Brief History of the Gold Standard in the United States

Craig K. Elwell
Specialist in Macroeconomic Policy

June 23, 2011

Congressional Research Service
7-5700
www.crs.gov
R41887

CRS Report for Congress
Prepared for Members and Committees of Congress

Summary

The U.S. monetary system is based on paper money backed by the full faith and credit of the federal government. The currency is neither valued in, backed by, nor officially convertible into gold or silver. Through much of its history, however, the United States was on a metallic standard of one sort or another.

On occasion, there are calls for Congress to return to such a system. Such calls are usually accompanied by claims that gold or silver backing has provided considerable economic benefits in the past. This report briefly reviews the history of the gold standard in the United States. It is intended to clarify the dates during which the standard was used, the type of gold standard in operation at the various times, and the statutory changes used to alter the standard and eventually end it. It is not a discussion of the merits of such a system.

The United States began with a bimetallic standard in which the dollar was defined in terms of both gold or silver at weights and fineness such that gold and silver were set in value to each other at a ratio of 15 to 1. Because world markets valued them at a 15½ to 1 ratio, much of the gold left the country and silver was the de facto standard.

In 1834, the gold content of the dollar was reduced to make the ratio 16 to 1. As a result, silver left the country and gold became the de facto standard. In addition, gold discoveries drove down the value of gold even more, so that even small silver coins disappeared from circulation. In 1853, the silver content of small coins was reduced below their official face value so that the public could have the coins needed to make change.

During the Civil War, the government issued legal tender paper money that was not redeemable in gold or silver, effectively placing the country on a fiat paper system. In 1879, the country was returned to a metallic standard; this time a single one: gold. Throughout the late 19th century, there were efforts to remonetize silver. A quantity of silver money was issued; however, its intrinsic value did not equal the face value of the money, nor was silver freely convertible into money. In 1900, the United States reaffirmed its commitment to the gold standard and relegated silver to small denomination money.

Throughout the period under which the United States had a metallic standard, paper money was extensively used. A variety of bank notes circulated, even without being legal tender. Various notes issued by the Treasury also circulated without being legal tender. This use of paper money is entirely consistent with a gold standard. Much of the money used under a gold standard is not gold, but promises to pay gold. To help ensure that the paper notes theretofore issued by banks were honored, the government created the national bank system in 1863. In 1913, it created the Federal Reserve System to help ensure that checks were similarly honored. The creation of the Federal Reserve did not end the gold standard.

The gold standard ended in 1933 when the federal government halted convertibility of notes into gold and nationalized the private gold stock. The dollar was devalued in terms of its gold content, and made convertible into gold for official international transactions only. Even this quasi-gold standard became difficult to maintain in the 1960s. Over the period 1967-1973, the United States abandoned its commitment to covert dollars into gold in official transactions and stopped trying to maintain its value relative to foreign exchange. Despite several attempts to retain some link to gold, all official links of the dollar to gold were severed in 1976.

Contents

Contacts

Introduction

The U.S. monetary system is based on paper money backed by the full faith and credit of the federal government. The currency is neither valued in, backed by, nor officially convertible into gold or silver. Through much of its history, however, the United States was on a metallic standard of one sort of another. On occasion, there are calls for Congress to return to such a system. Such calls are usually accompanied by claims that gold or silver backing has provided considerable economic benefits in the past.

This report briefly reviews the history of the gold standard in the United States. It is intended to clarify the dates during which the standard was used, the type of gold standard in operation at the various times, and the statutory changes used to alter the standard and eventually end it. It is not a discussion of the merits of such a system.

Gold Standards

Money exists to facilitate exchange, functioning as a "medium" or middle part of a transaction. In a modern economy, every time someone purchases something, that person engages in half of an exchange: one thing of inherent value has changed hands, with the buyer getting what he or she wants, but the seller still looking to get something of value in return. Money is a token given the seller signifying that he or she is still owed something of value.

What Is a Gold Standard?

A gold standard uses gold—directly or indirectly—as money. In a pure gold standard, gold itself is used in transactions, with all prices in essence expressed in terms of the amount of gold needed for purchase. Because gold may be alloyed with baser metals,[1] and its weight impossible to ascertain without proper scales, it became common to mint it into coins so that its purity and weight were certified by an authority (usually the government). Such coins typically also become a unit of account, so that instead of being specified in the number of grains of gold of a certain purity, prices are expressed in terms of dollars, guineas, doubloons, drachma, etc.

A monetary system can also be regarded as a gold standard if representations of gold are used in exchange. For example, paper notes can be part of a gold standard if they represent a claim to gold. However, "claim" can be ambiguous. Typically, people think of paper currency as part of a gold standard if the notes are "backed" by gold, that is, if there is for every note outstanding a certain quantity of gold stored as "cover."

Backing, however, may be largely irrelevant. For paper to represent gold, it must be regarded as equivalent to a given quantity and purity of gold. In general, this equivalence is achieved by "convertibility," the commitment to exchange the notes for gold on demand. For the purposes of this report, a paper money system in which notes are convertible on demand by the issuer into gold of a given weight and purity is regarded as a gold standard.

---

[1] Mixing base metals with gold produces an alloy that is harder, and therefore better holds the shape into which it is stamped.

Legal Tender

Legal tender is something that by law must be accepted in satisfaction of obligations denominated in currency. Should a suit arise over a commercial or public transaction, the law holds that a monetary obligation is satisfied if these notes have been “tendered” in the correct amount.[2]

Under such a law, it is still possible to make a contract in something other than the legally designated currency. A vendor, for example, may specify that the payment needed to induce provision of a service will not be accepted in legal tender. But if payment for an *obligation* not otherwise specified is tendered in the legally designated medium, it must be accepted at face value. If some medium is made legal tender, payment of that medium for a debt cannot be refused on the grounds that the designated currency is not money.

Issuing money is something else. It is possible to issue currency without making it legal tender. The government can—and has—paid out various forms of notes that have circulated as currency, but have not been declared legal tender. Full-bodied gold or silver coins may be issued without making them legal tender. At the same time, tender status can be conferred on the coins or notes of another country. Consequently, the monetary standard and legal tender can be different things.

Basically Silver: 1792-1834

Officially, the United States began not with a gold standard, but with a bimetallic standard in which both gold and silver were used to define the monetary unit. The first coinage act,[3] based on the recommendations of Treasury Secretary Alexander Hamilton, defined the dollar as 371.25 grains[4] of pure silver minted with alloy into a coin of 416 grains.[5] Gold coins were also authorized in denominations of $10 (“eagle”) and $2.50 (“quarter-eagle”).[6] The ratio of silver to gold in a given denomination was 15 to 1.[7]

These coins were declared legal tender. But in addition, a number of foreign gold coins were also declared legal tender.[8] Most significantly at the time, the Spanish milled dollar of silver was designated as legal tender and set equal to the U.S. dollar.[9]

---

[2] Under the *U.S. Code* (31 USC 5103), U.S. coins and currency (including Federal Reserve notes and circulating notes of Federal Reserve banks and national banks) are legal tender for all debts, public charges, taxes, and dues. Foreign gold or silver coins are not legal tender for debts.

[3] An act establishing a mint, and regulating the Coins of the United States, 1 Stat. 246, April 1792.

[4] There are 7000 grains to a pound and 437.4 grains to an ounce. However, these are avoirdupois weights. When the weights of these metals are expressed in terms of ounces and pounds, apothecary weights are used. There are 480 grains to a troy ounce and 12 troy ounces to a troy pound (5760 grains).

[5] Silver half dollars, quarter dollars, dimes, and half-dimes were also authorized in the same alloy with proportionate amounts of silver.

[6] The “eagle” or $10 piece had 247.5 grains of pure gold to make a 270 grain coin (i.e., eleven-twelfths fine).

[7] With an eagle equal to 247.5 grains of pure gold, 24.75 grains of pure constitutes a dollar. The ratio of 371.25 to 24.75 is 15 to 1.

[8] By an act of February 1793 (*Act to Regulate Foreign Coins*, 1 Stat. 300) certain coins of Britain, Portugal, France, Spain, and Spanish colonies were designated legal tender at prescribed rates until 1797. By a series of acts over the next half-century, legal tender status on foreign coins was extended to meet the currency needs of the growing U.S. economy.

A country's monetary system operates in the context of a world market for metals. And the world market price ratio of silver to gold fluctuates. Not long after the first coinage act was passed, the market price ratio of silver to gold moved to around 15½ to 1. As a result, silver being the cheaper metal, gold was used for purchases abroad, and the coins used for domestic purposes became primarily silver. Effectively, the United States found itself on a silver standard for the first 40 years of its existence.

Basically Gold: 1834-1862

In 1834, Congress moved to remedy the problem caused by the 15-to-1 silver-to-gold mint ratio, and therefore restore gold coins to use in domestic commerce.[10] The ratio was changed to 16 to 1 by reducing the gold in gold coins. The pure gold in an eagle was reduced from 247.5 to 232 grains (and the coin itself reduced to 258 grains, almost nine-tenths fine).

An additional adjustment was made in 1837 to 232.2 grains of gold to make the fineness exactly nine-tenths. The fineness of silver coins was also changed to nine-tenths. Since the latter was accomplished by reducing the alloy content, the amount of silver in a dollar remained the same (371.25 grains in the newer 412.5 grain dollar coin).[11]

The new coins were legal tender for debts incurred before the alteration in the gold content. This meant that debts from before the change could be discharged with effectively less money than was borrowed. Before 1834, a $10 debt could be paid of with 3712.5 grains of pure silver, worth about 236.465 grains of gold on the world market.[12] Afterwards, 232 grains of gold could pay the debt, a reduction of about 2% in the debtor's cost.

The change in the mint ratio, however, was too great. The new mint ratio made gold cheaper relative to the world market price ratio. Silver began to be exported, and after a few years, gold became the principal coin of domestic commerce.

The latter phenomenon became more pronounced with discoveries of gold in California and Australia. By 1850, silver coins had almost totally disappeared. This created a problem because there were no gold coins representing fractions of a dollar.[13] The shortage of fractional coins was remedied by an act of 1853.[14] This act authorized subsidiary silver coins (i.e., less than $1) with less silver than called for by the official mint ratio, and less than indicated by the world market price.[15] They were made legal tender for amounts less than $5.

(...continued)

[9] This was true even though the Spanish dollar had 373 grains of pure silver. Most of the Spanish dollars that circulated in the U.S. were worn and clipped, and therefore had a silver content similar to or less than the new U.S. dollar.

[10] An act concerning the gold coins of the United States, 4 Stat. 699, June 1834.

[11] An act supplementary to the act entitled "An act concerning the gold coins of the United States," 5 Stat. 136, January 1837.

[12] At the time of the change, the world market ratio was about 15.7 to 1.

[13] The value of gold is such that the proportionate quantity of gold in a small coin would make the coin physically too small to be practical.

[14] An act amendatory of Existing Laws relative to the Half-Dollar, Quarter-Dollar, Dime, and Half-Dime, 10 Stat. 160, February 1853.

[15] The half-dollar was set at 192 grains, nine-tenths fine, other coins proportionate. This was a ratio of about 14.9 to 1.

Paper Money in the Antebellum Period

Throughout the period before the Civil War, there was no legal-tender paper money in the United States. Yet a variety of paper money existed and circulated as readily as coin. These included private bank notes, some Treasury notes, and (in large transactions) financial instruments called bills of exchange. In each case, these paper claims were promises to pay gold or silver. Consequently, they were an integral part of the metallic monetary standard.

Bank Notes

Various banks conducted much of their business based on the issuance of notes. Taking deposits and making loans, the banks needed only a fraction of their total assets held as coin on hand. The rest could be held in the form of interest-earning loans, and issued as notes promising to pay the bearer on demand an amount of gold or silver on presentation of the notes. The notes were not legal tender, but circulated on the strength of the promise to redeem.

Sometimes the notes passed at a discount that represented the possibility that they would be dishonored. And the discount varied with the distance from the bank and its reputation for soundness. The congressionally chartered First and Second Bank[s] of the United States were able to issue such notes on a national scale through branches throughout the country. These notes were not legal tender, but tended to pass at par with no discount (i.e., at face value).[16] By presenting for redemption the notes of state-chartered banks that it received from customers, the Bank of the United States was able to help state bank notes remain at par as well.[17]

Banks were not always able to keep their promise to redeem notes, however, even when the banks were solvent. When unusually large numbers of customers presented notes for redemption, the demand for gold and silver exceeded what the banks had on hand. Periodic financial crises led to suspension of convertibility of notes. In such periods, paper money and metallic money diverged in value, and one was no longer a perfect substitute for the other.

Circulating Treasury Notes

Starting for the first time during the War of 1812, the Treasury issued Treasury notes that promised to pay gold or silver at a future date. These were in many ways indistinguishable from other forms of Treasury debt, because they typically bore interest.[18] The notes, however, were especially suited to be used in transactions, and therefore were used as money even though they were *not* legal tender.

[16] The notes of the first and second Bank of the United States were receivable by the government for payment of taxes and dues, which explains their tendency to circulate. This receivability feature is not the same thing as legal tender status.

[17] By having notes regularly presented to them for redemption, the state banks were disciplined, and had to take greater care not to over issue their notes.

[18] There were a few of issues that either did not bear interest or bore only a nominal rate of interest. In one instance, the notes took the form of receipts for taxes paid. In another case, they were redeemable on demand, making them similar to bank notes.

Notes that circulated usually were of denominations low enough to be useful in commerce, were the same general size as bank notes, and—most important—were receivable for taxes. The receivability feature guaranteed that they were always worth at least their face value. This meant that while the notes were not convertible into gold or silver on demand, they could satisfy obligations that would otherwise be paid with gold and silver, making them virtually equivalent to coin. Treasury notes of this type were issued at various times until the Civil War.

Bills of Exchange

In mercantile circles, large commercial transactions were often settled with bills drawn on other merchants. Bills of exchange were directives to a merchant or firm in another place to pay over to someone a certain sum on or after a given date. They were drawn on a merchant who held balances owed to the drawer or who had extended credit to the drawer of the bill.

Once paid to one merchant in a transaction, they were often used in payment in turn to another. They could be indorsed like a check and were considered fairly secure because any indorser of the bill could be held responsible for the debt if the bill were not honored. They were particularly important in foreign trade, enabling large transactions to take place without having ship gold or silver back and forth across the ocean. Like bank notes, they economized on the use of gold and silver, permitting debits and credits among many merchants to be canceled out against each other, with only the net balance needing to be transferred in the form of coin.

Fiat Paper Money: 1862-1879[19]

Under the fiscal pressures produced by the Civil War, the U.S. government issued Treasury notes of the type described above, as well as some convertible into gold and silver. But the government soon found it hard to maintain convertibility. Banks also suspended convertibility. In 1862, therefore, the government issued for the first time notes that were not convertible either on demand or at a specific future date, and that were declared legal tender.[20]

Known as "greenbacks," these notes were legal tender for everything but customs duties, which had to be paid in gold or silver.[21] The government made no specific promise to convert such notes to gold or silver. Hence, *it abandoned the gold standard*. Holders of greenbacks could obtain gold or silver in the marketplace, but one dollar in greenbacks could no longer buy 23.22 grains of gold because the government no longer stood ready to maintain the dollar at its mint price.

Greenbacks were issued in such large quantities that the United States experienced a substantial inflation during the course of the war. Just as occurred in the decades before, fractional silver currency disappeared because it was worth more in foreign trade than its face value. There were private issues of paper fractional currency, but these were subsequently outlawed. The

[19] Fiat money is money without intrinsic value that is used as money because of government decree.

[20] Collectively known as the "Legal Tender Acts" or "Greenback Acts," 12 Stat. 345, February 1862; 12 Stat. 532, July 1862; 12 Stat. 709, March 1863. In addition, some interest-bearing legal tender notes were authorized by legislation in 1863 (12 Stat. 709).

[21] Interest on the government's debt was also paid in gold.

government issued postage stamps for fractional currency, and subsequently fractional currency of its own.[22]

After the war was over, Congress determined to return to the metallic standard at the same parity that existed before the war.[23] To do this, the market exchange rate of greenbacks for gold had to be brought back to its old level. This was accomplished by slowly removing the greenbacks from circulation. This was an off-and-on effort, with notes removed, held steady, and even returned to circulation. In 1875, it was decided to reduce their number to $300 million.[24] In 1878, however, their number was frozen at about $347 million, where it remained for a century.[25]

Parity between the greenback and gold dollars was achieved in 1879, returning the United States to a metallic standard. The government stood ready to pay its debts in gold, accept greenbacks for customs, and to redeem greenbacks on demand for gold. Greenbacks were perfect substitutes for gold coins. The government had returned to a gold standard; but two important changes had taken place with respect to paper money: (1) the government now was an issuer of paper money redeemable on demand and (2) the paper money was legal tender.

A True Gold Standard: 1879-1933

Although much of the monetary debate of the 1870s was about ending the paper money standard and reestablishing gold convertibility, a relatively minor recodification of law in 1873 turned out to have enormous implications for the monetary system.[26] In defining the dollar and the coins of the United States, the legislation omitted the 412.5 grain silver dollar. Consequently, it eliminated silver as anything but fractional currency. What followed was the only period in U.S. history that can strictly be called a gold standard: 1879-1933.

Silver and Silver Certificates

At the time the legislation was enacted, silver had not played a significant role in circulation (except for subsidiary coins) for almost four decades, so that the law had no immediate impact. However, within a few years after the law was passed, the market price of silver was falling rapidly, and restoration of a silver dollar at the old mint ratio would have meant that silver, not gold, would again be the circulating currency. Thus, the 1873 legislation prevented the country from shifting to a de facto silver standard.

---

[22] An act to authorize payments in stamps and to prohibit circulation of notes of less denomination than one dollar, 12 Stat. 592, July 1862; an act to provide ways and means for the support of the government, 12 Stat. 709, March 1863.

[23] An act to amend an act entitled "An Act to provide Ways and Means to support the Government," 13 Stat. 468, April 1866; an act to strengthen the public credit, 15 stat. 1, March 1869; an act to provide for the resumption of specie payments, 18 Stat. 296, January 1875, known as "The Resumption Act."

[24] An act to provide for the resumption of specie payments, 18 Stat. 296, January 1875.

[25] An act to forbid the further retirement of United States legal-tender notes, 20 Stat. 87, May 1878. The provision was effectively repealed by a general recodification of Title 31 of the U.S. Code in 1982 (96 Stat. 980), leaving only a ceiling amount of $300 million.

[26] An act revising and amending the laws relative to the mints, assay-offices, and coinage of the United States, 17 Stat. 424, February 1873. This is sometimes referred to as "The Crime of '73."

Once aware of the repercussions of the 1873 act, silver producers and advocates of cheaper money agitated in favor of restoring silver to its previous status. In 1878, legislation was enacted[27] that called on the Treasury to purchase and mint a certain quantity of silver into dollars each year. It further permitted persons to deposit with the Treasury quantities of silver coins for which they would receive "silver certificates," which, although not legal tender, were receivable for taxes, and therefore suitable for circulation. In 1890,[28] the provisions under which silver was purchased was changed somewhat. In addition, a new feature was added: silver certificates could be redeemed for gold.[29]

Because of the fall in the value of silver, the silver dollars and certificates under this legislation—like the silver subsidiary coins—had a metallic value on the world market much less than their mint value. The difference in the value ("seignorage") was captured by the government as it bought the silver at market value and paid out the coins at the higher face value. Hence, the value of silver money was like that of the remaining greenbacks: held at artificially high levels by government fiat, but coexistent with a gold standard because the issue of silver dollar coins and silver certificates was limited.

Gold Certificates and Treasury Notes

In addition to issuing full-bodied gold coins, the government during this period also issued gold certificates. Essentially, these were promises to pay gold to the holder of the note on demand. They provided the public with money that was easier to carry and transfer. The law specified the amount of gold that had to be held in reserve for the notes.

Treasury notes were re-created by the 1890 legislation. They were issued upon the security of silver in the Treasury, based on its market value at the time of issuance. They were redeemable for silver on demand based on the market value of silver at the time of redemption. They were made legal tender. Their legal tender character, and their non-interest bearing nature, made them unlike the Treasury notes issued earlier in U.S. history.

National Bank Notes

Another significant change had occurred during the Civil War: the creation of the national bank system. The federal government instituted a system of chartering banks.[30] These banks, like the state banks before them and the Bank[s] of the United States, had the power to issue their own notes.

However, the notes had to be backed up by government bonds held on deposit with the Comptroller of the Currency. Because the bonds earned interest and the notes did not, banks made

[27] An act to authorize the coinage of the standard silver dollar and restore its legal-tender character, 20 Stat. 25, February 1878. This is known as the "Bland-Allison Act."

[28] An act directing the purchase of silver bullion and the issue of Treasury notes, 26 Stat. 289, July 1890. This is known as the "Sherman Silver Purchase Act."

[29] The 1890 act was repealed in November 1893 (an act to repeal a part of an act approved July 14, 1890, entitled "An act directing the purchase of silver bullion and the issue of Treasury notes," 28 Stat. 4).

[30] An act to provide a national currency, secured by a Pledge of United States Stocks, and to provide for the circulation and redemption thereof, 12 Stat. 665, February 1863; replaced by an act of the same title, 13 Stat. 99, June 1864.

profits from the issuance of bank notes. The notes were not legal tender, but passed readily at their face value because they were redeemable in gold or legal tender notes. The quantity issued was limited by the amount of government bonds eligible to be held as collateral.[31]

State bank notes were driven out of circulation by means of a punitive tax of 10% imposed on them. The new national bank notes were of uniform design. Thus, soundly backed by safe assets, these notes provided a safe and uniform—but still privately issued—paper currency for the country.

Gold Standard Act of 1900

The government's continued flirtation with silver after 1873 generated concerns that it might restore the dual gold and silver standard in which dollar debts could be discharged with 371.75 grains of pure silver. With silver approaching half its previous value in gold, the possibility of restoring the bimetallic standard made holding dollar claims risky. International investors watched the U.S. Treasury for any signs that it might pay debt service in silver—even at the market rate. This generated market instability whenever customs duties (the government's main source of revenue and gold) decreased.

In 1900, the government reaffirmed its commitment to the gold standard.[32] The gold dollar was declared the standard unit of account, and all forms of money issued by the government were to be maintained at parity with it. For the first time, a gold reserve for government-issued paper notes was formally established. Greenbacks, silver certificates, and silver dollars continued to be legal tender, and were redeemable in gold. Treasury notes were discontinued and recalled.

The Federal Reserve System During the Gold Standard

By the end of the 19th century, another form of money had become increasingly common: checks. Although checks had existed for centuries, state banks—compensating for the loss of their ability to issue notes—innovated them further. Improvements in transportation and communication, and the growth of clearinghouse associations, made it possible to use them in transactions between customers of different banks, and to some extent different regions of the country.

Checks functioned much the same as banks notes had: they permitted the public to conduct business with a smaller amount of coin and legal tender than they would have otherwise. Only a fraction of the money placed in checking account deposits had to be kept on hand or on deposit with clearing agents. Most transactions were settled by canceling debits against credits.

Checks also suffered from the same defect that bank notes had earlier in the century: banks were prone to periodic runs by customers demanding cash from their checking accounts. Because banks only kept a limited supply of legal tender and bank notes at any given time, these massive conversions of accounts for cash created crunches and sometimes caused banks to fail. The failure

---

[31] Initially, they were also limited by law not to exceed a certain sum.

[32] An act to define and fix the standard of value, to maintain the parity of all forms of money issued or coined by the United States, to refund the public debt, and for other purposes, 301 Stat. 45, March 1900. This is known as the "Gold Standard Act."

(or potential) failure of banks and losses from uninsured deposits created that much more incentive for depositors to withdraw their funds, producing more bank runs.

These periodic banking panics were symptomatic of a less dramatic but more regular problem: the seasonal variation in the need for currency for transactions. The system of gold and legal tender notes was not elastic, and it was subject to money "shortages" especially at harvest time.

In 1913, this problem was addressed by the creation of the Federal Reserve System (Fed).[33] The Fed was to remedy the situation in a two ways. First, it would provide a means by which banks could borrow in times of stringency to satisfy their customers' demand for cash. Second, it could create a new form of money, Federal Reserve notes, which could be expanded or contracted in quantity to respond to the need for more cash.

The creation of the Federal Reserve had little if any effect on the gold standard. The dollar was still defined in terms of gold. Federal Reserve notes were redeemable in lawful money. The Fed not only operated under the gold standard, but was charged with maintaining it, and kept a percentage of gold cover for its notes. Gold still dictated the value of the dollar.

Much of the world was forced off the gold standard during World War I. Under the Fed, the United States remained on the gold standard through the war.[34]It took several more years after the war before other major countries restored their currency to gold convertability. This was largely completed by 1927.

The End of the Gold Standard: 1933

In 1933, the gold standard was ended for the United States. Despite the creation of the Fed, a wave of bank runs resulted in massive bank failures over the period 1930-1933. The Fed failed to provide sufficient liquidity to enable the banks to meet their customers' demands for cash.

This failure was due in part—and possibly largely—to the gold standard. For the Fed to generate enough cash to meet the public's changed demand for it, it would have had to create much more money and to lower interest rates. Lower interest rates, however, would have sped up the export of gold from the country as investors looked abroad for higher returns. Creating more paper money, moreover, would have created doubts about the ability of the United States to remain on gold. The greater these doubts, the greater the incentive to export gold, reducing gold reserves, and making it harder to maintain the dollar at its legal gold value. Hence, to keep the economy from collapsing, the Fed needed a policy of expansion. To stay on the gold standard, it needed one of contraction. Until 1933, it largely went with the latter.

With the inauguration of Franklin Roosevelt, the government's policy changed. In a series of executive orders, legislative actions, and court decisions, the United States was taken off the gold standard. Convertibility into gold was suspended. Private holdings of gold were nationalized. A new parity with gold was established amounting to a devaluation of approximately 40%. This parity was only important for international transactions, however. Because Americans could not

[33] The Federal Reserve Act, 38 Stat. 251, December 1913.

[34] For a short time during the war, the government regulated the export of gold, resulting in something less than a true gold standard.

hold gold, their dollars were not convertible. The gold value of the dollar was largely meaningless. With no convertibility, the result was a quasi-gold standard.

Shortly after taking office, President Roosevelt closed the banks in order to stop the bank runs and the export of gold from the country. His order also prohibited the banks from paying out gold or dealing in foreign exchange.[35] He did this based on the Trading With the Enemy Act of 1917,[36] which gave him broad powers over banking and currency. Although the 1917 act appeared to confer these powers only in wartime, President Roosevelt acted on the basis of a "national emergency" and summoned Congress to a special session to prepare legislation to confer the powers he wanted to deal with the situation.

Three days later, Congress passed the Emergency Banking Act,[37] which amended the 1917 act to include national emergencies, retroactively approved the President's actions of the previous three days, and granted him power to regulate or prohibit the payment of gold. President Roosevelt promptly used these powers to continue the prohibition on gold transactions, even for banks that reopened.[38] By executive order, on April 5, 1933,[39] the "hoarding" of gold was forbidden. Gold had to be turned in to the government at the official price of $20.67 per troy ounce. Essentially, the country's gold was nationalized.

This action was endorsed by Congress in a joint resolution.[40] The resolution called for a suspension of the gold standard and abrogated gold clauses.[41] The Thomas Amendment to the Agricultural Adjustment Act of 1933 granted authority to the President to alter the gold content of the dollar, with power to reduce it to 50% of its previous value.[42]

In addition, the amendment gave the President power to authorize the issuance of up to $3 billion in U.S. notes, and the power to compel the Fed to issue money to finance up to $3 billion in government borrowing.[43] It also set out new conditions for the issuance of more silver certificates.

Under the authority of the Thomas Amendment, the market price of gold was allowed to increase to $35 by January 1934. At that time, the Gold Reserve Act[44] was passed, and the President thereby empowered to fix the new value of the dollar at not less than 60% of its previous value.[45] The Gold Reserve Act also gave legislative force to the nationalization of gold. Under its terms,

[35] Proclamation No. 2039.

[36] 40 Stat. 411, October 1917.

[37] An act to provide relief in the existing national emergency in banking, 48 Stat. 1, March 1933.

[38] Executive Order 6073.

[39] Executive Order 6102; this order was followed by a series of similar orders and proclamations over the course of the next few months.

[40] Joint resolution to assure uniform value to the coins and currencies of the United States, 48 Stat. 112, June 1933.

[41] Gold clauses had appeared in a number of bonds issued by the government and the private sector for many years prior to the joint resolution. They gave the lender the option of being paid in gold (or its value) at the earlier conversion rate. These were designed to protect bond holders from the kind of depreciation undertaken in 1933.

[42] Financing—and exercising power conferred by Section 8 of Article I of the Constitution: To coin money and to regulate the value thereof, 48 Stat. 51, May 1933.

[43] Neither power was ever exercised.

[44] Gold Reserve Act of 1934, 48 Stat. 337, January 1934.

[45] The value was fixed by proclamation on January 31, 1934.

title to all bullion and coin was vested in the U.S. government, gold coin was withdrawn from circulation, and the Treasury Secretary was given control of all trading in gold. Private holdings of gold were outlawed (except for numismatic and various industrial/artistic uses).[46]

In June 1934, the Congress passed the Silver Purchase Act.[47] The act called for at least one-fourth of the United States' monetary stocks to be held in silver, so long as the government did not have to pay more for the silver than its official monetary value. The silver could be coined or issued as silver certificates. Silver certificates were exchangeable for silver coin. Because the market value of silver was below its monetary value, this law provided for the issuance of a limited quantity of another form of what amounted to fiat money.[48]

The government's abrogation of gold clauses in contracts was upheld by the Supreme Court in February 1935.[49] Thus, the government could discharge all its interest and principal due in paper money. Because the dollar had depreciated due to official policy, it meant that the outlawing of gold clauses effectively reduced the amounts the government paid on its debts relative to what it would have paid in gold.

Quasi-Gold Standard: 1934-1973

Under the system adopted by the Gold Reserve Act of 1934, the United States continued to define the dollar in terms of gold. Gold transactions, however, were limited to official settlements with other countries' central banks. For an American citizen, the dollar no longer represented a given quantity of gold in any meaningful sense.

The gold standard without domestic convertibility was maintained under the Bretton Woods international monetary agreement of 1944.[50] Under this international agreement, the role of gold was severely constrained. Other countries' currencies were defined in terms of the dollar. Countries kept gold reserves and could settle accounts in gold, but were generally expected to settle balances with any other currencies that were freely convertible into foreign exchange. Countries typically used dollars to settle accounts; only limited amounts of gold were transferred across borders, and dollars were rarely converted into gold even in the international arena.

The International Monetary Fund was set up to assist in the exchange process and to provide foreign exchange to help nations keep their exchange rates fixed. Under the old international gold standard, a country with an overvalued currency would have lost gold and experienced deflation

[46] The profit from the devaluation allowed the Treasury to retire most of the remaining national bank notes by redeeming the federal bonds that backing them.

[47] Silver Purchase Act of 1934, 48 Stat. 117, June 1934.

[48] The conditions of purchase and value placed on the silver were to be set by proclamation. President Roosevelt set these by proclamation of August 9, 1934. The purchase price of the silver (about 64.65 cents per pound), while half the face value of the coins and certificates (about $1.2929), was still substantially higher than the market price of silver at the time of the proclamation. To capture the difference, the President called in all existing silver except that which was in coins and a limited amount for artistic purposes, paying approximately 50 cents per ounce.

[49] In Norman v. Baltimore and Ohio Railroad Company (294 U.S. 240; 1935), the court held that gold clauses in private contracts were constitutionally invalidated by the government's action. In Perry v. United States (295 U.S. 220; 1935), the court ruled that the government could not invalidate the gold clauses on its own bonds. However, it held that the plaintiff had not proven any monetary loss.

[50] Bretton Woods Agreement Act, 59 Stat. 512, July 1945.

until the currency was properly valued. Under Bretton Woods, this automatic adjustment was cushioned through credits that permitted a country to avoid deflating.

Although virtually all countries defined their currencies in terms of dollars, for a number of years, even major trading partners imposed exchange restrictions as "transitional" measures in order not to exhaust their reserves in an effort to maintain their official exchange rates. So in important respects, many currencies were still effectively inconvertible. It was only in the late 1950s that the major trading countries finally dropped enough of their exchange restrictions that one could fairly say that they were on an international gold standard.

Almost immediately, there were problems for countries maintaining the value of their currencies relative to the dollar/gold. With convertibility playing so small a role in the system, there was little of the automatic discipline which under the old gold standard forced countries' underlying currency values in line with official rates. Periodic currency crises were the result. The United States, in particular, because its currency was the key to the whole system, faced even less discipline in its monetary policy. Partly as a consequence, too many dollars were issued to keep prices stable or to keep the price of gold at its official level. A mild inflation developed.

Internationally, this meant that the dollar was becoming overvalued in the system: worth more officially than indicated by its relative buying power. Under the classic gold standard, this would have caused an outflow of gold from the United States, a fall in the money supply, and a return of the dollar's buying power to its official gold price. Under the Bretton Woods system, countries coordinated their efforts to maintain currencies at their official levels. Increasingly, other countries built up balances of dollars rather than convert them to gold. Meanwhile, the United States was getting closer to the legal limit on currency that could be outstanding on the gold stock that was held in reserve.

Domestically, U.S. inflation raised silver prices enough that the market value of silver in silver certificates and coins was approaching the mint value.[51] The United States was beginning to have difficulty keeping enough coins and silver certificates in circulation. The certificates presented a problem because they were the principal form of small-denomination currency. In 1963, Congress repealed the Silver Purchase Act and granted the Federal Reserve authority to produce Federal Reserve notes in $1 and $2 denominations.[52] The Kennedy Administration quickly made arrangements for the gradual retirement of the silver certificates, thereby freeing up the government's silver holdings for use as coins.[53]

As inflation continued, it was apparent that full-bodied silver coins would soon be impossible to keep in circulation. In 1965, Congress authorized the minting of clad coins of copper and nickel to replace the existing silver coins.[54] In 1965, the requirement to hold gold reserves against Federal Reserve deposits was repealed.[55] In 1968, the requirement to hold gold reserves against Federal Reserve notes was repealed.[56]

---

[51] A process exacerbated increases in the demand for silver for industrial uses.

[52] An act to repeal certain legislation relating to the purchase of silver, 77 Stat. 54, June 1963.

[53] Executive Order 11110, June 4, 1963.

[54] Coinage Act of 1965, 79 Stat. 254, July 1965.

[55] An act to eliminate gold reserves against Federal Reserve deposits, 79 Stat. 5, March 1965.

[56] An act to eliminate the gold reserve against Federal Reserve notes, 82 Stat. 50, March 1968.

Cutting the Links to Gold: 1967-1973

Although there was no private market for gold in the United States, such markets did exist abroad. By the late 1960s, prices in these markets were tending to deviate from official currency prices. The United States and other countries tried to combat this through a series of market interventions in which sizable amounts of the official gold stock were sold. In 1968, these "gold pool" arrangements collapsed. A new policy was adopted in which the private market price of gold would be allowed to deviate from the official settlements price. This made the international monetary arrangement a gold standard in name only.

It was also necessary for the United States to avoid large official settlements in gold. Through diplomatic channels it was made clear that other countries could not expect to redeem large quantities of dollars for gold. This "closing of the gold window" was not an official action, so that it did not constitute an official abandonment of gold. Nor was it an absolute prohibition on gold redemption. However, what had previously been routine became a matter of negotiation.

In August 1971, the Nixon Administration announced that it would not freely convert dollars at their official exchange rate. The measure was intended to be temporary. The gold price of the dollar and official rate of exchange into other currencies were not changed. The intention was to put pressure on other countries to revalue *their* currencies (and make other concessions). The country did not officially move to a "floating" rate. With no official conversion or redemption taking place, the dollar floated by default.

After a series of negotiations, the "Smithsonian Agreement" was reached in December 1972, by which the dollar would be devalued from $35 per troy ounce of gold to $38 while several other countries revalued their currencies upward. This new value was made official by an act of Congress in March 1972.[57] The new price was the official price of the dollar, and policies were pursued to maintain the dollar's value relative to other currencies. However, there continued to be no convertibility into gold—even for international transactions. The $38 price was the official price at which the United States neither sold nor purchased gold.

Within a year, it became impractical to maintain the new exchange rate. To do so would have required the United States to redeem more dollars than it had in gold and foreign currency reserves, or to contract the economy to increase the purchasing power of the dollar. In February 1973, the Treasury agreed to devalue the dollar to $42.22 per troy ounce of gold. Within two weeks of the second devaluation, it again became impractical to hold the rate. At that point, despite efforts to reach a new monetary agreement, the dollar was left to float.

The new $42.22 par value was made official in September 1973, long after it had been de facto abandoned.[58] The official rate was never maintained. In October 1976, the government made official what was already true in reality: the definition of the dollar it terms of gold was removed from statute.[59] The monetary system officially became one of pure fiat money.

---

[57] Par Value Modification Act, 86 Stat. 116, March 1972.

[58] An act to amend the "Par Value Modification Act," 87 Stat. 352, September 1973.

[59] An act to provide for amendment of the "Bretton Woods Agreement Act," 90 Stat. 2660, October 1976.

Conclusion

This brief history, although essentially factual in nature, yields a number of observations relevant to claims about the gold standard. U.S. monetary history is not one of steady commitment to gold suddenly abandoned in favor of a fiat standard. Nor were the metallic standards of the 19th and early 20th centuries without paper money or other characteristics abhorrent to some advocates of gold.

First, a genuine gold standard existed only from 1879 to 1933. Prior to that was a bimetallic standard in which silver was dominant from 1792 to 1834, a bimetallic standard with gold dominant from 1834 to 1862, and a fiat money system from 1862 to 1879. After 1933, it was a quasi-gold standard that gradually became a pure fiat standard over the period 1967-1973.

Second, even under the gold standard, the United States had paper money. For most of the time the standard was in operation, this money was issued by banks. Until the Civil War, none of the paper money was legal tender; yet, it circulated. Moreover, the gold reserve behind paper money was never more than a fraction of the total. This is a common characteristic of metallic standards.

Third, a metallic standard is no guarantee against currency devaluation. The definition of the unit of account can be changed. This was demonstrated by the currency depreciation of 1834, which occurred without ever leaving the standard. Similarly, under a bimetallic standard, depreciation can occur as a consequence of the changing availability of the two metals.

Fourth, even under a metallic standard, the United States issued legal-tender coins that were less than full-bodied. As early as 1853, coins were minted with less silver than called for by the official mint ratio.

Fifth, the Federal Reserve system did not replace the gold standard. The Fed operated under the gold standard for nearly 20 years. A central bank and a metallic standard are not mutually exclusive. Indeed, central banks historically were set up to help the gold standard operate.

Sixth, the classic gold standard ended in 1933; what followed was only a partial—and not full—gold standard. A definition of a dollar as a given amount of gold does not make a real gold standard. A genuine metallic standard is one in which the public is able to freely shift gold from exchange to other uses, and paper issued by the government freely convertible into gold.

Seventh, the final move to a fiat money was not deliberate or purposeful. It occurred by default as links to gold became impossible to maintain. Nor did the final abandonment of gold occur suddenly or cleanly. The United States began to halt its redemptions of dollars into gold for international transactions in 1967 and 1968. The actions of 1971 and 1973 were not the adoption of floating exchange rates and fiat money, but the loss of the ability to redeem dollars at a fixed price. Floating occurred by default.

Author Contact Information

Craig K. Elwell
Specialist in Macroeconomic Policy
celwell@crs.loc.gov, 7-7757

Acknowledgments

G. Thomas Woodward, a former specialist in Macroeconomics, Economics Division, originally authored this report.