NEWS RELEASE

FEDERAL DEPOSIT INSURANCE CORPORATION

WASHINGTON, D. C. 20429

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FOR RELEASE TO P. M. PAPERS
WEDNESDAY, FEBRUARY 10, 1965

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"Gold cover" legislation for the protection of the nation's gold reserves which the Administration is seeking in Congress "is in the nature of preventive therapy" rather than an emergency method to deal either with an economic or a dollar crisis, Joseph W. Barr, Chairman, Federal Deposit Insurance Corporation, said today (Wednesday, Feb. 10) in addressing the Notre Dame Finance Club at Notre Dame, Indiana.

"Our country is enjoying vigorous economic growth," Mr. Barr declared. "Our dollar continues strong and we have been successful in maintaining price stability. Action that is needed now, therefore, is not to deal either with an economic or a dollar crisis. Rather, it is in the nature of preventive therapy. Unless something is done, developments well within the range of possibility might cause the legal reserve minimum to be penetrated very soon. This would require the Federal Reserve either to suspend legal requirements, under existing authority and somewhat cumbersome restrictions intended only as a temporary expedient to deal with emergencies, or it must contract the money supply and with it economic activity as well. These are alternatives which are certainly unnecessary and unacceptable to our government or our people."

(more)

The best approach, Mr. Barr said, is legislation now before Congress that would repeal the present gold requirement against deposit liabilities, but would not affect the separate 25 percent requirement against Federal Reserve notes. "The effect," he stated, "would be to release approximately $4.8 billion in gold now earmarked for cover purposes and raise the total free gold certificate holdings to about $6.2 billion. This, it seems to me, should be fully adequate to meet present and foreseeable needs and sufficiently ample to remove any doubts anywhere about our ability or our resolve to defend the dollar, at the same time avoiding any action which might jeopardize the domestic economy."

"In the immediate future," Mr. Barr continued, "we face the prospect of some additional gold losses. But the fact remains that even after the large gold outflows of the past decade or more, the United States still holds some 35 percent of the monetary gold stock of the entire free world. Certainly it is essential that we continue to hold a large stock of gold, but we must not tie our own hands either. If we persevere in our strong efforts to correct our balance of payments deficit, we may look forward to a cessation of gold outflows and, over the longer run, a gradual growth of our gold stock from world supplies from both international settlements and sharing in the world's productive growth."

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THE GOLD COVER

Address of

JOSEPH W. BARR, CHAIRMAN

FEDERAL DEPOSIT INSURANCE CORPORATION
Washington, D. C.

before the

FINANCE CLUB OF THE UNIVERSITY OF NOTRE DAME

at its

SEVENTH ANNUAL FINANCE FORUM

University of Notre Dame

Notre Dame, Indiana

Wednesday, February 10, 1965

3:00 P.M.

Address of
Joseph W. Barr, Chairman, Federal Deposit Insurance Corporation
Before the Finance Club of the University of Notre Dame
At its Seventh Annual Finance Forum
University of Notre Dame, Notre Dame, Indiana
Wednesday P.M., February 10, 1965

THE GOLD COVER

There is today no more exciting and difficult challenge to the serious student of finance than contemporary problems in the area of international affairs. I would like to use the time that you have given to me, therefore, to discuss with you one of the important issues now claiming the attention of Washington officials. I would like to say something about gold reserve requirements--the so-called "gold cover". I shall not pretend before this academic audience to bring definitive formulae or methods for dealing with the problems in this area, many of which I am sure you have been discussing in your classes. But it might be worthwhile to re-focus our attention on some of them for a few moments, and then I hope that some of you will have specific questions that we can talk about in a more informal way a little later.

First, the gold reserve requirement....Today, throughout the Free World, when a citizen of one country trades with a citizen of another, whether or not either is an American, the chances are that their accounts will be settled in U. S. dollars. When foreign bankers, merchants, and investors acquire in their transactions more dollars than they would like to own, they usually sell them to their central bank.

Likewise, the central bank may keep the dollars as part of its monetary reserve or, if it desires, purchase gold from the U. S. Treasury. Conversely, if a country's international settlements should deplete its dollar balances, its central bank may purchase dollars by selling gold to the U. S. Treasury. The readiness of the U. S. Treasury to buy and sell gold at the fixed price of 35 dollars an ounce has greatly contributed to the willingness of foreign monetary authorities and private foreign residents to hold a growing volume of dollar reserve balances. The U. S. monetary gold stock has thus helped the dollar to obtain its unique position in international commerce and finance and has contributed greatly to the record of expansion of international trade during the post-war years. For this reason, the availability of adequate U. S. gold holdings is a matter of vital importance, not only to us in the United States, but to the international payments system upon which the whole free world relies.

This brings us to our basic problem. Since 1949, our gold reserves have been declining. As all of you know, there exists a 25 percent gold reserve requirement against Federal Reserve notes and deposit liabilities. The gold reserve requirement was established in the original Federal Reserve Act, and at that time reserves against deposits were set at 35 percent while those against notes were established at 40 percent.

During the first two decades of the Federal Reserve System, the level of Federal Reserve bank deposits and currency typically fluctuated far below these limitations. Even during the 1930's and early 1940's, after the convertibility of currency into gold by American

residents was ended, this pattern continued. At one time, in 1940 and 1941, the ratio of gold reserves to deposit and Federal Reserve note liabilities rose as high as 91 percent. Toward the end of World War II, however, the trend reversed and there was concern that the vast expansion of money and credit required by wartime finance might exhaust the gold supply held in excess of legal requirement, thus perhaps hampering the war effort. Accordingly, Congress reduced the reserve requirement set by the original Federal Reserve Act to the present uniform requirement of 25 percent against both notes and deposits.

In September, 1949, gold certificates reserves of Federal Reserve banks reached their peak of $23.4 billion, when our gold amounted to about 70 percent of the free world's stock. Over the last 15 years, however, Federal Reserve Bank holdings of gold certificates in excess of the minimum required by statute have declined by some $11.9 billion. At the end of 1964, Federal Reserve notes and deposit liabilities totaled $54.8 billion, requiring a gold reserve of $13.7 billion. This absorbs all but $1.4 billion of the total gold certificates issued to the Federal Reserve against the Treasury gold stock. In terms of ratios, gold holdings at the end of 1964 had declined to 27.5 percent of note and deposit liability.

What are the basic causes of this deterioration? The answer is that the United States sales of gold to foreign countries since 1949 have reflected post-war recovery from the monetary chaos created abroad by the second World War, and the efforts of the major foreign industrial countries to replenish their reserves and to re-establish convertibility of their currencies.

Our country is enjoying vigorous economic growth. Our dollar continues strong and we have been successful in maintaining price stability. Action that is needed now, therefore, is not to deal either with an economic or a dollar crisis. Rather, it is in the nature of preventive therapy. Unless something is done, developments well within the range of possibility might cause the legal reserve minimum to be penetrated very soon. This would require the Federal Reserve either to suspend legal requirements, under existing authority and somewhat cumbersome restrictions intended only as a temporary expedient to deal with emergencies. This in turn could raise entirely unnecessary doubts over our ability to provide the growth in the money supply necessary to support a healthy economy or to meet our commitment to provide gold on demand to foreign monetary authority. We should not permit these doubts to arise.

Fortunately, there are more palatable alternatives that the Congress might adopt to meet this situation. The 25 percent requirement on Federal Reserve deposits and notes could be lowered, or removed on one, or on both. The proposal now being considered in the Congress, H.R. 3318, would repeal the present gold requirement against deposit liabilities, but would not affect the separate 25 percent requirement against Federal Reserve notes. The effect of this would be to release approximately $4.8 billion in gold now earmarked for cover purposes and raise the total free gold certificate holdings to about $6.2 billion. This, it seems to me, should be fully adequate to meet present and foreseeable needs and sufficiently ample to remove any doubts anywhere about our

ability or our resolve to defend the dollar, at the same time avoiding any action which might jeopardize the domestic economy. I am conscious of the questions I can sense in some of your minds right now.

How do you justify removing the reserve requirement on deposits and retaining it on notes? The answer is simply that I will not try to satisfy you on theoretical grounds. Government is pragmatic business and this solution, I think, is largely a pragmatic one. By retaining the traditional backing for Federal Reserve notes, the proposal should be reassuring to those who in their continuing concern for the stability of the dollar see a gold cover requirement as an important element of strength, however symbolic that may appear to you. The value of any currency is so much the product of confidence that one must not disregard these important considerations. What counts in my judgment is which approach among those that will do the job is more acceptable to the public. From that standpoint, I believe it is preferable to preserve the cover on Federal Reserve notes and keep intact the existing tie between circulating currency and gold. This will maintain the "discipline" of gold and also satisfy many who feel that this constitutes added protection against irresponsible public officials.

In the immediate future, we face the prospect of some additional gold losses. But the fact remains that even after the large gold outflows of the past decade or more, the United States still holds some 35 percent of the monetary gold stock of the entire free world. Certainly it is essential that we continue to hold a large stock of gold, but we must not tie our own hands either. If we persevere in our strong efforts to correct our balance of payments deficit, we may

look forward to a cessation of gold outflows and, over the longer run, a gradual growth of our gold stock from world supplies from both international settlements and sharing in the world's productive growth.

I shall be glad to discuss with you now specific questions any of you might have.