TRANSCRIPT

FEDERAL OPEN MARKET COMMITTEE MEETING

February 15, 1977

Prefatory Note

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

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

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

Staff Statements Appended to the Transcript

Mr. Sternlight, Deputy Manager for Domestic Operations

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Meeting of Federal Open Market Committee

February 15, 1977

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D. C., on Tuesday, February 15, 1977, at 9:00 a.m.

PRESENT: Mr. Burns, Chairman
Mr. Volcker, Vice Chairman
Mr. Balles
Mr. Black
Mr. Coldwell
Mr. Gardner
Mr. Jackson
Mr. Kimbrel
Mr. Lilly
Mr. Partee
Mr. Wallich
Mr. Winn

Messrs. Baughman, Guffey, Mayo, and Morris, Alternate Members of the Federal Open Market Committee

Messrs. Eastburn and Roos, Presidents of the Federal Reserve Banks of Philadelphia and St. Louis, respectively

Mr. Broida, Secretary
Mr. Altmann,1/ Deputy Secretary
Mr. Bernard,1/ Assistant Secretary
Mr. O'Connell, General Counsel
Mr. Axilrod, Economist (Domestic Finance)
Messrs. Brandt,1/ Davis,1/ Keran,1/ Kichline,1/ Parthemos,1/ Reynolds,1/ and Zeisel,1/ Associate Economists

1/ Attended part of Tuesday session only.

Mr. Holmes, Manager System Open Market Account
Mr. Pardee,1/ Deputy Manager for Foreign Operations
Mr. Sternlight,1/ Deputy Manager for Domestic Operations

Messrs. Coyne and Keir,1/ Assistants to the Board of Governors
Mr. Ettin,1/ Associate Director, Division of Research and Statistics, Board of Governors
Mr. Truman,1/ Associate Director, Division of International Finance, Board of Governors
Mrs. Farar,1/ Economist, Open Market Secretariat, Board of Governors
Mrs. Deck,1/ Staff Assistant, Open Market Secretariat, Board of Governors

Mr. Van Nice, First Vice President, Federal Reserve Bank of Minneapolis
Messrs. Balbach,1/ Boehne,1/ Davis,1/ and Scheld,1/ Senior Vice Presidents, Federal Reserve Banks of St. Louis, Philadelphia, Cleveland, and Chicago, respectively
Messrs. Davis,1/ and Green,1/ Vice Presidents, Federal Reserve Banks of Kansas City and Dallas, respectively
Mr. McNees,1/ Assistant Vice President, Federal Reserve Bank of Boston
Mr. Kareken,1/ Economic Adviser, Federal Reserve Bank of Minneapolis
Mr. Hill,1/ Senior Economist, Federal Reserve Bank of New York

1/ Attended part of Tuesday session only.

Transcript of Federal Open Market Committee Meeting of
February 15, 1977

[Executive session]

CHAIRMAN BURNS. Good morning gentlemen. I was just about to apologize for being late, and I am sorry, but I had a breakfast meeting and I couldn't get away on time. But a colleague of ours suggested that this might be a 10-minute meeting, and in view of his wise pronouncement, I am not going to apologize. But I am sorry to be late.

As you all know, we have planned a luncheon to honor one of our colleagues, Lyle Gramley, who has left the Federal Reserve but has not left this city.

We will begin this meeting in executive session with a report by Mr. O'Connell, who will recommend to the Committee that the FOMC agree that the meetings of the FOMC are not covered by the [Government in the] Sunshine Act.

Now, just a word of introduction. This is the finding by Mr. O'Connell, and he has done very extensive research on the subject. His conclusion is firm. I have been keenly aware of the fact that this conclusion, if adopted by the Committee, could cause us some difficulty on Capitol Hill because some members of the Congress interested in the Sunshine law apparently have been under the impression that the FOMC is covered. And I've been a little concerned about the finding by our counsel on the ground that some members of the Congress interested in this subject might propose an amendment to the Sunshine law under which we might lose the two amendments we want. We fought hard to win and we finally did win at the last session of the Congress.

And therefore I have discussed this subject with considerable care with Senator Ribicoff, Senator Percy, Senator Chiles, Congressman Brooks, and Congressman Fascell, and I have also talked this over at length with John Gardner of Common Cause. And as you may know, John Gardner and his group played a very important role in getting this legislation enacted. I wanted to make sure that this finding by our counsel is not interpreted, first, as a circumvention of law, and second, that there will be or may not be a move in the Congress to amend the Sunshine Act. These conversations with the members of the Congress have gone well, and they understand the position that Mr. O'Connell has reached, which I am recommending that the Committee adopt. We don't have any actual assurance that there will not be congressional action, but as of today I have no reason to expect it. That's all by way of introduction, and the floor is yours, Tom.

MR. O'CONNELL. Mr. Chairman, the members of the Committee have, I believe, received [in] advance [of] the meeting [the] memorandum of law setting forth, as the Chairman has indicated, the conclusion that I have reached on researching this issue. And accompanying that memorandum was a proposed statement of policy that I have recommended, and with the concurrence of the Chairman, the language has been adopted for the Committee's study [unintelligible] the position that I recommend. May I take just a few brief moments and restate, in summary form, what I believe is a sustainable position with reference to the outcome of the study?

The issue, of course, is whether the legislative history of the statute can reasonably be read to exclude the FOMC from its coverage. As you have read in the memorandum page position guide, certainly by definition of the term “agency,” which is contained in the statute, there are three basic tests that an agency must meet as to whether it’s covered. One is whether it’s an agency as [defined] in that statute. The Committee is such an agency. Second, whether that agency membership is composed of [unintelligible] Committee meets that requirement test. And the third is whether two or more of the members of such collegial bodies have been appointed to such position by the President of the United States with the advice and consent of the Senate. If that final test is met, the agency is covered. And of course it is on that last, third criterion that I have taken the position that the FOMC is not covered.

[Unintelligible] the [Federal Reserve] Board members, of course, are appointed to the Board by the President with the advice and consent of the Senate, but they are ex officio members of the Committee--by statute, members of the Board are designated as members of the FOMC. And, of course, at any given time, the five [Reserve Bank] Presidents serving [as voting members of the FOMC] are not appointed by the President with the advice and consent of the Senate. So the [FOMC] does not meet the so-called agency test within the meaning of the statute. Nor, in my judgment, is the FOMC in any sense to be considered to be the subdivision of the agency [that is, the Federal Reserve Board], which is also a component part of that definition.

On examination, there is no function performed by this Committee that can be said to be the result of, or the direct follow-up of, the delegation of authority under the Board committee. Its principle functions are defined by statute and by some regulations issued pursuant to that statute. The Committee is a functioning agency for other purposes and within the meaning [of] the law. The Committee knows it is an agency within the meaning of the Administrative Procedure Act--which is [unintelligible] USC. The Committee is an agency and has taken that position with respect to the Freedom of Information Act. But for purposes of the Sunshine Act, I am perfectly well satisfied that the start [unintelligible] the composition of the Committee as explained by statute, viewed in the light of the definition of agency within the Sunshine Act, reasonably postures the Committee [as] not being covered by that act.

I cite in my memorandum, Mr. Chairman and members of the Committee, statutory reference to the historical points, as this bill was going through the Congress, that support this position, one such being the extract, contained in the memorandum, of an exchange by Ms. Abzug, sponsor [of the] bill in the House. When asked by a member of the Congress as to the actability of the term “agency,” she very clearly stated that the test of agency status is the definition itself. And she gave an example of an ex officio status of an agency that would not be covered by the act for the simple reason that the members were not appointed to such position by the President. Although she admitted that they were appointed to another position by the President, it was the body of which the question raised the statute’s actability that was the test that’s forming that same rationale that we shall have.

I must admit, there is contrary legislative history in the form of the debates on the floor of the House. But I point out that, on careful study, I adjudge those quoted portions of the debates to have assumed the status of coverage for the FOMC and then to have discussed other collateral issues such as who is a member--assuming that the agency is covered--such as the right to close a meeting and withhold a transcript. In that exchange it was assumed that the FOMC was mentioned in these two or three phases. The sentence carried was something like: the FOMC, it can close its meetings. So it was a stated assumption without itemized evaluation of the language and statutes.

Overall, I adjudge the legislative history to [be] balanced in favor of the position that is contained in the memorandum and as reflected in the statement policy--the recommendation for adoption of that statement. I submit that it has been very carefully prepared to adhere as closely as possible to the language of the statute without exaggerated statement of the Committee's position. That, upon examination of its own operating procedures, the Committee has determined that its present procedures, if continued to be followed--even though it demurs from the position of legal technical coverage by statutes--in fact [demonstrates] compliance [with] the spirit of the Sunshine Act.

And more particularly, the Committee under its present practice releases its Record of Policy Actions roughly a month following each of the respective meetings, and as now written [because of] the Committee's action of several months ago, [the Record] is a very full text when compared with coverage [required] by the Sunshine Act. Under the technical terms of that act, the Committee could hold major portions, if not all, of certain transcripts for months, even a year, or whatever period that the Committee determined [was required] under the particular exemption. As now written, there is basically nothing that is withheld per se [from] the Record of Policy Actions, which is released about a month after the meeting.

So in that sense, and as the Chairman has advised each of the members of Congress with whom [he spoke], we feel that there is full deliverance in the spirit of the Sunshine Act, and that we can go forward in that spirit, and that we are not in any sense cutting short the rights of the public with respect to the Sunshine Act. Mr. Chairman, I think those are the points I wanted to cover.

MR. ROOS. Mr. Chairman, does the emphasis that we're placing on this argument on whether or not members of the FOMC are appointed by the President, confirmed by the Senate, does that strengthen Mr. Reuss's position on the appointment of Reserve Bank Presidents, and will that stimulate further efforts on his part, based on this Government in the Sunshine issue, to try to force through Congress the bill that he was unable to get out of the Committee last year? Is that--

CHAIRMAN BURNS. Let me make an introductory comment and then turn the legal question over to Mr. O'Connell. All that we intend to release to the public is the statement of policy described as attachment B rather than the lengthy legal opinion that has been developed by Tom O'Connell. I think the legal opinion is a document to this Committee, and there is no intention to release that. Tom would you be good enough to--

MR. O'CONNELL. Mr. Roos, as you well know, it's difficult to respond to what will trigger Mr. Reuss into further action. The Reuss suit is now on appeal, and I should advise the Committee that, at this time, the burden is on Mr. Reuss's counsel to file his brief in support of his appeal. As of last night he had not filed the brief, so I don't know particularly the points he would make. It is possible, if he knew of this content, he could [use] the thesis of this position against us. I have thought this out. I have discussed it with my colleagues. None of us, including myself, is [of] the view that it [unintelligible] would weaken [our position in] the Reuss suit. I am not aware, really, of any rationale. It is possible he could attempt to interpret the Sunshine Act--

CHAIRMAN BURNS. Yes, Mr. Black.

MR. BLACK. Tom, is it possible we might do that all the time, not issuing our statement of position but the other actions which we worked on under the Government in the Sunshine Act?

MR. O'CONNELL. I am sorry, Bob, I didn't hear the last part--excuse me.

MR. BLACK. I was just saying is it possible that it would be better if we did not adopt the first part of the recommendation, issuing a statement that we don't think we [are] covered, [unintelligible] merely acting as if we were.

MR. O'CONNELL. I have an opinion on that President Black. To the contrary, I believe that our position is far better secured by the issuance of a statement of policy of the nature I have recommended--similar to the action by the [Federal Reserve] Board several years ago, when we issued a statement of policy with respect to the System's position on labor management.

In this case I have had calls from a number of public interest groups, I have had calls from the Hill, from the editors of the two newspapers, stating an assumption that the recently published Board regulations under Sunshine as they were released here some two weeks ago were seeming to cover the FOMC. "Do they cover it?" And my response has been that the matter of coverage of the Sunshine Act has yet to be determined by the Committee, and shortly we would announce the position.

I am concerned that if we don't publish a statement of policy in which we forthrightly set out the Committee's position and explain at the same time equal exposure as if covered, we will either have law suits compelling the publication of regulations or constant demand when they hit at us--"where are [the] regulations?" This will at least serve that purpose, so the public will know there will not be regulations covering the FOMC.

CHAIRMAN BURNS. There is an additional comment. We've been advised by two of the men whom I mentioned--very influential, greatly involved in this legislation--to put out such a statement of policy.

MR. GARDNER. Tom, isn't it true that we cannot pretend that we are covered by the Sunshine Act because a part of what you have to do is public [announcement of] regulations [regarding our operations under the Sunshine Act], if in fact you are covered by the Sunshine Act? We have already gone past the [deadline] date on that.

MR. O'CONNELL. Well, Governor, your point is well taken. Sitting now at the [15th] of the month, if we were to issue today a proposed regulation covering the Committee [under the

Sunshine Act] and allowed 30 days [for comment], as required by law, we are then at March 14, two days subsequent to the release date. Better late than never would be the attitude we [would] have to exhibit. If the Committee adopts the statement of policy, [and] we are sued, and a court were to require us then to [be covered] under Sunshine, and then we issued [our] regulations [regarding our operations under the Sunshine Act], we'd be even that much more late, so the matter of a few days I think probably wouldn't be at all decisive.

I should say, Mr. Chairman, and Governor Gardner's question [unintelligible], I believe I mentioned in a previous Committee meeting that I have great difficulty in lightly recommending that this Committee adopt the position of coverage when there is a clear appearance of noncoverage. [My difficulty is] that I don't know the administrative capability, under law, of an agency taking [upon] itself the [decision regarding its] coverage [under] a statute where it implies--and as a matter of fact, expressly involves--cutting the time in which the agency has to answer a suit under the law. [The Act] gives jurisdiction [to] many courts of law that otherwise would not have jurisdiction over this Committee [regarding] an ordinary lawsuit. It renders certain of the rights of this Committee negative by law, and I don't believe that the Committee has the right as a matter of law to adopt these positions, thus covering up [unintelligible]. So it would take an act of Congress or a declaration by a court of law, in my judgment, to cover us under this law.

CHAIRMAN BURNS. There are two supplementary observations that I would make. One is that the point that Tom has just made was made--Tom accompanied me to the meetings--with the legislators, and Tom developed this legal point in great detail, and the members of the Congress with whom we met were very much impressed by it. That is point number one.

Point number two, if the mood should develop within the Congress to amend the Sunshine law on the grounds that here is a loophole, and the loophole ought to be closed--if a serious move along these lines developed, then I might very well come before the Committee and suggest that we take the step of declaring ourselves as coming under the law in spite of the legal difficulties that Tom has mentioned. And that is simply something that may develop. As of today, I don't think that will develop in the Congress, but it may.

MR. O'CONNELL. Mr. Chairman, may I add to a point that I wanted to make? As a result of one of the visits the Chairman made to the Hill, a member of the Senator's staff, at the Senator's suggestion, referred the sole issue of law to the congressional library's law division, and without reference from us but from the Senator's office. And a memorandum of law was delivered from the congressional law library stating that its study of the statutes as applied to the FOMC led to the very firmly stated conclusion that the FOMC was not covered by the Sunshine Act for the very reason that we had argued. And we had not contacted [them], and [it was] an independent legal memorandum, stated in one paragraph.

MR. EASTBURN. Mr. Chairman, you mentioned today in a memo about the National Security Council, are there other agencies which come under this--

MR. O'CONNELL. May I respond to that? President Eastburn, [subject to] judicial [determination] or a declaration one way or the other, the Joint Chiefs of Staff [have a statutory] position on the National Security Council, the Loan Guarantee Board probably would be an example, the [unintelligible] President's advisors, apparently do not come under [the Sunshine law] for the same reason that they are ex officio members of the bodies that I mentioned. It is estimated that there may be as many as 10 agencies that are similarly situated.

CHAIRMAN BURNS. Any other questions? Well, if not, the recommendation by our counsel is before the Committee, and I think we need to vote on it formally. Is there a motion to approve? The motion has been made and seconded. Is there any objection?

SPEAKER(?). I would like to comment. I think it has been very thoughtfully researched, and I think all of us recognize that. And I guess, even with that, in reading [the memorandum], I was not overly impressed with taking that move. But I think your visits with the other people have convinced me that maybe this is well and wise.

CHAIRMAN BURNS. Well, I have not been either, and I kept on pressing Tom O'Connell on the point: Well, why not say that we are covered, since actually we are observing, we can live under, the Sunshine [law]? We've gone beyond the Sunshine law because the Sunshine law would be satisfied if we merely kept detailed minutes. We not only keep detailed minutes, we make them public. We make them public fairly promptly.

I kept pushing Tom on that, and I reviewed this question in some detail, that is, through Tom largely and with members of the Congress. And Tom's legal reasons, I must say, carry more weight with members of the Congress than they did with me, probably because they are lawyers and I am not. I think the position recommended is probably the best position we can take at this time.

Any dissent from Mr. O'Connell's recommendation? All right, the Committee will be recorded as being unanimous on the point.

While we are on these legal questions, let's get through with item 3 on the agenda, the Committee's information rules--some technical points you want to call the Committee's attention to?

MR. O'CONNELL. Yes, Mr. Chairman, I do. And very briefly, Mr. Chairman, the memorandum deals with the provision in the Committee's regulations with respect to the availability of information which at present [is] exempt from release under the Freedom of Information Act--memoranda and materials to the Committee that are authorized by statutes to be withheld from the public. At the present time, we have no specific statutory exemption that is apt, nor have we had challenge nor direct [unintelligible] applicability of the provision.

But in 1975 the Supreme Court of the United States had reason to address the issue of the applicability and coverage of the so-called third statute exemption in the suit involving the FAA administrator against Robertson. In that case, a challenge was made to the breadth of discretionary coverage of the statutory provisions. The Supreme Court determined that any time a statute gives an agency discretion to withhold certain information, even though the standards for withholding are extremely broad and discretion in the administrator is broad, that exemption applies.

This concerned a number of public action groups that addressed the issues to Congress. And [at] the time the Sunshine Act [was] before the Congress for consideration, these groups got language before the Congress that would closely limit and narrow the interpretation of exemption 3 of Sunshine as pronounced by the Supreme Court. As a result, and as contained in the memorandum that is before the Committee, by law, as in the law of the Sunshine Act, that exemption is now far more closely and tightly limited in its use. With the three circumstances set forth in the memorandum, namely, that you have to have a specific statute authorizing specifically withholding in a nondiscretionary manner--or if discretion is granted by the Congress, with the standards, the benchmarks, the factors that [show] the agency follows that exemption and the guidelines [unintelligible] so that a member of the public can look at that exemption and the guidelines and know precisely what the agency may withhold.

It locks our discretion, that's the name of the game. This statute, the Sunshine Act, has amended the [Freedom of Information Act], making mandatory the adoption of those standards by each agency. For that reason I presented it in an amended form to the Committee for adoption. I don't know and can't anticipate when the Committee will have to apply it. Hopefully it won't be soon. But on adoption, Mr. Chairman, the Committee will now act and report [unintelligible].

CHAIRMAN BURNS. Are there any questions? Does this require us to [unintelligible] the Committee's actions?

SPEAKER(?). I move that we adopt the proposal.

SPEAKER(?). Seconded.

CHAIRMAN BURNS. Any questions? All right, we will consider Mr. O'Connell's interpretation and recommendation [to be] adopted.

[End of executive session]

We now need to act on the minutes of the January meeting. Is there a motion to approve? A motion has been made and probably very most inaudibly seconded. I hear no objections, and therefore we move on to the report by Mr. Holmes on foreign currency operations during the past month.

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

CHAIRMAN BURNS. Thank you, Mr. Holmes. Are there any questions?

MR. COLDWELL. Are you able to buy your Swiss franc repayment in francs out of the market primarily, or are you drawing it from the Swiss?

MR. HOLMES. We are buying directly from the Swiss primarily. We have had occasion to buy Swiss francs from some of our correspondents who have been sellers. So we buy them directly at market rate. We have never really gone into the market. Really, it hasn't quite been that good. We hope to, over time.

MR. COLDWELL. Does the market know this?

MR. HOLMES. We see no impact of any of this on the market. I think the market has assumed, and rightly so, that we are buying mainly directly from the Swiss National Bank.

MR. PARDEE. All press releases we have had have indicated that it would be done directly [with the Swiss authorities] to avoid any market impact.

CHAIRMAN BURNS. Well, we haven't made a commitment to that effect, have we?

MR. PARDEE. No. It is one of three options. And to some degree we are buying German marks and French francs in the market, which we then supply to the Swiss when they need them. And the other options.

CHAIRMAN BURNS. Any other questions? All right, a motion to confirm the transactions of the foreign desk is now in order. Motion is made and seconded. Any dissents? Very well, do you have any recommendations, Mr. Holmes?

MR. HOLMES. Mr. Chairman, for once we have no swaps maturing in the period ahead, and so I have no recommendations to make to the Committee.

CHAIRMAN BURNS. Well, no one will object to that. We will now ask for consideration of the economic outlook. Mr. Zeisel, will you be good enough to report to the Committee.

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

CHAIRMAN BURNS. Thank you, Mr. Zeisel, for your report, and we'd now like to hear from members of the Committee. I think it would be particularly helpful to have any views on the economic outlook that diverge from the staff opinion expressed by Mr. Zeisel

MR. BLACK. In trying to prognosticate what lies ahead, I guess I generally tend to think in terms of probabilities, Jerry, and I come out thinking that what the staff has done this time has a pretty high probability of happening. I am right with you this time, more closely than I have ever been.

What I am wondering about is another scenario, as to how likely you think [it is that] this might happen. In a period now when inflation expectations seem to be strengthening and you have had some shortages and fuel problems and so on, what probability would you attach to the possibility that we might have an inventory cycle built up here, unreasonable levels that might cause trouble later on.

MR. ZEISEL. We've taken the optimistic tack, assuming that the caution that businessmen have evinced in their treatment of inventories over the last several quarters will continue, and they will not be panicked into a rapid increase in inventory investment during the second and third quarters when we get these temporary surges. After all, they were burned in 1975, but I must say that they could well be burned again, in the sense that we might very well have a rapid increase in inventory investment and then face the situation in which final sales do not support that rate of inventory accumulation, and we move into an inventory adjustment toward the end of the year. In terms of the probabilities, I hate putting numbers on things, but maybe I'll say one in three.

CHAIRMAN BURNS. What was that?

MR. ZEISEL. One in three, possibly.

MR. BLACK. I guess that's even higher than I would have put it. That is real interesting.

MR. PARTEE. What is a normative figure on inventory accumulation now? Do you sort of assume close to 1 percent of GNP would be a normal figure?

MR. ZEISEL. Well, the postwar average, as you know, was about 0.9 [percent], and our assumption more recently has been somewhat under that. And we have averaged somewhat under that for this period. We rise to above that rate toward the end of the projection period.

MR. PARTEE. For next year. The whole of this year is well below that.

CHAIRMAN BURNS. I would add only this comment. I would expect that, before this year is over, we'll run through an inventory cycle, induced in part by weather developments, induced in part by the Administration's fiscal package with its emphasis on the so-called rebate. And therefore I believe that all of us should pay far closer attention to final sales as the year unfolds rather than to a couple of GNP figures. Mr. Baughman, please.

MR. BAUGHMAN. Mr. Chairman, a number of somewhat disconnected comments. First off, it seems to me that a reading of the Redbook this time [was] rather interesting. Notwithstanding the great number of very unusual and generally adverse developments around the country, [in] almost every district there is a very strong flavor of optimism in the report and also a very strong flavor of adaptability and adjustability of the local economy to unusual developments. It seems to me that [is] there to an unusual degree this time.

With respect to the inventory question which Mr. Black has raised: At our recent directors meeting,--where we had two retailers represented, one nationwide and one regional--this question was discussed, and they were of the view that retailers will not make the mistake this time that they feel they made a year ago, in which they had to, as they feel, sell excessive inventories at substantial price reductions. The question was raised as to whether they might make the opposite mistake this time, and they seem not to be concerned about that.

CHAIRMAN BURNS. That's what I always hear from bankers--they won't make mistakes in the future.

MR. JACKSON. Are you speaking of commercial bankers or central bankers?

CHAIRMAN BURNS. Well, I was thinking of commercial bankers. I have no difficulty with your generalization.

MR. BAUGHMAN. We're in a very strong economic environment in the Southwest, which of course traces largely to the oil and gas business and, I suppose, in part to weather. There were reports from all members of our board of directors, who have had a wide range of contacts during the past month, that they can recall no time when they have had so many inquiries about industrial sites in that part of the country. And they are anticipating that the trend to move to that part of the country is going to substantially accelerate. And it's a rather substantial trend at the present time. You know, it's possible that this is simply weather talk, in view of the fact of the recency of the weather phenomenon. But there is a feeling that there is a good deal of substance to it.

Notwithstanding the fact that it's a prosperous area, it is a capital deficit area, and we had reports that there is a continuing improvement in the availability, and continuing improvement in the sense of more favorable terms, on funds to flow into the area. This is more obvious, of course, in the construction and real estate development area. It is reported from some individuals in the area who deal largely with small companies that the same thing is reflected in that they can now place stock privately in small companies in a much more effective way than they have been able to do in the past year or two.

With respect to the outlook for the prime rate on business loans, we had a variety of views expressed, but the one banker who has been closest to the mark during the past two years very interestingly expressed the view that the next move is more likely to be down than up. That is all I have.

MR. MAYO. Did he say why?

MR. BAUGHMAN. Because the loan demand is not that strong, and the availability of funds is continuing to improve.

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

MR. KIMBREL. Mr. Zeisel, you refer to minimum likelihood of the labor force negotiations this year, I wonder if your projections have accorded any dimensions to the possibility [of an] increase [in] the minimum wage.

MR. ZEISEL. Yes, we have incorporated the minimum wage increase that occurred January 1st into our projection of the--

MR. KIMBREL. I really had in mind any further increase though.

MR. ZEISEL. No, that is all we have incorporated. Anything else that may occur, of course, would add to the pressure. This increase in the minimum wage, to $2.30, affected--our guess is--about 2 million people, to some extent in residential construction and to some extent in trade and services. It is hard to know how much of an effect it has. It certainly has a tendency to push everybody up slightly. That is, we have an estimate in the first quarter of the impact of that on our wage costs.

CHAIRMAN BURNS. I am surprised by your reference to construction.

MR. ZEISEL. Apparently there are, in some parts of the country, relatively low wage construction people. I don’t think that’s the major group.

CHAIRMAN BURNS. Where wages of some construction workers are or have been below the present minimum of $2.30?

MR. ZEISEL. So I have been told.

CHAIRMAN BURNS. That is interesting. I didn’t realize that.

MR. COLDWELL. A lot of non-unions.

CHAIRMAN BURNS. Even so, it isn’t--any facts that you may be able to present on that, I for one would like very much to see [them]. That surprises me.

Any other questions, Mr. Kimbrel? Thank you. Mr. Winn now, please.

MR. WINN. Mr. Zeisel, in trying to assess the impact of the proposed universal welfare payments, to what extent have you adjusted the prospects in terms of the ’75 experience, where the ’75 payments came in a period following some declines in consumer credit outstanding? This will come [when] consumer credit outstanding has been increasing and perhaps deteriorating in quality. In other words we may not get the same impact this time as we did in ’75 because of the difference in credit circumstances.

MR. ZEISEL. You are perfectly right. There were a number of factors operating in ’75 that are not exactly similar to that here, and we may very well get a somewhat larger total effect from the rebate. However, I must say, we’ve used ’75 as a base for making our estimates of the impact of 1977 rebates, with a few judgmental adjustments for those special factors.

MR. PARTEE. You thought, Willis, that more will be used to begin to repay debts?

MR. WINN. Yes, and utility bills. You don’t have any penalty now, interest rate or anything else, on utility bills, so they can accumulate without being cut off. No interest payments, and some of those are climbing. The credit situation is not so good, so you may not get the multiplier effect that you got before.

CHAIRMAN BURNS. We didn’t get much of a multiplier effect last time.

MR. WINN. No, but look at what happened to consumer credit as a result of ’75; it really spurted, and then combined with these payments--

MR. PARTEE. Well, car sales went up. That’s why you’ve got consumer credit.

MR. WINN. That’s right. And that may not happen.

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

MR. MORRIS. Mr. Chairman, I think there is a need for the Committee to make policy in a longer-term time frame than we've been accustomed to. I thought I would ask if the staff has a concept of what the optimum growth path ought to be for the economy over the next few years, and if so, how does the projection for '77 relate to that time path.

MR. ZEISEL. Well the projection for '77 that we have is approximately a 6 percent rate of real GNP growth; that is the average of the four quarters, which would accomplish a moderate reduction in the unemployment rate--we anticipate getting down to 7 percent, or that general magnitude, by the fourth quarter. I think one has to make judgments about the implications of the rapidity of making that kind of progress for considerations like inflation. I think the approach that would involve a moderate rate of improvement over a period of several years is the more sensible one, and I think this rate of growth of approximately 6 percent, possibly a little bit larger than that, is consistent with something close to an optimum, given the continued sensitivity in the economy to inflationary anticipations. I think that's a critical dimension here. One can set various goals, after all, and can push the economy to reach those goals at greater or lesser speed. But to the extent that our judgment is that the rate of increase that we have projected appears consistent with no increased inflationary pressures, this suggests that we may be on the right track.

CHAIRMAN BURNS. Mr. Zeisel, am I right in thinking that the staff, in considering the longer-run trend of the economy, is now thinking of a rate of growth, over the long term, of 3-1/2 percent for real GNP for a year, in contrast to the figure that has become standard in the literature--4 percent?

MR. ZEISEL. That's correct.

CHAIRMAN BURNS. Recognizing the flattening out of the trend of productivity--

MR. ZEISEL. Productivity has weakened. and that has reduced the trend, correct.

CHAIRMAN BURNS. --so, without being able to specify the details, a 6 percent rate of growth this year, let us say, merging into a 3-1/2 percent figure over the longer run, assuming a reasonable development of the economy. Is that the correct statement?

MR. ZEISEL. That is right.

MR. PARTEE. It would take a number of years at 6 percent--

CHAIRMAN BURNS. --to accomplish that--well, that is to say, 6 percent growth or something higher than 3-1/2 percent.

MR. PARTEE. Literally looked at, the unemployment rate drops to 7.1 in its projection over the year; with 6 percent growth, [unemployment drops] from 7.9 to 7.1. That is an 8/10 [percentage point] reduction. So it would take another couple of years to get down.

MR. MORRIS. I think a kind of interesting development in the New England academic scene--we have Otto Eckstein, for example, coming out now with the concept that we really had not better plan for a rate of growth on the average over the next four or five years in excess of 5 percent--5 percent is really the outside limit, and the Phillips curve will rise very sharply with a growth rate in excess of that.

VICE CHAIRMAN VOLCKER. It's an undesirable growth rate?

MR. MORRIS. It's undesirable, right.

MR. WALLICH. Even temporarily? On the way to recovery or to some full employment goal?

MR. MORRIS. I think that's the implication. I think so. But he also argues that this path, which would get us to about 5-1/2 percent unemployment in 1980--that, at that time, we are likely to [have] approximately the same degree of strain on capacity [for] basic materials that we encountered in 1973. Now, I don't know how, I'm curious to know if you would share this particular view?

VICE CHAIRMAN VOLCKER. Let me just sharpen this question a bit, if I may. I have seen calculations which suggest, I think on an economic outlook very similar to the one you have projected--about the same rate of growth--but by the second half of 1978, also given projections of this sort for plant and equipment, we will be back at the 1973 operating rates on the average, maybe as early as the midpoint of next year. Is that what your calculations--

MR. ZEISEL. Well, as I recall it, our calculations for capacity use in manufacturing bring us to about 85 or 86 [percent] by the middle of next year. And that is beginning to move--

MR. PARTEE. It was about 87-1/2.

VICE CHAIRMAN VOLCKER. It was about 88, I think, so that would probably bring it to 88 or beyond by the end of next year.

MR. ZEISEL. About, by the end of next year. I think one can view this in several ways. One, of course, is to argue that one ought to have some sort of steady-state pattern throughout the period toward an objective. One can operate reasonably with a slightly more rapid rate of increase in the early period, moderating down as you approach fuller use of capacity and begin to get close to the danger zone. The argument in favor of this would be, of course, to reduce social costs in the early stages, where you still have extremely high rates of unemployment.

CHAIRMAN BURNS. Any further questions along these lines?

MR. JACKSON. Mr. Chairman, I will just say that all of this assumes that we will have had a relatively strong sustained rate of growth for three full years after the trough. And that may or may not occur. Well, I begin to question the validity of that strong a rate of growth for that long a period.

VICE CHAIRMAN VOLCKER. The dichotomy we have here is that maybe we have not much excess capacity on the physical side and we've got lots on the employment side. In a way, it's getting worse, but that depends on what the labor force is going to be doing, too. I don't know what kind of projection you have on the labor force.

MR. ZEISEL. Our projections on the labor force are [for a] less rapid pace than we had last year. We're figuring on about a 2 million rate of growth in numbers for 1977 versus about 3 million in 1976. That is larger than the average and larger than the growth in population [and it] assumed continued increase in participation of women largely--

MR. PARTEE. It would depend on how it is distributed, too. If you remember '73, it was rather a surprise that we had that much inflationary pressure with that level of capacity utilization. It was, of course, reported lower than it is now. It's been revised. But nevertheless, it seemed as if there were lots of pressure points. And if you had a more general distribution of demand so that we might not have a repetition of that--it would depend on the precise character of the forecast.

VICE CHAIRMAN VOLCKER. I agree it depends on the precise character of the forecasting of the distribution, but do you have any reason to think ex ante that it's going to be better distributed this time?

MR. PARTEE. Well, I wouldn't expect any 20 percent devaluation. And I think that had a major effect on that rate of inflation in 1973.

MR. WALLICH. Well, I see things somewhat as Mr. Volcker does. I note all sorts of arguments as to why capacity pressures are not likely and why the experience in '73 and '66, when it went to 89, is not relevant. But nevertheless, I think we have the fact that we've greatly changed our data and that these do show that we have a good deal less capacity. We know now it takes a lot more time to bring capacity on stream. Somebody here the other day said that, on some project, it took five years before you could put a spade in the ground. And under those conditions, I'm not very hopeful that these capacity margins that we still have are adequate.

CHAIRMAN BURNS. I would agree with that. The overall figure, I think, has always been historically deceptive because of variations among industries in rate of utilization and variations among firms within individual industries. And an overall figure of even 85 percent is consistent with developments as they have been historically, and I see no reason a priori to assume anything very different this time. An overall figure of 85 percent has been consistent with bottlenecks scattered through the system--individual firms and industries. Mr. Eastburn now, please.

MR. EASTBURN. Mr. Chairman, on prices, a comment and a question. Our projections, Jerry, would have a little bit more price effect as a result of the cold weather that we have been having. You might want to comment on that. And second, I have seen some scenarios--we have a chart here, for example, from DRI, which projects the deflator through this year by quarter, which has a rising trend in the price component. I happen to be more in agreement with what you have here. But what kind of odds do you attach to a rise in the deflator in the latest increase?

MR. ZEISEL. Well, let me break it down into three broad components--food, energy, and other. As far as food is concerned, we have situations for the immediate future deteriorating to the extent that the cold weather has had some effect on prices of fruits and vegetables. But, as I indicated, we expect that to be a fairly short-term phenomenon. Other than that, the last month or two has suggested that meat prices were going to be lower--weaker than we had earlier thought--so that without the freeze we probably would have edged off [our] estimate of food price increases in the first quarter.

As far as the remainder of the year is concerned, it is really very difficult to say. The drought in the West--I'm no agricultural expert, but [our expert] tells me that, at the moment, his evaluation is that the people are being a little pessimistic about the implications of the drought in the West for supplies. Grains are apparently in considerable supply. And later there may be some effect on California-produced fruits and vegetables. But they would not be a very important factor overall. So that basically, our feeling is that, unless we have continued bad luck in terms of weather, food prices would not be a factor pushing prices up markedly in the period of 1977.

As far as energy prices are concerned, we have made assumptions in regard to OPEC prices which involve a 5 percent increase, edging up to 7-1/2 percent. If that got worse, we would obviously have some problems. There are some additional costs associated with increases in gas which we have incorporated in our projections. We've made some assumptions in regard to the implications of the use of intrastate natural gas in the interstate system. It's a very small factor overall. That's obviously a factor pushing prices up, but not extremely rapidly, given our assumptions.

So we come back to the element of unit labor costs from other sectors as being a major determinant of prices. And there, productivity plays a large part, as do wage increases. The outlook for wage increases this year, it seems to us, is no worse than last year. Possibly slightly higher increases, but very little. We don't have any really large negotiations which involve a big catch-up to compensate for increases in the cost of living. Probably the most dramatic negotiations that we will have [involve] steelworkers, and that is going on right now. They are covered by a cost-of-living clause, which has kept their real wages above what [they were] when they negotiated the contract, so the pressures are not too intense.

It's a big settlement, it's a big year--there are some 4-1/2 to 4-3/4 million people being covered by contracts, but they're very widely dispersed, and virtually all of the big ones do have cost-of-living protection. So we are not going to get that kind of surge. And we are anticipating that wage compensation increases will remain under 8 percent--in the 7-1/2 percent to 7-3/4 percent range.

As far as productivity is concerned--based upon past experience, a rate of growth in real output in the 6 percent range is consistent with above-average increases in productivity. And we would think this probably will be the case now, since business generally suffered probably its worst productivity performance--certainly in the post-World War II years--during the recession, and I would think there would still be continued pressure to try to recover some of that. And, while [our forecast is] not terribly expansive on productivity-- our average is a little above 3 percent for the year as a whole--[but] if we're right on that, this gives us a unit labor cost increase of about 4-1/2 percent. That roughly would be consistent, we feel, with price increases slightly above that. And this gives us a pattern of price increases for the year which are somewhere in the 5 to 5-1/4 percent range.

CHAIRMAN BURNS. I hope you're right, Mr. Zeisel. Mr. Wallich.

MR. WALLICH. Well, I listened to a discussion of business economists the other day in which even more micro and nonmonetary approaches to prices all led to an impression of downward price pressures, which seemed very gratifying. But my own look at these numbers always is a little bit above what yours is: Wage increases--I think we would have to be a little optimistic to get 7-1/2 to 8. Productivity, 3 percent--well we might be able to do that. So that allowing for some losses from things like drought, oil, other adverse factors, we might be underestimating our rate of price increase. That is what I fear.

And the question I want to attach to this is, we have now mapped out what is a relatively slow rate of recovery-- growth about 50 percent above long-term trends. As I remember, in the past people would talk about 100 percent above the trend quarterly growth rate sometimes--8 percent with a trend assumed to be 4 [percent]. We ought to be getting downward pressures on prices simply from excess capacity and unemployment. And countries like Germany and Switzerland are getting this and have been quite successful. Why is it that this doesn't seem to be clearly happening in the U.S.?

MR. ZEISEL. I wish I could answer that question. I really don't know. I think one has to speculate about it. Certainly the past half year has been instructive in a sense. In a period when we had not only excess capacity but also a rather sluggish economy, [and] one looks at industrial prices abstractly from special consideration such as energy, one sees that the rate of increase, if anything, accelerates. This is not what one would have anticipated based on the kind of model that we are used to analyzing. So I think [we] have to start thinking about business attitudes and business perceptions of what their costs may be, what inflationary implications may be, what government programs may involve in terms of price regulation of one sort or another. I think these are in a sense new dimensions that have to be taken into consideration.

CHAIRMAN BURNS. You know, they're also old dimensions. One is, raw materials prices have been advancing; they started rising at the very beginning of 1975 once again. And historically, wholesale prices have moved upward starting at the very beginning of an economic recovery--a few months before, at the time, [and] one or two or three months later. And this historical pattern by now is being superimposed by a long-run inflationary trend of our economy. And therefore I hope our staff is right in this projection as to prices, but my own [projection] is less optimistic. Mr. Balles now, please.

MR. BALLES. Since Mr. Zeisel mentioned the drought in the West, I thought I might pass on a few calculations that I had my own staff make in terms of what impact they see this year. There will no doubt be disaster for a number of California farmers, but we have tried to figure out what this will result in, in terms of costs. In view of the almost record low levels we're seeing as we move into a second year of drought, in [moisture content] in the ground, of levels of water in the reservoirs, and snow pack in the mountains, they are guesstimating a possible 25 percent reduction in the output of fruits and vegetables in California farms this year.

The staff figures that fruits and vegetables make up about 3.1 percent of the cost of living index; and that 25 percent reduction, unless offset by increased production somewhere else in the country--the net bottom line result is about a 0.3 percent boost in the cost of living index for the year as a whole. Does that jive with the agricultural expert that you talked to, Jerry?

MR. ZEISEL. That's very much in line with our assumption. We figured a rise in fruit and vegetable [prices] of about 25 to 27 percent. We built that into a higher level for prices for the year.

MR. JACKSON. John, what [effect does] the development of much more modern farm techniques in all of Mexico begin to have on that projection and on our relationship with that country?

MR. BALLES. I don't know the answer to that question, Phil.

MR. JACKSON. Recent newspaper reports would indicate that the substantial improvement in modern farming techniques [in Mexico] could have some moderating effect on that influence of California.

MR. BALLES. I hope that's right.

MR. JACKSON. Maybe they just recently had a drought, too; I don't know.

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

MR. PARTEE. Well, Mr. Chairman, I just thought that I might say, since I think we need so many views on this, the economic outlook seems to me to be quite good and strengthened over the last month or two. We did have Henry refer, I think, to this group of business economists we had in last week, and they were also, it seemed to me, quite optimistic, talking really about a very good outlook for their products and their industries in the period to come. So I agree with the staff forecast that there is developing strength in the economy.

But I do think that we have to recognize that, at this instant, we haven't been able to assess yet the full effects of the weather. I understand this. Now there is, as I think Jerry said, somewhat of a strike effect there, that you cut output, cut inventory, cut income for a very temporary period--but, in this case, over a very wide number of employees. And you would expect that, when the weather changes, output will come back and the inventories will be reaccumulated and the incomes will be restored, and so there wouldn't be much overall effect.

There also is an income transfer point here, which has been mentioned, that may not be overcome; that is to say, that you shift income from consumers to sellers of fuel. And you could presume, I suppose, that the sellers of fuel have a lower propensity to spend than the ordinary consumers have, and we might get some depressing effect.

So I guess I wanted to indicate that, although the prospect is that we would get a very good snapback and maybe a very strong second quarter, it is not yet quite in the bag because we have not quite yet assimilated the total effect that this weather development [will have]. And I think we need to be a little cautious until we can see what the shape of our coming out of this weather will be.

CHAIRMAN BURNS. I agree in substance with what our staff has indicated and [with] Mr. Partee's pronouncement on the general outlook of the economy. I think the outlook is good, but I think I should report to the Committee that my own conversations with businessmen and business economists recently [have] suggested to me that there is a somewhat uneasy mood within the business community, as I sense it. There is an uneasiness about the possibility of price controls. There is uneasiness about the Administration's fiscal policy and where it may be going. There is uneasiness about the energy outlook. There is uneasiness about inflation, and that is interfering with judgments about capital expansion. And there is uneasiness also about foreign developments. And this mood of uneasiness, if I read it correctly, is a little stronger than it was a month or two ago. Mr. Coldwell, please.

MR. COLDWELL. Mr. Chairman, you and Governor Partee in effect have stolen exactly what I'd planned to say, except that I've got a little bit different scenario to it, and I think Chuck is right that we're headed upward. I have a sneaking suspicion that we may find ourselves in a kind of a peaking situation in the latter part of the year--maybe a downturn of no major proportion, but a kind of interruption in this nice smooth path the staff has laid out for us here. And I suspect that we can have exactly what you are talking about, in terms of the uneasiness in businessmen accumulating into a less-than-forward look [to] their operations, and certainly capital spending, and perhaps some other areas, too--an uneasiness translated into perhaps excessive caution. So while I think we may average out to where the staff is looking for it, I wonder if this pattern isn't going to be perhaps markedly different than that shown.

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

MR. WINN. Mr. Chairman, in their uneasiness, did they express any concern over the stock market behavior?

CHAIRMAN BURNS. Yes. And partly as an expression of their uneasiness, and partly as a cause of it.

Any other question or comment?

MR. BAUGHMAN. Mr. Chairman, could I ask Governor Coldwell if he could elaborate just a little on what he thinks it is? I think margin, in terms of the usual cyclical aspects, in which there is a little pressure on capacity, a little pressure on inventory.

MR. COLDWELL. No, I'm thinking in terms of a fairly low first quarter, with a growing boom in the second and third tapering off largely because of the impacts of business caution, reflected by the comments of the Chairman. We might have a consumer boom from the first to the third quarter quarters, [but] not supported by a capital spending boom.

MR. BLACK. You think that inventory explains what's causing it?

MR. COLDWELL. Yes, the inventories are playing a considerable part.

CHAIRMAN BURNS. Mr. Balles, please.

MR. BALLES. I'd like to ask Mr. Zeisel one more question in connection with the $50 dollar rebate program or, as the Chairman has more appropriately called it, a gift, by the government to its citizens. Do you have any estimates as to how much you expect that sum to be spent as opposed to saved?

MR. ZEISEL. Roughly--

MR. LILLY. What are you going to do with yours?

MR. BALLES. I'm going to spend it. Seriously, I'm not sure yet. I'll wait until I see it. We may not get it.

CHAIRMAN BURNS. I think it's a little hard--as far as I'm concerned, I don't know what I will do, period.

MR. ZEISEL. Historically, this kind of--quote--windfall, which is what I think it's generally called, has involved something in the neighborhood of 25 percent spent in the current period, and then drifting up to 40 or 50 percent total of it spent, possibly, and the remainder saved. And we built in about this kind of pattern; however., I think you've got an additional element that's come into play here, and that is the extra gas bills which are going to be coming in now. It's conceivable that people, to the extent that they are aware of these rebates, will be figuring they are going to use that rebate to pay their gas bills. So that adds another dimension of the word "uncertainty" on how's it going to operate.

MR. PARTEE. Yes, but assume they would pay their gas bill anyway.

MR. ZEISEL. Well, they have to pay their gas bill anyway.

MR. PARTEE. You've got about a $40 billion increase in savings in the second quarter.

MR. ZEISEL. Well, the payments out of these rebates, which are at $46 billion annual rate, come very late in the second quarter--May and into June--so that most of the--

MR. PARTEE. You add it.

MR. ZEISEL. There's a lagged spending response to them.

CHAIRMAN BURNS. Any other questions or comments on the economic outlook?

MR. GARDNER. May I make an observation, Mr. Chairman?

CHAIRMAN BURNS. Please do, Mr. Gardner.

MR. GARDNER. Listening to this concern about uncertainty, I have to reflect back to the beginning of last year. The midpoint of last year. What were the points of uncertainty? What prevented business from moving forward with capital goods planning or expansion? Well, the pause was on our minds almost all of the year. The pause as to whether unemployment began to rise after dropping. The election was certainly on our minds. OPEC's protestation that they would increase prices were with us for many months last year. In fact, there were a great many reasons or significant reasons for business uncertainty in 1976.

None of these are quite the same concerns today that they were last year. The election is behind us. We have seen the first stimulative program proposals. There's no question about the pause being a downturn any longer, and that's proven to be an unnecessary worry in some respects. Unemployment, even in a crazy mechanical way, dropped by a macro number for [a] month; but nevertheless, the Saudis seem to be holding out with a two-price system to [the] advantage [of] our economy. I remember a lot of concern about the fact that if we didn't have a big December, we would have great difficulty in retail sales, but we did have a big December.

I [am] persuaded, gentlemen, that businessmen are very inventive in thinking about things to worry about. Now they are worried about the weather and the energy shortage or what have you. But when I try to balance these against last year, I don't think they are terribly impressive.

All I'm trying to suggest is that I look someday to the time when the perception generally in business will be that they ought to go ahead with some of their capital expansion.

MR. WALLICH. God help us then.

MR. GARDNER. Pardon?

MR. WALLICH. God help us then.

MR. GARDNER. Now wait a minute. We haven't had any significant capital investments. We've had a recovery without that leading the way. And this has always appealed to me as a fact of future strength. At some point, we may indeed get some additional thrust from the longer-delayed capital expansion developments. I'm a little bit from Missouri when it comes to businessmen and their worries.

MR. WALLICH. If I may interject, I do see things somewhat that way, but late in the cycle, everybody will realize that [they don't] have enough capacity, that they should have invested earlier, there [will] come a great rush in this--bottlenecks in capital goods industries. And that's exactly how I negatively interpret the belief that, at some time, we all should go ahead.

MR. GARDNER. I want to ask one question, Mr. Chairman. Jerry, steel capacity worldwide, aluminum capacity worldwide--I don't know anything about pulp and paper capacity--do we have the same set of conditions today that we had in '73 on capacity? We are worried about our 85 percent rate or our movement toward an 85 percent rate [of capacity utilization]. I seem to remember an enormous burst in construction of steel plants throughout the world very readily available. Some very basic industrial commodities readily available from input. Can you comment on that?

MR. ZEISEL. Well, I can comment a bit. I would ask Mr. Reynolds to supplement my comment, since I am not as familiar with the worldwide situation, obviously, as he is. My impression is that we are not in a situation where the pressures in capacity worldwide [are] what they were then. And, in fact, the other day there was a comment from the conference of business economists group that there seemed to be a considerable amount of available capacity in these basic metal producing sectors worldwide. And so I think, to that extent, that we are not facing the same kind of pressure points that we did face back in ’73. John, do you?

MR. REYNOLDS. Yes, I think there is very little pressure on capacity abroad. That’s been the reason that investment spending there has lagged, too. Steel is certainly in ample supply. Most chemicals, I think, are in ample supply. Figures that Wharton School gathers on industrial capacity, while perhaps not very good, show capacity pressures much less than they were in ’73.

CHAIRMAN BURNS. Yes, Mr. Mayo, please.

MR. MAYO. Just one observation following up on what Steve was saying. I think there is another phenomenon that’s added to uncertainty that we tend to forget in-between time. We have almost a semiannual regularity of the August doldrums and February depression, in terms of attitudes, and I think this has been accentuated this year, and as they say, this too shall pass. The stock market decline has not helped it, either.

MR. LILLY. Well, I have to hasten to get in on the statement about businessmen’s worries. I think that what you describe has become a kind of a way of life. And they’re used to this; at this point, I think they’re just going ahead. My own view is the economy is going at a very fine rate, as Chuck says. I am concerned that perhaps too much liquidity [is] in the economy. And this bothers me more than anything else at this point.

I’m not too worried about the capacity problem. I think there is an international [unintelligible] that we [unintelligible]--furthermore, I think that all of you are paying too much attention to manufacturing, which is only 19 million employed even though there is a multiplier. [Unintelligible] the great job [unintelligible] has got to come in other areas.

CHAIRMAN BURNS. Any other question or comment? Well, if not, let us move quickly to Mr. Sternlight’s report on operations at the domestic Desk.

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

CHAIRMAN BURNS. Thank you, Mr. Sternlight. Any questions or comments? Yes, Mr. Wallich.

MR. WALLICH. There seem to have been significant shifts in interest rate relationships, with the principal rise in rates [being] in the medium-term Treasuries. What does that imply for the market’s expectations of future rate movements? [Is it] an indication of sharper rate increases in the area immediately below that in maturity?

MR. STERNLIGHT. I think there has been some expectation of rising rates as this year goes along. Just taking the period of the past month, this trend that you point out is not so very pronounced, but I think it would be pronounced if we go back to the beginning of the year. There has been a steepening of the upward sloping yield curves. And I think it was essentially a fading of the expectation of any further easing and some expectation developing that, as this year goes along, there would tend to be some higher rates developing.

CHAIRMAN BURNS. I think Mr. Wallich's question does raise a question for the Treasury as to debt management policy in the months ahead, and this is something that our financial staff should pay very careful attention to.

MR. AXILROD. Mr. Chairman, I was going to add, if I might, supplementing Mr. Sternlight's comment--I think that if it also had to do, not simply with expectations--expectations change--but that was the area where there was a very large supply of securities. The Treasury had been hitting that area rather consistently, and you saw a sharp reaction in that rate area in part because people who were just trading in the securities tended to unload them--and so it was something [more] than just a change in attitude in that area more particularly than in other areas because of the very large supply that was floating.

MR. EASTBURN. Mr. Chairman, may I comment. Once a month, in the preparation for these meetings, one of the things that we do is to take the yield curve and try to make projections of the rates on the basis of what the market seems to be expecting and reflected in the yield period. In recent months the market projections have not been as high an increase for the funds rate as the Bluebook would [make it] seem. But the latest one that we have done indicates that the market was expecting increases in short-term rates which were quite similar to those that the Bluebook projects. Which indicates to me that, if and when it's necessary for rates to go up, that the market apparently is expecting that. It would not be surprised.

CHAIRMAN BURNS. Thank you, Mr. Eastburn. Any other questions or comments? Yes, Mr. Black.

MR. BLACK. Steve's observation occasioned me to wonder about something. Steve, what maturities do you feel really compete most effectively with thrift institution obligations? I'm wondering about disintermediation here.

MR. AXILROD. Well, with thrift institutions, I would say that you really have to go through the whole maturity spectrum up to around four years. That is, the savings accounts are sensitive to the bills, and that may be more particularly true for commercial banks now with business and state and local governments.

CHAIRMAN BURNS. I think Mr. Black was directing his question to the assets, is that correct?

MR. BLACK. Yes sir.

MR. AXILROD. Oh, I'm sorry, I thought you were asking about the liability side.

MR. BLACK. Maybe I misunderstand the Chairman on it. I was really wondering--

CHAIRMAN BURNS. About mortgage interest rates, is that what you had in mind?

MR. BLACK. No sir. I was thinking about disintermediation on the liability side of the thrift institutions and what this might mean, you know, for debt management with this bulge--

MR. AXILROD. I would say on that, that it's up to the four-year Treasuries and maybe a little bit longer, that is when those issues have very attractive coupons. And, of course, those yields are low now, or relatively low. Then you tend to get funds that would otherwise be going perhaps into four-year certificates going into Treasury issues. And also, [with] very high bill rates, funds that would otherwise go into savings shares [going] into the bills, and sometimes from very short-term certificates into bills.

CHAIRMAN BURNS. Any other question or comments? Very well, we'll break for coffee now and we will be back in about 15 minutes.

[Coffee break]

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

MR. JACKSON. Have you noticed any change in the source of CDs for banks in domestic versus foreign?

MR. AXILROD. No, I have not. But I have not investigated that.

MR. JACKSON. --material shift in the sources of them?

MR. AXILROD. I'd have to investigate that more carefully to give you an answer, but I have not--none has come to my attention.

MR. JACKSON. Would you think it material if there was?

MR. AXILROD. Not from the point of view of our domestic finance. It might be material from the point of view of the balance of payments and pressures on exchange rates.

MR. STERNLIGHT. I've had some impression of banks drawing more from foreign sources.

MR. JACKSON. That's the impression I'm getting. That's the reason I was asking the question. But I frankly don't know whether it's material or immaterial.

MR. PARTEE. You mean the CDs--not Eurodollars? Issuing domestic CDs to foreigners?

VICE CHAIRMAN VOLCKER. It's not apt to be in the form of CDs; it would be in the form of Eurodollars.

MR. JACKSON. Excuse me. I used the wrong expression. I'm talking about purchased funds as a whole.

MR. KIMBREL. I'm not so sure. At least in the south Florida area, the CD related to foreign is significant. And so much so that some of the larger banks have put a $150,000 limit on what they will accept from foreign sources.

CHAIRMAN BURNS. Mr. Wallich, please.

MR. WALLICH. I wanted to ask a question about appendix table 3, which shows implied velocity growth rates. Now the growth rates that would eventuate under the various alternatives are pretty high--particularly when you look toward the third and fourth quarter, they are remarkably high for V2, because typically that doesn't fluctuate that much. Now, I think Steve has given a partial answer to the implied concern here, by pointing to the high degree of liquidity and the ability of the economy to take care of a growing demand for credit out of its existing resources. But I'm still puzzled by something like on alternative A and B, almost an 8 percent rise in velocity requirements. How does that come about? Do you expect a very low rate of money growth at that time after the initial blip in the earlier part of the year?

MR. AXILROD. That's right. We are expecting a very rapid growth rate in money in the second quarter. And I think the--actually that 5.3 percent velocity for that quarter is in some sense artificially low--it's around 6--you have to average through the second and third quarter, which still leaves you a high M1 around 6. And we're expecting a drop-off in the third quarter, so that, [unintelligible] because of the rebate money in effect being used over a longer period. But in addition, Governor Wallich, we are expecting interest rates to rise, and that accounts for a good part of the rise in velocity in addition--

MR. WALLICH. In the absence of rising interest rates, allowing for the special factors that are operative now on the demand for M1, did you say how large that trend growth rate would be?

MR. AXILROD. Well, Governor Wallich, in the course of working out the material for this Bluebook, we did not work out an alternative which had no interest rate increase involved. So I really cannot give you an answer which would be anything other than my hunch. And I don't know whether you want that at this point.

MR. WALLICH. Yes, I do.

VICE CHAIRMAN VOLCKER. I can tell you the New York hunch. That's a little over 7 percent.

MR. AXILROD. I was going to put my hunch at around 7, and that would be a lower number, I believe, than would be literally read out of some of the models.

MR. PARTEE. What's the number you're referring to?

MR. WALLICH. 7.

MR. AXILROD. The increase in money supply without an increase in interest rates over this Committee's one-year horizon.

VICE CHAIRMAN VOLCKER. What M1 would be without an increase in interest rates.

MR. WALLICH. Well, that would be a growth velocity of about 4 percent, if M1 grew at 7 percent.

MR. AXILROD. That's correct, and that would mean that we're allowing for some further shift from demand deposits to other transaction balances and for the fact that some of this liquidity might be given up willingly rather than require high interest rates in the atmosphere ahead.

MR. EASTBURN. Mr. Chairman, may I follow up? I was also struck by this table, Steve. What kind of historical precedent is there for this kind of a velocity rate at this stage of the cycle?

MR. AXILROD. I believe this is a high velocity rate, but again, as I point out, we're expecting higher interest rates. I don't believe there would be a precedent at this stage of the cycle without rising interest rates. I don't know whether you would even have found that. I don't have those figures at hand.

MR. MORRIS. There is a precedent. In the third year of the expansion beginning in '69, M1 velocity was 6.2. But, of course, that was accompanied by a sharp rise in interest rates. So there is a precedent, but not without major changes in short-term money rates accompanying it.

CHAIRMAN BURNS. You know, I think we have to be very cautious in approaching this question on the basis of historical perspective. I think it's fair to ask how did velocity behave in the past in the third year of a business cycle expansion. And that is the question that is being discussed and answered around the table. But I think that one ought to take into account the fact that we had a lull in the economy, a pause, a reacceleration--and from a certain point of view, a new expansion, you see, is getting under way, and one can therefore, from that point of view, regard it as being more nearly comparable to the first year of expansion. I think the truth is somewhere in between. And one has to look at it from both points of view in order to get a fair reading of what history can tell us.

MR. EASTBURN. This would be higher, though, even for the first year.

CHAIRMAN BURNS. No, this would be an average of 6 percent for the year, which is not high for the first year of business cycle expansion on the average. Now, next, one has to take into account the changes in financial technology. I'll tell you how I read this table. I didn't go back to any historical records at all, I didn't have the time, and I start with a 3 percent secular rate of growth. I make an allowance for a high rate of growth during a normal business cycle expansion. That gives me, say, another 1 percent, so I'm up to 4. I make some allowance for this being a reacceleration, that gets me up to 4-1/2 or 5. I make some allowance for changes in financial technology and I get to 6, and therefore, I'm not too unhappy with this figure.

MR. AXILROD. President Eastburn, it was in an effort to help explain this new table that I did want to point out that the movement in liquidity has been very unusual in this cycle as compared with previous cycles. And that is, people have improved their positions during a period when they ordinarily deteriorate. That doesn't mean that you are surely going to get more velocity without much interest rate pressure, but it is at least an indicator in that direction.

VICE CHAIRMAN VOLCKER. Is it not true, as Governor Wallich, I think, already suggested, that V2 may be a little more unusual than the V1 here in terms of a historical perspective? V2 hasn't got the 3 percent secular--

CHAIRMAN BURNS. More unusual if you go back to 1960 and stop there. If you go further back, it's a different picture.

MR. WALLICH. Well, I think one can sort of decompose what's happening to V2 to the extent that it contains M1 or if there is an increase in velocity. Now, if there's disintermediation, one would of course expect an increase in velocity during that period because M2 would be rising at a less than trend rate.

MR. AXILROD. If we're wrong, President Volcker, about the extent of interest rate pressures, then V2 would look more reasonable. If interest rate pressures are less, the V2 number is going to be considerably less, while the M1 velocity would be about the same.

MR. MORRIS. But even then, at this stage of the cycle, that is not an unusual level of velocity for M2. Because in the third year of the cycle beginning in 1960, M2 velocity was 6.2.

MR. AXILROD. That was the beginning [of] disintermediation.

MR. PARTEE. It's higher than what you've projected.

MR. AXILROD. Well, that's very sensitive to disintermediation.

MR. JACKSON. Have we done any studies on V3 which would tend to eliminate the changes in financial technology? It wouldn't totally do so, but it would reduce it.

MR. AXILROD. V2 does to a great extent.

MR. JACKSON. Until you get to V3 you don't have the total effect as well covered as you would.

MR. AXILROD. I don't have that data here.

CHAIRMAN BURNS. I have not done any.

MR. JACKSON. It just strikes me that it might tend to give you some indication [of what] effect changes in technology would have on this.

MR. PARTEE. [Unintelligible] a lot of technology in V2, that is, to the extent some of the shifts from demand deposits to savings accounts in banks [unintelligible].

MR. JACKSON. But it's not all going to banks [unintelligible].

MR. PARTEE. Some of it's going to thrifts.

CHAIRMAN BURNS. Mr. Kimbrel, please.

MR. KIMBREL. Mr. Chairman, [unintelligible]. Do you have any information that refunds are likely to be, in timing or amounts, significantly different from the usual this year?

MR. AXILROD. We think that the refunds will be a little bit higher than they were last year ,when they came in strong toward the end of February and March and had a definite effect on M1. But the stronger [rebates] were evident also in '74; we think our seasonals are beginning to pick it up. But we don't expect the refunds to be enough stronger in this year to have any significant effect on M1. It could provide some uptick in March, but we haven't built in anything very special for it.

CHAIRMAN BURNS. Yes, Mr. Volcker, please.

VICE CHAIRMAN VOLCKER. Well, I just want to follow up on this question. Apparently our analyst thought that the refunds would have a significant impact in March, anyway. But beyond that, the rebates, which won't come for a couple of months subsequent to that, you obviously must have made some calculations here that affect these numbers. I suppose I would be interested in knowing not only what impact that has but what degree of confidence you attach to estimates you can make about the rebate phenomenon at this point.

MR. AXILROD. Well, we did put the March growth rate somewhat higher than the February growth rate partly on this thought of the refunds, but it's not a significant enough difference for me to put any real weight on it. On the rebates, we have in process, and we'll have completed within two or three weeks, a very detailed study of the experience in 1975. Pending that, we have made some tentative estimates, which in my view are somewhat arbitrary at this moment, of the effects on demand deposits and time and savings deposits. And we have added some 9 percentage points or so to May growth rates and something like 5 percentage points or so to June growth rates and then taken these out later in the summer, in July.

VICE CHAIRMAN VOLCKER. 9 percentage points?

MR. AXILROD. I believe that it's 8 to 9. It's in that order of magnitude. Again I would like to stress that these may not be the numbers that we will be using when the rebates come upon us or when we get a better fix on them, because we have not completed this very detailed study we have under way of the 1975 experience.

These numbers are very sensitive to assumptions you make about whether people have learned from the 1975 experience; whether they're going to spend [the rebate funds] faster than they did at that time; whether they are going to move them out of demand deposits faster or slower. And you can get radically different numbers for various months depending on whether you assume they come out two weeks, three weeks, four weeks, or five weeks [later]. The monthly numbers are enormously sensitive. And our pattern at the moment has something like a

14-1/2 percent rate of growth in M1 in May, a 10 percent in June, a minus 5 in July, and if you just change an assumption about a week or two, we can get a much lower number for June and a higher number for May. But at the moment these are the numbers we're working with for M1.

MR. PARTEE. I'm surprised that your average increase in the second quarter was only 8 percent under alternative B.

MR. AXILROD. Well, that's how it works out with this 5 percent for April, 14-1/2 for May, and a 10 percent for June. The average rate of increase for the first quarter is somewhere around 5-1/2 percent.

VICE CHAIRMAN VOLCKER. I have no idea what confidence to attach to any of these things, but apparently the New York people have a much lower estimate of this rebate impact that you're just citing now. I thought they had a little confidence in what they were doing, but if I can do it over again and see whether we--

MR. AXILROD. Well, I had hoped, President Volcker, that the subject would not come up because I did not feel that the work that we had done was adequate for a very confident estimate. And that's why I'm stressing that these are very first approximations and that we are working on a very detailed paper to try to get whatever you can out of the '75 experience. But as I say, these estimates will be very sensitive whether you decide that a person is going to hold [the rebate] for a week and then spend it or hold it for two weeks and spend half. It's just highly sensitive.

CHAIRMAN BURNS. There's only one way to do this. Since you don't know what people will do, and since '75 experience may or may not be repeated--history has a way of springing surprises on all of us--I would submit to this Committee a series of estimates based on varying assumptions. And my advice to the Committee at that time will be to allow for a very significant margin of error in any of these estimates as [we give] our directions to the Desk at that time.

MR. AXILROD. We also don't know, Mr. Chairman--and this may cause differences in the assumptions--the exact timing of the payout. We have, I think, here assumed that it begins in late April or early May. Again, you get a different [result depending on whether] payouts [are] being [held or] drawn down in May. It's a highly difficult area. And we will Mr. Chairman, when we get into the months--

CHAIRMAN BURNS. We don't want that. The point I'm trying to stress is, don't give us a single estimate.

MR. AXILROD. No, that's what I was going to say.

CHAIRMAN BURNS. --give us a series of estimates.

MR. AXILROD. When we're presenting the months where they will be highly relevant to policy, we will provide a range of estimates for the Committee.

CHAIRMAN BURNS. All right any other questions?

Let's turn to our discussion of monetary policy, and at the end of that discussion we will consider Governor Partee's memorandum.

I find myself in a tranquil mood today. Alternative B--considering the state of the economy, the state of markets--that seems entirely satisfactory to me. I commented earlier on elements of uneasiness within the business community that I believe I have detected during the past month or two. The sources of the uneasiness, one can guess about; there's very little we can do about that, I believe, but there's one contribution we can make and that is to recognize the nervousness that has existed in financial markets. And I see no reason for departing from the federal funds rate objective that we've pursued with very little change here in the past few months. And that is my suggestion to the Committee. And now let's hear from members of the Committee. Who would like to speak first? Mr. Volcker, please.

VICE CHAIRMAN VOLCKER. My initial approach to this would be, I think, similar to what you just stated. That, on the basis of what I see now, by which I mean I would include the projections we have of the aggregates during this period, I don't see any basis for making any change in our stance.

Let me consider what would happen, or what should happen, if things in the next month turn out, particularly in the aggregates, not to follow the pattern that is now projected. And I speak in this connection against the feeling of some confidence in the outlook that has been expressed earlier by a number of people. And that the fiscal program may be a little larger rather than a little smaller if the Congress does change it, although I don't think that's terribly significant.

I am concerned in the longer range about the possible capacity problems that were discussed earlier. I tend to share the staff's optimism about prices, but I think it's a very shaky projection, and I think it's very important that prices--we don't have a feeling in terms of confidence in the business community that prices are moving up again at a stronger rate of speed. So all this makes me a little sensitive to the aggregates speeding up well beyond the projection, should that happen. And I'm particularly sensitive against the difficult background--as we get into the rebate period, not wanting, rightly, I think, to act strongly then--in view of the uncertainties of those estimates inevitably.

So while I see no reason for a change right now on the basis of any information we have, I could see the case more easily for shading upwards just a bit on the federal funds rate than shading down should the estimates come in higher than we now expect on the aggregates. Now how you transfer that into the precise specifications, I'm not sure. I have no trouble with the B specifications on the aggregates, although maybe I prefer that A specification on M1. But the difference is only 1/2 percent, it's not enough to argue about.

I wonder on the federal funds rate. I suppose I can express my view in terms of substance more accurately if the federal funds rate was 4-1/2 to 5-1/4, let's say, or even 4-1/2 to 5, with a midpoint asymmetrical toward the lower end of that range. Something like 4-3/4, or even 4-5/8 to 4-3/4, so we have less room on the downside than on the upside.

CHAIRMAN BURNS. That's where we are now; 4-5/8 to [4-3/4].

VICE CHAIRMAN VOLCKER. That's where we are now. I don't really want to change now, but I'd like to give myself a little leeway for changing a bit if in fact the aggregates came in high, and I mean quite high--a couple of percent, anyway.

CHAIRMAN BURNS. You know, under our rules, if that should happen, then the Desk would communicate with the Chairman promptly, and he in turn would get in touch with the Committee and take actions that are appropriate.

VICE CHAIRMAN VOLCKER. I think that would be acceptable. All I want to express is, I feel a little asymmetrical about the situation. I'd be a little readier to move up just a bit if things came out that way. I hope they're not going to come out that way. They're moving in the other direction.

MR. PARTEE. Paul, you could move to 5 within this specification.

VICE CHAIRMAN VOLCKER. That's right.

MR. PARTEE. Because if you were toward the top on the aggregates, why, you could move up. If the aggregates were very strong, you could go beyond 5 through the device of [a Committee consultation].

VICE CHAIRMAN VOLCKER. I don't really want to move above 5, don't misunderstand me. I'm not sure I want to move to 5. I just feel a bit asymmetrical about the desirability of moving if the estimates came in on the high side, and that's the only thought I wanted to express here really.

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

MR. BLACK. Mr. Chairman, I'm a tad more hawkish today than you are, but not a great deal. I'm not particularly concerned about M1, and I recognize these uncertainties involving the rebates and refunds and the likelihood that whatever does take place may be reversed. I think we have to be very cautious in reacting to the behavior of M1, and to compound my confusion, the projections we've been doing in Richmond suggest that in February, M1 may actually decline a little bit, but [may have] a pretty good spurt in March. But that's, of course, a guess. But anyway, regardless of what happens, three sets of projections for the first quarter would be in the neighborhood of 5 to 5-1/2 percent, or something like that. And I think that's perfectly appropriate.

The thing that really concerns me is something that's bothered me for some time, and that's this rapid rise in M2, and I would hate to see this continue for very many more months. I think that's something we definitely have to be concerned about. So I'm inclined to make a little move toward less ease right now, although I recognize the uncertainties of the weather. I think that's going to be temporary, as I indicated a little earlier. But I certainly don't think we should do any more than a very gradual move at this time, keeping in mind that the financial markets are very uncertain and that they could react very sharply to even a slight tightening move.

And when we get to the numerical specifications, I would take the language of B and the Ml specifications of B, which would be 3 to 7 per cent. But on M2, I would like to see that range reduced to 6 to 10 per cent so that we could trigger some reaction on the funds rate if we move up to 10 per cent. And I would favor going back to our 1 percentage point spread by adopting 4-1/4 to 5-1/4 on the federal funds rate. But I wouldn't make any move toward a 4-3/4 midpoint unless in fact we do see the aggregates accelerating from the sluggish pace that we've been experiencing recently.

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

MR. COLDWELL. Mr. Chairman, I'm in a basically hold position, which I guess is what you're saying. I think the interest rate structure is generally satisfactory for growth over this near-term period, and monetary aggregates seem to be growing at a reasonably satisfactory pace, given the liquidity in the economy. I wouldn't resist much of an increase if we came down to the rebate, but that's a down-the-road decision. I might want to change my mind later on.

Right now, I would resist too much of an increase in the fundamental growth here. I do have a feeling that we may end up with some international pressures which might impact upon our decisions in the near-term future, in the next few months. I think the Committee's posture right now ought to be one of a rather cautious stability. And, it seems, that is an appropriate position for the uncertainties of the economy ahead, until we see exactly what kind of a fiscal policy and impact these various things have had over the past few months. So I would stay with B with a federal funds rate of 4-1/4 to 5.

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

MR. KIMBREL. Mr. Chairman, I think we share the same concern for the delicate uneasiness and all of the reasons you suggest, but I did detect that you referred to the weather-induced distortions that we are experiencing. And I think they, too, are contributing to that uneasiness. I think this caution that's been generated has probably pushed [backward] some of the capital investment commitments for two or three months. I don't think we need to anticipate any of this in our action. I personally would like to see more definitive developments both in the fiscal area and in the business community before we move.

I guess I have a natural inclination to rather anticipate some movement in the federal funds rate, and would be naturally inclined to spread that from a 4-1/4 to 5-1/4, but I guess my restraint is more in the area of trying to maintain some stability at this particular moment. I think that would serve us better for this immediate period. So I would opt for alternative B exactly as is written, and the specification.

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

MR. PARTEE. Well, Mr. Chairman, I find myself I guess mostly in agreement with President Volcker. I think the danger right now is that we could have higher-than-expected growth rates in the aggregates, and I think if we do, we ought to move against them fairly promptly because of our feeling that the second quarter is going to have a bulge.

I might point out to the Committee that it may appear that it's made headway in gaining a little room for the bulge because, as reported by Peter, the M1 was at or below the midpoint of the range all through the intermeeting period. But if you look real hard at this Bluebook, you will find that January is going to be revised up in the 4.6--or something like that--growth rate, to 5.8 because of the change in seasonal factors. And mainly what we've done is we've added to the January growth rate and taken away from the March growth rate in that seasonal factor adjustment, so that, in fact, we haven't made any progress in providing room for the second quarter bulge.

Therefore, I guess, Paul, I would be opposed to raising that M1 range to 3-1/2 to 7-1/2. I wouldn't want to give any ground, and I think 3 to 7 as in alternative B is the best way to go. And I suppose I might have a small preference for a 4-1/4 to 5-1/4 range [for the federal funds rate], but I don't feel strongly about it if it's understood that if [we] move up toward the high end on these growth rates, we will be moving toward 5, and if we move significantly over those growth rates, why, we'll reconsider the instruction to the Manager. So I would go along with B as written.

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

MR. MAYO. I really have no trouble with alternative B, Mr. Chairman. I think you could make a case for keeping the federal funds range just where it is now--4-1/4 to 5--on the grounds that we don't know about the weather and so forth and so on. But I think I would be rather shocked if we took advantage of going even to 4-1/2, much less to 4-1/4. So there seems to be no great [problem] here other than the usual one of not being able to see clearly.

I have no problem with the M1 and the M2 growth rates as they're spelled out here. I think that wrestling with that problem is at least one more month down the line. And I don't feel that we ought to consciously try to curb the M1 expansion too much in anticipation of the rebates. I think we're in a more appropriate posture to play that as we see it when they come about.

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

MR. JACKSON. I don't see the need to make a big, long speech, Mr. Chairman. I think you ought to just stay at alternative B.

CHAIRMAN BURNS. Thank you, Mr. Jackson. Mr. Lilly.

MR. LILLY. Well, I'm not going to make a big, long speech, either. I'm only going to echo what Chuck said, except that I want to make one point. I think it's going to be easier now to move to 5-1/4 than it will be a month from now, two months from now. It might be prudent now to go to 4-1/4 to 5-1/4, [with] the midpoint of 5/8 going to 3/4. Otherwise, I'm in perfect agreement with B.

CHAIRMAN BURNS. Thank you, Mr. Lilly. Mr. Wallich.

MR. WALLICH. Well, I think our concerns once more are more with inflation than with growth now that the pause seems clearly over the dam. We also see some substantive blips ahead in the aggregates due to rebates, refunds, rebounds. As I look at those velocity estimates and the associated interest rate increases, I'm [sufficiently] troubled by the pressures that may be ahead that I'd like to lay in a little reserve against all of these things.

So I would lean toward alternative B, with a slight shading toward C to widen the funds rate 1/4 point on the upside, 4-1/4 to 5-1/4, and leave M1 as is. In M2, I'd go with Mr. Black, 6 to 10.; I think that's an interesting innovation.

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

MR. EASTBURN. I would align myself with those who would stay with alternative B and the specifications noted under that. I would like to have a wider federal funds range, but given the way the Committee's operating, I'm satisfied with what we have, and I do think that there's ample room to move if the aggregates were to come in large. And I feel better about that based on the comments I made earlier, that the market, I think, would not be surprised if this were to happen.

CHAIRMAN BURNS. Thank you, Mr. Eastburn. Who would like to speak next please? Yes, Mr. Van Nice.

MR. VAN NICE. I think I'd align myself with Governor Wallich. I would adopt alternative B--which would happen to give us an average growth rate in M1 for this quarter exactly along the lines of our long range targets--with a slight leaning toward alternative C for the same reasons that he's mentioned. And perhaps a raising of the federal funds rate by 1/4 on the top end of the range.

CHAIRMAN BURNS. Thank you, Mr. Van Nice. Mr. Guffey now.

MR. GUFFEY. I think I would also prefer B [and] adopting the suggestion to widen the fed funds rate range to 4-1/4 to 5-1/4. I think I would also like to see us, by the Committee meeting next month, to be at a midpoint of that range, 4-3/4. It's a very slight change, to be sure; we're averaging 4.66 now. I'd like to see us end up at 4-3/4 next meeting.

CHAIRMAN BURNS. Thank you, Mr. Guffey. Mr. Balles now.

MR. BALLES. I think I would agree with what Governor Wallich has expressed. I am concerned with the constant outlook for the economy that I have, and keeping in mind the sharp upward base drift we had in M2 last year, which was over $11 billion and especially strong in the fourth quarter. [And] a concern Governor Lilly has earlier expressed, which I share, which is the amount of liquidity in the economy. And in view of all of these things, I would come out about half way between B and C, I guess, and I think Governor Wallich has expressed the specifications pretty well.

I would favor a federal funds rate of about 4-1/2 to 5-1/4 and would like, as Mr. Black has indicated, to pull the M2 range down a little bit to, say, 6 to 10. But my fear is that if we don't begin to lean against the bulge that's in prospect, and in view of the very large overshoot in M2, I'm quite concerned about the implications for inflation as we move into next year.

CHAIRMAN BURNS. Thank you, Mr. Balles. And who would want to speak now? Mr. Gardner, please.

MR. GARDNER. I have the conviction that we should stay with B as stated here. In addition to all else that's been said, I want to make this comment. I don't think that we can pragmatically lay in some supplies for the future in this instance. The reason I say that is the stimulus program is not yet passed into law. If market rates begin to do things that those who [seek] stronger stimuli take exception to, we could be possibly a partial instigator. I'm entirely clear that we should stay where we are at the moment, although I recognize that the job before us in the coming months is terribly important. I suggest if we start that job prematurely, we may compound [the difficulty of] our own mission. So I would stay right where we are at the moment.

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

MR. WINN. I'd identify myself with those in support of B. I think I would take the insurance step of widening the range, not that I advocate using it, but it's being on record that it's there.

CHAIRMAN BURNS. Thank you, Mr. Winn. Yes, Mr. Morris.

MR. MORRIS. Mr. Chairman, I support your position with alternative B. I think that the time to lean against the bulge will be in the third quarter, when we find out how much the bulge was. I think in terms of timing, [it is] more appropriate to do it then than to start to do it now. I agree with Governor Gardner that to take even the minor step toward that now is premature.

CHAIRMAN BURNS. Thank you, Mr. Morris. Mr. Baughman.

MR. BAUGHMAN. I would think that alternative B would probably serve our needs for the next month, with a monetary directive as the aggregates directive and understanding that, if we go to the top of the aggregates, we would go to the top of the funds range as well.

CHAIRMAN BURNS. Mr. Roos, you have the opportunity to pronounce the benediction.

MR. ROOS. Well, I become a voting member possibly next month, so I'll keep my powder dry, Mr. Chairman. B is fine, though.

CHAIRMAN BURNS. Thank you. You know, without going through the expressed opinion meticulously, but having listened very carefully to the views expressed around this table, I would like to make the following proposal: that we vote on a monetary aggregates directive; that we specify a range of 3 to 7 for Ml; a range of 6-1/2 to 10-1/2 for M2; and a range of 4-1/4 to 5 per cent for the federal funds rate. Is there any unhappiness around the table if I put this set of suggestions to a vote?

MR. PARTEE. The center point in the funds rate 4-5/8--

CHAIRMAN BURNS. Where it is now, yes. It's off-centered toward the higher end. Well, I don't hear any shriek of horror, and therefore would you be good enough to call the roll.

MR. BROIDA.

Chairman Burns	Yes
Vice Chairman Volcker	Yes
President Balles	Yes
President Black	Yes
Governor Coldwell	Yes
Governor Gardner	Yes
Governor Jackson	Yes
President Kimbrel	Yes
Governor Lilly	Yes
Governor Partee	Yes
Governor Wallich	Yes
President Winn	Yes

It is unanimous.

CHAIRMAN BURNS. All right, let's turn to item 7 on the agenda, the memorandum from Governor Partee reporting on the thinking of [his sub]committee as to the precise form of our domestic policy directive.

This was put before the Committee, oh, two months ago, and a question was raised at that time by Governor Jackson, and I thought that that question ought to be explored by our general counsel before we proceeded to vote on it. Our general counsel has not found any difficulty. Since that time, there have been some very minor changes made by Governor Partee and members of this Committee. And as far as I could see, the recommendation is one that I, for one, can support. Mr. Partee, would you like to comment on this?

MR. PARTEE. Well, Mr. Chairman, the subcommittee has not made an effort in this proposal to do anything substantive. All we wanted to accomplish in the way, you might say, of a clean-up of the records of the Committee was to put directly into the directive the directive [specifications]. And to discontinue the specification sheet, which is sort of a side agreement that we've had for some years, and its position was never absolutely clear in anyone's mind whether it be a legal document or an instruction to the Manager.

So that the purpose here--and I want to emphasize that [it] is not to make any changes in the previous procedures or in the Committee's way of speaking. The longer range, which represents the thrust of the Committee's thinking over the longer run and [is] voted upon with the qualification that those long-term ranges could be respecified at any time. And [in] the short-term range we try to capture precisely what we'd recommend the Manager to do, that is, a monetary aggregates or money market directive, [giving] attention to the aggregates or to the money market. In either case, the directive is affected by where we're falling in the projections relative to the range of expectation. And again, we qualify the short-term specification, as in practice that has been done, by pointing out that if the specifications are inconsistent [with the money market range], the Manager informs the Chairman, and the Chairman may call for a change in the specifications.

So I don't think there's anything here that represents any kind of departure. The sample directive from Mr. Broida that we have attached to this memo, February 7, could be used today, for example, by putting into the blanks in the monetary aggregates formulation the numbers that we've just agreed to. And I think it would be an exact representation of what the instructions to the Manager have been. And of course, it goes without saying that if the Committee were prepared to adopt these numerical specifications, the so-called specification sheet would then be discontinued, and this would be the record.

I might note that there were differences, sometimes, about individual words that appear in this directive language, and you may have noted that Governor Wallich would like, in the case of the long-term range, to insert the word "target." The subcommittee decided against that because that would be a change in practice from what had previously occurred, but Governor Wallich may wish to speak to that issue. I can't recall that we had at the end any other differences, among our subcommittee of four, that call for a [comment] by the members of the [sub]committee, but if they would like to say something, I certainly don't mind.

Governor Wallich, did you want to say something about the use of the word "target"?

MR. WALLICH. There is no basic disagreement at all on my part with the subcommittee. I do feel that stressing aggregates is a defense for us, even though the Chairman has pointed out many times that Congress really thinks in terms of interest rates and that hiding behind good-looking aggregates will not help us if interest rates go up. I think there is some defense. Moreover, there is substance here. In an inflation, interest rates, both are less meaningful--we don't know what the real rate really is--and they are less controllable. Our span of control over, certainly, long-term rates may be minimal, maybe zero.

So I would like to do what one can to stress that we are focusing on the aggregates, and hence I'd like to add the word "target" to ranges, so that it's clear it's a target.

And I'd like to substitute for the rather timid "appear to be consistent with," which is good for the Federal Reserve prose but really doesn't, I think, influence anybody else. Say "reflect," which is still very much Federal Reserve--a very modest, cautious term--and yet I think a little stronger in focusing on what I think we mean--namely, that we try to set an aggregate and try to exert our influence on the economy through it.

MR. PARTEE. Would the other members of the Committee wish to say anything? Frank?

MR. MORRIS. No, I have nothing to add.

MR. PARTEE. John?

MR. BALLES. I must say that I'm sort of attracted by Henry's reasons for using the word "target," and I would be prepared to go with that. I caught up with this fairly recently. It's an interesting alternative to consider.

MR. PARTEE. Well, as I say, Mr. Chairman, it seems to me that that recommendation, which may have merit on its own, violates the spirit of the exercise here, which was to simply transfer what we now have into a different and more useful form. So I think it could be considered by you and by the Committee if it wishes, but it is not a necessary part of the transference [of] procedures that we have in mind.

MR. LILLY. How would you feel if it didn't violate the spirit?

MR. PARTEE. Well, you know, I must admit that I'm inclined to back away a little from the use of the word "target" in the case of the monetary aggregates because I've always felt that, as I think the Chairman has stated to the Committee, our target is the performance of the economy. That is, our objective and the target we have in mind is a meaningfully good improvement in the performance of the economy. And therefore, the monetary aggregates are only an instrument toward achieving that.

Now, it's a little difficult, frankly, not to use the word "target" as shorthand when you refer to these long-term ranges--because they are targets on the assumption that those will produce economic results that we want. They're very shiftable targets, and I think this might be misunderstood when [one calls] them targets. So I don't think I can go along--at least I feel uncomfortable about accepting Governor Wallich's suggestion at this point.

CHAIRMAN BURNS. May I make this suggestion: that we consider first of all the main thrust of the memorandum by Mr. Partee and then discuss further to the extent that we may wish to do so the verbal changes that Governor Wallich has suggested?

Is there any difficulty with the main recommendation , that is, spelling out these ranges of ours in the policy record? Any difficulty with the main recommendation?

VICE CHAIRMAN VOLCKER. You say any difficulty. I have a slight difficulty in that I think it has a kind of spurious precision to it. And maybe it neglects some of the nuances in our conversation. But I don't have any strong feeling if this is the way the Committee wants to go.

I think even in this case it's pretty hard just to drop in these figures we've just talked about and reflect all the conversation adequately around the table. By not putting them actually in the directive, you leave that a little fuzzy. I think that's a merit, but I don't feel so strongly about it.

CHAIRMAN BURNS. But actually, all of these numbers now--

VICE CHAIRMAN VOLCKER. --now appear anyway.

CHAIRMAN BURNS. --now appear in the monthly policy record.

VICE CHAIRMAN VOLCKER. They're just a little more formalized this way, and I don't see that advantage, but I have no--

MR. PARTEE. Paul, you just voted on it.

[VICE CHAIRMAN VOLCKER.] That's correct.

MR. COLDWELL. But I would echo Paul's reservation. This does provide a bit more emphasis, placing them within the directive.

CHAIRMAN BURNS. Well, what is the thinking of other members of the Committee?

MR. GARDNER. Mr. Chairman, the release of the policy record is in a new phase--of 30 days. I would have some concern if I thought that release might be accelerated. I think we all would.

MR. MORRIS. But in that event, you could contemplate that we might only release to the public the almost meaningless directive that we've published in the past. I don't see how, if we were advised by a court that we had to release it earlier, that the court would permit us to simply release such an innocuous statement.

CHAIRMAN BURNS. Well, Mr. Morris, at this particular point you've stepped outside of your own realm of expertise. You had better listen to our counsel as to what--

MR. PARTEE. We had a memo from the counsel on this.

CHAIRMAN BURNS. --as to what a court would or would not permit us. Mr. O'Connell.

MR. O'CONNELL. Mr. Chairman, I stated earlier the possibility that the Court of Appeals may render a judgment to confirm an interpretation of law requiring immediate release of a directive policy action. Assuming the directive were included in that record, we are taking the position that the most immediate time frame within which that Record of Policy Actions can be formulated, finalized, adopted by the members of the Committee, and then be ready for final action would be the period of time we are now operating in, namely, roughly a 30-day period, no matter what were the immediacy the Court should render. So it's within that time frame that I express the view that I see no adverse impact, even should the Court of Appeals render the judgment of which I speak.

CHAIRMAN BURNS. All right, thank you, Mr. O'Connell. Mr. Jackson.

MR. JACKSON. I think we ought to incorporate it in the record just like it's proposed. We just had a long discussion this morning about our living within the spirit of the Sunshine Act, and I think this is just evidence of that intent.

CHAIRMAN BURNS. Well, you see, these specifications are now reported in the policy record, and what we're really talking about is the inclusion of these specifications in the directive to the New York Reserve Bank as well. Which means, as far as the monthly policy record is concerned, these numbers would be reported twice instead of just once, as is the case now. But if you take the instruction to the New York Desk--and I think this was the main point that the [sub]committee worked on--it's a fuller statement and more honest statement as to what the New York Desk is instructed to carry out. Is that correct?

MR. PARTEE. That's exactly it.

MR. COLDWELL. I raise a question, Mr. Chairman. If we were to, at a later date, decide there were to be a reserves intermediate target or something, would you also advocate that that be a part of this?

MR. PARTEE. If it were a short-run target, absolutely. It would appear down here in the operative instruction. Art, I'd forgotten what we had in the longer-run statement. Do we now use reserves? We had proposed that, at one point, to carry out the intent of the previous subcommittee report. That is, it's a longer-run thing if you look at it; reserves and--

MR. BROIDA. Oh, yes, Governor Partee, I'm sorry, it does say to foster bank reserve and other financial conditions.

CHAIRMAN BURNS. Yes, but we don't specify the numbers.

MR. COLDWELL. We don't specify the amount.

MR. PARTEE. Because we don't have a specified target, you see.

MR. COLDWELL. That's why I said, if later on you did, you would include that in your directive.

MR. PARTEE. I'm not sure--depending on what we did, it might appear in the long-run paragraph rather than a short-run paragraph.

MR. COLDWELL. Well, you have both. It would appear in one place or the other.

MR. PARTEE. No, I think we could amend it, you know, and anyway amend their operation. We would amend the instructions. And as a matter of fact, it seems to me that the instruction--because it is specific and is what we've told the Manager to do--is more amenable to a modification of [this] kind, than is the case now in our current [specifications].

CHAIRMAN BURNS. Mr. Lilly.

MR. LILLY. Just a question of how this would be carried out. As I understand, if this were adopted in the Committee's directive and instructed in this form, on page 3 we would show the weekly average federal funds rate of about 4-5/8--

CHAIRMAN BURNS. No.

MR. LILLY. 4-5/8 to 4-3/4.

CHAIRMAN BURNS. That is exactly what we would release.

MR. HOLMES. It would not show the range for the funds rate, Mr. Chairman?

MR. LILLY. 4-1/4 to 5, which gives you the little range within the big range.

CHAIRMAN BURNS. Yes.

VICE CHAIRMAN VOLCKER. In this particular instance.

MR. COLDWELL. That's not presently reported in this.

CHAIRMAN BURNS. Yes it is. I just checked that. It was reported in the last policy record.

MR. PARTEE. My guess is that this is just the second time we've done that.

MR. HOLMES. Would it say 4-5/8 or 4-5/8 to 4-3/4?

CHAIRMAN BURNS. It's at 4-5/8 to 4-3/4.

MR. PARTEE. I think that's what it would have to say.

CHAIRMAN BURNS. Well, at least I've been very precise that we shouldn't. This was released February 10.

MR. BROIDA. Well, this is part of a January meeting, which will be released on Friday.

CHAIRMAN BURNS. Oh, I'm sorry. Yes, but this has been approved by the Committee.

MR. EASTBURN. We need to reemphasize what Chuck said, that the big advantage of this is that it does away with the specification sheet, which I think always made us vulnerable--as far as our public posture is concerned--in having some kind of a secret document.

CHAIRMAN BURNS. Well, I honestly don't see that, because the policy record contains the numerical specifications now, and that particular sheet is a piece of a working paper for the Committee. I don't think we're vulnerable.

The advantage I see is that when you segregate and look solely at the instructions to the New York Desk at the present time, those instructions are incomplete. And the substance of the Partee [sub]committee recommendation is that the instruction to the New York Desk as we publish them be made complete. And that requires specification of the numbers. These numbers are reported now in the policy record, released after approximately one month.

MR. COLDWELL. Is there any possibility, Mr. Chairman, that this may trap you in your testimony with Congress.

CHAIRMAN BURNS. I don't see--I considered that very carefully, and at a certain time I was a little opposed and seeing some possible difficulty. And my next objection was that it was simply repetition--why do we have to say the same thing twice? But I finally--my present position is that there is a slight advantage in saying it twice, in [the] sense that [our] instruction to the New York Desk, looked at separately, is more complete.

MR. GARDNER. Mr. Chairman, I have one final concern, and that is, twice, I think, it appears that you [are] given the discretion in this statement of calling the Committee together. Now if it appears "the Manager will notify the Chairman and will then decide," this could--I may need counsel's assistance on this--but this could conceivably create a position where you might be criticized for not calling the Committee together. You might--

CHAIRMAN BURNS. To the extent that that is a difficulty, we lived with that difficulty for some time thus far without trouble or embarrassment, you see, because that is contained in the policy record now, and has been for some time.

MR. COLDWELL. I think the rules of the Committee permit calling a meeting by a certain number of members anyway.

VICE CHAIRMAN VOLCKER. I think that this doesn't technically mean you can't call a Committee meeting anytime you want to. This just says the Manager would notify you if [the directive] is significantly inconsistent, and there may be other reasons for calling the meeting.

MR. PARTEE. It's an instruction to the Manager, not to the Chairman.

MR. JACKSON. It imposes a duty on the Manager, though.

CHAIRMAN BURNS. Any further discussion desired? Let's have just a show of hands. Members of the Committee in favor of the Partee [sub]committee recommendation, would they kindly raise their hands. Those opposed. The majority is clearly in favor. We don't need a formal vote on this.

MR. BROIDA. Mr. Chairman, can we interpret the prior vote to cover this directive with the numbers inserted?

CHAIRMAN BURNS. I think we should.

We still have an opportunity--one that we've delayed time and again--to act on the report of our [sub]committee which has considered [public] agency [securities].

MR. WALLICH. Mr. Chairman, excuse me, there is a point--

CHAIRMAN BURNS. Sorry, I overlooked that. Now, as for the changes in language which Mr. Wallich has recommended, I share the sentiments expressed by Governor Partee. I have resisted the word "target." I never use it because it can lead to misinterpretation. And your main point, Mr. Wallich, namely the need to accent the attention that we give to the monetary aggregates, I don't think that you would advance that any by using the word "target."

You take the testimony that we have given before the Banking Committees. We've accented the monetary ranges, our objectives with regard to the growth of various monetary aggregates. That has been the main thrust of that testimony. And I don't really think that it would be advanced any by having the word "target" as a modifier of range.

But what is the sentiment of the Committee? Those in favor of having the word "target," kindly raise their hands. Well, there is no strong sentiment at the present time, but with your usual eloquence, Henry, in time you may possibly persuade the members of the Committee.

Let's turn to the report of our subcommittee on [public] agency [securities]. Mr. Volcker served as the chairman of that group. Mr. Volcker, would you be good enough to report.

VICE CHAIRMAN VOLCKER. You may recall, Mr. Chairman, this group was appointed specifically in response to a question about whether we should be purchasing what might be called some special agency issues. More specifically, WMATA, the Washington Metropolitan Area Transit Authority, and whether that was an appropriate kind of security for us to be buying.

Our charge was more general, just to examine lists in general of what we should be buying. I'm not sure that the Committee, faced only with the WMATA issue, would have reached the unanimous [result in the] report very easily. But we came up with the unanimous report quite simply based upon a broader consideration of what kind of agency [securities] it was appropriate to be buying, in the sense that we found we had been buying [securities of] some agencies, of which WMATA was certainly one. They were not currently issuing any securities in the markets and didn't have any real prospect of [doing so], and there were relatively few outstanding.

And we considered various alternatives as to how the instructions or directive might be changed to exclude some of these issues. And what stood out, I think quite naturally, was, under present conditions--unlike those that existed when the directive was originally formulated--with the Federal Financing Bank [now] in existence, and in fact [with] the Federal Financing Bank picking up a lot of these older agency issues--we could simply change the directive to exclude securities that were eligible for Federal Financing Bank purchase.

The practical consequence of this would be to concentrate on purchases in the federally sponsored agencies. These are the agencies that are not now eligible for the Federal Financing Bank because they have private ownership--FNMA [Fannie Mae], Home Loan Banks, and the Farm Credit [System], primarily. This is where the action has been; these are the agencies that were specifically mentioned by the Congress [as being ineligible for the Federal Financing Bank] when the [Federal Financing Bank] legislation was formulated, and so we unanimously concluded that the simple, straightforward thing to do would be to confine our purchases to agencies not included in the purchase authority of the Federal Financing Bank. In fact, in practice this means very little at the moment because those [eligible] agencies are selling their issues to the Federal Financing Bank, and we are not purchasing any significant amount of them currently in any event. So it regularizes to some degree the de facto situation that exists.

It has the further merit, as the subcommittee saw it, of providing rather visible support for the intention of the Federal Financing Bank to purchase these more singular-type issues, and we felt, I think consistent with the thinking of the Committee as a whole, that the Federal Financing Bank concept should be supported, and the Federal Reserve generally had supported the development of the Federal Financing Bank.

So this is a step, in a sense, consistent with that earlier view [and] recognizes the de facto situation that the Federal Financing Bank is buying these other issues, and [it avoids] any necessity on our part of selecting among agency issues.

The one exception to the general statement that [only] agency issues other than the [government]- sponsored-[agency] issues are being purchased by the Federal Financing Bank is

GNMA pass-through securities. This Committee, as a matter of practice, has not purchased those issues anyway. This would, in a sense, formalize its decision not to purchase those issues because they are eligible for Federal Financing Bank purchase. That's the only one [of the government-sponsored agency securities] that I am aware of that is eligible for purchase by the Federal Financing Bank, of any significance certainly. It would not involve any change of policy on the part of the Committee because we are not purchasing them anyway.

So I think I can report a unanimous recommendation that we meet the issue with which we were presented by [means of] this simple change of adding a few words to the instruction--that we will limit our purchase to issues not eligible for the Federal Financing Bank. It will involve very little change in practice, but a change in the way we describe practice.

We are aware that new agencies may arise in the future, and if [they do], then we conceivably would want to make a different decision then. But we felt we had to face that decision in the future anyway, and this doesn't prevent us from [doing so].

One other point I might mention. We did not interpret our mandate as looking more broadly at the practices of buying agency issues, including the size of the issue that might be eligible for purchase, the ones that would remain eligible, the percentage of those issues that might be purchased. Some question was raised in our discussion about that. The [System Open Market] Account Manager has been looking at the issue and is preparing to make some recommendations. If the Committee so desires, those recommendations could be filtered through the subcommittee if you want to keep it in existence for that purpose. I don't think we have any strong feeling one way or the other, other than some feeling that the thing ought to be looked at. And the Account Manager ought to look at it anyway. And our basic recommendation is the Federal Financing Bank.

CHAIRMAN BURNS. I have one concern about this rule. I would love to see the Metro Washington issue now in our portfolio, I'd like to see us get rid of that, and for a very obvious reason. [The presence of] this [asset in our portfolio] is dug up by individual Congressmen, and they come forward with the argument: "Now you have supported and rendered financial assistance to the City of Washington. You bought their securities. Why don't you buy the securities of New York City, and why are you discriminating against New York?" How much do you hold, Alan?

MR. HOLMES. $117 billion, according to table 1.

VICE CHAIRMAN VOLCKER. I should just add, Mr. Chairman, which I did not say--that the subcommittee contemplated that we would not sell those issues that would in the future not be eligible for new purchase except as part of any general sales program which was undertaken in any event. Since they have been at the very least extremely rare, I think in practice we are not contemplating that particular issue, or any other particular issue, that it would be sold out of the portfolio.

MR. COLDWELL. But we did agree that where opportunities arise when we were going into sales, we ought to view that as our prime--

VICE CHAIRMAN VOLCKER. Certainly.

MR. HOLMES. Mr. Chairman, would it be acceptable to the Committee if we discussed with the Federal Financing Bank whether they would like to take over? This may be very difficult.

CHAIRMAN BURNS. Sell these to the Federal Financing Bank?

MR. HOLMES. Yes, this would be an unusual sort of transaction.

CHAIRMAN BURNS. Why not do the unusual thing--get them to buy it?

MR. PARTEE. And maybe take the financing back.

CHAIRMAN BURNS. Give it to them. Sell it to them at a market price.

VICE CHAIRMAN VOLCKER. On the substance of your concern, Mr. Chairman, I don't think the [sub]committee was of one view that there is a concern [but] I would have the concern that it's hard for this Committee to distinguish among issues that are fully guaranteed by the federal government. That, in effect, the decision about support of a local instrumentality is made by the Congress in providing the 100 percent guarantee in the first place, and it's a little hard for us to second-guess that one if we are buying guaranteed agency issues. And that's of course why we slid into this other approach, where that kind of consideration is absent from our recommendation.

MR. PARTEE. There's a big difference. Unfortunately, the people who comment on this don't recognize this--it stirs up concerns.

CHAIRMAN BURNS. I must say my main interest in the work of your subcommittee was in getting rid of the D.C. issues.

VICE CHAIRMAN VOLCKER. We thought we were accomplishing that purpose and have accomplished the purpose in terms of new purchases. We haven't accomplished it in terms of--

CHAIRMAN BURNS. That will have very little influence, I think, on congressional opinion, but maybe municipal finances from this point on will be handled so wisely, so prudently around the country that this problem will not arise.

MR. PARTEE. Mr. Chairman I have only one question about the report. Let me just check this with Paul. It's a nice way of getting rid of these bits and pieces. My recollection was that the financing bank was originally sold to the agencies as an optional source of financing. That is, it was wasn't mandatory. For a while, the Treasury wanted to make it mandatory that the agencies would do the financing with the financing bank. The way it was left, as I recall, it was optional; they could do it if they wanted to or not do it.

So it does suggest as a possibility, you might have some fully guaranteed agency in the future that doesn't use the financing bank. It goes out on the market itself, and then we may not be providing--we could not be considering this, as I understand it, as we would consider another agency, because of this narrowing, this particular determination we have made. Now, is that appropriate?

VICE CHAIRMAN VOLCKER. I think conceptually you are correct. If my memory is right, virtually all these agencies--not by the terms of the Federal Financing Bank legislation, but by the terms of their own substantive legislation--can't go into the market without some other device where the Secretary of the Treasury can force them into the Federal Financing Bank. That may not be 100 percent true, but I remember big discussions we had with the Post Office--that the terms of the Federal Financing Bank legislation don't require it, but there's a fancy provision in the Post Office legislation which gives the Secretary of the Treasury the whip hand so that he can force it, and he currently is forcing it.

But I think the conceptual implication is correct. And I can speak for only one member of the subcommittee--[I] would have thought that that was desirable, to support the Treasury's effort to get them all in the Federal Financing Bank.

MR. COLDWELL. I think this is [desirable], too, Chuck. We encourage them to come into the Federal Financing Bank. They decide in their own judgment that they want to issue something separately--why, then, they ought to stand on their own.

MR. BLACK. Could they get as attractive a rate by doing it on their own, you think?

VICE CHAIRMAN VOLCKER. No, but some of them have wanted to anyway. Historically, they wanted to be independent of any other government financing source.

MR. JACKSON. Most of these require the Secretary of the Treasury's approval?

VICE CHAIRMAN VOLCKER. Most do, but I can't swear that every one of these eligible agencies do. In the case of GNMA pass-throughs, I don't know what the situation is, but that's one that the Treasury didn't want to get into the financing bank. Whether they have the power to force them out, I don't know.

MR. PARTEE. Well, I think you are right. I agree with the thrust that we gave the financing bank a lot of special support in listing it and putting it into our own assets, and so forth.

VICE CHAIRMAN VOLCKER. As the memorandum made clear, if I didn't make it clear, we can, under the terms of this, buy the Federal Financing Bank issues themselves. They are currently financing through the Treasury. But if they ever finance themselves, they would be eligible for purchase by, and presumably would be purchased by, the [Federal Reserve] System.

CHAIRMAN BURNS. Well, then, are we ready to thank Mr. Volcker and his [sub]committee? Is there anyone among us who is unwilling to thank Mr. Volcker?

VICE CHAIRMAN VOLCKER. You want us to look at this other--

CHAIRMAN BURNS. Let's think about further instructions to the [sub]committee. I'd like to have that before me, and we will think about that later. For the present, I think this is a good report, and is there any feeling on the part of the Committee that the recommendation not be carried out? Well, I'm instructed by the Committee to thank you for--

MR. HOLMES. Mr. Chairman, does this mean that the Committee has adopted the new guidelines that are--

MR. PARTEE. Should we move to adopt then? I so move.

SPEAKER(?). Second.

CHAIRMAN BURNS. Any questions? Gentlemen we are three minutes late.

END OF MEETING