ask you whether or not the administration would oppose those two provisions being written into this bill and whether or not they would be helpful.

Secretary DILLON. Those two provisions, as I understand it, are provisions that would renew—make permanent—an act by the Congress which allows the commercial banks to be relieved from the limitations on the rate of interest they pay on time deposits to foreign governments, the financial arms of foreign governments, international financial institutions, et cetera. That bill was enacted at the administration's request and it was enacted on a temporary basis in 1962. It is a part of the administration's proposals this year either to extend that or, preferably, make it permanent, because it did work well and there was a considerable volume of foreign

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assets that were maintained here in dollar accounts that would otherwise have gone overseas except for the provisions of that bill. So we would like to see something like sections 11 and 12 of H.R. 625 enacted. The only question is where is the proper place to do that—whether it should be in a separate bill or as a part of this bill. I think that you would have to leave that to the Congress to determine. We would certainly like to see that done before the session is over.

Mr. MULTER. Just one other item, sir. Presently the maximum amount of Federal Reserve notes that may be issued by the Federal Reserve banks is fixed by law as the result of a mathematical computation. Am I not right?

Secretary DILLON. It is the 25-percent cover. There is a 25-percent cover and that is the only thing that fixes that maximum amount. If you count the entire reserve against the notes it has never approached that total yet.

Mr. MULTER. In order to relieve those who suggest that if we enact this bill that we then permit the Federal Reserve to, without limitation, issue so-called printing press money—can we reassure those raising that opposition which raises this ghost—if I may call it that—by putting in a maximum figure in the law beyond which the Federal Reserve banks may not issue currency?

Secretary DILLON. Well, actually, they cannot issue a note unless there is a demand for it—unless somebody pays them for it. I do not think that there has ever been a danger of printing press money here. If we decided that we just wanted to print money, we could not do it. There is no way that we could directly accomplish that. And so I would think that that was not necessary. I do not think that there is much actual concern about that. The only problem with any limitation of that nature is that it seems that some 10, 15, 20, 25 years later the situation has changed and you come up against it and then it becomes a problem which it is unnecessary to create.

Mr. MULTER. Thank you.

The CHAIRMAN. We have a request for three short questions here of Mr. Dillon. Mr. White?

Mr. WHITE. Mr. Secretary, there are many people throughout the world who are considering what action the United States may take with respect to its gold cover, and some very learned economists suggest that we are putting up the ultimate devaluation of the dollar and a rise in the price of gold. I am wondering if someone, looking at this today and considering the time of the Bretton Woods Agreement being entered into, at the time that we had control of a great amount of the gold of the world, if the conditions are not different today and that this might ultimately be a consideration that would have to be made. I realize that the President has indicated that we are to maintain the stability of the dollar, reemphasizing those remarks on the second page of your statement, but I would like you to address yourself briefly, if it is possible, to this particular eventuality and to those people who propound it.

Secretary DILLON. Well, there are certain people, a certain school of economists, that believe that everything could be solved by increasing the price of gold. The Treasury does not belong to that school. We do not think that would accomplish anything. All it

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would do would be to give a substantial benefit to South Africa and the Soviet Union who produce such a great bulk of the gold in the world today. It would not solve the question of balance-of-payments adjustment which is the basic question in the world. It might temporize for awhile with liquidity, but we really do not believe that it would be of any use. And our belief in this matter is supported by, certainly, the great majority if not all of the other industrialized countries who have a fairly large stake in the international monetary system. The study that was made over the past year by the group of 10 Finance Ministers, who represented all of these countries, made the point that the international monetary system had to be based on a fixed price of gold. So I think that those who feel that a change in the price of gold is desirable are a small minority, and one with which we have never agreed.

Mr. WHITE. Thank you.

The CHAIRMAN. Mr. Widnall?

Mr. WIDNALL. If the present trend should continue, it could result, is it not so, in the continued balance-of-payments deficit?

Secretary DILLON. Well, certainly, yes. There has to be, irrespective of what action you may take today, a continued and intensified effort to bring the balance of payments into balance.

Mr. WIDNALL. We do have to watch that at the same time that we are talking about the gold reserve. Is not that the reason that you mention on page 11 of the statement the independent Federal Reserve System—that was tied in with this sort of action? I am talking now about national and international reactions from what we are doing with respect to our policy here in this country.

Secretary DILLON. I do not quite understand. Internationally the Federal Reserve System does operate on its own. It also operates as the agent of the Treasury. The Federal Reserve Bank of New York is our agent. I do not think that its independence, which is traditional in this country, has anything particularly to do with the way the foreign countries look at us because some foreign countries have independent central banks and some do not. They are all over the lot on that.

Mr. WIDNALL. I was thinking about the psychological aspect of it that you spoke about earlier in your testimony. May I ask one other short question?

Has any particular effort been made in respect to a proposed tax or license on tourists?

Secretary DILLON. No; no decision has been made on any of that.

Mr. WIDNALL. In connection with that it would seem to me that the ones to be hurt most would be the students and the low-income people who would find it impossible to pay more whereas the wealthy would be glad to pay a fee of $100, for example, is that not so?

Secretary DILLON. I think individually that is quite true. I think if you are going to lower the tourist deficit, the only way that you can do it in any substantial amount is to reduce the number of tourists going abroad. The only way that you can reduce it; that is, is by reaching the bulk of the tourism. I do not think that the millions that go abroad are wealthy people. Certainly I would think that if anything should be done, special care should be taken regarding students

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who go abroad for very specific purposes, to better their knowledge, to help them later on in the world.

Mr. WIDNALL. Thank you.

The CHAIRMAN. Mr. Barrett has a question.

Mr. BARRETT. Mr. Secretary, if we were to amend section 16 and section 18, and we would accumulate another $5 billion in gold, what inflationary effect would that have on the local currency of foreign governments? In the last paragraph of this document I have which gives comparison, it says—

> Deposits made under this section standing to the credit of any Federal Reserve bank with the Board of Governors of the Federal Reserve System shall, at the option of said bank, be counted as part of the lawful reserve which it is required to maintain against outstanding Federal Reserve notes or as a part of the reserve it is required to maintain against deposits.

Doesn't this option give them a little more than we are trying now to accomplish through restriction by holding them at 25 percent?

Secretary DILLON. Actually, we are not making any change in our suggestion in that option. It is a highly technical matter which I think probably the Chairman of the Federal Reserve Board could explain a little more fully than I would be able to do on this short notice.

Mr. BARRETT. Mr. Secretary, I purposely asked you this question so that I would know how to get an answer from Mr. Martin. This seems to give him tremendous flexibility. I was a little bit concerned about it.

Secretary DILLON. Well, I think that they do have flexibility. They have always had it. And the only time that they do not have flexibility is right now at this moment. Next year, if there is no action taken, we will be up against a 25-percent gold cover, but when our gold cover was at 90 percent and at 50 percent, and all of these other high percentages which are in the record, the Federal Reserve had full flexibility and they did not in any way abuse that. I do not see any reason to expect that they will in the future.

The CHAIRMAN. Thank you very much, Mr. Dillon. Now, we will hear from Mr. William McChesney Martin, Jr., the Chairman of the Board of Governors of the Federal Reserve System.

We appreciate your testimony, Mr. Dillon. The committee is always interested in what you have to say. Mr. Martin, we are glad to have you back. You have a prepared statement, I believe?

Mr. MARTIN. Yes.

The CHAIRMAN. You may proceed.

Mr. MARTIN. Thank you. May I congratulate you at the start for overcoming so successfully your bout with the flu?

The CHAIRMAN. Thank you.

STATEMENT OF HON. WILLIAM McCHESNEY MARTIN, JR., CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM; ACCOMPANIED BY RALPH A. YOUNG, ADVISER TO THE BOARD OF GOVERNORS AND DIRECTOR OF ITS DIVISION OF INTERNATIONAL FINANCE

Mr. MARTIN. Mr. Chairman and members of the committee, you have asked for comment on H.R. 3818, which would repeal the requirement of present law that each Federal Reserve bank maintain a gold certificate reserve of at least 25 percent against the deposits it holds.

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The bill would not affect the separate 25-percent requirement for Federal Reserve notes.

That conditions now call for some change in these requirements seems clear. By the end of 1964, the ratio of the Federal Reserve banks' gold certificate holdings to their deposits and notes combined was 27.5 percent, down 2 points from a year earlier and only 2½ points above the legal minimum now prescribed in section 16. If developments well within the range of possibilities should be realized, the legal minimum could be penetrated soon, possibly within a year.

Nevertheless the dollar is strong, and so is our economy. We are enjoying vigorous economic growth and have been reasonably successful in maintaining a relatively stable average of prices. American goods and services are doing well in competition in world markets, as indicated by the substantial surplus in our trade balance, running at a rate of about $7 billion. Therefore, action on this legislation can be taken now, not to deal with a dollar crisis but to maintain the dollar's current strength.

Gold certificate reserves of the Federal Reserve banks reached their peak of $23.4 billion in September 1949 when the total U.S. gold stock amounted to about 70 percent of the free world's monetary gold. Over the period from 1949 through 1964, net sales of U.S. gold to foreign monetary authorities reduced our gold certificate reserve by $8.4 billion, as shown by the table attached to this statement. In the same period, growth in Federal Reserve deposit liabilities and notes in circulation absorbed in required reserves $3.5 billion. Over these 15 years, therefore, Federal Reserve bank holdings of gold certificates in excess of the minimum required by statute have on balance declined by $11.9 billion.

In substantial part U.S. sales of gold to foreign monetary authorities since 1949 have reflected postwar recovery of the free world from the monetary chaos created by the Second World War, and the desire of the major foreign industrial countries to reestablish convertibility of their currencies. These countries sought to accomplish this by accumulating monetary reserves partly in the form of gold and partly in the form of dollar balances. Between the end of 1949 and the end of 1964, the dollar component of monetary reserves of foreign countries rose by $10 billion (from $3 to $13 billion) while their monetary gold stocks rose by $16 billion (from $9 to $25 billion). Foreign private holdings of dollars also increased by $8 billion, from about $3 billion to nearly $11 billion.

In the half century since the enactment of the Federal Reserve Act, the function of gold in our monetary system has undergone fundamental change. More than three decades ago, coinage of gold, redemption of bank notes and deposits in gold, and private acquisition and holding of monetary gold were discontinued in this country. Domestically, these actions in effect ended the private use of gold as a store of value. Internationally, they enlarged the availability of U.S. gold for official settlements with other governments in response to the needs of our foreign commerce and our foreign investment.

Today, throughout the free world, when a citizen of one country does business with a citizen of another—whether or not either of them is an American—the chances are that they will settle their accounts in U.S. dollars. When foreign bankers, merchants, and investors ac-

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quire in their transactions more dollars than they wish to hold for working balance or investment purposes, they usually sell them to their central bank. The central bank may keep the dollars as part of its monetary reserves or use them, if it desires, to purchase gold from the U.S. Treasury. On the other hand, if a country's international settlements should use up its dollar balances, its central bank may acquire dollars by selling gold to the U.S. Treasury.

In short, the readiness of the U.S. Treasury to buy and sell gold at the fixed price of $35 an ounce in transactions with foreign monetary authorities has greatly contributed to the willingness of foreign monetary authorities and private foreign residents to hold a growing total of dollar reserves and working balances. Consequently, the U.S. gold stock has come to play the dual role of supporting the international convertibility of the dollar and of facilitating the interconvertibility of other currencies among themselves and into the dollar.

This dual role of the U.S. monetary gold has helped the dollar to attain a unique position in international commerce and finance. And the universal acceptability of dollars has greatly facilitated the record expansion of international trade over the past 15 years, with world trade rising from less than $60 billion to nearly $160 billion. For this reason the availability of U.S. monetary gold holdings to meet international convertibility needs is a matter of vital importance not only to the United States but to the entire present system of international payments on which the free world relies.

These developments underscore the need for speedy correction of the deficit in our international payments, which for all too many years has been eroding our gold reserves. The President, in his Economic Report, has stressed the seriousness of the problem, and has unequivocally stated that "we must and will reduce and eliminate" the deficit.

In consequence of the large and persistent deficit in the U.S. balance of payments after 1957, many foreign countries accumulated dollar balances in excess of their needs for working balances, reserves, and investments. Their monetary authorities used such excess dollar balances to purchase gold from the U.S. Treasury and the resulting decline in the U.S. gold stock has contributed to the sharp reduction in the System's reserve ratio.

In order to avoid any deflationary impact from this outflow, the Federal Reserve offset the effects of the decline in its gold certificate holdings by expanding its holdings of U.S. Government securities. In addition, the Federal Reserve further increased its Government security holdings in order to sustain an expansion of bank credit consistent with a growing economy and a relatively stable average of prices.

Over the years ahead, the continued growth of U.S. economic activity will require continuing monetary expansion consistent with a stable dollar. Under prospective conditions, it appears all but certain that the gold certificate reserve ratio of Federal Reserve banks, for domestic monetary reasons alone, will steadily decline, even if gold sales to foreign monetary authorities are small. Of course, any substantial further outflow of gold would accentuate such a decline.

Accordingly, the time is ripe for legislative action that will, as President Johnson said in his Economic Report last week—

* * * place beyond any doubt the ability of the Federal Reserve to meet its responsibility for providing an adequate but not excessive volume of bank reserves—

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And—

* * * place beyond any doubt our ability to use our gold to make good our pledge to maintain the gold value of the dollar at $35 an ounce with every resource at our command.

As you know, the President himself expressly requested that Congress—

eliminate the arbitrary requirement that the Federal Reserve banks maintain a gold certificate reserve against their deposit liabilities.

The specific provisions to accomplish this are encompassed in H.R. 3818, introduced by your chairman.

To me, the question before us is a practical one. H.R. 3818 offers a pragmatic response, proportioned to the present circumstances. By removing the reserve requirement against deposits, it would free approximately $4.8 billion in gold now earmarked for cover purposes and raise the total free gold certificate holdings to about $6.2 billion.

Moreover, by retaining the traditional gold "backing" for Federal Reserve notes, the proposal would be reassuring to those who, in their continuing concern for the stability of the dollar, see in a gold cover requirement an important element of strength. The value of any currency is so much a product of confidence that one should not disregard this advantage of H.R. 3818, the present bill.

The removal of the reserve requirement against deposits would seem to me fully adequate to meet our present and foreseeable needs and sufficiently ample to remove any doubt anywhere about our ability to defend the dollar abroad, and to further advance the progress of our domestic economy.

I might note here that, on an earlier occasion, Congress reduced the gold reserve requirements by lowering the percentage of reserves required against Federal Reserve notes as well as deposits in the Federal Reserve banks. Specifically, in 1945, Congress reduced the gold cover requirements from 40 percent against notes and 35 percent against deposits to the present figure of 25 percent for both. That action was taken after the amount of free gold certificates had dropped from $12.4 billion at the beginning of the war to $3.2 billion by mid-1945. If an across-the-board reduction of the present 25-percent requirement were to be made now, say to 15 percent, it would release about $5.5 billion of the earmarked gold, as compared to the $4.8 billion released by H.R. 3818.

From a technical viewpoint this approach may be just as sound as that taken by the present bill. What counts, in my judgment, is which approach would be more acceptable to the public. And from that standpoint, I believe it is preferable to preserve the 25-percent requirement for Federal Reserve notes and thus to keep intact the symbolic tie between our circulating currency and gold.

The Congress could, on the other hand, take a more all-out approach and repeal the gold cover requirements altogether. This would release our entire gold certificates holdings of $15 billion by severing the last statutory link between the volume of our Federal Reserve notes in circulation and gold. The theory here is that, since neither Federal Reserve notes nor deposits in Federal Reserve banks can be redeemed in gold, there is no need to have any gold backing against either of them. Further, it is suggested that outright repeal of both gold reserve requirements would eliminate the possibility that Con-

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gress might be called upon to take further action later. Those who would keep the discipline of gold, however, answer that this very possibility offers added protection against irresponsible public policies.

While judgments differ as to the value of this kind of statutory protection, we need not attempt, in my judgment, at this time to resolve forever the problem of whether or not a gold cover requirement serves a useful end. We need only to adapt our traditional cover requirements so that we can better meet present and foreseeable needs. If we keep the gold cover requirement for our currency, our free gold certificate holdings of more than $6 billion will be enough to accommodate normal growth in circulating Federal Reserve notes for some time to come.

We face the prospect of some additional gold losses this year. But if we persevere in our strong efforts to correct our balance-of-payments deficit, we can look forward to a cessation of gold outflow and, over the longer run, a gradual growth of our gold stock from world supplies, at times in consequence of international settlements and at times by sharing in new production.

In considering these proposals, I think we must be careful to keep in mind that, regardless of what is done about legal requirements, there is an inescapable practical requirement that we maintain an adequate gold stock to back up the role of the dollar as a key currency in world trade. Hense the need to conserve our gold stock will continue to exert a disciplinary influence on monetary and other policies, and a statutory gold reserve requirement for notes will serve to emphasize this need.

All of us need to be mindful that sound money is not established by statute alone. In the end, our Nation cannot have sound money unless its monetary and fiscal affairs are well managed. The fundamental elements in keeping our financial house in order are thus sound and equitable fiscal and monetary policies. None of us can emphasize that too much.

It may be helpful to your consideration of legislation for me to say at this point a few words about the present provisions of the law respecting the suspension of gold reserve requirements. The Board's authority in this regard is contained in section 11(c) of the Federal Reserve Act. It provides that we can suspend the gold reserve requirements for a period of 30 days, and renew such suspensions for 15-day periods thereafter.

Upon action to suspend the requirements, the Board would have to establish a tax on the Reserve banks graduated upward with the size of their reserve deficiencies. The tax could be very small so long as the reserve deficiencies were confined to the reserves against deposits and the first 5 percentage points of any deficiencies against Federal Reserve notes. But if the reserve deficiencies should penetrate below 20 percent of the Federal Reserve notes outstanding, the tax would undergo a fairly steep graduation in accordance with statutory specifications.

The Federal Reserve Act further specifies that, should the reserve deficiencies fall below the 25-percent requirement against notes, the amount of the tax must be added to Reserve bank discount rates. But if the deficiencies were confined to reserves against Reserve bank deposits, the required penalty tax could be nominal and no addition to Reserve bank discount rates would be necessary.

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From a technical point of view, it might be possible under existing law for the Board to suspend gold reserve requirements indefinitely, since there is no limit on the number of times the Board might renew suspensions for periods of 15 days each. Yet it seems clear that the purpose of the provisions for suspension was to facilitate adjustments by those Reserve banks whose reserves fall temporarily below required levels, and not to provide a solution to a national problem of more than temporary import.

In a world in which the role of the dollar as an international means of payment and a reserve asset has been under criticism, it is important for the Congress to assure the world of the availability of U.S. monetary gold for legitimate monetary uses in international commerce, to reaffirm the relationship between the dollar and gold, and to reassert the intention of the United States to maintain an adequate gold reserve for the dollar. Enactment of H.R. 3818 would accomplish this triple purpose.

In conclusion, I would reemphasize that we do not need now to resolve this question of gold cover for all time, for monetary arrangements and institutions are constantly evolving in accordance with domestic and international needs, and these changes call for adaptation from time to time in monetary legislation. The all-important need for legislation at this juncture is to assure the world that U.S. monetary gold is always available to maintain the convertability of the dollar and that the United States will honor its debts and liabilities in the form of foreign dollar holdings, as I have said many times before, down through the last bar of gold, if that be necessary.

The CHAIRMAN. Thank you very much, Mr. Martin. We will also attach to the record and make a part of it the table attached to your statement entitled "Consolidated Reserve Position of the Federal Reserve Banks." Will that be satisfactory?

Mr. MARTIN. That will be very satisfactory, Mr. Chairman.

(The document referred to follows:)

Consolidated reserve position of the Federal Reserve banks

[Dollars in millions]

Item	Sept. 21, 1949	Dec. 31, 1963	Dec. 31, 1964
Reserve bank deposits	$17,523	$18,392	$19,454
Federal Reserve notes	23,248	32,878	35,342
Liabilities requiring reserves	40,771	51,270	54,796
Required reserves against deposits	4,381	4,598	[1] 4,864
Required reserves against notes	5,812	8,220	8,835
Total required reserves	10,193	12,818	13,699
Free gold certificate holdings	13,247	2,419	[1] 1,376
Gold certificate reserves	23,440	15,237	15,075
Ratio of gold certificate reserves to deposit and note liabilities (percent)	[2] 57.5	29.7	27.5

[1] Elimination of required reserves against deposits, as recommended in the President's Economic Report, would raise free gold certificate holdings to $6,240. "Free gold" includes some additional gold held by the Treasury (amounting to $240,000,000 on Dec. 31, 1964) that is not pledged as cover for gold certificates or U.S. notes.

[2] Postwar peak.

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The CHAIRMAN. Now, if I forgo asking questions at this time and other members desire to do likewise, and instead in lieu thereof submit to you in writing the questions that I would like answered when you look over the transcript, would that be satisfactory with you?

Mr. MARTIN. That is satisfactory to me.

The CHAIRMAN. Thank you, sir. With that understanding I will insert my questions into the record at this point.

(The questions follow:)

1. In a recent issue of the American Banker, January 13, 1965, you stated in an interview that you thought it might be necessary for the President to invoke his standby authority to curtail bank loans made by U.S. banks to foreign entities.

(a) What do the figures show for the last several years? How much of the annual balance-of-payments deficit has been caused by U.S. bank loans made to foreign entities?

(b) Would you at this moment curtail long-term bank loans to foreign entities made by U.S. banks?

2. What is the effect on our balance of payments of the activities of the Edge Act companies and foreign branches—those companies owned by U.S. banks which operate in foreign countries? Do the transactions of these companies appear in our balance-of-payments figures? Do such transactions have an adverse effect on our balance of payments on a net basis, and if so, to what extent?

3. Mr. Martin, the interest cost on 3-month Treasury bills has increased over 100 percent since 1958, and since 1961 by 63 percent. This increase has been brought about by direct action of the Federal Reserve Board operating through its Open Market Committee. It has been done in the name of protecting our balance-of-payments situation. We have been told that if short-term rates were kept high it would prevent an outflow of dollars from the United States and attract foreign currencies and investments to this country.

This action has cost the American people a great deal of money when you recall that 3-month Treasury bills were yielding 1.839 percent in 1958 and now cost the Government better than 3.8 percent.

Since 1961 what has been the increase in the dollar cost of 3-month Treasury bills comparing the rate in 1961 to the rate currently? And what—in value-in-dollar terms—has been the advantage? Can you in any concrete way measure how successful the program has been? What, in monetary terms or other measures, have we accomplished?

ANSWERS TO QUESTIONS SUBMITTED BY CHAIRMAN PATMAN OF THE HOUSE BANKING AND CURRENCY COMMITTEE

Question No. 1. In a recent issue of American Banker, January 13, 1965, you stated in an interview that you thought it might be necessary for the President to invoke his standby authority to curtail bank loans made by U.S. banks to foreign entities.

(a) What do the figures show for the last several years? How much of the annual balance-of-paymens deficit has been caused by U.S. bank loans made to foreign entities?

(b) Would you at this moment curtail long-term bank loans to foreign entities made by U.S. banks?

Answer. The attached table 1 shows that expansion of bank credit to foreigners was probably equal to more than half of the entire payment deficit in 1964.

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In particular, expansion of long-term bank credits to foreigners—only a small fraction of which directly finances exports of U.S. goods and services—rose from $336 million in 1961 and $126 million in 1962 to about $900 million in 1964.

Under these circumstances, it seems clear to me that the correction of the U.S. payments problems will be extremely difficulty if not impossible unless the expansion of such credit to foreigners is curtailed. The question is not whether or not such curtailment is necessary but how it will best be accomplished without interfering with the financing of domestic activities necessary to promote maximum employment, production, and purchasing power.

It should be noted, however, that the figures do not necessarily indicate that the amount of bank lending "caused" a U.S. payments deficit of equal magnitude, except in a purely statistical sense.

First, if a foreigner makes a deposit with a U.S. bank and that bank then lends an equivalent amount to another foreigner, the international payments position of the United States would seem to have suffered no real damage. Unfortunately, it is impossible to deduce from the statistics the extent to which this has actually hapened. For any loan granted by a U.S. bank to a foreigner creates, in most instances, an equivalent deposit of a foreigner; it is therefore a chicken-and-egg question whether in any particular case an increase in deposits of foreigners "caused" an increase in loans to foreigners, or whether an increase in loans to foreigners "caused" an increase in deposits of foreigners.

Since deposits of foreigners with U.S. financial institutions rose in the 12 months ending November 1964 by $1¾ billion, this problem is of more than theoretical importance.

Second, insofar as bank credits finance exports of U.S. goods and services, the negative impact of the transaction on the capital account of the U.S. payments balance is offset by the positive effect on the trade account.

Both these considerations have to be kept in mind, particularly in evaluating the balance-of-payments effects of transactions of foreign subsidiaries and branches of U.S. banks (see question 2, below).

TABLE 1.—*Bank credit to foreigners and U.S. payments deficit*

[In millions of dollars]

Year	Increase in bank credit			Payments deficit on regular transactions
	Total	Short term [1]	Long term	
1961	1,048	912	136	3,071
1962	453	327	126	3,605
1963	1,022	452	570	3,261
1964 (estimate)	[2] 1,730	[2] 830	[2] 900	3,000

[1] Short term bank loans and acceptance claims.
[2] Eleven months data at annual rates.

Question No. 2. What is the effect on our balance of payments of the activities of the Edge Act companies and foreign branches—those companies owned by U.S. banks which operate in foreign countries? Do the transactions of these companies appear in our balance-of-payment figures? Do such transactions have an adverse effect on our balance of payments on a net basis, and if so, to what extent?

Answer. Edge Act corporations and foreign branches of U.S. banks affect the U.S. payments balance directly and indirectly. Directly, their lending to foreigners and their investments in foreign securities would contribute to the U.S. payments deficit, but only insofar as these credit and investments were financed by funds transferred from the United States. Insofar as they are financed by deposits of foreigners, they have no real effect on the U.S. payments balance (see question 1, above). And insofar as deposits of foreigners are larger than credits to foreigners and investments abroad, these deposits aid in the financing of the U.S. payments deficit since they prevent foreign-held dollar balances from being shifted from private holders to foreign central banks, which could convert them into gold.

Indirectly, these corporations and branches affect the U.S. payments balances by helping to finance activities of U.S. corporations and individuals abroad. These activities in turn may benefit our payments position, e.g., by raising exports of U.S. goods and services or promoting the inflow of foreign capital. They

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may harm our payments position if they promote the outflow of U.S. capital funds.

On balance, the effect of the activities of those corporations and branches seems to have been helpful to the U.S. payments position.

In the case of foreign branches of U.S. banks, U.S. head offices had claims on their foreign branches totaling $736 million at the end of 1963 (latest date for which figures are available) but liabilities to those branches of $1,411 million, and hence net liabilities of $675 million. This figure represents roughly the excess of foreign deposits over foreign credits and investments of these branches, which helps to finance our payments deficit.

In the case of Edge corporations, the data (see table 2) do not permit as exact an appraisal of the difference between foreign and domestic assets and liabilities. Their liquid assets (cash, bank deposits, and U.S. Government securities) were largely domestic. But their equity investments were made abroad, and their other assets (mainly loans and customers' liabilities on acceptances) largely represented credits to foreigners. On the other hand, a substantial part of their deposits came from foreigners since Edge Act corporations are restricted in their power to accept deposits from domestic residents. Hence, in the case of these corporations, too, foreign deposits were apparently larger than credits to foreigners and investments abroad.

As far as the indirect effects are concerned, the positive impact on U.S. exports was probably at least as large as any negative effects.

Hence, Edge Act corporations and foreign branches of U.S. banks have, in my judgment, no substantial real adverse impact on the U.S. payments balance.

The transactions of Edge Act corporations and of foreign branches of U.S. banks appear in our balance-of-payments figures. The domestic head offices of Edge Act corporations are treated as domestic financial institutions; their foreign branches and subsidiaries and the foreign branches and subsidiaries of U.S. blanks are treated as foreign financial institutions. Hence, for instance, an increase in the claims of head offices on their foreign branches is treated as a capital outflow.

TABLE 2.—*Assets of liabilities of Edge Act corporations* [1]

	Millions of dollars
Assets:	
Cash and due from banks	$283
U.S. Government obligations	23
Other bonds and notes	9
Stocks (less reserves)	67
Loans and discounts (less reserves)	262
Customers liabilities for acceptances	69
Other assets	8
Total	721
Liabilities:	
Deposits	444
Borrowings	11
Acceptances	71
Other liabilities	9
Capital accounts	186
Total	721

[1] As of June 30, 1964; includes "Agreement" corporations (sec. 25 of the Federal Reserve Act).

Question No. 3. Mr. Martin, the interest cost on 3-month Treasury bills has increased over 100 percent since 1958, and since 1961 by 63 percent. This increase has been brought about by direct action of the Federal Reserve Board operating through its Open Market Committee. It has been done in the name of protecting our balance-of-payments situation. We have been told that if short-term rates were kept high it would prevent an outflow of dollars from the United States and attract foreign currencies and investments to this country.

This action has cost the American people a great deal of money when you recall that 3-month Treasury bills were yielding 1.839 percent in 1958 and now cost the Government better than 3.8 percent.

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Since 1961 what has been the increase in the dollar cost of 3-month Treasury bills comparing the rate in 1961 to the rate currently? And what—in value-in-dollar terms—has been the advantage? Can you in any concrete way measure how successful the program has been? What, in monetary terms or other measures, have we accomplished?

Answer. First of all, I cannot agree that the increase in money-market rates since 1961 has been brought about just by action of the Federal Reserve, or, for that matter, by coordinated action of the Federal Reserve and the Treasury. It is doubtful that we could have held the pace of monetary expansion to non-inflationary levels without some increase in money-market rates even aside from the balance-of-payments considerations. The year 1961 began with a recession; at present we are closer to full employment of our labor and capital resources than we have been at any time since 1957. We cannot expect to have the same money-market rates in times of recession and of prosperity.

Moreover, we must remember that money-market rates are of lesser importance for domestic economic activity than other interest rates. American business is far more concerned with bank lending rates and long-term interest rates than with Treasury bill yields. These other rates have not risen. The so-called prime rate on bank loans has remained unchanged, as has the average interest rate for small business loans, which was 5.9 percent both in 1961 and in December 1964.

Even more importantly, those long-term rates that are particularly important for the level of business investment, State and municipal improvements, and construction activities actually have fallen since 1961. Corporate bond yields averaged 4.66 percent in 1961 and 4.58 percent in December 1964. Yields on State and local bonds were 3.60 percent in 1961 and 3.23 percent in December 1964. Conventional mortgage rates dropped from 5.98 percent in 1961 to 5.75 percent at the end of 1964.

Between 1961 and December 1964, the yield on new Treasury Bills rose from 2.378 percent to 3.856 percent. In December 1964, Treasury bills held by the public (excluding Government agencies, Federal Reserve banks, and State and local governments) amounted to $44.4 billion. The gross budget cost of the difference in yields between 1961 and that date would thus be about $656 million annually. The net cost would be much lower since the great bulk of those holdings was subject to U.S. income taxes.

The increase in money-market rates has encouraged foreigners to keep their monetary reserves and international working balances invested in dollars, instead of converting their dollar holdings into other currencies or gold and thereby putting further pressure on the U.S. gold reserves. The remarkable feat of financing the 1964 deficit, which is now estimated at $3 billion, with only a small decline in our gold reserves would have been impossible if our money-market rates had not remained competitive with rates in other financial centers.

In the 12-month period ending in November 1964, the short-term dollar assets held by all foreigners (including international agencies) rose by $2½ billion. Holdings of foreign corporations and individuals alone increased in that period by 1¾ billion. Insofar as these increases represent our continuous balance-of-payments deficit, they are regrettable. But insofar as they show how well, in spite of that deficit, foreign confidence in the stable value of the dollar has been maintained, they can be viewed as a clear indication of the success of our monetary policy in the international field.

In spite of that confidence, foreigners would have not only refused to accumulate further dollars but would certainly have withdrawn part of the $26 billion they held in short-term dollar assets at the beginning of the year if the yields on dollar investments had not been maintained at approximate parity with those in other financial centers. Over the last 6 months of 1964, for instance, the difference between returns on U.S. Treasury bills and on British Treasury bills, covered against exchange risk, fluctuated between .55 percent in favor of London and .11 percent in favor of New York; the similar difference between United States and Canadian Treasury bills fluctuated between .30 percent in favor of Canada and .28 percent in favor of New York. It is clear that this parity could not have been maintained at a significantly lower level of U.S. Treasury bill rates.

The effect of our efforts to maintain competitive money-market rates is shown in the attached table 3 on outflows of liquid funds from the United States. A substantial outflow in the first half of 1963 was replaced by an inflow in the second half, a reversal at least partly explained by the increase in U.S. money-

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market rates connected with the change in the Federal Reserve discount rate in July 1963. But in the first half of 1964, the outflow reached even larger dimensions. The third quarter showed virtual balance, but preliminary data suggest that an outflow occurred again early in the fourth quarter, prior to the change in the Federal Reserve discount rate last November.

Hence, while the rise in money-market rates has kept net outflows of liquid funds far smaller than they would have been in the absence of such rise, it apparently has not been sufficient to eliminate those outflows altogether.

TABLE 3.—*Outflows of liquid funds*

[In millions of dollars; — indicates inflow]

Year	Quarterly averages		
	Total	Dollar assets	Foreign currency assets
1961	113	91	22
1962	44	36	8
1963:			
1st half	155	120	35
2d half	−129	−97	−32
1964:			
1st half	[1] 304	[1] 170	[1] 134
3d quarter	[1] 1	[1] 71	[1] −70

[1] Revised (from data in CEA report).

The CHAIRMAN. Mr. Widnall?

Mr. WIDNALL. Thank you, Mr. Chairman. It is good to see you before us, Mr. Martin.

Mr. MARTIN. Thank you.

Mr. WIDNALL. In my mind I have been wondering over the suggestion to reduce the requirements, that is, the 25 percent requirement to 15 percent on both rather than on just one. The only reason that I can see would be possibly the psychological effect of not doing otherwise. I cannot help but feel that our people might feel that way. In the end we would end up with more available to meet our commitments by doing that, would we not; by reducing it to 15 percent?

Mr. MARTIN. Yes, you would have slightly more. I indicate here that it is a difference between $5.5 billion and $4.8 billion, the difference between those figures.

Mr. WIDNALL. It is on the asset side to take off the restriction. It should be fully discussed in the Congress. Nothing is to be hidden at any time. Rightfully the American people should know all about it. We should not keep it hidden. I realize the predicament we are in, because if we do not do anything when we reach the end of 1965 we are down to that 25 percent.

Mr. MARTIN. That is correct.

Mr. WIDNALL. That is, if the current trend continues, so definitely something will have to be done, and we have to face up to it at this time. Is there anything psychological, that is, outside of that, which might make it wrong to cut both to 15 percent?

Mr. MARTIN. No. I do not see anything outside of the psychological feature, but I think that it is a very important element. I do not mean to exaggerate it, but confidence is one of the key factors in money. And when you go back to the original Federal Reserve Act and see the struggle that they had at that time to see whether they were going to have any statutory cover in gold or were going to rely on the real-bills doctrine, they came up with a requirement against

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notes higher than against deposits, and it seems to me that the history of money which, as I say, is an evolving thing, does lend some support to the view at this juncture that it would be wiser to keep the 25-percent requirement on notes and forgo it on deposits. It is true that they are interchangeable, but nevertheless, what we are trying to maintain here in not going all the way is some discipline, something that will bring us back to this committee, to the Congress, something that will make it more difficult for all elements of the Government, not just the Federal Reserve, to be irresponsible in fiscal and monetary policies.

I have worked with this thing a great many years off and on and I think that you could make a case the other way, but in a broad outline it is my judgment that this is the safer course of the two. That is purely a judgment, Mr. Widnall.

Mr. WIDNALL. You say on page 8 of your statement that if we keep the gold cover requirement for our currency, that $6 billion will be enough to accommodate normal growth for some time to come. Can you give us some idea what you mean by "some time to come?"

Mr. MARTIN. I would say if you take the growth and project it on the basis of what has been going on in recent years, that it would be about a decade, roughly, 9 to 10 years. Now, that would assume, of course, that there would be no reflow of gold to this country. But certainly we have to stop this unfortunate balance-of-payments situation and I would anticipate that if we do, within the decade, we will have some increase in our gold stock, partly by reason of acquiring newly mined gold. So I think it is fair to say that so far as the foreseeable future is concerned that 10 years is a reasonable estimate, a decade.

Mr. WIDNALL. You are saying strong action is necessary in the balance-of-payments field and it takes special ingredients to do the job properly?

Mr. MARTIN. Absolutely. That is the basic thing and the basic requirement and it has been recognized. President Kennedy in his balance-of-payments message in July of 1963 stated very clearly that we must get on top of this problem, and we are still dealing with it.

Mr. WIDNALL. Thank you.

The CHAIRMAN. Mr. Multer?

Mr. MULTER. Mr. Chairman, I am always glad to have you with us. Do you not agree, Mr. Martin, that if we kept our international accounts on an accrual basis that our imbalance of payments would substantially, if not completely disappear?

Mr. MARTIN. Not quite, Mr. Multer. I happened to be here when the Secretary was asked that question. And he answered it and I still think that no matter how we keep it in terms of short-term operations, we still have been running a balance-of-payments deficit. It is true as he indicated that we have $40 billion plus in our international accounts. And that is one of the reasons why we have such a strong dollar. We do have the investment net advantage in the world.

Mr. MULTER. It is also true, is it not, that all of these loans we are making to foreign countries and to foreign central banks and the foreign securities sold here will eventually bring that money back and that we expect to get it all back eventually?

Mr. MARTIN. We will, indeed.

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Mr. MULTER. With reference to the psychological reaction that we have heard so much about—and we always do hear about this when we are talking about this problem—are we talking about the psychological reaction of the man in the street or the psychological reaction of the banking community?

Mr. MARTIN. I think that you are talking about both. I think that there is only a gray line between the two. I do not think that you can compartmentalize them, because we are talking about money. You have an age-old, traditionally wide held belief that one of the ingredients of money is gold. And you do not sweep that away with just one sweep of the brush.

Mr. MULTER. Is it fair to say that the banking community, both the international and the domestic banking community believe that it is a good thing to do, to enact this bill, the one that we have before us?

Mr. MARTIN. Yes; I think that is right—yes, sir.

Mr. MULTER. One other item. If the Congress was to decide to take off the gold reserve both from the deposit liability and the Federal Reserve notes, would you recommend that we then place a dollar limitation on the maximum amount of Federal Reserve notes that may be issued by the Federal Reserve banks?

Mr. MARTIN. I do not think that would be necessary, Mr. Multer, because by the terms of our actions we could not exceed a reasonable limitation and it seems to me that to put a precise figure on it would be self-defeating.

Mr. MULTER. You don't think that would lay at rest the ghost of printing press money?

Mr. MARTIN. No; I don't. I think you get into a great many complex technicalities here, but I don't really think that we at the present time have specific authority in a definitive form to issue printing press money.

There is a responsibility on the Federal Reserve under the Federal Reserve Act to keep our circulating currency in line with the needs of commerce and trade.

Mr. MULTER. The last item that I would like to refer to is the matter of taxation which you referred to. Who would pay this tax in the event it were imposed, the tax that you refer to in your statement?

Mr. MARTIN. The individual Federal Reserve banks would pay it, Mr. Multer.

Mr. MULTER. To whom would they pay it?

Mr. MARTIN. To whom would they pay it?

Mr. MULTER. Yes.

Mr. MARTIN. They would pay it to the Treasury.

Mr. MULTER. In other words, the right pocket would pay it to the left pocket?

Mr. MARTIN. It would be a part of the earnings that we turn over to the Treasury now.

Mr. MULTER. Presently the entire net earnings are now divided approximately 10 percent to the reserves and 90 percent paid into the Treasury.

Mr. MARTIN. That is correct, and this would just be in addition to that.

Mr. MULTER. It would actually come out of the earnings of the banks though——

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Mr. MARTIN. Yes.

Mr. MULTER. Or from the capital.

Mr. MARTIN. No, from the earnings.

Mr. MULTER. You might have to deplete the capital if the tax were high enough.

Mr. MARTIN. If it were high enough; yes. I would hope it would never get that high.

Mr. MULTER. Actually the tax would be taking it from one pocket and putting it it another.

Mr. MARTIN. In essence that is right.

Mr. BROCK. Would the gentleman yield? Is it not true that below 20 percent on your net the tax comes from an increase in the discount date, so it is paid back.

Mr. MARTIN. That is right.

Mr. BROCK. Not the Federal Reserve System itself.

Mr. MARTIN. That is right.

Mr. BROCK. There is a very definite penalty involved.

Mr. MARTIN. That is right. There is a penalty.

Mr. MULTER. You have to pay the tax first and then add it to the interest rate.

Mr. MARTIN. That is right.

Mr. MULTER. That would only be a very small part of the tax, would it not?

Mr. MARTIN. It could ultimately become quite large. It might be worthwhile for me to put into the record the actual provisions here. They are not terribly important to what we are talking about, but we would be glad to have them in the record.

The CHAIRMAN. If you desire to put it in, without objection it is so ordered.

(The material referred to follows:)

SEC. 11. The Board of Governors of the Federal Reserve System shall be authorized and empowered:

* * * * * * *

(c) To suspend for a period not exceeding thirty days, and from time to time to renew such suspension for periods not exceeding fifteen days, any reserve requirements specified in this Act: *Provided,* That it shall establish a graduated tax upon the amounts by which the reserve requirements of this Act may be permitted to fall below the level hereinafter specified: *And provided further,* That when the reserve held against Federal Reserve notes falls below 25 per centum, the Board of Governors of the Federal Reserve System shall establish a graduated tax of not more than 1 per centum per annum upon such deficiency until the reserves fall to 20 per centum, and when said reserve falls below 20 per centum, a tax at the rate increasingly of not less than 1½ per centum per annum upon each 2½ per centum or fraction thereof that such reserve falls below 20 per centum. The tax shall be paid by the Reserve bank, but the Reserve bank shall add an amount equal to said tax to the rates of interest and discount fixed by the Board of Governors of the Federal Reserve System.

Mr. MULTER. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Harvey?

Mr. HARVEY. Thank you, Mr. Chairman.

Mr. Martin, when Secretary Dillon was here this morning, he described in the table attached to his statement how the ratio of gold reserves to combined liabilities had decreased from the year 1941, for example, when it was at 90 percent approximately, down to 1945 when it went down to 41 percent. And it was in 1945 that the ratio was

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changed to the 25-percent figure that we have right now, and then he described also how the time backed up from the year 1949 to a postwar high of $54\frac{7}{10}$ percent.

I asked him at that time, and at least he agreed during those wartime years from 1941 to 1945 that the wartime deficit financing had very definitely expanded our monetary supply, and probably that the lend-lease program as well had accounted for some of our gold shortage during those years. Now will you agree with that also?

Mr. MARTIN. Yes.

Mr. HARVEY. Looking at it historically from the years 1941 to 1945.

Mr. MARTIN. Yes. I would agree with that.

Mr. HARVEY. And my question then to you, sir, is this. Is our recent problem in any way connected with the deficit financing that has been going on in recent years?

Mr. MARTIN. I wouldn't think it was directly connected with the deficit financing that has been going on, but it is certainly related to our balance-of-payments deficit.

Mr. HARVEY. I am well aware of——

Mr. MARTIN. I am trying to distinguish between our domestic deficit financing and our balance-of-payments deficit which began not many years after the time you refer to, 1949, which was the peak of our gold holdings, and finally reached a point in 1957 where we began to have a serious outflow of gold and confidence in the value of our currency began to wane. But what we are really dealing with now is our balance-of-payments deficit.

Mr. HARVEY. So are you saying that our domestic deficit financing has no relation whatsoever?

Mr. MARTIN. I would say that it has a very minimal relationship, because I think we have succeeded in largely financing domestic deficits outside of the banking system. If it had been through the banking system, I think it would have had a direct relationship.

Mr. HARVEY. Do you have any figures on that?

Mr. MARTIN. I can get up a total for you.

Mr. HARVEY. I don't know whether the rest of the committee is interested in it, but I would personally be interested in it.

Mr. MARTIN. I would be very glad to get it for you.

Mr. HARVEY. All right. As I understand it then from the testimony from Secretary Dillon and from yourself, the balance of trade that we have is very favorable, that actually where we are running into trouble is our expenditures abroad.

Mr. MARTIN. That is correct.

Mr. HARVEY. Through our military servicemen stationed over there, through the number of people traveling there, the foreign aid program I presume.

Mr. MARTIN. We are much more fortunate than the United Kingdom, for example. We have a stronger currency in my judgment than they have. I am not trying to make any invidious comparison with theirs now, but what I am saying is we have a trade surplus that is running in the neighborhood of $7 billion.

We also have, as I pointed out to Mr. Multer, a net advantage in foreign investment of about $40 billion, and also the fact that we are running this trade surplus at about a $7 billion rate indicates that our dollar is not overvalued.

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Mr. HARVEY. Thank you very much, Mr. Martin. I have no further questions, Mr. Chairman.

The CHAIRMAN. Yes. Mr. Barrett?

Mr. BARRETT. Mr. Martin, what is the amount of our free gold reserve today?

Mr. MARTIN. About 1.6, I think.

Mr. BARRETT. 1.6?

Mr. MARTIN. Right.

Mr. BARRETT. Regarding the psychological effect on the public domestically, it appears to me that this couldn't be very effective with the free gold reserve we now have.

I was wondering, and maybe I have been misled for a number of years, but isn't it true the Federal Reserve System has about $17 billion in gold reserves that is not obligated and hasn't been used?

Mr. MARTIN. I don't have the exact figure. It isn't that much, Mr. Barrett. We have now about $15 billion in our gold certificate reserve, most of which is needed for our statutory cover, leaving about $1.4 billion that is not earmarked. To judge the adequacy of this reserve we must consider our commitments abroad.

As I have indicated, I think we have commitments to them to make good in gold. There are claims on us. These are contractual claims, and as these claims rise, of course, there is wonder on their part as to whether we will fully satisfy them.

Now there is no doubt in my mind that we will fully satisfy them, and this has been the position of the Government from the Kennedy message of July 18, 1963, right on down.

But the real point at issue here is that this would make it easier for us to do this without invoking the suspension operations, and it also puts pressure on us to conserve the gold asset.

The psychological effect on world holders of dollars is one of the things in our dealing abroad that concerns me very much about our balance-of-payments deficit.

We have gradually lost our initiative in the world, so that we are put in the position when claims are made against us that our initiative is lost so far as the strength that we have had, and to preserve the dollar as a reserve currency and maintain our initiative in the world is to me one of the very fundamental things that this country is facing today.

The CHAIRMAN. Mr. Brock?

Mr. BROCK. Mr. Martin, following this line of reasoning, we talk about the present statutory requirement of 25 percent being sort of the philosophical or psychological base.

In practicality if we were to remove the 25 percent from both notes and deposits, trade in the entire $15 billion, we would be expressing confidence in only one thing, and that is our ability to reduce our inbalance of trade.

Mr. MARTIN. That is right.

Mr. BROCK. Because if we don't, within a very short period of time the $15 billion is going to be gone, and then restrictions will be imposed upon us whether we like it or not, by the international community, is that not true?

Mr. MARTIN. That is absolutely correct; as I say, this has been debated by a great many people for years, going right back to the

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start of the Federal Reserve System, as to what value there is in a statutory cover.

You have put your finger right on it in terms of what actually is involved. I do think there is some disciplinary value in having to come back to the Congress when the 25 percent is reached, but we are living in a period when nobody wants any discipline. I say that, nobody wants any discipline today, just throw it all off. Well, this legislation would still leave us with a little bit of discipline.

Mr. BROCK. Frankly it seems to me we would have more discipline although it would be imposed from without, if we were not under a statutory limitation and went ahead and washed out these gold reserves, then we would be, by golly, faced with the toughest kind of discipline you can imagine, and that is discipline from the international community, because the value of the dollar would then be based upon our willingness to act responsibly rather than upon any fixed statutory requirements, is that not true?

Mr. MARTIN. That is right. It would put more responsibility on the Federal Reserve.

Mr. BROCK. Your darned right it would.

Mr. MARTIN. No question about that.

Mr. BROCK. So you don't have Mr. Multer's problem of these people that worry about the gold actually physically backing up the dollar. It doesn't mean very much in that context.

Mr. MARTIN. Not a great deal.

Mr. BROCK. As far as Mr. Barrett's question as to weighing the psychology domestically though, the psychology would, it seems to me, have some point of impact in the banking community inasmuch as our dollars will, if we do have a lack of confidence in the dollar, and if the reserve is further reduced, then the community would be more reluctant to engage in dealings which might be jeopardized by a fall in the value of the dollar at some subsequent time, is that not true?

Mr. MARTIN. I agree with that.

Mr. BROCK. So psychology has a direct impact upon the domestic economy of this Nation, or could have.

Mr. MARTIN. Well, it has a retarding effect.

Mr. BROCK. It is a retarding effect.

Mr. MARTIN. It slows it down, right.

Mr. BROCK. It is one that could be felt rather dramatically.

Mr. MARTIN. That is right.

Mr. BROCK. All right. In that context then would it not be a sounder approach to apply this 15 percent to both notes and deposits than just the 25 percent to notes, because, in fact, your greatest potential for monetary expansion comes through reserves rather than through dollar bills.

Mr. MARTIN. Well, it is a matter of judgment. I don't think so. I have debated this in my own mind for a long time, for the simple reason that if you go back to the start of the Federal Reserve Act, there was a distinction made there between notes and deposits.

Now they are interchangeable, as you say. But in the suspension provisions which we are not asking for any change in in this bill, the initial gradation is against deposits.

Then, getting down to notes, I think you can make a case, I am not denying this, and I think it is purely a matter of judgment as to the

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effectiveness of it. On the notes, I personally like the linkage of 25 percent rather than 15 percent, against the circulating currency, although it is interchangeable with the deposits.

Mr. BROCK. But isn't there more room for expansion of total money supplied by an expansion of reserves than there is by an expansion of the currency?

Mr. MARTIN. It is the same thing. There is ability to expand it in either form. That is why I say it is a matter of judgment.

Mr. BROCK. If it is the same thing, then, perhaps we should have the same statutory requirements. That is the point.

Mr. MARTIN. It could be, could be, as I say. I personally prefer it this way. It is not a life or death matter. It is a matter that somebody has to make a judgment on.

Mr. BROCK. Thank you.

The CHAIRMAN. Mr. Reuss?

Mr. REUSS. Mr. Chairman.

Welcome to you, Mr. Martin and Mr. Young. We are glad to have you with us again. This is becoming a seminar on psychology, and I would like to get in on it too.

Am I not correct in thinking that foreign central banks and monetary authorities now have roughly $12 billion in various forms of dollar obligations which they and they alone could, on demand, convert into gold?

Mr. MARTIN. That is correct.

Mr. REUSS. And is it not also your experience, as it is mine, that foreign central bankers and monetary authorities, certainly those who hold substantial amounts of dollars, are sophisticated people, and that the passage of legislation for removing or diminishing the gold cover, far from causing a crisis of confidence which would set them to demanding gold, would reassure them and be welcomed by them?

Mr. MARTIN. I agree.

Mr. REUSS. If that is so—and I am confident it is, as I know that you have been discussing this matter with them for some years now, as you should have—if that is so, the so-called psychological repercussions of whatever Congress does will be felt more largely among less sophisticated elements of the financial community, would they not?

Mr. MARTIN. That is correct.

Mr. REUSS. If the Patman bill is enacted, the United States would then have showing some $5 or $6 billion in available gold as against some $12 billion of current short-term liabilities to people who could demand gold, is that not so?

Mr. MARTIN. That is right.

Mr. REUSS. Would not our balance sheet look better to the great mass of mankind, leaving aside central bankers and monetary authorities, if we had $15 billion showing against $12 billion liabilities, than if we only had $6 billion showing against $12 billion liabilities, and would not that kind of a balance sheet more correctly reflect the truly giant strength of the United States, and in your excellent phrase of a minute ago in response to a question by Mr. Barrett, give us more initiative in the world?

Mr. MARTIN. No, I don't think that would give us more initiative. The only thing that will give us more initiative in the world today is to correct our balance-of-payments deficit and get back on a plus.

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If we want to really have growth and convince the world that we are able to handle this, leaving the psychological elements out, we have for a time to get back to not only equilibrium in our balance of payments, but I think to a surplus. I actually think one of the reasons that some of our foreign countries have grown so rapidly is because of their surplus.

Mr. REUSS. No one could agree with you more than I do that the attaining of equilibrium at least should be a very prior first order of business. However, let's assume that we do that which ought to be done. I return to my question.

Wouldn't a 15 to 12 balance sheet give us greater strength, if only among the unsophisticated, than a 6 to 12 balance sheet?

Mr. MARTIN. I don't really think so, Mr. Reuss. Again it is a matter of judgment. But I think that the sophisticated people as well as the unsophisticated have been in recent years pretty well convinced on the basis of statements by President Kennedy and other high officials of this Government, including the Chairman of the Federal Reserve Board, that we would handle our gold in accordance with our contractual relationships.

What they have come to doubt is when are we really going to deal with this balance-of-payments problem, and that applies to the unsophisticated as well as the sophisticated.

Mr. REUSS. And you don't think that the retention of the mortgage, lien, cover, limit, or whatever you call it on some two-thirds of our gold would cause the unsophisticated to think that somehow or other it was not as completely available as the five or six which are now being completely unfettered?

Mr. MARTIN. No, I don't think so, but I admit it is a matter of degree. They might have slightly more confidence in it if it were completely unfettered than if it is partially mortgaged, as you say.

Mr. REUSS. Thank you.

The CHAIRMAN. Mr. Talcott?

Mr. TALCOTT. Thank you, Mr. Chairman. Mr. Chairman, I would like to ask one question of you, if I may. How are we going to have the benefit of questions that you ask and also of the answers that you get?

The CHAIRMAN. Mr. Martin will answer them when he examines the transcript, and before the bill is taken up on the floor of the House, the hearings will have been printed, and each member will have a copy.

Mr. TALCOTT. But we aren't going to have the benefit before our committee votes on this bill.

The CHAIRMAN. I didn't think we would need them particularly, because any member can ask any question he desires.

Mr. TALCOTT. Mr. Martin, I would like to get straightened out a little bit about this tax that you mentioned on page 10, in response to Mr. Multer. Isn't the tax actually a tax that is going to be finally paid by the user or the consumer, like any other tax that we have? Is it not also paid by the user or the consumer, so it doesn't make any difference to us who pays it, out of whose pocket it comes? All it amounts to is just a disciplinary mechanism.

Mr. MARTIN. I think that is essentially true, though it will be paid by the borrowing bank if it is added to the discount rate you see. This would be the private community, as I think was pointed out. It becomes a penalty rate at that point.

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Mr. TALCOTT. This business of confidence that we are talking about so much here, isn't the confidence immediately lost when we talk about removing the reserve requirements? Isn't there a good deal of confidence lost just by the fact of removing the reserve requirement on deposits alone?

Mr. MARTIN. I certainly agree with you that confidence would be stronger today if we didn't have the balance-of-payments deficit which we have. This is what has been undermining confidence and in essence what causes us to be here today. We are expanding our note issue in accord with the needs of the economy, but our gold certificate reserve ratio would not have dropped anything like this extent except for our gold outflow.

Mr. TALCOTT. Are we worried about international confidence or are we worried about domestic confidence? It seems to me like the most important confidence we should be thinking about is the local domestic confidence in our own currency, our own monetary system, upon which the international confidence is built.

Mr. MARTIN. I think that is right, but I don't think we can entirely separate international and national. After all, our people are going abroad and people abroad are coming here, so I think it is pretty difficult to separate them. I agree that what we are talking about ultimately is our own confidence.

Mr. TALCOTT. So when the domestic dollar isn't fully backed by gold, or if you don't have reserve requirements, do we not then lose confidence in our own domestic dollars?

Mr. MARTIN. And we want to rebuild that confidence by straightening out our balance of payments.

Mr. TALCOTT. We always get back to that.

Mr. MARTIN. That is right. That is the key to this in my judgment.

Mr. TALCOTT. I have no further questions.

Mr. MULTER. Mr. Ashley?

Mr. ASHLEY. Mr. Martin, on this subject of confidence, which is understandably significant——

Mr. MARTIN. Right.

Mr. ASHLEY. You have a problem either way you go, isn't that true? If nothing is done, there are apt to be serious consequences in terms of confidence that really outweigh the aspect of confidence that we invite by taking the action that is being proposed.

Mr. MARTIN. I agree with you, Mr. Ashley.

Mr. ASHLEY. I think you have given us a very good education, Mr. Martin, and I am prepared to vote. Thank you.

Mr. MULTER. Mr. Clawson?

Mr. CLAWSON. Thank you, Mr. Chairman.

Mr. Martin, following the line of questioning of Mr. Brock, and parallel with the idea that if we removed all of the gold coverage in both our currency and the deposits there would be a very serious disciplinary action from international pressures upon you and our own monetary system, I recall a request from a constituent of mine in the 88th Congress to vote for the tax reduction bill because this would then be a very definite disciplinary action upon the administration to reduce expenditures and not come in with another big budget because the money would not be available.

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Following this parallel, I am afraid it didn't happen that way. As a result I am not sure that these international pressures would bring about the proper response, even though it might be a disciplinary action.

I have a question in connection with your statement on page 8. You indicated at the bottom of the page in the next to the last line:

"If we persevere in our strong efforts to correct our balance-of-payments deficit."

May I inquire and request at least a partial list of those "strong efforts" because the table which was given to us by Mr. Dillion earlier today indicates that the ratio has steadily declined in 1960 from a 37.4 percent to a 27.5 percent as of 1964. So whatever the strong efforts are, they have certainly not been successful in these last 4 years.

Mr. MARTIN. They haven't been strong enough.

Mr. CLAWSON. What are these efforts?

Mr. MARTIN. Well, if you take the statement that I referred to several times, the balance-of-payments statement by Mr. Kennedy of July 18, 1963, you will see there that there is outlined a series of steps, including a reduction in military expenditures abroad, some change in foreign aid activities.

We have talked about a slightly less easy monetary policy, and at that time we raised our discount rate one-half of 1 percent, and all of these things are spelled out. The question is whether we have done enough.

Mr. CLAWSON. Have we followed these steps? Has the administration followed the recommendations to the extent they might have been followed in order to achieve the goals that were set?

Mr. MARTIN. I don't think we have followed it to the extent that we have solved the problem, but we have followed it. Right now I can't speak for the administration, but right now it is obvious, as I am sure Secretary Dillon indicated this morning, that we are wrestling with this problem, the administration and everyone else at the present time.

Mr. CLAWSON. Are there other avenues of action that we might take while we are wrestling with this problem, to achieve what you indicated on page 9, a gradual growth of our gold stock from world supplies? At this point wouldn't that correct the problem that we are wrestling with today?

Mr. MARTIN. Well, we certainly hope that we can move in that direction.

Mr. CLAWSON. What are the other avenues that we might explore or actually use under existing statutory restrictions?

Mr. MARTIN. Well, one of them was mentioned earlier here I think by Secretary Dillion. There is tourist expenditures, which are a big drain abroad. I am not suggesting that anything be done. That is an avenue, however.

There is military expenditure abroad. There is foreign aid abroad. There are bank loans abroad, both short term and long term. We have an interest equalization tax at the present time, and the Gore amendment to that. These are the principal avenues.

Mr. CLAWSON. What could the Fed do, still within the statutory limitations?

Mr. MARTIN. The Fed could pursue a less easy monetary policy, but the Fed is not anxious to do that, if it is going to retard the economy.

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But that is certainly one of the things that we can do, and probably would be somewhat effective in this.

Mr. CLAWSON. I have no further questions.

Mr. MULTER. Mr. Moorhead.

Mr. MOORHEAD. Mr. Chairman.

Mr. Martin, if this bill is enacted, would I be correct if I showed a $5 Federal Reserve note to my constituent and said that the legal gold backing requirement is the same now as it was before the bill was enacted?

Mr. MARTIN. That is correct.

Mr. MOORHEAD. So that this way of changing or releasing gold would maintain domestic confidence more than the technique of the 15-percent across-the-board change, would it not?

Mr. MARTIN. In my judgment it would, although it is true, as I indicated earlier, that the deposits can be converted.

Mr. MOORHEAD. And so far as confidence in the international community, the difference between the two techniques is substantially the same. The only difference being between $4.8 and $5.5 billion of gold released; is that correct?

Mr. MARTIN. That is correct.

Mr. MOORHEAD. Now, Mr. Martin, on the balance-of-payments situation, you have pointed out that actually over these crucial years, in our investments or our assets acquired abroad, we have netted out $40 billion in the black; is that correct?

Mr. MARTIN. That is correct, plus, overall.

Mr. MOORHEAD. But the difficulty comes from the fact that we have been borrowing in the short-term market to invest long; is that correct?

Mr. MARTIN. That is correct.

Mr. MOORHEAD. Well, then, sir, isn't the solution we should be seeking a method of financing our alleged balance-of-payments deficit, rather than trying to eliminate it?

Mr. MARTIN. Well we have gone quite a distance in financing it at the present time, and there is a limit to the extent to which you can finance it.

Mr. MOORHEAD. I mean finance it in the long market, if we could finance it in the long market, we would not be faced with the problem.

Mr. MARTIN. That is correct.

Mr. MOORHEAD. Therefore my question is, Shouldn't we be attempting to finance it in the long market rather than trying to eliminate the deficit?

Mr. MARTIN. Well, I think we should do both. I want as much growth as it is possible to have in this country, and I believe that if we had a little surplus in the balance of payments, we would be having considerably more growth than we have today.

We might be wrestling with the problem of inflation a little bit more actively than we are, but I think we would have more growth. So while I am agreeing with you that this is one approach to it, I would still like to see us get a surplus in the balance of payments.

Mr. MOORHEAD. But if one of the ways we did it was to eliminate or substantially reduce direct investments abroad, we could cut down on our balance-of-payments deficit and possibly end up with a surplus, but we wouldn't have this happy balance sheet situation to look at, or at least we wouldn't have the increase in it.

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Mr. MARTIN. You are absolutely right.

Mr. MOORHEAD. And if that $40 billion black item in the balance sheet had been properly financed, would that have been a good thing for the United States or a bad thing?

Mr. MARTIN. Well, the direct investment abroad is clearly a good thing in the sense I think our earnings—I don't have the figures right at hand, but our earnings—from our direct investment abroad are $6 billion plus, and our outgo on investments that foreigners have in this country is substantially less, I would say less than $2 billion. So we have a net advantage, if my figures are roughly correct there, we have an advantage of about $4 billion right there.

Mr. MOORHEAD. What we are doing is looking at the opposite side of the coin of which General de Gaulle is complaining. He is complaining that France is financing the long-term economic takeover of Europe by the United States. Aren't we just looking at the other side of that coin?

Mr. MARTIN. We are indeed.

Mr. MOORHEAD. Thank you.

The CHAIRMAN. Mr. Johnson?

Mr. JOHNSON of Pennsylvania. Thank you, Mr. Chairman.

Let's get back to these deposits that we are going to remove the gold backing from. Are these deposits of member banks in the Federal Reserve banks?

Mr. MARTIN. Yes.

Mr. JOHNSON of Pennsylvania. And how do they arrive—why are these deposits in the Reserve banks?

Mr. MARTIN. Well, because of the reserves which we hold. The present law that we are seeking to amend provides that the Federal Reserve must always have 25 percent in gold against the deposits which it holds and the notes it issues.

Mr. JOHNSON of Pennsylvania. These deposits of the member banks are because a member bank must maintain a certain percentage of their time deposits and a certain percentage of their demand deposits?

Mr. MARTIN. That is right.

Mr. JOHNSON of Pennsylvania. In the Federal Reserve bank?

Mr. MARTIN. That is right.

Mr. JOHNSON of Pennsylvania. If they are a member of the System?

Mr. MARTIN. That is right.

Mr. JOHNSON of Pennsylvania. Is that right?

Mr. MARTIN. That is right.

Mr. JOHNSON of Pennsylvania. And do you have the right, whenever you think it necessary, to change the reserve requirements of member banks?

Mr. MARTIN. We do within the statutory limitations that the Congress has set up for us in the act, which are something like 7 to 14 percent on demand deposits for country banks and 10 to 22 percent for reserve city banks. Three to six percent on time deposits.

Mr. JOHNSON of Pennsylvania. Now if we are to do away with this requirement of 25-percent gold backing against deposits in the Federal Reserve banks, your hands will now be free so that you can, if you want to, at will without worrying about the gold backing, raise the requirements of member banks, and it will give the reserve banks a much tighter, much firmer grip on expansion of credit in this Nation

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than it does at the present time where you really can't raise the reserve requirements because of the limitation of the amount of gold for the gold backing, is that right?

Mr. MARTIN. Well, that is partially right. Our problem there is we could make the gold requirements slightly less onerous at the present time by reducing reserve requirements down to the statutory minimum. We could reduce it, and we would release about $1 billion in gold.

But we would flood the market with additional currency and reserves upon which the currency could be issued, deposits, which we think would be unwise, and would create inflation and overheating. Conversely, as you have suggested, we could raise the reserve requirements and then we would have more stringent gold requirements.

Mr. JOHNSON of Pennsylvania. But if this law passes in the future in raising or lowering the reserve requirements, you will be able to disregard the effect it would have on the availability of gold backing, wouldn't you?

Mr. MARTIN. You are giving the Federal Reserve more latitude in this bill.

Mr. JOHNSON of Pennsylvania. What of the inflationary and other dangers that will occur in the business community if we do away with this 25-percent safeguard against inflation of deposits in Federal Reserve banks? Is there a danger?

Mr. MARTIN. Inflation is always a very real danger, but I think that we are doing everything in our power to contain inflation at the present time.

I don't believe there is any more danger as a result of this than presently. We have had a normal expansion of notes and deposits which have reduced our ratio, quite apart from gold outflows. Now I do think the fact that we are up here indicates that we are not doing a good enough job on the balance of payments.

Mr. JOHNSON of Pennsylvania. Another question. I notice in your statement you have adopted the statement of the statement of the President that now is the time to eliminate the arbitrary requirement of the Federal Reserve banks maintaining a gold certificate reserve against their deposit liabilities.

You feel that in the past this 25-percent requirement has been arbitrary and unnecessary, and has served no useful purpose, and now it is time to get rid of it. Is that your feeling?

Mr. MARTIN. No, I don't say it has served no useful purpose. I am suggesting that if you go back to the original Federal Reserve Act, that there was considerable discussion at that time whether the real-bills doctrine, as it was called, would not be a more effective way of limiting expansion and contraction of credit than to have a statutory gold requirement, and they decided, in light of the evolutionary history of money, that it would be wise to put this requirement on.

I think it has had some impact. I don't go along with the people who say this is entirely a myth, because it seems to me that the fact that we have had this is one of the reasons why we are up here today, and that this is putting pressure on the Federal Reserve and all branches of the Government to bring this balance-of-payments problem into line.

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But I believe that in the development and the course of events, that it is perfectly proper and wise at this juncture to remove it, and as I say, it could be for both of them, this is a matter of judgment, but historically, and all things put together, I have come out in my own mind with the view that this is the preferable way to do it.

Mr. JOHNSON of Pennsylvania. Thank you. My time has, I believe, expired.

The CHAIRMAN. Yes, sir; Mr. Stephens?

Mr. STEPHENS. Mr. Chairman, I don't know whether it is necessary for the record, but I noticed in the statement of Mr. Martin that he makes reference to it being H.R. 3318, and I believe it is H.R. 3818.

The CHAIRMAN. In referring to the bill number? The correction will be made. Thank you, sir.

Mr. STEPHENS. I would like to ask one question that has come up in my mind. There apparently seems to be some differentiation in the minds of some of us as to international confidence in the dollar and domestic confidence in the dollar.

Is it proper to make any real distinction between those two, Mr. Martin? If we have lack of domestic confidence in the dollar, it certainly would undermine international confidence in the dollar, and if we have lack of international confidence in the dollar, and there is sort of "run on the bank" for gold, it certainly would affect the domestic confidence in the dollar.

So is it correct to make any true differentiation between the two, but merely one statement that you have made and continually have made, that it is just "confidence in the dollar," no matter where it might be?

Mr. MARTIN. I think you are quite right, Mr. Stephens, and as I said earlier in answer to a question, I think the two tend to merge. I don't think you can compartmentalize it.

Mr. STEPHENS. It is just confidence in the dollar that we are trying to maintain.

Mr. MARTIN. That is what we are after.

Mr. STEPHENS. That is all, Mr. Chairman.

The CHAIRMAN. Mr. Stanton?

Mr. STANTON. Thank you very much, Mr. Chairman.

Mr. Martin, my question is one more of curiosity than anything else. I happen to be somewhat familiar with your statement of last July 18, in regard to the all-important subject of balance of payments. We expect to hear from the President on this particular subject in the very near future.

Does the President or his economic advisers check with you and your thoughts and your ideas which you have in regard to the particular statement that is forthcoming?

Mr. MARTIN. Yes, I have been consulted. I was consulted on that statement, and at the present time President Johnson has made me a member of his Cabinet committee that is considering this. Now they haven't reached any conclusions, but I have had every opportunity to speak my piece for what it is worth.

Mr. STANTON. You have. Thank you.

The CHAIRMAN. Mr. St Germain?

Mr. ST GERMAIN. Mr. Martin, this morning when Secretary Dillon testified, he, in answer to a great number of questions told us that, in

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his opinion, the only reason for keeping the gold cover on the notes and removing them on deposits was psychological. This we hear from a great many angles by a great many of the members.

He said that in his opinion if we were to remove the gold cover from both, it would not, in essence, do any harm except possible psychological harm, and we discussed that. However, he felt that it would not be that harmful in any other manner because it would then be left to the judgment of the members of the Federal Reserve Board. We would be relying on their judgment.

This afternoon I have noticed that you, in response to most of the questions here, and I am rather surprised at the emphasis you have been placing on discipline as against the Secretary of the Treasury saying that he felt it was the judgment of the members of the Board that would prevail, yet you seem to feel there should be a certain amount of discipline maintained by the statutory requirement.

I fail to coordinate your two opinions, and I am wondering if there are other factors probably or possibly affecting your opinion here?

Mr. MARTIN. No. I think it is a matter of judgment.

Mr. ST GERMAIN. Is it subjectivity?

Mr. MARTIN. Yes, I think so. I have great confidence in the Federal Reserve Board. Naturally I have confidence in my colleagues. We work hard at this problem, and I am delighted at the confidence the Secretary has expressed as you outlined it this morning. I wasn't here this morning, but I am delighted at that confidence.

I merely say that as a member of the Board, I think there is some advantage in having this statutory discipline which will require us perhaps to come back earlier than we would otherwise, if there are irresponsible policies, fiscal and monetary, employed in not only the Federal Reserve, but all other branches of the Government. I do think it does have some disciplinary value. I don't want to exaggerate it.

Mr. ST GERMAIN. In discussing the psychological effect this morning, I made a point that psychology works two ways. If we were to remove the statutory requirement in both instances at the present time, when there is no necessity, no absolute necessity for doing so, I felt in my own mind that psychologically this would be better, would be preferable, than waiting until we have to remove the other statutory requirement that we might possibly do as the bill now reads.

We would then in effect be admitting that there is a crisis, or that we are faced with a tremendous problem, and that we must remove the second requirement on notes.

Mr. MARTIN. I think you have stated it very well. This confidence factor works in opposite directions at times, and I think you have stated it very well.

It is my judgment, and I have turned this over a good many times, that overall this is the most appropriate bill, and the best approach to it under present conditions, but I don't hold myself out as having all the answers particularly in the psychological sphere. I mean I am only one individual.

Mr. ST GERMAIN. My last question. Do you agree that eventually, whether it be 5, 10, or 20 years, because we have been given different figures on this, that eventually we will be called upon or the Congress

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will be called upon to remove the statutory requirement of 25 percent on the notes also?

Mr. MARTIN. I would hope that we wouldn't have to. I would hope that there would be a reflow of gold to the country, because I look on gold not as just a monetary asset alone.

I think you can argue about the price of it, whether it is properly valued as a commodity, but it is part of the physical assets of the United States.

Mr. ST GERMAIN. So you are not convinced that this——

Mr. MARTIN. I am not convinced that it will.

Mr. ST GERMAIN (continuing). That it will within 5, 10, or 20 years?

Mr. MARTIN. No. I am not convinced of it.

Mr. ST GERMAIN. Are you convinced the other way, that it shall not?

Mr. MARTIN. No; I am not convinced there either.

Mr. ST GERMAIN. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Mize?

Mr. MIZE. Mr. Chairman.

Mr. Martin, Secretary Dillon said this morning the need for this legislation doesn't arise from any sudden emergency or crisis, and apparently you feel the same way.

Mr. MARTIN. That is right.

Mr. MIZE. What did trigger this thing? Was it the fact that France decided to convert that $150 million in gold, and the fear that there might be other countries doing the same thing?

Mr. MARTIN. No. If you ask why it has moved in this direction, we have got to increase our notes in accord with the requirements of business and finance, and also we have had to increase our money supply.

But in the final analysis, we would have hoped that the measures that were taken in the summer of 1963 would have borne more fruit than have come about to date. Therefore we have this necessity earlier than we might otherwise have had it.

We have been discussing from time to time in the Federal Reserve Board an appropriate period to do this, and also a way to change it in the most satisfactory way which we might have considered, quite apart from this.

Mr. MIZE. Thank you.

The CHAIRMAN. Mr. Gonzalez?

Mr. GONZALEZ. Mr. Chairman, since apparently the opinion has been voiced that there is no impelling economic or financial reason for maintaining the cover, what would be wrong with amending this bill, instead of having the bill as it is now, removing the necessity for the cover, delegating the power to remove it when and if in the opinion or judgment of the Federal Reserve it will be necessary not to maintain the cover. I know the present act provides temporary suspensions, but what about giving it a more permanent delegation of power?

Mr. MARTIN. That would be possible, Mr. Gonzalez. I always think it is difficult. We do have, not properly in my judgment because of the way it was originally conceived—we don't really have the proper authority for the suspension at the present time. It could be written on the basis that you suggest.

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But I would have some question as to whether that is as sound an approach to the present situation, all circumstances considered, as the one that is embodied in this bill which Mr. Patman has introduced.

Mr. GONZALEZ. The reason I thought of that was because if there is a psychological association with this that could be adverse or unfavorable, and giving it an air of finality that this bill would in removing the necessity for the cover, I thought perhaps then the next best thing would be to suggest a delegation of power, anticipating when and if in the judgment of the Reserve it would be necessary not to observe the cover requirements.

Mr. MARTIN. Well, there is a heavy responsibility on the Federal Reserve now. That would increase our responsibility, and to a certain extent we are sharing the responsibility with Congress under the present proposal.

Mr. GONZALEZ. I would think that a bill amended with some suggestion would give you the concomitant power to go hand in hand with your responsibility.

Mr. MARTIN. I think it might. It was a matter of judgment there.

Mr. GONZALEZ. But technically there wouldn't be anything inadvisable, would there? It wouldn't be as simple as this bill, but I think it would accomplish one thing. It will remove any possibility of adverse psychological effect.

Mr. MARTIN. Well, it could, except that of course again this psychology works two ways. It could be interpreted at the present time as there being more of a crisis than I happen to think there is.

Mr. GONZALEZ. More so than in this case here, this bill as it is written?

Mr. MARTIN. That is the way—I think I would be inclined to that view. We thought about this, and it has been weighed, and I think there would be differences of judgment on it. But I express my own personal view that this is a preferable way to do it.

Mr. GONZALEZ. Thank you very much.

The CHAIRMAN. Mr. Weltner?

Mr. WELTNER. No questions, Mr. Chairman.

The CHAIRMAN. Mr. White?

Mr. WHITE. Thank you very much, Mr. Chairman.

It would seem to me, after listening to your testimony, Mr. Martin, and to the responses to the various questions, that the main problem we have here is the balance of payments, and to try and get gold back into our possession in the United States.

Mr. MARTIN. I agree.

Mr. WHITE. And these are stopgap measures that we are undertaking to peak through the possibility of not being able to maintain the statutory requirements that we are presently obligated to maintain.

There is one question I would like to ask you. At the present time the deposit requirements, gold certificates backing deposits, are they a lendable asset of the member banks?

There is a restriction on how this amount of asset is used. In other words, if you put up the 25-percent deposit, and it ends up in the gold certificate purchased, then is this asset part of the lending base of the member banks of the Federal Reserve System?

Mr. MARTIN. Well, the lending base of the System in accord with the reserve requirements can only be expanded so long as we hold 25 percent of our notes in deposits.

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Mr. WHITE. In other words, they are not a part of that base today.

Mr. MARTIN. That is right.

Mr. WHITE. All right. If we pass this legislation, then this requirement is removed, and this amount of deposits will become a part of the lending base of the System; is that not correct?

Mr. MARTIN. You are giving us more latitude in this bill, that is correct.

Mr. WHITE. In other words, we are increasing your lending capacity of the System by 25 percent, by the removal of this requirement; is that not correct?

Mr. MARTIN. That is correct.

Mr. WHITE. And then getting back to the question of a moment ago, the thrust and what triggers this, we have two things triggering this.

We have the balance-of-payments situation, but we also have, I hate to use the word "avarice," but I think I shall, of some of the people who feel that this requirement for stability of the System can be used now to increase our lending capacity, so they will be making more money, the member banks. Is this correct, or am I incorrect in my analysis?

Mr. MARTIN. Well, I wouldn't agree with you on the avarice side of it. I think that you do have the authority to lend more.

Mr. WHITE. Well, this means that this legislation will be desirable to the banking interests, so that they would have a greater lending base than they have at the present time under the present statute and the law.

Mr. MARTIN. Yes; but I think how that is effected depends upon the policy pursued by the Federal Reserve.

Mr. WHITE. Well, then I will ask the question. What would the policy be if this legislation is enacted?

Mr. MARTIN. Well, I can't determine. You see this is for the Board or the Open Market Committee to determine as a matter of policy. They might decide that they wanted to reduce the reserves that are outstanding by selling Government securities, or they might decide to increase them, by buying Government securities.

Mr. WHITE. But it does give them that capability; does it not?

Mr. MARTIN. It gives the capability, that is right, Mr. White.

Mr. WHITE. Well, with that question I thank you very much, Mr. Chairman.

The CHAIRMAN. Mr. Gettys?

Mr. GETTYS. I have no questions, Mr. Chairman.

The CHAIRMAN. Thank you sir. Mr. Cabell?

Mr. CABELL. Mr. Chairman, I would like to just clarify one thing as to a former question.

In the first place, if you make more money available by virtue of being able to accept those deposits and make more, you are increasing the supply of money for industry and commerce to expand their operations.

Mr. MARTIN. That is correct.

Mr. CABELL. It isn't evil for the banks to make a profit on that; is that right?

Mr. MARTIN. That is the reason I wouldn't go along with the avarice part.

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Mr. CABELL. The next thing I wish to clarify is this. In the event this cover were not removed, then you get up against a rock in a hard place and had to invoke the statutes and suspend it, you would then have to impose this tax which in the final analysis means you would have to charge your member banks more interest for the money they borrow.

Mr. MARTIN. That is right.

Mr. CABELL. Which increases the cost of consumer money, and then makes money harder to get.

Mr. MARTIN. That is correct.

Mr. CABELL. Thank you.

The CHAIRMAN. Mr. McGrath?

Mr. MCGRATH. Thank you, Mr. Chairman. I just want to thank Mr. Martin for giving us the benefit of his views on the Patman bill. I have no questions.

The CHAIRMAN. Mr. Hansen?

Mr. HANSEN. Thank you, Mr. Chairman. I want to get into this gold supply thing just a little bit deeper than you have thus far hit it. If my recollection is correct, there was a time when we had a huge supply of gold in this country back in the 1940's, and it was not considered a good thing. There was much planning indulged in to make arrangements so that some of these other countries could get some of this gold, and thus make trade and commerce in the world a little more effective.

Now the burr is on the other side of the saddle as I view it, and there has been some talk here today about getting the balance of payments back in order, that we might even get it around to a point where we would start having the reverse flow start our way.

When that happens, will the world powers, the foreign countries with whom we are dealing, get back into the same shape they were in before where they will be in the fix we are in now?

Mr. MARTIN. I would hope in terms of this international financial mechanism that we would endeavor by loans or by using whatever surplus we might develop, to try to help them, have time to help correct any internal problems that they have.

We would be in the position, if we had this surplus, of doing this at our initiative, just as they would have to finance whatever deficit they were running just as we recently had to finance it by bonds or other activities of our Government.

Mr. HANSEN. I see. Well, evidently the balance of investments on the plus side that we have developed in the world, as I remember it the figure was what, $40 billion——

Mr. MARTIN. $40 billion plus, right.

Mr. HANSEN. Has there been any study made as to when those investments might cease to be needed, that is the expansion of them and a calculation made as to how this will help us gain back our equilibrium on the balance-of-payments situation, or to what extent this will take place in the next few years?

Mr. MARTIN. It is very difficult, Mr. Hansen, to project that sort of thing, but as I indicated earlier, our balance of payments has been benefited by return flow of dividends and interest on the direct investment which we have abroad, as against the outflow to pay the interest and dividends on investment that foreigners have in this country, in the neighborhood of $4 billion net.

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Mr. HANSEN. Thank you. Now the next question. It goes back to this gold supply again. Has there been any study or effort made to determine the possibility of increasing the production of gold in the world?

Mr. MARTIN. Yes, there has been a lot of discussion of that. Last year we had, what is it, about $1,800 million worth of new gold supply for the world's use, and about $400 million of it went into industrial uses of one sort or another, and about half of the remainder into monetary reserves.

Mr. HANSEN. Is it true that we have finally reached the point where based on its present value, there is no longer in the world a supply of gold sufficient to handle the trade and commerce to the extent by which it is now flowing?

Mr. MARTIN. My own judgment is that we have adequate financing facilities for the current volume of world trade.

Now if you project that a few years ahead, we might not have sufficient liquidity. At the present time the world reserves are largely made up of gold plus the currency issued by the reserve currency countries either through acquiring gold or each other's currencies or through running a balance-of-payments deficit. This is what makes up the reserves of the world.

Now we have an international financial mechanism today that is working effectively, and you hear from time to time about bold and dramatic moves to change this.

I believe that in the long future, there may be some evolutionary changes in this mechanism. But so far it has worked quite satisfactorily, and I think we ought to be careful about upsetting such a satisfactorily working mechanism until we are sure we have components, reserve units, that will have the same stature and confidence that gold plus dollars plus pounds plus the International Monetary Fund have today.

Mr. HANSEN. I am highly in favor of what you have said here, and I am highly in favor of what is being proposed. My time is up now.

The CHAIRMAN. Thank you. Mr. Annunzio?

Mr. ANNUNZIO. Thank you, Mr. Chairman. One of the advantages of being last is that I have the benefit of Mr. Martin's testimony and answers, he was very effective, and I am ready to vote on the bill.

The CHAIRMAN. Fine. Thank you, sir. Mr. Martin, thank you very much.

Mr. MARTIN. Once again I am delighted to see you came through the "flu" so well, Mr. Chairman.

The CHAIRMAN. Thank you, sir. We appreciate that. We are always glad to have you as a witness.

The committee will have an executive session.

(Whereupon, at 4:15 p.m., the committee proceeded into executive session.)

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APPENDIX

[Editorial from the Washington Post, Jan. 30, 1965]

GOLD COVER STRATEGY

In requesting that the outmoded 25 percent gold cover be eliminated on deposits but not on the currency issues of the Federal Reserve banks, the President has chosen the safer legislative course. Through this strategy of compromise, he appears to have secured the support of the conservative coalition of Democrats and Republicans. Their support is required if gold is to be made quickly available for the settlement of official international obligations.

A demand for the complete elimination of the gold cover might have precipitated a protracted debate during which confidence in the international dollar could have been shaken. But in the opting for a partial and safe solution of the gold problem, the administration—or perhaps its successor—will have to pay a price. Within 5 years or less, the growth of the currency supply will compel the Government to reopen the gold-cover issue even if there are no gold losses to foreign countries. And in the interim zealots who make a fetish of gold, banking groups with other axes to grind and the army of the articulate uninformed will be given an opportunity to beat the drums of fear and confusion. It would be better to lay the myth of the need for a gold cover here and now. But who is to say that half a golden loaf is not better than none?

[From the Congressional Record, Sept. 12, 1962]

GOLD: HOW IMPORTANT IS IT?

Mr. MULTER. Mr. Speaker, once again, I am taking the time to give expression to the thought that monetary and fiscal policy are not so intricate that only the expert economist understands it.

It is the duty of every American to know the simple basic principles.

If he understands them, he will be less inclined to react emotionally in times of crisis and will not panic at every downturn of either the stock market or of the economy generally.

It is high time we tried to understand the fundamental economics on which our very existence depends.

An excellent start is to make required reading the following article from the June 1961 issue of Reader's Digest:

"WHAT IS PROFIT?

"By Fred I. Kent

"(A schoolboy, disturbed by the current fashion of speaking disparagingly of the profit system which has formed the basis of the American way of life, wrote to his grandfather asking him to 'explain just how there can be a profit which is not taken from the work of someone else.' The grandfather, Fred I. Kent, LL.D., was president of the council of New York University and a former director of the Federal Reserve Board. Dr. Kent replied to his grandson's query as follows:)

"MY DEAR GRANDSON: I will answer your question as simply as I can. Profit is the result of enterprise which builds for others as well as for the enterpriser. Let us consider the operation of this fact in a primitive community, say of 100 persons, who obtain only the mere necessities of living by working hard all day long.

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"Our primitive community, dwelling at the foot of a mountain, must have water. There is no water except at a spring near the top of the mountain: therefore, every day all the 100 persons climb to the top of the mountain. It takes them 1 hour to go up and back. They do this day in and day out, until at last one of them notices that the water from the spring runs down inside the mountain in the same direction that he goes when he comes down. He conceives the idea of digging a trough in the mountainside all the way down to the place where he has his habitation. He goes to work to build a trough. The other 99 people are not even curious about what he is doing.

"Then one day this 100th man turns a small part of the water from the spring into his trough and it runs down the mountain into a basin he has fashioned at the bottom. Whereupon he says to the 99 others, who each spend an hour a day fetching their water, that if they will each give him the daily production of 10 minutes of their time, he will give them water from his basin. He will then receive 990 minutes of the time of the other men each day; this arrangement will make it unnecessary for him to work 16 hours a day in order to provide for his necessities. He is making a tremendous profit—but his enterprise has given each of the 99 other people 50 additional minutes each day.

"The enterpriser, now having 16 hours a day at his disposal and being naturally curious, spends part of his time watching the water run down the mountain. He sees that it pushes along stones and pieces of wood. So he develops a water wheel; then he notices that it has power and, finally, after many hours of contemplation and work, he makes the water wheel run a mill to grind his corn.

"This 100th man then realizes that he has sufficient power to grind corn for the other 99. He says to them, "I will allow you to grind your corn in my mill if you will give me one-tenth the time you save." They agree, and so the enterpriser now makes an additional profit.

"He uses the time paid him by the 99 others to build a better house for himself, to increase his conveniences of living through new benches, openings in his house for light, and better protection from the cold. So it goes on, as this 100th man finds new ways to save the 99 the total expenditure for their time—one-tenth of which he asks of them in payment for his enterprising.

"This 100th man's time finally becomes all his own to use as he see fit. He does not have to work unless he chooses to. His food and shelter and clothing are provided by others. His mind, however, is ever working, and the other 99 are having more and more time to themselves because of his thinking and planning.

"For instance, he notices that 1 of the 99 makes better shoes than the others. He arranges for this man to spend all his time making shoes, because he can be fed and clothed and sheltered from profits. The other 98 do not now have to make their own shoes. They are charged one-tenth the time they save. The 99th man is also able to work shorter hours because some of the time that is paid by each of the 98 is allowed to him by the 100th man.

"As the days pass, another individual is seen by the 100th man to be making better clothes than any of the others, and it is arranged that his time shall be given entirely to his specialty. And so on.

"Through the foresight of the 100th man, a division of labor is created that results in more and more of those in the community doing the things for which they are best fitted. Everyone has a greater amount of time at his disposal. Each becomes interested, except the dullest, in what others are doing and wonders how he can better his own position. The final result is that each person begins to find his proper place in an intelligent community.

"But suppose that, when the 100th man had completed his trough down the mountain and said to the other 99, 'If you will give me what it takes you 10 minutes to produce, I will let you get your water from my basin,' they had turned on him and said, 'We are 99 and you are only 1. We will take what water we want. You cannot prevent us and we will give you nothing.' What would have happened then? The incentive of the most curious mind to build upon his enterprising thoughts would have been taken away. He would have seen that he could gain nothing by solving problems if he still had to use every waking hour to provide his living. There could have been no advancement in the community. Life would have continued to be drudgery to everyone, with opportunity to do no more than work all day long just for a bare living.

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"But we will say the 99 did not prevent the 100th man from going on with his thinking, and the community prospered. As the children grew up, it was realized that they should be taught the ways of life. There was now sufficient production so that it was possible to take others away from the work of providing for themselves, pay them, and set them to teaching the young.

"Similarly, the beauties of nature became apparent. Men tried to fix scenery and animals in drawings—and art was born. From the sounds heard in nature's studio and in the voices of the people, music was developed. And it became possible for those who were proficient in drawing and music to spend all their time at their art, giving of their creations to others in return for a portion of the community's production.

"As these developments continued, each member of the community, while giving something from his own accomplishments, became more and more dependent upon the efforts of others. And, unless envy and jealousy and unfair laws intervened to restrict honest enterprisers who benefited all, progress promised to be constant.

"Need we say more to prove that there can be profit from enterprise without taking anything from others, that such enterprise adds to the ease of living for everyone?

"These principles are as active in a great nation such as the United States as in our imaginary community. Laws that kill incentive and cripple the honest enterpriser hold back progress. True profit is not something to be feared, because it works to the benefit of all.

"We must endeavor to build, instead of tearing down what others have built. We must be fair to other men, or the world cannot be fair to us.

"Sincerely,

"GRANDFATHER."

Mr. Speaker, there, briefly but succinctly, is a primer on economics. But that is only the beginning.

Let us proceed further from where grandfather stopped. These same primitive people grandfather talked about soon found that one of their number liked to gather shells. In other similar communities people found different kinds of metals which were pounded into various forms. One of these metals was copper, another silver, a third gold.

In all of these communities, quite independent of each other, the same problems arose.

When goods were not made fast enough to supply the demand, instead of 10 minutes of labor per item, 20 minutes were demanded. Throughout these remarks "minutes of labor" is intended to include capital and the products of both.

When the opposite occurred and the goods were made faster than they could be acquired, instead of 10 minutes of labor per item, 5 minutes were acceptable in exchange for it.

Call it what you will—it all added up to inflation and deflation. And for thousands of years, despite these invidious labels, the world has made progress, become more civilized—I did not say completely civilized—and has even become a better place in which to live, at least in the free areas of the world.

Also within each community, they found it was just too difficult to keep account of how many minutes one person owed another. It was difficult to stockpile minutes of labor. Even if they could, how could Mr. A, to whom was owed 100 minutes by Mr. B, transfer those minutes to Mr. C in exchange for Mr. C's products, assuming he could precisely measure the correct number of minutes to pay Mr. C. What happened if Mr. C could not use Mr. B's type of labor or if Mr. B could not get along with Mr. C or, if as permitted in a free enterprise system, Mr. B just would not work for Mr. C or would refuse at Mr. B's bidding to work 50 minutes for Mr. C and 50 for Mr. D?

That is when the shells, the copper, the silver, and the gold, came into the picture. Paper money came much later.

In one community minutes of labor were equated to shells; in another to a piece of copper, or a piece of silver or a piece of gold.

Soon, instead of trading minutes, they were trading shells, copper, silver, or gold. Few, if any, communities had all four. Within each community the medium of exchange, yes, the money, was not all four but one or more of them.

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It was not until communities began to trade with one another that the shells, the copper, the silver, and the gold had to be matched against or exchanged for each other. Even then, however, the basic value was not the intrinsic value of the shell, the copper, the silver, or the gold, but the number of minutes of labor each represented.

I have, of course, been speaking of a primitive precapitalist society in which minutes of labor roughly determine value. In our modern capitalistic society, things are a little more complex. Even though the minutes of labor are the same, today values are quite different for two roadbuilding workers, one working with a shovel and the other with a giant bulldozer. Identical twins with the same number of minutes of labor, one working poor land and the other rich, establish very different values. A farmer using thousands of dollars worth of machinery and equipment can do all the preharvest labor on a wheat farm half the size of Manhattan Island—with no more minutes of labor than a less efficient farmer with only hand tools needs to eke out the barest existence from 3 or 4 acres of barren land. A lawyer's value is not determined alone by the minutes of labor—but by what he does with them. One lawyer may be paid $50 a week, and another one $5,000. The difference comes from richer education, more extensive knowledge, greater skill—even greater luck.

So in the modern world, to determine value we must add to minutes of labor a variety of factors which for simplicity we will call capital. The combination of the two determines basic values.

In modern society, the fourth step came about just as naturally. Who wanted to cart around a truck full of shells, or push a wheelbarrow of copper tokens, or carry a bag of silver or a pouch full of gold?

Imagine the squeals from the salaried man today calling for his $165 paycheck if, instead of that piece of paper—the check—or four pieces of currency—a $100, a $50, a $10, and a $5 bill, he were handed 5 ounces of gold. Therefore, ingenious man developed the system of issuing paper money instead of shells, copper, silver, and gold.

Paper money, just like the coins, was originally made and issued by men, not by governments. It deteriorates and becomes worthless when it loses its representation of minutes of labor and capital and instead represents merely the coins or bullion.

As the value of the metal changed or the metal was destroyed or stolen, the value of the paper money changed or was destroyed.

Bankers and banks came into being as warehousemen of the shells, copper, silver, and gold, issuing on paper promises to pay on demand the equivalent of what they received. These promises to pay became the currency and checks of today.

The reserves are the coins—or the bullion from which coins are made. As long as the banker reserves, that is, keeps on hand enough to meet the demands made against the outstanding promises to pay, the currency and checks are good—but good only for exchange to what was held in reserve or warehouse, to wit: the coins and bullion. But the coins and bullion are worthless unless they always represent a certain number of minutes of labor and capital. That necessarily means minutes of labor and capital that can be converted into useful, usable production or products.

It should now be too obvious to require further exposition that the problems of inflation and deflation remain the same throughout all of these stages and basically are neither encouraged nor discouraged by the medium of exchange.

That is not to say that the quantity of the mediums of exchange has no effect. Just as obviously, increasing or decreasing the quantity of the shells, the metals, or the paper must affect the price of goods and of labor and necessarily the loss of profit derived from the marketing.

It took civilized nations a long time to arrive finally at the determination that individuals cannot be trusted to fix the value of the mediums of exchange. Whether they be called entrepreneurs, monopolists, private bankers, or any other kind of bankers, the economic history of the world teaches us that even though the free enterprise system may permit any and everyone to gather, mine, or produce as much as he pleased of shells, copper, silver, gold, or paper, only responsible governments should determine which, if any or all, and to what extent and in what denominations they could be used as mediums of exchange.

Note that I say "responsible governments." Irresponsible governments or irresponsible action by responsible governments will throw us back to the eco-

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nomic chaos of the days when individuals "rigged" and "manipulated" the money markets.

That brings us to the point of understanding the need, no longer questioned but unanimously supported, for the existence of central banks, owned and controlled by government.

Our Central Bank, owned and controlled by the U.S. Government, is the Federal Reserve System. The head of the System is the Federal Reserve Board. The operating branches are the Federal Reserve banks in the 12 regional districts.

Let me repeat, what should nowhere be contradicted—the Federal Reserve banks, all of them, are owned lock, stock, and barrel by the U.S. Government.

Despite the issuance of paper, miscalled stock, to member banks of the System, those member banks do not own the Federal Reserve banks or any part thereof. Their misnamed stock cannot be sold, transferred, or hypothecated. It has no voting rights. It is merely a receipt for dollar deposits coupled with a promise of repayment when the member bank gets out of the System, either by withdrawal or liquidation.

Each member bank's right to vote to elect directors of a Federal Reserve bank is fixed by statute and exists quite independent of the issuance of the misnamed stock certificate and regardless of the amount of stock issued to it. Each bank has only one vote. There are other limitations of no consequence, however, to this discussion. Membership on the board of directors of a Federal Reserve bank should not be confused with membership on the Board of Governors of the Federal Reserve System.

Long before our own country learned the economic lessons of life as to governmental central bank operation, there was written into our Constitution the provision that only the Congress can coin money or issue currency. By the method of trial and error, we learned the grievous lesson that there can be no economic stability if this privilege is delegated to any but a Government agency.

Today coins may be produced only by the U.S. mints. Currency may be issued only by the U.S. Treasury or by the Federal Reserve banks. The weight and fineness of the coins are fixed by our Government. There is no variance but complete uniformity within each type of coin. Theoretically each is worth its weight in the particular metal of which it is made. The Government must retain the sole right to fix the price of the raw metal. If it did not, the value of each type of coin would change as the market price of the metal changed.

I again use the word "theoretically" because, and this will strike some people as incredible, the bullion value of our silver coins is by statute less than the monetary value and in our copper and nicket coinage there is no relationship between the demonation or monetary value of the coin and the value of the bullion or metal therein.

Try raising an objection next time you get a dime, a nickel, and a penny in change and you will be looked upon as psychotic.

No one ever dreams of raising any questions about it. Our Government coins these "shells," fixes their metallic content, names their denominational values, and everybody takes it for granted that they are worth as many "minutes of labor" as the market offers for them. Their monetary value does not change.

What the coin will buy, however, in a free competitive enterprise system, such as we try to make ours, will vary in accordance with what happens in the marketplace, uncontrolled by our Government, though regulated in certain phases.

So it is also with our currency. The Government issues it in various denominations. The cost of producing a $10,000 bill is no more than that of the $1 bill. It is legal tender for the denominated amount impressed on it not because of any intrinsic value but because that is the amount the U.S. Government promises to pay. The legal effect and validity of that promise is exactly the same, whether the currency is issued by the U.S. Treasury or by a Federal Reserve bank.

Every dollar, currency or coin, is worth 100 cents only because of the credit of the United States of America and the faith, the confidence, we and the rest of the world have in it. It is not worth 100 cents on the dollar because of the gold, silver, or copper our Government owns.

Take out of your pocket and look at a Federal Reserve note—say a $10 bill. It carries this engraved statement: "Redeemable in lawful money at the United States Treasury or at any Federal Reserve bank." But take it to the Treasury and ask for redemption in "lawful money." An astonished clerk will look at you, take your bill with one hand—and give you back an identical bill with the other. You are actually handling not a piece of paper—but a piece of the faith, credit, and confidence of the United States.

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Silver certificates are literally backed by silver, dollar for dollar. But who can guarantee that the value of the silver will not change in the marketplace.

As a matter of fact, the silver in our silver dollar does not have a bullion value equal to a dollar. But here, too, whether you use the silver certificate or the silver dollar to make a purchase or pay a debt, the monetary value does not change.

The rest of our currency by law must be backed by a percentage of gold. But why not like silver require dollar for dollar. Again, in either event, whether dollar for dollar or 25 cents for each dollar, who can guarantee that the value of gold will not change in the marketplace?

From 1913 to 1945 the law required a reserve of 35 percent in gold certificates or lawful money against deposits and 40-percent gold certificates against Federal Reserve notes in circulation.

In 1945 that was all changed to require only 25 percent of gold certificates against the Federal Reserve notes.

But so far as currency and money are concerned today, no American can own gold or gold certificates in or out of our country.

So of what earthly use is a gold reserve to our domestic economy? It cannot add or detract from its stability. It cannot affect inflation or deflation.

Historically at one time the U.S. gold reserve laws had meaning. When the Nation operated under the gold standard, and individuals could own gold, actual boxes of physical gold were shipped in or out of the country, depending on prices offered for the gold in the various gold markets. This movement in turn affected bank reserves, the volume of currency, and the country's economic position. But for years we have not operated under the gold standard—and today our gold reserve laws are a meaningless economic fiction.

The physical movement of gold into and out of the United States now depends largely on decisions of monetary authorities as to whether they wish to hold gold under earmark in the United States or ship it from the United States to their own country. Under the old gold standard there were also shipments of gold by banks and brokers in response to movements of exchange rates to the so-called gold export or import points; and fundamentally, these movements resulted when there was a surplus or deficit in the U.S. balance of payments. Internationally, the United States continues to operate on the international gold bullion standard and the international aspects of the gold standard have not been fundamenally changed. The major change from the gold standard of the past is the elimination, since 1933, of the redeemability into gold of U.S. money for domestic holders of dollars. Before 1933 these domestic holders could legally demand gold for internal monetary use. Under this system, sometimes called the gold coin standard, there could be an internal drain on our gold reserves even though the balance-of-payments position might be in balance. Like the United States, most leading countries have abandoned the practice of redeeming their money domestically upon demand.

The gold reserve will not help or hurt our gold miners. As long as our Government will provide who may and who may not own gold and also fix its price, the lot of the gold miner will be no better or no worse.

We can, if we want to, continue to dig gold out of one hole in the ground and rebury it in another hole in the ground at Fort Knox.

Gold or no gold, each piece of paper, check, or currency and each coin, copper, nickel, or silver, will buy and pay for a certain number of minutes of labor and capital, nothing more, nothing less, even though the number of minutes may vary.

As of June 27, 1962, there were outstanding Federal Reserve bank obligations, exclusive of capital accounts, of $47.3 billion against which the Federal Reserve banks had a gold reserve of $16.2 billion. Under existing law, against that gold reserve, the Federal Reserve System could add to the total of currency and deposits about $17.5 billion for a total of 66.5 billion. In other words, the Federal Reserve notes—currency—could be increased from $27 billion to more than $44 billion. No one has suggested that that be done. I am certain that there is no intention to do so. Imagine what would happen to the value of that minute of labor and capital if we suddenly increased the quantity of currency in circulation by $17.5 billion.

This then is the case against requiring a gold reserve on the domestic scene and in favor of repealing the law requiring it.

To those who argue that history tells us that every country without a gold reserve has collapsed economically, I say they confuse gold with manipulation of the economy.

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Our gold reserve is subject to the same manipulation as our economy. Irresponsible Government officials can manipulate either. Thus far in our country in our generation that has not been done. We must be alert to be sure it is not done. Gold, however, is not the brake on such conduct.

To repeal the law requiring a gold reserve has certain positive advantages. We would replace a legalistic myth with reality. We would be freed from juggling around reserve percentages to meet conditions which might arise. We would simplify the economy's financial structure. And in time of potential war with a power possessing vast gold deposits, we would strengthen our economy in the world, add greater flexibility and mobility, and increase our chances of survival and success for the United States.

But will this affect our balance of payments? Will we not cause a run on our gold by foreign claimants if we abolish our statutory requirement for a gold reserve? The answer is positively, unequivocally, and categorically "No."

Checkbook money calls for dollars, not gold.

U.S. currency is either Treasury certificates or Federal Reserve notes.

Each calls for silver or for lawful money of the United States. None call for gold.

No individual, no corporation—American or foreign—can demand gold from us.

Foreign governments and foreign central banks, that is, government banks, do not have a right to demand settlement of their claims against the United States in gold. We can satisfy such claims either with gold or with the currency of that country making the claim. As a matter of national policy the Treasury sells gold for dollars to foreign governments and central banks for the settlement of international balances.

By repealing a sterile and useless domestic gold reserve requirement, we have available to meet foreign claims a gold stock of more than $16.4 billion.

The total amount, private and Government, of foreign claims is only $20 billion and only about half of it is foreign government. Our gold stock is almost double that amount. Total short-term liabilities to foreign countries reported by banks in the United States amounted to about $18.8 billion on April 30, 1962, of which $10.3 billion were official balances of governments and central banks. In addition, foreign countries held about $1.4 billion of U.S. Government bonds and notes for which we have no official-private breakdown. The total of these foreign dollar holdings was $20.2 billion. These figures do not include the $5.6 billion held by international institutions, which do not constitute potential claims on our gold.

In addition, we have a right to call on the International Fund for the use of $1.4 billion in currencies we could use in lieu of gold to meet foreign government claims. That much we can get, as of right. We can borrow almost as much more, if necessary, plus much larger sums by negotiated agreement. But how could we possibly need it, and for what?

Over and above the foreign claims referred to, Americans own investments in foreign countries in excess of $54 billion. All of them are earning profits for Americans. Some of the earnings and of the capital is repatriated—brought home to the United States—every year.

Those who argue that we must have a gold reserve to prevent printing excessive quantities of paper money, completely ignore the fact that it is the law, as made by Congress and approved by the President, and not the quantity or quality or fineness of gold, which determines how much and what kind of paper money should be issued in this country.

The quantity of money that is held in the form of currency and coin is determined primarily by the habits of the public and the need for pocket money. The quantity of money in the form of deposits in the banks results, on the one hand, from the operations of the Federal Reserve System and the commercial banks, under the laws affecting these institutions made by Congress and approved by the President. On the other hand, it is affected by the current requirements for bank loans by the community.

Only if our entire gold stock were needed to meet the 25-percent gold requirement could this requirement be said to impose a limit on the money supply. At the present time our gold reserve is substantially more than the minimum established by law.

Those who argue that we should go back on the gold standard and devalue the dollar, that is, increase the price of gold from $35 to $70 an ounce, or to any other figure, also tell you that that must not be done unilaterally by the United

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States, but we must do it in agreement with the major "hard" currency countries of the world, else we upset the world currencies.

If that is what we must do, why waste the time with such mathematical gymnastics? If we double the value of the ounce of gold and thereby cut the dollar in half, and do the same to the British pound sterling, and the German mark, and the French franc, and the Italian lire, what have we accomplished? But look at the windfall we create for the country that will not enter into so foolish an international agreement—"fiasco" would be a better word. Would the Swiss bankers join us in such a move? I doubt it.

Would the Russians? You can bet your last dollar they would not.

It is said that half of the world's gold is owned by the Russians. For every dollar we add to the price of gold, we add a dollar to the value of the Russian hoard.

Double the world price of gold, and the Russians get a windfall which will automatically put them in a tremendously powerful economic position worldwide.

Every last economist and financial writer who regularly tries to instill fear about our balance of payments, and tries to destroy confidence in the American dollar, and urges increasing the price of gold, also insists that our fractional reserve system is the best yet devised by man.

The fractional reserve system is that which permits the issuance of currency or checkbook money in multiples of the gold or other reserves on hand. The theory proved by experience is that not more than one-sixth to one-fourth of the gold on hand is ever demanded by the holders of claims against the gold.

As long as the free world keeps most of its gold in the United States of America, it is safe. Safe not only from misappropriation and embezzelment, but safe from capture by dictators of the left or of the right, and certainly safe from the Communists.

Everyone knows that the last place in the world the Communists can get to is the United States of America. They know, too, there is no safer place than here for their gold. They can trade with their claims on that gold while it is here. If the Communists steal those claims, the United States of America can refuse to honor them, holding the gold here for the true owners thereof. If the claims are redeemed and the gold taken home, and the gold captured by the Communists, it is gone forever.

Of course, the earmarking of gold for a foreign country or central bank takes it out of our gold reserves, whether the gold remains here or is shipped abroad. But such gold once so taken out of our gold reserve is effectively immobilized. It becomes a nonearning asset that eats into its own value by the cost of storage, insurance, etc. Their dollars, on the other hand, cost nothing to store, need no insurance, and can earn interest while waiting to be used.

The one thing the economists do not tell us, and yet the only basic truth, is—no economy, domestic, foreign, or international, depends on gold or on the medium of exchange, no matter what it is called.

Our economy, every sound economy, must depend upon the production of our farms and of our factories. The dollar protects itself when we protect our economy. We protect our economy when we keep our people employed in producing. Every producer is an earner; every earner is a consumer.

That is the one circle that cannot be called vicious. It is the unalterable, but happy circle that makes for peace and contentment.

It is axiomatic that a sound domestic economy cannot operate in an international vacuum. A domestic economy which is sound produces for resale on the international markets goods that may be sold abroad at competitive prices.

In that atmosphere, all the world knows that our dollar, whether check, currency, or gold, is exchangeable for full value in minutes of labor and capital, no more and no less.

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