BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
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TO: Federal Open Market Committee

FROM: Arthur L. Broida ALB

Attached are reports submitted by Governor Wallich summarizing developments at the March meeting of the C-20 Deputies and the April Basle meeting.

Attachments

Henry C. Wallich
E. M. Truman

April 15, 1974

Report to the FOMC on the C-20 Deputies' Meeting
(March 27-29, 1974)

The Tenth Meeting of the Deputies of the Committee of Twenty established the basic agenda for the last meeting (May 7-9) of the Deputies and the final meeting of the Committee on June 12 and 13.

It was generally recognized that it was not possible or desirable at this time to try to reach agreement on the specific provisions for a comprehensive reform of the international monetary system. There was general endorsement of the U.S. position that international monetary reform should be an evolutionary process. But the French, with some support from the Italians, stated that the Committee should merely frankly acknowledge its lack of progress. And the representatives from the developing countries expressed considerable disappointment concerning the lack of agreement on the long-run reform and dismay about what was in the reform for them.

In terms of the long-run reform, therefore, a Revised Outline of Reform will be issued following the June meeting of the Committee. The content of this document will not differ greatly from the First Outline of Reform issued in Nairobi last September. But it is anticipated that the Revised Outline will be an agreed statement endorsed by the Committee itself, rather than just a report prepared by the Chairman and Vice-Chairmen of the Deputies. There will be, however, a separate document, or set of annexes, prepared by the Chairman and Vice-Chairmen of the Deputies that will not necessarily reflect the views of the Deputies and the Committee. It will describe the extent of the remaining disagreement concerning the operational provisions for the reformed system and will, inter alia, outline some of the options examined by the four Technical Groups established in Nairobi (Adjustment, Global Liquidity and Consolidation, Intervention and Settlement, and Transfer of Real Resources).

To cover the so-called "interim period," there will be either a separate part of the agreed Revised Outline or a separate document containing provisions that will be implemented right away. These provisions will include: (a) the establishment of a high-level Council representative of the twenty constituencies in the IMF that will periodically review the operation and structure of the international monetary system; (b) the resolution of the issues surrounding the valuation of Special Drawing Rights; (c) the establishment of guidelines for intervention during the expected continuation of an exchange-rate regime of generalized floating; and (d) the basis for review of the adjustment process and international liquidity probably using experimentally a reserve indicator structure. The agreement covering the interim period may also cover (a) the possible treatment of gold, (b) new provisions governing the use of trade restrictions for balance-of-payments purposes, (c) special arrangements for the developing countries, and (d) possible procedures for dealing with oil-money flows.

It has not been decided whether or not the provisions in such an interim package should be embodied in a set of amendments to the IMF Articles of Agreement. The United States supported the amendment approach. France, consistent with its views on the failure of the C-20, rejected it. Most countries reserved their positions. Moreover, the developing countries stated that they would not support an interim package that excluded the establishment of a link between SDR allocation and development assistance; if they were to maintain this position, agreement on a set of amendments to the Articles would be very difficult.

Four aspects of the interim package received extensive discussion at this meeting of the Deputies: guidelines for floating, provisions concerning gold, the possible new provisions governing trade restrictions, and the terms of reference for the continuing work of the C-20 Technical Group on the Transfer of Real Resources.

On guidelines for floating, there was continued resistance by the French to the idea that any new provisions were needed. The rest of the participants did not seem to share this view. In particular, there was general support for a guideline calling for intervention for smoothing purposes to maintain orderly market conditions. There was extensive, but less than unanimous, support for a guideline permitting intervention to moderate trends in market rates. There was considerable resistance to a guideline that would call for the establishment of zones or ranges for effective exchange rates outside of which countries could or should be more active in resisting exchange-rate movements. Canada, Japan, Germany, Italy, and the United States were among the skeptics; the United Kingdom, the Scandinavians, and the developing countries were among the more active supporters of such a guideline. The entire subject will be discussed by the Deputies in Paris in May and is also being considered by the Executive Board of the IMF.

The discussion on gold primarily involved a restatement of previously stated positions, although the representatives of several major countries (United States, Germany, France) did not speak at all. A major personal statement was made by Mr. Mitchell of the United Kingdom. He reaffirmed his support for the SDR, rejected an increase in the official price, rejected any procedure that would lead to official manipulation of the market price, but had no objection to voluntary transactions among monetary authorities at mutually agreed prices. The representatives of the developing countries expressed their dismay about any arrangement concerning gold that might be agreed outside of the IMF -- a position also taken by Japan -- and stated their concern about the distributional implications of any action on gold that would increase the effective reserves of a limited group of developed countries.

Mr. Jack Bennett of the United States introduced a proposal that, in light of present circumstances, countries should pledge not to impose trade restrictions for balance-of-payments purposes and that, in support of this concept, there be an amendment to the IMF Articles requiring IMF approval of any such trade restrictions in the future. Most participants reserved their positions on this proposal. There were, however, doubts expressed concerning the implications of the proposal for the GATT and its procedures. The proposal will be discussed again by the Deputies in May.

Finally, it was agreed that the Technical Group on the Transfer of Real Resources should prepare, in cooperation with the relevant international institutions, a detailed framework for the study of the broad question of the transfer of real resources and make recommendations concerning the implementation of such a study. It is understood that this proposal might look toward the establishment of what has been called a "C-20 for Development."

If the final result of the C-20 exercise turns out the way the meeting here reported on suggests, there will be no real reason to call the effort a failure. To develop a new monetary system from scratch and in the abstract is an almost impossible task. Whether having on the shelf a plan that is agreed only in part will help at some future point is an open question. The history of the IMF suggests that agreements reached in the past can be helpful more than ten years later, even if not implemented fully in the meantime. On the other hand, the experience of floating is likely to change the minds of policymakers in many ways and may cause them to make a fresh start at some future time.

The American plan, upon which the long-run reform is based, is highly innovative. It seeks to reconcile the demand of mainly the Europeans for dollar convertibility with the need of the United States not to let convertibility hamstring domestic monetary policy. In the course of a period of floating the Europeans may well come to take a different view of the need for dollar convertibility. Conceivably, also, the U.S. may come to take a different view of its own interests in international monetary relations. This consideration lends strength to the view that long-run reform should be an evolutionary process.

The group decision to focus immediate attention upon short-run matters seems to be a wise one. Worldwide inflation in combination with the great increase in oil prices will make the period ahead a very difficult one. This is reflected in the great difficulties that the C-20 group had in arriving at a consensus on guidelines for floating after both the Committee Bureau and the IMF had proposed rather detailed formulations for that purpose. The desire to restrain inflation makes countries want to keep the value of their currencies high. Difficulties in financing the oil deficit may force the weaker countries in the opposite direction. In the absence of more detailed guidelines for floating, continued international contact among policymakers, including on the delicate subject of exchange rates and interest rates, is urgently needed.

Henry C. Wallich
April 15, 1974

BIS Meeting of April 8-9, 1974

The following principal points of interest emerged.

Inflation

There appears to be a growing resignation with respect to inflation and less of a sense of urgency and even of capability to do much about it. Among the reasons are the supply conditioned nature of the present inflation, which has its roots in good part in the food, oil, and other commodities situations; the weakness of the governments in some countries, e.g., the U.K. and Italy, and the lack of a government in others, e.g., Belgium and France; finally, the familiar evidence of massive wage increases and unwillingness to accept severe restraining measures. This state of mind seems to lead to a growing interest in means that would make it possible to live with inflation. An Italian plan reported by Carli for the issuance of government bonds, the interest rate of which would be tied to short-term market rates, possibly with some additional indexing features, aroused considerable interest. Zijlstra suggested that indexing should be discussed at some future meeting.

Lender of Last Resort

There was continued concern about the impact of Arab money on the liquidity of Eurocurrency banks. It seems to be taken for granted that there will be a considerable amount of medium-term lending based on short-term deposits. Should a problem arise, it was indicated, the responsibility for helping the bank or banks in trouble could lie with the central banks of the country where the trouble occurred, or with the central banks of the head office of the branch if a branch were in trouble, or the central bank responsible for the currency in which the bank affected principally operated. Janson (Belgium) and Masera (Italy) indicated that their respective central banks could not be responsible for the foreign currency operations of banks located in their countries. I pointed out that a central bank could not be expected to act as lender of last resort with respect to problems that arose in its currency but affecting banks in third countries. If the problem affects a branch whose head office in turn might be affected, this would be a different matter. I believe that the lines of responsibilities in this regard will need to be clarified more effectively than they have been by the meeting on which I am reporting.

National Economic Conditions

No great concern was visible concerning the consequences of the oil situation. Only the Italians were quizzed intensively, especially with regard to their anti-inflation program. It involves both fiscal and monetary restraints, the latter both in the form of higher interest rates and credit ceilings. The recent support of the lira at a rate of about a billion dollars a month was questioned.

The Germans believe that they turned the corner in the first quarter and are on their way up, although housing, automobiles, and textiles remain weak.

The British are aiming at expansion, within the context of what was claimed to be a neutral budget. The Japanese economy, with inflation approaching 30 per cent per year, is slowing somewhat. A tight monetary policy nevertheless is intended to be maintained to curb inflation.

Money Supply

A review of the main national statistics conveys the impression that the over-all increase in national money supplies is slowing, a development which contrasts somewhat with the resigned attitude toward inflation.