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Statement of

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Chairman, Board of Governors of the Federal Reserve System

before the

Committee on Banking and Currency

United States Senate

on

Legislation to Repeal the Gold Cover Requirement

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

I want to emphasize that domestic developments will necessitate elimination of the "gold cover" requirement in the relatively near future even if there are no further net sales of gold to foreigners. Federal Reserve notes account for nearly 90 per cent of all currency in circulation in this country, and for nearly 20 per cent of the total money stock including demand deposits. The amount of such notes outstanding increases each year with growth in our economy. The increase in 1967 was $2.2 billion--about 5-1/2 per cent--and this alone added $540 million to the amount of gold required under present law to be held as reserves for Federal Reserve notes. Moreover, our domestic industrial and artistic uses of gold, over and above domestic production, amounted to $160 million last year, and such uses can be expected to be at least that large in the future.

These two factors are reducing what is called our "free gold"--the amount of gold over and above that required as cover for notes--by about $700 million a year. At that rate, our free gold, which came to $1.3 billion at the end of December, would be absorbed in less than two years, even in the absence of further sales of gold to foreigners. And it would be unrealistic not to allow for some additional foreign purchases. Thus, it is clear that a change in the cover requirement is unavoidable, and cannot be postponed for long.

It is true that Congress has given the Federal Reserve Board authority to suspend the gold reserve requirement for a period of up to 30 days and to renew such suspension for 15-day periods thereafter. The Board would, of course, make use of this authority if necessary, rather than permit a shortage of currency to interfere with the conduct of the nation's business. But the gold reserve requirement was established at a time when Federal Reserve notes were convertible into gold domestically, and authority to suspend the requirement was intended to deal only with a temporary shortfall. Both the requirement and the provision for suspending it are anachronisms under present-day conditions. With growth in the economy the attendant need for an increasing volume of currency in circulation will certainly continue. There is no way to ensure a corresponding increase in the gold stock. Hence, if the reserve requirement were not removed, we would soon face a continuing and increasing reserve deficiency. Furthermore, upon suspension of the requirement by the Board, we would be required by law to tax the Reserve Banks and they would have to add this tax to their discount rates. Clearly, repeated suspensions of the reserve requirement would be an unsatisfactory expedient in the face of a permanent change in the underlying conditions. To provide the additional currency that the economy requires calls for a permanent change in the law, rather than Board action every 15 days.

The primary function performed by gold today is not as a reserve against domestic currency but as a monetary reserve for use internationally. This has long since been recognized in almost all other countries by suspension or elimination of domestic gold reserve requirements. The major part of the United States international monetary reserve is in gold. In the past six months our gold stock has diminished by more than $1 billion, and it now amounts to about $12 billion. In order to arrest this decline, we must achieve a major improvement in our balance of payments. That is the objective of the program announced by the President on January 1.

But while we are taking the fundamental steps needed to bring our international payments into equilibrium and stop the drain on our gold, we should avoid any understatement or misunderstanding of our international reserve position. We still hold about 30 per cent of the total gold reserves held by all countries in the free world. We should make it absolutely clear that all of our gold stock is available to serve its primary purpose, and thus discourage market speculation against the dollar or anticipatory takings of gold by central banks. Speculation against the dollar might be encouraged if the gold cover requirement were regarded as immobilizing part of our reserves; the labeling of only part of our gold reserves as "free" might seem to imply that the rest of our reserves are somehow unavailable to perform their primary function of maintaining the convertibility of the dollar. Any possible misunderstandings on this point should be put at rest. This legislation would do that.

Removal of this requirement would in no way reduce our determination to preserve the soundness of the dollar. To achieve our goals both domestically and internationally we must pursue sound and equitable fiscal and monetary policies. Whatever discipline gold imposes in this connection makes itself felt from the fact of a decline in the gold stock rather than from the existence of a reserve requirement, and this will continue to be the case.

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

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