

# TRANSCRIPT

## FEDERAL OPEN MARKET COMMITTEE MEETING

December 19-20, 1977

### Prefatory Note

This transcript has been produced from the original raw transcript in the FOMC Secretariat's files. The Secretariat has lightly edited the original to facilitate the reader's understanding. Where one or more words were missed or garbled in the transcription, the notation "unintelligible" has been inserted. In some instances, words have been added in brackets to complete a speaker's thought or to correct an obvious transcription error or misstatement.

Errors undoubtedly remain. The raw transcript was not fully edited for accuracy at the time it was produced because it was intended only as an aid to the Secretariat in preparing the record of the Committee's policy actions. The edited transcript has not been reviewed by present or past members of the Committee.

Aside from the editing to facilitate the reader's understanding, the only deletions involve a very small amount of confidential information regarding foreign central banks, businesses, and persons that are identified or identifiable. Deleted passages are indicated by gaps in the text. All information deleted in this manner is exempt from disclosure under applicable provisions of the Freedom of Information Act.

### Staff Statements Appended to the Transcript

Mr. Sternlight, Deputy Manager for Domestic Operations

12/19-20/77

Meeting of Federal Open Market Committee

December 19-20, 1977

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D. C., on Monday and Tuesday, December 19-20, 1977, beginning at 4:00 p.m. on Monday.

PRESENT: Mr. Burns, Chairman  
Mr. Volcker, Vice Chairman  
Mr. Coldwell  
Mr. Gardner  
Mr. Guffey  
Mr. Jackson  
Mr. Lilly  
Mr. Mayo  
Mr. Morris  
Mr. Partee  
Mr. Roos  
Mr. Wallich

Messrs. Balles, Baughman, Eastburn, and Winn,  
Alternate Members of the Federal Open  
Market Committee

Messrs. Black, Kimbrel, and Willes, Presidents  
of the Federal Reserve Banks of Richmond,  
Atlanta, and Minneapolis, respectively

Mr. Broida, Secretary  
Mr. Altmann, Deputy Secretary  
Mr. O'Connell, General Counsel  
Mr. Axilrod, Economist

Except as noted, the following attended the Tuesday session only:

Messrs. Balbach, R. Davis, T. Davis,  
Eisenmenger, Ettin, Reynolds, Scheld  
Truman, and Zeisel, Associate  
Economists

Mr. Pardee, Deputy Manager for Foreign  
Operations

Mr. Sternlight, 1/ Deputy Manager for  
Domestic Operations

Mr. Hudson, Assistant to the Chairman,  
Board of Governors

Messrs. Coyne 1/ and Keir, Assistants to  
the Board of Governors

Mrs. Farar, Economist, Open Market  
Secretariat, Board of Governors

Miss Klaput, Open Market Secretariat,  
Board of Governors

Messrs. Boehne and J. Davis, Senior Vice  
Presidents, Federal Reserve Banks of  
Philadelphia and Cleveland, respectively

Messrs. Brandt, Broaddus, Burns, and Keran,  
Vice Presidents, Federal Reserve Banks  
of Atlanta, Richmond, Dallas, and  
San Francisco, respectively

Mr. Duprey, Senior Economist, Federal  
Reserve Bank of Minneapolis

Mr. Ozog, Manager, Securities Department,  
Federal Reserve Bank of New York

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1/ Attended Monday and Tuesday sessions.

Transcript of Federal Open Market Committee Meeting of  
December 19-20, 1977

[Executive session]

CHAIRMAN BURNS. Our meeting will get under way now. I believe all of you have been informed of the passing of [former Board Chairman] Marriner Eccles, who served us for 12 years or more--I'm not sure of the exact period--at the Federal Reserve Board. I think it would be proper if all of you joined me in standing to pay our respects to the departed member of this family, in a moment of silence. Mr. Gardner will represent the System at the funeral, which will be held on Thursday, I believe.

We will get this meeting under way by calling on Mr. O'Connell to discuss the present status of the Merrill case, and where he thinks we are in the judicial realm, and where he thinks we will be going. Mr. O'Connell, please.

MR. O'CONNELL. Yes, Mr. Chairman. For the Committee's recollection, the Merrill case, of course, involves a demand that is made under the Freedom of Information Act for certain of the Committee's documents derived from two meetings of the Committee in '76. And the lower court decision, from which an appeal has been taken--the issue on appeal relating primarily and almost solely to the requirement [that] the Committee issue and make public promptly after its adoption the directive of the Committee, including the short-range targets. That was the issue on the appeal, and as you recall, Mr. Chairman, the mandate [of the] Court of Appeals, under its rule, was to be effective December 1. That is, the Committee is required to follow the order of that court.

We filed with the Department of Justice on December 9 a very thoroughly researched request for the Solicitor General to take to the Supreme Court, a request for review by that body of the Court of Appeals decision. We had preceded [that] with the request that the Department [of Justice] obtain for the Committee an extension of this December 1 mandate, and they requested of the Court of Appeals an extension until January 1 [for] the Committee to comply with the mandate issued by the Court of Appeals pending the preparation of the Solicitor's position.

As of noon today, in my conversations with our counsel in the [Justice] Department, the department's Civil Division position--[what] it will recommend to the Solicitor General--has not yet been forwarded to the Solicitor General. At the appellate level [of the department], the attorney to whom I spoke has recommended a position to the Assistant Attorney General in that division [the Civil Division]. He describes [that position] as, while not being as strongly supportive of certiorari as he felt our document was, in no sense was it negative, as he said.

CHAIRMAN BURNS. What document is this now?

MR. O'CONNELL. The attorney in the Civil Division prepared an intraoffice memorandum analyzing the case for and against the certiorari petition, Mr. Chairman. He was not at liberty to tell me exactly what his recommendation was, but he merely came close to

saying it wasn't as strongly supportive as the Committee's letter, but he felt it didn't have a negative cast to it. He has advised [us] of his receipt of the Treasury Department's letters supportive of our position, copies of which have been distributed to the [FOMC] members. So there has gone forth to the Assistant Attorney General of the Civil Division our letter on behalf of the Committee, the Treasury Department positions, and a memorandum position from the attorney staff level [of] the [Justice] Department. There will now go, from the Assistant Attorney General to the Solicitor General, the total recommended position of the Civil Division, a copy of which, hopefully, we will obtain when it goes forward. As yet, to my knowledge, it hasn't gone forward.

Meanwhile, the Committee has until January 1, as best we know, within which to comply. Hopefully, as we get near the first of January, that date will be extended, as is necessary and if it can be obtained. Or it will automatically be extended--if the Solicitor General files on the Committee's behalf a petition for writ of certiorari, under the rules, that will automatically stay any requirement of this Committee to comply with the Court of Appeals orders until the Supreme Court has either accepted and ruled upon our position or denies it. And I will, of course, promptly advise the Committee on receipt of either of those dates.

May I quickly touch on the fact that, with respect to the suit of Reuss v. Balles et al., which you recall involves allegations by Mr. Reuss that the selection method for the [Bank] President members of the FOMC is unconstitutional because it does not derive from a selection by the [U.S.] President with the advice and consent of the Senate. We won that case on motion in the District Court, the court holding Mr. Reuss didn't have standing to bring the suit. Mr. Reuss appealed that issue and that decision, and it was argued [earlier] this month, December 8, before a three-member panel of the Court of Appeals here in the District of Columbia.

The argument, I think, went fairly well. Our counsel from the Department of Justice was well prepared and, I think, a pretty sharp man. He knew his case, he was able to respond to questions put to him by the court. One of the three members of the court was absent, Judge Tamm, but a recording of our arguments will be presented to him so he will have heard all arguments before he begins to deliberate on the decision. We have no idea when to expect an action by the Court of Appeals. Mr. Chairman, I think that brings my information current on both cases. If I can answer any questions, I will be pleased to do so.

CHAIRMAN BURNS. All right, thank you, Mr. O'Connell. Are there any questions about the status of the Merrill case? Yes, Mr. Eastburn.

MR. EASTBURN. If the Supreme Court were to accept it, what kind of timetable do you suppose would be involved?

MR. O'CONNELL. It's hard to tell, Mr. Eastburn. From the notification of acceptance, we follow certain established procedural time limits for filing of briefs, answering briefs, oral arguments, dates, and so forth. As much as six months could be involved, even on the established calendar.

CHAIRMAN BURNS. Any other questions?

MR. PARTEE. And if they don't accept it, Tom, that would make it, after the first of January rather promptly, something we would have to do on a current basis?

MR. O'CONNELL. Governor, if it is rejected as of that date, it is up to the Court of Appeals to issue a date of mandate effectiveness. But I think it would follow promptly upon the actions of the Supreme Court in the denying of writ, but we would get a date definite, and I would advise the Committee as promptly as possible.

CHAIRMAN BURNS. Mr. Baughman.

MR. BAUGHMAN. Would you have an opportunity to present views to the Court of Appeals relative to an effective date?

MR. O'CONNELL. With respect to the mandate per se, no, we would not. Presumably our petition having been denied by the Supreme Court--that they will not accept the case on appeal--and a sufficient extension having been obtained to enable us to pursue that, we are pretty well bound by whatever mandate the Court of Appeals issues. It is possible--an outside possibility, Mr. Baughman--that the Court of Appeals could be addressed on the single issue of taking to the Congress a petition for congressional relief as suggested in the opinion. If that were the sole reason, [the Justice] Department questions whether the court would grant an extension solely for that, but it's a reasonable possibility, and I think we would try it to gain further administrative time under that matter.

CHAIRMAN BURNS. Mr. Guffey?

MR. GUFFEY. Tom, did I understand, if the Solicitor General files with the Supreme Court for a writ, then we have as much as six months before the Court rules whether they will grant the writ and hear the case or deny the writ. Is that correct?

MR. O'CONNELL. I stated, President Guffey, as a minimum, my judgment, about six months would be involved. The Supreme Court could respond to our writ promptly within a month. The scheduling of that, the briefing, would be automatic, but scheduling for the oral argument could be months, and so forth. As you know, the Court recesses and then takes up again at a later date. It's difficult to know how long we would be with respect to that calendar.

MR. GUFFEY. But the critical part of the timing, though, is the Solicitor General's decision to file for writ?

MR. O'CONNELL. Correct. If he does so, pending the Court's answer of affirmative or not, a status is still in effect, and that is automatic once the petition has been filed. Correct.

CHAIRMAN BURNS. Any other questions? If not, let me say a few words about efforts directed toward legislative relief. Unless the Supreme Court decides to set aside the decision of the Court of Appeals, assuming that the case ever gets to the Supreme Court--that is quite uncertain. First, the Solicitor General has to recommend that the Supreme Court take on an appeal. And second, the Supreme Court has to decide whether to have the case appealed to it. Assuming these two hurdles are overcome, unless the Supreme Court overrules the lower court,

we will need to seek legislative relief, and I think that is something we should get under way rather promptly.

Now, I have had several conversations with members of the Congress on this question. One was a suggestion to Mr. Hannaford, who had introduced a bill calling for the reinstatement of the Memorandum of Discussion, and as you may recall, I testified on that piece of legislation several weeks ago. I suggested to Mr. Hannaford that he add a title to his bill that will permit us to delay the release of our directive for something like 30 days. In other words, give legislative sanction to our current practice. And he is sympathetic to that, but I don't have a definite response from him. Secondly, I have held a preliminary conversation with Congressman Parren Mitchell on this, and he's been noncommittal. Third, I had a lengthy meeting with Chairman Reuss on this question, and as you may know, in the past Chairman Reuss has indicated that he felt that the decisions reached by the FOMC should be announced promptly. And that has been his position all along, as far as I can remember. When I outlined the problem to him, indicating what I and most, if not all, of my colleagues felt about this decision of the Merrill case, he stated that yes, he had objected to the delay in making public the FOMC decisions; he had objected to that in the past, but now, it is no longer an academic issue, and he is prepared to re-examine his own position.

Now in addition to these preliminary conversations, I and the staff have been giving some consideration to the possibility, or more accurately, the desirability, of seeking an amendment to the GAO [General Accounting Office] bill that is now being considered by the Government Operations Committee of the Senate. Now that is something that might possibly be useful. That is, to have an amendment added to that bill, and that is the quickest legislative medium we have for obtaining our objectives. The chances are, [the House sponsor, Rep.] Rosenthal, wouldn't much care about that particular thing one way or another, but he would be interested primarily in getting the kind of bill that was passed by the House, getting that accepted in Congress. And that is something I intend to take up, well, that's my present intention. I haven't reached a firm decision on this. I intend to take up first with the senators--Sasser is it? You testified, Governor Coldwell, on the GAO bill. That is a matter of courtesy, and I think I should start there and go to [Senators] Ribicoff and Percy, the senior members of that committee.

MR. COLDWELL. That presumes, however, that you are going to endorse the GAO bill.

CHAIRMAN BURNS. No. No, it presumes that a compromise on the GAO bill may need to be reached. The kind of compromise that I have in mind is the possibility of striking the section dealing with bank examinations. In other words, not allow GAO access to bank examination reports and--

MR. COLDWELL. Well, I guess my question is, question of strategy--you deal with it more than the rest of us, but the question is whether the GAO bill is actually going to get passed. I have not crossed that bridge in my mind.

CHAIRMAN BURNS. Well, that is a fair question. My own guess is that the GAO bill in some form is going to pass. And that, if the section on bank examination reports could be deleted, we could do reasonably well. Now, in saying that, I have no objection at all, needless to

say, seeing the whole bill defeated. On the contrary, there is nothing I would like to see better. But I am not optimistic that that can be accomplished.

MR. COLDWELL. I'm not totally optimistic that it can be accomplished either, Mr. Chairman. But I would like to see a little more evidence of some real interest [in] the Senate before we start a compromise of it.

CHAIRMAN BURNS. Well, that's fair, that's fair. That's why I have delayed any conversation there, because I like to feel my ground there. In the House, that's different.

MR. COLDWELL. That's already gone. The Senate--I'd like to see what they come back with after their vacation.

CHAIRMAN BURNS. Well, now, we have to be a little careful. Unless I have a conversation with Senator Sasser to begin with rather soon, there is a chance that the bill as it came from the House will be reported out favorably.

MR. COLDWELL. Well, they haven't had a markup session yet.

CHAIRMAN BURNS. Well, I know, but I think I would have to hold my conversation before that. Once you reach the markup stage, well then, the fate is, practically speaking, sealed. You need to have somebody there within the committee, or more than one, to lead the fight for the elimination of the whole thing or for some sort of decent compromise. So I think testing the waters within the Senate Committee on Government Operations will become essential very soon.

MR. COLDWELL. Couldn't that be done by a person or people not particularly in favor of it--somebody who would take this as an acceptance of GAO?

CHAIRMAN BURNS. Well, I'd love to have someone on the Democratic side as well as on the Republican side. If you are going into a legislative battle, you ought to be armed on both sides if at all possible, and Senator Sasser--having served as chairman of the hearing--will undoubtedly speak with a measure of authority in the committee's deliberations.

MR. JACKSON. I think maybe we are getting too much into strategy right now, but it also opens this opportunity. If the Senate Government Operations Committee would accept such a proposal, it opens the chance that members of the Senate Banking and Currency Committee would feel that their turf has been invaded, and they might start the type of judicial arguments that would serve to delay even if not the [unintelligible].

MR. COLDWELL. I'd have to remember more carefully than I do, but I think there is some comment about referring that GAO [bill] to Senate Banking as a courtesy referral before a final passing.

CHAIRMAN BURNS. Well, that I'm not acquainted with--

MR. COLDWELL. I'm pulling something out of memory that I'm not positive about. The reason I was--

CHAIRMAN BURNS. That, I'm not acquainted with. I wish you would look that up immediately, because if that is true, we'd have a better chance in Senate Banking for doing something than we will have in the Government Operations [Committee].

Well, that is all I can say, really, about the steps that have been taken or are presently being considered in the way of seeking the legislative solution. As for the chances of success, it is much too early to try to evaluate that. Are there any questions about the legislative approach? If not--

MR. BALLEES. Mr. Chairman?

CHAIRMAN BURNS. Yes, Mr. Balles.

MR. BALLEES. I had hoped that we wouldn't keep this GAO bill alive because we were using it as a legislative vehicle to help solve the Merrill decision. After my session with you and subsequently with all of the Presidents, the tone that we tried to communicate to our directors on an active campaign is that [it's] possible to get the Fed exempted entirely from the GAO bill. And we kind of meet ourselves coming around the barn, I'm afraid, if we are going to use the same bill for amendment purposes to solve another problem. I'm afraid we are going to get our goals kind of mixed up here. That bothers me a little.

CHAIRMAN BURNS. No, we are not going to do that. I was trying to indicate something I am thinking about, and this is on the assumption that, after as good appraisals as we could make, the chances of defeating the GAO bill [in] the Senate Government Operations Committee are [found to be] negligible, are small.

MR. BALLEES. Okay.

CHAIRMAN BURNS. I don't think we will have that problem. We'll guard against that. Any other questions? If not, let me call on Governor Partee, who has worked with a [sub]committee of our members on the procedures that might be followed if the court's order becomes effective. Mr. Partee, would you be good enough to make your report now?

MR. PARTEE. Well, Mr. Chairman, we were asked to consider on an emergency basis this contingency planning, the question of what we would do in the event that we lose the court case or have to suddenly publish the directive. The subcommittee had two meetings since the last meeting of the Committee, and the staff met and drafted a report which has been approved by the subcommittee. You all have it before you, and I see no great purpose to be served in going through it in any detail with you today, since I am sure you have read it. I would say that we considered three separate problems having to do with the directive, and they are taken up in order in the draft material.

The first is what to do about specification of the short-run instructions to the Manager. The recommendations are contained on page 12 of the report. We considered quite a wide variety of alternatives in looking at this--having meetings more frequently, giving more discretion to the Manager, turning to more qualitative kinds of characterizations of the directive, having wider or narrower ranges for the aggregates or for the funds rate than we now do,

meeting on a different day of the month. We had quite a variety of proposals, and in the end we decided that the best procedure would be to continue with the same kind of a specification of short-range targets as now exist in the directive, I think for two reasons, principally.

The first is that that this is something that we have worked out over a considerable period of time, and it's working reasonably well. And we would be fearful that to radically change the procedure now could possibly upset policy and the carrying out of policy, which, after all, is the major purpose to be served by the directive. And the second reason is that to change significantly the procedures and the directive of the Committee could be judged in the wake of a court determination as an effort to avoid the finding of the court, which would have some disadvantage to us. Even if it weren't a substantial criticism, it could still have a cosmetic disadvantage to us. So our feeling was that, everything considered, we ought to continue to follow along with the short-run specs much as they exist now in the directive.

We did, however, think that two modifications in the directive procedures and language might be considered by the Committee. First of all, we would add a sentence to the effect that the Manager should take account of emerging financial market conditions. This is a variant of a phrase that was in the directive for a long number of years, as you recall, but was taken out a couple of years back because it didn't seem to be actively used, it didn't seem to have any real bearing on operations in the ordinary course of events. Now, however, there will be two advantages to reinsert such a sentence. One is that it would, in fact, permit the Manager to take special action in the wake of the court decision, not knowing how market reactions would be to the publication of the directive. And the second purpose to be served, I think, is that it would establish a degree of looseness between the specifications and the Manager's actions, which would provide an uncertainty in the market's mind so they wouldn't think that deciding what was going to happen to rates was like shooting fish in the barrel. And, therefore, we would have that modification.

The second [modification] is that, at least for awhile, we think that the Committee would be well served to keep a relatively narrow funds rate range. Now, in fact, we have had a narrow funds rate range for quite a few recent meetings, typically 1/2 point. And we think that the 1/2 point range might be continued for awhile just to reduce the exposure to large-scale changes in market expectations that the publication of the directive might bring about. That raises the hazard that there might need to be more frequent reconsideration of instructions and amendment of instructions, but it's a hazard we think that probably should be taken in the short run while we are feeling our way, at least with regard to how publication affects market behavior. So that's our recommendation with regard to the short-run specs.

Now, there is also a problem having to do with the longer-range specifications of movements in the aggregates thought to be appropriate [for] the financial and economic conditions that we seek. That is the 12-month specifications. The difficulty there is that the current directive has no particular rationale for the choice of those, for the kinds of thinking that goes into choosing and updating those long-run specifications. And it seems particularly appropriate in the case of those that are mandated by the Federal Reserve Act as amended. It seems particularly appropriate for the long-range growth rates of the aggregates to be associated with a rather full explanation of the reasons why the Committee has chosen these particular

growth rates. Now those reasons in recent years have been given by the Chairman in his testimony before the proper oversight committee. And rather than try to create a system of explanation over and above the directive that would be published promptly in connection with the revision of longer-run ranges, we think it best to continue to associate the announcement of the longer-run ranges with the Chairman's statements before the oversight committees.

This means that the Committee could not in fact determine what the long[-run] ranges would be until just before the Chairman testifies--a date that we don't have total control over because there is a Senate or a House Committee that controls the hearings. And it frequently means that there would be a delay of a week or two weeks between the immediate predecessor meeting of the Committee and that testimony. Well, on one, perhaps two occasions in the last couple of years, the Committee has faced this problem with regard to the Chairman's appearance, and it has had a tentative discussion of the appropriate longer-range targets. I shouldn't use the word targets--longer-range aggregate growth rates--and then has had a telephone conference call to firm them up the day before the Chairman is testifying.

And we see nothing wrong with that as a procedural matter. Our general counsel feels that this might, in fact, seem to be arbitrary--a way of getting around the court order. But it seems to me that the need to have the explanation of the long-range targets, and also the possibility that intervening developments might change our view on the appropriate long-range targets, make it quite reasonable to have a preliminary discussion of that sort and then a final discussion, by telephone if you wish, of the long-range targets just before they are presented to the oversight committee. So that with regard to the long-range part of the directive, that would be our recommendation.

The third problem that we addressed, not very successfully because we didn't have our general counsel's views at the time of our second meeting, is the problem of dealing with the record of [affirmations and] dissents--votes for [and against] the regular short-term directive and for [and against] the long-range specifications that I have just discussed. It appears that the publication of the directive would either immediately or very soon thereafter call for a presentation of the votes on the directive and on the long-run specifications that had been decided upon by the Committee.

The awkwardness there is that, as soon as the press, public generally, finds that a member of the Committee has dissented, or certain members of the Committee have dissented, there would be a desire to find out why. And although an individual could give a very quick brief reason for his dissent, that would be in the absence of an explanation of the majority point of view, which is contained in the policy record [Record of Policy Actions] entry and is not published until 30 days, I guess, after the previous meeting. And it takes quite a while to develop, as you know, the policy record, the orderly discussion of the proceedings of the Committee--the review of that material, as prepared by the Secretariat, by each member of the Committee, and changes in that, and then that policy record is adopted as a proper summary of the previous meeting at the subsequent Committee meeting. And therefore it is difficult to upset that rather full explanation of the give and take of the Committee meeting and of the reasoning behind the consensus that was reached.

It would be far preferable, in our view, if the fact of dissents, the particular names of the dissenters, and the [numbers] of dissents could be held until the time we put that policy record out. Our general counsel thinks it is very unlikely that we can do that, and so, if in fact we cannot hold [the reporting of] those votes until an orderly time for putting out the Record [of Policy Actions] of the Committee, why we would simply have to hope, perhaps reach an informal understanding, that dissenters would not give an explanation of their dissents until the time that the policy record had been cleared, which would be just following the next meeting of the Committee. And so that was the third area that we discussed.

There is also attached to the report of the Committee a little review of informal conversations that the Desk has had with a number of securities dealers--banks and nonbank dealers in the market--Peter, you [also] have one mutual fund listed here, and a nondealer bank--indicating what their feelings would be as to the impact of current publication of the directive. It's a mixed bag, as these things generally are. Some think that there would be a substantial effect. Some could see traps for us at particular times when policy was in the process of changing. I think it's an interesting review of informed market comment--informed in the sense that they follow the activities of the Committee; but not so informed in terms of what our particular strategies would be in this event--that Peter, I think, was mainly responsible for. And so, if there are questions about that, I am sure he would be glad to answer them.

Well, that's all I have to say, Mr. Chairman. Our three recommendations, therefore, are, with minor amendments: (A) We continue to publish the current short-term specifications in a directive form just as they exist today. (B) With regard to the longer-term ranges for the aggregates, we withhold a Committee determination until just before the Chairman's periodic appearances before the oversight committees. (C) With regard to dissents on both parts of the Committee's policymaking procedures, that preferably the directive [with] the dissents be held up until the publication of the policy record [Record of Policy Actions] as a whole; if that is not possible, then the dissenters agree not to give reasons until the policy record has come. Thank you.

CHAIRMAN BURNS. Well, thank you for a very constructive and also lucid report. I wonder if other members of the [sub]committee, and I know--

MR. PARTEE. --may well have comments. Governor Gardner and President Volcker and President Eastburn.

CHAIRMAN BURNS. All right, Mr. Gardner, do you have a--

MR. GARDNER. The only thing that I didn't like was--I think Chuck did that extremely well--but I don't like his idea of characterizing as a small, unimportant addition in the first recommendation.

MR. PARTEE. No, no, it's just that it has a--I meant to imply that it has a precedent, you see. So that it wouldn't be so unusual to add that back in, since we had something like it earlier.

MR. GARDNER. I strongly support that as you know. I'm sorry I called you on this, very minor change.

CHAIRMAN BURNS. All right. Mr. Volcker, please.

VICE CHAIRMAN VOLCKER. I don't think I have anything to add, Mr. Chairman.

CHAIRMAN BURNS. Mr. Eastburn?

MR. EASTBURN. Well, I would like to say something, Mr. Chairman. I support the thrust of the report. I happen to feel that we not only can live with the kind of solution that the report recommends, but we may find that more information may actually improve the functioning of the open market operations.

I'd like to [make] a comment, however, on the last subject, having to do with the treatment of dissents. If counsel is correct that we can't withhold the names of people who have dissented on the day that the announcement is made, I am concerned about the problem of waiting for some 30 days for the explanations behind this. I think that the report explains what must be done in the context of our present practice, and therefore I do agree with that. But I'd like to see us explore a little bit the possibility of changing our procedure so that we can get a summary of our discussion out sooner than 30 days, perhaps as [early] as 3 or 4 or 5 days after the meeting.

I've discussed this with Art Broida, and, of course, this is a very difficult task for the Secretariat. I happen to think that the way the present policy record is formed is excessive, so far as a lot of background information is concerned anyhow. And with an abbreviation of that, and with a relatively short and concise statement of the majority view behind the current position, together with a very short statement on behalf of the dissenters, it wouldn't be at all impossible to get a summary of this out within say 3, 4, 5 days after the meeting. I'd like to hear us discuss that.

CHAIRMAN BURNS. Mr. O'Connell, suppose that a request is made under the Freedom of Information Act concerning the vote of the Committee, whether it was unanimous or not. And if there were dissents, who dissented. How much time would our staff have in respect to such a request?

MR. O'CONNELL. Under the statute, Mr. Chairman, I believe a maximum of 10 days for the initial answer to such a request. The statute calls and contemplates for a period--but that's a maximum period, 10 days. That 10 days contemplates the necessary search of information and compilation of the data.

With respect to the subject of your inquiry, someone asking for identification of the votes, knows as a matter of judgment that 10 days isn't required. But the agency could, if it wished, rely on that, subject to a push of this petitioned party to the court, if you will, [who would claim] that "10 days wasn't necessary, and I have filed suit now to get an earlier response."

CHAIRMAN BURNS. Well, just to explore, what might be done under the law? Suppose that at the end of 10 days the response is negative. Or to be more accurate, the response is such that, by such and such a date, the exposure will be made--it will not be made within the 10-day period, but somewhat later than that. Suppose that is the response on the 10th day.

MR. O'CONNELL. I believe that would be fairly read as a denial of the request for the information sought.

CHAIRMAN BURNS. Well, what would be the consequences of denial?

MR. O'CONNELL. Under the Freedom of Information Act, the party petitioning has a right then to seek an appeal of that action; and that would be, under the Committee's appellate procedure, to a designated officer of the Committee, who would review the action below, namely a denial of a timely response, and there's a period of time within which that decision must come forth. Once that's delivered, if it affirms the lower action--the initial reaction--and it is still negative, then the party seeking the information could file--

CHAIRMAN BURNS. Well, by that time, the 30 days will have run its course.

MR. O'CONNELL. You're just about there--

MR. PARTEE. Then would they have to file an absolutely new one with the next directive?

MR. O'CONNELL. I think, were I counsel for the party that had been seeking the original information, I would revert to a lawsuit to get the court to straighten out what we consider to be some rather delaying response on the part of the Committee.

CHAIRMAN BURNS. I think what this discussion has indicated is that, if such a request is forthcoming, we'll have a good month, anyhow, to work out an answer if we don't have an answer earlier. Is that a fair conclusion?

MR. O'CONNELL. That, as a matter of fact, for logic, yes, it is, Mr. Chairman.

MR. PARTEE. Yes, but do you mean the first time, or each time?

MR. O'CONNELL. I'd say the first time.

CHAIRMAN BURNS. I'd say the first time and the last time.

MR. O'CONNELL. It's the same incident.

CHAIRMAN BURNS. Yes, please.

MR. COLDWELL. I'd like to hear the Committee's feeling a little bit more on why you think the very narrow range of the federal funds rate is desired.

MR. PARTEE. Well, it's simply, in my view--and each of the Committee members can speak for themselves--that in the context, of, let's say, the publication of the directive tomorrow, the market will have two things to look at. First, it will have the funds rate range that was specified to look at. And secondly, it will have the aggregates for the two-month period to look at. And if they feel--if the betting, or the evidence, of the next couple of weeks is that those aggregates are likely to run quite high in the range specified or quite low in the range specified,

the tendency will be quickly to force the funds rate to its limits. And in view of that, and in view of the fact that we don't know how bold they're going to be in projecting the current information that bears on the aggregates, or the two-month period, why, we feel that it would be desirable to continue a narrow range.

Now let's assume that we set--and that 1/2 point range, by the way, is one we have used in most months this year, and so it isn't all that narrow with regard to our recent practice--now let's assume that we set a funds rate range of, well, let's say, for purposes of illustration, 6-1/4 to 6-3/4 tomorrow and that we set a range for the aggregates that turned out to be, let's say, way low. [So] the aggregates seem to be developing to exceed by appreciable margins the ranges that we have set for them. In that event, the market would immediately move the funds rate, of course, to the 6-3/4, but in addition, we would have the option, obviously--the Manager would, as in the past--to inform the Chairman that he considered that the instructions were not consistent, and the Chairman would have the option of calling for, after special consideration, another 1/8, 3/8, or 1/2 to that range, as the situation warranted. It keeps it a little more in our control, I guess I'm saying, as compared with having a wide funds range and letting the market run it in one direction or another depending on how it viewed the aggregates as coming out.

MR. COLDWELL. Let me come back to that question on the running side. On the question of intermeeting decision, would that also, counsel, come under this immediate release?

MR. PARTEE. Yes, it would certainly have to. And in that event, you see, we would have announced, in effect, to the world that the aggregates are running strong enough or weak enough relative our expectations that we are changing our funds rate. But that's an explicit decision we make, and at that time we wouldn't be misleading in the market, or the market wouldn't be moving falsely into one range or into another range. We would be saying, yes, you were right, the aggregates are too strong or they are too weak, and so therefore, we are going to adjust the market. So I don't see so much harm coming from that, although there would be very pronounced announcement effects.

VICE CHAIRMAN VOLCKER. Well, except, presumably, the second decision would come at a time when we would have otherwise changed the federal funds rate anyway, and they would have seen it in the market. Now they will see it out of our mouths as well as in the market, which changes it somewhat, but I don't think it changes it from night to day.

MR. COLDWELL. Yes, but what I don't see is the early information on the aggregates ranges, which we are basing the decision on, before it's published in the papers. We may have a set of aggregates figures that we are looking at which strongly go beyond the market perception or beyond our released aggregates guides. And we are taking an action which then, in advance, probably a week in advance from the past, moves us beyond our limits.

MR. PARTEE. Where we see that we have the aggregates coming in strong or weak, I don't see anything wrong with that.

CHAIRMAN BURNS. You know, when we depart from the Committee's decision through a telephone meeting--or, typically, what we have done is send out a telegram--we've indicated our reasons. We spell those out in a few sentences, and presumably that procedure will

continue to be followed so that our reasons for deviating from the FOMC decision would be laid before them.

MR. COLDWELL. I guess it's a matter of perception as to whether a 1 point range in the federal funds market might give more leeway for the Committee not to have to have these special announcements, as opposed to a narrower range, [which], in at least a few instances, would almost assure that we would have an announcement to make.

CHAIRMAN BURNS. As I understood Mr. Partee, this is a recommendation to be followed over the next few meetings rather than to be followed permanently.

MR. PARTEE. Yes, and I don't think it should be a fixed rule.

CHAIRMAN BURNS. That might be a later decision, while we are learning how to live under this new rule, and with a view to learning what the market reactions are and with a view to minimizing the disturbance. This is not a recommendation for a new permanent procedure, is that correct?

MR. PARTEE. I am inclined to think, Phil, that what's going to happen is that market people, like Morgan and the bond houses, will start to focus more than they have and more publicly than they have on the two-month aggregate outlook. And they're spending more time on the weeklies now, but I think they will convert this to a two-month average, and seeing what our two-month range is. We are going to get, I think, newspaper releases saying so-and-so believes that the aggregates will run well above the specified ranges. And it does, I think--at least if that's what happens, and it may not--expose you to erratic changes in the funds rate beyond the points that the Committee would like to see them go without its having its own information on that. Perhaps Steve has a view on this. Do you, Steve?

MR. AXILROD. Well, I think that's essentially the way the staff came out, Governor Partee. As you know, we did consider even narrower ranges than 1/2 point, which we felt was unfavorable because it would mean the frequent Committee announcements, frequent, very frequent Committee decisions on the funds rate, and probably kind of make the decisionmaking process more complex than it need be.

And we also considered wider ranges, in part what you're thinking of. And we felt, again, that it would either have adverse market effects, or, if the ranges were so wide that the Committee really didn't intend to use them, it was almost a subterfuge relative to what the court was considering as proper release of information--I think a 1 point range, 3/4 point range, clearly falls within the shadow area here where you couldn't claim that it was a subterfuge. And there, the staff felt that the Committee has been working with a 1/2 point range in this learning period. So it really came down to a judgment, at least in our view, about two ranges, one of which is only somewhat wider than the other.

CHAIRMAN BURNS. Gentlemen, the several members of the Committee would like to address questions and make comments, and I'm going to call on Mr. Guffey next, and then Mr. Roos, and then Mr. Winn, and then Mr. Mayo.

MR. GUFFEY. Well, first, I think I tried to make a comment earlier with regard to the dissent. My comment, essentially, was that I would hate to see this Committee deny a request or even hold up a request for a vote, because I think it would look as if we were trying to be obstreperous and not cooperating with that court order--even one time I'd hate to see us do that. Secondly, the comments with respect to [unintelligible] all toward the side of dissent, but that does not cover the whole issue, in the sense that the reporter can call up one that they know as being part of the majority, and at that particular time what went on, why was it decided, that per se allusion, perhaps, that you would not want to create. So much for that comment. But with respect, now, the more--

CHAIRMAN BURNS. I missed the import of your last statement about the reporter calling a member. I'm sorry, would you be good enough to restate that point?

MR. GUFFEY. I am only suggesting that all of the focus and the comments before were with respect to those who would have dissented at a meeting and did dissent at a meeting, but had left out everybody else. Those that voted for the majority, for the consensus view, you can exclude. The situation--a reporter calls up one that voted with a majority and asks him what went on at that meeting--actually what they're seeking is information.

CHAIRMAN BURNS. Yes, but I thought that our rule was not to discuss with reporters what goes on in the meeting. Therefore, if anyone of us received a call like that, we shouldn't respond.

MR. PARTEE. I think Roger's point is that you might get an unbalanced or not an impartial view of why the majority voted as it did, from one member.

MR. GUFFEY. Exactly. Whether it's a majority or a dissenting member, I just wanted to [be] clear [on] that.

CHAIRMAN BURNS. Well, I think that's something to watch if we--certainly, I hope, no matter what happens, we are not going to get on a new course and start talking about what goes on at these meetings.

MR. GUFFEY. My only concern was, Mr. Chairman--

CHAIRMAN BURNS. Therefore, the possibility of a distorted impression should never arise if we don't talk about it--there will be no possibility of a distorted impression. And I think that's been our practice all along.

MR. COLDWELL. But you could have a reporter ask a majority opinionated member why did you vote for this. Which is the same thing Chuck was saying--why did the dissenter vote for this, or against this.

CHAIRMAN BURNS. Well, I think that whole question has to be reexamined, and what the specific answer may be at the moment, I'm not sure, but I am sure of one thing. And that is we have to work out a procedure whereby the amount of talking we do and the kind, the amount,

of talking that we do in response to reporters' inquiries will be negligible if it takes place at all, and some kind of disciplined procedure, I think, has to be worked out.

MR. GUFFEY. I'd like to follow up, if I may, with the most current discussion, and that is, I think, Chuck, you mentioned that there would be two figures published--that is, the range for the federal funds and then the aggregates ranges. But there is one other figure that seems to me to be important if we follow the procedures that we have followed in the past, and that is that we actually publish the federal funds range target that we are trying to hit right then.

MR. PARTEE. You mean the current rate.

MR. GUFFEY. The current rate, and the question is whether that is a quantified 6-1/2, for example, or whether you use the language that we used in [the] past month's directive. That seems to be the more important issue than perhaps the breadth of the federal funds range, in the sense that you're establishing--when you start moving up, and you say that you want a 6-1/2 now. But if you put the range at 6-1/2 to 7, for example, what has been important in the past has been the midpoint. I think that's the market's perception.

And it may be necessary to in some way disabuse the market [of the idea] that the midpoint is an important part of the operation [for] the Manager in the month ahead--either by public statement or something in the directive that essentially says, don't worry about the midpoint, we are telling you what it's going to be now. And either we are going to be slightly higher, slightly lower, remain the same, that's our perception as of this day. But that figure will become very important to the market, it seems to me. Some way, we will have to deal with it. I don't have an answer; I'm the one raising the question.

CHAIRMAN BURNS. Well, the answer may be found in saying less, rather than saying more. For example, if, say, the range is 6-1/4 to 6-3/4, and if we want the asymmetrical midpoint, it is not at all clear to me that that is something that has to be made a part of the directive.

MR. GUFFEY. Well, I think that is a very important question. Because, if we are to follow the court's decision, and if we have actually taken a vote that we want asymmetrical, I would judge that the counsel would [say] that that probably would have to be published.

CHAIRMAN BURNS. If we actually took the vote, yes. But we could have a general discussion which would serve as a guide to the Desk without taking a vote, and I think we've frequently done just that.

MR. PARTEE. I don't know why we couldn't say, Roger--now our current construction says that we think the ranges for the aggregates that we have specified are consistent with a funds rate of about [X]. And I don't see why we couldn't say about 6-1/2 percent. But the Manager may move between 6-3/8 and 6-7/8 if the aggregates seem to be deviating significantly from the midpoint of those ranges. I don't know why that wouldn't work all right--it is a skewed distribution around the midpoint, but I don't know why it isn't okay.

CHAIRMAN BURNS. If that is something that we want to put into the directive. We may not want to put it in the directive.

MR. GUFFEY. We have, in the past, up until last month, I believe. It is my point that that has been a published figure. It is a figure to stand--

MR. PARTEE. We may want to change the midpoint at the time the directive is put out. And the same range, we might say we think it's consistent with the funds rate of about 6-5/8 rather than 6-1/2, and then a range from 6-3/8 to 6-7/8.

MR. COLDWELL. Your problem might be a 6-1/2 to 7 percent.

MR. PARTEE. Well, that would be a problem because you get nothing on the downside.

CHAIRMAN BURNS. Well, yes, the range of 1/2 percentage point, I think, is likely to work quite well when you have a gradual evolution of interest rates. But now, take an extreme case and suppose that the decision were to move to a range of 6-3/4 to 7-1/4; then the purpose that you seek of preventing a jolt, or minimizing the probability of a jolt, just couldn't be served.

MR. PARTEE. In that case, I guess I'd have to say, Mr. Chairman, we should violate the rule of a 1/2 point in order to keep 6-1/2 percent in the directive.

MR. MORRIS. Well, if you do violate that rule, that is precisely the time you're going to get a whopping market response.

MR. PARTEE. I guess you ought to be pretty sure you want it.

MR. JACKSON. You're going to get it anyway.

MR. MORRIS. Except you'll be telling the market a lot more than if you always had a 1 point spread. You'd be giving the market a lot more information when you move from a half point to a full point spread.

CHAIRMAN BURNS. Well, one way of dealing with a kind of abrupt change that I spoke of would be to divide that change, to carry out that change in two sets. One decision being made at the time of the FOMC, and a further move that completes the change a couple of weeks later, let's say, in a special meeting or telephone conference.

VICE CHAIRMAN VOLCKER. But this has--

MR. PARTEE. That's what I thought. In cases like that, you would move deliberately as expectations were borne out.

CHAIRMAN BURNS. Well, let's move on to questions now. Next to Mr. Roos, please.

MR. ROOS. Mr. Chairman, I have a question, and then I'd like to briefly comment. I'd like to direct this to Governor Partee. Just who would be harmed or what are the damaging consequences, damaging to whom, if the market were to move rather abruptly 1/2 point up, and

what is the advantage of our not--if I understood Frank Morris correctly--are we really in the business of trying to fool the market or to control the market? In other words, what is our fear of having a more free movement of the market? Who will be hurt?

As I read these responses of some of the traders, I have the feeling that some of our more sophisticated traders might not be as comfortable as they presently are, but I'm not sure we are in the business of protecting them. What is the dangerous consequence of having a more free movement of interest rates?

MR. PARTEE. I think any of us could speak to this, and I hope they will. I guess my view is, Larry, that it's all right to have the 1/2 point to 3/4 point move in the market if that is the deliberate policy of the Federal Reserve because of a clear, perceived danger that it's working against. But I wouldn't want to have that kind of a move in the market that seemed to be precipitated by a Federal Reserve policy statement where it didn't really mean it, and where it was reversible. And therefore, I guess, Frank's case, where you need to move the market considerably--I have less difficulty with [that case] than [with] the idea that the rate will move as a result of being given a bad steer by us. A bad steer by us that is subsequently the reverse of that size.

So I guess it just depends on how badly you want to move it. If you want to move it, you can move it a long way. Now the people that are hurt are obviously the people who didn't borrow the day before and the people that loaned the day before. Because if they had known you were going to do this, they could have done better by borrowing before or lending after the event, if it's upward.

MR. ROOS. You know, Mr. Chairman, I see one salutary effect of this Merrill decision, and that is that it is forcing us--at least for the first time since I've been on this group or at least [since I have] been able to understand a little of what we're doing--I think it's forcing us to actually consider some fundamental policy questions, such as the relative weight that we place on targeting on interest rates vis à vis the weight that we give to achieving the ranges of aggregates growth.

I think that it may be obvious to some of us that there is some inconsistency between our efforts to set interest rate targets and [our efforts to set] ranges for the growth of the aggregates, and I get the feeling that your [sub]committee's recommendation essentially targets in on the interest rates and says, maybe by holding up, doing this in two steps, we'll be able at least to accommodate what the reaction is in terms of aggregates movements so that we won't look as though we've missed the boat on either one of these two objectives. Are we, within our family, are we essentially choosing the interest rate route and hoping the other will fall in line?

MR. PARTEE. The intention was to put weight on what the Committee thinks is important now. That is, we did consider whether we should suggest a revolutionary change in procedure to the Committee--for example, run on nonborrowed reserves, which was an experiment we had some time ago. We could have considered, though we didn't explicitly, whether we have all become monetarists and didn't want to pay any attention to interest rates anymore. But our view was that the Committee, through its decisions, has got a balanced view between not wanting to see undue changes in interest [rates] and not wanting to see undue

changes in the aggregates, and we didn't think we ought to upset that view. We are just trying carry out what we understand to be the purposes of the Committee.

CHAIRMAN BURNS. I think you've done it very well. Let me try an answer to your question, please, Larry. Our present federal funds rate range is 6-1/4 to 6-3/4. Now let's assume, just for purposes of analysis, a modest move in an upward direction, a range of 6-1/2 to 7 percent. We make that decision today, we publicize it today. All right, now then, the market is going to respond to that. The judgment of the market will be that interest rates are going up and securities prices are coming down. Now then, a week or two later, depending on how the monetary aggregates estimates unfold, we find that the aggregates are coming in at relatively low values, and we'll be then aiming at a federal funds rate of 6-1/2 percent; and possibly we'll want to go a little lower if the monetary aggregates are coming in extremely low or negative.

In the meantime, the Treasury will have put out an issue, and some of our corporations will have put out issues, and they will never forgive us. [They will say,] "Here, you've mislead us, you've rocked the market and we came in, we paid a higher interest rate, you've mislead us." Now I think what Partee and his [sub]committee have tried to do is to smooth the adjustment as much as possible. That's my understanding.

MR. ROOS. If the aggregates, sir, were to overshoot in a manner that concerned us, would we be prepared to adjust the interest rate?

CHAIRMAN BURNS. We'd be just as prepared to do that under the new set of rules as we have been hitherto, because no change in policy has been recommended by the Partee [sub]committee. All that the Partee [sub]committee is trying to do is to take the kind of thinking that exists within the Committee and enable us to adjust to the Merrill decision so as to minimize shocks in the market. Now that's my interpretation.

MR. COLDWELL. I think there's a question of the interpretation here, as to whether the market would react stronger with a half point or a full point. And that, no one can tell until we try it.

MR. PARTEE. Then perhaps you could start off with a half, and then you can try 3/4 and see what happens, and try a [full] point and see what happened. But I guess our recommendation is the conservative recommendation--you start thinking small rather than start thinking big.

CHAIRMAN BURNS. Well, it's two things. You are thinking small on analytic grounds, and you're thinking in terms of a small range, because that's where we've been recently.

MR. BAUGHMAN. That's right.

CHAIRMAN BURNS. Mr. Winn, please.

MR. WINN. I guess my comments are in the same direction, Mr. Chairman. But it seems to me that, with the small range, when we're forced to move it, since we tend to be reluctant to move until we are sure of the aggregates, that you're going to get your next adjustment instantaneously. And if you want to try to smooth that as a set-up, you are going to add more

reserves, which adds more to your quantitative movement, and I wonder if we don't have less flexibility in terms of really meeting our objectives. I would assume that your next step would be up just another 1/4 point centered around the midpoint of where you'd reached. And you'd actually get that instantaneously because the market realized that we've really gone beyond our objectives in order to make the move. And then you're going to get that, it seems to me, almost at once unless you intervene. If you intervene again, then your quantity problems start.

MR. AXILROD. I might add, in consideration of that, presumably the Committee at that point is willing to see the rate effect. We were most concerned with the undesired rate movement. That is, you had a rapid rate increase and there, in order to moderate that, you would be putting out excess reserves. But if, in a consideration between meetings, presumably that the Committee is wanting to see the rate effect and you would not--

MR. WINN. Well, wouldn't you get it almost all at once this time?

MR. AXILROD. Oh, I assume so. If you raise the funds rate 1/4 point, you get about a 1/4 point reaction, but that's not outside of the normal mode.

MR. STERNLIGHT. But just because it went that route of another publicized Committee decision, you could possibly get a bit more of a rate effect because you had to do it that way.

MR. PARTEE. I think there's just no getting around that; that's what's going to happen. That is, when you move and you say you are moving, you're going to get more of a prompt adjustment than you do now, and so you have to be pretty certain of your ground.

CHAIRMAN BURNS. Well, just a factual point. We have had a 1/2 percent[age point tolerance range in the] federal funds rate since May, and the federal funds rate has moved during that period by approximately 120 basis points. And possibly the reference point here should be the April figure rather than the May figure, in which case it would have moved about 170 basis points. In other words, with the narrow federal funds rate [range], we still have been able to achieve a significant upward thrust.

MR. EASTBURN. Mr. Chairman, could you add to that analysis how many [times] we've had special intermeetings?

CHAIRMAN BURNS. Only once, I think--how many--

MR. BROIDA. Since the May meeting, there was one in August, following the August meeting.

MR. PARTEE. There were a couple of them back in April.

SPEAKER(?). There was one in April.

MR. BROIDA. There was one on May 6, and one on August 5. Those were the only two--

CHAIRMAN BURNS. Well, prior to May of this year we had a range of 3/4 percent except for one month, when we had a range of 1 percent. But I want to repeat what I think is an important part of Mr. Partee's report. Mr. Partee did not recommend that we adopt a federal funds rate [with a] 1/2 percentage point [range]. What he recommended is that we do that over the next few meetings. Is that correct?

MR. PARTEE. Yes.

VICE CHAIRMAN VOLCKER. We do it in recognition [that there] may have to be more frequent adjustments.

CHAIRMAN BURNS. More frequent adjustment between meetings and a recognition of perhaps the desirability of widening the range depending on what we learn about the market behavior. Mr. Mayo, please.

MR. MAYO. Well, just continuing on the same theme, I think this is an excellent report, and my only question is, I guess like Phil Coldwell's, to put it a little different way, I think there is perhaps a slight violation, in the 1/2 point recommendation, [of] the basic principle that the Chairman enunciated quite well, that the Partee [sub]committee was not making policy. I think we are trying to judge this prematurely. We may come down in the February meeting to a decision that maybe a 3/4 spread is what we would like to do, and I don't see any necessity of inhibiting such a policy decision by a very more pontifical decision now that, well, 1/2 percent is probably as much as we should do. I would obey the conservative instinct here, but I wouldn't give it a quantity. I guess that's all I'm saying.

CHAIRMAN BURNS. Well, I--

MR. PARTEE. Ordinarily--

MR. MAYO. Ordinarily, yes, you have all the escape you need. I just come back to the Chairman's recitation of what we have been doing over the past year, we've had a 1, and a 3/4, and some halves, all of which have been justified in our minds at the time we did it. I don't see any reason to decide today that we are going to depart from that, so I feel that we are discussing this too much, I guess is what it amounts to--thereby adding to the discussion.

CHAIRMAN BURNS. Well, I don't feel that way. I feel that this recommendation is an important recommendation. I think this discussion is very helpful. Nevertheless, I would accept your conclusion that we need not decide today to observe a federal funds rate range of 1/2 percentage point over the next six months. I don't think we need to decide that. In fact, I don't think we should. But I do feel that the report made by Mr. Partee's [sub]committee and the sympathetic discussion, to the extent that it has taken place, is something that we ought to try to remember for the next few months and evaluate as we see fit, month by month, as we deliberate. So I accept your conclusion. Do you, Mr. Partee?

MR. PARTEE. It just requires careful thought--

MR. MAYO. Sure. Well, that's really all we are saying.

MR. PARTEE. --when you adopt a broader range.

MR. MAYO. We are starting from a half, and it's logical to consider that [as being] home base as we feel our way here. And we will be feeling our way. I had one question which was raised by the speculation earlier. Well, suppose the aggregates are coming in stronger, and we decided we do have to make a move. This may seem like a silly question--it would have been a silly question two years ago; maybe it isn't so silly now--but, honorable counsel, are we well protected in the Freedom of Information Act from somebody coming in and saying, "Say, you are moving the federal funds kind of fast within your ranges. Do you have information that we don't have as to the behavior of the aggregates? I demand such information under the Freedom of Information Act."

MR. O'CONNELL. Well, I would ask you to articulate exactly the document you are talking about.

MR. MAYO. These are reports from all of the member [commercial] banks that Steve Axilrod gets in, and so forth. To what extent is this privileged?

CHAIRMAN BURNS. I think the answer is easy. We publish dependable information when we have it.

MR. MAYO. Oh, you are making judgments on undependable information?

CHAIRMAN BURNS. Yes, we are, as every statistical agency does.

SPEAKER(?). Didn't you ever know that?

MR. MAYO. I am trying to state, be a devil's advocate here, to be sure that we understand our degree of protection.

VICE CHAIRMAN VOLCKER. Just to put it pointedly, do we have to publish our projections? Which we haven't.

MR. MAYO. That's about it. Well, the preliminary information is supposed to be information as against forecast. There's a line here, today is the line. Are we protected? I hope your answer is yes. I think I'll be sorry I raised the question if it isn't.

MR. O'CONNELL. Well, I don't know how. If I may, Mr. Chairman--the requirements in the demands in the Freedom of Information Act, Mr. Mayo, relate to records of an agency. That's the broad concept of that statute. And to the extent that an agency is in possession of what I will refer to as intra-agency information, recommendations, materials that are not adopted records of the agency, the agency is protected from disclosure of such. I consider what you've been describing as the latter type of information. The Committee [possesses], of course, bundles of information that it has not itself determined to be matters that it has adopted for use of the Committee. It can reject or accept that which it chooses. And until it has done so, I would defend that it is not a record of the agency that must be subject to disclosure requirement by the FOIA.

MR. MAYO. Okay, thank you.

CHAIRMAN BURNS. All right. Mr. Wallich, please.

MR. WALLICH. I have two points, Mr. Chairman. One goes somewhat in the direction of what Mr. Roos said. I think we ought to test our procedures here by how well they will allow us to control the aggregates as well as by how well they will allow us to stave off undesired effects in the money market. Now, it is certainly true that choosing a 1/2 percent[age point] range does stave off the danger of undesired effect when we have to announce immediately. In the past, we didn't announce, and when we had a wider range that we set, a year or so ago, we didn't think it was very likely the market would go there, but we made it possible.

Now we have to ask ourselves if we are going to make the changes in the rate--since we are not going to allow the Manager or the market to make them frequently and easily enough--in order to control the aggregates, and I'm somewhat doubtful. If this is only going to be an interim procedure, it's not very important. But if you visualize that this may go on for a longer time--it always takes a telephone meeting to make a change beyond the 1/2 [point] range in other words, a move more than 1/4, typically. Every move becomes somewhat like a discount rate change, when one always wants to see a little more information, so we wait for next week's average aggregates, or for the week thereafter. This is the concern I have, Mr. Chairman.

CHAIRMAN BURNS. I think we've had not very frequent--but it hasn't been necessary very frequently--special recommendations made to the Committee in line with the evidence as it turns up, as the aggregates develop, with the recommendation to move beyond the Committee's recommendation. We have done it twice this year; we've done it, I think--

MR. BROIDA. Earlier, Mr. Chairman, they were very much more frequent, in '73, '74, and '75. If I can remember the count I made, it was eight, nine, and six intermeeting telegrams to change the funds rate range. In the last two years, there were only two each. I think that's a consequence of the movement of the aggregates rather than a change in procedure.

MR. WALLICH. Well, we can, if we steel ourselves, make these frequent changes. The fact that, of late, we have had 1/2 point spreads and the aggregates have run high are not, I think, completely unrelated, although there have been other reasons that have contributed. So we certainly have to bear in mind that we may have to move the funds rate, painful though it is.

The second point I wanted to make is a question to counsel. Does this court order imply that we are stuck on a particular form of directive? I see this implied in some of the concerns expressed that some change or other might be interpreted as an evasion of the court order. I would intuitively think that a new situation having been created, we are within our rights, and maybe just doing our duty, in adapting the directive to that new situation.

MR. O'CONNELL. Governor, I read the court's decision as taking the Committee procedure and format as it was found and as described in pleadings that reached the Court of Appeals. I see nothing in that opinion that prohibits this Committee from exercising its own discretion in the format that it adopts. The allusion that I believe you refer to--evasions or subterfuge--were intended to calculate a judgment on the basis of practice as found by the Court

of Appeals of what we might be doing to go around that position rather than preventing the Committee from adopting a reasonable position it reaches.

CHAIRMAN BURNS. Well, that is, I think any suggestion for a new type of directive will be reviewed by the Partee [sub]committee.

MR. WALLICH. That's what I had in mind; we are not precluded from--

MR. O'CONNELL. In my judgment we are not.

MR. PARTEE. I think we would want to have an explanation when we [make] a significant change in the directive if we were on a publications schedule--

MR. WALLICH. Could the explanation be that, because of the conditions created by the immediate announcement, we now face a market problem that we want to cope with by changing our procedure, changing the directive.

MR. O'CONNELL. The Committee's explanation, Governor, I counsel only, should not confront any mandate of the Court of Appeals. You have already read, the court has said actions taken by the Committee as reflected in adoption by the Committee should be promptly published. It does not say that you may not change the mode of your arrival or the actions that you will take, but once done, and once adopted, you must publish. And I think no other conclusion is intended from that Court of Appeals decision.

CHAIRMAN BURNS. All right, let's turn to Mr. Balles now, please.

MR. BALLEES. Mr. Chairman, I was impressed by the thoroughness of the [Partee sub]committee's search for alternative solutions to the Merrill problem, and if the case goes against us, which we hope it won't, I think we are all going to learn a great deal. And I doubt if we are going to find another final answer to all these problems as we sit here today. But there are two things about this report which otherwise I find very thorough and convincing. I do have doubts about one of them that already have been expressed, and I won't go into any detail on that. I would simply join those, like Governor Coldwell and President Morris, who would like to retain the option of a wider federal funds range as we gain experience with market reactions, if we are forced to release our directive immediately. My concern is, in a nutshell, that the narrow range, a 1/2 point range [achieves] a minimized market reaction or announcement effect at that moment, but the announcement effects will be magnified at a later time when we do have to change the range.

But my more broad point has to do with a statement on page 2 of the subcommittee report--I shall just quote [from my] recollection, it's in the middle paragraph. It says, "we don't feel that the court order itself should be taken as reason for adopting a basically new approach to operations unless such an approach has clear economic advantage. Accordingly, the subcommittee does not believe it desirable at this point to consider such alternatives as shifting to a reserve target, a course which the FOMC has debated and experimented with and decided against in recent years."

Well, I don't have too much trouble with that phrase as long as that sentence says desirable "at this point" to reconsider. But given the whole history of the [Sub]committee on the Directive, and given the fact that committee number one [is] followed by committee number two, and that the players change and so do the recommendations, I would like to just go back and indicate briefly a few of the key points in here. According to my quick look at the history of committee number one, when we presented stage 1 of our report and found out that this was clear back to--

MR. PARTEE. Which is committee number one, is that the Mitchell committee?

MR. BALLEES. No, this is the Holland committee--was Holland.

MR. MORRIS. Well, that was really committee number three.

MR. BALLEES. Committee number one of my experience, Chuck. That really was committee number three, and it was Holland, Morris, Wallich, and Balles, I guess.

MR. BROIDA. I think it was before Governor Wallich came on the Board.

MR. BALLEES. Dane, for awhile; Wallich. Okay, there was a time when that committee, I believe, was unanimous in the spring of 1975 in recommending two things: getting rid of RPs [repurchase agreements] and proposing nonborrowed reserves. Well, when it finally came full circle and we decided to conduct an experiment, I was very satisfied with the nature of that experiment. I thought it was inconclusive. We discussed it at some length in the final session, I think, in December 1976.

What I call committee number one, when I was still on it, was inconclusive in a sense that the work of the staff indicated that we've typically been dealing with that multiplier over a two-month span, [and it] was just too uncertain and you wouldn't be really any further ahead with using nonborrowed reserves. At that time I made a suggestion, and I still think it has merit, that we ought to perhaps lengthen the period over which we try to achieve certain objectives. So, say a three-month period, and as I remember, Steve indicated the multiplier becomes a lot more predictable if you, in fact, move to a three-month span. That is one of the areas in my consideration, Chuck, that needs and desires some further exploration.

To kind of wind this up, I guess what I'm really trying to say is, when the old committee--one or three, as it may have been--that I served on made its final report, and this was in December of last year, I made the point, expressing my own personal views--and I think this is clearly of a majority view around the table as a whole--that the Committee should retain a balance between interest rate stability and control of the aggregates; that there is a middle ground we should achieve. But my own judgments were that the FOMC leaned too far toward the interest rate stability goal given the experience up to the time. I formed that view, and that was one of the things that had caused us to get into base drift and considerable overshoots as well as undershoots from time to time.

And I still feel that way today, that one of the inhibitions in achieving this middle ground has been excessive concentration, perhaps, with too narrow a federal funds constraint and delays

in moving, even though, as you well pointed out, we have the long distance. There have been times when we've moved too slowly, in my judgment, in adjusting the federal funds rate and thereby leading to these overshoots of indexes.

Well, just as a concluding point, I would urge that the subcommittee not close the door on fully reexamining the possible advantages of a reserve target in a new climate that might be created if we lose this Merrill case. One of the things, getting away from all the fine points and technicalities, that have bothered me for several years and bother me even more today is the perception among the general public, and especially the perception of the Congress, that the Fed can and does control rates. Now, as we know, we can do that only in the most short-run sense. Inflationary expectations and demands for credit are, of course, the other big elements.

And I feel we are just lending credence to that perception of our ability to control rates by not uncoupling our actions [from interest rate movements], as I think one could do, by using a nonborrowed reserve target. There was a staff paper that came out of the New York Bank a month or so ago, from Dick Davis, that I found quite convincing on this subject. If we really want to get the market and the Congress and others educated to the fact that, longer run, we can't control interest rates in the sense that they perceive it, there would be real advantages to moving to a reserve target, even though I would personally hope that we always have a federal funds constraint to go along with that.

CHAIRMAN BURNS. You know, I follow everything you say with a great deal of sympathy until you get into the political part of the argument. If we had a reserve target, and if in the process of applying it, interest rates moved up, believe me, the Congress would respond in just the way it has been doing. And there may well be great advantage in what you suggest, but as for the politics of it, I think you're off base.

MR. COLDWELL. Mr. Chairman, I have one other--

MR. BALLE. Could be. It's a judgment, and my judgment is the other way.

MR. PARTEE. We are exploring these things, John. This was just a sudden assignment within the last 30 days. We are looking at the relationship within short-range, long-range targets. We're looking at the question of the different kind of [unintelligible], where I hope that we will explore the idea of going back to a money market directive with the aggregates as only an indicator for changing the money market directive.

VICE CHAIRMAN VOLCKER. At this point, it's meant quite literally, I think, to mean at the point we're ready...

MR. BALLE. You are not exploring depth, breadth, and resiliency.

MR. PARTEE. No, we haven't done that as yet.

MR. COLDWELL. I have one other concern on this. I want to state this carefully. I don't have any interest in this Merrill decision. I wish it would go away someplace. But if we are actually going to be subjected to this court interpretation, then I raise questions, counsel, as to

whether we can be charged with evasion of the court's activity or requirement if we do a pro forma on the long-range targets after a full discussion.

CHAIRMAN BURNS. May I suggest that is a question of law that I want to fight out with Mr. O'Connell, and I don't want to raise that question here and now because it would take a great deal of time. I've been troubled by that, and I suggest that, as far as today is concerned, that we not dig any more deeply into the matter until--

MR. COLDWELL. Moot until we hit the next long-range target discussion.

CHAIRMAN BURNS. Well, we'll have to--

MR. PARTEE. That's next month.

CHAIRMAN BURNS. In the meantime, these discussions of the decision and of our directive will have taken place.

MR. BLACK. Mr. Chairman, most of the points that I wanted to make have been made by various people. I started off with this point to which John Balles alluded a while ago, on page 2, where we don't think the court order ought to be, in and of itself, the reason for adopting basically a new approach. And I think that ought to be the starting point on this. I guess I felt initially, although Governor Partee has allayed a lot of my fears on this, that the 1/2 point range was unduly narrow, and I would have preferred that you say we do exactly what we have been doing, which sometimes involves a 1/2 point spread, sometimes more than that, but his intention seems to be sound and pure on that.

Now he has clarified that, so my fears are alleviated, but I just feel that human beings suffer from a certain amount of inertia, and you would have unnecessary barriers to going beyond that 1/2 point if you had, in fact, set it. So I'd rather at least consider the possibility of going beyond that if, in fact, you did pass these barriers and change by raising the range, say, another 1/2 point. I think you could conceivably be accused of having tried to circumvent the intent of the court.

Other points have been made, and I won't go over those, but I do endorse what Mr. Balles was saying a while ago. I think this is a significant enough change in our procedure that we really ought to go ahead, as Governor Partee indicated that we would, in reexamining our procedure still further. I think interest rates and aggregates are both important. I hope we can move on in that direction. Otherwise, I think we are exactly where we should be in this report.

CHAIRMAN BURNS. All right. Mr. Jackson.

MR. JACKSON. I think Governor Coldwell has expressed the concern that I have because the question was the degree to which we would have a meeting and discuss long-range objectives without coming to a final conclusion. Because I see us constrained in two ways--to the extent we get a general consensus, or sense, or whatever you want, without formal action and then have a telephone meeting later to take formal action, you're obviously circumventing the thrust of the court.

And yet on the reverse side of it, I think, is that electronic communication has reached marvelous levels but is not a substitute for collegial discussion of a serious material issue. And by the time we hear Mr. Roos say that he's got a new telephone system and he can't hear anything at all, and by the time somebody at the Board drops a microphone or something like that, I must say that the quality of substantive decisions that can be reached in that environment is modest under the most polite assessment.

And so I think we are facing a difficult decision to not circumvent the court but at the same time follow our real decision, which is to collectively make the right judgment. And I think the Committee needs to work very carefully now, when, as you mentioned a second ago privately to me, maybe the answer is to try to adjust our meeting dates. But adjusting meeting dates--to meet the whims of a current Chairman who might have a speech to make that week in the Congress, you get various discussions backward and forward as to when they [in the Congress] want to hold sessions; that might be done only if you had a clear cooperative spirit on the part of those two committees; and never have anybody on the Committee die or have a birthday or something. It's not going to be easy to solve those two problems.

CHAIRMAN BURNS. Well, I think the solution may be found outside the recommendation of the [sub]committee. But I am not going to enter into a legal debate with Mr. O'Connell with so many people listening. We will have to do that in private. Mr. Morris now, please.

MR. MORRIS. Mr. Chairman, my only concern about the report, which I thought was very good, was the interest rate spread recommendation. I think it will prove to be very advantageous to us to pick a spread and stay with it. Because from now on, if we are having instantaneous release, every time you change the spread, you are going to be giving information to the market that may be misinterpreted. I think we ought to make a decision as to how wide the spread ought to be and stay with it rather than varying it from meeting to meeting, which I think is going to cause a lot of trouble.

While right now I think a 1/2 point spread is fine, I don't think that, long term, we will be able to sit through a 1/2 point spread without impairing our response time to changing conditions. And it seems to me that the ideal time to establish a 1 percent spread is when you don't have expectations in the marketplace of a rapid change in interest rates to come. I don't think you have that now. And I think this is exactly the kind of time you want to get the market used to a 1 percent spread. Because whatever we pick, I think we are going to find it hard to move away from it.

MR. JACKSON. May I ask you a question about that? To what extent would you weigh the relative merits of a 1 percent [age point] federal funds constraint, versus a 4 percent aggregates [unintelligible]. It strikes me that you have both alternatives.

MR. MORRIS. Yes, but we won't be publishing anything about a zone of indifference, I don't think. This will be again, a sort of thing that we don't vote on but--

MR. PARTEE. No, but his point is, you can either widen the funds rate spread or you can narrow the aggregates. Precipitate action on either--

MR. JACKSON. We have two tools and we have only focused on one; we have not discussed the other.

VICE CHAIRMAN VOLCKER. This strikes me as the perfect example, Mr. Chairman, of [unintelligible], we may say we want to consider [unintelligible] substantive issues, but we can't avoid getting into the substantive issues. And I'm not prepared to sit here and say we always want a 1 percent[age point] spread. There may be times when I positively don't want the interest rates to go that far; therefore, I wouldn't want to get locked in permanently to that large a spread because of this publication need, which I think is why we came out the other way. We can always change a narrow spread, but you can't narrow the wider spread until the damage is done.

MR. MAYO. We may want the announcement effect of a change in spread sometime--it's quite conceivable.

MR. COLDWELL. In either direction.

CHAIRMAN BURNS. Mr. Willes now, please.

MR. WILLES. Thank you, Mr. Chairman. I'll be very brief because I've heard most of the things I was going to say. I'd like to fall in line with Governor Wallich and those who expressed the concerns that they have and will just make two brief additional comments. [A point was] made in the discussion--if we follow this procedure, interest rates will move if we intend them to move, otherwise we will avoid unintended sharp movements in interest rates. I have a little difficulty with that because I'm not sure we always know what rates we really intend to have. We may think we do in the short run, but as we gather more information, often we'll come back and wish that something else had taken place. So that distinction is not as clear in my mind as it may be to some others.

Second, I would simply point out that while there are announcement effects and market reactions to changes in interest rates, there can also be--and in fact, I think in recent history, have been--more frequent announcement effects and market reactions to changes in the aggregates. And so it's again not quite as clear to me that this is as conservative an approach as it may appear to be. This is [in keeping with] what we are doing. It's in that sense that I accept that. But it's not clear to me that we might not, by following this procedure, generate some market and other kinds of reactions that could, in fact, be quite sharp because there are now a large number of participants who do look at the aggregates and respond accordingly. So I think Phil's comment on what to do [with] the range in the aggregates is a very real one that we may have to confront perhaps sooner than we'd like to.

CHAIRMAN BURNS. All right, thank you. Mr. Kimbrel now, please.

MR. KIMBREL. Mr. Chairman, I find the paper to be rather helpful, and it's even approaching erudite, and I like the approach [and] share the suggested procedure. I think this discussion has been productive, and I think it certainly comes under the heading of advance planning is prudent. Having said that, I have a natural preference for a wider interest rate spread, but I think, beyond what we have done, I'd elect to wait [for] some more of the details of the

Merrill decision without trying to resolve everything here, anticipating what the court's going to dictate.

CHAIRMAN BURNS. Well, I think that's wise. I think that the objective of this meeting, as I see it, is not to arrive at any decision but to share our thinking, and I believe it would be fair to say that most of us think that the recommendation by the Partee committee for the months immediately ahead are a good starting point for our deliberations later on; are not necessarily an articulated starting point, but one that we will retain as we deliberate in the months immediately ahead, assuming that the Merrill decision is going to stay with us.

We may be lucky, and something may happen, and if the Supreme Court takes on this case, we'll have time for a legislative decision, which I can't be too optimistic about, but I would not be pessimistic about legislative relief. I think once this matter is explained to members of Congress, there will be a fair degree of sympathy with a 30-day delay such as we have practiced. Anything else we'd like to say this afternoon?

MR. BAUGHMAN. Mr. Chairman, I'd like to raise a possibly heretical question. But if it were to develop with, say, a 1/2 point interest rate spread, most of the time we were operating either at the floor or the ceiling, which seems to me a fair possibility. Now, really, a two-stage question. One, would the Committee be inclined to feel a necessity to meet and reconsider its position whenever we were at the floor or the ceiling?

And then, two, which picks up something the Chairman alluded to earlier--the very different world we'll be in, having announced our program, and then people conducting operations based on our [announced] program rather than on what they think it is; when people may feel that we, in effect, have a contract with them not to deviate from our program and therefore feel taken anytime we do deviate from it. And this raises a time-frame question--presumably the program is announced for the next month, but if we come in and make changes in the interim, a lot of people may feel that they are caught off base.

CHAIRMAN BURNS. Yes, but when we announce in our directive the quantitative specifications that we intend to live by during the coming weeks, we also indicate that there may be some inconsistencies among these specifications. We also indicate there may be some change in the Committee's thinking, and we always have a sentence in our directive that makes that clear. And all that we have to do to take care of your point is to perhaps underline that sentence so the people will pay attention to it.

MR. BAUGHMAN. Well, now the heretical part. Insofar as there might be problems of this type, might we avoid them by using our general phrase and a federal funds rate point, as compared with a range, so that we would not have committed ourselves [on] how acceptable to us [it would be] to have the results [be in terms of] a deviation from a point. I seem to detect a flavor running through the discussion here, that if the data come in above or below the range that we have specified, then we might have difficulties explaining ourselves. It seems to me that [with] data coming in above or below a generalized point, say, consistent with the federal funds rate of about 6-1/2 percent, and [our] not having declared how much deviation from that is acceptable to us, [then] we might be in a better situation.

MR. PARTEE. I think that is a money market directive, and any time the aggregates are running strong or weak relative to expectations, it calls for a meeting or a wire to move off that rough point--you know, point plus or minus 1/8 or something like that.

MR. BAUGHMAN. But assume that our performance indicated that the phrase might have a connotation at some points in time of a 1/4 percent deviation and other times might have a connotation of a 1/2 percent deviation.

MR. PARTEE. How would we tell the Manager that? If we told the manager that, we would be giving him an instruction.

CHAIRMAN BURNS. Not only that, but a movement of 50 basis points is not regarded as standing approximately still in the marketplace. Not by traders, and not by our Treasury, and not by most of us.

MR. BAUGHMAN. I accept your observation, and yet I am not completely persuaded.

CHAIRMAN BURNS. Mr. Guffey, please.

MR. GUFFEY. Mr. Chairman, I'd like again to make the point that the Committee did not address the advantages or disadvantages of making an announcement as to what the federal funds rate precisely would be in quantitative terms from the date following the day of the meeting. That's laid against the alternative of casting it as we did last time--that the federal funds rate at about the "prevailing" level, or you could choose alternative language "slightly higher or slightly lower"--and thus not be so precise, to permit the market to move to a particular federal funds level the next day providing you wanted to move it one way or the other. That was not addressed by the Committee.

MR. PARTEE. Well, we did, Roger, address the question of qualitative expression. We decided that that was the step backward--to talk in terms of slightly higher, slightly lower--which used to be the way the directive was put. The other, I think you're distinguishing between a money market directive, which shows [unintelligible] [and] an aggregates [directive] of the kind we had, say, two times ago, three times ago. And there, I think, our thought is that the Committee would be free to treat a money market directive or an aggregates directive depending on what it saw as the circumstances of the moment.

MR. GUFFEY. Well, it would seem to me that if we did not express the federal funds rate in that meeting at a particular, quantitative level, that it might give the Desk some flexibility to let the market seek a level in conjunction with the Desk action, much as we are doing today. [It] might have some advantage that you do not have if you say it's going to be 6-5/8 tomorrow. In other words, I would prefer to stay away from that.

MR. BLACK. Roger, could I ask you a clarifying question? On page 13 under the monetary aggregates directive, aren't you talking about the second sentence from the bottom in the Bluebook, where you say, "In the judgment of the Committee, such growth rates are likely to be associated with a weekly average federal funds rate of about X percent"?

MR. GUFFEY. Yes, that's right, and I'd rather not say "X percent," but I'd rather use the language that apparently the Committee considered and recommends against, that is to cast it in something less than a precise figure.

MR. BLACK. If that's different from what you are now operating at, it would clearly have very quick market repercussions.

MR. ROOS. What if we did exactly what we're doing now, except announce immediately, and if there were a temporary disruption [then see] if that disruption would not give us grounds to seek remedial action in the Congress. In other words, we are being driven to this by people beyond our control; in [our] complying with the law, Mr. Merrill has pushed us into this. This isn't our doing, and if for 30 days there was some disarray or disruption in the markets, wouldn't this give the Chairman the best possible reason to go to the Congress and say, look, we are doing what we are forced to do--look what's happened. If it doesn't happen, then all of our discussion today is for naught. If we did have disruption because of this Merrill action, why don't we let it show? It is not our doing.

MR. MAYO. Congress won't get that excited about it.

VICE CHAIRMAN VOLCKER. It may not show for four months.

CHAIRMAN BURNS. If we are right in thinking that disruptive moves may occur, then I think it is our duty to try to prevent that rather than let the destructive movement take place and then go to the Congress and say, "See, a destructive movement has taken place, and therefore we seek legislative relief."

MR. ROOS. Why, you are a gentleman, Mr. Chairman.

VICE CHAIRMAN VOLCKER. [The Congress] might just say, you are a damn fool. You could have done something different--

CHAIRMAN BURNS. Well, anything else to be said on this subject this afternoon? If not, I think we have had a good discussion. We will start tomorrow, on time, and with our regular--

[End of executive session]

December 20, 1977

CHAIRMAN BURNS. Good morning, gentlemen. We'll get our deliberations under way. And as always, we need to act on the minutes of the last meeting. Is there a motion to approve?

MR. MAYO. So moved.

CHAIRMAN BURNS. The motion has been made and, I take it, seconded, and I hear no objections. And we will move on, therefore, to the report on foreign currency operations by Mr. Pardee.

MR. PARDEE. [Secretary's note: This statement was not found in Committee records.]

CHAIRMAN BURNS. Thank you, Mr. Pardee. Are there any questions or comments?  
Mr. Roos.

MR. ROOS. Scott, is it the relative rate of inflation or the trend rate of inflation that affects the value of the dollar? In other words, isn't the effort expended by the various nations to control inflation and the success of that effort more of a factor than the rate of inflation in the various countries?

MR. PARDEE. Certainly, we have had a number of very interesting and useful studies, including the studies by the Board's staff recently, on the real rates of exchange. But at this moment, and under these conditions, the exchange market is not focusing on rates of inflation as such. There is concern, and the concern about potential rates of inflation, and I think that's more important as one of the many factors influencing the market now than any new and recent figures we might have on inflation.

MR. COLDWELL. I get the impression that the Desk would prefer greater intervention. What's your concept of intervention?

MR. PARDEE. Well, I'd prefer to be more forceful at the moment and hope to save overall in the amounts that I use. The problem is, now, we lack credibility. And so to the extent that we do intervene, people say, well, they're not going to do very much, so we can rake them over the coals. If we could be more forceful when we do approach the market, then we might have more effect. On the other hand, we are facing a market in which it's a gambling atmosphere here. We raise the ante, they'll raise the ante; until we have a change in one or another of these underlying conditions, it would be very difficult for us to have a major turnaround in the market simply on our own methods.

MR. COLDWELL. Which implies then, you'd just be throwing some money down the drain if you did too much with it daily.

MR. PARDEE. Well, we have to live up to our responsibilities, and this is a very disorderly market. So we should be there. It's a question of how to minimize the damage to us while we're also trying to contain the disorder. It's a very difficult situation.

MR. JACKSON. If intervention at the levels conducted by the foreign central banks in recent weeks has been unsuccessful, what leads us to believe that anything appropriate by us could be successful?

MR. PARDEE. One of the concerns of the marketplace is that the U.S. government wants exchange rates down--the dollar rates down. Many statements have been made by government officials, and ourselves when we have had the opportunity, to try to dispel this impression. But it remains in the market. The fact--

CHAIRMAN BURNS. How much do you think we would need to commit in order to change that opinion, assuming that it really exists?

MR. PARDEE. I would not put a strict amount on it. I think we would have to be prepared ourselves to commit, on a given day, \$100 million, \$150 million.

CHAIRMAN BURNS. How much do you think we might need to commit over a month?

MR. PARDEE. The thing is, it's the preparedness, not the amount. I'd say \$2 billion or \$3 billion and it would be meaningless. If we started and [gave] the impression to the market that we were prepared to deal effectively with the market, then we wouldn't need the big numbers that I would put on the table.

CHAIRMAN BURNS. Mr. Volcker?

VICE CHAIRMAN VOLCKER. I want to say a few words about the relevance of the foreign exchange situation for our general policy probably later, but it does seem to me this intervention has been something of a rear-guard action, necessary but still not very impressive in turning the market sentiment. I myself doubt that you're going to do that by intervention. You never can tell in terms of the psychology of the market at the moment, but everyone does seem to be confused about what the [unintelligible] posture of the United States is, and you've got to put this in a context.

It seems to me some coherent statement of policy, not just involving the Federal Reserve, [is needed] if intervention, to the extent that's desirable and necessary, is going to have the maximum impact in reversing the psychology. There aren't a great many things that can be done, I fully recognize. I think there are some things that could be done and certainly some attitudes that could be expressed that would maximize the chances of intervention having some leverage. I don't think that has been the condition under which we have been operating in the last month, which has made it very difficult. Hopefully, that might change.

MR. PARTEE. Well, it seems to me, Paul, that the evidence of recent months is that there's a very, very large amount of money available to be moved from border to border in a speculative way. And this \$7 billion intervention by the three other countries--it's just an indication; it's been much more than that, sometimes.

CHAIRMAN BURNS. Since the beginning of the year, the figure would be \$32 billion, \$33 billion, and that amount with interest rates higher here than in most industrial countries now. And even our own modest intervention--and in spite of that, the dollar is down perhaps 6 percent now against the G-10 countries plus Switzerland.

MR. PARTEE. Well, I just think that, when you get a market move of size, with the kind of depth of trading behind it that is occurring, intervention is unlikely to do very much.

CHAIRMAN BURNS. Unless you have what Paul has indicated.

MR. PARTEE. I mean, well, what is the program? To have a smaller expansion domestically so that we can be like the rest of the world?

CHAIRMAN BURNS. No, I'll tell you what the program should be really. It isn't that. I don't think that would make much sense.

MR. PARTEE. Well, that would reduce the current account deficit.

CHAIRMAN BURNS. I realize that, but at a price that I would consider unacceptable, as you would.

MR. PARTEE. Well, I would, too.

MR. WALLICH. Nobody in the world that I know recommends that. Everybody tells us what to do, but not that.

MR. PARTEE. That might hurt their export markets.

CHAIRMAN BURNS. The course of action open to us, and I think Mr. Pardee mentioned some--I think once we get a creditable energy bill which will signify, first, a conservation policy in this country, and second, the encouragement for developing new sources of supply, I think that will be very constructive to the foreign exchange market. I think, second, once we get a tax policy designed to improve the business environment, investment climate, in this country, that will help to bring dollars here, and not central bank dollars but private dollars, investment dollars in the way of direct investment, portfolio investment. I think that would be constructive. I think third, once we have a creditable anti-inflation policy on the part of the Administration, that that will be constructive. I think these are the fundamental changes that we need.

I do think we'll have an energy bill, and a good energy bill, before too long. I think we'll have a good tax bill before very long. As for an anti-inflation policy, that is now being seriously considered by the Administration; as yet, nothing that is very encouraging apparently has developed in that area, but that is receiving serious thought at the present time. And therefore, by mid-January, certainly by January 19, we will have economic messages, I think, that will be constructive.

In the meanwhile, there is a modest program, that I will not describe, that Mr. Blumenthal [Secretary of the Treasury] and I have put before the President, which could be helpful in reducing our trade deficit for the coming year. What the chances are of the President adopting it, I can't say. We have been over this ground with him before, and he has not responded with any enthusiasm. And that may still be his position. So I think, no, we don't want to contract our economy, holding down our rate of growth. We may have a problem in that area quite apart--we don't want deliberately to do that. We may have a problem in that area before too many months pass. I'm well aware of that possibility. But I think there are other areas where we can influence foreign exchange sentiment, and I believe we'll do so before too long.

Now as for intervention, I would favor intervention on a larger scale, but only once some official action of a constructive sort occurs, and then I'll support larger intervention. Right now, I see very little point in it. I think we have been demonstrating our ineffectiveness, and if anything we will continue on the present scale or do less. And there are also--you know there is some loose talk about intervention. Suppose--make the assumption that we were willing to

intervene in the amount of \$5 billion, \$8 billion; it's quite an assumption, but make that with me. Who abroad will support that program? Which central bank will support that program on a scale?

MR. PARDEE. None.

CHAIRMAN BURNS. It couldn't be done. We couldn't carry it out. Now, then, I think central banks around the world have acquired so many dollars by now, they're not at all eager to add to their holdings of dollars. If we, therefore, wanted to borrow dollars on a large scale, we'd be frustrated. That's my opinion. Am I wrong on that, Mr. Pardee?

MR. PARDEE. You're right. Once they see the domestic market implications of our intervention in their currency, they would shrink from it. Even the Bundesbank is beginning to have second thoughts about how many marks have been created in recent weeks.

CHAIRMAN BURNS. Well, they have very serious second and third thoughts on that subject at the present time.

MR. WALLICH. Mr. Chairman, I would like to make a couple of points. One, I don't think one can compare our scale of intervention with what's going on abroad. It's precisely our low intervention as it's perceived abroad that generates the image of benign neglect. And intervention on a smaller scale conveying the impression that we are concerned would probably do more on our part than larger intervention in Europe.

Now, it's perceived that our intervention is of limited effectiveness because we have to buy back the currency later. Now that undoes the monetary effects and reduces the concern of foreign central banks. But it also means that other countries--that the exchange rate is going to be pushed in the wrong direction again if we buy it back. Now, if we are to buy the exchange to repay the swaps directly from the foreign central bank, then the problem you point to--permanent expansion in their money supply, their dollar holdings--would occur. This is an inherent defect of the swap network.

So, abroad, recommendations are made, for instance, to use gold. And I suspect that when they say use gold, they don't mean sell it in the market--they mean sell it to another central bank. This we would not do, because it would get gold back into the System instead of--like a sale to the market--get it out of the System. But there is here a resource, including gold sales to the market, which would at least have a demonstration effect. It's argued that high interest [rates], to the extent that they're consistent with a domestic expansion, could be a means. Well, it's very difficult so see increases in the interest rates of any size that would be consistent with continued expansion, and so there is a limit to that. But we shouldn't be unaware that there are a number of devices and things people think we could do. The fact that we don't do them, they regard that as an indication of the degree of importance we attribute to the dollar.

Now universally, oil policy, the energy bill, is pointed to as the necessary action. I think the effect of that is exaggerated in the minds of people abroad because the effect would not come very quickly, and it wouldn't be all that spectacular as far as the trade deficit is concerned. That does seem to be the closest to a policy that would carry conviction abroad.

CHAIRMAN BURNS. You know, there's a lot of loose talk about oil conservation. And if we started conserving oil on a significant scale immediately, this would guarantee a business depression in this country and over the entire world. So on a moderate scale, you get it under way, build it up gradually, that's one thing. But to move in with a conservation policy of a kind that some foreigners--well, people here, too--talk so loosely about would be very destructive of our economy--therefore, the world economy, too.

So, you take gold. Well, you mentioned a number of things that, yes, are under consideration--serious consideration--but there are limits there. A significant amount of gold sales at the present time could bring great troubles to France, political trouble, that we ought to think about, and trouble to Portugal. And as for selling gold to central banks, quite apart from the policy consideration, I don't know to what degree central banks around the world would be willing to buy gold. Do you have an opinion on that, Henry?

MR. WALLICH. I think they would do it if they thought it was a step toward turning gold back into the monetary asset. I wouldn't recommend doing that. Neither would I recommend sales in the market, exactly for the reasons that you say. But it all adds up to this--that we find a good argument against any action we can take--

CHAIRMAN BURNS. You know, selling perhaps a half a billion dollars of gold--all that I would say is, beyond a modest amount, would cause--well, we ought to think twice, three times before we begin to embark on it.

MR. PARTEE. Well, isn't it true, Henry, that the reduction in the price of the dollar should tend to narrow the trade deficit?

MR. WALLICH. It certainly does.

MR. PARTEE. That is, it's a corrective in itself.

MR. WALLICH. That is the corrective. The reason people are worried about the deficit is not the deficit per se, but precisely that it's going to be cured by this means that they do not like.

CHAIRMAN BURNS. Well, I think that's only a--

MR. PARTEE. I don't think it's so bad.

CHAIRMAN BURNS. I think it is a--yes, I think it's very bad. And I'll tell you why.

MR. PARTEE. I don't think so.

CHAIRMAN BURNS. I think this is an analysis that applies in the abstract to individual countries around the world, and applies concretely, practically, to most countries of the world, but certainly not to the United States. First, because world trade is conducted preponderantly in terms of the dollar, and second, because the dollar is a store of value for every central bank, for every multinational corporation, for people of wealth and means around the world as well as Americans.

And when the dollar depreciates, this releases dangerous forces for the world economy. To the extent that you have movement out of dollars into other currencies, the dollar will depreciate further. But then, as that happens, the people holding dollars, and they're everywhere, become troubled about their own future, the future of their company, their country. And when people become troubled and uncertain, there is a pronounced tendency to delay action; spending, investing that might have been done will be postponed. And there is a real danger of stagnation, or worse than that, spreading around the world.

And beyond that, the OPEC members are meeting now, and hopefully they will decide to do nothing about the price of oil. Well, these countries have their political problems, and being paid in dollars as they are, every time the dollar depreciates, they see the price that they receive declining, and forces build up within their countries to raise the price of oil. And we haven't yet adjusted to the increase that got under way toward the end of 1973. So I don't think that the conventional theory about a depreciation of a currency leading to a restoration of a trade balance really applies to any significant degree to a country such as the United States, with its dollar responsibilities and involvements all around the world.

MR. WALLICH. Mr. Chairman, if I may, I agree fully with your statement about the effect of a dollar depreciation, that it is undesirable. I just wanted to make the analytical point that, if the dollar were to go down, this would have a favorable impact on the trade balance.

CHAIRMAN BURNS. Other things equal, which I've tried to argue will not remain equal.

VICE CHAIRMAN VOLCKER. You have touched upon a number of the points, the most basic points, that I had in mind, Mr. Chairman. There was some reference made earlier to economic growth, and I think the feeling that this is a free ride for us or even positively helpful is not right in the current circumstances--given the level of the dollar--in large part for the reasons that you suggested, including the uncertainty about oil prices and the general economic uncertainty.

But more specifically, you get an inflationary impact on the United States which, I think, is not measurable but undeniable. And partly psychologically as well as through its direct effects in terms of the trade balance, I think this has certainly reached a point where the concern in some of the other major economies, specifically Japan and Germany, may affect their investment activity and economic activity, and that may have a sharper [negative] effect on our trade balance in the short run than any [positive] effect of the change in the currency value itself.

You referred to the political uncertainties and problems surrounding gold. I think the decline in the dollar itself is becoming a political problem that can't be ignored. And the volatility of the market is presenting us with some unknown risks, harking back to [the closing of the] Herstatt [bank] and all the rest, that we don't know about. But it can make one a little bit nervous when one sees the amount of speculative activity that has been spawned in recent weeks. And of course, for many U.S. companies [with] operations abroad, it has a direct impact on their profits. And it makes an already not-very-robust profit picture look worse in terms of reported profits--

MR. WALLICH. Particularly FASB 8 [Statement No. 8 of the Financial Accounting Standards Board].

CHAIRMAN BURNS. Have I--

MR. WALLICH. That's an accounting rule under which the losses on foreign exchange due to foreign exchange liability must be taken directly into each quarter's profit.

MR. PARTEE. But the exchange rate is taken in for financial assets, and therefore they will have appreciation.

MR. PARDEE. They are selling dollars right now, and a lot of the transactions in the last few days have been by U.S. corporations under FASB 8 to straighten out their accounts and taking their losses--

VICE CHAIRMAN VOLCKER. Hedge.

MR. PARTEE. Well, then you can say they lose when the dollar goes up, and they lose when the dollar goes down.

MR. WALLICH. It's those that have borrowed in Swiss francs and have similar liabilities, they are particularly hit by this.

VICE CHAIRMAN VOLCKER. I think this is not uniform. But you find a number of major companies seem to be on the side that they weren't assuming a big depreciation. They were not fully hedged, and now they get hedged and it kind of multiplies the market impact. The only other point I would make is, given all these other things, the threat of protection in these is, I think, alive in the world, not just in the United States. And I really think this degree of volatility and the degree of decline in the dollar makes this situation even more threatening than it would otherwise be.

None of this adds up to a great support for domestic expansion in terms of the situation that exists. So I do indeed think it's a situation that can't be shrugged off in terms of our own policy determinations. And the considerations are not all one way, to say the least, in terms of economic growth as well as in other countries.

MR. LILLY. Well, the analysis I think I've heard here is very interesting, but I have not caught what the alternative is. What is the program that we should be following?

CHAIRMAN BURNS. We think the--

MR. PARTEE. Other than the Chairman's.

CHAIRMAN BURNS. We at the Federal Reserve or the U.S. government?

MR. LILLY. Both.

CHAIRMAN BURNS. I seek basic improvement along four routes, three within the control of the United States. A definite, creditable, persuasive energy policy; a tax policy that will create clearly a more hospitable environment for investment, foreign as well as domestic; and a creditable anti-inflation policy. Now these are the basic things we can do; they're small things we can do that I refer to without becoming specific.

Now the fourth channel for improvement is a faster rate of growth abroad, which will mean larger imports from the U.S., and that is a province--yes, we can be helpful at the margins, perhaps, but that is something that lies outside of our power. I don't see any other route, any other basic path to improvement in the position of the dollar.

MR. LILLY. Any kind of intervention that would be meaningful to us, then, is a long way down the road.

CHAIRMAN BURNS. Well, to my mind, larger invention, [if it is used] at a time when some official action is coming into play, to help the market along and give it an extra push--at that time it would make good sense. Short of that, I am very doubtful about larger intervention. And I haven't mentioned, and in fact I have not given much thought so far to, a congressional problem we have if we do embark on an intervention policy that differs significantly from the one that we have been pursuing.

MR. COLDWELL. Only one facet of that bothers me, and I've listened with care about the reason we can't do this--there's a cost-benefit relationship here. And I think the deterioration of the exchange rate is building an inflationary force here, and the cost of that inflationary force might be even more than the intervention cost--if it carries too far.

CHAIRMAN BURNS. Well, Mr. Volcker referred to that very appropriately.

MR. JACKSON. Well, I think we've got another aspect of the energy policy issue as well. I would agree that dramatic increases in the cost of domestic energy could precipitate economic problems. But I think, at the same, the failure to do so is likely to precipitate economic problems that won't be as readily perceived and that won't be as directly addressed. The fundamental problem that we're having to look at in our country is that the cost of energy is going to go up. It's just a questions of how it is administered publicly. And perhaps if we were more realistic about facing the problem and facing the consequences of a decreased rate of increase in the standard of living or perhaps even a decrease in our standard of living, I think our people would be more prepared to face that issue in a rational way than to keep hiding it under things that they don't understand as readily as they do the increase in the cost of energy.

They don't understand things like differentials in foreign exchange rates, and our export policy, and the ramifications of protectionism. These are problems that the American public has difficulty in understanding, even experts have difficulty in understanding them. But the American public could understand the ramifications of an energy policy that related to the value of the dollar and to their standard of living. I think they'd be more willing to address themselves to a solution if we were more direct in our attempts to find them.

Until that takes place, it's my judgment that intervention on a level that's greater than we presently have embarked upon for purely short-term [management of a] disorderly [market] is foolishness. Until such time as our country is willing to at least have some significant turn of major policies, on which we could then have better foreign credibility toward our conviction of sustaining the dollar, I think we're wasting our resources and creating disorder rather than doing the opposite.

MR. PARTEE. Well, I have to say I was surprised by the amount of intervention that we've had. I realize we all voted this \$500 million limit. I was thinking of it in gross, and I hadn't exactly thought of it in terms of being a net, but it turns out to be essentially a net when the market's running one way. And I agree there's been no day that you've had a lot of intervention, but the total \$430 million strikes me as being quite a lot, quite a lot.

MR. PARDEE. Not in the market we are dealing with now.

MR. PARTEE. It's quite a lot in terms of our exposure, that's what I--

MR. PARDEE. Right. I think of that every night before I go to bed.

CHAIRMAN BURNS. Relative to the \$32 [billion] or \$33 billion of the central banks around the world--

MR. PARTEE. But they are doing it in order to protect their manufacturers from having a less favorable exchange rate.

CHAIRMAN BURNS. And we are doing it really to prevent the dollar, to the extent that we can, from depreciating. Now we like to talk about disorderly markets, in correcting that, and some of us may understand what that means. Others do not understand what that means.

Mr. Baughman, you wanted to comment. I'm sorry I've been so late in getting to you.

MR. BAUGHMAN. I was simply going to raise a question as to whether the intervention thus far was viewed exclusively in connection with moving against disorderly markets or whether it was oriented to a projected time and possibly amount in which we would expect a reversal of this depreciation of the dollar against key other currencies. But the succeeding discussion has answered that to my satisfaction.

CHAIRMAN BURNS. Well, I'm glad of that.

MR. BAUGHMAN. Well, I was going to ask Mr. Pardee. I inferred from the remarks that it was strictly a disorderly markets' attack.

MR. PARDEE. No. I used the terms "contained the disorder," "rear guard action," these are the--Mr. Volcker also even used the same terms. This is what we have at this stage. We are waiting for this opportunity which Chairman Burns has suggested, Governor Jackson suggested, when there is a possibility for a turn in market psychology from other policy changes. Then I agree with the Chairman, a more forceful approach would be more effective.

At this moment, if I were to go in and offer \$100 million worth of marks and try to choke the market, the market would gobble them up and say, "Have you got any more?" Until we have some help from other policy, we have to continue this very painful operation, which is embarrassing to me because I often advocated more forceful intervention and in bigger amounts than we had to. But the amounts out in the marketplace now are so huge that even the modest approach we've had has run up a bigger bill than I would have liked to come to the table with today.

MR. BAUGHMAN. But the other aspect is that we've been doing this thus far without any fairly firm time frame in mind as to when we might expect a reversal?

MR. PARDEE. That's the problem, and that's why I'm going day-to-day in having it.

CHAIRMAN BURNS. All right, we'll hear now from Mr. Winn, and then Mr. Willes.

MR. WINN. Mr. Chairman, in the energy area, I hope you'll take another look at our policy with respect to the export of reactors; that's about a \$9 billion market.

CHAIRMAN BURNS. Well, I don't know whether this is--to me it's one of economics, [the most] massive economic stupidity of this century. Here is an industry which was pioneered--we did the scientific work, we devised the technology, we led the world--and the industry is dying in this country and beginning to flourish abroad. And why we are doing that to ourselves, I don't understand, but I'm out of touch with the environment with so many ecologists who know what is right for America, who want to purify our air, and cleanse our souls, and make us ready for Heaven immediately.

MR. JACKSON. But they want to do it to the rest of the world as well.

CHAIRMAN BURNS. Well, why not.

MR. WINN. But this is big for our domestic employment as well as for the balance of trade.

MR. JACKSON. What is it, 15,000 jobs I've heard the figure quoted--

MR. WINN. Oh, more than that.

MR. JACKSON. Or 115,000 jobs.

MR. WINN. I think they have a much bigger figure than that.

CHAIRMAN BURNS. Oh, I think they got it much bigger than that.

MR. WINN. And then you've got \$9 billion in export trade involved.

MR. PARTEE. We won't permit exports, is that it?

MR. WINN. That's right. That's all going to Germany and France; it's going ahead.

CHAIRMAN BURNS. We are just permitting that industry, or forcing it, to die.

MR. COLDWELL. We're even trying to block it from other countries.

CHAIRMAN BURNS. Gentlemen, we are a little outside of our own area there; these are subtle matters of foreign policy and whatnot, and we have no expertise in that area. Mr. Willes, please.

MR. WILLES. I don't know how to ask this question without sounding incredibly naive, but I'll ask it anyway. I haven't had the impression as we've talked about policy in the six months that I've been here that usually, when we get to that stage, we talk very much about the international implications of policy. And yet what I've heard so far this morning would suggest that at least other countries think we ought to be doing things in terms of monetary policy that would have an effect in terms of the exchange rate. I guess my question is, what role does it play? How does it fit into our thinking, these kinds of international questions, when we talk about domestic policy operations?

VICE CHAIRMAN VOLCKER. Well, it seems to me, anyway, a very relevant question, which maybe we should defer until we talk about the policy implications. I alluded to that earlier when I said I wanted to make a comment connecting the two. But I think in logic it's probably better when you're talking about how it affects our policy to defer it until we get to the policy.

MR. PARDEE. Well, if we do--

MR. PARTEE. I guess--

VICE CHAIRMAN VOLCKER. --as opposed [to] the intervention policy.

MR. PARTEE. As a straightforward matter, people would say we would like to have larger interest rate differentials. And that either means their rates have to decline or ours have to go up.

MR. WALLICH. They're aware that their rates may have to decline, and the German reduction in the discount rate was very much angled toward that. Now, it was not unsuitable in terms of their domestic developments. But so long as they thought about it only in domestic terms or mainly, apparently they were split. But when the international implications dawned on them, they took the action.

Now we can point to having had higher interest rates over the last few months, and that's a contribution, a very substantial contribution. Somebody says, "Did you do it for that reason?" The answer is, "That's the wrong question. We did it for whatever reason, and we benefit internationally here." Now probing a little deeper, should we ever do something with interest rates for purely international reasons? I think then one comes to a halt and says, basically, this is a very large country and its interests are governed by domestic concerns mainly, and not by international.

MR. COLDWELL. But we have done it for international purposes at this table.

VICE CHAIRMAN VOLCKER. I'm not so sure a distinction can be made--

MR. PARTEE. Well, we've tried to deal with the yield curve sometimes, but I don't know that we have tried to change the general level of interest rates.

VICE CHAIRMAN VOLCKER. There hasn't been much, I agree.

MR. EASTBURN. Does anybody want to make a guess as to how much more depreciation we are going to have before these three policy changes are in place?

MR. MAYO. Give us the answer, Dave, as to when the policies are going to change.

VICE CHAIRMAN VOLCKER. You're an optimist if you can say three policy changes are going to take place.

MR. EASTBURN. I asked the question. What is the--

MR. PARDEE. I think, if there is no change in the oil price this week, that will help a great deal; that's one of the matters that's terribly troubling to the market and one of the areas in which public pronouncements by government officials have been most twisted by the press in recent months. Get that out of the way and you have some benefit. If there is some agreement on the energy package before Christmas, that is another area that--at least the language, the uncertainty--will be reduced. So we can have some benefit even in the next two weeks. The more fundamental change is further down the road.

MR. WINN. What about a 10 percent increase.

MR. PARDEE. If something's done; one of the problems is that nothing is being resolved, everybody is discussing the same thing. The press is filled up with the same stuff day after day. And if some of these issues just get off the front pages, or off the financial pages, then we'll have less to talk about and more time to think about interest rate differentials and rates of inflation and more fundamental economic issues.

[Chairman Burns temporarily turns meeting over to Vice Chairman Volcker.]

VICE CHAIRMAN VOLCKER. You haven't got any specific recommendation at this point--unless there are other matters--do you?

MR. PARDEE. Well, I do have a recommendation that we have some six swap drawings in the amount of \$136 million equivalent marks coming up for renewal by next FOMC meeting; and this is the first renewal; it's not for a formal approval.

VICE CHAIRMAN VOLCKER. You've got that specific thing which we have to act upon--

MR. PARTEE. That means they have lasted three months already.

MR. WALLICH. I noticed that while the swap can be renewed up to one year, the Germans talk in terms of renewing it once, maybe twice; but apparently they would much rather see it shorter rather than run up. Is that your impression?

MR. PARDEE. Yes. In the swap arrangement with the Germans, it's one renewal, and then after six months, we have to repay it either out of the market or in direct deals with them. So we have to face a six-month limitation.

MR. WALLICH. Well, they did talk about a third quarter.

MR. PARDEE. That's possible, but we would have to negotiate, and I would have to bring it forth as a specific recommendation to the Committee for the Committee's authorization.

VICE CHAIRMAN VOLCKER. I think we just have to note this, but I would conclude from the earlier discussion that nobody's talking about any drastic changes, or any changes at all, in the basic intervention approach, and we do have to approve, ratify, and confirm the last transaction; can I take it that that's done? And that we have noted this renewal with the swap business, and you are operating on the presumption that the basic approach is unchanged?

MR. GUFFEY. Does that mean that we go the \$400 million-plus next month, next month and next month waiting on these policy--

MR. PARTEE. It opens another \$500 million.

VICE CHAIRMAN VOLCKER. It opens another 300 without the subcommittee acting on it--

MR. PARTEE. With the subcommittee, you can have another 500.

MR. GUFFEY. Does that mean we are going down the drain more slowly?

VICE CHAIRMAN VOLCKER. Well, I don't think we can predict the amount.

MR. COLDWELL. Art, under the rules, does the subcommittee really have an additional 500 million between meetings?

MR. BROIDA. Not an additional. The subcommittee can authorize an additional 200, but the total would be 500.

MR. PARTEE. Yes, another 500 million.

MR. COLDWELL. No, not another, he said on top of what we have done.

MR. BROIDA. Starting today, the Desk has authority to do 300 million before the next meeting. The subcommittee can make it 500.

MR. PARTEE. So that's another 500 on top of the 430 that we've done.

VICE CHAIRMAN VOLCKER. If the subcommittee approves it.

MR. PARDEE. We've done bigger amounts.

SPEAKER(?). Huh?

MR. PARDEE. We've done bigger amounts before.

MR. PARTEE. Well, I would like it to be known that I'm rather concerned about this, and I think we ought to make an effort to hold down the amount of intervention while still doing what the directive calls for. That is, dealing in disorderly conditions, and let's not overdo.

VICE CHAIRMAN VOLCKER. Well, I think that's what we have been doing. I think it's a question of what's overdoing, I suppose. But given the markets as they've existed, the amount has not been very large.

MR. PARTEE. That's what you think.

SPEAKER(?). I can see some disagreement on that.

MR. COLDWELL. I agree with your formulation, unless this deterioration moves more rapidly. At this point, I think I might want to reconsider that.

VICE CHAIRMAN VOLCKER. Well, that's not purely a question of how rapidly, I think; it's where it is in absolute terms. You get down another 10 percent on the mark from where it now is, you're down to around to \$1.85 or something, which raises some rather more pointed questions.

MR. COLDWELL. That's my point.

MR. PARTEE. Well, that would have to come to the Committee.

MR. COLDWELL. It wouldn't under--could at least spend \$500 million before you get there.

MR. WALLICH. As the rate drops, the prospects of loss for these operations, of course, diminishes and--

SPEAKER(?). It does?

MR. WALLICH. Well, the image of neglect rises as the rate goes down and we continue at the same rate of intervention. So I think there is a case for operating on a larger scale as the rate goes down.

MR. COLDWELL. Refresh my memory, Secretary. Have we a sharing on losses on this swap?

MR. BROIDA. With the Germans--

MR. COLDWELL. 50-50 loss sharing.

MR. WALLICH. --and profit.

MR. BROIDA. Yes.

VICE CHAIRMAN VOLCKER. Well, I'd be surprised if you really wanted to quantify this very precisely.

MR. MAYO. We could make a lot of money on this.

VICE CHAIRMAN VOLCKER. It's clear in the context that the general approach remains as it has been, which certainly has been cautious and subject to day-to-day appraisal in the market. And on that understanding I think we can go to the domestic side now.

[Chairman Burns returns to the meeting.]

[To Chairman Burns:] I got you up to agenda item 4.

CHAIRMAN BURNS. Mr. Zeisel, we are ready for you now.

MR. ZEISEL. [Secretary's note: This statement was not found in Committee records.]

CHAIRMAN BURNS. [Interrupting] The increase in the third quarter--

MR. ZEISEL. --was about 4 percent.

CHAIRMAN BURNS. Of what magnitude?

MR. ZEISEL. That was real final demand.

CHAIRMAN BURNS. And real GNP?

MR. ZEISEL. --was 4.7.

CHAIRMAN BURNS. There is another revision, recently made; has that been reported--

MR. ZEISEL. There is a revision that will be coming out this afternoon that you may be aware of. I haven't seen it yet.

CHAIRMAN BURNS. Well, I am aware of it. It's not unfavorable; let me stop there.

MR. ZEISEL. [Secretary's note: This statement was not found in Committee records.]

CHAIRMAN BURNS. What labor force growth are you assuming for 1978?

MR. ZEISEL. About 3-1/4 percent, as I recall.

CHAIRMAN BURNS. In terms of numbers what is it? Do you remember, and how does it compare with the actual number for this year?

MR. ZEISEL. It's slightly less than this year, Mr. Chairman, about 1/2 million less, as I recall, but substantially well above the normal, that is, the increases in population and long-term trends in participation rates.

CHAIRMAN BURNS. Don't bother, I think you've answered my question.

MR. PARTEE. It's 2.2 million.

CHAIRMAN BURNS. --2.2 million. But we had a much larger increase this year. Didn't we have an increase of--

MR. ZEISEL. Oh yes, closer to 3 million.

CHAIRMAN BURNS. Well, thank you very much for your report. Now I think that it would be well if purely technical questions were put aside and put to the staff after the meeting, or during the recess. And I think we as a Committee should focus our comments around the staff's projections. That is to say, whether we think they're approximately right in our judgment, or too optimistic, or not optimistic enough, so that the general thinking of the Committee with regard to the economic outlook would come through in the course of our discussion.

That is important for our internal purposes--that is, in arriving at a judgment on monetary policy--and there is a public reason, because now, what happens in this Committee, you see, in the course of our deliberations, has to be summarized and made public. And unless we express our views concerning the outlook for the economy--whether we more or less agree with the staff or deviate in one direction or another--the report that our staff draws up and which is made available to the public [will] not [be] as revealing as it should be. And you know, very often we will not speak out because we tend to agree with the staff. Well, if we don't speak out, then our staff doesn't have enough of a basis for expressing the Committee's thinking. So that's the reason for my emphasis this morning.

Who would like to speak first? Mr. Wallich, Mr. Black, Mr. Kimbrel, then Mr. Jackson and Mr. Baughman--well, we're started--and then Mr. Roos. Mr. Wallich, please.

MR. WALLICH. Well, with respect to our forecast, I think it's fair to say that, for the end of 1978 we are high among forecasters. So certainly our staff couldn't be [accused of] not stressing elements of strength. I think that very few forecasters actually have a higher end for 1978; many of them go below 4 [percent], some close to 3, or even below.

I think, however, all this is relatively unrealistic because it doesn't seem to factor in a tax policy. Now we read in the paper that a tax cut is being discussed--that we've known all along. We see now that at least what has been told to the journalists is within the range of \$20 billion to \$30 billion. So far, I have heard mostly about \$20 billion, so that one has to now begin to think about what would be the impact of a tax cut of that order--what would be its timing, would it come early, late; is it applied to the first half or only to the second. It would be apparently done

partly through changes in withholding and subsequently through changes in rates. These are all matters that are very relevant to one's view of 1978 and I think would raise the forecast quite a bit above what it is now.

Now, I don't know what the multiplier on a tax cut of this magnitude would be, but surely not less than 1. Probably more than 1. And if so, that's about 1 percent of GNP. This year we're going to make \$2 trillion GNP, and I guess nobody celebrates because it's mostly inflation. Well, I would regard the 4.1 [percent] of our forecast as an unsatisfactory result if it weren't for the expectation that we are going to have this fiscal action. What troubles me about the fiscal action is that it's a continuation of what we've done all along: fiscal ease, combined with, I won't call it monetary tightness, but at least if there's been any restraint anywhere, it's been through monetary policy, and that has an adverse effect on investment.

I can't see that monetary policy should have had any adverse effect on investment. Interest rates have been low in real terms. It is very difficult to believe that monetary policy has restrained investment. But the net effect of this combination of easy fiscal and less easy monetary has been to hurt investment, and we see it in the investment data that we get. I just wanted to lay this out because it's the result of the interaction of factors that, in part, we have no control over, and yet we ought to think about the interaction.

CHAIRMAN BURNS. Thank you, Mr. Wallich. Mr. Kimbrel now, please.

MR. KIMBREL. Mr. Chairman, I think from our vantage point we are inclined to feel that the projections for automobiles are rather optimistic, significantly so. We have a similar view about housing. As a matter of fact, it would seem that the projections are almost at the high end of the surveys we've seen available, and I'd like to query if there's any special reason that we are not aware of that would give the staff this amount of optimism. We hope it's right, but we don't share it at the moment.

MR. ZEISEL. Yes, we are--certainly in the housing area--at the upper range of forecasts generally being made, and we think we have a reasonable defense of that position, and Mr. Ettin is prepared to provide that.

But let me make a few comments first about autos, if I may. I mentioned that we are concerned, obviously, with what appears to be a deterioration in the rate of sales of autos, and that deterioration, when one looks at a chart, suggests that it was occurring well before the introduction of the new models, which is now being blamed in part for the weakness. But a couple of points, I think, must be taken into consideration. First, in the early part of the year, the strength in auto sales was in part a rebound from the strike late last year. There was a deficit of possibly a quarter of a million cars in about the fourth quarter, which was probably made up early in the year. So that moderates somewhat the decline that appears.

In terms of the underlying factors that give us some optimism, a major factor supporting auto demand is household formation. Household formations are very much on the upside these days. These demographic factors, according to our studies, suggest an increase in demand for cars of about 150 thousand a year in that factor. The second factor is the second and additional

car syndrome in America, which continues, apparently unabated, as reflected in the vans and the light trucks as well as cars.

CHAIRMAN BURNS. Well, also, you know, I think the neglected factor in the automobile market is the increased participation of women, and to some degree teenagers, in the labor force. Now these new participants in the labor force need transportation. And with public transportation in many parts of the country neglected or poor, and with the penchant that the American public has for private automobiles, I think that this must be a significant factor on automobile sales. What do you think?

MR. ZEISEL. I think that's a very good point, and that is reflected in part, of course, in young people establishing their own household. But it is reflected as well in women having to get to work and young people having to get to a job and expecting to have a car to get there--I think a strong support to car purchases. And just to round out, we feel that our projections of disposable income through the year are fully adequate to support the kinds of projections of auto sales that we've made based upon past performance. And we have not really projected sales rates in 1978 that are substantially higher than '77--they're about the same. They may not be quite that strong; I'm not concerned about that overall. I think we'll wait and see on that one. On housing, Mr. Ettin is prepared.

MR. ETTIN. Our housing projection is on the high side of most other projections, and it suggests that, while the housing starts statistics for 1978 will be very close to '77, it's about peaking even now or early in '78 and will be declining modestly. This view is supported, we believe, mainly by the funds availability at thrift institutions and other lenders. While deposit flows have been moderating sharply from the third quarter rate, that third quarter rate was a bit of an outlier as far as the whole year is concerned. Moreover, we think that those flows to thrift institutions, as the Bluebook has pointed out, will remain largely [greater than] what we would expect based on historical rate relationships alone, given changes in ceiling rates that have occurred in the past and high rates of growth of nominal incomes.

Additionally, the amount of repayment of existing mortgages is producing a substantial cash flow to the thrift institutions that can supplement their deposit flows. Our projection does call for a considerable reduction in the liquidity of the thrift institutions, but their liquidity is already very, very high. It also calls for continued, relatively large support from the Federal Home Loan Banks to the S&Ls, and by FNMA [Fannie Mae] in the secondary mortgage market acquiring mortgages. But these--the degree of support--is relative to the size of the housing market in the fund flows--smaller than in past periods of rising interest rates.

CHAIRMAN BURNS. Well, now you've accented the supply of finance; what about the demand side?

MR. ETTIN. On the demand side, the most recent statistics, as Mr. Zeisel has pointed out, suggest continuing demand for housing. There is no indication that the price increases in housing have, as yet, shown much impact on housing demand. Indeed, one can argue that if the household sector continues to believe that housing is one of the best inflation hedges available, continued price increases of housing at about the past rates, we believe, should not act as a considerable dampening on housing demand. There is no indication that we've been able to

discover, as yet, as to whether resource limitations--in materials, for example--will be adding any additional buildup in housing prices in 1978. So we think the demand factors are there as well, given our projections of nominal income.

MR. JACKSON. The opposite side of that, I think, should be mentioned. There is a school of thought that believes that much of the demand side of single family housing is a product of the collapse in production that took place in earlier years; and that the increases in equity of existing homeowners, together with this pent-up demand from the collapse in production, has been able to sustain new house production at this price level. But soon [the thinking goes], increases in nominal incomes and family formations and things like that will begin to assert their long-term effect, and this present bulge may have overstated underlying demand, and we may see ourselves unable to sustain final demand at this price level much longer.

CHAIRMAN BURNS. That's entirely possible, but I think there is another factor that is of increasing significance to the housing market--

MR. JACKSON. The psychological factor as a financial asset is a major deterrent to that.

CHAIRMAN BURNS. the increasing awareness on the part of the American public [that] the one really effective hedge against inflation is real estate, and to the average man, that means owning a home.

MR. JACKSON. This even is one of the arguments made for the higher participation rate by women--that, [being] able to afford housing prices at these levels requires a two-earner household in order to be able to have any prospect [of buying a house]--which encourages women [to enter] the labor market.

CHAIRMAN BURNS. You know, wherever you go these days, people talk about protecting their family and doing something for themselves and their families, and then those who bought a home will recite their experience for the benefit of others. And as long as we have inflation at anything like the present rate, to say nothing of the possible higher rate, I think this will continue for some time.

MR. COLDWELL. There should be mentioned also, if you do get your major energy program curtailing consumption of gasoline, you do have a significant impact on housing construction out in the far suburbs of major towns, because you cannot create new public transport overnight to service areas like that.

CHAIRMAN BURNS. But the opposite side of that is rebuilding of inner cities and urban centers.

MR. COLDWELL. All right, but not on a single-family basis.

CHAIRMAN BURNS. No.

MR. COLDWELL. You can do it on a condominium or high-rise apartment.

CHAIRMAN BURNS. All right. Mr. Roos now, please.

MR. ROOS. I had a question, Mr. Chairman. When Mr. Zeisel reported, he alluded to two factors that confused me somewhat. One was the anticipated drop in real GNP from maybe a 4.7 percent rate to something in the lower 4 percent position, and you stated that this probably won't do much about unemployment. And the question that comes to me--as I understand, two of our objectives in establishing goals for monetary policy are maintaining economic growth and doing whatever realistically can be done to keep unemployment at a reasonably low level.

What do we see, Mr. Chairman, as realistic goals, I mean for these two aspects of our economy? It seems to me that when we say we are not going to be able to do much about unemployment, you cited the record amount of people that are employed. Is it conceivable that we have accomplished miracles in dealing with unemployment, that we really have gotten it nearly as low, with the expanding labor force, as could be expected? And, if average annual real GNP growth in the last 30 years has been, maybe, 3-1/2 percent, is it true that real GNP growth [at] maybe something over 4, 4-1/2 percent is a pretty good batting average?

The question I raise is, in making our monetary policy decisions, are we realistic in what we're trying to accomplish, or do we feel that we always are doing poorly vis à vis unemployment and that any reduction in real GNP, even though it's considerably above what has been the average economic growth factor for our nation, that these things are unsatisfactory. Do we have any feeling in that regard?

CHAIRMAN BURNS. Well, each of us has more or less definite views on that. As far as I am concerned, what I find so troublesome about the unemployment problem is not the overall total but its massive concentration among black people, and particularly black teenagers. I think we have an explosive factor in our society in that fact. I think the consequences of black and teenage unemployment will be with us for the next 50 or perhaps 100 years, even if that trend were arrested, but we haven't arrested that trend. Now we've had a very sizable expansion in employment, but it hasn't touched our black people or teenagers to any extent. As far as black teenagers are concerned, the unemployment rate has risen during this remarkable period of expansion of jobs.

MR. BAUGHMAN. Mr. Chairman, with the minimum wage--

CHAIRMAN BURNS. Beg pardon?

MR. BAUGHMAN. With the minimum wage, isn't it likely to increase even more?

CHAIRMAN BURNS. Yes. I think so. I think we are on a tragic course. There is some new thinking going on. Whether it will bear fruit or not I don't know. We came closer to a youth differential [wage] in Congress this year than ever before--the youth differential lost by one vote. And that question will come up in the next session of this Congress, and there are two proposals that I think will be receiving serious attention. One is a youth differential to be effective, let us say, for a period of six months or thereabouts and then it would be eliminated. That is, for the first six months, it would be a much lower minimum wage, and then it would rise to the regular, legally established level. Another proposal--and I threw [it] out in a recent speech

and after doing some checking with a slender sample of the black community--and that is to try a pilot experiment in a half-dozen cities, where you [would] have a permanent youth differential.

MR. ROOS. Mr. Chairman, but aren't those sort of structural problems? In other words, if I understand the purpose of this exercise that we are involved in, [it] is to try to develop some facts from which we will make our later decision with regard to monetary policy. I doubt whether--and I don't say this in a quarrelsome way--but it's questionable whether monetary policy, per se, can solve the particularly high unemployment problems amongst blacks or--

CHAIRMAN BURNS. Oh, I would agree with that entirely.

MR. ROOS. And so I wonder whether we don't have to be realistic in what we think we've accomplished in reducing unemployment, or cannot be accomplished; and whether we don't have to be realistic in where we are pinpointing and attempting to get real GNP growth, if we are going to relate that to a later monetary decision. What I'm saying is, should we be depressed about the present, or should we be expansionarily inclined in our monetary policy? Because real GNP [growth] is somewhere between 4 and 4-1/2 [percent] and unemployment is where it is, and I get the feeling that whenever there is any movement downward in real GNP, even though it may be at, historically, relatively satisfactory levels, we tend to feel that this is a reason why, an hour from now, we might take a more expansionary monetary policy posture.

CHAIRMAN BURNS. Well, I suggest that we postpone trying to answer that question until we turn to the monetary policy part of our discussion. I'm not going to try to pre-judge the trend of our thinking.

MR. WALLICH. May I make a quick comment, Mr. Chairman? I think the problem [of] teenagers, which is very dominant now, is in part a demographic one, which in time is going to be changed around by the decline in the birth rate. That means that we have a generation that, moving up the years, will have its problems. But the teenage problem as such, I think, will tend to diminish as a result of lower birth rates following the '50s and '60s.

CHAIRMAN BURNS. Well, it may work out that way, but you have counterforces, you know--white women entering the labor force in increasing numbers; unskilled, relatively uneducated black teenagers out of jobs. Now that has been going on for some time. It's complicated. I don't think we can do very much about it here except to be alive to the issue and in our individual capacities do what we can to deal with the problem. I think it's a distressing national problem with explosive potentiality. Mr. Black, please.

MR. BLACK. Mr. Chairman, our sense of the business outlook has strengthened significantly in the last month or so, and I would come out about where the staff does in the overall outlook, assuming no change in tax policy, inflation policy, or regulatory policy. But if we can get some significant inroads in those areas, as you seem to think we might, then I think this can take off a great deal faster than projected.

CHAIRMAN BURNS. Okay. Mr. Jackson, please.

MR. JACKSON. I think it's unfortunate that we don't furnish the other FOMC members a table labeled 1-A in the Bluebook, which discusses the details of the time and savings component. The Board gets them, and I think they have some information that is pertinent for our policy discussion.

CHAIRMAN BURNS. That should be corrected in the future, Mr. Axilrod.

MR. AXILROD. Yes. We'll provide that.

MR. JACKSON. The reason I bring it up is because I think it contains some information that is pertinent, in my judgment, about the immediate course of the economy. I think it would illustrate that the so-called passbook savings component [for] individuals is down significantly below its previous level. And it illustrates that our potential for sustained final personal consumption expenditures is likely to be good because people are apparently spending their savings, or failing to save it. And I hear reports from some of my friends in that industry indicating that at their branches, the lines with the people with the passbooks in their hands to draw checks out is very significant in recent weeks.

And so I think our prospects for a good strong final consumption are excellent, which in turn will lead us into a good industrial production level and so forth for the early parts of 1978, maybe somewhat like we saw for '77. I also think that the prospects for capital expenditure are as good as the staff has indicated, perhaps even better. We have to recognize that one of the advantages we've gotten as a consequence of the changing of the value of the dollar is the relative attractiveness of U.S. investments by foreigners, particularly long-term investments, industrial facilities, and things of this sort. I see that that will sustain us and offer increased activity in the investment area.

I also think that the change in the value of the dollar will produce a different perception as to what capacity levels might be appropriate for us in this country. Heretofore, I suspect, many of our multinational corporations have seen that their capacity levels in the United States did not need to be expanded because of the potential for foreign capacity--which has been relatively more slack than ours in my general perception--to meet this demand; and therefore U.S. capacity expansion was not as necessary. However, due to a change in rates, the cost of that foreign capacity may be significantly increased and therefore encourage people to expand domestic capacity at a rate that they hadn't previously perceived to be necessary. So I think that will be a plus in the capital expenditure side--perhaps even where we have not seen much, and that's the major new facility, the major new entity that will [provide] major increases in capacity, particularly processing and things like that. I think, unfortunately, the situation in many of these process industries, chemicals, textiles, and things of this sort is so dismal abroad [unintelligible].

In short, I would say that our economic prospects are good. Unfortunately, the ramifications for political and social policy will not be easily obtained, going back to your labor situation. It's my judgment that we may be getting close to a real tightness in skilled labor, despite the macro unemployment figures. I think we are getting very close to a tight situation in that market for labor, which will mean that, as they say, the rich will get richer and the poor will have more children. It's a situation [with] tragic social and political consequences, [and] it may pose some difficult economic choices and monetary choices for us as a consequence of this fact.

CHAIRMAN BURNS. Thank you, Mr. Jackson. Perhaps we cannot conclude our economic discussion before coffee break.

[Coffee break]

CHAIRMAN BURNS. Mr. Baughman, please. We are resuming our economic discussion.

MR. BAUGHMAN. Mr. Chairman, with respect to the staff projection, I have no particular quarrel with it. I'm still inclined to the view, and as I mentioned before, it may be a reflection of the economic situation in our District, that the staff projection may well be on the low side rather than the high side. And that's notwithstanding the fact that it's currently on the high side of many other projections. But, it seems to me, there are some expansive elements in the economy, and they are likely to stay with us through a good part of 1978.

Two or three bits of information that I thought I would mention--they might be of interest to the Committee. We are seeing very strong retail sales in the District, running on the order of about 20 percent above a year ago. And sales tax revenues, for example, collected in the state in October were 22 percent above a year-ago level, and that's without a change in rates. And the oil and gas drilling activity continues very strong, with all of the available equipment in use, and with a stretch out in lead times on orders for new equipment, and with capacity to produce new equipment being expanded. There is a continuing very tight labor situation in the areas where oil and gas exploration takes place, with some significant difficulties in putting together crews and moving ahead with the work.

It's what I hear reported in the real estate area that leads me, in part--in addition to that gas and oil business--to [be] rather optimistic. Just an interesting fact--we see that real estate loans in the Eleventh District banks in the first 11 months of this year [were] up 32 percent compared to the first 11 months of last year. And one of our directors, who engages extensively in construction activity all around the country [and] in other countries, reports concern of sufficiently widespread activity in the office-structure [market] that he contemplates we will have a surge in stuff brought onto the market within the next one to two years, which will again put that [market] in a position of being substantially overbuilt, and [result in] a lot of unrented space around. The major reason he gives for this is that he reports that insurance companies, [as well as] some other builders and financiers, those who extend a permanent credit, are reducing the requirements [imposed on] the developer. They are willing now to enter into firm agreements to take out permanent credits for these prospective projects with a much lower amount of firm rental agreements for tenants. He sees this pretty well all around the country, and he suggests, of course, that the builders will build all that the lenders will finance, and that this is almost a certainty.

CHAIRMAN BURNS. With 100 percent?

MR. BAUGHMAN. Pardon me?

CHAIRMAN BURNS. Or 100 plus percent loans?

MR. BAUGHMAN. He indicates that's another facet of the thing on which he sees ground being given. Now there's a related development there in that part of the country, and I'm not in a position to generalize elsewhere--a rather strong foreign demand for income-producing real estate. And this foreign demand is bidding up the price relative to the current flow of income on this type of real estate, and this is both multiunit residential and commercial, and even to a lesser extent industrial. And, of course, there's been some farm real estate in that picture as well. That also provides some thrust, it seems to me, to real estate development, in a sense that people who currently own this, being bought out and having liquid funds available, if they normally invest in that kind of stuff they are probably going to turn to further investment in it. Those are some things I thought might be of interest.

MR. PARTEE. The thing to do with their teenagers is to ship them to Texas.

CHAIRMAN BURNS. I have names of members of this family in a certain order, but I'm going to part from what I have now, and having heard from Texas, I think we ought to hear from New England next.

MR. MORRIS. I think [hearing from] New York would probably have been the best thing, because New England is doing surprisingly well in this expansion, much better than the middle-Atlantic states. This is not the basis for my feeling that I'm modestly more optimistic than the staff forecast. First, for the reason Henry Wallich mentioned, that the President's tax reduction program is not yet factored into the forecast. And that even if the implementation is deferred until October, I think that once the dimensions of the program are made known, it will affect expanding decisions--

CHAIRMAN BURNS. You know, as a political parentheses, it's hard for me to believe that Congress would write a tax bill the effectiveness of which starts in October.

MR. PARTEE. That's the beginning of the fiscal year, and I think that's the reason.

CHAIRMAN BURNS. I understand that; November follows October--

MR. MAYO. It sure does, very closely.

CHAIRMAN BURNS. And therefore the effective date will be sooner.

MR. MORRIS. But beyond that, Mr. Chairman, it seems to me that the numbers that have come in the past month have been considerably stronger than I had anticipated. I think the employment numbers, for example, plus the increase in the work week at the same time, was surprisingly strong. We have seen a real turn in the basic commodity prices, and the indicators in general are showing an acceleration--show the economy coming out of the little mini inventory cycle that slowed us down temporarily. So I'm not looking for a boom period, but I'm, as I say, modestly [more] optimistic than the staff.

CHAIRMAN BURNS. All right, now. Mr. Volcker, please. This is the time for your balancing act.

VICE CHAIRMAN VOLCKER. That's right. There is some difference of opinion. I really should have had New York balancing Texas. I could even add northern New Jersey. However, Fairfield County [Connecticut] is booming; Stamford has more headquarters than Houston, I think. It's all moving out of New York City. But in general terms--the staff starting out by saying things look better now--I think they clearly do. In fact, I'm inclined to think the numbers will come out higher than they have projected for the next couple of quarters. So I have no disagreement with the tone of things there, maybe a little stronger.

However, as you move out [further into the projection period], I guess I would still say the staff case is not proven, and we think the likelihood is slower growth. They already have growth tapering off slightly during '78, mainly because we don't share the optimism at this stage on further increases in residential construction, and we are inclined to accept the survey evidence on plant and equipment at this point. There's a possibility of a considerably sharper slowing during the course of '78. As others have pointed out, that's without the tax stimulus, and I think that that is important. It could turn out better on those grounds alone.

The only point I would make in this connection, when I look at some of the discussion in the Bluebook and elsewhere, and anticipating a little bit the later discussion, looking toward higher interest rates to keep the aggregates in line, reaching as high as 7-3/4 percent--if it is at all true that the economy will show a risk of slower growth than the staff shows, as we think, and you get some fiscal stimulus on top of that and a bigger budget deficit, it may be hard to take action at that time to keep the aggregates down if the economy is both looking sluggish and you have a bigger budgetary deficit at the same time. I just note that as a possible hazard for the future [and part of our] not sharing the degree of buoyancy that the staff has as 1978 wears on. Although we agree that it's quite buoyant at the moment.

CHAIRMAN BURNS. Thank you, Mr. Volcker. Mr. Winn now, please.

MR. WINN. Mr. Chairman, I associate myself with being somewhat more optimistic than the staff in terms of the outlook, with a couple of flags, one of which has been mentioned--the automobile area. The parts people and the accessories people are not as optimistic as the basic manufacturers in the outlook for automobiles, and I think that's something we need to watch. The second problem I'd mention is the inflation problem, which may be underestimated by the staff in terms of what's happening in costs--steel, coal, and a number of raw materials are starting to go the other direction. And then the basic Social Security, minimum wage, health costs. It looks to me like state taxes may be going up, too, rather substantially, because of school and other problems across the country. And I wonder if the cost-push may not hit us next year. We have been lulled a little bit by our favorable inflation experience this year, [and] this is of concern, I do believe, as we look ahead.

CHAIRMAN BURNS. Okay, Mr. Winn. Mr. Eastburn now, please.

MR. EASTBURN. Thank you, Mr. Chairman. I agree essentially with the staff projections, although, as Frank indicates, I come from an area that isn't booming. But there is one development that I think will have some effect in the near term, and that is the implications of the coal strike. One of our directors is in the utility field and is very much concerned about this and makes a point that there is too much complacency about the adequacy of the stocks, that

they are not well distributed, and that you can't count on anything happening until they run out. Because once you are about half-way through, then they start to put into effect rationing devices that will affect users of coal, and they will have to be making decisions as to who they will ration, and they are likely to ration the large consumers first. And we can see this showing up. Particularly since he feels that it is going to take some time for the strike to be settled--feelings are running high, and it's going to take time for the negotiators to get to the table. We could have some short-term serious effects on our output.

CHAIRMAN BURNS. You know, some years ago, I made a study on the effects of major strikes on the economy--an historical study taking strikes that lasted four weeks or longer in the coal industry, the railroad industry, steel industry. And if you look at the output figures of those industries, yes, the effect was very large, but in the overall economy, it was hardly noticeable. While you are living through one of these periods, it's something that people attach great importance to, but somehow these major strikes get lost.

MR. EASTBURN. That's why I stressed the near-term aspects; it seems to me [that] at the end of the year you will find it.

CHAIRMAN BURNS. Near-term influence on rhetoric and some influence on psychology, but not overall activity. Well, this may be different. Thank you, Mr. Eastburn. Mr. Coldwell now, please.

MR. COLDWELL. Mr. Chairman, I am satisfied with the status of the economy today. I think we are having very good improvement. The short run, I don't see much problem through the early part of '78. But I differ from the staff when we get down into mid and late '78--not on the basis of housing or anything of that character. I can see a major run-up in inflation this coming year. Government policy, I think, has weakened very sharply in any resistance to inflation. The actions they have taken with regard to the stockpile--sugar, grains, copper--and other things which are coming down the pike. I think it's going to provide a major stimulus to raw materials and prices.

CHAIRMAN BURNS. I haven't been aware. What's been happening in stockpiles?

MR. COLDWELL. Well, we've got a stockpile policy now, if I understand this correctly, to rebuild the stockpile which Nixon tore down and sold off.

CHAIRMAN BURNS. Has the staff been following this? I'm not aware of this.

MR. ZEISEL. The staff has been following it. I'm afraid the staff that's here is not expert on that matter. We have someone following it, Mr. Chairman.

CHAIRMAN BURNS. Well, let's have a report, rather promptly, on what is happening here.

MR. COLDWELL. The last I heard on this, Mr. Chairman, was a policy statement which would roughly put out \$3 billion to \$5 billion in raw materials, one of the major elements of which would be copper.

CHAIRMAN BURNS. Is this for the next fiscal year?

MR. COLDWELL. It was to be spread over the next 2-1/2, as I recall, sir.

VICE CHAIRMAN VOLCKER. I saw something about buying copper but selling aluminum, I think, which seems to make sense in the current situation.

MR. COLDWELL. Yes it did, but the net, I believe, Paul, was a major stockpile. Furthermore, I think the deterioration of the dollar is going to add a significant inflation stimulus over the next few months. I hope you are right that we'll get a reduction, or a correction, in these various elements you've mentioned to stop the deterioration, but I have my doubts about it over the short-run period. On balance, what I'm saying is that I think we are going to be facing a fairly significant inflationary run-up in the early part of next year, culminating, perhaps, in the summer of the year. How that culminates--whether we are in a downturn or in a roaring boom, I don't know. It's too far out for me to guess. But I think the staff may be severely underestimating the inflationary problems next year.

CHAIRMAN BURNS. Thank you, Mr. Coldwell. Mr. Lilly next, please.

MR. LILLY. I'm on this program by mistake. I heard you suggest we might get through early, so I volunteered not to speak, and therefore got put on the agenda. So being here, I will speak very briefly. I agree with the forecast in general. I am coming around to a tentative hypothesis that perhaps our business fixed investment forecasts are optimistic. I'm beginning to think that perhaps the manufacturing side has achieved an efficiency of investment that we haven't really gotten hold of and that capacity has been increased substantially without any new structures of significance.

In addition to that, I think there has been a lot of capacity that's been displaced overseas--and I think your comments were very interesting--but nevertheless I think some of our raw materials are permanently going to be coming from overseas. We haven't had any refineries built in this country in seven years. You heard the aluminum people a few days ago tell us they hadn't any plans to build any aluminum refineries in this country. So it may well be that the staff is a little on the optimistic side on the business fixed investment, and I hope I'm wrong on that.

I think we're in a kind of minor boom. We have the highest percentage of our population employed today that we have had in history as I know it, and we have added 8 million jobs, roughly, since the trough, and we are going to add 2.2 million more next year, and that's just a fantastic addition to the labor force, and it's a fantastic performance. We are still going to end up with an unemployment number that is not going to be satisfactory, and it certainly points up the need for structural programs of the kind you are talking of. If business fixed investment is not going to eventuate, we certainly are going to be dependent on the consumer, and he needs a lot of care. See what you get for putting me on?

CHAIRMAN BURNS. Well, thank you. Yes, Mr. Black?

MR. BLACK. Mr. Chairman, I'm very intrigued by Governor Lilly's observation that he thinks we have been able to achieve more efficiency in this. Would you elucidate a little bit? I'm--

MR. LILLY. Well, factories are being expanded today by the addition of new wings or rearranged to increase line productivity, rather than the selection of a new site and the construction of the new 1/2 million square foot facility. And you see some verification of this when you see that the machine tool figures are pretty good and other short-term things are good. This looks to me like some people are making do with their fixed real estate investments, and they are really squeezing out additional capacity from those facilities.

CHAIRMAN BURNS. I think that's true, but there seems to be a new trend emerging in industrial and commercial construction since the first quarter of the year. How far that will go--

MR. JACKSON. Do we get a breakdown between industrial and commercial? The figures we see are just a gross of 70 thousand--

MR. ZEISEL. Yes, I'll send you a table.

MR. JACKSON. What does it tell us?

MR. ZEISEL. Both have been growing recently.

MR. JACKSON. They have been growing on parallel paths?

MR. ZEISEL. Both of them have been growing quite vigorously over the last couple of quarters, as the Chairman points out. There's an enormous variation month by month. You get a sudden decline like last month, but basically they are both on an upward slant.

MR. JACKSON. How does warehouse get classified? As commercial or industrial?

CHAIRMAN BURNS. Commercial.

MR. JACKSON. It is.

CHAIRMAN BURNS. I think that one item that doesn't fit either category is theaters. How large a factor that is--I don't know.

MR. LILLY. That's part of services.

CHAIRMAN BURNS. Well, I'd put it in commercial. You have to squeeze it in somewhere.

SPEAKER(?). I think it's more industrial.

CHAIRMAN BURNS. All right. Mr. Partee now, please.

MR. PARTEE. Well, Mr. Chairman, I'm prepared to take the staff projections as a sort of datum against which we can compare performance in the period to come. I guess my instinct says that the very immediate outlook is stronger than the staff projection, but the longer-run outlook is weaker than the staff projection. I think we have had a little twist in retail sales here, and it looks as if the inventory numbers are adjusting downward, and now I think we can get a sizable rise in output in the next few months. That would probably mean a first-quarter GNP considerably above this number of 4.6 that the staff has.

But I am concerned about [a cutback in] auto sales, and I think its impact would fall in the spring. Producers continue to produce pretty well through the winter to see whether the market comes, and if it doesn't come, why, they will make a sizable cutback in the spring--that is historically what they have done. And I would think they would do it again, that is, assuming we are only talking about a mild reduction, say, of a million units or so below the staff projection, which I do think is the prospect. And so, therefore, there could be a spring slow-up in the growth in the economy because the automobile industry's effect is very widespread as they deal with suppliers and the parts people and textiles and rubber and steel and all that.

Later on, I think the prospect would depend on plant and equipment coming in, and I, too, am beginning to grow a little restive about the prospects of a sizable rise in plant and equipment. I have continued to feel that it was coming, but I must say there hasn't been--well, it just continues to look a little sluggish to me, and I'm starting to wonder whether we are going to get the large rise.

CHAIRMAN BURNS. When you say that, Mr. Partee, are you taking into account the probability of the sizable reduction in tax--

MR. PARTEE. No, no. That was my next point. I think that that's offset by the prospect, which Henry first mentioned, of the fiscal package, one aspect of which is likely to include something intended to stimulate investment. Perhaps an investment tax credit effective back to the date when the President announces it, or perhaps accelerated depreciation, or perhaps a general tax cut for corporations. And that could make a difference as we go through the year, even though the effective date of the tax bill might be June 30, or even September 30. There could be retroactive aspects to it, and there could be impacts that would occur in advance of final ultimate passage of a bill by the Congress.

Now, I don't think it's going to be all that easy to get a tax cut--a package that everyone will agree to. The Administration has had great difficulty with the Congress on particularities of proposals this year, and I see no reason to think that they won't have the same kind of difficulty unless they have become much more adept next year. So I don't--it's a little bit like counting your chickens before they're hatched to start to talk about the stimulative effect of a tax cut or a fiscal initiative, because it's got quite a distance to go. But I am inclined to think that in the absence of some kind of a constructive fiscal initiative, that the economy will be weaker in the latter part of next year than the staff projection. And therefore, that will make that awfully important in our consideration of policy as we get into the new year.

But for the very immediate prospect, I would expect more of a pickup than the staff has projected. I might say that one of the difficulties that I am more struck by is that people are so

much affected by where they come from. Ernie is without fail bullish, and I sometimes feel that the whole state of Texas will be paved over by development down there. But it is more and more the case that the average performance of the economy contains two aspects. One, very strong growth in the South, and the other, rather weakish growth, particularly in New York and Pennsylvania and New Jersey--in that section of the Northeast--and Ohio, I would say also. And that's something I think we need to take account of when we are evaluating what the overall outlook is.

CHAIRMAN BURNS. I think that's true, but in such an evaluation, it's not just a matter of adding up; we must not neglect the energizing effect that the Texas economy may have on the country as a whole. That's where the pioneers and the innovators and community boosters come from, and that proves a little infectious, partly psychologically, simply by virtue of the competition that it offers to other parts of the country, which are bound to respond in order to stay alive.

MR. WILLES. Hopefully you won't limit those comments to Texas.

CHAIRMAN BURNS. No.

MR. PARTEE. They can still pave--there's a lot to pave--

MR. GARDNER. The South and the West were settled by immigrants from New England.

CHAIRMAN BURNS. That's right.

SPEAKER(?). The best people left.

MR. BAUGHMAN. It is interesting, I think, that in addition to the strong growth we had in the larger metropolitan areas, that many of the companies coming to Texas are putting their plants out in the smaller communities.

CHAIRMAN BURNS. Mr. Mayo, may we hear from you now?

MR. MAYO. Your remarks on energizing, remind me, Mr. Chairman, that when I was in Japan, I had the pleasure of going through the [unintelligible] color television plant, which is, if not the largest in the world, close to the largest in the world. There were only 4 lines operating, and we asked the question, "Well, what's going on? Is demand off?" [They said,] "No, demand is heavier; this plant was built to have 12 lines, we put in 8, and we are operating them. We are now making the same number of television sets on the 4 lines that we did on the 8."

So we have some encouragement from abroad to be more efficient, too. The point I wanted to make, other than my basic agreement with the staff forecast, which I think is sound--except maybe for housing starts, which may be overestimated a little--is to mention two things. First of all, on the auto side, some of our informants do give quite a bit of credence to this idea that it is discomfort, so to speak, with the downsizing of the new models; and that this is not a switch out of automobile purchases into savings--it is a switch of automobile purchases into

purchases of other goods, and that it may not be affecting demand as much as some people are attributing to it.

On the agricultural side, no one has mentioned it today. I have nothing really new to report, except that I think the agricultural credit situation has stabilized a little; at least it doesn't seem to have gotten worse. The farmers' strike seems to have three goals, one of which is to stop buying farm machinery. Well, they already did that before the strike started; farm machinery purchases are way down. Second is, they are going to refuse to plant crops, and nobody in the Midwest plants crops in December anyway. And the third is to get 100 percent of parity. So I think the fact that the farmers' strike hasn't even been mentioned here today is a correct interpretation. It isn't of any significance.

CHAIRMAN BURNS. Thank you, Mr. Mayo. Mr. Willes now, please.

MR. WILLES. Thank you, Mr. Chairman. I would just like to pick up on the comment that Dave Lilly made with regard to expansion in capacity. As you know, I have been reporting that the businessmen in our District have had very aggressive expansion plans. At the same time, they have done exactly what you suggested, David, and had significant increases in capacity by making do with their own plants. Their interpretation of that, though, at least as they played it back to me, is that they have done that because they have been uncertain about the payoff of more permanent increases in capacity, primarily because of energy and taxes, and most importantly, in their case, inflation. And if they could resolve in their own minds any of those things, then their feeling is that the more long-life kinds of expansion to capacity would come on stream relatively quickly and in rather large amounts.

Now, following that up, we have been more optimistic than the staff over the last six months. More optimistic than most people around the table. As I hear the discussion today, people seem to be moving a little bit in our direction, and as much as I hate to admit it, we are moving--not for the short term but for the longer term--back the other way. That is to say, we are less optimistic about the latter half of next year than we have been, but I think for a very important reason, and that's the one identified by Governor Coldwell. The businessmen in our area are becoming increasingly concerned about the prospects of inflation for next year. And that is causing them to re-assess what, up to this time, have been very ambitious capital spending plans.

I don't know whether this is typical elsewhere in the country. And it's not to the point yet where they are changing anything. But what they are telling me is they are re-looking at some of those things, and if those current concerns continue, then it seems to me that we could start to have, at least in our area, some reductions in plans that I personally think could be quite unfortunate and quite significant.

MR. LILLY. What kind of labor settlements have they been making?

MR. WILLES. We haven't had any of those this year of any significance; I don't have any information on that.

CHAIRMAN BURNS. All right, thank you, Mr. Willes. Mr. Gardner now, please.

MR. GARDNER. Well, I have very little to say. I felt two months ago that the staff was not expecting as good a fourth quarter as I thought I saw in prospect. I said at the time, "Fortunately, we have to go through the fourth quarter to get to 1978." We are having a good fourth quarter, and I'm not going to abandon the staff now that they have improved their forecast for '78. I am also interested in the Redbook comments, which I take as a further expression by my colleagues that they see relatively good conditions.

I refer to the automobile industry only because it's commented on as a disappointment. But I want to point out that [it is] a disappointment [that] is confined to two or possibly three of our 3-1/2 major producers. And we have evidence [of] foreign car sales and evidence of one auto company which is setting all kinds of records. Now I think that the auto companies that are not achieving this have expressed clearly their view that they have created some unpopular models. But I have great confidence that these people are flexible enough to deal with the situation if a competitor is succeeding well. I expect that they will make some adjustments in their own activity.

The preliminary surveys taken some months ago on capital expenditures for 1978 seem incongruously low, and all of us are now agreeing that those surveys were perhaps biased in a most conservative way. Housing continues to be a keystone of what is going on. All in all, gentlemen, I'm quite pleased with the way '77 is ending and with the staff's forecast for '78. I'm particularly pleased that the domestic monetary markets have quieted, and this is all very helpful to me as we approach the next subject on this agenda.

I'm still optimistic about the extension of this long-term recovery. I even see virtue, as has been said a number of times before in other meetings, in the fact that we haven't had full support of a strong capital spending program, and therefore there is an element that could reinforce the staff's projection for '78 and could surprise us in some respect. I don't look for this particularly, because there are too many constraints on capital spending. I just point out that we really have one way to go on capital spending.

CHAIRMAN BURNS. Thank you, Mr. Gardner. Mr. Guffey, please.

MR. GUFFEY. Thank you, Mr. Chairman. I think, with regard to the staff projection, we would feel it is a good projection. If it would miss, it would miss on the low side. But with the mix suggested by Governor Partee, it would be a little stronger in the first half of '78, and maybe they would be about right in the second half, so they would be marginally stronger than what they are projecting. With respect to regional matters, I would like to join with Ernie and others with regard to the Tenth District, in the sense that the agricultural problem has moderated somewhat with the government subsidy payments and the increase in corn and wheat prices, cattle prices. So the farmers, ranchers are somewhat better off than they were 60 days ago. Also, with regard to the agricultural sector, I think it could be described as booming. And we are running now into a point where the unemployment level is dropping to what I think is a good level. In September, Districtwide, we are talking about an unemployment rate of 4.6 [percent], which has dropped from a 5 percent level that was registered about April and continued through the summer but now is beginning to move on down.

Personal incomes have continued to be very strong in the District. And there's one note of caution, I should think, with respect to the residential housing sector. The thing that we have been facing in much of our District is an order by the Federal Power Commission and its successor, the Energy Department, which would have cut off any new hookups for much of the Tenth District as a result of limitation in the supply of gas through a major pipeline. Through court action and efforts by our congressmen and Senators, they have indeed set that order aside. The order was to prohibit any additional hookups after January 1, which meant we have had a flurry of residential building in the area simply to get those structures up so gas could be hooked up before January 1. And it was projected that the residential construction would then drop off very rapidly after the first of the year. That order has been set aside because of some political pressures, but I'm told that this is sort of an experiment; if by administrative fiat they can limit the number of gas hookups in this area, then it would spread to other parts of the country, and we can have a very serious effect upon businessmen's or others' projection for what they want to do.

CHAIRMAN BURNS. Thank you, Mr. Guffey. I'm not going to take any time in commenting on the economic outlook. I do want to say just one word about the automobile market. The fact that automobile sales have been a little soft recently does not disappoint me at all. I think that consumers are acting rationally in that department. I would expect some decline in auto sales, and I welcome it. I think consumers have been going into debt at an excessive rate. Automobiles are bought largely on credit, and the terms in that industry trouble me. The overall expansion of consumer credit troubles me. I think we are, if anything, at a dangerous level now.

As far as the future is concerned, I look to business capital investment to drive this economy forward. I hope that consumer spending will not move up rapidly, partly for reasons that I have stated and which I will not stop to amplify. I do think that business capital investment will be in line with our staff expectations and perhaps go beyond that, but I am optimistic on a good tax bill. If that isn't forthcoming, I would have to join some of the skeptics around this table. But we will know relatively soon. If the tax bill is a simple tax reduction bill which gives adequate recognition to the needs of the business community, I think it will receive wide support in the Congress. And I'd be much more optimistic about speedy enactment than Mr. Partee was when he commented on the subject. But much will depend on the character of the bill that is sent down, and the thinking in the White House is moving in the direction that I would term constructive. But final decisions--not all of them have as yet been made.

We're ready to move on. Mr. Sternlight, may we have your report on operations of the domestic Desk.

MR. STERNLIGHT. [Statement--see Appendix.]

CHAIRMAN BURNS. Thank you, Mr. Sternlight. Mr. Coldwell.

MR. COLDWELL. Peter, what can you tell us about dealer attitudes now with regard to interest rate expectations? I noticed some shifting in their [long-term] positions over the last few weeks. Is that indicative of a shift in attitude?

MR. STERNLIGHT. They have tended to lighten their positions, Governor Coldwell, and I'd say that that's consistent with more of a feeling that rates are likely to rise next year. They

don't see it as an immediate event, but they tend to feel that, sometime in the first quarter or first half of next year, rates are likely to move higher.

CHAIRMAN BURNS. Any other questions?

MR. ROOS. Those are long term and short term?

MR. STERNLIGHT. Well, I've heard it expressed--I think it extends across the board, mainly, President Roos.

CHAIRMAN BURNS. Mr. Eastburn, please.

MR. EASTBURN. Peter, we have had a 6 point spread on M1 for some time now. Could you tell us what your concept of the zones of indifference are on that? For example, alternative B [in the Bluebook], this time, is 3-1/2 to 9-1/2. What point would the aggregates have to reach before the funds rate would be permitted to go up?

MR. STERNLIGHT. Well, it seems to me, President Eastburn, that with a money market directive such as we have had, that one would want to be very closely approaching the outer limits of the indicated range before making any move in the funds rate.

MR. EASTBURN. Suppose it is an aggregates directive?

MR. STERNLIGHT. With an aggregates directive, it would be not quite as wide a zone of indifference. I hesitate to get into the precise numbers on the thing, but at times we have thought, when you get within about 1 percent[age point], say, of the outer bounds, that, with an aggregates directive, then it's time to consider moving away from what had been the central point [of the federal funds rate range], I think.

MR. PARTEE. You might have eased a little bit if you had an aggregates directive this time?

MR. STERNLIGHT. I don't think we quite would have reached that, not much, but it would have been moving on the horizon.

MR. COLDWELL. If he knew what he knew last week in the first week--

CHAIRMAN BURNS. Any other questions? Very well, is there a motion to approve the transactions of the Desk?

MR. COLDWELL. So moved.

MR. MAYO. Second.

CHAIRMAN BURNS. The motion has been made and seconded, and I take it that the transactions are approved, and we thank you, Mr. Sternlight, for your report. We will move now to Mr. Axilrod, who will instruct us with his customary brevity.

MR. AXILROD. [Secretary's note: This statement was not found in Committee records.]

Mr. Chairman, I would also like to inform the Committee of one statistical problem, if I may. As the Committee knows, we have for some years now been making quarterly revisions of the money supply related to the nonmember-bank benchmark. Since early 1976, our benchmark has been based on especially collected daily averages of seven days around the Call Report date--collected at the time of the Call but not on the Call. We have not adjusted to the March benchmark, nor have we adjusted to the June benchmark for 1977. The last benchmark adjustment we made was in December.

The reason we haven't is that we have found enormous and rather startling statistical problems in the data. In fact, the problems begin not with the March benchmark but with the December '76 benchmark, which we have already made. Without going into details before the Committee, it turns out that the FDIC [Federal Deposit Insurance Corporation], the agency responsible for this, has simply stopped editing the data starting with December 1976. The data prior to December '76, so far as we can tell, and according to them, are all right.

This material is now all in their hands, and they are re-running and re-estimating, which requires them going back to nonmember banks. They tell us that normally they have to go back to around 2,000 nonmember banks each time; they're going back for the data for December '76, March '77, June '77, and they promised us that they will properly edit the September '77 data. All this should be available early next year. But that is the reason that we have not come forward with any benchmark adjustments.

We have been asked by the public, and our information officer has told them that we're having statistical problems with the data.

CHAIRMAN BURNS. Yes, Mr. Black.

MR. BLACK. Steve, do you have any clue as to whether this will raise or lower our estimates of the movement in the aggregates?

MR. AXILROD. Well, President Black, I properly would not have a clue because this data is simply inadequate. It's not a basis on which you can make a judgment. If I gave you my sense of the clue, there are some nontrivial odds that I would just be misleading you, and I really rather hesitate to do that.

MR. BLACK. I suspected that that was the case.

CHAIRMAN BURNS. Any other questions? Yes, Mr. Wallich.

MR. WALLICH. Steve, can you assess the chances of another strong blip early in the first month of the next quarter, and is your high, very wide range on the aggregates--the 6 percentage points we have had the last two times--partly a reflection of that danger?

MR. AXILROD. Well, we have checked which of the months and which of the two-month periods are our estimating periods. The worst month, it turns out--and they're all relatively bad--

the worst month is January and the worst two-month period is December-January. It's a winner, if I may use that term, by a small margin. So I think if the Committee were going to widen the range in reflection of estimating errors, December-January would be a quite appropriate area.

MR. PARTEE. But, of course, that doesn't necessarily mean a blip; it could be the opposite.

MR. AXILROD. It's not clear whether we'd miss on one side or another.

CHAIRMAN BURNS. I think Mr. Wallich was referring to the seasonal that seems to be emerging in seasonally adjusted data.

MR. AXILROD. Well, as you recall, January of last year was the first month of a quarter where we did not get a large increase. So we projected about a 7 percent increase. And our experience with January really is that we've been consistently overprojecting that month, projecting a too-high rate of growth. That's been the experience of the last five years. What will happen this year, I'm really quite uncertain.

MR. COLDWELL. But didn't you explain away that January miss in a recent document, that maybe this was covered up by some lack of seasonal reflection and changes in bank statistics? That you might have actually had a blip of significant proportion if the seasonal had been caught?

MR. AXILROD. January '77? Well, your memory, Governor Coldwell, is somewhat better than mine. I don't remember that particularly.

MR. COLDWELL. Well, I saw something recently where you were trying to explain away the April or whatever months you had--

CHAIRMAN BURNS. Not explain away--explain scientifically.

MR. COLDWELL. All right, all right. I thought there was reference in that document to January, but maybe we actually had one in January, too, and that this would mean all four [first-month-of-]quarter months.

MR. AXILROD. I'm not aware of that.

MR. COLDWELL. I have to look up my memory with [unintelligible].

CHAIRMAN BURNS. Any other question or comment? Very well, thank you, Mr. Axilrod.

We are at a point now where I need guidance from the Committee as to procedure. Mr. Broida advises me that items 7 and 8 on the agenda can be postponed, and item 6, therefore, is our decisive subject matter still before us. This is something that we can try to take up before we break for luncheon, or we can break for luncheon around 1 o'clock and then come back. As far as I'm concerned, I always keep my calendar on FOMC days entirely free. My patience is infinite. I want members of the Committee to feel that each one has a full opportunity to speak

his mind. And therefore, we can either rush this part of the proceedings or take whatever [time] members of the Committee feel is advisable. Mr. Balles?

MR. BALLEES. Mr. Chairman, just to remind the Governors, some of whom know this, others may have forgotten it, the Presidents' Conference, with the chairmanship of President Winn, is scheduled to meet this afternoon and tomorrow morning, and I suspect that from our standpoint, if we are to try to keep on schedule--at least I can speak for myself--I don't think the decision is very difficult. I hope we can finish it by 1 o'clock.

CHAIRMAN BURNS. Well, we don't have to make up our mind now. Our thinking about the time for ending may change in the course of our discussion. Sharp differences may emerge within the Committee that will call for a more lengthy debate. On the other hand, we might find ourselves moving toward a consensus rather speedily.

So let's get our discussion of monetary policy under way. And without taking much time, let me say this. I think our monetary aggregates have quieted down. I think also that the economy is behaving quite well, but there are uncertainties surrounding the economy, and they have been duly noted at this meeting. I think it would be very unfortunate if interest rates were to drop in the weeks immediately ahead in view of the condition of the foreign exchange market. I personally would not like to see--in view of the behavior of the aggregates and the condition of the economy and some of the uncertainty surrounding the President's program--I would not like to see interest rates go up, though I'd be more concerned about a decline in interest rates than about a rise.

I would suggest to the Committee as a target to shoot at or to shoot down, a federal funds rate under alternative B and an M2 rate of growth as specified under alternative B. As to M1, I would prefer 2-1/2 to 8-1/2, and that is my suggestion to the Committee, to accept or reject or modify as members of the Committee may see fit. Now, who would like to speak first?

MR. KIMBREL. Amen, Mr. Chairman.

MR. BALLEES. I'll buy that.

CHAIRMAN BURNS. Mr. Guffey.

MR. GUFFEY. I would second the amen that was given over on the other side of the table.

CHAIRMAN BURNS. Mr. Eastburn.

MR. EASTBURN. I'd like to say a word about the general posture--I agree, I think we ought to make no change, essentially. But I'm increasingly disturbed by this 6 point spread that we have in the aggregates for M1. I'd remind the Committee that the original purpose for this was to extend on the downside at a time when we really wanted to put all our risks down there, that we were not concerned with the aggregates coming in low. It seems to me that a 6 point spread, even with an 8-1/2 percent ceiling, is a higher top than I would like to see. And I would

narrow that. I would buy your 2-1/2 bottom and lower that top point to 7-1/2, to 6-1/2, or something like that.

CHAIRMAN BURNS. All right, thank you, Mr. Eastburn. Mr. Volcker now, please.

VICE CHAIRMAN VOLCKER. Well, my way of ending where you are, essentially, Mr. Chairman--I guess I do want to state for the record, or otherwise, that I think we should take account of what's going on in the international markets and the need to attract capital for a long period of time to maintain confidence in that area. I can't really separate domestic and international in this situation, and I don't think it's at all antigrowth to say that we should take the international into account. Because I think it's ambiguous, at the least, as to what this exchange rate decline is doing to growth, and I think the unfavorable consequences, viewed broadly, outweigh the favorable ones. And it's always very difficult politically to put it into this context of taking account of the international, and I've had enough experience around here to know how difficult it is. But I think we ought to face up to it and be aware of what's going on there in making up our policy, and I don't think it's at all inconsistent with the domestic.

And most of the noises I hear around here are more optimistic on the domestic economy than I personally feel as you get out longer. I personally feel optimistic in the short run. So I share your feeling. I'd hate to see interest rates go down here. I'm not particularly looking for them to go up, but if we got provoked by the movement of the aggregates or indeed provoked enough by the exchange markets, I think we ought to swallow that, too.

So in practice I'd come out just about where you were Mr. Chairman. I would be inclined to maybe even go half a point lower--that puts me halfway with Mr. Eastburn, I guess--and make it 2 to 8 percent on the M1, but that's a marginal difference. I would urge that we do recognize the international in the directive itself. There is a sentence proposed about taking account of emerging conditions in the financial markets, and I would feel very strongly that we ought to make an overt reference to international financial markets or the exchange markets in this particular instance in amplifying that sentence. Because I think it is a relevant consideration in our policy, and we ought to recognize it.

MR. PARTEE. You mean to refer to both, domestic and international.

SPEAKER(?). Yes, domestic and international.

CHAIRMAN BURNS. I would strongly support that. The specific suggestion by Mr. Volcker is on lines 78 to 80, to be revised as follows: "In the conduct of day-to-day operations, account shall be taken of emerging financial market conditions, including the unsettled conditions in foreign exchange markets." And I think the added phrase is constructive and realistic, and it shows a sense of responsibility. Any dissent from that?

MR. PARTEE. Well, that would be within the [federal funds rate] range that we would select--your 6-1/4 to 6-3/4 percent?

CHAIRMAN BURNS. Now, there is another change that has been suggested--it's purely factual, and that is on line 18, where "a decline of about 2-1/2 percent in the value of the dollar

against major foreign currencies,” that should read “a decline of more than 3 percent”; that’s simply a correction. The dollar has been moving; as a matter of fact, 3-1/2 percent would not be wrong, would it?

MR. TRUMAN. Right, Mr. Chairman. As of this morning, since the last Committee meeting, the change on our weighted average is 3-1/2 percent. I think “more than 3 percent” captures it. It might be more than that now.

CHAIRMAN BURNS. “More than 3 percent” will capture it. This is just a single day’s quote, you see. No dissent from that I take it? All right, thank you, Mr. Volcker. And now, Mr. Black, please.

MR. BLACK. Mr. Chairman, you opened your statement by mentioning that the aggregates had quieted down, and I share this feeling. I would simply like to add one amplification to that, and that is, if you look at the behavior of M2 in the last couple of months and subtract out the large time component on that, instead of an apparent rate of increase of 7.3 percent, that residual has increased at a rate of only 2.2 percent. And I think there’s a good case for taking these into account, since they don’t seem to be as closely related to transaction demands for money as the other types of time deposits.

I think in view of the uncertainty and difficulty of projecting the aggregates in this particular period, we’d be well advised to adopt the money market directive, although I’ll put your minds to rest to some extent by telling you that Richmond has projected about the same rate of growth in the aggregates as the Board’s staff.

MR. PARTEE. Very reassuring.

MR. BLACK. I’m sure it is. Turning to the federal funds rate, I think the specifications of B are about right. I have a lot of sympathy for what Dave Eastburn was saying. [For M1], I would not even worry about bringing the floor down below the 2-1/2 percent that he specified, and I would prefer a 7 percent or so ceiling on the other end of that. If you have a 7 percent ceiling with a 5.8 percent rate of increase in December, then that would mean that, in January, you could go up as high as 8.2 percent before you acted. And I would not want M1 to go up much more than that. So far as M2 is concerned, I think 6 to 10 is perfectly appropriate, and I would support Mr. Volcker’s suggestion on the modifications of wording in the directive.

CHAIRMAN BURNS. Thank you, Mr. Black. Mr. Coldwell now, please.

MR. COLDWELL. Mr. Chairman, the suggestion you’ve raised bothers me only a little bit, the 2-1/2 to 8-1/2 percent [range for M1], because if I read these estimates for December and January, the average is 6.8 percent, which leaves you a margin of only 1-1/2 percent if the staff estimate, on an averaging basis, is anywhere near correct. Given the margin of error which Steve has already alluded to--while I don’t like 9-1/2 percent, I wonder if we aren’t setting ourselves up for a change in the fed funds rate by narrowing that top level down to this narrow a range against the average.

I believe I would rather have taken the wider spread that Steve suggested, certainly the 6 point spread. I wouldn't be disturbed if [M1] did come in at 2-1/2 percent, but if you hold me to a 6 point spread, then I'll almost have to come up to 3-1/2 to get to a 9-1/2 or a 9. I hate to be caught in these statistical traps. And all I'm saying is, I would hate to be today making a decision which might be said to be couched in a framework of a movement in the [federal funds] rate even though I don't hear any support for much of a change in the fed funds rate over the next month. So I guess I would come out somewhere in the 3 to 9 range, Mr. Chairman.

CHAIRMAN BURNS. Thank you, Mr. Coldwell. Mr. Roos, please.

MR. ROOS. Mr. Chairman, I'm troubled by the upper limit of the M1 range. As I calculate it, in the Bluebook projection, they project first-quarter money growth at about a 5-1/2, 5.6 percent annual rate. If we permit M1 to grow at anything like 8, 8-1/2 to 9 percent, and if it should get to the top of the range, which certainly has happened frequently during the past year, it would mean, in order to achieve anything like a 5.6 percent rate of growth for the first quarter of 1978, we would have to force M1 to grow at 0, or to remain at 0 growth in both February and March of next year.

And so I think one of the problems--I could buy the 2-1/2 to 8-1/2 percent range if I firmly understood that the Desk would permit fed funds to increase if it felt that M1 growth was exceeding 6-1/2 percent. If I understood Peter correctly before, he said that under a money market directive, the trigger point, or whatever we might want to call it, of the Desk taking action on fed funds is the upper part of the top limit of the range, normally. And that under an aggregates directive, they really don't respond or react until it gets within about 1 point, if I understood what you said, of the top of the M1 range.

I believe firmly that we would be making a mistake to permit M1 to grow at a faster rate than 6-1/2 percent over the next 30 days. I would be able to buy 2-1/2 to 8-1/2 percent if I were assured that we were really serious about a midpoint between the upper and lower part of those ranges. But if my interpretation of what Mr. Sternlight said is true, and if we could quite probably get to a 7-1/2 or 8-1/2 percent rate of growth before we moved on fed funds, I would have a very difficult time going along with that upper end of the range.

I'd like to see the upper end of the M1 range 6-1/2 percent, or as an alternative, make certain that we agree, and that the Desk be directed, in whatever way it can be, to act before M1 could reach the upper part of this 2-1/2 to 8-1/2 or 2-1/2 to 9 percent range.

CHAIRMAN BURNS. Would this be a correct interpretation of your position, that you prefer a monetary aggregates directive?

MR. ROOS. Yes, certainly.

CHAIRMAN BURNS. Which would mean an earlier response by the Desk.

MR. ROOS. Could the response--coming to the extent that we can anticipate what might happen--does that response have to be delayed until it's within 1 percentage point? I don't--

CHAIRMAN BURNS. I don't think we ought to change the rules under which we operate. That is something that we ought to do only after due deliberation.

VICE CHAIRMAN VOLCKER. The trouble with that is, if they come in low you are forced to move it lower and we don't want to--

MR. WALLICH. By changing the habitual range for the aggregates and for the funds rate, we have really made every directive we give into a money market directive, because it used to be that the ratio was 2 to 1 between the spread in the aggregates and the spread in the funds rate. Now, it is on the order of 12 to 1, so it takes much more movement in the aggregates to produce a given change in the funds rate, 6 times as much as it used to.

CHAIRMAN BURNS. Well, I don't want to debate the past about whether we did or did not change the rules. If the Committee wants to change the rules, the Committee obviously is free to do so. I merely caution against doing it without due consideration, but that's up to the Committee.

MR. ROOS. Well, Mr. Chairman, if I may, if we do view potential inflation late next year or early in '79 as a serious problem, if business is concerned about inflation--which certainly everything we hear in our District implies that it is--if we feel that the economy is fairly strong, and with the growth of money that has occurred over the past three or four quarters, if we do not take advantage of this opportunity in some way to at least put a top limit on money growth, which would preclude a continuation of the same rate of money growth, [that rate] could be inflationary a year hence. So I think we are missing a golden opportunity to take remedial action, and whichever way it can be accomplished, I just think to let M1 grow more than 6-1/2 percent in the next 30 days would be a terrible mistake.

CHAIRMAN BURNS. I don't disagree with you. What troubles me is that, you see, the monetary aggregates evolve and they evolve on the basis partly of hard data, partly on the basis of soft data, partly on the basis of no data. And therefore, the distinctions that you're making with such precision are fuzzy in my own mind in view of the kind of evolution of these figures that our staff generates.

MR. ROOS. Well, Mr. Chairman, if there is this fuzziness and this uncertainty, then why don't we retreat from spending the time and effort that we do on the aggregates, and why don't we just tell the world--I don't mean this in a disrespectful way--but why don't we go the fed funds route instead of trying to imply--I think the world believes that M1 and M2 are important, that they are fairly accurate, and that we really give a great deal of attention to attempting to control M1 and M2 to some extent. If M1 and M2 are fuzzy, and if they are relatively less meaningful than the interest rate targets that we set, why don't we just tell people that that's the case and therefore--

CHAIRMAN BURNS. I think my statement--I didn't make my position clear. I didn't mean to say that M1 and M2 over a period of time are fuzzy. I meant to say that the Desk is responding to estimates. And therefore, the distinctions that you are making, I felt in view of the way in which the Desk operates--and it can't operate in a very different way--I thought the distinctions were not really very realistic.

MR. ROOS. Is there not a problem--and I would agree on the short run--is there not a problem of the accumulative effect of a lot of short run--

CHAIRMAN BURNS. There, there I am entirely with you. Well, I think you've made your position clear, and I think to accomplish your objective, what that requires is not so much--first of all, a monetary aggregates directive, and second, probably a lower upper limit of the M1 range, rather than some change in our procedure and special instructions to the Desk.

MR. BLACK. Mr. Chairman, couldn't you also go with a money market directive and still lower upper limits?

CHAIRMAN BURNS. Yes, yes, that's another way of doing it.

MR. BLACK. That would be my preference. I don't think we are so far apart on our objectives, but in view of uncertainties, I'd prefer that route.

CHAIRMAN BURNS. Well, I think we understand one another reasonably well, now. Mr. Partee, please.

MR. PARTEE. Well, I'm somewhat sympathetic with Phil Coldwell's point. I think that the 2-1/2 to 8-1/2 percent range will bias the result in terms of a higher funds rate when the period is over because the midpoint of the staff estimate is in the upper part of that 2-1/2 to 8-1/2 range. And I must say that, without knowing anything at all about what's going to happen given the increase in economic activity that we all see occurring right now--higher retail sales, perking up industrial production, better employment figures--I would be inclined to think that the exposure, the risk is toward a higher growth in the aggregates, not a lower growth, than the staff has projected. So I do think it biases it.

I'm somewhat sympathetic with President Roos because we do have a range that we are seeking, although I think in fact we won't be able to achieve that because velocity just won't grow as much as we anticipate in the period to come.

Well, I guess I'm prepared to accept your specifications, recognizing that there is probably some upward bias in the funds rate in the acceptance of that. I think in view of the fact, as Steve tells us, we have such great uncertainty at this time of year, particularly about the aggregates, that the money market directive is appropriate. I think it also appropriate because of the modification that we made for the international--the international phrase was added. So I would go for the money market directive with your specification.

CHAIRMAN BURNS. Thank you, Mr. Partee. Mr. Wallich now, please.

MR. WALLICH. I have no problem with the specifications of the funds rate in [alternative] B. I would prefer an aggregates directive. But let me explain why I said I think all our directives now are money market directives; [it is] because the range for the funds rate is very narrow and the range for the aggregates is going wide, so that it takes a very large move in the aggregates to achieve a small move in the funds rate depending on how the Desk moves with the zone or without the zone. That, I think, has been a change in our procedures, but sometime

we could talk about that. Right now, I could try to salvage what flexibility we have by going for an aggregates directive. I'm concerned about conflicting difficulties. One, the situation with the dollar, the other, the danger of a blip in January and high aggregates. On balance, I think we'd better keep the aggregates low. And I would go with 2 to 8 for M1.

CHAIRMAN BURNS. Thank you, Mr. Wallich. Mr. Jackson now, please.

MR. JACKSON. I share the concern that was expressed by Governor Wallich about our spread. However, I'm afraid our reasons have been produced by different circumstances, and that is, our recent experience with the inaccuracy of the projections with which we're dealing. If I thought for a moment that our projections, which were the basis of our consideration, were a little more accurate, I'd be delighted to move to a smaller range. But unfortunately, I find that we base our policy conclusions for the short term on the projections, and the projections prove to be wrong instead of the underlying circumstances to be wrong. So if we could find a way to solve that, I'd be delighted to make a more narrow range of monetary aggregates.

I do think that we're faced with considerations this time that lead me to support a money market directive. Because in addition to the risks of M1 we've faced, I think there is a substantial possibility that in the year-end period, we would see our financial institutions, and the banks that are covered by M2 in particular, issue a continued substantial volume of nonnegotiable CDs, over \$100,000, which, for reasons I never have understood, are included in M2. But I think, given our decision to give equal weight to M1 and M2, we could get a high M2 as a consequence of that, which would encourage the Desk, with a miss in M1 projection, also to have an M2 projection which would be distorted as a consequence of the credit demands that we are having and the slow growth in the savings component of M2.

So for that reason, I would encourage us to go to a money market directive. I would, to that extent, though, support the lower ranges preferred by the Chairman for the M1 aspect of the directive because I do think the consequences of continuing to tolerate ranges in the 9-1/2 range over a two-month period are not appropriate at this time.

CHAIRMAN BURNS. Thank you, Mr. Jackson. Mr. Baughman now, please.

MR. BAUGHMAN. Mr. Chairman, your suggested modification of alternative B is acceptable to me. I would like to see the Committee move to give the aggregates a little more weight in policy than they've had for awhile now. And it seems to me that, at the present time, it might be all right to do that by going with an aggregates directive. I'd just like to say that I have a good deal of sympathy for the point that Mr. Eastburn has raised. Right at the moment, however, I'd be inclined to go with your recommendations.

CHAIRMAN BURNS. Thank you, Mr. Baughman. Mr. Gardner next, please.

MR. GARDNER. Mr. Chairman, I can agree with your specifications, and if we can negotiate a slightly lower top, I won't have any trouble with that. But in any event, I believe that I came into this discussion with the hopes that we would continue on as much of our present course as possible, and I would favor the money market formulation in order to do that. So I have no difficulty with your proposal.

CHAIRMAN BURNS. Thank you, Mr. Gardner. Mr. Balles, please.

MR. BALLEs. Mr. Chairman, for reasons you've set forth and which others have repeated, I think your specifications are good. If anything, I would lean a little more toward the view that Mr. Eastburn expressed, but I could accept either one. It seems to me that this is a pretty good time for us to be holding steady, and because of the great uncertainties over this year-end period, it would probably be wise to adopt the money market directive.

CHAIRMAN BURNS. Thank you, Mr. Balles. Mr. Winn now, please.

MR. WINN. Mr. Chairman, I'd associate myself with John's comments, that I would be happier if we could lower the range of the aggregates a little bit; but I find your suggestions acceptable. I'd like to make one point, however, that we're placing an awful lot of emphasis on the aggregates numbers. And I must confess, I get nervous when we get a decline during a period of rapidly expanding loan volume and rapidly expanding business activity. And somehow, intuition makes me wonder about our numbers even more this time. And yet I have no way of--

CHAIRMAN BURNS. You are worried about the accuracy of our statistics?

MR. WINN. Yes, that's correct. I mean, when you see this expanding loan volume and expanding business activity, and here we are getting a negative number, which makes me--

MR. PARTEE. Probably very temporary.

MR. WINN. I know, but it still makes me nervous.

CHAIRMAN BURNS. A little earlier, when the economy was--

MR. WINN. I know; it happened in reverse. That makes me nervous about those numbers, too.

MR. BLACK. You're just nervous.

MR. COLDWELL. Maybe we are dealing with lag time, then.

MR. WINN. I don't know.

CHAIRMAN BURNS. Well, I think we ought to be dealing with averaging time on the aggregates.

SPEAKER(?). Yes, that's right.

CHAIRMAN BURNS. Several members of the Committee have not yet spoken. Mr. Mayo, please.

MR. MAYO. Mr. Chairman, unlike Henry, who says that all of the recent directives have looked like money market directives to him, even if they are stated in the other words, I think a

good case can be made that all of our directives over the last year have been aggregates directives because we do, I think, tend to pay too much attention in our short-run specs to the aggregates.

I just mention that as a balancing point to a more general statement that there isn't really tweedle dum and tweedle dee between the aggregates directive [and the money market directive]. It depends on where you want to put the "whereas." Having said that, I would go along with the money market directive this time. I would retain, though, the words "current level," which somehow have surreptitiously disappeared from page 5 of the directive suggestion. There might be a reason for that. But I prefer that to the 6-1/2 that would normally pop up there if we didn't say anything.

CHAIRMAN BURNS. Where is that?

MR. MAYO. Well, it's page 5, the very last page, I guess it is, of the directive formulation that was circulated to us yesterday. Lines--well, it's specifically line 80.

CHAIRMAN BURNS. You'd have that read "at about the current level"?

MR. MAYO. Yes, I'd keep it there. That was what this Committee agreed to last time, and I see no reason to change it. Roger reminds me that we had in mind that this may get published, and I think the same reasons--

CHAIRMAN BURNS. I don't know why that happened. I don't know why.

MR. MAYO. Well, I'd like to suggest that it be put back in, the "current level."

MR. AXILROD. In the money market formulation, it would have been.

MR. BROIDA. We normally take out the specifications shown last time with the strike-throughs on page 5,

MR. MAYO. On page 5, it's crossed out.

MR. BROIDA. Last time the specification [unintelligible]. And the specifications last time at that point were in the form of the words in the current level. So following our standard procedure, we struck it, but the Committee can, of course write them back in.

CHAIRMAN BURNS. Any difficulty in writing that in? Well, I hear none.

MR. PARTEE. It's pretty clear what it is.

MR. MAYO. It's very clear this time.

CHAIRMAN BURNS. I'm glad you caught that, Mr. Mayo.

MR. MAYO. To continue, I find alternative B quite congenial--2-1/2 to 8-1/2 is all right, and I don't worry as much as some of my associates about that 8-1/2 despite my remarks on

statistics. I think we are quite capable and will be alert and the Chairman can call us in session if indeed there seems to be a quarterly aberration, as I think of it, that would otherwise cause us to make a change in the Desk action.

The 2-1/2 to 8-1/2 is all right. I feel strongly enough about Governor Jackson's point that I would go 6-1/2 to 10-1/2 on M2, given our statement--that I don't propose to change--that we give equal weight to M1 and M2. I actually don't think we ought to give equal weight to M2 this time because of the point he makes on big CDs, and therefore, I would remedy that [problem] by raising the range just another notch, so that way we wouldn't pay as much attention to M2.

MR. JACKSON. May I respond, just briefly on--that was one reason for supporting [the] lower range for M1 that a wider range for M2 would give you.

MR. MAYO. It does, but I would just go you one notch further, Phil.

CHAIRMAN BURNS. Thank you, Mr. Mayo. Mr. Morris now, please.

MR. MORRIS. Well, Mr. Chairman, things are going our way for a change, and I think your specifications are quite acceptable. I would have a slight preference for Paul Volcker's 2 to 8, but apart from that--

CHAIRMAN BURNS. Thank you, Mr. Morris.

MR. LILLY. I'm fine with your specifications.

CHAIRMAN BURNS. Thank you, Mr. Lilly. Anyone else who hasn't spoken and who would like to speak, or anyone who has already spoken would like to speak again?

MR. ROOS. A question, Mr. Chairman.

CHAIRMAN BURNS. Please.

MR. ROOS. Am I correct in assuming that if we adopt a money market directive, that there is a greater delay in action by the Desk? In other words, that we have a greater possibility [with a money market directive] of reaching the upper level of whatever ranges we adopt [unintelligible] than if we have an aggregates directive?

MR. STERNLIGHT. That is how I would understand the final decision.

MR. ROOS. Is it possible, Mr. Chairman, is it procedurally correct, that we take the vote on the directive prior to the range?

CHAIRMAN BURNS. Yes. Yes, in view of the fact that not all members of the Committee have indicated what they feel, the directive language ought to be--we'll do that. But let me just take a few seconds to see where we are.

MR. COLDWELL. Mr. Chairman, while you are doing that, may I suggest something here. I'd like to have the staff look into the possibilities of using two-month retro and one-month forward instead of our present two-month aggregates figure. So that for today--

CHAIRMAN BURNS. That is something for Mr. Partee's committee to look into.

MR. PARTEE. One thing we're studying.

MR. COLDWELL. You are studying it now?

MR. PARTEE. Yes.

MR. COLDWELL. Good.

MR. PARTEE. That is, using this as the midpoint of a quarter.

MR. COLDWELL. Right.

MR. BALLEES. That has a great deal of merit, and I hope that you will pursue that signal.

CHAIRMAN BURNS. That's been studied to some degree, but let's study it more intensely.

MR. COLDWELL. Well, it reduces the amount of forecasting influence.

MR. MAYO. That isn't the midpoint Phil. [Unintelligible.]

MR. COLDWELL. Well, I'm talking about for today, in December, using November, December, and January.

CHAIRMAN BURNS. Gentlemen, let me indicate where we are. I think there is a pretty clear consensus within the Committee with regard to the several ranges. A range of 2-1/2 to 8-1/2 percent for M1, a range of 6 to 10 for M2, a range of 6-1/4 to 6-3/4 [for the federal funds rate].

And now let us have a show of hands on the language of the directive. Those who prefer a monetary aggregates directive would kindly raise their hands--members of the Committee.

MR. BROIDA. Three, Mr. Chairman.

CHAIRMAN BURNS. Those who prefer a money market directive would kindly raise their hands.

MR. BROIDA. Eight.

CHAIRMAN BURNS. Well, I think we are ready for a vote on this--members of the Committee who would like to raise some questions or make some supplementary comment?

VICE CHAIRMAN VOLCKER. I'd really like an aggregates directive on the upside and a money market directive on the downside. Can't have that?

SPEAKER(?). I'd join Paul.

CHAIRMAN BURNS. Well, I think we are ready for a vote, Mr. Secretary.

MR. BROIDA.

Chairman Burns	Yes
Vice Chairman Volcker	Yes
Governor Coldwell	Yes
Governor Gardner	Yes
President Guffey	Yes
Governor Jackson	Yes
Governor Lilly	Yes
President Mayo	Yes
President Morris	Yes
Governor Partee	Yes
President Roos	No
Governor Wallich	Yes

Eleven to one, Mr. Chairman.

CHAIRMAN BURNS. Well, gentlemen--

MR. WINN. I hate to interrupt, but would you care to comment just briefly on the legality problem in the discount rate area?

CHAIRMAN BURNS. Legality problem--I don't know.

MR. MAYO. Let's do it at lunch.

MR. LILLY. I can tell you what that is about. That's when they're putting the directors of the banks under 208, making them criminally liable--

CHAIRMAN BURNS. Well, I'm not acquainted with that issue. I can't comment on that. Is Tom O'Connell here? Let's talk about that at lunch, or is this something you could answer fairly promptly, Mr. O'Connell?

MR. O'CONNELL. I believe so, if I may.

CHAIRMAN BURNS. Why don't you do that, Mr. O'Connell. Let's have your answer now.

MR. O'CONNELL. With respect to the discount rate action itself, that is the issue of--I'm not concerned, Mr. Chairman, that there would be any problem of legality of action taken with respect to the rate itself. I have no trouble Mr. Chairman, firmly. But my judgment would be

that there is no problem with respect to the action itself. I could go further into detail with respect to the reason behind it and the legality of the action, but I see no need to.

CHAIRMAN BURNS. Well, maybe this is something Mr. Winn is concerned about. I don't know the problem. Now I understand the section of the new bill that is perhaps troublesome. But that is perhaps something that, Tom, you might want to discuss with Mr. Winn, and possibly you might want to discuss it with the attorneys of the several Banks.

VICE CHAIRMAN VOLCKER. If I may say, Mr. Chairman, I think not the discount rate itself but the approval of loans; but the whole thing is going to be very troublesome.

MR. MAYO. Approval of loans.

VICE CHAIRMAN VOLCKER. We had a long discussion at our board meeting last week, and I think there are a great many problems here that are going to need some discussion.

MR. O'CONNELL. There are, but my response, Mr. Chairman, was with particular reference to the discount rate. There are other problems--

CHAIRMAN BURNS. But to the extent that our directors are disturbed, we ought to get working on these problems.

MR. LILLY. We are.

CHAIRMAN BURNS. All right, now, Tom, will you be in charge of that?

MR. O'CONNELL. I will.

MR. JACKSON. Mr. Chairman, I think there's something very important for the Presidents to know--to the extent that there is a problem, it's not an FOMC problem. The Board of Governors--it is my understanding of the law--has the right to specifically excuse the potential conflict of interest which any of our directors may have and to specifically authorize them to participate in a policy matter in which the conflict might otherwise be apparent.

In other words, members of the Board of Governors have appeal only to the President of the United States, whereas the Federal Reserve Bank directors have the right to appeal to the Board of Governors, and the Board of Governors will be meeting, and if the issue becomes obvious where we need correction, we have the power to correct it. So I don't think it's as big a problem as the directors anticipate.

MR. WINN. It has to be corrected, that's all.

MR. JACKSON. To the extent that is necessary, I think we have the capacity to do. That's--

CHAIRMAN BURNS. I think this has to be clarified.

MR. JACKSON. Oh, I agree. But that's one reason we don't need to do it this afternoon.

MR. O'CONNELL. I will be--

MR. BALLEES. Mr. Chairman, just one more quick question for Tom, If I may. I'm not quite sure how we came out yesterday, as to whether today's directive will or might have to be published immediately if we lose the Supreme Court appeal.

MR. O'CONNELL. My judgment is that, under the present extension on which we are operating to the Court of Appeals, this directive and the Committee's action are not subject to an immediate publication mandate for the court. We are under a pause effected by the request for extension of time. And so this month's directive, I think, operates as did the previous directive. We are not under that mandate.

MR. BALLEES. Okay, thank you.

CHAIRMAN BURNS. A very Merry Christmas and a Happy New Year to all of you.

END OF MEETING