BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

STRICTLY CONFIDENTIAL (FR)

January 29, 1971

To: Federal Open Market Committee

From: Robert C. Holland, Secretary

Subject: Expression of views on MSP contingency plan.

At the direction of Chairman Burns, all voting members of the Federal Open Market Committee were contacted on or around January 19, 1971, to ascertain their views with regard to the possible contingency plan for Federal Reserve matched sale-purchase transactions with member banks to help moderate Euro-dollar repayments. That plan had been outlined in a staff memorandum dated January 11, 1971, and had been discussed by the Committee on a preliminary basis at its January 12, 1971, meeting.

In response to my telegram of January 19, 1971, seeking their views, nine of the twelve voting Committee members indicated that they agreed in principle with the proposed amendment of the continuing authority directive as a useful contingency plan, to be acted on finally at a subsequent time if deemed necessary. Governor Robertson, Governor Brimmer and President Hayes indicated they disagreed in principle with this type of approach.

The Committee members agreeing with the proposal generally felt that the contingency plan should be in readiness so that the Federal Reserve System would be prepared to do whatever it could if circumstances became compelling and all preferable courses of action were unavailing. However, these members felt strongly that sales of securities by the Treasury Department (or by the Export-Import Bank or other Government agencies) designed to moderate Euro-dollar repayments would be a much better method of dealing with the problem.

Some of the members of the Committee who approved in principle expressed various reservations concerning the MSP proposal. Question was raised about the legality of the transactions, and the possibility was noted that litigation might be brought by some bank not included in the arrangement. It was observed that the operation was easy to misinterpret and thus vulnerable to criticism if and when exposed to public view. Concern was also expressed that the Federal Reserve might be drawn into MSP's up to the full $8 billion of Euro-dollar liabilities presently outstanding at U.S. banks to their foreign branches. Several Committee members believed that the scheme for reduced reserve requirements against an amount of deposits equal to Euro-dollar liabilities might be preferable both politically and on substantive grounds. Finally, the view was expressed and agreed to by Board members of the Committee that if the MSP proposal were to be implemented, the duration of the Federal Reserve liability should, in principle, be limited to one year.

Committee members Hayes, Robertson and Brimmer, in disapproving of the plan, expressed several points of disagreement in principle. They believed that the problems associated with Euro-dollar repayments were primarily a Treasury responsibility. They were also very much concerned that if the FOMC began to engage in MSP transactions, there would be pressure for the System to finance more and more of the U.S. balance of payments deficit in this fashion, and for an indefinite span of time.

If events developed in a way that compelled Federal Reserve action, they much preferred resort to the proposal for reduced reserve requirements mentioned above. Additionally, Governor Robertson emphasized that, in his view, there was no justifiable legal foundation for either the purpose of the proposed System MSP transactions or the means chosen.

Governor Brimmer added that he felt the probable size of further Euro-dollar repayments was not large enough to warrant the kind of extraordinary action that MSP transactions would represent, given the likelihood that U.S. banks and their foreign branches would want to retain some of their Euro-dollar liabilities for operating purposes. President Hayes also objected to the idea of a central bank in effect borrowing back its own currency and at a premium.

In the light of these expressions of views by the members of the Committee, the Chairman instructed the staff to proceed with further development and refinement of contingency plans on both the MSP and the reduced reserve requirement proposals. In particular, the staff was directed to explore procedures that might help to limit the duration of any such Federal Reserve MSP operations to one year or less.