Appendix A

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

CONFIDENTIAL (FR)

May 16, 1972

To: Federal Open Market Committee

From: Mr. Holland

Subject: Professor Chandler's report on procedures in releasing FOMC minutes.

Enclosed is a copy of a memorandum from Lester V. Chandler entitled "Deletions from the Minutes of the Federal Open Market Committee for the Years 1962-66 Inclusive."

As you will recall, it was suggested in my memorandum to the Committee of January 25, 1972, that it would be helpful to have the independent judgment of some recognized scholar of national stature on the appropriateness of the current practice of publishing FOMC minutes for back years with certain sensitive passages withheld. Professor Chandler, whose name was mentioned in that memorandum as a possible choice, subsequently agreed to undertake the review. He was given consultant status for the purpose and agreed to abide by the rules relating to disclosure of materials labeled "Confidential (FR)" that apply to other System personnel.

In view of Professor Chandler's endorsement of current procedures in releasing minutes, we do not plan to schedule a discussion of the enclosed memorandum at a meeting of the Committee unless some member so requests.

Robert C. Holland, Secretary
Federal Open Market Committee

Enclosure

April 28, 1972

To: Mr. Robert C. Holland

From: Lester V. Chandler

Subject: Deletions from the Minutes of the Federal Open Market Committee for the Years 1962-1966 Inclusive.

As you requested, I have reviewed the deletions that have been made from the original Minutes of the FOMC before they were delivered to the National Archives.

Since my evaluation must be largely in qualitative terms, I should make clear my standards and procedures. It is my strong belief that the Federal Reserve, as a public service institution, should to the maximum feasible extent make available materials to enable outsiders to understand and evaluate its decisions and policies. To this end, the public record should indicate the types of information available to the decision-makers, the alternatives considered, and the reasons why alternatives were accepted or rejected. Relevant materials should be excluded only if their publication would, directly or indirectly, be injurious to the public interest. Thus, my central concern has been with this question: "Are the deletions during these years consistent with the above principles?"

I have not considered the question: "Do the original FOMC minutes conform fully to these principles?" Not having been present at the meetings, I am in no position to know what may have been omitted. However, on reading a sample of the minutes, I find them unusually full, informative, and useful for an understanding of the decision-making process. Also, since I have not had time to read all the minutes, I can not say whether some of the published materials should have been deleted. My comments relate only to the deletions that were made.

In summary, my findings are that deletion policies and practices have conformed very well to the principles stated above. The four bases for deletion are all legitimate and appropriate. They are, of course, stated in general terms and could be interpreted either restrictively or liberally. I find that they have been interpreted restrictively and that actual deletions have been justified and relatively few in number. I also like the way the deletions have been indicated in the copies of the Minutes sent to the Archives. The reader is informed of all deletions and of the extent and nature of the deleted materials. This procedure is much superior to the alternatives of omission without indication or of paraphrasing the deleted materials.

Table I
Deletions From the FOMC Minutes
for the Years 1962-1966, Inclusive

Basis for deletion	Number of deletions
1	27
2	16
3	1
4	1
Total	45

Let us now look at the bases for the deletions that were made from the Minutes for the five years, 1962-1966. The total number of deletions in those years was 45. Of these, 27 were on Basis I: Information relating to the affairs, policies, or views of particular foreign central banks or governments which they wish to have held in confidence at this time. Most of these related to foreign exchange and credit operations of foreign central banks. By my standards, these foreign institutions are often too secretive. Yet they should have the right to determine their own rules for divulging information about their affairs, and the effectiveness of the Federal Reserve could suffer over time if it violated their confidences. Moreover, the deletions on this basis do not reduce significantly the ability of the reader to understand and evaluate Federal Reserve policies and actions. The remaining materials indicate the nature of the issues involved, the alternatives considered by the Federal Reserve, and the decisions made.

Because such a large proportion of the total omissions are on this basis, the Federal Reserve might in the future be tempted to omit such materials from the original minutes. I believe this would be a mistake. It is better to start from a full record and later have the Committee decide what should be deleted.

Another 16 of the deletions were on Basis II: Comments about foreign countries, institutions or individuals of such a nature that their release at this time was deemed not to be in the interests of good international relations. These deletions were not only appropriate but also wise. Most of the deleted comments were gratuitous and no more than tangentially related to Federal Reserve policies. However, I would not omit such comments from the original record; they can be reconsidered later.

Only one deletion (one comment in the Minutes of December 3, 1963) was on Basis III: In the judgment of the U.S. Treasury Department, its release at this time would not be in the interests of the United States. That the Treasury should request only one deletion in a five-year period is commendable and suggests that there is little danger that the Treasury will abuse this power. On the basis of only inadequate knowledge of all the issues involved, I question this deletion. However, I recognize that the situation is complicated by the agency relationship between the Federal Reserve and the Treasury in such matters and by the Treasury's accountability to the public for its actions.

One deletion was on Basis IV: Information about the internal affairs of a named business organization. This deletion was fully justified. The comment related to the fact that a named bank had removed certain borrowers from its list of borrowers eligible for the prime rate. No wrongdoing was alleged. To have published the comment might have embarrassed the bank without serving any useful purpose.

In short, I find that policies and practices with respect to deletions from the minutes have been commendable and consistent with Federal Reserve responsibilities to the public and to historians.

The question naturally arises: Should the deleted materials be published later, and if so when, where and in what form? On this I can offer little help; instead, I can say only that decisions should be made on a case-by-case basis, balancing benefits and costs. If publication of specific deleted materials would lead to large benefits in terms of increased understanding, they should be published even if costs and other disadvantages are high. My guess, however, is that after balancing benefits and costs, few of the materials will be found to be worth publication. For this there are at least two reasons. (1) If the 1962-1966 experience is a reliable guide, a large majority of the deletions will be on Basis I. Given the long tradition of foreign central banks, the long professional lives of some central bankers, and the slowness of change of their practices, many foreign central banks are likely to insist on long delays in publication, by which time the material may be obsolete. Their reluctance is likely to be increased by the fact that undue importance is likely to be attached to the publication of previously-suppressed materials. (2) Most of the deleted materials are of no more than marginal usefulness to an understanding and evaluation of Federal Reserve policies.

The above reasoning leads me also to the conclusion that the present procedure is to be preferred over one in which no deletions would be made but publication of the complete minutes would be postponed until such time as they would create no embarrassment.

Appendix B

(Text of note included at front of volume of FOMC minutes for each year in period from 1962 through 1966)

Prefatory note

Certain pages in the minutes of the Federal Open Market Committee for the years 1962 through 1966 have been replaced in the materials transmitted to the National Archives by substitute pages on which particular passages contained in the original minutes are deleted. In each such case, the point at which the deletion has been made is noted and the general nature or subject of the omitted passage is indicated by footnote.

Deletions have been made only for the following reasons:

1. The passage contains information relating to the affairs, policies, or views of particular foreign central banks or governments which they wish to have held in confidence at this time.

2. The passage contains comments about foreign countries, institutions, or individuals of such a nature that its release at this time was deemed not to be in the interests of good international relations.

3. The passage contains information of such a nature that, in the judgment of the U.S. Treasury Department, its release at this time would not be in the interests of the United States.

4. The passage contains information about the internal affairs of a named business organization.

It is anticipated that the originals of all pages for which substitutes have been introduced will be reviewed from time to time to determine whether they can be released.

Appendix C

Passages recommended for deletion
1967

1967 - Case 1
(Bracketed passage to be deleted)

Holdings of the Stabilization Fund were about $50 million, and at the moment there were no sizable central bank orders in sight. On the London gold market, however, serious trouble appeared to be shaping up. During 1966 the gold pool lost $300 million, leaving resources at the end of the year of only $60 million. In addition, and this was not generally appreciated, during 1966 the U. S. sold $150 million for domestic uses. Thus, over the year the total drain into market uses from official stocks was $450 million--a very large figure and, as he had indicated at previous meetings, one that threatened to grow in future years.

Toward the year-end, Mr. Coombs continued, a good deal of gold had been bought for window-dressing purposes, some of which might flow back; indeed, in the first few days of the year the gold pool picked up about $11 million. But there had been two disturbing events recently. One was the First National City Bank letter which pointed up the deterioration in the supply-demand situation for gold and concluded that all new production in 1966 had gone into private hands, with none left for official stocks. The true situation was worse than that, but the publication of the National City Bank's analysis had had a highly unsettling effect on the market, which now was beginning to realize the underlying situation. A second, and more disturbing, development was the French campaign1/ [against the U.S.,] which was now directed at raising doubts about the official price of gold. Of course, the French were well aware of the nature

1/ Part of a sentence has been deleted at this point for one of the reasons cited in the preface. The deleted material was descriptive of the "campaign" under discussion.

1967 - Case 2
(Bracketed passage to be deleted)

of the supply-demand situation through their participation in the London gold pool. Their campaign moved into higher gear last weekend with the French Finance Minister, Mr. Debre, calling for multilateral consideration of the official price of gold. His statement was taken by the market as an official suggestion that the price of gold should be increased. Mr. Debre would meet with the other Common Market Finance Ministers on January 16 and if past experience was a guide the communique issued after that meeting might well stir up still further speculation. There had been very heavy buying of gold in London today, and thus far the pool had lost $9 million. That situation could get worse.

There had been quite a bit of discussion of Mr. Debre's press conference at the Basle meeting this past weekend, Mr. Coombs continued,1/ [and the atmosphere was one of genuine alarm. He thought it fair to say that all of the Governors were angry with the French. It was not clear what they could do about it; it would be hard for them to break with France on financial policy because of their relations in the Common Market.] He hoped, however, that it would be possible to get the cooperation of other central banks in devising some sort of contingency plan for dealing with a possible breakout of the London gold price. As he had said many times before, he thought that was the single most serious threat facing the U.S. in the area of international finance, and it was more dangerous today than it had been earlier.

1/ Two sentences and part of a third have been deleted at this point for one of the reasons cited in the preface. The deleted material related to views expressed at the Basle meeting.

1967 - Case 3
(Bracketed passage to be deleted)

In response to the Chairman's request for comment, Mr. Coombs said it seemed to him that the paper Mr. Solomon and his associates had prepared was a very good one. His only comment related to the discussion of possible disadvantages of enlarging the swap network. On the basis of the System's operating experience to date, he did not consider the risks to be serious in connection with the first three possible dangers noted--namely, that new members of the network might tend to hold fewer uncovered dollars; that many countries, impelled by prestige considerations to seek membership in the network, might attempt to demonstrate eligibility by appearing less willing to hold uncovered dollar balances; and that any damping of fluctuations in new members' reserves might increase public sensitivity to such fluctuations as did occur and thus lead to unwise policies designed to minimize even temporary fluctuations. Such developments, in his judgment, were not very likely. As to the fourth possible development noted--that certain present members of the network would be dismayed by a widening of the membership--Mr. Coombs thought that might well occur, especially on the part of the Dutch, Belgians, and French.1/ [Those countries might be somewhat disturbed because the entry of the Danes and the Norwegians would dilute their influence in matters relating to the dollar. On balance, however, that might be a desirable development.]

1/ Two sentences have been deleted at this point for one of the reasons cited in the preface. The deleted material consisted of further comments by Mr. Coombs regarding possible attitudes of members of the swap network toward a widening of the membership.

Treasury Department and, if so, whether they had any attitude toward it. Finally, while he agreed with that part of the second proposed criterion which read, "The central bank, with its government's approval, . . . should be prepared . . . to exchange relevant information freely and frankly, without diplomatic participation and intervention," he hoped it would be agreeable to the Committee for the diplomats to be kept acquainted with the negotiations.

Mr. Coombs said he had held only brief discussions with the Treasury on the subject. It was his impression that the Treasury would like to continue its swap arrangements with Mexico and Venezuela, but that it would have no objection to the inclusion of those countries in the System's network. In general, he thought the Treasury would support the proposal. It was also his impression that the proposal would be warmly welcomed by the central banks of Mexico and Venezuela.

On the point that had been raised regarding political aspects, Mr. Coombs continued, he felt sure that the approach that had been made by the Governors of the Banks of Denmark and Norway had no political overtones.[1/] [In his earlier comment about diluting the influence of the French, Belgians, and Dutch he had not meant to refer to the Governments but rather to the central banks, which had taken an unduly aggressive attitude with respect to U.S. negotiations with other countries.]

Mr. Mitchell said that in his earlier reference to political aspects he had meant to employ that term in a broad sense. He

1/ A sentence has been deleted at this point for one of the reasons cited in the preface. The sentence reported a comment by Mr. Coombs regarding the attitudes of certain other central banks in recent negotiations.

respect to the risk of gold sales, the Danes had bought gold in 1960, when the price on the London market broke out, and either country could change its gold ratio. Secondly, the swap network, by and large, had become focused on the Basle group of countries, which gave undue weight to the members of the Common Market.[1/] [As he had indicated at the preceding meeting, it would be useful to dilute the influence of those countries by adding Denmark and Norway.] The staff papers on the two countries--which he thought were excellent--suggested that they were stable financially, economically, and politically, and that they could be expected to observe the rules of the game.

Third, Mr. Coombs said, a network of credit lines with foreign central banks provided a nucleus for rounding up additional support for a country in case of need. Last September, when an effort was being made to round up $400 million of additional help for the Bank of England, it was found possible to raise only $350 million from the System's swap partners. The sum desired was obtained because the Danes and Norwegians contributed $50 million to the package even though they were not members of the network. Their sense of responsibility and their willingness to help deal with emergencies were evident.

Finally, Mr. Coombs said, while avoiding losses of gold was important to the United States, the swap network had the additional important purpose of protecting the international role of the dollar. In that connection countries with low gold ratios could contribute

1/ A sentence has been deleted at this point for one of the reasons cited in the preface. The sentence reported a comment by Mr. Coombs concerning a possible consequence of expanding the swap network to include Denmark and Norway.

1967 - Case 6
(Bracketed passage to be deleted)

On the London gold market, Mr. Coombs continued, South African deliveries continued to run well above normal and enabled the London gold pool to take in $18 million during March. The pool now had available a reserve of $106 million, which would provide a useful cushion when the flow of gold from South Africa returned to normal--or what was perhaps more likely, subnormal--levels during coming months.

Sterling was in very strong demand throughout March, Mr. Coombs said. The Bank of England took in a total of nearly $700 million in what was probably the best month sterling had ever had. Of that gross inflow, only $90 million had been allotted to a reserve increase that was being announced today; $350 million had been used to pay off central bank debt, including a $100 million payment to the Federal Reserve early in the month; and a sizable reduction in forward contract liabilities also was made. The March debt repayments left $180 million still outstanding at month-end under the so-called sterling balance credit arrangement, and that figure was reduced to $150 million yesterday.[1/] [As the Committee would recall, last summer the Bank of England incurred central bank and market forward obligations of roughly $2-1/2 billion, with their central bank debt alone rising to more than $1-1/2 billion.] In effect, they had now repaid all but $150 million of their central bank debt, as well as substantially reducing their forward commitments. That represented a tremendous turnaround in their position. He would hope that the publication today of good figures for March would give further stimulus to the demand for sterling, and that April would start off well. (B of E)

1/ A sentence has been deleted at this point for one of the reasons cited in the preface. The sentence cited figures on the Bank of England's obligations to foreign central banks and in the forward market as of the previous summer.

network partners in the European Economic Community were trying to subject the network to a new dimension of surveillance by arranging to have the swap lines with the central banks of Common Market countries mature on the same date. He felt that they were planning eventually to go even further to seek also some sort of Common Market control over the actual drawings under the lines.1/ [This movement had begun in the Netherlands Bank, with considerable backing from the National Bank of Belgium. The attitude of the central banks of Germany and Italy had been relatively neutral; indeed, the Italians had made some effort to achieve a compromise that would be satisfactory from the point of view of the United States.]

The2/ [Netherlands Bank] official primarily concerned originally had been one of the strongest supporters of the swap network, Mr. Coombs continued, and it was not entirely clear why he was now engaged in an effort of this kind. Part of the explanation, perhaps, was that he had become increasingly pessimistic about the U. S. balance of payments problem and about the damage he thought the United States had done by "exporting inflation" to Europe in the process of running persistent payments deficits. Secondly, his views had shifted from an acceptance of the kind of exchange guarantee involved in the swap drawings to a preference for a gold guarantee. Third, he and others2/ [in the Netherlands] had been consistently pessimistic with respect to sterling and had strenuously opposed some of the sterling rescue operations of the past three years. The fact that those rescue

1/ Two sentences have been deleted at this point for one of the reasons cited in the preface. The deleted material reported comments by Mr. Coombs about the attitudes of individual central banks.

2/ A phrase has been deleted at this point for one of the reasons cited in the preface. The phrase indicated the nationality of the official referred to.

operations had been successful had not lessened his opposition, but had served only to increase his disaffection.

That disaffection had been particularly whetted by the increases in the swap lines negotiated last September, Mr. Coombs said. The first reaction of the[1] [Netherlands Bank] official at that time had been to try to persuade all the Common Market countries to treat such increases as temporary and separate from the previous swap lines.[2] [His effort to develop a solid Common Market front on that point had been spoiled when the Germans and Italians agreed to consolidate their enlargements into new over-all swap lines.] Having failed in that effort, he had shifted his objective to that of achieving a common maturity date for the various Federal Reserve swap lines--with all lines maturing at the end of each quarter--so as to facilitate surveillance by the Common Market central banks at renewal dates.

Those efforts to subject the Federal Reserve network to special surveillance, Mr. Coombs observed, had been pursued through private conversations with other Common Market central bankers. Although some of the latter had suggested open discussions with Federal Reserve representatives, thus far no direct approach had been made to the System.[3] [He (Mr. Coombs) had heard of the plan indirectly through the Germans and Italians, and had urged those central banks not to participate in it.]

Mr. Coombs noted that the Italians had attempted a compromise by suggesting that their swap line with the System, which was already on an annual basis, might be scheduled to mature at the end of each year. He thought that had been a constructive suggestion. The swap

1/ A phrase has been deleted at this point for one of the reasons cited in the preface. The phrase indicated the nationality of the official referred to.

2/ A sentence has been deleted at this point for one of the reasons cited in the preface. The sentence reported a comment by Mr. Coombs about the reactions of certain Common Market countries to the proposal cited in the preceding sentence.

3/ A sentence has been deleted at this point for one of the reasons cited in the preface. The sentence referred to certain conversations relating to the subject under discussion.

them not to press for a June 30 maturity date. Mr. Hayes also had been in touch with the German Federal Bank and would be visiting that Bank again on Friday. And, of course, there would be discussions at the Basle meeting next weekend.

Superficially, Mr. Coombs observed, the question of coordinated maturity dates for swap lines with Common Market countries might not be considered a matter of great concern to the Committee. The underlying danger, however, was that the proposal reflected an intention of ultimately subjecting the System's network of swap arrangements with the Common Market countries to tight control by those countries acting in concert.1/ [That would give a disproportionate degree of power to small nations such as Belgium and the Netherlands.]

In general, Mr. Coombs said, the events he had reported had a number of unfortunate aspects. First was the failure of the countries involved to consult the Federal Reserve directly. More importantly, the approach seemed to reflect an unwarranted attitude of distrust of U.S. motives and actions. The only justification that he could see for the intended consultations was the risk of some abuse of the swap network, while in fact there had been no abuse. The nature of the whole approach to the matter of uniform maturity dates suggested that it was a testing operation. His own strong inclination would be to have the issue thrashed out now, when the swap lines were virtually clear, rather than to let matters drift on and possibly come to a head during the summer months when there might well be heavy drawings outstanding under the swap lines.

1/ A sentence has been deleted at this point for one of the reasons cited in the preface. The sentence reported a comment by Mr. Coombs about a possible consequence of the proposal under discussion.

At the previous meeting, Mr. Coombs noted, the Committee had approved his recommendation that the swap line with the Bank of France be renewed for three months when it matured on May 10. The French had now advised that they would not accept a renewal for three months, but only one through June 30.[1/] [In effect, they had taken the initiative in trying to dictate terms to the Federal Reserve.] His own view was that the System should not acquiesce. He would recommend that the French be told that the Committee would let the arrangement lapse if they were willing to renew it only until June 30. In the weekend discussions at Basle Mr. Hayes and he would be talking with the Germans and Italians on the matter, and it would be helpful to have the views of the Committee in this respect.

In response to the Chairman's request for comment, Mr. Daane said that he had mixed feelings. To a large extent he shared Mr. Coombs' views; in his judgment the effort to coordinate maturity dates of swap lines ran counter to the spirit of international cooperation that was reflected in past practice of undertaking bilateral arrangements to deal with disruptive swings in payments flows between countries. But while he sympathized with Mr. Coombs' view he found the underlying issue a difficult one to resolve.

Mr. Daane noted that he had discussed the matter with Under Secretary Deming who, like Mr. Coombs and himself, was disturbed about the implications of the recent developments in light of the purpose of the swap arrangements. Mr. Deming had suggested making a maximum effort at Basle this weekend to persuade the French to renew their swap line on the customary three-month basis. Whatever the French reaction, Mr. Deming

1/ A sentence has been deleted at this point for one of the reasons cited in the preface. The sentence reported a further comment by Mr. Coombs on the subject under discussion.

the French he was not sure the Committee could stave off a common maturity date. If they were not, it would be very useful to have their counsel.

Mr. Coombs observed that the attitude of the Italians posed no problem, since they had already indicated they were fully prepared to retain a one-year period for their swap line, with maturity at the end of the year. The Germans at the moment were not on a quarterly basis; as he had indicated, they had agreed in February to a six-month renewal, and their swap line would mature on August 9. He was hopeful that they could be persuaded to renew the line for another six-month period at that time. However, if the System agreed to a June 30 maturity for the line with the Bank of France, the Germans would be put under very heavy pressure. Perhaps the best hope was to try to persuade the French to defer the question, if only to extend to the System the courtesy of having an opportunity for thorough discussion. Central bank relations were based on a spirit of mutual trust and confidence, and unilateral actions were contrary to that spirit.

Mr. Coombs added that the costs of permitting the swap line with the Bank of France to lapse could easily be exaggerated. That line had been useless for some time, and market participants were aware of that fact.[1/] [Indeed, there would be an advantage in discontinuing the French swap line; if France was no longer a member of the network, any plan for coordinated surveillance of swap line activity by all the Common Market countries would fall through.]

1/ A sentence has been deleted at this point for one of the reasons cited in the preface. The sentence reported a further comment by Mr. Coombs on the subject under discussion.

preferred that its arrangement be announced at the same time. In Mr. Lang's conversations with the Venezuelans following the Committee's preceding meeting, they had indicated that they appreciated being kept informed on developments, but since there was no present prospect of Venezuela's moving toward Article VIII status in the near future they understood that the System would wish to proceed with the other countries involved. With respect to the renewal of the swap arrangement with the Bank of France, the developments following the preceding meeting had been reported to the Committee in a memorandum from Mr. Coombs dated May 9, 1967.[1/] He (Mr. MacLaury) had little to add to the information in the memorandum, except to say that Mr. Coombs felt that the frank discussions with the European central bankers had done a lot to clear the air and to bring home the importance of the swap network to them as well as to the United States.[2/] [The prospect that the System might be prepared to drop one of its arrangements--that with the Bank of France--was sobering to the Europeans.] In that connection, Mr. Coombs had asked him to say that the firm stand the Committee had taken at its preceding meeting had been of great help to Messrs. Hayes and Coombs in their discussions with the Europeans.

Mr. Brimmer asked whether the operation of bringing the remaining British portfolio into their reserves would have any effect on the U.S. balance of payments.

1/ A copy of this memorandum, entitled "Swap arrangements with Common Market countries; discussions at Basle, May 6-7," has been placed in the Committee's files.

2/ A sentence has been deleted at this point for one of the reasons cited in the preface. The sentence reported a further comment on the subject under discussion.

members over the cost of the operation, and at each of the Basle meetings they continued to urge the U.S. to join in a fundemental discussion of longer-term solutions. The French clearly had concluded that the problem of dealing with the market price of gold was hopeless. If pressures continued on the pool--and he thought that was quite likely--it would be necessary to go back to the members for an additional $50 million since the pool's resources were down to $48 million as of today. He was hopeful that the additional $50 million could be obtained, but beyond that resistance was likely to increase.

There had been a good deal of activity in the exchange markets recently, Mr. Coombs continued. The recovery of sterling had been choked off around the middle of May by some poor trade figures for April and General de Gaulle's press conference, and later by the Middle East hostilities, and since mid-May the pound had barely managed to hold its own.[1/] [In fact, at the end of May the British were seeking $100 million of window-dressing money to avoid showing a sizable reserve loss. In view of the distaste a number of Committee members (B of E) had expressed in the past for that sort of operation, arrangements had been made for the U.S. Treasury to put up the $100 million on an overnight swap.] For Federal Reserve account, however, market swaps of sterling (purchases of sterling for immediate delivery and concurrent sales of sterling for future delivery), with the Treasury joining in on a 50-50 basis, were initiated, with a total of $113 million made on June 1 and 5. The Bank of England felt that those operations had

1/ Two sentences have been deleted at this point for one of the reasons cited in the preface. The deleted material referred to a financial transaction by the Bank of England.

1967 - Case 18
(Bracketed passage to be deleted)

of the outstanding commitments over the next few months. If Italy experienced a deficit in the late fall some progress might be possible then in reducing the System's forward lire commitments.

In response to a question by Mr. Galusha, Mr. Coombs said he felt quite uneasy about the prospects for the pound over the summer, since it would be exposed to various kinds of pressures. The main source of encouragement was that, by virtue of the wage-price freeze and other actions last summer, the British had made much progress toward a more solid balance of payments position--their payments were in surplus in the first quarter--which had enabled them to ride through the recent difficulties as well as they had. If the Middle East crisis had occurred a year earlier, at the time of the maritime strike, the situation could have become hopeless overnight. Much depended now on whether Middle East balances were shifted out of sterling.1/ [Those balances totaled about $2 billion, a sizable sum. (B of E) However, about $1-1/4 billion represented balances of Kuwait, and that country might very well decide it was to its advantage to keep those funds in sterling; if they were to scatter them around, in Swiss francs, gold, and so forth, they might find themselves much more vulnerable to a takeover by Iraq.] The more aggressive members of the Arab League, including Egypt, Syria, and Iraq, were virtually bankrupt and had little money to move. Unless the Arab League managed to put together a solid front, which they had never been able to do in the past, the British losses should remain moderate.

1/ Two sentences have been deleted at this point for one of the reasons cited in the preface. The deleted material reported comments by Mr. Coombs on possible developments with respect to sterling balances held by Middle Eastern countries.

1967 - Case 19
(Bracketed passage to be deleted)

indicated then that wages in the U.K. might rise about 6 per cent over the next 18 months.

Mr. Brimmer then noted that he had two questions. First, what was the British attitude toward the losses of sterling balances and what were their plans for coping with them? Secondly, Mr. Coombs had said that members of the gold pool were urging discussions of longer-run solutions to the problems the pool faced, but he gathered that the United States was not anxious to hold fundamental discussions of that type. Was the Treasury likely to agree to such discussions, or would they try to avoid them?

With respect to the first question, Mr. Coombs said that the British naturally were worried over the risk of large-scale liquidation of Middle East sterling balances.[1/] [However, certain British officials seemed to feel reasonably confident that by one means or another they might be able to dissuade the large holders--particularly Kuwait--from making massive conversions, since it was very much in the latter's interest not to do so.] As he had indicated, if the balances were converted the British could request drawings of up to $1 billion on the sterling balance credit package. Such credits would be available for about nine months, after which the British could make a drawing on the International Monetary Fund. Ultimately, however, he thought the conversions would have to be charged off to British reserves.

(B of E)

1/ A sentence has been deleted at this point for one of the reasons cited in the preface. The deleted material reported views of British officials with respect to the outlook for Middle Eastern sterling balances.

Mr. Coombs replied that he had come to believe in the course of the recent negotiations that there was very little the System could do to dissuade the Common Market countries from consulting with one another about their swap lines with the Federal Reserve, since the concept of consultation was rooted in the Rome Treaty. Moreover, he thought it would be unwise to try to dissuade them. In the recent discussions he and Mr. Hayes had objected, not to such consultations within the Common Market, but to their moving on to making firm and binding decisions affecting the network without prior discussions with the System.[1/] [They had conceded that that was inappropriate, and had reversed the decision they had taken.] At the same time, their consultations would be more frequent if the present maturity dates were retained than if they were shifted to year end. In his judgment an annual multilateral surveillance exercise would be too infrequent to be very effective.

Mr. Coombs went on to say that he had given a great deal of thought to the question of what date would be best for swap line renewals if a common date was to be arranged. His conclusion was the opposite of Mr. Mitchell's; renewals near the year end seemed preferable to him. At that time, when flows of funds were large for strictly technical reasons associated with window-dressing activity, the swap network was of maximum usefulness to all parties and the System's partners were least likely to be inclined to take any drastic action affecting the network. While

1/ A sentence has been deleted at this point for one of the reasons cited in the preface. The sentence reported a further comment by Mr. Coombs on the subject under discussion.

the London market. In his opinion, events were moving toward a "flash point"; and if a speculative outbreak did occur, widespread consequences could be expected.

On the exchange markets, Mr. Coombs said, sterling trading had been fairly well balanced during most of the period, but the Bank of England suffered fairly heavy losses on several days through intervention in the spot market. In addition, the Bank had also had sizable payments to make on maturing forward contracts. Thus far this month, through yesterday, the Bank of England had lost roughly $350 million, and another $50 million so far today; by month end the figure might easily rise to the $600 million level, and possibly beyond. He assumed that the British Government would be reluctant to show as a reserve loss more than a small fraction of the deficit, so the British presumably would be looking to the U.S. for credit assistance. He hoped that the System could limit its financing role at month end to no more than $250 or $300 million, with the U.S. Treasury and other sources providing the residual amount needed[1/] [on the basis of overnight credits.] (B of E)

While some encouragement could be found in the fact that sterling had survived as well as it had the pressures arising out of the Middle East hostilities, Mr. Coombs characterized the British situation as extremely fragile, with little scope left for dealing with any new confidence crisis through international financial assistance over and above that already committed. He thought the

1/ Part of a sentence has been deleted at this point for one of the reasons cited in the preface. The deleted material referred to the form in which the credit in question might be granted.

had developed in the past few months. Perhaps it just reflected a feeling that no country deserved such a run of continuing bad luck. Nevertheless, the situation was leading to market pressures, and another speculative attack could develop during the summer months.

Mr. Mitchell observed that the French evidently thought devaluation was appropriate. He asked whether that was their sincere evaluation or whether it reflected a view that devaluation would detract further from British prestige.

Mr. Coombs replied that in his view the French attitude reflected political considerations.[1/]

[Mr. Hayes inquired whether the French would be likely to let sterling be devalued against the franc, and Mr. Coombs said he had received indications that if sterling were devalued the French would follow quickly. That issue was discussed at some length in 1964 and 1965 in various committees of the Common Market. His understanding, on the basis of confidential reports he had received, was that all of the Common Market countries except France had indicated that they could live with a 10 per cent devaluation. The French refused to go along.

Mr. Hayes inquired whether Mr. Coombs viewed the French position as a tactic of obstruction, and Mr. Coombs replied in the affirmative. He thought it reflected political policy, with finance used as a tool.]

Mr. Maisel suggested that, since the gold question was so critical, the staff should look beyond the projected 10 per cent per

1/ Six sentences have been deleted at this point for one of the reasons cited in the preface. The deleted material reported questions by Mr. Hayes, and replies by Mr. Coombs, concerning the probable reactions of France and other Common Market countries to a devaluation of sterling.

At the Committee meeting on May 2, Mr. Coombs recalled, he reported that the central banks of the Common Market countries had apparently entered into a binding agreement under which the maturities of their swap arrangements would be moved to end-of-quarter dates. His recommendation at the time was to deal firmly with the problem, even to the extent of allowing the French swap arrangement to terminate if that was necessary in order to undo the agreement. That recommendation was disapproved by the Committee, with concern expressed about the consequences of terminating the French arrangement, and he and Mr. Hayes were asked to negotiate some compromise.1/ [Therefore, they went to the next BIS meeting with the objective of keeping the French swap arrangement intact and yet, at the same time undoing the agreement by the Common Market countries to move their swap maturities to quarter-end dates.] There emerged a proposition, which seemed to him reasonable and relatively harmless, to move the entire swap arrangements to a one-year basis, with maturities at year end, at which time renewal of the arrangements would come up for discussion and negotiation. It developed in the course of the Basle discussions that the pressures for special surveillance were not widespread.2/ [Governors Carli and Blessing were not sympathetic, and even Governor Brunet was rather neutral.] The proposed compromise solution provided something of a face-saving device and, as he had said, it seemed to him relatively harmless. He assumed that the Common Market countries would continue to push certain common policy measures, but he hoped that those would focus elsewhere

1/ A sentence has been deleted at this point for one of the reasons cited in the preface. The sentence reported the position taken by Messrs. Coombs and Hayes in the discussions at the next BIS meeting.

2/ A sentence has been deleted at this point for one of the reasons cited in the preface. The sentence reported the attitudes of certain foreign central bank governors in the discussions at Basle.

and that the Federal Reserve swap network would be left out of the picture.

Mr. Coombs urged that the Committee adopt a policy decision to move the entire swap network to a full-year basis, maturing at year end. On the question whether something would be gained by changing the arrangements with the non-Common Market countries to that basis, he thought there would be an advantage. An argument could be made for fragmenting the dates, but the Federal Reserve had good friends among the non-Common Market group, and he could see an advantage in having the maturities of those swap arrangements coincide with those of the arrangements with the Common Market group. He had checked with the Treasury on that point, and the Treasury shared the view that if changes in maturities were to be made it would be better to have the non-Common Market group synchronized with the Common Market group. The Treasury felt that the year-end maturity date proposal was a reasonable compromise.

Mr. Mitchell said he did not understand why Mr. Coombs referred to a compromise. The issue at stake was multilateral surveillance. Under the proposed plan, there would be a review of the entire swap network at the same time each year.

Mr. Coombs replied that the Federal Reserve had been presented with a binding agreement on the part of the Common Market countries to move their swap arrangements to end-of-quarter maturity dates.1/ [That was broken up; they consented to give up that agreement.]

1/ A sentence has been deleted at this point for one of the reasons cited in the preface. The sentence reported that the Common Market countries had decided to give up the agreement mentioned in the preceding sentence.

had been a difficult one. The basis on which they had agreed to abandon the agreement--although it was not a binding condition--was the possibility of working toward a year-end maturity date, which appealed to them as a face-saving device. He believed it was indeed a compromise, and he saw little likelihood of the Common Market countries successfully caucusing against the System on an annual basis, particularly at year end when many of them found the swap lines valuable. In his opinion, the plan should not unduly embarrass the System, and having the other swap arrangements on the same maturity basis would strengthen the System's hand because any concerted action by the Six, if it developed, could be better resisted.

Mr. Scanlon asked whether any of the non-Common Market countries had a contrary view on the matter.

Mr. Coombs replied that he thought all of them would be prepared to move to a full-year basis and that they had no particular concern about the maturity date.[1/] [The Swiss, for example, had indicated that they would be willing to do whatever the Federal Reserve suggested.]

Mr. Coombs then pointed out that if the Committee was favorable to a move toward synchronization of maturities on a 12-month, year-end basis, that might involve a somewhat varied interim pattern, since the periods of the maturing arrangements differed. Certain banks, if confronted with the prospect of switching to a new maturity basis, might prefer initially to renew the existing arrangement until the end of this year. Others might want to renew for a year at this time and change to the year-end maturity pattern later. He hoped the Committee would permit flexibility in working out such matters.

1/ A sentence has been deleted at this point for one of the reasons cited in the preface. The sentence reported a comment by Mr. Coombs on the attitude of the Swiss concerning the subject under discussion.

could tell, that did not reflect the reappearace of a large basic deficit in the British position. While the surplus earlier projected by British financial officials had pretty well withered away over the past few months, there was still reason to hope that they would end up the year in a roughly balanced position. The July trade figures just released this morning showed a strong recovery of exports and a dip in imports.

What had been doing the damage during recent weeks, Mr. Coombs continued, was a combination of factors. First of all, the United Kingdom tends to experience, just as the U.S. does, a heavy seasonal deficit in the third quarter of the year. That had been further aggravated this year by several unfortunate developments, such as the liquidation of Arab holdings of sterling and the German recession, which had had a temporarily depressing effect on British exports. Another trouble spot was the fact that the British money market no longer enjoyed a competitive advantage in relation to the Euro-dollar market, with the result that earlier inflows of short-term funds into sterling were now tending to move back out. Furthermore, with no interest rate inducement to the market to shift Euro-dollar funds into sterling, the Bank of England was finding it increasingly difficult to roll over maturing forward contracts by executing market swaps; that is, buying dollars spot and selling them forward.[1/] [Since the existing volume of forward contracts--and this was a highly (B of E) confidential fact--ran into several billion of dollars equivalent,

1/ A sentence has been deleted at this point for one of the reasons cited in the preface. The sentence discussed the volume of Bank of England forward contracts and the implications of any inability to roll over such contracts.

even a temporary failure to roll over maturing contracts could quickly mean a very sizable reserve loss; and that was what had been happening.] Finally, and most important of all, there had occurred during the last few weeks a sharp break of confidence in sterling, with all the usual speculative consequences in such forms as an adverse shift of the leads and lags. That break of confidence was attributable in part to market recognition of the various difficulties he had just mentioned. Perhaps more importantly, however, it was attributable to a general feeling that the British Government had pretty well shot its bolt so far as major policy measures were concerned, that political loyalties within the Labor Party had been strained to the limit by the austerity measures already introduced, and that the program had failed to bring about a convincing recovery of sterling. The erosion of market confidence in sterling had been further aggravated by a series of articles appearing in influential British publications, including The Economist, which had openly advocated devaluation as the missing ingredient in the Labor Government's program. Perhaps the July trade figures might bring some strengthening of confidence.

(B of E)

Mr. Coombs reported that during May, June, and July the Bank of England suffered losses of $800 million, of which $140 million was acknowledged as a reserve loss while the remaining $660 million was covered by recourse to central bank credit. Of the latter total, $450 million had been provided by the Federal Reserve and $210 by other sources.

however, as the time approached at which new drawing rights would be created to stand side by side with gold and dollars. All one could do was wait to see what the reaction would be then.

Mr. Mitchell referred to Mr. Coombs' suggestion that the drain of short-term funds from London might be stopped by changing interest rate relationships somewhat. Observing that the differential between Euro-dollar rates and U.S. CD rates had been more or less nominal over the past two or three months, he asked whether Mr. Coombs thought the change in rate relations would have to be large enough to destroy the incentive for U.S. banks to borrow in the Euro-dollar market.

Mr. Coombs replied that the relation he had had in mind was that between Euro-dollar rates and U.K. local authority rates, which had been in favor of the former by varying amounts for the past two or three months. As a result people with maturing forward contracts had had no incentive to leave the funds on deposit in London; they could earn a larger return in the Euro-dollar market. The local authority rates would have to be moved up by at least one-half of a percentage point to end the drain.

In reply to a question by Mr. Sherrill regarding the outstanding volume of British forward contracts, Mr. Coombs said that the peak figure reached recently was[1/] [$3 billion.] The present (B of E) volume was less as a result of the run-offs of maturing contracts during the summer months,[2/] [but it was still high enough for

1/ A figure has been deleted at this point for one of the reasons cited in the preface.

2/ Part of a sentence has been deleted at this point for one of the reasons cited in the preface. *The deleted material reported the rate at which the forward contracts in question were maturing.*

$200 - $300 million of forwards to mature each month.] As he had indicated, the British now had only $1 billion of unmortgaged reserves. How much further they would be prepared to go in mortgaging their reserves was an open question; they would have to plan on having some on hand if a break in the present situation should occur. (B of E)

Mr. Hayes remarked that the top British financial authorities were fully aware of the problem. The question facing them was the old one of the kind of actions that were feasible from the political standpoint.

> By unanimous vote, the System open market transactions in foreign currencies during the period September 12 through October 2, 1967, were approved, ratified, and confirmed.

Mr. Coombs then referred to the program for shifting the System's swap arrangements to full-year terms maturing around the year end, and noted that the $450 million standby arrangement with the Bank of Italy would mature on October 20, 1967. Although he had not yet discussed the question with the Bank of Italy, he anticipated that they would prefer to renew the arrangement only until December 29, 1967 now and plan on renewing it then for twelve months, rather than renewing it now until October 1968 and replacing it in December 1967 with a new twelve-month arrangement. He did not think there was any particular disadvantage to the first course, and recommended its approval.

Any use the British made of their U.S. securities portfolio would have a corresponding adverse effect on the U.S. balance of payments, Mr. Coombs noted. Such use also was likely to be interpreted by the market as an official acknowledgment that Britain's short-term central bank credit facilities had been completely exhausted. A Fund drawing might be interpreted as a vote of confidence by the Fund in the present sterling parity. At the same time, however, it unavoidably would be accompanied by a great deal of publicity.[1/] [Furthermore, of the $1.4 billion available to the British in the Fund, $750 million was earmarked for repayment (B of E) of credits under the sterling balance package.] A major risk in either course was that the market might guess that the British were approaching the end of their resources. In general, sterling's difficulties were deepening, and the next few weeks clearly were going to be weeks of critical decisions.

Mr. Hickman asked if Mr. Coombs would comment on the observations concerning sterling in the recent report of the Common Market Executive Commission.

Mr. Coombs replied that the section of that report dealing with sterling probably was largely of French authorship, but it formalized certain questions that had been of concern not only to the French but to the other Common Market countries also. One was the question of whether sterling was over-valued at its present

1/ A sentence has been deleted at this point for one of the reasons cited in the preface. The sentence reported a further comment by Mr. Coombs with respect to possible British use of IMF credit.

In response to questions by Messrs. Wayne and Robertson, Mr. Coombs commented that the swap line with the Bank of France was of no utility to the System.1/ [Indeed, it might be said to have negative utility, since its existence gave the French access to information they would not otherwise have and which they may have used on occasion to the disadvantage of other members of the network.] However, if the Federal Reserve did not propose renewal at this time--which in effect would be to suggest that the arrangement be allowed to lapse, since the System customarily had taken the initiative in connection with swap line renewals--the program for moving all of the arrangements to full-year terms maturing at year end might be jeopardized. That was because such an action probably would be regarded by the other Common Market countries as a breach of faith on the part of the Federal Reserve; the System had agreed in the earlier negotiations to seek year-end maturities for all of its lines, including that with the Bank of France. There would, of course, be no breach of faith by the System if the French declined to renew the line,2/ [and in his judgment that would be a fortunate outcome.]

Mr. Wayne then noted that if the French swap line was renewed now until year end and then for another three months, the next maturity date would occur around the end of March 1968. He asked whether Mr. Coombs thought the constraints that affected the System's actions now would also apply with equal force to the decision regarding further renewal that would be taken then.

1/ A sentence has been deleted at this point for one of the reasons cited in the preface. The sentence reported a further comment by Mr. Coombs about the role of the System's swap line with the Bank of France.

2/Part of a sentence has been deleted at this point for one of the reasons cited in the preface. The deleted material reported a further comment on the subject under discussion.

Mr. Coombs went on to say that at that point, when an impasse seemed to have been reached,[1/] [Governor Carli of the Bank of Italy] had made another proposal; namely, that the Bank of England apply to the Fund for a credit not of $1.4 billion but of roughly $3 billion. To extend such a credit the Fund would have to waive the limit of 200 per cent of quota on its holdings of an individual country's currency. It would also be necessary for the Fund to activate, in substantial amount, the General Arrangements to Borrow, under which Group of Ten countries have undertaken to lend currencies to the Fund over and above the amounts provided by their quota subscriptions. The central bank governors at Basle--with the exception of[2/] [Governor Brunet of the Bank of France]--had indicated that they would be prepared to make favorable recommendations to their governments with regard to the provision of whatever sums the Fund would need to provide so massive a credit to the British.

That proposal, Mr. Coombs continued, had been communicated to Mr. Schweitzer, Managing Director of the Fund, who, after consultation with his staff, had taken a strongly negative view. At the moment discussions among Group of Ten representatives were proceeding in Paris, in the course of which, he understood, the U.S. Treasury representatives were pressing their proposal for European countries to join with the U.S. in agreeing to acquire a total of $1 billion of guaranteed sterling. There was some possibility that the German

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1/ Part of a sentence has been deleted at this point for one of the reasons cited in the preface. The deleted material identified the central banker who had made the proposal in question.

2/ Part of a sentence has been deleted at this point for one of the reasons cited in the preface. The deleted material identified the central banker referred to.

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(Bracketed passage to be deleted)

Federal Bank and the Bank of Italy together might agree to match the $500 million U.S. share suggested by the Treasury.

There was one ray of light in a generally dark situation, Mr. Coombs remarked. That was the fact that sterling had not fared badly in the exchange markets since Bank rate was increased to 6-1/2 per cent last Thursday. The British had incurred some reserve losses on Friday, but not unduly large losses, and they took in about $30 million on a swap basis yesterday. So far today they had managed to execute about $40 million of swaps, despite the announcement of extremely poor foreign trade figures for October, and both the spot and forward rates were up moderately. That kind of market reaction was being obtained on the basis of new reports that the British had received credit assistance through the BIS to repay the $250 million Fund credit. Thus, in view of the enormous short positions in sterling, it was possible that, if a reasonable package of credits to the British was arranged and if the British were able to cope with the recent wildcat dock strikes, return flows might be brought about that would give sterling a reprieve until the middle of next year.[1/] [On the other hand, the French had now shifted to outright financial warfare against sterling and the dollar, and the markets might be flooded with pessimistic reports emanating from Paris.] Sterling was poised on a knife edge.

1/ A sentence has been deleted at this point for one of the reasons cited in the preface. The sentence reported a comment by Mr. Coombs about a possible source of difficulty for sterling.

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(Bracketed passage to be deleted)

At the Basle meeting, Mr. Coombs continued, there also was a good deal of discussion of an exchange rate for sterling--if the British decided to devalue--that on the one hand was likely to prove tenable, and on the other hand would be unlikely to precipitate competitive devaluations. The main alternatives considered were devaluations of 10 and 15 per cent.[1/] [The Governors of all of the Common Market central banks except the Bank of France, and the Governor of the Bank of Sweden, indicated that their countries probably could hold their present exchange rates if the British devaluation did not exceed 15 per cent. Governor Brunet had noted that his Government was of the view that sterling should be devalued but that it could not accept a devaluation of 15 per cent without reacting. He did indicate that there was some chance that France would accept a 10 per cent devaluation. Since the difference between 10 and 15 per cent was not very great this position seemed to be simply another illustration of France's current tactics to keep things on edge, and perhaps pave the way for a subsequent French move if the British devalued.

One curious aspect of the discussion, Mr. Coombs observed, was that Governor O'Brien continued to press the question of the degree of devaluation the other countries could

1/ Six sentences have been deleted at this point for one of the reasons cited in the preface. The deleted material reported views concerning an exchange rate for sterling expressed by individual central bank governors at the recent Basle meeting.

accept even after general agreement was reached on the desirability of approaching the Fund regarding a $3 billion credit to the British. That fact probably convinced the continental Europeans that Governor O'Brien personally favored devaluation.] In any case, if the question of a sterling rate that would be tenable was being renewed in the current Paris meeting, there were serious risks of leaks.1/

[It was his impression, Mr. Coombs continued, that both Prime Minister Wilson and Chancellor Callaghan were still determined to hold the present sterling parity, but that they were quite clearly in the minority within their own Cabinet. Further, they were taking the position that massive aid should be extended with no conditions, which might prove impossible. The apparent division of views among the British authorities was contributing to a feeling of hopelessness among those taking part in the discussions.]

In conclusion, Mr. Coombs said that the U.S. Treasury, as previously indicated, had put forward a suggestion for a package of credit assistance to Britain that would include U.S. contributions of $500 million in the form of purchases of guaranteed sterling. In view of the possibility that the Germans and Italians might agree also to contribute to such a

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1/ Three sentences have been deleted at this point for one of the reasons cited in the preface. The deleted material reported Mr. Coombs' impressions of the attitudes of particular British officials on the subject under discussion.

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(Bracketed passage to be deleted)

package, the Open Market Committee might be faced with the need to make a fairly quick decision on how much, if any, assistance the Federal Reserve would be prepared to extend in company with the Treasury.

Chairman Martin then noted, to complete the picture, that on Monday of last week (November 6) there had been a meeting at the U.S. Treasury--attended by Messrs. Coombs, Daane, Hayes, Solomon, and himself from the System--to discuss the general situation with respect to sterling.1/ [At that meeting he had been asked to explore with Governor O'Brien the possibility of a further increase in Bank rate from its level at that time of 6 per cent. Subsequently, he had quite a long discussion with Governor O'Brien by telephone. In response to Mr. O'Brien's request for his views on whether a Bank rate increase would be helpful generally, he had said it was his belief that the recent increase from 5-1/2 to 6 per cent had been inadequate to close the gap between short-term rates in London and abroad; that a further increase of one-half of a percentage point would be helpful; and that a further increase of a full percentage point might well be desirable, if it was feasible politically. Governor O'Brien indicated a willingness to consider a Bank rate increase. He had also commented on the matter of possible credits to Britain, saying--as Mr. Coombs

1/ Five sentences have been deleted at this point for one of the reasons edited in the preface. The deleted material reported a development at the meeting under discussion and the substance of a subsequent telephone conversation between Chairman Martin and Governor O'Brien.

had indicated he subsequently said at Basle--that Britain would not find further short-term credits useful and needed longer-term credits.]

Chairman Martin added that later in the week, while in Dallas, he had received a call from Governor O'Brien, who advised that he had been trying to reach Chairman Martin to tell him that a decision had been taken to increase Bank rate by one-half of a percentage point. At the time the phone call was put through the announcement had been made. Market developments early on Friday, the day after the increase was announced, suggested that the rate change had not materially helped the situation, but subsequently the market became calmer.

The Chairman then invited Mr. Daane to report on the Washington meetings in which he had participated during the past weekend.

Mr. Daane said that at the Treasury on Saturday, November 11, members of the so-called "Deming Group," including Under Secretary Deming, Mr. Fried of the White House Staff, Mr. Okun of the Council of Economic Advisers, and himself, met with two representatives of the United Kingdom, Messrs. Rickett and Morse. The latter outlined Britain's position, to the effect that the alternatives were substantial long-term credit assistance or immediate devaluation. At that time the U.S. Treasury was urging that the best course would be

Paris in which Mr. Deming participated to put together a support package employing the guaranteed sterling route, plus a $1.4 billion standby from the Fund.

Chairman Martin then commented that in the various discussions in which he and Mr. Daane had participated they had taken pains to make it clear that they could not in any way commit the System to participation in the guaranteed sterling proposal, and that such participation would involve a change in the character of the System's operations to date. For one thing, a question might easily be raised whether a sizable amount of guaranteed sterling would not be a holding of investment character, because the British obviously wanted longer-term credit. Thus, the System would have to look at any such proposition carefully. He personally had been quite enthusiastic regarding the proposal that the Fund extend a $3 billion credit to Britain,[1/] [and Mr. Morse had also seemed encouraged.] (B of E) There was disappointment on learning that the Fund had reacted negatively. Yesterday morning he had suggested to Secretary Fowler that the latter might have a further conversation with Mr. Schweitzer to ensure that all aspects of the matter had been fully explored. Then he and Messrs. Fowler and Deming did have a luncheon meeting with Mr. Schweitzer, but they found the latter adamant on the $3 billion proposal. It appeared that Mr. Schweitzer probably would acquiesce in a $1.4 billion credit to Britain, though with some reluctance, but he would not agree to a $3 billion credit.

The Chairman added that the situation had been reported to the President late yesterday. Mr. Deming then left for Paris, where

1/ Part of a sentence has been deleted at this point for one of the reasons cited in the preface. The deleted material reported the reaction of a British official to the proposal under discussion.

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(Bracketed passage to be deleted)

Mr. Coombs replied that of the System's $200 million authorization to buy guaranteed sterling, about $90 million was in use at present; and of the Treasury's $300 million authorization, about $195 million was in use. Thus, of the combined authorizations of $500 million, $285 million was in use and $215 million remained available. System drawings on the swap network totaled $862 million at the moment, of which $300 million were drawn on the Bank of Italy, $262 million on the BIS and Swiss National Bank together, $150 million on the Netherlands Bank, and $150 million on the National Bank of Belgium. Arrangements had already been made to pay off $60 million of drawings included in the total, so that in effect the aggregate outstanding was $802 million. The System also had $500 million of technical forward commitments in Italian lire.

Mr. Coombs added that the System's outright holdings of sterling had been reduced to $4.5 million.1/ [If sterling should be devalued he would expect to receive word in advance, and would plan on immediately selling the System's remaining outright sterling holdings to the Bank of England at the present rate of exchange.] Over the past year he had followed the practice of converting to dollars all of the System's interest earnings on sterling. In that connection, there was some ambiguity in the Committee's foreign currency instruments. On the one hand, under paragraph 2D of the foreign currency directive he was authorized to adjust System balances within limits specified in the authorization for foreign

1/ A sentence has been deleted at this point for one of the reasons cited in the preface. The sentence reported a comment by Mr. Coombs regarding prospective Federal Reserve operations in sterling.

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(Bracketed passage to be deleted)

Mr. Coombs replied that it was often difficult to assess the real reasons for which people took particular positions, and he could only speculate about Governor O'Brien's reasons in the present case. Mr. O'Brien was the custodian of the reputation of the Bank of England, and no doubt was unwilling to have the Bank take on additional short-term debts when it could not guarantee repayment on the due date.1/ [One could not be sure about his real views as to whether sterling devaluation was inevitable, although he certainly had conveyed the impression that he was prepared to see it occur. He was as fully aware as anyone of the damage that would be done by devaluation; perhaps he anticipated a chain of events under which the sterling situation would no longer be a special case.]

Mr. Mitchell then asked whether the Fund's negative view on a $3 billion credit to Britain could be taken as an indication that the Fund management thought sterling had to be devalued.

Chairman Martin replied that it was hard to say. He had no information on the attitudes of the executive directors of the Fund, but from his conversations with Mr. Schweitzer he gathered that the latter had two reasons for his negative view on the $3 billion credit. First, he thought that so large a credit would endanger the entire structure of the Fund if anything went wrong. Secondly, Mr. Schweitzer apparently did not consider the economic case for the credit to be very good. In view of Britain's already large debts to the Fund and to others, he did not consider it desirable to extend another $3 billion credit to that country.

1/ A sentence has been deleted at this point for one of the reasons cited in the preface. The sentence reported a further comment by Mr. Coombs on the subject under discussion.

Mr. Daane commented that the question could be debated at length.1/ [The best judgment of the British seemed to be that if sterling was overvalued at present the amount did not exceed one or two per cent.] In the view of staff at the Board and the New York Bank, if there was overvaluation in a basic sense the margin was slim. Nevertheless, if the British devalued, they would have to move 10 or 15 per cent, with possible consequences such as Mr. Hayes had outlined.

Mr. Hayes remarked that there had been no indication in the discussions at Basle that the British would be prepared to devalue by as little as 10 per cent; they seemed inclined more toward 15 per cent if they were to devalue at all.

Mr. Daane noted that the British balance of payments experience had been favorable in the first part of 1967. Mr. Coombs added that their international payments had been in balance in the fiscal year ending in June, and probably would still be in balance had there not been hostilities in the Middle East.

Mr. Wayne observed that the type of assistance to the British now under discussion represented something of a departure from the character of past System operations in foreign currencies. He asked whether it was possible to indicate the specific consequences that would follow if assistance was not given to the British and sterling was devalued. He personally was inclined to share the concerns Mr. Hayes had expressed.

1/ A sentence has been deleted at this point for one of the reasons cited in the preface. The sentence reported a comment by Mr. Daane regarding the apparent position of the British on the question under discussion.

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(Bracketed passage to be deleted)

tremendous domestic importance in France. A breakout of the price of gold in Paris would thus put all parts of the French financial markets under great strain, and France might decide to follow Britain in devaluing its currency. That, of course, would magnify the tremendous pressures that were likely to be converging on the dollar.

(Treas.)

[Mr. Coombs went on to say that if the U.S. Treasury should decide in that eventuality to place an embargo on gold, repayment of the System's drawings under the swap network would not be possible unless the Treasury was willing to sell gold to the individual countries to which the System was indebted. Accordingly, he would recommend that the System move quickly to obtain an agreement in writing to the effect that, if it became necessary, the Treasury would provide the gold required to enable the System to meet its commitments. Until that point had been clarified he would recommend that the System be cautious with respect to any further drawings on the network, at least in sizable amounts.

In response to a question by Mr. Daane, Mr. Coombs said that under his recommendation the Treasury would be asked to commit whatever amount of gold would be required to repay the swap line debts of the System outstanding at the time. The amount that

1/ About 3 pages have been deleted at this point for one of the reasons cited in the preface. The deleted material reported a discussion of alternative possible means of ensuring that the Federal Reserve would be able to repay outstanding swap debts. The discussion culminated with an understanding that Chairman Martin would discuss the question with Treasury officials.

would be involved could not, of course, be predicted in advance. It had been clearly understood, throughout the period since the System first undertook foreign currency operations in 1962, that System drawings on its swap lines were for the purpose of avoiding or delaying purchases of gold from the Treasury by foreign central banks and governments. If an action by the Treasury prevented the System from repaying debts it had incurred for that purpose, to his mind the Treasury had a responsibility to provide the means for their repayment.

Mr. Daane commented that the Treasury might not have enough free gold to make good on the kind of commitment Mr. Coombs thought should be requested.

Other members noted that the System could free additional gold for that purpose by suspending the requirement for gold backing of Federal Reserve notes, and Mr. Daane rejoined that under the Federal Reserve Act any such waiver could only be temporary. He agreed that the System would face a serious problem if the circumstances Mr. Coombs had described eventuated. However, he was not sure it was realistic to expect the Treasury to agree in writing to sell whatever amount of gold was necessary to repay the System's swap drawings, since they could not be certain now whether they would have enough free gold for that purpose.

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(Entire page to be deleted)

(Treas.)

Mr. Mitchell asked why Mr. Coombs thought that an agreement of the sort he had suggested had to be made in writing. Mr. Coombs replied that the System had asked for and received certain statements in writing from the Treasury in connection with the package of credit assistance to the British arranged in September 1966, and a far more important problem was now facing the System.

Mr. Hayes commented that the difficulty Mr. Daane had noted might be met by asking the Treasury to commit some specific amount of gold for the purpose of repaying System swap drawings. While that amount might prove insufficient, it would at least give the System some leeway.

Mr. Coombs remarked that that possibility was worth consideration. The result, however, would be to paralyze the System's swap network beyond a certain point, which would mean that gold would then have to be paid out immediately as necessary.

Mr. Daane asked whether the understanding had ever been formalized that the Treasury would take over any System debts under the swap network that had run on for six months.

Mr. Coombs replied in the negative. Nevertheless, he said, there was no question that the understanding was clear; it had been acted on whenever System swap drawings reached the end of six-month terms during the whole period the swap network had been in existence. However, he thought it would be useful to formalize the understanding now.

Mr. Mitchell remarked that he would not favor issuing an ultimatum to the Treasury. In his judgment an appropriate method for dealing with the matter at hand would be for Chairman Martin to discuss the problem with Secretary Fowler.

Mr. Coombs said he was less concerned about the precise form of the assurance than with obtaining the assurance.

Other members of the Committee then concurred in Mr. Mitchell's suggestion, whereupon Chairman Martin said that he would take up the question with the Treasury.]

The Chairman remarked that the System was indebted to Messrs. Hayes, Daane, and Coombs for the long hours they had put in trying to find a solution to the problem under discussion.

Chairman Martin then observed that in light of the current international situation it seemed obvious that the Committee would not want to make any overt change in monetary policy today. No disagreement with the Chairman's statement was voiced.

Mr. Scanlon asked whether it was possible to estimate how long domestic monetary policy might be locked in by the international situation.

Mr. Coombs commented that if sterling was to be devalued, the action might be taken as early as tomorrow and probably by Friday of this week. It should be known by the weekend whether airlift gold from this country to London. Although under normal circumstances the Bank of England supplied market demand during the course of the month from its own reserves, private demand had been so heavy this month that the Bank of England's readily available supplies in London had been exhausted with last Thursday's transactions. Arrangements had been made to have gold held in London by the German Federal Bank and the BIS placed at the disposal of the Bank of England, in sufficient quantity to meet immediate demands, while "operation airlift" got into gear. While he would not go into the details, it was a formidable task to ship hundreds of tons of gold across the Atlantic and process them at the other end.

Turning to sterling, Mr. MacLaury noted that the New York Bank had provided a fairly detailed account of the final days of the $2.80 parity in its written report on recent foreign currency operations. As Mr. Coombs had mentioned at the previous meeting of the Committee on November 14, various types of credit packages were being discussed just prior to and at the time of the last Basle meeting on the weekend of November 12. In essence, the impasse was that continental central banks refused to provide credit to the British in the form of guaranteed sterling holdings although some of them were prepared to provide credit in the form of currency swaps; the Bank of England, however, was not prepared to take on any more short-term debt. At the initiative of 1/ [Governor Carli of the Bank of Italy,] a proposal for a $3 billion British standby credit

1/ Part of a sentence has been deleted at this point for one of the reasons cited in the preface. The deleted material identified the central banker who had made the proposal mentioned.

attributable to transactions undertaken at the initiative of their commercial customers or correspondent banks and were not the result of over-all short positions undertaken by the banks themselves.

The New York Reserve Bank staff was convinced that the case put to it was legitimate, Mr. MacLaury noted. It was also convinced that failure on its part to act would be detrimental to the reputation of the New York foreign exchange market and--unjustly--to the banks involved, and would also threaten to produce disorderly conditions in the exchange markets when sterling trading opened on Tuesday. Because of the limited time available, the New York Bank's staff simultaneously surveyed the positions of foreign exchange banks throughout the country with the assistance of the other Reserve Banks, sought the views of the Bank of England[1/] [--which concurred in a proposal that the System use holdings of guaranteed sterling for the operation--] and submitted the proposed transaction for approval to the Subcommittee of the Federal Open Market Committee established by paragraph 6 of the authorization for System foreign currency operations. The Subcommittee's approval was sought because an operation of the type under consideration was not explicitly authorized by the foreign currency directive, and there was insufficient time to consult with the members of the full Committee. (B of E)

With the concurrence of a majority of the Subcommittee, Mr. MacLaury observed, the New York Bank sold to commercial banks a total of $87.2 million of sterling, value Tuesday, at $2.40 and repurchased an equivalent amount, value Friday, at $2.3925. The

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1/ Part of a sentence has been deleted at this point for one of the reasons cited in the preface. The deleted material contained a comment by Mr. MacLaury on the attitude of the Bank of England toward the matter under discussion.

Mr. MacLaury replied that the sterling swaps made on Tuesday were heavily concentrated in one bank, but that bank was one of the most active foreign exchange traders in the market. Those made on Wednesday were more evenly spread among the total of ten banks involved. Details on the transactions with each bank would be included in the supplementary memorandum being prepared for the Committee.

Mr. Robertson said that, irrespective of any member's view of the operation, it should be noted that[1/] [the Bank of England had concurred in it, even though it suffered a loss as a result. The Bank of England also had provided sterling to the Bank of Canada to facilitate a similar operation.] Moreover, as Mr. MacLaury had reported, the German Federal Bank had provided such facilities to German commercial banks. (B of E)

Mr. Mitchell commented that he was not unhappy with Mr. MacLaury's explanation of the operation, although he would be interested in studying the more detailed memorandum when it became available.

Mr. Robertson remarked that in his judgment the Account Management was fully justified in carrying out the operation on the basis of the approval it had received from a majority of the Subcommittee. The main value of the memorandum, he thought, would be in helping the Committee to determine how it should react if a similar problem arose in the future.

1/ One sentence and part of another have been deleted at this point for one of the reasons cited in the preface. The deleted material contained comments by Mr. Robertson on the attitude of the Bank of England toward the operation in question and on certain other transactions.

1967 - Case 47
(Bracketed passage to be deleted)

In reply to another question by Mr. Galusha, Mr. MacLaury said that Britain's reserve position was negative at the moment.1/ [As of the Friday before devaluation they held exactly $45 million in foreign currency reserves and approximately $1.5 billion in gold. Their outstanding short-term debts were now close to $2 billion; they had borrowed the full $1,350 million available under the Federal Reserve swap line and over $500 million under the sterling balance arrangement.] (B of E)

Mr. Ellis remarked that one implication of the statement that the British had a free choice with respect to devaluation was that they had full opportunity to negotiate with respect to credit assistance. However, the press reports gave the impression that they were not really free to conduct confidential negotiations; that there had been deliberate leaks to forestall free negotiations. Would Mr. MacLaury accept that as another reason the British chose to devalue?

Mr. MacLaury replied that if the British had been prepared to accept short-term credits he thought the necessary arrangements could have been made expeditiously and confidentially, as had been the case in the past. It was Britain's refusal to accept additional short-term credit--and one could advance arguments for and against their position--that prolonged the negotiations and led to the leaks.

Mr. Swan commented that while the U.S. Treasury would sell gold only to central banks and governments, the London gold market

1/ Two sentences have been deleted at this point for one of the reasons cited in the preface. The deleted material contained details on the composition of Britain's reserves and short-term debts.

1967 - Case 48
(Bracketed passage to be deleted)

was to be overcome it would not be by words, but by actions following through on the measures announced simultaneously with the devaluation. Some question had been raised in connection with the discussions of the International Monetary Fund standby credit for the British as to whether the planned cutback of government spending was sufficient.

By unanimous vote, the System open market transactions in foreign currencies during the period November 27 through December 11, 1967, were approved, ratified, and confirmed.

Chairman Martin then invited Mr. Hayes to report on the developments at the meeting held over the weekend in Basle.

Mr. Hayes said he might comment first on the attitudes at Basle with respect to sterling, although that was not the main subject of discussion at the meeting. A good deal of uneasiness and skepticism about sterling was evident,1/ [some of which originated in the attitude of the Bank of England people themselves. The latter seemed rather discouraged and dubious about the probable effectiveness of the measures announced at the time of the devaluation. Governor O'Brien said that those measures were not sufficient and that the Bank of England would press for additional measures. That comment did not add to the confidence regarding Britain's determination to do what was necessary.]

1/ Three sentences and part of a fourth have been deleted at this point for one of the reasons cited in the preface. The deleted material consisted of further comments by Mr. Hayes on the subject under discussion.

1967 - Case 49
(Bracketed passage to be deleted)

In reply to a question by Mr. Mitchell, Mr. Hayes said that Governor Brunet of the Bank of France had been invited to the Sunday night dinner given by the BIS, but had not attended because of illness.1/ [When arrangements had been made for the late-November meeting in Frankfurt it had been mutually agreed that French participation would not serve any useful purpose and the same conclusion had been reached with respect to the meeting with Mr. Deming yesterday. He should add that the question of French participation in such discussions posed a difficult problem, since the other countries in the Common Market were acutely aware of the splitting of their group. They were exasperated with France's attitude and were quite willing to pursue the matter of the gold market with the United States. However, they felt that if measures were to be taken with respect to the London gold market, at some juncture France should be urged to cooperate with those measures, and they had some confidence that France would in fact cooperate.]

In reply to a question by Mr. Mitchell, Mr. Solomon briefly outlined the policy position on gold the U.S. delegation had in mind when it left the country to attend yesterday's meeting in Basle.

In reply to questions by Messrs. Wayne and Hickman, Mr. Hayes said the whole emphasis of the discussion in Basle of the United States situation was that action by this country was required first, to adopt appropriate fiscal and monetary policies,

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1/ Four sentences have been deleted at this point for one of the reasons cited in the preface. The sentences reported further comments by Mr. Hayes with regard to French participation in discussions of the London gold market.