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Gold: Uses of U.S. Official Holdings

name redacted
Specialist in Macroeconomics
Government and Finance Division

Summary

For centuries nations have accumulated gold as a symbol of wealth and power. Gold was once also of practical value as a medium of exchange and until recent times provided a commodity backing to most paper currency. Recent decades have seen a steady erosion of gold's economic significance. Nevertheless, the U.S. government continues to hold a sizable stock of gold. What is this stock used for? Although there continues to be some confusion about the role of government agencies and other institutions with relation to the gold stock, gold is little used. The U.S. Mint, the principal custodian of the government's gold holdings, engages in minor gold transactions associated with producing and selling commemorative coins. The Federal Reserve Bank does not own or have market transactions in gold, but it does facilitate the "monetization" of U.S. gold holdings, through its gold certificate account. The Exchange Stabilization Fund, an agency of the Treasury Department, no longer undertakes actions that use gold, and gold is not used as the basis of the Treasury's Special Drawing Rights. The "gold standard" that established a gold backing for the dollar ceased for domestic purposes in the 1930s and for international purposes in the 1970s. The continued willingness of the U.S. government to hold a large underutilized stock of gold is, perhaps, best understood as a hedge against times of severe economic crisis when paper assets could be useless. This report will not be updated.

Introduction

In early 2002 the U.S. government owned nearly 262 million fine troy ounces of gold.[1] That is about half the size of the stock held in the early post-war years. Steady reductions through the 1950s and 1960s brought the gold stock to its current size by the early 1970s. There has been little change in the size of U.S. gold holdings since that time. The U.S. has the largest public holdings of gold, more than double the holdings of Germany and the International Monetary Fund (IMF), who have the second and third largest official gold holdings respectively.

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[1] A fine troy ounce is equal to about 1.097 standard (or aviordupois) ounces. A troy ounce is therefore heavier than a standard ounce. In this report all references to ounces are fine troy ounces.

The U.S. gold stock is managed by the U.S. Mint, a bureau of the U.S. Treasury Department. The Mint's gold holdings are stored at seven locations around the country. About 94 % of the gold stock, or about 245 million ounces, is held in three "deep storage" facilities at, Fort Knox, KY; West Point, NY; and Denver, CO. Much smaller amounts, totaling about 9,000 ounces, are held among the mint in Philadelphia, PA, at an offsite warehouse, and the U.S. Mint headquarters in Washington. In addition to Mint holdings, the Federal Reserve Bank's New York branch holds about 13 million ounces of gold for the Treasury.

The vast majority of the U.S. gold stock, or about 259 million ounces, is in the form of bullion, and the remainder, or about 3 million ounces is in gold coins. By law, the U.S. gold stock is valued on the government's books at $42.22 per ounce, for a total value of slightly more than $11 billion in early 2002. [2] The current free market value of the U.S. gold stock would be about $77 billion, at a market price of gold of $300 per ounce.

Table 1. U.S. Official Gold Holdings
(At book value, in millions of dollars)

1996	1997	1998	1999	2000	2001
11,048	11,047	11,047	11,046	11,048	11,046

Source: U.S. Treasury Department

What is the U.S. Gold Stock Used For ?

The short answer is: not very much. For clarity, however, let us examine several government operations, including some that are sometimes thought to use gold.

The U.S. Mint. If one looks at the data on gold stock holdings of the U.S. Mint, one will see that the size of the gold stock, while generally stable, does fluctuate slightly. This small movement occurs in a component of the U.S. gold stock called the "working stock." This is gold that is acquired and used to make various commemorative coins mandated by the U.S. Congress to honor people, places, and historical events (e.g., a recent issue commemorates the 2002 winter Olympic games).

Gold is purchased, it is transformed into coins, and the coins are sold to the public. As these transactions occur, the gold stock will fluctuate accordingly. Fluctuations in the "working stock" amount to only one or two million dollars each year. The U.S. Mint's gold holdings are audited each year by the Department of the Treasury's Office of Inspector General.

[2] This book value price was established in 1973. At its inception this price was a meaningless vestige of the Bretton Woods system of international payments that had been effectively abandoned in 1971. But it remains the accounting convention for valuing U.S. official gold.

The Federal Reserve. The Federal Reserve system owns no gold and conducts no official transactions using gold. The Fed does hold gold for others, however. As noted above, the Fed holds a small amount of gold for the Treasury, but it also holds a stock of what is called "earmarked" gold that is held in custody for other official entities such as foreign governments and central banks. Earmarked gold is all held at the New York branch of the Fed and is not counted as part of the official U.S. gold stock. It is valued at the U.S. official price of $42.22 and currently totals nearly $9 billion. The stock of earmarked gold has fallen substantially in recent years.

A possible source of confusion about the Fed's use of gold is the "gold certificate account" on the Fed's balance sheet, currently valued at $11.04 billion. This account comprises certificates that have been issued to the Fed by the Treasury and each is backed by an amount of the gold held by the Treasury. For each gold certificate issued, the Fed, in turn, credits the Treasury's deposit account at the Fed by an amount priced at the statutory gold price of $42.22 per ounce. Through this intra-governmental transaction the Treasury acquires cash backed by an otherwise idle asset. This practice is called "monetizing" the gold stock, and occurs without the government selling or lending any of its gold stock on the open market. Nor is ownership or control of any of the gold stock transferred from the Treasury to the Fed. The Treasury has in effect created an intra-governmental "mortgage" on its gold holding to gain an improved liquidity position.

Currently the U.S. gold stock is fully monetized, with the Fed's gold certificate account equal to the legal value of the official U.S. gold stock, or about $11 billion. If the Treasury acquires more gold, then more gold certificates could be issued. If gold holdings fall, the Treasury must redeem an equal value of gold certificates from the Fed, reducing the Treasury's deposit at the central bank. If the rule for valuing the gold holdings changes (e.g., an increase in the official $42.22 price), so could the level of gold certificates.

Because the gold stock does not exhibit much fluctuation in volume or value, neither does the Fed's gold certificate account. This is the Fed's only operational link to the gold stock and it does not involve any market transaction in gold.

The Exchange Stabilization Fund. The Exchange Stabilization Fund (ESF) is an agency of the U.S. Treasury created in 1934 to stabilize the exchange value of the dollar on world markets. In recent years the ESF has also been used to fund foreign economic support programs. The resources of the ESF include dollar denominated assets (e.g., cash and Treasury securities), assets denominated in foreign currencies (e.g., Euro and Yen), and special drawing rights (SDR). It uses these assets to buy and sell in foreign exchange markets with the intent of influencing the dollar and other currencies' international exchange value. Over its history the ESF has dealt in gold, but has not owned or transacted in gold since 1978.

A possible source of confusion over the ESF's connection to gold is the use of the SDR holdings. The SDR is an artificial international reserve asset that was created by the International Monetary Fund (IMF) in 1969, and allocated to each member to supplement its international reserves. The value of the SDR was once based on the price of gold, but is now determined in reference to a basket of international currencies. While the SDR was at one time referred to as "paper gold," it does not represent any claim on gold held by the

IMF or any of its members. By law the ESF is the holder of the U.S. allocation of SDRs. In practice the U.S. has little need for the SDR to settle its international payments, but it does make use of its SDR assets by transforming them into a more liquid and more useable form.

In a maneuver similar to the Treasury's use of its gold holdings, the ESF has a relationship with the Fed that allows it to monetize its SDR assets. In an amount up to the current dollar value of the SDR holdings, the ESF can issue to the Fed an SDR *certificate* that is a claim against the SDR assets. The Fed, in turn, transfers to the ESF a dollar denominated asset (e.g., cash or Treasury securities) which the ESF can spend more readily in its foreign exchange dealings. SDR certificates will then appear as an asset on the Fed's balance sheet, but as a liability on the ESF's balance sheet.

The ESF's use of this arrangement increases and decreases with its need for dollar denominated assets. If the need for such assets falls, the ESF will buy the SDR certificates back from the Fed, exchanging cash or Treasury securities for the SDR certificate. In the mid 1990s the ESF had fully monetized its SDR holdings, generating an SDR certificate account worth about $9.2 billion. In recent years, however, with few liquidity problems, the ESF has moved to reduce its SDR certificate obligations, steadily buying those certificates back from the Fed, bringing the account balance down to $2.2 billion in 2001. The Fed, in turn, has received an inflow of cash and Treasury securities and an outflow of SDR certificates. These transactions are purely internal to the U.S. government, do not affect any private market, and do not involve any transactions in gold.

The Gold Standard. The current U.S. monetary system is based on the use of paper money that is backed only by the "full faith and credit" of the federal government. This so called "fiat" currency is not valued in or convertible to gold or any other precious commodity. This has not always been the case. Over most of its history the U.S. has been on some type of metallic standard. Paper money proliferated under these metallic standards, but was most often valued and redeemable in some amount of gold or silver. By 1879 a true gold standard emerged, in which the U.S. currency was effectively valued and convertible exclusively in terms of gold. The Gold Standard Act of 1900 marked the official adoption of a gold standard, valuing the currency at $20.67 per ounce of gold.[3]

The pure gold standard ended with the Great Depression. In 1933 the federal government faced a severe banking crisis with a high risk of widespread runs on banks and, in turn, on the gold stock. Another economic problem needing resolution at this time was that adherence to the gold standard for international payments precluded pursuing the policy of strong monetary stimulus that the economy needed to help break the grip of economic depression. Monetary stimulus lowers interest rates and this would tend to accelerate the export of gold as investors look for higher yields abroad. In addition, the creation of more currency would tend to undermine confidence in the convertibility of dollars into gold. Together these forces would make it more difficult to maintain the dollar

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[3] *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. Also known as the "Gold Standard Act".

at its legal gold value. Maintaining the gold standard imparted a strong contractionary bias to domestic economic policy.

What emerged in 1934 was what has been called a "quasi' gold standard. The dollar was devalued in its gold content to $35 per ounce. This devaluation in the gold value of the dollar gave the Fed some room for applying monetary stimulus to the struggling economy. However, convertibility into gold applied only for official international transactions. Domestic convertibility was ended and ownership of all gold bullion and coin was vested in the Treasury Secretary.[4]

This quasi gold standard endured into the 1970s. In practice only limited amounts of gold were transferred under this system, since countries largely relied on currencies that were readily convertible into foreign exchange to settle payment balances. In the post-World War II era of rapidly expanding international trade, the currency of choice was most often the dollar. However, U.S. economic policies over this period led to such a substantial accumulation of foreign holdings of dollars that confidence in convertibility to gold at the legal par value was ultimately undermined. The U.S. government steadily moved away from redeeming dollars for gold in international transactions. Attempts to reconstitute this system failed. In early 1973 the Treasury devalued the dollar to $42.22 per ounce, but no attempt was made to maintain the new parity and the dollar was left to float in its international value as it continues to do today. In 1975 citizens were again allowed to own gold. In 1976 the government officially removed the definition of the dollar in terms of gold from statute[5].

Conclusion

For the last 30 years the public gold stock has not played any important role in the domestic or international monetary affairs of the nation. Events had steadily pushed the government to the realization that tying the currency to gold had proved to be a significant impediment to providing the liquidity a growing economy needed and exposed the economy to periodic crises. Moreover it was becoming clear that maintaining stable monetary conditions (i.e., keeping inflation low) did not hinge on a linking of the currency to gold.

Gold, while not actively used as a monetary medium, does remain a significant reserve asset for the United States (particularly if valued at the much higher market price). However, the U.S. has shown no inclination to substantially increase or decrease its gold holdings over the last 30 years. In the mid-1990s several European governments did sell off some of their gold holdings in an effort, as they saw it, to make better use of an underutilized asset. But this practice largely ended in 1999 when most major central banks agreed to limit gold sales to no more than 400 tons per year for the five years ending in

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

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

2004. That agreement is also a re-affirmation by these nations of an on-going commitment to holding sizable reserves of gold.[6]

Why continue to hold an asset that would not seem to be earning the highest possible financial return? One can conjecture that most nations still see gold as the ultimate form of payment and therefore holding significant amounts of gold will continue as a last-ditch hedge against economic catastrophe. In times of severe crisis fiat money could be shunned, while gold is always likely to be accepted.

[6] An agreement reached in Washington D.C. by the European Central Bank and the central banks of 14 European countries on September 26, 1999.