



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

November 10, 1976

CONFIDENTIAL (FR)
CLASS II FOMC

TO: Federal Open Market Committee

FROM: Arthur L. Broida

ALB

Attached is a copy of a memorandum from the Subcommittee on the Directive, dated today and entitled "Recommendations regarding last two paragraphs of domestic policy directive."

It is contemplated that this memorandum will be discussed at the meeting of the Committee to be held on November 16, 1976.

Attachment

November 10, 1976

CONFIDENTIAL (FR)
CLASS II FOMC

TO: Federal Open Market Committee SUBJECT: Recommendations
FROM: Subcommittee on the Directive^{1/} regarding last two para-
graphs of domestic policy
directive

The Subcommittee on the Directive recommends that the FOMC recast the last two paragraphs of the domestic policy directive to incorporate the longer-run growth ranges adopted quarterly and the short-run specifications agreed upon at each meeting. Specifically, we recommend that:

1. The next to last paragraph, which now sets forth the Committee's broad economic objectives, be expanded to cite the numerical ranges most recently adopted by vote of the Committee, and to note that the ranges appear to be consistent with the economic objectives.

2. The last paragraph, which now sets forth the Committee's short-run instructions to the Desk in very general terms, and the so-called "specifications sheet," which lists the numerical ranges for the aggregates and the funds rate, be replaced by a last paragraph that incorporates the short-run specifications in **numerical** form.

Each of these recommendations is discussed briefly below.

Illustrative language is given in the appendix; for the last paragraph, alternatives are shown corresponding to the "monetary aggregates" and "money market conditions" formulations the Committee now uses.

1/ Messrs. Bales, Morris, Wallich, and Partee (Chairman). Mr. Morris participated in the Subcommittee's discussion but did not have an opportunity to review the specific recommendations in this memorandum.

-2-

Citing longer-run ranges in next to last paragraph

The obvious reason for citing the current longer-run ranges for the monetary aggregates in the next to last paragraph is that they are intimately related to the economic objectives set forth there. Citing the longer-run ranges would serve the additional purpose of providing perspective for the short-run figures, assuming that the latter are to be given in the last paragraph.

Two further comments might be made. First, it is assumed that the Committee will continue the practice (begun at the telephone conference meeting of November 8) of voting formally on the longer-run ranges, so that any member disagreeing with the Committee's decision will have an opportunity to cast a dissenting vote. Presumably, the member would not find it necessary to dissent again from the directive simply because it cited the ranges. Secondly, while the Committee adopts a new directive (and short-run specifications) at every meeting, it customarily reviews the longer-run ranges only once a quarter. If identical language was used at the quarterly meetings when the ranges were reviewed and at the intervening meetings, the public might be given the mistaken impression that the Committee had reviewed the longer-run ranges at each of the intervening meetings. To avoid such impressions, it might be desirable to indicate in directives adopted at intervening meetings that the longer-run ranges cited remain the same as those agreed to at an earlier date. Some possible language is given in the appendix.

-3-

Incorporating short-run specifications in last paragraph

There are two main arguments for including the short-run specifications in the last paragraph of the directive.

1. The short-run specifications in fact transmit operating instructions to the Desk, which is the function the directive is intended to perform. Thus, the proposed change would make form consistent with substance. The fact that qualitative language of the present type (e.g., calling for "moderate growth in monetary aggregates") can be and often has been left unchanged for long periods demonstrates--if any demonstration is needed--that it conveys relatively little information regarding the Committee's current intentions.

2. The proposed change would provide a ready means to record formal votes on the short-run specifications, paralleling the new practice of voting formally on the longer-run ranges. For purposes of FOMC records, both short- and longer-run targets have traditionally been treated not as "actions" of the Committee but rather as "informal understandings regarding the manner in which the directive is to be interpreted." This practice arose during the period when the specifications were treated as confidential and were not included in the policy record; had formal votes been taken, publication would have been required by law.^{1/}

^{1/} The Federal Reserve Act requires inclusion in the policy record of "all votes taken in connection with the determination of open market policies...." The Freedom of Information Act requires publication in the Federal Register of all "...statements of general policy..." and public access to records of "...the final votes of each member in every agency proceeding..."

-4-

However, the reason for the practice disappeared when the Committee began publishing the targets--in January 1974 for the short-run specifications and April 1975 for the longer-run ranges--and it is not clear that any important purpose is now served by not recording formal votes on the short-run specifications.

Appendix

I. Longer-run ranges in next-to-last paragraph

At present the next-to-last paragraph of the directive reads as follows:

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions that will encourage continued economic expansion, while resisting inflationary pressures and contributing to a sustainable pattern of international transactions.

At meetings at which the Committee considers and decides on longer-run targets, the figures might be incorporated simply by adding the following sentence:

Annual rates of growth for M_1 , M_2 , and M_3 within ranges of 4-1/2 to 6-1/2 per cent, 7-1/2 to 10 per cent, and 9 to 11-1/2 per cent, respectively, from the third quarter of 1976 to the third quarter of 1977 appear to be consistent with these objectives.^{1/}

At intervening meetings, it might be desirable to introduce the sentence cited above with some such clause as "At its meeting on (date), the Committee agreed that...."

^{1/} Governor Wallich would prefer to insert the word "target" before "ranges" and to replace the words "appear to be consistent with" with the word "reflect."

-2-

II. Short-run specifications in last paragraph--monetary aggregates formulation

At present, the monetary aggregates formulation of the last paragraph reads as follows:

To implement this policy, while taking account of developments in domestic and international financial markets, the Committee seeks to achieve bank reserve and money market conditions consistent with moderate growth in monetary aggregates over the period ahead.

The proposed form is as follows:

To implement this policy, the Committee seeks to encourage near-term rates of growth in M_1 and M_2 on a path believed to be consistent with the longer-run ranges^{1/} for monetary aggregates cited in the previous paragraph. Specifically, it expects the annual growth rates over the October-November period to be within the ranges of 5 to 9 per cent for M_1 and 9 to 13 per cent for M_2 . In the judgment of the Committee such growth rates are likely to be associated with a weekly average Federal funds rate of about 4-7/8 per cent.

If, giving approximately equal weight to M_1 and M_2 , it appears that growth rates over the 2-month period will approach or move beyond the limits of the indicated

^{1/} Governor Wallich would prefer to insert the word "target" before "ranges" here and at the corresponding point in the money market formulation.

-3-

ranges, the operational objective for the Federal funds rate shall be modified in an orderly fashion within a range of 4-1/2 to 5-1/4 per cent.

III. Short-run specifications in last paragraph--money market formulation

At present, the money market formulation of the last paragraph reads as follows:

To implement this policy, while taking account of developments in domestic and international financial markets, the Committee seeks to maintain prevailing bank reserve and money market conditions^{1/} over the period immediately ahead, provided that monetary aggregates appear to be growing at about the rates currently expected.

The proposed form is as follows:

To implement this policy, the Committee seeks to maintain prevailing money market conditions^{1/} during the period immediately ahead, provided that monetary aggregates appear to be growing at about the rates currently expected, which are believed to be on a path consistent with the longer-run ranges for monetary aggregates cited in the previous paragraph. Specifically,

^{1/} Or, "to achieve slightly (or somewhat) easier (or firmer)... conditions."

-4-

the Committee seeks to maintain the weekly average Federal funds rate at about $4\frac{7}{8}$ per cent, so long as M_1 and M_2 appear to be growing over the October-November period at annual rates within ranges of 5 to 9 per cent and 9 to 13 per cent, respectively. If, giving approximately equal weight to M_1 and M_2 , it appears that growth rates over the 2-month period are deviating from these expected ranges, the operational objective for the weekly average Federal funds rate shall be modified in an orderly fashion within a range of $4\frac{1}{2}$ to $5\frac{1}{4}$ per cent.