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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

REC'D IN RECORDS SECTION
NOV 3 1961

November 3, 1961.

CONFIDENTIAL (FR)

TO: Federal Open Market Committee

FROM: Mr. Young

Enclosed is a set of documents relating to System operations in foreign currency that has been presented to the Board of Governors for its information and consideration. At Chairman Martin's suggestion and with the concurrence of the Board, the documents are also being distributed at this time to all members of the Federal Open Market Committee. It is expected that they will be placed on the agenda for consideration at a future meeting of the Committee.

Ralph A. Young, Secretary,
Federal Open Market Committee.

Enclosures.

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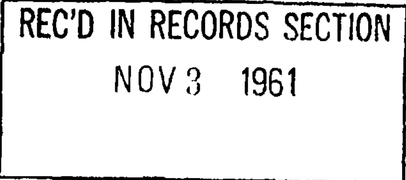
CONFIDENTIAL (FR)

November 2, 1961.

To: Board of Governors

From: Ralph A. Young

Subject: System Operations in Foreign Currencies.



Following the FOMC discussion of a proposal to initiate System open market operations in foreign currencies at its meeting on September 12, 1961, Chairman Martin requested me, as a basis for further consideration by the Board and the Federal Open Market Committee, to prepare specific plans for implementing that proposal.

The complexities of the problem make it impossible to compress these plans into a single document. Therefore, they are embodied in the following drafts:

No. 1: Proposed actions of the Board of Governors to amend Regulation N, concerning Federal Reserve Bank accounts with foreign banks; to authorize the Federal Reserve Bank of New York to maintain accounts with designated foreign banks; and to request the Federal Reserve Banks to report their foreign currency holdings.

No. 2: Proposed action of the Federal Open Market Committee to issue instructions and a standing directive to the New York Bank on operations in foreign currencies, including the establishment of a Subcommittee to direct and supervise the day-by-day conduct of foreign currency operations of the New York Bank for System account.

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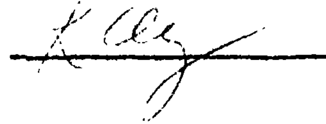
No. 3: Briefing paper for discussion with the Treasury on the division of responsibility for foreign currency operations between the Federal Reserve and the Stabilization Fund.

No. 4: Initial action of the proposed FOMC Subcommittee to establish guidelines for the conduct of foreign currency operations of the New York Bank for System account.

No. 5: Explanatory paper on aims and scope of System foreign exchange operations, perhaps to be discussed with members of the Congress and possibly to be used as a basis of a press release in case the Board and the FOMC decide to go forward with the operations.

Also attached, as No. 6, is a paper prepared by Mr. Hackley at the request of the Federal Open Market Committee, concerning legal aspects of the proposed System operations in foreign currencies.



Attachments.

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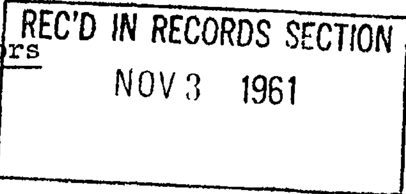
Paper No. 1

CONFIDENTIAL (FR) November 2, 1961.

Proposed Actions by the Board of Governors



A. Amendment to Regulation N

Regulation N, Relations with Foreign Banks and Bankers, is amended by changing the numbering of Section 5 to Section 6 and by inserting after Section 4 the following new Section:

SECTION 5. ACCOUNTS WITH FOREIGN BANKS

(a) Any Federal Reserve Bank, with the approval of the Board, may open and maintain accounts in foreign currencies with such foreign banks as may be designated by the Board.

(b) Notwithstanding other provisions of this Regulation, any officer or other representative of a Federal Reserve Bank which now maintains an account with a foreign bank or which opens an account with a foreign bank pursuant to this section may conduct such negotiations and enter into such agreements, contracts, or understandings with such foreign bank as may be authorized or directed by the Federal Open Market Committee in order to effectuate the conduct of open market transactions of the Federal Reserve Banks incident to the opening, maintenance, operation, increase, reduction, or discontinuance of such account; and, in any such case, such negotiations, agreements, contracts, or understandings shall be subject to such directions, regulations, and limitations as may be prescribed by, or pursuant to authority of, the Federal Open Market Committee.

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(c) Upon the opening of any account by any Federal Reserve Bank pursuant to this section, any other Federal Reserve Bank may carry on and conduct transactions through such account.

(d) Notwithstanding other provisions of this Regulation, reports with respect to any accounts opened and maintained, or negotiations, agreements, contracts, or understandings entered into, pursuant to this section shall be made to the Board by a duly authorized officer of the Federal Reserve Bank involved at least quarterly and more frequently if so requested by the Board.

B. Designation of Foreign Banks

SUPPLEMENT TO REGULATION N

Pursuant to section 5(a) of Regulation N, Relations with Foreign Banks and Bankers, the Board of Governors authorizes the Federal Reserve Bank of New York, in addition to maintenance of existing accounts with the Bank of Canada, the Bank of France, and the Bank of England, to open and maintain accounts in foreign currencies with the following foreign banks:

National Bank of Belgium

German Federal Bank

Bank of Italy

Netherlands Bank

Swiss National Bank

All such accounts shall be subject to the provisions of section 5 of Regulation N, as amended.

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C. Letter to Presidents of Federal Reserve Banks

Dear Sir:

Hereafter, the dollar cost of total foreign currency holdings of the Reserve Banks, acquired pursuant to the Federal Open Market Committee's instructions of ________, 1961, should be reported on Form FR 34 in "Other assets" opposite a new caption "Foreign currencies".

The amount of such holdings will be shown separately in the Federal Reserve Bulletin table concerning the weekly and monthly consolidated statements of condition of all Federal Reserve Banks. However, these holdings will not be shown separately but will be included as part of "Other assets" in the weekly press statements issued by the Board and the Reserve Banks.

The International Financial Statistics section of the Bulletin will show each month averages of daily holdings of foreign currencies for the preceding month. In addition, a breakdown of the holdings by currencies will be shown as of the end of each quarter in the Bulletin issued three months later.

Very truly yours,

Merritt Sherman,
Secretary.

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REC'D IN RECORDS SECTION
NOV 3 1961

Paper No. 2

CONFIDENTIAL (FR)

(Draft of proposed FOMC actions)

Federal Open Market Committee

November 2, 1961.

A. INSTRUCTIONS REGARDING OPEN MARKET TRANSACTIONS IN FOREIGN CURRENCIES

In accordance with Section 5 of Regulation N of the Board of Governors of the Federal Reserve System, as amended, and the Board's action of ________________, 1961, pursuant to Regulation N, the Federal Open Market Committee has issued the following instructions governing open market operations incident to the opening and maintenance by the Federal Reserve Bank of New York (hereafter sometimes referred to as the New York Bank) of accounts with foreign central banks.

I. Role of Federal Reserve Bank of New York

The New York Bank shall execute all transactions in such currencies for the System Open Market Account, as defined in the Regulation of the Federal Open Market Committee.

II. Purposes of Operations

The basic purposes of System operations in and holdings of foreign currencies with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the United States are:

(1) To help protect and maintain the value of the dollar in international exchange markets;
[Possibly omit]

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(2) To aid in making the existing system of international payments more efficient and in fostering orderly conditions in exchange markets;

(3) To promote monetary cooperation with central banks of other countries maintaining convertible currencies, with the International Monetary Fund, and with other international payments institutions;

(4) Together with these banks and institutions, to help moderate such temporary imbalances in international payments as may adversely affect monetary reserve positions and thus to provide a first line of defense against international financial instabilities;

(5) To encourage growth in the liquid assets available to international money markets in accordance with the needs of an expanding world economy;

(6) To facilitate thereby the balanced growth of international trade and investment and thus to contribute to the promotion and maintenance of high levels of economic activity and employment, and of currency relationships favorable to the most efficient use of capital and credit resources and to the stability of international price levels.

III. Arrangements with Foreign Central Banks

In making operating arrangements with foreign central banks on System exchange holdings the New York Bank shall reserve the freedom to change its balance, subject to the need for minimum working balances.

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The Bank shall instruct foreign central banks regarding the investment of such balances in accordance with Section 14 (e) of the Federal Reserve Act.

The Bank shall consult with foreign central banks on coordination of exchange operations.

IV. Maximum Quota for System Foreign Currency Holdings

The maximum quota for the New York Bank's total holdings of foreign currencies for System Account shall be the equivalent of $__________________ computed at cost.

With the approval of the Federal Open Market Committee, this maximum may be increased in the case of System participation in a U.S. drawing on the International Monetary Fund.

V. Currencies Authorized for Purchase

The New York Bank is authorized to purchase for System Account any or all of the following foreign currencies:

Pounds sterling

Belgian francs

French francs

German marks

Italian lire

Netherlands guilders

Swiss francs

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VI. Methods of Acquiring and Selling Foreign Currencies

The New York Bank is authorized to purchase and sell foreign currencies in the form of cable transfers through spot or forward transactions on the open market at home and abroad, including transactions with the Stabilization Fund of the Secretary of the Treasury established by Section 10 of the Gold Reserve Act of 1934 and with foreign central banks.

Unless the New York Bank is otherwise instructed in accordance with Section VIII., below, all authorized transactions shall be at prevailing market rates within the margin set by Article IV, Section 3 (i) of the Articles of Agreement of the International Monetary Fund.

VII. Participation of Federal Reserve Banks

All Federal Reserve banks shall participate in the System Account for foreign currency operations in the same proportion as their holdings of U.S. Government securities in the System Account bear to the total amount of securities in that account.

VIII. Subcommittee on Foreign Currency Operations

The Federal Open Market Committee hereby establishes a Subcommittee on Foreign Currency Operations to direct and supervise the day by day conduct of foreign currency operations of the New York Bank for System Account in accordance with general policies established by the Committee.

The members shall be the Chairman and Vice Chairman of the Federal Open Market Committee and the Vice Chairman of the Board of Governors in his capacity as a member of the Federal Open Market Committee. The Chairman and Vice Chairman of the Federal Open Market Committee shall serve as Chairman and Vice Chairman of the Subcommittee. The Chairman

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of the Subcommittee shall designate two Board members as alternates for himself and the Vice Chairman of the Board, and the First Vice President of the Federal Reserve Bank of New York shall serve as alternate for the Vice Chairman of the Federal Open Market Committee.

The Secretary of the Federal Open Market Committee shall serve as Secretary of the Subcommittee. The Subcommittee may appoint such additional staff as it may deem necessary.

The Subcommittee shall hold regular meetings at appropriate intervals and such other meetings as may be called by the Chairman or, in his absence, the Vice Chairman of the Subcommittee.

The New York Bank shall report daily to designated staff officials of the Subcommittee all transactions in foreign exchange and the amounts of its holdings in each authorized foreign currency, and the Subcommittee at its regular meetings shall review these matters as to conformity with its instructions.

The Subcommittee shall:

(a) designate maximum amounts of individual authorized foreign currencies to be purchased, sold, or held at any time by the New York Bank;

(b) establish minimum and maximum rates of exchange for the Bank's open market purchases and sales of authorized foreign currencies;

(c) establish guidelines for the Bank's holdings of, and spot and forward transactions in, authorized foreign currencies within the designated maximum amounts.

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The actions of the Subcommittee and the transactions of the New York Bank under the Subcommittee's instructions shall regularly be reported to the Federal Open Market Committee for its review as to conformity with the Committee's general policies.

The Subcommittee shall be empowered to authorize or enter into any needed agreement or understanding with the Secretary of the Treasury about the division of responsibility for foreign currency operations between the System and the Stabilization Fund.

The Chairman or in his absence the Vice Chairman of the Subcommittee or both shall from time to time advise the Secretary of the Treasury concerning foreign currency operations conducted pursuant to their instructions and consult with the Secretary on such policy matters as may relate to the Secretary's responsibilities. The Chairman shall also transmit to the National Advisory Council on International Monetary and Financial Problems such reports and information as are required by Section 4 (c) of the Bretton Woods Agreements Act.

The Subcommittee shall, subject to general policies established by the Federal Open Market Committee, exercise special supervision over all relationships and transactions between the New York Bank and foreign central banks concerning operations conducted pursuant to these instructions, and in particular have authority to review and approve all agreements and understanding between the Bank and foreign central banks under Section III above.

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IX. Special Manager of System Open Market Account

The New York Bank shall select one of its officers, who shall be satisfactory to the Federal Open Market Committee, to serve as Special Manager of the System Open Market Account for foreign currency operations.

The Special Manager and designated staff officials of the Subcommittee on Foreign Currency Operations shall regularly consult on current tendencies in the flow of international payments and on current developments in foreign exchange markets, and inform the Subcommittee of all matters pertinent to the decisions that the Subcommittee is called upon to make.

X. Amendment of Action

The Federal Open Market Committee may at any time amend or rescind these instructions.

B. STANDING DIRECTIVE

The Federal Reserve Bank of New York is directed:

(a) to purchase and sell for System Account cable transfers denominated in the currencies of any or all of the following countries: Belgium, France, Germany, Italy, the Netherlands, Switzerland, and the United Kingdom;

(b) to conduct its operations in those currencies in accordance with the instructions of the Federal Open Market Committee of ________________, 1961, so as to achieve the following aims:

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(i) to offset or compensate, when appropriate, those fluctuations in the international flow of payments to or from the United States that are deemed to reflect temporary disequilibrating forces or transitional market unsettlement;

(ii) to temper and smooth out abrupt changes in spot exchange rates and moderate forward premia and discounts judged to be disequilibrating; and

(iii) to provide a means whereby reciprocal holdings of foreign exchange may contribute to meeting needs for world liquidity, especially as required in terms of expanding world trade.

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Paper No. 3

CONFIDENTIAL (FR) (Draft for discussion with Treasury)

Board of Governors and
Federal Open Market Committee November 2, 1961.

REC'D IN RECORDS SECTION
NOV 3 1961

RESPONSIBILITY OF THE TREASURY AND THE FEDERAL RESERVE FOR FOREIGN CURRENCY OPERATIONS

The Treasury and the Federal Reserve have common goals and responsibilities:

(1) In protecting and maintaining the value of the dollar in international exchange markets;

(2) In making the existing system of international payments more efficient, and in fostering orderly conditions in exchange markets;

(3) In promoting monetary cooperation with central banks of other countries maintaining convertible currencies, with the International Monetary Fund, and with other international payments institutions; and

(4) More specifically, in avoiding or acting to stop runs on convertible currencies which are primary means of settlement of international transactions.

Accordingly, both agencies should join forces and conduct operations cooperatively toward these ends. This objective might be accomplished by dividing responsibility along the following lines.

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Area of Stabilization Fund Operations

The Stabilization Fund, as a practical matter, faces difficulty in executing its varying important tasks and at the same time committing much of its limited resources to holdings of and operations in convertible European currencies. Rather than committing this limited sum to operations spread thinly over six or seven European currencies, there would be advantages in concentrating the Fund's holdings and operations to a single currency, such as the Swiss franc.

Switzerland is the only important international money market that is not represented by membership in the IMF. Also, at the present time, it has the only money market that is readily open to U.S. Government borrowing and security offerings. Swiss investors are large holders of U.S. corporate securities and Swiss banks are continuous participants in U.S. money markets. Large movements of funds are constantly taking place, therefore, between the U.S. and Swiss credit markets, and sizable funds must be available to cope with any potential disequilibrium in capital flows between them.

Area of Federal Reserve Operations

Concentration of Stabilization Fund operations in European currencies on Swiss francs would leave the dollar subject to exchange market exposure in pounds sterling, Belgian francs, French francs, German marks, Italian lire, and Netherlands guilders. The Federal Reserve might be prepared to assume responsibility for a foreign currency holding program embracing these currencies. The area of System operations would thus include the currencies of the major countries expected to participate in the IMF stand-by credit arrangement, with the exception of the Japanese yen which is not yet convertible under IMF criteria and the Canadian dollar which has no declared par value.

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Such a division of responsibility along geographical lines would avoid any over-lapping of Treasury and System operations, and thereby considerably simplify the problem of coordinating the foreign currency operations of the two agencies.

Changes in Areas of Operations

The Treasury and the Federal Reserve might from time to time agree to change their areas of operations or to allocate specified operations in some currencies to one or the other agency.

Whenever a currency would be newly allocated to the Federal Reserve, the System might purchase from the Stabilization Fund, within an established quota, whatever holding of that currency the Stabilization Fund might have.

Conversely, whenever a currency would be newly allocated to the Stabilization Fund, the System might sell its holding to the Stabilization Fund.

Drawings on the International Monetary Fund

The Treasury and the Federal Reserve might agree that the System help to accommodate a U.S. drawing on the International Monetary Fund by acquiring from the Treasury foreign currencies that the Treasury had previously drawn or was simultaneously drawing from the IMF.

Spot or Forward Transactions by the Stabilization Fund in Unusual Situations

If the Treasury believed that it had over-riding reasons for endeavoring to influence either spot or forward rates at a time when the Federal Reserve believed that such transactions were inappropriate, it might be agreed in advance that the System would supply the Treasury out of its holdings with the foreign currency needed to enable

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the Stabilization Fund to enter into spot or forward sales of the currency for its own account. It would be understood, however, that the System would not purchase from the Treasury any foreign exchange acquired through spot or forward transactions conducted by the Stabilization Fund without previous understanding regarding such purchases.

Policy Relations with Treasury and National Advisory Council

Coordination of policy between the Treasury and Federal Reserve might best be achieved by means of informal meetings or conversations at the highest policy levels and appropriate staff levels, as in coordination of domestic financial policies. Insofar as the System program of foreign currency operations might be deemed to require coordination by the National Advisory Council on International Monetary and Financial Problems under Section 4 (a) of the Bretton Woods Agreements Act, the Federal Reserve would request that the Council agree, as it did in the case of System gold collateral loans (Council Action No. 39, February 27, 1946), that individual operations need not be submitted to the Council for consideration and possible action. However, the plan would be submitted to the Council for discussion and comment and the Council would be furnished continuously with reports of operations and all other pertinent information, in accordance with Section 4 (c) of the Bretton Woods Agreements Act.

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REC'D IN RECORDS SECTION
NOV 3 1961

Paper No. 4

CONFIDENTIAL (FR)

Federal Open Market Committee

(Draft of Suggested Initial Action of the FOMC Subcommittee on Foreign Currency Operations)

November 2, 1961.

GUIDELINES FOR SYSTEM OPEN MARKET OPERATIONS
IN FOREIGN CURRENCIES

In conformity with the action of the Federal Open Market Committee of ________________, 1961, the Subcommittee on Foreign Currency Operations instructs the Federal Reserve Bank of New York to start operations for System Open Market Account on the basis of the following guidelines.

Aims of Operations

As stated by the standing directive of the Federal Open Market Committee relating to foreign currency operations, the transactions of the Federal Reserve Bank of New York are to be conducted within the broad purposes set forth in the action referred to above with a view to the following specific aims:

(a) Offsetting or compensating, when appropriate, those fluctuations in the international flow of payments to and from the United States that reflect temporary disequilibrating forces or transitional market unsettlement;

(b) Tempering and smoothing out abrupt changes in spot exchange rates and moderating forward premia and discounts judged to be disequilibrating; and

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(c) Providing a means whereby reciprocal holdings of foreign exchange may contribute to meeting needs for world liquidity, especially as required in terms of expanding world trade.

Temporary Fluctuations in Payments Flows

In general, temporary or transitional fluctuations in payments flows may be cushioned or moderated whenever they occasion market anxieties, or undesirable speculative activity in foreign exchange transactions, or excessive leads and lags in international payments.

In particular, seasonal variations in payments may be cushioned or moderated when normal swings are widened by market unsettlement or other temporary pressures on the dollar or on other convertible currencies used in international transactions.

To the extent that they can be identified and delineated, cyclical swings in payments may similarly be cushioned or moderated, in particular, when they give indication of hampering counter-cyclical domestic monetary policies.

Other exchange market instabilities may be moderated, in particular, when they indicate rate movements that reflect responses to short-run increases in international political tension, differences in phasing of international economic activity that give rise to unusually large interest rate differentials between major markets, or a rise in market rumor of a character likely to stimulate speculative transactions.

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Increase in U.S. Gross Reserve Strength

System holdings of foreign exchange may be acquired directly from foreign central banks in exchange for dollar holdings at prevailing exchange rates. Such reciprocal holding transactions shall have the broad purpose of enlarging U.S. gross reserve strength to satisfy rising world needs for dollars without reducing U.S. net reserves, and may serve to complement stand-by credits negotiated through the facilities of the International Monetary Fund.

Guidelines for System Holdings of Foreign Currencies

The guiding principle for System holdings of foreign currencies shall be, first, that the maximum amount be not too large in relation to System resources considering risks involved, and second, that the amount be not so small as to rob the operations of market influence. The maximum would be realized only when the U.S. balance of international payments attains a large surplus, permitting the ready accumulation of major convertible currencies.

The setting of amounts of individual currencies to be held by the System shall be guided by two considerations: first, the importance of the individual currency in international transactions (measured, for example, by the country's IMF quota or by its contribution to the "borrowing arrangement"); and second, a country's willingness to hold part of its reserves in dollars.

Spot holdings of a currency should generally be kept sufficient to meet forward contracts in that currency (exclusive of contracts made under parallel arrangements with foreign monetary authorities which provide their own cover) expected to mature in the following three-week period.

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Foreign exchange holdings above a certain minimum should be invested as far as practicable in conformity with Section 14 (e) of the Federal Reserve Act.

General Guidelines for System Exchange Transactions

System exchange transactions should mainly be geared to pressures of payments flows so as to cushion or moderate disequilibrating movements of volatile funds and their destabilizing effects on U.S. and foreign official reserves and on exchange markets.

The New York Bank should, as a usual practice, purchase and sell authorized currencies at prevailing market rates without trying to establish rates that appear to be out of line with underlying market forces.

The Subcommittee may at times, however, authorize the Bank to operate for the purpose of influencing market rates if this seems advisable in order to cope with unusual market conditions or to counteract destabilizing speculative transactions.

Except under special instructions, the Bank should not purchase or sell more than 15 per cent of the established maximum quota for each currency in any one calendar week.

If market offers to sell or buy intensified as System holdings increased or declined, this would constitute a clear signal for a review of the System's evaluation of international payments flows. This review might suggest direct transactions with the foreign central bank involved to be able to accommodate a larger supply or demand, and a temporary change in the quota for System holdings of a particular convertible currency.

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As a general principle, it will be desirable for the U.S. gold stock to rise in times of balance-of-payments surplus and to decline in times of deficit. The New York Bank should aim at limiting its purchases of authorized foreign currencies to part of the inflow in periods of surplus, and at limiting its sales to part of the outflow in periods of deficit.

If operations were started at a time when the United States was not experiencing a net inflow of any eligible foreign currency, initial System holdings (apart from sums that might be acquired from the Stabilization Fund) might be purchased directly from foreign central banks. To avoid the use of gold in acquiring currencies, the Bank may resort to a direct exchange of spot currencies with foreign central banks.

It should be the practice to arrange with foreign central banks for the coordination of foreign currency transactions in order that System transactions do not conflict with those being undertaken by foreign monetary authorities.

Transactions in Spot Exchange

The guiding principle for transactions in spot exchange should be that, in general, market movements in exchange rates, within the limits established in the IMF Agreement or by central bank practices, index affirmatively the interaction of underlying economic forces and thus serve as efficient guides to current financial decisions, private and public.

Whatever the cause of exchange market instability, System intervention is appropriate whenever the Special Manager reaches a

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judgment that it may help to re-establish supply and demand balance at a level more consistent with the prevailing flow of underlying payments. Whenever supply or demand persists in influencing exchange rates in one direction, System intervention should be modified, curtailed, or eventually discontinued pending a re-assessment by the Subcommittee of supply and demand forces.

Transactions in Forward Exchange

As a beginning for operations in the forward market, the New York Bank may acquire from the Stabilization Fund any outstanding contracts for forward sales and purchases of eligible currencies which the Fund now holds. Occasion to engage in further forward transactions will arise mainly when forward premia or discounts are inconsistent with interest rate differentials and are giving rise to a disequilibrating movement of short-term funds.

Administration of Accounts in Foreign Countries

Any agreements or understandings concerning the administration of the accounts maintained by the New York Bank with the central banks of Belgium, France, Germany, Italy, the Netherlands, Switzerland and the United Kingdom are to be referred to the Subcommittee for review and approval.

Purchases of Foreign Currencies

The New York Bank is authorized to purchase the currencies of the countries named in the preceding paragraph up to the following amounts:

	Dollar equivalent (In millions)
Pounds sterling	
Belgian francs	
French francs	
German marks	
Italian lire	
Netherlands guilders	
Swiss francs	

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Within these maximum quotas, the Bank may purchase these currencies from the Stabilization Fund at the rate at which the Stabilization Fund in turn has acquired them, or at the current market rate, whichever is lower.

The Bank may also purchase these currencies from other sources at prevailing market rates.

Insofar as possible, the Bank should purchase a currency only at or below its par value, and should lower the rate at which it is prepared to purchase a currency as its holdings of that currency approach the established maximum.

If the Bank is unable to build up its holdings of an authorized currency to at least one-half of the maximum through such purchases at or below par and if such a build up seems desirable, the Subcommittee may authorize the Bank to purchase the currency at prevailing market rates above its par value.

Sales of Foreign Currencies

Insofar as possible, the Bank should engage in sales of an authorized currency only at rates at or above its par value, and should raise the rate at which it is prepared to sell a currency as its holdings of that currency approach zero.

Other Transactions

Proposals of the Special Manager for other transactions, or for transactions at rates other than those outlined in the two preceding sections, should be referred to the Subcommittee for concurrence before entering into arrangements for their execution.

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Accounting Procedures

All transactions, spot and forward, in a given currency should be aggregated for accounting purposes in determining net profits (or loss). Apart from situations of par value change, uncovered forward positions should normally be capable of liquidation without causing a net loss in the aggregate operations in the currency.

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Paper No. 5

CONFIDENTIAL (FR)

(Explanatory paper)

REC'D IN RECORDS SECTION
NOV 3 1961

Board of Governors of the
Federal Reserve System and
the Federal Open Market Committee

November 2, 1961.

AIMS AND SCOPE OF SYSTEM FOREIGN EXCHANGE OPERATIONS

The basic purposes of System operations in and holdings of foreign currencies would be:

(1) To help protect and maintain the value of the dollar in international exchange markets; /Possibly omit 7

(2) To aid in making the existing system of international payments more efficient and in fostering orderly conditions in exchange markets;

(3) To promote monetary cooperation with central banks of other countries maintaining convertible currencies, with the International Monetary Fund, and with other international payments institutions;

(4) Together with these banks and institutions, to help moderate such temporary imbalances in international payments as may adversely affect monetary reserve positions and thus to provide a first line of defense against international financial instabilities;

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(5) To encourage growth in the liquid assets available to international money markets in accordance with the needs of an expanding world economy;

(6) To facilitate thereby the balanced growth of international trade and investment and thus to contribute to the promotion and maintenance of high levels of economic activity and employment, and of currency relationships favorable to the most efficient use of capital and credit resources and to the stability of international price levels.

Specific Aims

In pursuing these broad purposes, System open market operations in foreign currencies would have the following specific aims:

(a) To offset or compensate, when appropriate, those fluctuations in the international flow of payments to and from the United States that reflect temporary disequilibrating forces or transitional market unsettlement;

(b) To temper and smooth out abrupt changes in spot exchange rates and to moderate forward premia and discounts when judged to be disequilibrating; and

(c) To provide a means whereby reciprocal holdings of foreign exchange may contribute to meeting needs for world liquidity, especially as required in terms of expanding world trade.

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The first two aims can be viewed in both a longer and shorter term context; the third has relevance mainly from a longer range perspective.

Moderation of Temporary Fluctuations in Payments Flows

Temporary fluctuations in payments flows may reflect seasonal, cyclical, or some unusual forces that are expected to correct themselves when their strength is spent.

Fluctuations in payments flows, unless offset, cause changes in the U.S. gold stock and in foreign dollar reserves. Since financial markets keep alert and responsive to such changes, effects on the international payments system may become unfavorable when they are unduly abrupt and large.

Thus, a rapid decline in the U.S. gold stock, or a rapid increase in foreign dollar reserves, may affect adversely international confidence in the dollar and endanger the present international reserve currency standard.

On the other hand, a rapid increase in the U.S. gold stock, or a rapid fall in foreign dollar reserves, may revive fears of international illiquidity and of an international "dollar shortage," and thus hamper or slow down the removal of restrictions and other obstacles to the expansion of world trade.

Seasonal instabilities -- The flow of U.S. international payments shows a distinct seasonal swing, with outpayments relatively larger than inpayments in the second and third quarters, and inpayments relatively larger in the fourth and first quarters. The seasonal swing of the British net reserve position is at times the opposite of ours.

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Other major industrial countries also experience significant seasonal swings in international payments.

In circumstances of high market sensitivity and responsiveness to disturbing international events, actual or potential, it is no mere coincidence that peak seasonal pressure against the pound or dollar often has aggravated payments pressures for other temporary reasons. On occasion, the whole pattern has assumed a character encouraging to any anxieties held by the international financial community.

Experience proves that market anxieties accentuate gold hoarding tendencies and provoke speculation as to the future value of reserve currencies. Hence, all reasonable steps need to be taken to moderate seasonal swings that might encourage market uneasiness.

Central bank operations to temper seasonal swings in the international payments flows and in foreign exchange fluctuations ought, therefore, to be recognized as having the same economic rationale as operations to offset seasonal pressures in domestic money market conditions and seasonal swings in money rates. The Federal Reserve System, in its formative period, properly made the dampening of seasonal swings in domestic payments and money rates a main focus of its monetary operations.

Cyclical swings in international payments -- Postwar cyclical variations in domestic economic activity have been accompanied by some cyclical variation in exports and imports and in capital movements. While the regularity of these cyclical patterns has not been fully identified and delineated, their existence is sufficiently known for steps to be taken in foreign exchange operations looking towards such cyclical compensation as experience may show to be practicable.

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Other temporary instabilities -- Other instabilities in international payments may reflect responses to short-run increases in international political tensions, differences in phasing of economic activity that give rise to unusually large interest rate differentials between major markets, or a rise in market rumors of a character likely to stimulate speculative transactions. These movements are reflected not only in recorded flows of short-term capital but also, at times to an even larger extent, in "leads and lags" in commercial payments.

Whatever the causes and whatever the form under which the instabilities appear, experience of the recent past indicates that potentials for volatile fund movements are large. Expansion and contraction of Federal Reserve holdings of foreign exchange could be used to mitigate for short periods the incidence of these flows on the U.S. gold stock and foreign dollar reserves.

Such operations would need to be conducted in the light of a careful diagnosis of longer-term underlying forces so as to avoid operations that might prevent or obstruct desirable adjustments from taking place.

Intervention in Exchange Markets

In general, market movements in exchange rates, within the limits set by the International Monetary Fund Agreement or by central bank practices, should index affirmatively the interaction of underlying economic forces and market expectations and thus serve as efficient guides to current financial decisions, private and public. At times, however, short-run fluctuations may be unduly influenced by speculative forces, or for other temporary reasons the basic payments situation may be obscured.

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In either case, System intervention might try to help re-establish supply and demand balance at a level more consistent with the prevailing flow of underlying payments and thus facilitate the efficient performance of the market functions.

Intervention in the foreign exchange market is not analogous to intervention in the Government securities market for the following two reasons:

(1) The United States Government is required by the Bretton Woods Agreements to prevent the price of the dollar in terms of foreign currencies from fluctuating in excess of one per cent above or below its par value in terms of gold ($35 per ounce of gold). Other countries that are members of the IMF are similarly obligated. Thus, international agreement limits the range of rate fluctuations of the major currencies to 1 per cent above and below par. Intervention in the form of gold transactions or foreign exchange operations is then mandatory if the market exchange rate falls outside that margin. In contrast, prices of Government securities may fluctuate within wide margins, without any obligation of the monetary authorities to maintain fluctuations within a narrow range around an established par value.

(2) For a country like the United States, whose international payments run but a small fraction of total domestic payments, the volume of central bank transactions in foreign exchange can confidently be expected to remain negligible in comparison with the volume of central bank operations in Government securities. Therefore, while System open market operations in Government securities could be used to offset System transactions in foreign currencies, the reverse would not be

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practicable. It is difficult to imagine that System transactions in foreign currencies could present either a serious problem of coordination with open market operations in Government securities or a serious risk of unwanted expansion or contraction of Federal Reserve credit.

Increase in U.S. Gross Reserve Strength

Concern has been expressed about the ability of the present international monetary system to generate the growth in liquid resources needed for a sustained rapid expansion in world trade. With world gold production tending to rise more slowly than world trade, ever larger dollar exchange holdings have been relied upon by other countries to supply liquidity needs. This rise in foreign dollar holdings has reflected almost continuous large deficits in U.S. international payments.

A further large build-up by other countries of monetary reserve holdings in dollars or in sterling, resulting from further reserve country deficits, would threaten to undermine confidence in these two currencies. Hence, it is argued that the present international monetary system must collapse either because it will fail to provide enough growth in liquidity to support current world price levels or because it will lead to growing distrust in the maintenance of convertibility and in the stability of the dollar and sterling.

There is indeed some substance in this pessimistic diagnosis. It will turn out to be false only if appropriate adaptations are progressively made in institutional arrangements so as to permit a growing supply of reserve currencies (particularly of dollars) while also permitting maintenance of basic balance in reserve currency payments. As seen now, needed institutional improvements include:

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(a) An enlarged capacity of the International Monetary Fund to supplement for a period the liquidity resources of its members.

(b) An increased supply of international money market paper, such as bankers' acceptances and short-term securities payable in more than one convertible currency, so that private financial institutions may better provide liquidity to foreigners.

(c) A capability on the part of central banks of leading industrial countries to expand their reciprocal holdings of foreign exchange, when appropriate, thus enabling them more effectively to mobilize their gross reserve strength.

An arrangement of the first kind is expected to be consummated by the end of this year, in the form of an activation of the Fund's authority to lend and borrow international currencies in case of need.

Arrangements of the second kind need further study and exploration. In any case, they can be realized only through relatively slow adaptations in the instruments and practices of international finance.

Arrangements of the third kind have been developed among the central banks of major industrial countries in connection with the recent sterling crisis, but need Federal Reserve participation to make the circle of participating industrial countries complete. Thus, a Federal Reserve action to hold foreign exchange would serve to complement the International Monetary Fund stand-by credit arrangement now being negotiated.

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This action would also be consistent with the position taken by the United States during postwar years which has stressed the need for foreign central banks to give up exclusive reliance on gold as a medium of international monetary reserves. As long as the United States itself keeps its official reserves exclusively in gold, proposals designed to encourage foreign countries to keep part of their reserves in dollars have a hollow sound and smack of special pleading.

Initial Scale of Operations

Ideally, a System practice of holding foreign currency assets should be launched in a period when the U.S. balance of payments has been showing a definite tendency to over-all equilibrium. This would enable the System to proceed flexibly in coping with seasonal swings in payments flows or in adapting to cyclical or other unusual flows regarded, all tendencies considered, as relatively temporary. It would also enable the System to project such gradual expansion in holdings as might be deemed to be appropriate from the standpoint of longer term liquidity needs.

To illustrate the pattern of System response to an unusual inflow of foreign payments of a temporary character in an apparent situation of sustainable basic balance, the Federal Reserve would inform the central banks of the countries experiencing an unusual outflow of dollar payments of its willingness to make marginal amounts of dollars available for payments in the United States in exchange for holdings of their currencies. If they accepted the offer, foreign central banks would to some extent be enabled to avoid either depleting their dollar holdings or having to acquire dollars by means of gold sales.

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The action would represent tangible evidence of System cooperativeness in meeting a temporary payments flow problem, and so encourage the foreign central banks in question to act reciprocally at any time the payments flow reversed itself.

Under conditions of sizable payments deficit such as have obtained recently and evidently are continuing, System operations in the foreign exchange markets would necessarily be subject to important constraints.

It is recognized that the imbalance recently and currently shown in U.S. payments must be eliminated and that national policies of a corrective nature must be pursued. Pending such correction, however, there is still room for a System program of foreign currency holdings to be initiated on a modest scale, primarily for the purpose of establishing an effective mechanism of operations to cope with future contingencies. Even when total U.S. international payments show a deficit, there may be a significant inflow of individual foreign currencies. Moreover, such action might have the effect of establishing with other central banks both the desire and willingness of the Federal Reserve System to cooperate actively with them in smoothing out abnormal payments fluctuations, in mitigating undesirable changes in gold reserve positions, and in coping with flows of volatile funds.

From a technical standpoint, the Federal Reserve Bank of New York has acquired considerable experience in foreign exchange operations for the U.S. Government and for foreign correspondents, and in the past eight months also through its transactions for the

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Stabilization Fund. But the System can learn still more by diligent observation, intensive analysis of experience as it is acquired, and systematic research into market practices and seasonal and cyclical patterns of payments flows and exchange rate movements.

The need to build greater staff and Open Market Committee knowledge about international financial operations is another argument for limiting foreign currency activity in the beginning to a moderate scale. For much of the knowledge required for a constructive foreign currency operation can be gained only through the process of the operation itself.

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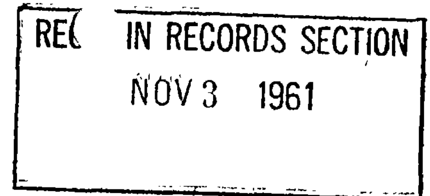

Paper No. 6

CONFIDENTIAL (FR)

November 2, 1961.

Federal Open Market Committee

Mr. Hackley, General Counsel

Subject: Legal aspects of proposed plan for Federal Reserve operations in foreign currencies

At the September 12, 1961 meeting of the Federal Open Market Committee, legal questions were raised regarding a proposed plan under which the Federal Reserve Bank of New York would open and maintain accounts in certain foreign currencies with foreign central banks, acting pursuant to directions and regulations of the Committee and, to the extent legally necessary, in accordance with regulations of the Board of Governors.

It is understood that in general the principal purposes of operations in foreign currencies through such accounts would be to promote international monetary cooperation among the central banks of countries maintaining convertible currencies, to foster orderly conditions in exchange markets for such currencies, to facilitate the expansion and balanced growth of international trade, and to supplement the activities of the International Monetary Fund in this field.

It is also understood that such accounts with foreign central banks would be opened and maintained principally through the purchase of cable transfers by the Federal Reserve Bank of New York, although they might also be created through sales of gold to foreign central banks and the direct establishment of "cross-credits". It is further

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understood that, while such accounts would be established primarily for the purposes above indicated, any amounts in excess of minimum working balances might be invested in foreign bills of exchange.

As the plan has been described, it gives rise to a number of legal questions, some of basic importance and others that may be of only minor or secondary importance. In general, it appears that the questions may be regarded as falling within the six categories indicated below, and they will be discussed here in that order:

(1) authority of a Federal Reserve Bank to open and maintain accounts with foreign central banks (pp. 7-15);

(2) the legality of the proposed methods of acquiring foreign exchange (pp. 15-20);

(3) investments of foreign accounts (pp. 20-22);

(4) the respective jurisdictions of the Board of Governors and the Federal Open Market Committee (pp. 23-33);

(5) the possible effects of the Gold Reserve Act of 1934 and the Bretton Woods Agreements Act (pp. 33-36); and

(6) administration of the proposed plan, including delegations of authority with respect to "day-to-day" operations (pp. 36-38).

This memorandum does not consider policy questions that may be involved in the present proposal.

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CONCLUSIONS

For the reasons hereafter presented, my conclusions are as follows:

1. General. - The opening of accounts with foreign central banks by the Federal Reserve Bank of New York for the purposes and through the methods contemplated by the proposed plan would be consistent with the law, provided appropriate actions are taken by the Board of Governors and the Federal Open Market Committee within their respective jurisdictions. However, this matter is admittedly subject to question; and, while it is unlikely that the plan would be challenged in court, there can be no assurance, in the absence of legislation, that it would not be criticized from some sources on legal grounds. The risk of such criticism might be minimized through prior consultation with the appropriate Committees of Congress. Certain suggested features of the plan (e.g., purchases of foreign Treasury bills) would require specific legislation.

2. Opening of accounts with foreign banks. - Pursuant to section 14(e) of the Federal Reserve Act, a Federal Reserve Bank may open an account with a foreign central bank even though such account is not opened for the principal purpose of purchasing foreign bills of exchange and is not fully or extensively utilized for that purpose; but any questions as to such authority would be lessened if some portion of the account was used to purchase foreign bills (pp. 7-15).

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3. Methods of acquiring foreign currency accounts. - A Federal Reserve Bank may lawfully open and maintain such an account through cross-credits, sales of gold to the foreign bank, or transfers of credit to the account through either spot or forward purchases of cable transfers in the open market (pp. 15-16).

4. Purchases from Stabilization Fund. - The purchase by a Federal Reserve Bank of cable transfers directly from the Stabilization Fund of the Treasury would constitute a purchase in the "open market" as authorized by the first paragraph of section 14 of the Federal Reserve Act. The validity of this conclusion is not believed to be open to serious legal question. However, it is possible that such direct purchases from the Stabilization Fund might be criticized as being inconsistent with section 14(b) of the Act which indicates that direct purchases of Government obligations from the Treasury are not purchases in the "open market". Moreover, such criticisms would have some validity if cable transfers sold by the Treasury to the Reserve Bank had been acquired by the Treasury from the IMF for that purpose (pp. 16-19).

5. Dealings with International Monetary Fund. - Purchases of cable transfers by a Federal Reserve Bank directly from the International Monetary Fund could be made by the Reserve Bank only on behalf of the United States (as a "member" of the Fund) and could not be regarded as "open market" transactions for the account of the Reserve Bank itself as authorized by section 14 of the Act (pp. 19-20).

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6. Investment of foreign accounts. - Such foreign accounts could be invested in foreign bills of exchange and acceptances that arise out of actual commercial transactions and have maturities of not more than 90 days. They could not, in the absence of further legislation, be invested in foreign Treasury bills or other obligations of foreign Governments or central banks. Some portion of any such account could lawfully be invested in a time deposit with a foreign central bank (pp. 20-22).

7. Jurisdictions of Board and FOMC. - All of the above actions would be subject to regulations of the Board of Governors or the Federal Open Market Committee, or both, as follows:

(a) Open market purchases of cable transfers, bills of exchange, and acceptances would be subject to direction and regulations of the Committee (pp. 24-27);

(b) The opening and maintenance of accounts with foreign banks, negotiations and arrangements with foreign banks for this purpose, and sales of gold to foreign banks would be subject to the consent and regulations of the Board pursuant to sections 14(e) and 14(g) of the Federal Reserve Act (pp. 28-31); and

(c) The Board could not lawfully delegate to the Committee the Board's statutory responsibilities with respect to supervision and regulation of such foreign accounts and incidental transactions with foreign banks.

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However, the Board could, by regulation, consent to the maintenance of such accounts and to such negotiations and arrangements with foreign banks as may be authorized or directed by the FOMC in order to effectuate open market transactions, subject, however, to such limitations and reporting requirements as the Board may prescribe, and subject also to reservation in the Board of the right to modify or revoke such authorizations (pp. 31-33).

8. Effect of other laws. - The authorities of the Committee and the Board, as above described, would not be legally limited by the provisions of section 10 of the Gold Reserve Act with respect to the Stabilization Fund of the Treasury. (Dealings in gold would, of course, continue to be subject to the licensing authority of the Secretary of the Treasury.) Nor would such authorities be legally limited by provisions of the Bretton Woods Agreements Act, although it would be desirable, in view of the language and purposes of that Act, for any plan of the kind proposed to be brought to the attention of the National Advisory Council (pp. 33-36).

9. Administration. - If the Board should take appropriate actions along the lines indicated in paragraph 7(c) above, it is believed that the Committee could lawfully (a) direct the Federal Reserve Bank of New York to open accounts and execute transactions pursuant to the plan, subject to limitations prescribed by the Committee, (b) delegate to a Subcommittee of the Committee authority for supervision

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of day-to-day operations by the New York Bank, subject to general policies established by the Committee, and (c) designate an officer of the New York Bank to conduct such day-to-day operations subject to immediate supervision by the Subcommittee (pp. 36-38).

I. AUTHORITY TO OPEN FOREIGN ACCOUNTS

Section 14(e) of the Federal Reserve Act (12 U.S.C. 358) authorizes any Federal Reserve Bank

> ". . . with the consent or upon the order and direction of the Board of Governors of the Federal Reserve System and under regulations to be prescribed by said board, to open and maintain accounts in foreign countries, appoint correspondents, and establish agencies in such countries wheresoever it may be deemed best for the purpose of purchasing, selling, and collecting bills of exchange. . . ." (Underscoring supplied)

A basic legal question is whether the underscored "wheresoever" clause in this provision has the effect of permitting a Reserve Bank to open an account with a foreign bank only for the purpose of "purchasing, selling, and collecting bills of exchange" and as, therefore, forbidding the opening of such accounts for the purposes contemplated by the present proposal.

Previous position of Board. - In 1933, in a letter to the Federal Reserve Bank of New York, the Federal Reserve Board stated:

> ". . . Federal reserve banks are authorized to establish and maintain accounts in foreign countries only with the consent of the Federal Reserve Board and subject to such regulations as the Board may prescribe; and it is the Board's view that such accounts may be opened and maintained only for the purpose of facilitating the purchase, sale and collection of bills of exchange and the conduct of other open market transactions of the kind specified in section 14 of the Federal Reserve Act. . . ."

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The same position was indicated by the Board in another letter to the New York Reserve Bank dated August 16, 1934:

> ". . . it is the Board's view that the deposit balance with the Bank for International Settlements should be reduced as soon as practicable to the minimum amount which is actually needed for the purpose of facilitating the purchase, sale and collection of bills of exchange and the conduct of other open market transactions of the kinds specified in section 14 of the Federal Reserve Act. . . ."

To the extent that acquisitions of foreign currencies under the present proposal would be accomplished through open market purchases of cable transfers, it might be argued that to that extent the proposal would be consistent with the Board's 1933 and 1934 letters, which indicated that one of the permissible purposes of a foreign account is to facilitate the conduct of open market operations. However, those letters have generally been regarded as reflecting the position that a foreign account may be opened only for the purpose of buying, selling, and collecting bills of exchange. If that position is sound, it would seem to constitute an effective bar to the present proposal.

Language of the statute. - Presumably, the Board's 1933-34 position was based on a construction of the language of the statute under which the "wheresoever" clause was regarded as limiting not only the authority of a Reserve Bank to appoint correspondents and establish agencies but also its authority to open foreign accounts. There is reasonable ground, however, for a contrary construction.

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While commas appear after the authorities "to open and maintain accounts in foreign countries" and to "appoint correspondents", there is no comma after the authority to "establish agencies in such countries" and, consequently, it may be argued that, as a matter of grammatical construction, the "wheresoever" clause modifies only the nearest antecedent, that is, the authority to establish agencies. However, it seems unreasonable to suppose that Congress intended to make an arbitrary distinction in this respect between correspondents and agencies.

The so-called Aldrich Bill, upon which the Federal Reserve Act was based, contained a corresponding provision that appeared to limit the establishment of agencies to the purpose of buying and selling bills of exchange but not to place such a limitation upon the opening of foreign accounts. The Aldrich Bill would have authorized a Reserve Bank

> ". . . to open and maintain banking accounts in foreign countries, and to establish agencies in foreign countries for the purpose of purchasing, selling, and collecting foreign bills of exchange, and . . . to buy and sell, with or without its indorsement, through such correspondents or agencies. . . ."

The provision of section 14(e) that authorizes the opening of accounts, the appointment of correspondents, and the establishment of agencies is immediately followed by language authorizing a Reserve Bank to buy and sell bills of exchange or acceptances "through such

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correspondents or agencies", again suggesting, although not conclusively, that the purchase and sale of bills of exchange was intended to be linked with correspondents and agencies but not with the maintenance of accounts with foreign banks.

A final, and perhaps the strongest, argument for the more liberal construction of the statute may be based upon the ambiguous nature of the phrase "wheresoever may be deemed best". Even if that phrase is interpreted as applying not only to the appointment of correspondents and agencies but also to the opening of foreign accounts, it does not expressly require such accounts, correspondents, or agencies to be utilized <u>only</u> for the purpose of buying and selling bills of exchange. It is susceptible of the construction that such accounts may be opened wherever geographically it may be reasonably contemplated that they <u>might</u> be used at some time for such purpose but that they need not be limited to that purpose.

Some support for this construction may be derived from the last sentence of section 14(e). That sentence provides in effect that whenever a Reserve Bank opens a foreign account or appoints or establishes a foreign correspondent or agency, any <u>other</u> Reserve Bank may carry on, through such Reserve Bank, "any transaction authorized by this section [section 14]" In other words, where one Reserve Bank opens foreign accounts or appoints foreign correspondents or agencies, <u>other</u> Reserve Banks may conduct through such accounts, correspondents, or agencies not only transactions in bills of exchange but <u>any</u>

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transactions authorized by section 14 - even non-open market transactions, such as dealings in gold. From this, it may be argued that it would be illogical if not absurd to hold that the Reserve Bank opening such accounts or appointing such correspondents or agencies could use them only for the purpose of buying and selling bills of exchange. This argument, of course, points to the conclusion that the "wheresoever" clause, even if it modifies the authority to open foreign accounts, was not intended to limit the use of such accounts to the buying and selling of bills of exchange.

Intent of Congress. - The intent of Congress in the enactment of the provision in question is not crystal clear. However, legislative history tends in some degree to support the conclusion that Congress contemplated that foreign accounts opened by the Reserve Banks might be used to influence foreign exchange and to control international movements of gold as well as to purchase and sell bills of exchange. For example, the House Committee Report on the original Act contained the following statement with respect to this provision:

> "The final power to open and maintain banking accounts in foreign countries for the purpose of dealing in exchange and of buying foreign bills is necessary in order to enable a reserve bank to exercise its full power in controlling gold movements and in facilitating payments and collections abroad."

Since it refers to "dealing in exchange" as well as "buying foreign bills", this statement might be interpreted as contemplating that

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foreign accounts could be broadly used as a means of dealing in foreign exchange, other than through purchases of bills, in order to control gold movements and facilitate payments and collections abroad. Admittedly, however, the statement is not entirely convincing, since the phrase "dealing in exchange" might have been used only as a loose phrase to cover dealings in foreign bills of exchange.

Administrative construction. - In 1925, the Federal Reserve Bank of New York opened an account with the Bank of England which was clearly not for the purpose of buying, selling, and collecting bills of exchange. Under that arrangement, the Reserve Bank agreed to place $200 million of gold at the disposal of the Bank of England, with the understanding that the proceeds of sales of such gold would be deposited in an account in pounds sterling with the Bank of England to the credit of the Reserve Bank to be available for investment for the account of the Reserve Bank in sterling commercial bills guaranteed by the Bank of England, and with the further understanding that, at the end of the standby period, any amount outstanding was to be payable at the Reserve Bank in gold or its dollar equivalent. This arrangement was described by the Board in its Annual Report to Congress for the year 1925, and as thus described it was made clear that the account with the Bank of England might be used from time to time for the purchase of commercial bills, but that this was not the principal purpose of the arrangement.

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Although the Board subsequently (in 1933 and 1934) construed section 14(e) as limiting foreign accounts to the purchase of bills of exchange, the fact remains that the 1925 arrangement with the Bank of England did not conform to this construction and that Congress, with full knowledge of that arrangement, did not then or subsequently amend the statute in any manner designed to prevent such an arrangement.

Conclusion. - For all of the reasons above indicated, it is my opinion that a Federal Reserve Bank may lawfully open and maintain an account in foreign currency with a foreign central bank whether or not the account is maintained and utilized for the purpose of investing in foreign bills of exchange and that, therefore, the opening of such accounts for the purposes now contemplated would not be inconsistent with the statute. I do not believe that the "wheresoever" phrase was intended to limit the authority to open foreign accounts; but, even if it may be so regarded, I believe that it can be construed as meaning only that such accounts shall be established where it may reasonably be expected that they might be used for the purchase and sale of bills of exchange. The present proposal would comply with that requirement.

Consultation with Banking and Currency Committees. - Admittedly, the question is debatable, particularly in view of the 1933-1934 position of the Board. Moreover, it may be noted that in 1932, Senator Glass had criticized certain foreign operations of the Federal Reserve Bank of New York, which might be considered as similar to those now contemplated, as being contrary to the law.

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When the bill that subsequently became the Banking Act of 1933 was under consideration by Congress, Senator Glass on the floor of the Senate referred to Federal Reserve "stabilization" operations under which credits had been extended to European banks, and suggested that such operations were inconsistent with the Federal Reserve Act. The pertinent portions of his statement were the following:

> "For a period of six years one of the Federal reserve banks has apparently given more attention to 'stabilizing' Europe and to making enormous loans to European institutions than it has given to stabilizing America. Accordingly, we have a provision in this bill asserting, in somewhat plainer terms, the restraint the Federal reserve supervisory authority here at Washington should exercise over the foreign and open market operations of banks which may assume to be a 'central bank of America.'
>
> "We did not think that we were having a central bank. We thought we were having 12 regional banks. The operations of the bank particularly referred to were so extensive in the European field that it found itself liable for hundreds of millions of dollars of foreign acceptances which could not be collected, which had to be renewed at maturity--just a sort of revolving fund--absolutely foreign to the intent, and, as I contend, to the text of the Federal reserve act." (75 Cong. Rec. 9884, May 10, 1932)

For the reasons heretofore indicated, it is believed that the legal validity of Senator Glass's statement may be questioned. In any event, he was obviously referring to instances in which the Federal Reserve had undertaken operations to bolster the credit of foreign countries; and some distinction may be drawn between those operations and the plan now proposed, which, in net effect, is designed to insure international monetary cooperation and convertibility of currencies, as well as to protect the American dollar.

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Nevertheless, in view of the uncertainties as to the construction of the law and the history of this matter, it might be desirable, before instituting the plan now proposed, to inform the Banking and Currency Committees of Congress. Such action would not, of course, have any legal significance; but it could help to diminish the likelihood of adverse criticism.

II. METHODS OF ACQUIRING FOREIGN EXCHANGE

A. Cross-Credits and Sales of Gold

As indicated at the outset of this memorandum, it is understood that the proposed foreign currency operations would be effected principally through purchases of cable transfers that would result in credits in accounts with foreign central banks. However, such credits could be established also through direct arrangements for cross-credits between the Federal Reserve Bank of New York and foreign banks or through sales of gold to foreign banks.

Opening of foreign accounts through cross-credit arrangements would appear to be authorized by section 14(e) of the Federal Reserve Act in accordance with the construction of the law heretofore suggested. Such arrangements would not constitute open market operations, and I see no legal objections thereto, provided they are entered into pursuant to the consent of the Board of Governors and under regulations of the Board as provided in section 14(e) and section 14(g). The nature of such consent and regulations will hereafter be discussed.

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As to the establishment of foreign accounts through sales of gold, it seems clear that this would be authorized by section 14(a) of the Federal Reserve Act (12 U.S.C. 354) which empowers the Reserve Banks to "deal in gold coin and bullion at home or abroad." Again, such sales of gold would not be open market operations and, as hereafter discussed, would be subject only to such regulations as the Board might prescribe pursuant to sections 14(e) and 14(g).

B. Purchase of Cable Transfers Generally

The first paragraph of section 14 provides in part that

> "Any Federal Reserve Bank may, under rules and regulations prescribed by the Board of Governors of the Federal Reserve System, purchase and sell in the open market, at home or abroad, either from or to domestic or foreign banks, firms, corporations, or individuals, cable transfers. . . ." (12 U.S.C. 353)

To the extent that the proposed foreign exchange operations would be effected through purchases of cable transfers in the open market from domestic banks or dealers in foreign exchange or from foreign banks, there would, in my opinion, be no legal question of authority involved, whether the cable transfers related to "spot" or "forward" transactions.

C. Dealings with Stabilization Fund

A more difficult question would be presented if the Federal Reserve Bank of New York (or any other Federal Reserve Bank) should

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purchase cable transfers from the Stabilization Fund administered by the Secretary of the Treasury under section 10 of the Gold Reserve Act. (31 U.S.C. 822a)

First, it may be questioned whether such a purchase from the Treasury would be an "open market" purchase within the meaning of the first paragraph of section 14 of the Federal Reserve Act.

Doubt on this score is engendered by the provisions of section 14(b) of the Act (12 U.S.C. 355), which seem clearly to regard direct purchases of Government obligations from the Treasury as not constituting "open market" purchases. On the other hand, there are at least reasonable grounds for concluding that these provisions are not inconsistent with holding that direct purchases of cable transfers from the Treasury constitute "open market" purchases within the meaning of the first paragraph of section 14. The same term may sometimes be differently construed in the light of different statutory contexts and purposes.

From 1913 until 1935, the Reserve Banks under section 14(b) freely purchased Government obligations directly from the Treasury, even though section 14 was designated as relating to "open market operations". By the Banking Act of 1935, Congress prohibited such purchases of Government obligations except in the "open market". In 1942, Congress permitted the "direct" purchase of Government obligations from the Treasury for a temporary period and up to a limited amount;

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and this authorization has been extended by subsequent amendments. It seems clear, however, that this limitation on direct purchases of Government obligations was intended to prevent the Federal Reserve System from lending its resources to the Treasury in a manner that might be inconsistent with the System's monetary and credit responsibilities. These considerations, of course, are not applicable to purchases of cable transfers from the Treasury. In other words, an "open market" in cable transfers may be regarded as embracing any person with whom a Reserve Bank may feel free to deal, including the United States Treasury, which is a part of that market; whereas an "open market" in Government obligations may be regarded as excluding the United States Treasury, which issues such obligations and consequently is <u>not</u> a part of that market.

A further question arises as to whether the United States is a "corporation" within the meaning of the first paragraph of section 14 from which a Reserve Bank may properly purchase cable transfers. Obviously, the United States is not a corporation in the usual sense of a business corporation with stock outstanding; and it is probable that, in the original Federal Reserve Act, Congress had in mind only such corporations. However, the courts have held that, depending upon the context, the United States may be regarded as a "corporation" in the sense envisaged by Chief Justice Marshall in the <u>Dartmouth College</u> case (4 Wheat. 636): "an artificial being, invisible, intangible and existing only in contemplation of law."

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On balance, it is my opinion that a Reserve Bank's purchases of cable transfers from the Stabilization Fund may reasonably be regarded as "open market" purchases from a "domestic corporation" within the meaning of the first paragraph of section 14.

Admittedly, however, the provisions of section 14(b) regarding open market purchases of Government obligations may be superficially regarded as suggesting that the direct purchase of cable transfers from the Treasury, like direct purchases of Government obligations, should not be treated as "open market" transactions. For this reason, such direct purchases of cable transfers might be subjected to criticism. Any such criticism would have greater substance if cable transfers acquired from the Treasury had been acquired by the Treasury for that purpose from the International Monetary Fund, since, as hereafter indicated, purchases of cable transfers by a Reserve Bank from the International Monetary Fund would not, in my opinion, constitute "open market" transactions.

D. Dealings with International Monetary Fund

Section 1 of Article V of the Articles of Agreement of the International Monetary Fund provides:

> "Each member shall deal with the Fund only through its Treasury, central bank, stabilization fund or other similar fiscal agency and the Fund shall deal only with or through the same agencies."

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Assuming that the Federal Reserve System may be considered the "central bank" of the United States, it appears that the United States could deal with the Fund through the Federal Reserve Bank of New York acting under directions of the Board of Governors, and the Federal Open Market Committee; but in that event the Reserve Bank could not be regarded as engaging in "open market" operations for its own account as contemplated by section 14 of the Federal Reserve Act. Literally, the first part of the above-quoted provision of the Articles of Agreement of the Fund would not prohibit such dealings by the Reserve Bank for its own account, and it might be argued that the second part of the provision would permit the Fund to deal directly "with" the Reserve Bank as well as "through" the Reserve Bank. While this is, of course, a question for determination by the Fund, it is my opinion that the provision contemplates that the Fund will deal only with a member country or its fiscal "agencies" and that, therefore, dealings between the Fund and the Reserve Bank in a capacity other than fiscal agent for the Treasury would not be permissible.

III. INVESTMENT OF FOREIGN ACCOUNTS

Assuming that the proposed plan would not be impeded by lack of authority of the Federal Reserve Banks to open and maintain accounts with foreign central banks or to purchase cable transfers, questions arise as to the types of instruments in which such accounts may lawfully be invested.

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Bankers' acceptances and bills of exchange. - The first paragraph of section 14 of the Federal Reserve Act authorizes any Reserve Bank, under rules and regulations prescribed by the Board, to purchase and sell in the open market, at home or abroad, "bankers' acceptances and bills of exchange of the kinds and maturities by this Act made eligible for rediscount, with or without the indorsement of a member bank." (12 U.S.C. 353) Putting aside for the moment the question whether such purchases are subject to regulations of the Board (to be discussed hereafter), it seems clear that under this provision a Reserve Bank could use accounts with foreign banks only for investment in acceptances and bills of exchange that would be eligible for rediscount under sections 13 and 13a of the Federal Reserve Act. In general, this would limit such investments to 90-day commercial paper, 9-months agricultural paper, and acceptances of the kinds and maturities described in section 13.

In addition, section 14(e) authorizes a Reserve Bank, with the consent or upon the order and direction of the Board of Governors and under regulations of the Board, to "buy and sell, with or without its indorsement", through foreign correspondents or agencies, "bills of exchange (or acceptances) arising out of actual commercial transactions which have not more than ninety days to run, exclusive of days of grace, and which bear the signature of two or more responsible parties." Unlike the authority conferred by the first paragraph of section 14, section 14(e) does not require that paper purchased through foreign

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correspondents or agencies must comply with the eligibility requirements of the Federal Reserve Act; instead, section 14(e) sets its own requirements as to such purchases through foreign correspondents or agencies. However, these requirements, like those of section 13, limit purchases to paper arising out of "actual commercial transactions" with maturities not exceeding 90 days.

Foreign Treasury bills. - In view of the provisions of law just discussed, it seems clear that Federal Reserve Banks would have no authority to purchase through an account with a foreign central bank paper that does not arise from actual commercial or agricultural transactions. Consequently, such accounts could not be utilized for the purpose of investment in obligations of foreign Governments, such as foreign Treasury bills. If the investment of foreign accounts in such obligations is considered desirable, further legislation would be necessary.

Time accounts. - Question has been raised as to whether any part of an account with a foreign bank could be invested in a time account with a foreign bank. If, as heretofore concluded, the opening of accounts with foreign banks need not be conditioned upon investment of such accounts in bills of exchange, there appears to be no reason for which a Reserve Bank may not maintain a time deposit with such a foreign bank. The authority conferred by section 14(e) is not limited to the opening and maintenance of demand accounts with banks in foreign countries.

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IV. RESPECTIVE JURISDICTIONS OF BOARD OF GOVERNORS AND FEDERAL OPEN MARKET COMMITTEE

A. General

So far in this memorandum, the powers of the Reserve Banks with respect to the opening of foreign accounts, the methods by which such accounts may be opened and maintained, and investments through such accounts, have been discussed without reference to the extent to which the exercise of those powers may be limited or regulated by the Board of Governors or the Federal Open Market Committee or both. Discussion of this aspect of the matter has been deferred because, while it directly affects the exercise of the powers of the Reserve Banks, it presents somewhat separate and distinct considerations.

In general, it is clear that the Committee has regulatory authority with respect to "open market" transactions of the Reserve Banks and that the Board has supervisory and regulatory authority with respect to other operations of the Reserve Banks. However, the exact boundaries between the jurisdictions of the Board and the Committee are difficult to determine when, as in the present matter, certain of the operations of the Reserve Banks appear to fall in both areas of jurisdiction.

All of the Reserve Bank powers heretofore discussed are based upon provisions of section 14 of the Federal Reserve Act which is entitled "Open-Market Operations", and which was a part of the original

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Federal Reserve Act. As described in section 14, some of these powers, such as the powers to purchase cable transfers and bills of exchange and to open foreign accounts, are made subject to regulation by the Board. However, section 12A of the Act, as amended by the Banking Act of 1935, provides that

> "No Federal Reserve bank shall engage or decline to engage in open-market operations under section 14 of this Act except in accordance with the direction of and regulations adopted by the [Federal Open Market] Committee. . . ." (12 U.S.C. 263)

The jurisdictional question is complicated by the fact that the contemplated operations involve both open market transactions and non-open market transactions which are nevertheless closely interrelated.

B. Purchase of Cable Transfers, Bankers' Acceptances, and Bills of Exchange

The first paragraph of section 14 provides that a Federal Reserve Bank

> ". . . may, under rules and regulations prescribed by the Board of Governors of the Federal Reserve System, purchase and sell in the open market, at home or abroad . . . cable transfers and bankers' acceptances and bills of exchange of the kinds and maturities by this Act made eligible for rediscount, with or without the indorsement of a member bank." (12 U.S.C. 353)

Although this provision, which was a part of the original Federal Reserve Act, continues to refer to rules and regulations of the Board, it seems clear that, since the transactions described are "open market" operations, they are now subject to the direction and regulation of the FOMC pursuant to section 12A of the Act.

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Cable transfers. - When section 12A was first enacted by the Banking Act of 1933, it vested the Board with regulatory authority over open market operations of the Reserve Banks; and, pursuant to that authority, the Board issued its Regulation M which, among other things, made purchases and sales of cable transfers subject to the Board's approval. However, when section 12A was amended in 1935 to vest regulation of open market operations in the FOMC, the Board withdrew that regulation.

The current Regulation of the FOMC clearly assumes that open market purchases and sales of cable transfers by the Reserve Banks are within the Committee's jurisdiction. Section 7 of that Regulation provides:

> "(4) No Federal Reserve Bank shall engage in the purchase or sale of cable transfers for its own account except in accordance with the directions of the Committee."

Apparently pursuant to this provision of its Regulation, the Committee adopted on November 20, 1936 a resolution which is still in effect authorizing the Reserve Banks to purchase and sell cable transfers "to the extent that they may be deemed necessary or advisable in connection with the establishment, maintenance, operation, increase, reduction, or discontinuance of accounts of Federal Reserve Banks in foreign countries." It may be noted that this resolution assumes that the FOMC has authority with respect to purchases and sales of cable transfers even though they relate to the opening and maintenance of foreign accounts.

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Bills of exchange and acceptances. - It seems clear that the Committee, rather than the Board, now has regulatory authority with respect to the open market purchase and sale of bills of exchange and bankers' acceptances pursuant to the first paragraph of section 14.

There is, however, a distinction to be noted between cable transfers on the one hand and bills of exchange and acceptances on the other. The former are not eligible for discount under the Federal Reserve Act, whereas acceptances and bills of exchange are eligible for discount subject to certain requirements of the law and regulations of the Board. Consequently, even though the Committee has regulatory authority with respect to the open market purchase of acceptances and bills of exchange, they must still comply with statutory and regulatory requirements as to eligibility for discount. Moreover, the Board still has outstanding a regulation (Regulation B) regarding the eligibility of acceptances and bills of exchange for purchase by the Reserve Banks, despite the authority of the Committee to regulate such purchases in the open market. Any conflict of jurisdiction, however, is resolved by section 7(2) of the Committee's Regulation:

> "(2) Only acceptances and bills of exchange which are of the kinds made eligible for purchase under the provisions of Regulation B of the Board of Governors of the Federal Reserve System may be purchased: Provided, That no obligations payable in foreign currency shall be purchased and sold for the account of the Federal Reserve Bank except in accordance with directions of the Committee."

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In addition to the authority contained in the first paragraph of section 14 for the open market purchase of bills of exchange and acceptances, authority for the purchase of such obligations is also contained in subsection (e) of that section. Subsection (e) of section 14 provides that "with the consent or upon the order and direction of the Board of Governors of the Federal Reserve System and under regulations to be prescribed by said board," a Federal Reserve Bank may buy and sell, through foreign correspondents or agencies, "bills of exchange (or acceptances) arising out of actual commercial transactions which have not more than ninety days to run, exclusive of days of grace. . . ." Even though here again the law continues to refer to regulations of the Board, it is my opinion that purchases of bills of exchange and acceptances through foreign correspondents and agencies under this provision are subject to regulation by the Committee rather than the Board, despite the failure of Congress to repeal the Board's regulatory authority in this respect when in 1935 it transferred to the FOMC authority over open market operations.

That such purchases through foreign correspondents and agencies, like other open market operations, are subject to the jurisdiction of the Committee, was indicated by the Board in a letter to the Federal Reserve Bank of Boston dated May 15, 1936 (F.R.L.S. #4276), wherein the Board stated:

> ". . . no Federal Reserve bank can open and maintain accounts in foreign countries, appoint correspondents or establish agencies in such countries except with the consent of the Board, nor can it engage in the purchase or sale of bills through such accounts, correspondents or agencies without the consent also of the Federal Open Market Committee. . . ."

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C. Dealings in Gold

To the extent that the proposed plan may involve acquisitions of foreign exchange through sales of gold by a Reserve Bank it seems clear that such transactions would not constitute open market transactions subject to regulatory authority of the Committee. Section 14(a) of the Federal Reserve Act authorizes the Reserve Banks to "deal in gold coin and bullion at home or abroad." (12 U.S.C. 354) Any such transactions would seem to be subject to supervision by the Board of Governors, under both its general power of supervision conferred by section 11(j) of the Federal Reserve Act (12 U.S.C. 248(j)) and its special supervisory powers over relationships with foreign banks conferred by section 14(g) of the Act (12 U.S.C. 348a), to be discussed later in this memorandum.

D. Opening of Foreign Accounts

Section 14(e) authorizes a Federal Reserve Bank

> ". . . with the consent or upon the order and direction of the Board of Governors of the Federal Reserve System and under regulations to be prescribed by said board, to open and maintain accounts in foreign countries . . . ." (12 U.S.C. 358)

The question whether such foreign accounts may be opened and maintained only for the purpose of buying and selling bills of exchange has heretofore been discussed. At this point, we are concerned only with the question whether regulatory authority as to the opening of

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such accounts is vested in the Board or in the FOMC. Clearly, the language of the statute seems to vest such authority in the Board. However, it may be argued that, if such accounts are established through the open market purchase of cable transfers, the opening and maintenance of such foreign accounts is merely an incident to open market operations and therefore subject to regulation by the Committee. (This argument might be considered implicit in the Committee's 1936 resolution previously mentioned.) Conversely, however, it might be argued that the purchase of cable transfers is merely a mechanical incident to the opening of foreign accounts and that, therefore, the authority of the Board is paramount.

It would not seem necessary, however, to determine whether the Board or the FOMC has paramount authority. The question seems to be resolved by the over-all intent of Congress that the Board and the Committee shall have separate but coordinate jurisdictions. This intent, I believe, is clearly reflected in the legislative history of the Banking Act of 1935 as hereafter discussed.

E. Authority with Respect to Foreign Relationships

Section 14(g) of the Federal Reserve Act (12 U.S.C. 348a) provides in effect that -

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(1) the Board of Governors shall exercise "special supervision" over all relationships and transactions of any kind between any Federal Reserve Bank and any foreign banks;

(2) all such relationships and transactions shall be subject to "such regulations, conditions, and limitations as the Board may prescribe";

(3) no representative of a Reserve Bank shall conduct negotiations with representatives of a foreign bank without the Board's permission;

(4) the Board shall have the right to be represented in any such negotiations; and

(5) a full report of any such negotiations shall be filed with the Board.

When section 14(g) was added by the Banking Act of 1933, the same Act authorized the Board of Governors (in section 12A of the Federal Reserve Act) to regulate not only the open market operations of the Federal Reserve Banks but also "the relations of the Federal Reserve System with foreign central or other foreign banks."

Subsequently, the Banking Act of 1935 amended section 12A to vest authority over open market operations in the FOMC instead of the Board. Significantly, however, the 1935 amendment to section 12A eliminated the reference to relationships with foreign banks, thus indicating the intent of Congress that the Board should retain its authority with respect to this matter, despite the Open Market Committee's authority over open market transactions.

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It is my conclusion, therefore, that, whether or not the opening of foreign accounts as the result of open market purchases of cable transfers would be subject to the "consent" and regulations of the Board under section 14(e) of the Federal Reserve Act, any such foreign accounts would be subject to supervision and regulation by the Board under section 14(g) of the Act, even though they may also be subject to regulation by the FOMC to the extent that they involve open market transactions.

F. Possible Actions by Board and Committee

On the basis of the foregoing discussion, it is my opinion that effectuation of the plan here proposed would require actions by both the Board and the Committee but that such actions may be coordinated without conflict. Such actions might be taken along the following lines:

1. The Board could authorize the New York Reserve Bank (a) to open accounts with foreign banks in such foreign currencies, through such methods, and in such amounts as may be determined by the FOMC to be necessary for effectuation of the proposed plan; and (b) to conduct such negotiations and enter into such arrangements with foreign central banks as, in the judgment of the FOMC may be necessary to effectuate or implement open market transactions under the plan.

Logically, any such action by the Board should be taken in the form of an appropriate amendment to the Board's Regulation N, "Relations with Foreign Banks and Bankers."

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Such action would be based upon the Board's authority under both sections 14(e) and 14(g) and it should be in the form of an exercise, rather than a delegation to the Committee, of the Board's statutory responsibilities with respect to foreign transactions of the Reserve Banks. For this reason, it would be desirable for the action to include a requirement, in conformity with section 14(g), that reports of agreements with foreign banks and operations in such foreign accounts be made to the Board at periodic intervals.

The Board's action might also include consent to participation by other Reserve Banks in accounts opened by the New York Reserve Bank.

2. The Committee could issue appropriate regulations or directives, or both, regarding (a) the purchase and sale by the New York Reserve Bank of cable transfers in connection with the opening and maintenance of accounts with foreign banks and (b) the purchase and sale of bills of exchange and acceptances through such foreign accounts. Action as to these matters would be within the Committee's own authority over open market transactions; and logically such action might be taken through appropriate amendments to provisions relating to cable transfers and bills and acceptances now contained in section 7 of the Committee's Regulation.

3. The Committee could take action, in accordance with the action of the Board described in paragraph 1 above, regarding the foreign currencies to be acquired, limitations on aggregate amount and on the amounts of particular currencies, the foreign banks with which accounts could be opened, minimum balances in such accounts, etc.

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4. To the extent that the operations of the plan might involve purchases and sales of gold or borrowings or loans on gold by the New York Reserve Bank, such transactions should have the approval of the Board.

The above or similar actions would, in my opinion, be consistent with the law and would properly preserve the respective authorities of the Board and the Committee. It is necessary, however, to consider whether the authority to take such actions would in any way be affected by other statutes that may appear to give other Government agencies certain responsibilities in this field.

V. EFFECT OF OTHER LAWS

A. Gold Reserve Act of 1934

Section 10 of the Gold Reserve Act of 1934, as originally enacted (31 U.S.C. 822a) established a "Stabilization Fund" of $2 billion under the Secretary of the Treasury, for the purpose of "stabilizing the exchange value of the dollar." Since the purposes of this provision were so obviously similar to the purposes of the plan now proposed, question arises whether Congress by the Gold Reserve Act meant in any way to modify or supersede whatever powers the Federal Reserve System might have had in this field.

In my opinion, there is no evidence that Congress had any such intent.

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In the first place, the Stabilization Fund was originally designed as a temporary measure to expire two years after the date of enactment. It is not reasonable to suppose, therefore, that it was intended as a substitute for whatever powers the Federal Reserve System might have in this respect.

Secondly, when the Fund was made permanent by the Bretton Woods Agreements Act of 1945, it was reduced to $200 million, since the rest of the Fund was allocated for investment in the International Monetary Fund. This action was hardly consistent with the exclusive use of the Fund as a means for stabilizing the exchange value of the dollar.

Finally, section 3 of the Gold Reserve Act of 1934 itself authorized the Federal Reserve Banks to hold gold for the purpose of settling international balances or of maintaining the equal purchasing power of United States currency. Such action, again, would be inconsistent with any intent by Congress to repeal any authority possessed by the Federal Reserve System to maintain the integrity of the dollar.

Even though the provisions of section 10 of the Gold Reserve Act do not affect Federal Reserve authority in this field, it would, of course, be desirable as a matter of policy for Federal Reserve activities under the proposed plan to be coordinated with the utilization of the Stabilization Fund for related purposes.

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B. Bretton Woods Agreements Act of 1945

Section 4 of the Bretton Woods Agreements Act of 1945, relating to the National Advisory Council on International Monetary and Financial Problems (of which the Chairman of the Board of Governors is a member) provides in part as follows:

"SEC. 4. (a) . . .

" * * *

"(3) The Council shall coordinate, by consultation or otherwise, so far as is practicable, the policies and operations of the representatives of the United States on the Fund and the Bank, the Export-Import Bank of Washington and all other agencies of the Government to the extent that they make or participate in the making of foreign loans or engage in foreign financial, exchange or monetary transactions.

"* * *

"(c) The representatives of the United States on the Fund and the Bank, and the Export-Import Bank of Washington (and all other agencies of the Government to the extent that they make or participate in the making of foreign loans or engage in foreign financial, exchange or monetary transactions) shall keep the Council fully informed of their activities and shall provide the Council with such further information or data in their possession as the Council may deem necessary to the appropriate discharge of its responsibilities under this Act."

While the Federal Reserve Banks are quasi-governmental agencies exercising public functions, they are not "agencies of the Government" within the meaning of these provisions. However, to the extent that the Board and the FOMC would participate in the plan here

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proposed, it seems clear that they would be "agencies of the Government" participating in "foreign financial, exchange or monetary transactions".

Nevertheless, the Bretton Woods Agreements Act refers only to coordination, "by consultation or otherwise, so far as is practicable." It does not endow the National Advisory Council with any enforceable authority. Consequently, there would appear to be no legal respect in which activities by the Board and the Committee would be subject to control by the Council. At the same time, it would seem desirable as a matter of policy for any Federal Reserve operations of the kind contemplated to be brought to the attention of the Council in advance, particularly in view of the related operations of the Stabilization Fund of the Treasury and of the International Monetary Fund.

VI. ADMINISTRATION

As the proposed plan has been described, it would contemplate that the Committee would designate the Federal Reserve Bank of New York to execute the transactions (opening of accounts with foreign banks, purchase of cable transfers, etc.) necessary to accomplish the purposes of the plan on behalf of the System Open Market Account, pursuant to directions of the Committee. The plan further contemplates that immediate direction and supervision of operations in foreign exchange would be vested by the Committee in a Subcommittee consisting of the Chairman and Vice Chairman of the Committee and the Vice Chairman of

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the Board of Governors in his capacity as a member of the Committee; that the Committee would designate an officer of the New York Reserve Bank as "Special Manager of the System Open Market Account for Foreign Currency Operations" who would conduct day-to-day operations in this field; and that the Subcommittee would establish maximum amounts of currencies to be purchases, rates of exchange, and other guidelines for such day-to-day operations.

The proposed designation of the Federal Reserve Bank of New York to execute transactions would be consistent with section 5 of the present Regulations of the Committee and with section 3(b) of the Committee's Rules on Organization and Information.

There would appear to be no legal objection to the proposed delegation to a Subcommittee of authority to supervise and direct day-to-day operations in foreign currencies, provided, of course, that general policies are established by the full Committee. The Open Market Committee, unlike the Board of Governors, is not a "full-time" Government agency; and it is clear that Congress in section 12A did not expect that the Committee would meet daily or exercise day-to-day supervision over the implementation of policies formulated by the Committee. This is evidenced by the fact that the Committee was required to consist of the 7 members of the Board of Governors and 5 of the Federal Reserve Bank Presidents - individuals who are obviously already fully occupied as a daily matter. It is also significant that

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the Committee is required to meet only at least four times each year, a requirement scarcely consistent with any intent that the Committee should directly supervise day-to-day implementation of its policies. In addition, the presently proposed delegation of authority to a Subcommittee is similar (and perhaps not even as extensive) to the delegation of authority to an "Executive Committee" that existed with the knowledge of Congress for many years prior to 1955.