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

December 1, 1978

CONFIDENTIAL (FR)
CLASS II FOMC

TO: Federal Open Market Committee

FROM: Murray Altmann M. A.

Attached for your information is a report by Mr. Truman on the recent meeting of the OECD.

Attachment

CONFIDENTIAL (F.R.)
CLASS II FOMC

November 30, 1978

TO: FEDERAL OPEN MARKET COMMITTEE

FROM: Edwin M. Truman EMT

Report on Meeting of Working Party Three
(Paris, November 28-29, 1978)

The main themes at the November 28-29 meeting of the OECD's Working Party Three were: (I) the November 1 U.S. program and foreign reactions to it, (II) U.S. exchange-rate policy in light of the November 1 measures, (III) the longer-run working of the international adjustment process, and (IV) reserve diversification.

I. Reactions to the November 1 U.S. Program

Under Secretary Solomon's presentation of the content and background of the U.S. measures on November 1 generated many generally favorable reactions. Poehl (Germany) emphasized the change in the U.S. attitude, the importance of the changes in U.S. domestic economic policies, the large proportion of Deutschemarks in the $30 billion package, and Germany's willingness to intervene in exchange markets for its own account if this becomes necessary. Languetin (Switzerland) also noted the basic changes in U.S. policies, the consistency of these changes with the shift in Swiss policies in early October toward an all-out prevention of a further appreciation of the franc,*/ and his belief that the lesson from recent experience was that governments needed to apply firm and strong measures to make their intentions

*/ However, Languetin broadly hinted that Swiss monetary policy could well tighten somewhat before too long. Poehl made similar hints about German monetary policy.

clear to the market. Sagami (Japan) similarly expressed support for the U.S. program noting that Japan had called for such a cooperative effort at the Bonn Summit and the IMF Annual Meeting.

The major questions raised about the U.S. measures involved (1) why the U.S. authorities waited as long as they did (2) whether U.S. policies (especially monetary policies) would be relaxed too soon, and (3) whether the U.S. inflation rate would in fact stabilize or decline soon enough to ensure the success of the overall program. McMahon (United Kingdom) welcomed the U.S. measures and observed that the change in the U.S. attitude toward the dollar should have a lasting effect on the international monetary system. However, he wondered how the United States would react if the domestic economy softened markedly and the dollar was still weak. Haberer (France) raised a similar point and also asked several questions about the proposed U.S. foreign currency securities ("Carter Bonds").

II. U.S. Exchange-Rate Policy

In general, the U.S. November 1 measures were accepted and interpreted as marking a significant shift in U.S. exchange-rate policy. However, Weber (Germany) choose to interpret Under Secretary Solomon's initial remarks on this topic as indicating no change in the U.S. attitude toward the dollar and dollar exchange rates.*/ This comment

*/ This comment was made for the benefit of the U.K. delegates who had argued in the EMS negotiations that U.S. exchange rate policy had changed since November 1 and, therefore, the EMS discussions should be broadened. One leitmotif of the WP-3 meeting was the EMS discussions; in fact, Van Ypersele (Belgium) gave a progress report on the EMS which contained no new information.

distressed Languetin and Janson (Belgium). Consequently, Under Secretary Solomon had to correct Weber. Solomon said that U.S. exchange-rate policy had changed quite significantly. However, we were not seeking to peg or to put a cap on dollar exchange rates nor were we abandoning our support of a flexible exchange-rate system under present circumstances. He emphasized that we were committed to an "activist defense of the dollar" because the fundamental trends were in the right direction. Those trends would be reinforced through supporting policies and massive, coordinated intervention as necessary. Our aim was to avoid disorders and to correct the decline of the dollar, although a moderate decline of the dollar from present levels might be possible.

III. The Adjustment Process in the Longer Run

The group held an inconclusive discussion of the workings of the flexible exchange-rate system, agreeing that exchange-rate flexibility was necessary in the long run but disagreeing over the desirable amount of short-run flexibility and the ways and means of reducing it. Under Secretary Solomon made a forceful intervention during this discussion. Noting the rest of the world's ambivalence about U.S. economic growth, the U.S. trade position, and the stability of the dollar, he called on the group to recognize that sole reliance on exchange market and monetary policies would be unwise. Broader macro and micro policy coordination is necessary. He cited the need for the United States to increase its exports while other countries maintain their growth; with regard to U.S. exports, he said, part of the problem is our own fault but part is due to foreign protection in the sensitive agricultural and high-technology areas where the United States has a comparative advantage. He added that if it comes down to restricting market access, the United States has less to lose than other countries. Later, McMahon agreed that the basic problem was one of countries' incompatible aims. Marris (O.E.C.D.) argued that the group tended to put too much emphasis on U.S. monetary policy.

IV. Reserve Diversification

As part of a report on international banking, Lamfalussy (BIS) noted that in the twelve months ending June 1978 reported official holdings of Euro-dollars had increased only $1.5 billion while official holdings of other Euro-currencies increased $6.8 billion. He concluded that the only way to control this process of diversification was through a policy of U.S. monetary restraint that would keep the dollar strong and the Euro-dollar market tight. This prescription was not universally accepted. Under Secretary Solomon said that what we needed was a U.S. current account surplus without a permanent U.S. recession; under such circumstances the United States would be quite happy to see diversification out of dollar-denominated assets.