

MEMORANDUM OF DISCUSSION

A meeting of the Federal Open Market Committee was held on Wednesday, March 7, 1973, at 12:30 p.m., at the call of Chairman Burns. This was a telephone conference meeting, and each individual was in Washington, D.C., except as otherwise indicated in parentheses in the following list of those participating:

PARTICIPATING: Mr. Burns, Chairman<sup>1/</sup>  
Mr. Hayes, Vice Chairman (New York)  
Mr. Balles (San Francisco)  
Mr. Brimmer  
Mr. Bucher  
Mr. Daane  
Mr. Mayo (Chicago)  
Mr. Mitchell  
Mr. Morris (Boston)  
Mr. Robertson

Mr. Holland, Secretary  
Mr. Broida, Deputy Secretary  
Mr. Altmann, Assistant Secretary  
Mr. Hackley, General Counsel  
Mr. Partee, Senior Economist  
Mr. Axilrod, Economist (Domestic Finance)  
Mr. Bryant, Associate Economist  
Mr. Holmes, Manager,  
System Open Market Account (New York)  
Mr. Coombs, Special Manager,  
System Open Market Account (New York)

Mr. Reynolds, Associate Director,  
Division of International Finance,  
Board of Governors

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<sup>1/</sup> Entered the meeting at the point indicated.

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Mr. Holland observed that Chairman Burns had been unavoidably detained and that Vice Chairman Hayes would preside until Chairman Burns arrived.

Mr. Hayes noted that, as the members had been informed, Chairman Burns would be joining Secretary Shultz at a meeting on current international monetary problems to be held in Paris on Friday, and he had called today's meeting for the purpose of consulting with the Committee prior to his departure for Paris. Mr. Hayes asked whether Mr. Holland had anything to add with respect to the background and purposes of the meeting.

Mr. Holland said it was not contemplated that any proposals for action would be put to the Committee at this meeting; the purpose, as Mr. Hayes had suggested, was simply to provide an opportunity for the Chairman to consult with the members--that is, to exchange information and views, and to answer any questions they might have. It was perhaps unnecessary to stress the confidentiality of the matters to be discussed. He might mention, however, that because of the security problems associated with a telephone conference meeting, some of the responses to questions might be less full than they would be in the customary type of meeting.

Mr. Hayes then asked Mr. Coombs to provide the Committee with some background information on conditions in the foreign exchange market at present.

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Mr. Coombs remarked that the second devaluation of the dollar last month and the subsequent breakdown of the new parity structure had had a shattering effect on confidence in the dollar throughout the world. All of those holding, lending, or even invoicing dollars had been taught a harsh lesson, and their main concern now seemed to be to eliminate further risk on that score. Moreover, the credibility of official statements had plunged to a new low on both sides of the Atlantic.

Mr. Coombs observed that during the past week the Europeans had made a major effort to put together some kind of joint float, but that effort did not appear to have been successful, at least so far. The British and Italians wanted their currencies to remain on an individual floating basis, and the French apparently did not want to float at all. He did not know the official U.S. view on that matter.

All of the major central banks had withdrawn from the foreign exchange market, Mr. Coombs continued, and exchange rates were moving erratically in an atmosphere of extreme uncertainty. Spot quotations were abnormally wide and only small commercial orders were being handled in a routine fashion. Activity in the forward market was down to minimum levels; premiums on one-month forwards in a number of European currencies ranged between 10 and 15 per cent, with most quotations fairly nominal.

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New and much more severe measures were being taken to restrict foreign transfers of dollars into the Netherlands and Belgium, Mr. Coombs said. If exchange rates were permitted to continue floating over coming weeks, it seemed to him all too likely that there would be a proliferation of exchange controls, probably directed in an increasingly discriminatory way against the dollar. When there had been similar breakdowns of the international financial system in the past, such exchange controls had invariably bred controls on trade as well. In general, he thought that the existing situation was serious if not dangerous, and that if it were allowed to persist it would probably become worse rather than better.

In response to a question by Mr. Hayes, Mr. Holland said he could provide certain information regarding the Paris meeting that Chairman Burns wanted to have transmitted to the Committee. On the subject of government policies, it was not yet possible to say what position would be taken by the United States; that position was still being developed. Nor was it possible to say what the other countries represented at the meeting would urge for themselves, on each other, or on the United States. As Mr. Coombs had noted, the Europeans had made the political decision to try to work out a Common Market float but seemed not to have succeeded. Whether they would renew those efforts was

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a matter of conjecture; but in the unlikely event that they were successful in launching and maintaining such a float, no Federal Reserve action would be involved.

However, Mr. Holland said, one at least hypothetical possibility--and he would underscore the word "possibility"--might be a decision during the Paris meeting to mount a firm multilateral defense of some range of currency values. As part of such a multilateral program, Federal Reserve intervention in exchange markets, using the proceeds of swap drawings, could emerge as a constructive element. The Chairman and the Special Manager had been in consultation on that subject with Treasury officials and with the members of the Subcommittee of the Open Market Committee. If decisions as to the size and timing of swap line actions and market intervention could practically be deferred until there was an opportunity for full discussion by the Open Market Committee, that would be done. On the other hand, if prompt decisions on those points proved necessary to the working out of a constructive multilateral agreement, and if the Treasury--speaking, in effect, with the President behind it--certified that such decisions by the Federal Reserve were in the national interest of the United States, the Chairman would expect to act and to instruct the Special Manager accordingly. The Chairman would, of course, take due account of the guidelines and limits set by the Committee's foreign currency authorization and directive, and he might attach additional limiting conditions that he deemed prudent.

Mr. Holland emphasized that such observations were entirely in the nature of contingency planning for actions that appeared at the present juncture to be no more than a possibility--and one for which the probability might be very low. As soon after the Paris meeting as time and circumstances permitted, Committee members would be informed of developments at the meeting and of any decisions that might have been reached there, and they would be asked to consider any proposals to them that might emerge and to cast any requisite votes.

Mr. Hayes asked whether the members had any questions or comments at this point.

Mr. Mayo said there was some uncertainty as to whether the latest speculation against the dollar was a consequence of inappropriate exchange rates or whether it simply reflected efforts by speculators to make a profit. He asked Mr. Coombs whether there was reason to believe that some further basic realignment of the existing exchange rate structure was needed.

Mr. Coombs replied that the recently established parities of European currencies against the dollar probably involved a substantial undervaluation of the dollar. As far as the yen was concerned, he thought it would be misleading to say that any particular rate was right or wrong; the problem there was a structural one which was not amenable to changes in the yen exchange

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rate. On the general subject of speculation, he thought it was understandable that market participants would now attempt to protect themselves against a repetition of their recent experience. Certainly, one large element in present speculative thinking was the possibility of a joint float of European currencies against the dollar. Almost as big an element, however, was the possibility that a rampart of exchange controls might be constructed around the Common Market to keep dollars out. Such controls would make it extremely difficult for U.S. firms or others with real or financial investments in Europe to finance their activities.

Mr. Robertson asked whether it was correct to describe the present situation as one involving a "clean" float of all major currencies.

Mr. Coombs said the answer was yes, if a "clean" float was defined as the absence of official intervention in the market for a currency. He was not sure that that was an adequate definition, however, since the objectives that governments might seek through market intervention could be achieved with various kinds of exchange controls. In any case, what the exchange rates emerging under the current float were supposed to represent was not at all clear to him.

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Mr. Robertson referred to Mr. Holland's comments about the possibility that a multilateral agreement to engage in market intervention might be reached in Paris, and he asked whether there was anything to indicate that the central banks would be able to "outspeculate the speculators" at this point.

Mr. Coombs replied that in his judgment the solution to the problem of speculation lay in restoring confidence. Admittedly, that would not be easy.

Mr. Robertson asked whether confidence was more likely to be restored by repeating an approach that had failed in the past or, rather, by continuing the current float and letting the speculators speculate against one another.

Mr. Coombs observed that there had been both successes and failures in past efforts to stabilize exchange rates. The efforts had failed when they had not been backed up adequately; they had succeeded when effective programs had been put together.

In reply to a further question by Mr. Robertson, Mr. Coombs said that market intervention by central banks would be only a part--and possibly a minor part--of the type of program he thought would be required to stabilize exchange rates. Intervention by itself was likely to do no good whatsoever. The recent episode involving the German mark was a case in point. There had been a great deal of intervention--\$6 billion by the German Federal Bank and



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\$300 million by the System--but in the absence of any official statement about the objective for the mark-dollar parity the market drew the conclusion that the United States did not support the prevailing parity.

In response to a question by Mr. Mitchell about the revaluation clause in the System's swap contracts, Mr. Coombs noted that when the swap lines with the central banks of Germany and Belgium had been reactivated last summer new language had been negotiated under which the System was protected only if the foreign creditor revalued "in isolation among the G-10 currencies." Other Common Market central banks would no doubt insist on similar language if it was proposed to reactivate the swap lines with them. In his judgment, a revaluation by one or two major trading countries in Europe would put pressure on others to follow a similar course and would quickly become a joint revaluation.

Mr. Brimmer asked whether official intervention in defense of current parities might not simply mean using public money to provide a means for private holders of funds to move them out of the United States. In other words, he wondered whether the structure of exchange rates established in mid-February was consistent with the present program of U.S. capital controls.

Mr. Coombs replied that until confidence was restored private holders would no doubt continue to move funds abroad to

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the extent they could do so. The main hope of a program--and he would repeat that it was not profitable to think of intervention except as part of a much larger program--was that it could change psychology. In his judgment capital controls would be an essential element in whatever new system emerged; the only question was whether they would be applied by the United States or by foreign governments.

Chairman Burns entered the meeting at this point.

Mr. Daane observed that the question of the appropriateness of the currency parities established in mid-February had been touched on in the preceding discussion. It was worth noting that in his Congressional testimony this morning Chairman Burns had said that those parities appeared to be basically sound, and that the U.S. competitive position had improved substantially as a result of the February changes together with the Smithsonian realignment. And while the Chairman had not implied that the present parities would necessarily prove to be ideal for an indefinite period, he had expressed confidence that progress would be made in reducing the U.S. deficit later in 1973, and more so in 1974. On the matter of possible market intervention, in testimony yesterday Under Secretary Volcker had said that the United States would not try to maintain "an artificial value of the dollar," but he had gone on to indicate that he did not consider the new parities to be artificial.

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Chairman Burns remarked that the question of market intervention may or may not prove to be a serious possibility. Since it may be raised in the Paris meeting, however, he had considered it desirable to discuss it with the Committee today. He would be grateful for any comments or advice the members had to offer, and he would be happy to respond to any questions they might have.

Mr. Mayo said he thought the best outcome of the Paris meeting would be an agreement on some kind of joint float. In his judgment that outcome would be best calculated to restore the sense of confidence that many observers had expected to prevail following the recent exchange rate realignments. He hoped it would not prove necessary for the United States to pledge that it would undertake intervention. He was seriously concerned about the risks that would be involved in a massive support program, in view of the magnitude of the potential speculative flows and the problems of identifying the speculators and controlling their operations. It was possible, of course, that the very announcement of a support program would make it unnecessary to engage in more than minimal operations. He did not see, however, how one could be sure that that would be the result.

Mr. Hayes remarked that he differed with Mr. Mayo regarding the desirability of a joint float. In his judgment, the certain

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consequence would be a proliferation of strong exchange controls in the area of the float--that is, the Common Market--against inflows of dollars. In view of the huge stake this country had in the form of private investments in all of the Common Market countries, he would not look on that prospect with any great optimism. He believed that market intervention, in the context of an appropriate program of supporting measures, could be very useful in restoring confidence.

Mr. Balles asked whether Mr. Hayes would describe the types of supporting measures he had in mind.

Mr. Hayes replied that while there were various possibilities, he did not have a specific program to suggest. Perhaps Chairman Burns would comment on the question.

The Chairman observed that it was difficult to advance any concrete suggestions at this point because of the uncertainty about the positions that would be taken by other governments at the Paris meeting. It was not even clear whether the Europeans would be united or divided in their views. He had the impression that the Europeans were leaning toward a joint float, and if that impression was correct any discussion of intervention was probably idle. Should an international agreement regarding intervention be considered in Paris, the President obviously would be involved in the decision; once the U.S. delegation reached some definite view, Secretary Shultz, as head of

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the delegation, would consult with the President and get his approval before acting. In effect, the negotiations in Paris would be similar to many other international negotiations on economic and political issues in that it was impossible to say in advance how they were likely to come out.

Mr. Morris asked whether the Europeans had developed the operating techniques that would be required for maintaining a joint float.

Chairman Burns said it was his impression that they had been working on that problem but that it was still not clear that they were in a position to overcome the difficulties. He asked Mr. Coombs whether his impression was correct.

Mr. Coombs responded affirmatively. He noted that the subject of a joint float had been discussed informally in Europe on many occasions in the past year or so, and that there was widespread understanding of the serious institutional and technical difficulties involved. It was his guess that the Europeans would be unable to resolve those difficulties at this time.

Mr. Balles noted that as an alternative to a joint float the individual European currencies might be permitted to float separately. He asked whether Mr. Coombs thought such a course also would be undesirable.

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In reply, Mr. Coombs noted that the major currencies had, in fact, floated separately in the late summer and autumn of 1971. During the period there had been a steady drift toward a breakdown of the usual international financing arrangements, with associated depressing effects on domestic economies. When the Smithsonian agreement brought that period to an end, the feeling of relief--both in the exchange market and within individual European governments--was enormous. The experience in a new period of separately floating exchange rates would probably be similar to that of 1971.

In reply to a question by Mr. Mayo, Mr. Coombs said that despite the opposition of the French to floating exchange rates, they probably would go along if other major countries agreed to float.

Mr. Mayo said he would repeat his view that a solution involving floating currencies for the time being would be best. He added that Mr. Balles' suggestion for separate floats of major currencies was attractive to him.

Mr. Balles remarked that he was inclined to agree with Mr. Robertson that it would be desirable to let the speculators speculate against each other. Accordingly, he would be inclined to recommend measures that involved at least a temporary float as a major element.

Mr. Daane observed that one could never be sure that a "temporary" float would in fact terminate within a reasonably short period. In terms of the U.S. payments position, it was also highly uncertain that floating exchange rates of others would move in a desirable direction or that induced changes in their rates would have a desirable impact.

Mr. Mayo noted that there was another possible disadvantage to separately floating rates--namely, that if speculators had venal motives they could attack individual currencies in turn. In the absence of official support for the currencies, the resulting problems could be serious.

Mr. Daane went on to say that in recent history no major country had maintained a clean float. Under a system of separately floating currencies there obviously would be a risk of competitive interventions against one another and against the dollar.

Chairman Burns remarked that under current circumstances concepts of "clean" and "dirty" floats tended to become confusing. If all currencies were permitted to float cleanly, in the sense that central banks made no attempt to influence rates of exchange, the large volume of dollars that had moved into foreign central banks would never return. Dirty floats would be necessary if a return flow of dollars was to be facilitated.

Mr. Coombs said it might be useful to define floats as clean or dirty depending on whether they were helpful or not.

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The United States was hardly likely to object if a European country supplied dollars to the market to prevent its rate of exchange against the dollar from depreciating below some floor level. On the definition he proposed, such operations would not render a float "dirty".

Mr. Brimmer asked about the scale of operations that might be contemplated if an agreement on market intervention was reached at the Paris meeting.

In reply, the Chairman said that if it was decided to intervene--and he did not know whether such a decision was likely, all things considered--it would make no sense to operate on a token scale. The realistic choice, in his judgment, was between standing ready to intervene on a scale sufficiently large to leave no doubt that the objectives would be accomplished or not entering the market at all.

Mr. Hayes said he recognized that the probabilities were not high that the System would be called upon to engage in any intervention operations at this time. He would reiterate his view, however, that if such operations were undertaken it was essential that they be part of a broader package aimed at restoring general confidence in the dollar.

Mr. Balles said he did not know whether the discussion at the Paris meeting would cover possible longer-run measures. If it did, he would recommend that consideration be given to a



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further widening of the bands around central values--perhaps by a percentage point on either side--and also to sliding pegs. And he would recommend strongly against any further moves to monetize gold; if anything, the movement should be in the other direction.

Mr. Hayes indicated that he did not agree with Mr. Balles' suggestions either for wider bands or for a sliding peg. With respect to the former, he thought the bands incorporated in the Smithsonian agreement were certainly wide enough and possibly too wide. He was not sure that the wider bands adopted then had served their intended purpose; in general, that experiment had not been particularly successful.

Mr. Mayo expressed the view that wider bands might still prove useful if they were combined with sliding pegs, so that the bands themselves could show some movement.

Mr. Daane noted that Mr. Balles' comment raised the general question of international monetary reform. In that connection it was worth noting that Chairman Burns, in his testimony this morning as well as on several other occasions during the past week, had expressed the view that the restoration of confidence required an intensification of the current efforts to reform international monetary and trading relationships.

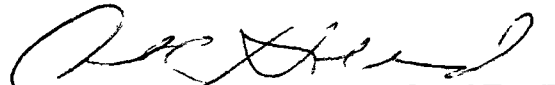
In response to Chairman Burns' request for any further comments or advice, Mr. Balles said he thought the Chairman should be armed with maximum flexibility at the meeting.

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Chairman Burns then said he regretted that the pressure of time had necessitated a meeting of this kind, in which some members participated by telephone; the discussion no doubt would have been fuller and more satisfactory if all of the members could have been present in Washington. He was happy, however, to have had the opportunity to consult with the members today and he was grateful for their counsel.

Thereupon the meeting adjourned.

  
Secretary