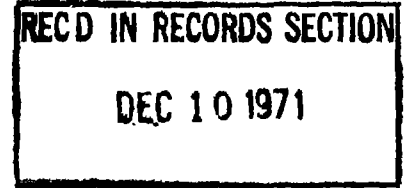




BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551



CONFIDENTIAL (FR)

December 9, 1971

To: Federal Open Market Committee

From: Arthur L. Broida

Enclosed for your information is a copy of a memorandum from Governor Brimmer, dated today and entitled "Comments on EPC Meeting of November 18-19, 1971."

A handwritten signature in cursive script that reads "Arthur L. Broida".

Arthur L. Broida
Deputy Secretary
Federal Open Market Committee

Enclosure

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

DEC 21 1971

Office Correspondence

Date December 9, 1971

To Federal Open Market Committee

Subject: Comments on EPC Meeting of

From Andrew F. Brimmer

November 18-19, 1971

The following comments on the November 18-19 meeting of the Economic Policy Committee (EPC) of the OECD are shared for your information. The United States delegation expected to encounter severe criticism of the international measures announced on August 15. However, if such sentiments existed, they were expressed in a surprisingly soft manner and only in isolated instances.

There obviously was great concern about the downward trends in economic activity which were discernible in almost all countries outside North America. However, there was general agreement that these trends existed prior to the U.S. August 15 measures. There also was general agreement that, as the balance of payments adjustment process worked through, the necessary shifts in world trade were manageable. This was particularly so since--in the initial stages of the adjustment process--economic activity in the United States would expand at above trend rates. Thus, the immediate effects of a realignment of exchange rates would be somewhat mitigated. For the OECD countries as a whole, it was thought that the necessary adjustment might equal about 1/2 of a percentage point in GNP annually for a period of two years. On the other hand, it was also recognized that the impact on individual countries might vary considerably.

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Thus, the recurrent theme which characterized the discussions was not so much the direct impact of the August 15 measures, but rather the uncertainties created by the failure to come to a solution of the problem. Country after country expressed its concern about the ability of the authorities to maintain confidence in the private sector in an environment of growing uncertainties about the international financial system. Virtually all representatives appeared to be rather sanguine about the economic prospects in their own countries and about their ability to deal with the cyclical softening in economic activity--and particularly in private investment. But, almost universally, concern was expressed about the general economic environment and the ability of other countries to maintain an appropriate growth path. These concerns applied primarily to Germany, Japan, and the United States.

A second universal point was the fact that the business communities in individual countries were much more pessimistic about economic prospects than were official forecasters. This stemmed partly from difficulties existing before August 15 (cost-push inflation, profit squeezes and stagnant industrial output), but the added factor of international uncertainty was thought to be very important. The difference between the private and the official assessments of the economic outlook was explained mainly by the fact that governments believed the balance of payments adjustment to be manageable and that a number of reflationary measures had been taken, the effect of which was not as yet evident to the business community.

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A factor that was neglected in these discussions was the fact that in the current cyclical situation this dichotomy between business and government views is to be expected: business will err on the pessimistic side in an attempt to shift the risks of expenditure decisions to the government, and the government will err on the optimistic side in an effort to shift the decision risks to the business community. The possibility that governments might be somewhat optimistic in their assessments of the situation, and particularly about the speedy effectiveness of policy measures, was expressed repeatedly by the U.S. delegation. It was pointed out that, given the observed time-lags, policy actions needed to be taken before they had obviously become necessary. Most policy actions likely to affect activity in the first half of 1972 had already been taken; if concerns existed about satisfactory growth rates in the second half of 1972, actions might have to be readied now.

Nevertheless, there was no unanimous agreement that the time for decisive reflationary actions had arrived. Particularly, the German and the Dutch representatives were hesitant in view of continued inflationary tendencies. It was further argued by representatives of the smaller open economies that reflationary actions by them might do little to restore confidence in the business community so long as the international situation continued to be uncertain. The Canadian and the Japanese representatives, at an earlier meeting, had estimated that GNP growth in their countries might be 1 percentage point greater (annual rate) in the first half of 1972 in the event of a settlement of the international uncertainties before the end of 1971 than in the absence of such an outcome.

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The Belgian representative noted that in the future domestically-led growth might be more important than the export-led growth of the past two decades. This was amplified by a statement by the Dutch representative that structural changes in the industrialized economies might lead to higher unemployment rates and lower long-term potential growth rates than estimated. The U.S. delegation thereupon suggested that EPC's working party 2 on long-term growth might reorient its work program to consider these structural problems as well as the long-term implications of short-term policy decisions.

Given the uncertainty with respect to the economic outlook in OECD countries (especially outside North America) during the second half of 1972, the United States delegation urged that EPC advance its regular meeting into early spring--rather than waiting until late May or early June. The final agreement was to hold two meetings: February 1 and 2 and April 27 and 28.