1968 January 30

Statement by Secretary Fowler, January 30, 1968, before the Senate Banking and Currency Committee, on legislation to remove the gold cover. The requirement that the United States maintain a cover for 25% of the dollar notes in circulation prevented the United States Government from using those gold reserves to defend the international position of the dollar. In 1968, the growth in foreign demand for gold and domestic demand for currency pushed the US Government to abandon its domestic gold cover in order to free up its gold reserves to meet international monetary obligations.

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I am grateful to you for the opportunity to appear before you promptly in support of the President's recommendation for removal of the gold cover.

The legislation before you would eliminate the 25 percent gold reserve requirement from Federal Reserve notes and the $156 million reserve held against U.S. notes and Treasury notes of 1890.

The Administration believes that prompt action to remove the cover requirement is necessary for three principal reasons:

—Prospective normal increases in currency holdings—Federal Reserve notes— by the public will "lock up" more and more of our "free" gold and soon reach a point inhibiting further expansion of our pocket cash, one portion of our domestic money supply. Obviously we cannot tolerate such a situation.

—There should be no doubt whatsoever that our total gold stock is available to insure the free international convertibility between the dollar and gold at the fixed price of $35 an ounce.

—The world knows as a fact that the strength of the dollar depends upon the strength of the U.S. economy rather than upon a legal 25 percent reserve requirement against Federal Reserve notes, and it is clearly appropriate for this fact now to be recognized in legislation.

Despite these facts, the gold reserve requirement against Federal Reserve notes, instituted at a time when gold circulated freely in the domestic economy, is still part of our law. It should be removed.

The need for prompt removal is apparent from a look at the simple arithmetic of the problem.

The U.S. gold stock is now at $12 billion—the cover requirement is approximately $10.7 billion—the balance remaining is $1.3 billion.

The normal increase in notes will absorb over $500 million annually and a further $150 million or more will be absorbed each year for domestic artistic and industrial purposes. These two factors taken together mean that about $700 million a year of our free gold will be absorbed for domestic reasons. There is thus but 2 years grace at most even if one assumes that no gold at all will be needed for international purposes. Clearly we cannot proceed on such an assumption.

Since the passage of the Federal Reserve Act more than a half century ago, the function of gold in our monetary system has undergone a fundamental transformation. Gold no longer circulates freely as domestic currency in any major country in the world. We Americans have not used gold as domestic currency since 1934. Gold belongs in a nation's international reserves. The dollar serves as a reserve currency to the world; the U.S. gold supply is available to convert dollars held by national monetary authorities at a fixed price. As such, it is one cornerstone—and a very main cornerstone—of our international monetary system.

Today, the strength of the dollar is not a function of this legal tie to gold— a tie which is only applicable to one portion of our total money supply, Federal Reserve notes. The value of the dollar—whether it he in the form of a bank balance, a coin, or "folding money"—is dependent on the quantity and quality of goods and services which it can purchase. It is the strength and soundness of the American economy which stands behind the dollar. Balanced growth at home and a strong competitive position internationally give the dollar we use as everyday pocket money its strength.

An expanding U.S. economy needs an expanding supply of currency. Our main form of currency is Federal Reserve notes. In the years ahead, we can expect increases in Federal Reserve note circulation of about $2 billion a year. This growth is a normal response to the public's demand for cash in a growing economy. It is basically a trend development, reflecting a growing population, a growing economy, and a growing number of transactions.

Not to move on the cover requirement at this time would only mean putting off the inevitable. We cannot afford to permit an outmoded provision of our law to impinge on the nation's supply of pocket money.

Removal of this requirement is also of key importance from the viewpoint of the role of the dollar and of gold in the international monetary system.

I know most members of this committee are well versed in the functions of gold and the dollar in the international monetary system. Rather than take up your time with a description at this point, I would refer you to a Treasury report which was issued 2 weeks ago, entitled "Maintaining the Strength of the United States Dollar in a Strong Free World Economy."

If this system, which has served the entire free world so admirably in the past 20 years, is to continue to facilitate the growth of world trade and prosperity, we must assure that confidence in the system and in the strength of the dollar is maintained. This requires action on four fronts :

—We must continue the long-standing U.S. policy of maintaining the gold-dollar relationship at $35 per ounce. This must not be open to question, and the best way to make continuation of that policy crystal clear is to free our entire gold stock for that purpose.

—We must assure that the U.S. economy grows in an environment of cost and price stability through enactment of the anti-inflation tax and through expenditure controls and appropriate monetary policy.

—We must achieve sustained equilibrium in our balance of payments.

—We and the rest of the free world must put into place the plan for the creation of a new reserve asset agreed upon in Rio last September.

Our policy of maintaining the fixed relationship between gold and the dollar at $35 an ounce for legitimate monetary purposes is one of the reasons why virtually all countries hold dollars in their reserves and why many of them hold very large amounts of dollars. In addition, of course, countries hold dollars because, unlike gold, they can invest them in interest earning assets.

The monetary authorities of most of the major industrialized countries understand full well that the link between gold and domestic currencies is no longer a pertinent and relevant fact and that gold is an international asset. Only three other countries in the Group of Ten plus Switzerland, the major industrialized countries, still maintain some link between their domestic currencies and gold. While foreign authorities are aware of the fact that the Federal Reserve can suspend the cover requirement, they find it difficult to understand why the United States, the world's major reserve currency country, still maintains this legal impediment to the free international use of gold.

Thus, legislative action on the cover requirement, by making it clear to the world that the Congress as well as the Executive Branch are committing our total gold stock to international use, is necessary to maintain confidence in the dollar.

Removal of the gold cover will not solve the U.S. balance of payments problem nor is it a substitute for the solution of that problem.

The need to achieve sustained equilibrium in our international payments position is essential to confidence in the dollar and the future stability of the international monetary system. The series of measures announced by the President on January 1, with which you are all familiar, are designed to bring us to, or close to, equilibrium this year. It is vital that they be successful. [...]

I urge the committee to consider and act promptly on the gold cover legislation before you in order that, domestically, we can continue to be assured that the Federal Reserve will be able to supply appropriate amounts of currency to meet the needs of our growing economy for cash, and in order that our policy of maintaining the gold-dollar relationship-one of the major elements of confidence in the dollar and the international monetary system-will not be open to question.

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***Source*:** *Treasury Department. 1969. Annual Report of the Secretary of the Treasury on the State of the Finances*, (Washington: Government Printing Office), pp. 224-226.