The original documents are located in Box B65, folder "International Monetary Crisis, 1971 (3)" of the Arthur F. Burns Papers at the Gerald R. Ford Presidential Library.

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date August 17, 1971

To Chairman Burns

Subject: Checklist of Issues to be Resolved in Coming Weeks

From Ralph C. Bryant RCB

CONFIDENTIAL (FR)

The international aspects of the Administration's New Economic Policy have not yet been explicitly spelled out. The overture has been played, and augurs well for the remainder of the score. But it is the dénouement in Act III, not the overture, that will determine the ultimate success of the show.

A resolution of the current period of uncertainty in international financial markets -- both the substantive character of this resolution and the timeliness with which it can be brought about -- depends critically on strong leadership from the U.S. Government. A prerequisite for strong leadership on our part is a clear conception of our own preferred outcome. How do we want the script to read for Act III? I believe it is a matter of great urgency for the Administration to develop a well-thought-out answer to this question, and to do so quickly. As far as I can tell from my limited perspective, we have not yet done so.

In my opinion, all of the following issues need to be considered carefully in formulating our preferred outcome:

(1) The "post-resolution" pattern of exchange rates among national currencies;

(2) The post-resolution values of national currencies in terms of gold, SDRs, and reserve positions in the IMF -- in particular, of course, the dollar price of gold;

(3) Institution of procedures for ensuring greater flexibility of exchange rates in the future;

(4) Reduction of the reserve-currency role of the dollar as part of a move towards the consolidation of reserve assets;

(5) Methods for increasing the ability of the United States in the future to initiate changes in the exchange rate of the dollar vis-à-vis other currencies;

(6) Cooperative international management of the growth of world reserves; and

(7) Removal of restrictions on U.S. capital outflows.

Several further issues, although important, seem to me secondary compared with those listed above. They include:

(8) Possible "compensation" for official holders of dollars in the event of any change in the dollar price of gold; and

(9) Possible understandings with other industrial countries about regulation of short-term capital flows.

I am assuming that the 10 per cent import surcharge is essentially a bargaining chip that we intend to bargain away in the course of the negotiations with other countries. If the import surcharge is

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not clearly seen in this light, I would want to add its retention to the list of major issues.

Issues (1) and (2) above will be jointly determined when the United States and other countries agree on a post-resolution pattern of par values in the IMF.

Issues (3) through (6) are the most complex. And they are the issues on which we are furthest from having a carefully worked out position. In my view, they are every bit as important to us as the first two issues.

Although we have addressed ourselves to all of these issues in the past, the current circumstances naturally demand an urgent reconsideration and refining of earlier views. I would like to be of any assistance I can in this regard, and I know that other members of the International Division share this sentiment. Intensive work is already in process in some obvious areas -- particularly on Issues (1) and (7) -- and I believe we ought to be preparing position papers for you on issues (2) through (6).

cc: Governor Daane
Mr. Holland
Mr. Robert Solomon
Mr. Pizer

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date August 18, 1971.

To Chairman Burns

Subject:

From Samuel Pizer

CONFIDENTIAL (FR)

The attached material provides a somewhat more full account of the Japanese market situation.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date: August 18, 1971

To: Mr. Pizer

Subject: Latest Japanese Developments.

From: Reed J. Irvine

A source at the Japanese Embassy informs me that there has been only a slight decline on the Tokyo stock market today, and it looks like the fall has bottomed out. This source reports that the Bank of Japan has bought an additional $300 million worth of dollars today, bringing the three-day total to $1.6 billion.

The Dow-Jones ticker this morning reports that the Japanese Government is studying all possibilities for action on the exchange rate front, but at present they will continue to support the dollar within the existing IMF band. The D-J says that resistance to revaluation is probably being reinforced by growing anti-American feeling in Japan.

The Dow-Jones index for the Tokyo Stock Exchange closed at ¥2328.28 yesterday. The drop was ¥210.50 on Monday and ¥89.66 on Tuesday. Yesterday's decline was attributed largely to rumors that European countries might put restrictions on Japanese goods.

I am attaching a memorandum from Mr. Emery that responds to the questions raised by Chairman Burns.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date August 18, 1971

To Mr. Reed J. Irvine

From Robert F. Emery RFE

Subject: Recent Economic Developments in Japan.

On Monday and Tuesday of this week (August 16 and 17), the Japanese foreign exchange banks reacted to the United States August 15 economic measures by selling large amounts of dollars to the Bank of Japan. According to the Representative Office of the Bank of Japan in New York City, this was primarily because the banks had a substantial net asset position in dollars, but the dollar sales also reflected some leads and lags in foreign transactions. The Bank of Japan reportedly purchased about $600 million on Monday and $700 million on Tuesday, bringing Japan's official foreign exchange reserves to $9.9 billion, or $2 billion higher than at the end of July. According to Mr. Akita, there was virtually no influx of speculative funds on Monday and Tuesday. Only a small amount of additional purchases of Japanese securities.

The spot rate for the dollar on Monday and Tuesday apparently was maintained at about ¥357 to the dollar, or approximately the same level as prevailed during the previous week. Transactions in the forward market were very thin on Monday, with the four-month discount for the dollar quoted at 5.94 per cent.

For some time the Bank of Japan has indicated that it has the necessary powers and controls to restrain any large influx of speculative funds into Japan. But there is a difference of opinion as to whether the Japanese authorities will really be able to do this successfully. The Bank of Japan has various controls including guidelines on foreign short-term borrowing by individual Japanese banks, and ceilings on each banks' net foreign asset position. The latter ceilings apply to both the net amount in dollars for the individual banks as well as the absolute amount of increase over a certain time period. In general, the net foreign asset ceilings must be observed either at the end of the month or semi-monthly.

Last Saturday the foreign exchange banks had a net foreign asset position of approximately $1 billion. However, on Monday and Tuesday they sold $1.3 billion in dollars to the Bank of Japan. The Bank of Japan contends it can use moral suasion to prevent the banks from assuming a heavy net foreign liability position, and therefore the banks are not likely to continue their heavy sales of dollars. However, a contact at the U.S.-Japan Trade Council has indicated that the Japanese trading companies are engaging in speculation and the Japanese

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have about $6 billion in foreign assets. These are mostly deferred payments credits. Although he would not say whether there would continue to be an influx of dollars into Japan this month, the implication was that it was possible unless the Bank of Japan took new strong measures to halt the influx.

Besides the above restraints, there are also some restraints on the volume of foreign purchases of Japanese securities. Since May 17, 1971, foreigners have been forbidden to purchase unlisted securities in Japan, as well as short-term (60 days or less) government securities. In addition, no single foreigner is allowed to hold more than 10 per cent of the outstanding shares of a Japanese company, and the share holdings of two or more foreigners in a Japanese company are not allowed to exceed 25 per cent.

On Monday and Tuesday, stock prices on the Tokyo exchange fell 11 per cent from the previous level on Saturday. Mr. Akita indicated that most of the decline involved the stocks of firms that would be adversely affected by the new U. S. import surcharge. Other issues were not affected significantly.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date August 19, 1971

To Mr. Samuel Pizer

Subject: Late Japanese Developments

From R. J. Irvine

The Dow-Jones ticker this morning reports that the Bank of Japan has purchased another $600 million worth of dollars today. This brings the four-day total to $2.2 billion. The Bank of Japan has ordered Japanese banks not to increase the total of foreign currency borrowing above the level of August 18. Four leading commercial banks announced they were temporarily suspending spot transactions in dollars. However, inter-bank transactions were not affected. This is apparently the basis for the broadcast report that the Japanese had suspended trading in dollars. The Bank of Japan did not suspend dollar purchases.

The Tokyo stock exchange was hard hit again today, the Dow-Jones average declining by ¥138 to ¥2190, a 5.9 per cent decline. This brings the decline for the week to 20 per cent.

The Japanese steel industry has asked for an exemption from the U.S. 10 per cent import surcharge on the ground that they are maintaining quotas on steel exports to the U.S. The Japanese industry indicated that it would be willing to see a formal government-to-government agreement on steel quotas negotiated.

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date August 18, 1971

To Mr. Reed J. Irvine

Subject: Recent Japanese Economic Developments

From Robert F. Emery

Central bank intervention

On Wednesday, August 18, the Bank of Japan intervention in the foreign exchange market in support of the dollar reportedly amounted to $300 million. Total intervention for the first three days of this week thus came to $1.5 billion. This reportedly raised Japanese official reserves to $10.2 billion. The Bank of Japan office in New York indicated that while this partly reflected leads and lags in foreign transactions, there was virtually no speculative inflow of funds.

Exchange rate

For the third straight day this week the Bank of Japan continued to support the dollar at the minimum interbank rate of ¥357.35 to the dollar. Prime Minister Sato is also reported by the AP news ticker to have said that Japan would continue to maintain the present yen parity since he did not want to have deflation at a time when the economy was already very sluggish.

Stock market

Stock prices continued to decline on Wednesday and fell 4.6 per cent. This compares with declines of 7.7 per cent on Monday and 3.5 per cent on Tuesday. Since Saturday, the market has declined 15.1 per cent.

Run on gold objects

The AP news ticker reported on Wednesday that there has been a rush on the part of Japanese consumers to buy objects made of gold. This was attributed to the possibility of yen revaluation.

Ministry of Finance Official

Mr. Yusuke Kashiwagi, formerly Vice Minister of the Ministry of Finance, and currently Special Adviser to the Minister of Finance, has left Japan and will be in Paris on Thursday for consultations. He will continue on to Washington and be here over the weekend.

Revaluation rumor

Unofficial trading sources reported in New York Wednesday morning that the yen had been revalued by 8 per cent. This was later denied by Ambassador Ushiba after a visit with Secretary John Connally and also by the Ministry of Finance in Tokyo.

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<u>Supplemental import duty</u>

The <u>New York Times</u> reported on Wednesday that the 10 per cent supplemental import duty is expected to affect about 90 per cent of the United States' imports from Japan. The same issue reported one U.S. Government official (unspecified) as saying that the yen was very undervalued and should be revalued by 20 to 25 per cent.

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THE WHITE HOUSE

WASHINGTON

August 19, 1971

FOR: ✓ARTHUR BURNS
PAUL McCRACKEN
GEORGE SHULTZ

This is something I got from Paul Volcker that relates to our meeting tomorrow morning.

Attachment:
"International Negotiations"
8/18/71

~~SECRET~~

August 18, 1971

INTERNATIONAL NEGOTIATIONS
OBJECTIVES, ISSUES, AND CONCLUSIONS

The state of flux in the international monetary order presents large opportunities and risks. On the favorable side, we may be able to re-establish the strength of our external position in a framework of a stronger, orderly multilateral system. At the least, we may ease the transition to a world more closely aligned into regional blocs -- with open trade and investment between the blocs. At worst, the world economy will degenerate into uncooperative, protectionist blocs. A time for critical decision is at hand.

We can press now for certain of major objectives in a multilateral setting and get a firm start on others, along the road to rebuilding a multilateral order. This initial effort may well have a relatively high probability of failure -- but, even if it fails in its immediate objectives, it could be important in keeping open the path to "benign regionalism."

A passive stance by the United States now, in an effort to maximize later gains, also maximizes risks. The rest of

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E.O. 12356, Sec. 3.4
MR 92-31, #29, Treasury ltr. 10/28/92
By KBH NARA, Date 12/24/92

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the world -- and particularly Europe -- is capable of "going it alone." Left to themselves, they are likely to do so in a divisive manner, arguing, rightly or wrongly, we cast the first stone.

Objectives

We have two inter-related objectives:

(1) We want to secure our own external position, both to strengthen the position of the dollar as an anchor for the international system and, even more directly, to support a prosperous domestic economy, trading freely with others.

(2) We want a strong and durable international monetary system, offering stable conditions for growth and investment and an economic setting for political cooperation.

The first objective requires both exchange rate adjustments and, in time, a revision in trading arrangements and burden sharing. The trick will be to obtain sufficient

action or assurances to be reasonably confident the objective is achieved (assuming satisfactory internal performance).

The second objective will require extended negotiation, with the proper agenda and will for agreement.

Proposed Approach

A. Try to get agreement on the exchange rate question promptly, using the Group of Ten. If achieved in sufficient measure, with necessary further assurances from Japan on our bilateral balance and some consensus on the framework for other negotiations, the surcharge could be removed. (Holdouts could be penalized by maintenance.) (The new rates might have a wider band.)

Convertibility would be restored only in limited and tentative form, pending (a) visible rebuilding of strength and (b) progress on trade and burden sharing. Other countries would assume the principal burden of market intervention and

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agree to refrain from converting present dollar holdings pending further agreements on monetary reform.

Questions: How large an exchange rate adjustment is needed?

Is the gold price negotiable under <u>any</u> circumstances?

How can the role of gold be depressed?

What assurances do we need from Japan?

B. Following the realignment (and surcharge end), monetary negotiations would extend to:

(a) Exchange flexibility. (The present U. S. position is a minimal need.)

(b) Role of SDR's.

(c) Methods of funding dollar holdings and moving to some kind of reserve settlement account.

We would have ample time to review a detailed position on these points. As they are satisfactorily resolved, a modified form of full convertibility could be re-established.

C. In parallel negotiations, we would:

(a) Deal with outstanding trade issues.

(b) Develop multilateral burden sharing.

As in B, this will be time consuming. Progress will help determine our recommitment to convertibility, as well as removal of any residual surcharge on imports from particular countries.

Conclusions

The size of the adjustments needed may make any early agreed solution impossible. But we have much to gain from trying.

(1) While others are off balance, our advantage is considerable; after markets settle down, the advantage might be gone.

(2) The image of cooperativeness is important; others have pride and prestige considerations that will drive them to autarchy. Politically, this Administration will get the blame.

(3) To try and fail is not to lose. It will tend, in all probability, to maintain a more constructive attitude internationally than an appearance of turning our back.

Consequently, we should soon join the call for a Group of Ten meeting -- in Washington -- with a prepared exchange rate, convertibility, surcharge position.

BOARD O[F G]OVERNORS OF THE FEDERAL RESERVE S[YST]EM IMP

CONFIDENTIAL (FR) August 19, 1971

To: Chairman Burns

From; Robert Solomon

Subject: The U.S. Negotiating Stance on International Monetary Matters.

Suspension of convertibility and imposition of the temporary import surcharge have created a unique opportunity for U.S. leadership in the achievement of an improved international monetary system. In fact President Nixon on the evening of August 15 said that "we will press for the necessary reforms to set up an urgently needed new international monetary system."

Since we have taken drastic action internationally, there is much to be said for trying to achieve some lasting improvements, in addition to an immediate realignment of exchange rates.

U.S. Objectives

I would list U.S. negotiating objectives as follows:

1. Substantial revaluation of other currencies against the dollar.

2. An understanding on greater flexibility of exchange rates in the future.

3. Improvements in trade policy (by Japan but also a reduction of EC preferential arrangements with non-EC countries and an agreement to do something on non-tariff barriers.

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AUTHORITY Fed. Res. ltr. 11/16/82; State guidelines; Treasury ltr. 8/22/06
BY [signature] NARA, DATE 9/29/09

4. Better offset of U.S. military expenditures in Europe (here we must weigh the danger that the Germans will insist on revocation of the Blessing/Martin letter as a quid pro quo).

5. Agreement that the SDR needs to be kept alive, since SDR creation will be a necessary condition for the maintenance of balance of payments equilibrium (in the absence of U.S. deficits there will be no other adequate source of growth of international reasons).

6. A willingness by the United States to start negotiating a consolidation of reserve assets in the IMF--that is, to give up our role as the reserve currency.

Negotiating Package

In the actual negotiations, it would be useful to add to the above objectives a U.S. objective to get rid of our capital controls. Although we may have to defer achievement of this objective, the very willingness to do so may be a useful negotiating device. Furthermore, inclusion of this item makes it possible to push for a larger revaluation of other countries than is specified in the IMF table.

RS

UNITED STATES INFORMATION AGENCY

OFFICE OF THE DIRECTOR

August 19, 1971

NOTE FOR: The Honorable
Arthur F. Burns

The French Gallup affiliate IFOP conducted for the newspaper L'Express a poll on the President's economic measures on August 18. The results will be published next Monday, August 23. We have them on the basis that we will not release these findings prior to publication.

Frank Shakespeare

August 19, 1971

French Attitudes Toward President Nixon's New Economic Policies

On Wednesday, August 18, the French Instiute of Public Opinion (IFOP) conducted a public opinion survey commissioned by the French weekly L'Express. The sample comprised 360 white collar workers and persons in higher-level occupations living in cities with 20,000 or more inhabitants. L'Express will publish the findings next Monday, August 23.

The following findings were transmitted by phone and the exactness of of the translations have not yet been verified. There could also be minor discrepancies in the "don't know" and "no effect" categories.

IFOP has asked that we not release these findings to the public prior to publication.

1. Have you heard about the measures decided by President Nixon to protect the dollar?

1. Yes, have heard	90%
2. No, have not heard	10
	100%

2. Do you think that the dollar crisis will have a good or a bad influence on your standard of living?

1. Good	8%
2. Bad	41
3. No effect (voluntary)	51
	100%

3. In your opinion should the French government support the dollar?

1. Yes	43%
2. No	31
3. Don't know	26
	100%

Determined to be an administrative marking Cancelled per E.O. 12356, Sec. 1.3 and Archivist's memo of March 16, 1983
By gp NARS date 6/11/84

4. In your opinion, is the current dollar crisis a rather disquieting or rather reassuring phenomenon for the French economy?

1.	Disquieting	63%
2.	Reassuring	10
3.	Don't know	27
		100%

5. Which among the following currencies appears to you currently to be the most solid one?

1.	Deutsche Mark	50%
2.	Swiss Franc	31
3.	French Franc	6
4.	American Dollar	4
5.	British Pound	2

6. Can you conceive of a monetary system that would be founded on another basis than gold?

1.	Yes	32%
2.	No	45
3.	Don't know	23
		100%

7. Do you believe that this crisis will favor or hinder the establishment of a European currency?

1.	Favor	51%
2.	Hinder	28
3.	Don't know	21
		100%

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August 19, 1971

Requirements for Balance of Payments Equilibrium

I. U.S. Objectives

1. The United States should maintain a balance in its international payments which will for the foreseeable future:

   (a) Not impose undue constraint on the pursuit of full employment with reasonable price stability and healthy economic growth in the U.S.;

   (b) Foster a stable international monetary system conducive to a freer flow of trade and payments across international boundaries;

   (c) Facilitate the achievement of a global structure of peace, the promotion of economic progress in less developed nations, and a partnership with other nations which "will make this planet a better place to live." 1/

1/ President Nixon in "U.S. Foreign Policy for the 1970's," a report to the Congress.

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BY [initials] NARA, DATE 9/29/09

~~CONFIDENTIAL~~

2. A balance of payments position meeting these requirements should be recognized by the world financial community as a strong and stable position compatible with the balance of payments positions of other major countries. To meet these requirements the United States will need a statistical position which over a period of years assures:

   (a) an official settlements balance averaging around zero, excluding allocations of Special Drawing Rights;

   (b) a surplus on current and long-term capital account of not less than $1 billion annually -- a surplus sufficient to cover a negative figure for errors and omissions, which has been averaging roughly $1 billion annually;

   (c) in order to finance a foreign aid program worthy of the United States and to accommodate foreign demands for U.S. private capital, a surplus on goods, services and private remittances of not less than .5% of the U. S. GNP will be necessary

for some years to come. For 1973, this would mean a surplus on goods, services and remittances of $6 to $7 billion. A surplus of this magnitude would be sufficient to maintain the desired position on current and long-term capital only if there is a substantial reduction in the relative attractiveness of other countries as a site for investment in manufacturing industries.

(d) a surplus of this magnitude cannot be achieved except through a surplus on merchandise trade account. Given present prospects -- both with respect to the level of military expenditures and the increase in investment <u>payments</u> as well as receipts, a trade surplus of $5 billion will be needed in 1973. The sooner a current account surplus is restored the less interest payments will increase.

II. The improvement required to meet U.S. objectives

1. Prior to recently announced actions, the U. S. balance-of-payments position was projected as follows:

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	1st Half 1971	Year 1971	1972	1973
Merchandise Trade	-.8*	-1.9	-3.5	-6.5
Goods, Services and Remittances	-.2*	-1.0	-2.7	-5.5
Current and long-term Capital	-4.8	-8.4	-8.9	-11.4

* Actual Seasonally Adjusted Rate.

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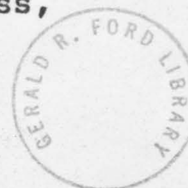
2. The deficit in 1971 would be substantially larger if the U. S. economy were operating at the full employment level. On a rough "full employment" basis, the trade deficit for the year 1971 would be in the range of $3 to $3-1/2 billion and the deficits on the other balances would be increased by comparable amounts.
3. Even more importantly, our merchandise trade position, based on the exchange rates in effect prior to May 1, 1971, could have been expected to deteriorate at a rate of nearly $2-1/2 billion annually. Under these circumstances we could not expect any net improvement in our investment income, since liabilities would be rising more rapidly than assets.
4. Any projection of the U. S. payments position is subject to a wide margin of error. Nevertheless,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there is every indication that if there were no exchange rate changes or other major policy steps by

the U. S. or other major countries, the United States would by 1973 have found its balance of payments position short of its requirements in the following orders of magnitude:

	Billions of $		
	Requirement	Projected 1973 Position	Shortfall
Merchandise trade bal.	+5 to +6	-6	11 to 12
Balance on goods, services and private remittances	+6 to +7	-5	11 to 12
Balance on current and long-term capital	Over +1	-11	12

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5. The foregoing projection takes no account of the trade effects of the contemplated enlargement of the European Common Market or any preferential trade arrangements which might be concluded between the enlarged EC and other nations. Damage to our agricultural trade from U.K. entry is expected to be at least $100 to $150 million annually and preferential arrangements already concluded by the EC could damage our manufactured

trade by a similar account. In addition we could also suffer from trade diversion effects of enlargement. These factors would need to be taken into account over the longer term.

6. Neither does the projection allow for the removal of the restraints on capital outflows currently being maintained by the United States. These restraints are believed to have an impact on the net outflow of long-term capital of about $1 billion annually. Any balance of payments adjustment program should be designed to produce a position which would be in equilibrium without the necessity of maintaining these restraints. Since an exchange rate realighment would change the market incentives to which capital movements would respond in the absence of restraints, removal of the restraints under such conditions might not have a major impact on our balance.

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III. <u>Extent of required exchange rate realignment</u>

1. It is extraordinarily difficult to estimate the effects of exchange rate changes. The IMF staff has undertaken extensive econometric studies which suggest that a series of changes in the exchange rates of all other OECD countries vis-a-vis the dollar averaging about 10 percent might produce an improvement in the U.S. position on goods, services and private remittances of $8 billion.

2. We have had no experience with simultaneous changes in the exchange rates of a number of countries vis-a-vis the U.S. since 1949. Consequently, all attempts to use econometric studies to determine the extent of the change required suffer from a lack of data. We are reluctant to rely too heavily on the IMF studies, although they may be helpful as an indication of the maximum amount of impact which could be expected from a given change.

3. What is apparent is the need for a change which eliminates the ~~trend~~ tendency of the trade balance to deteriorate $2-1/2 billion a year and to shift the expected trade balance in 1973 from $-6 to $-7 to $+5 billion-- a shift of $11 to $12 billion. The goods and services

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balance would have to improve by roughly the same amount.

4. To achieve an adjustment of this magnitude a change in the rates of other OECD countries averaging at least 15 percent would be required. If the IMF studies of trade relationships and the distribution of the effects of exchange rate changes are employed, the required changes in individual country rates would be along the following lines:

	Percent
Japan	22.5
Canada*	18
U.K.	11
Germany*	20
Belgium/Luxembourg	15
Italy	14
Netherlands*	11
France	11
Other OECD countries	14

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5. These estimates are based on the assumption that there would be no significant change in the exchange rates of non-OECD countries. Given exchange rate adjustments of this magnitude on the part of the major industrial nations of the

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* These changes are measured from the parities prevailing before the Canadian dollar was allowed to float in 1970.

world, it is quite possible that some countries outside the OECD could appropriately appreciate their rates while the economic assistance requirements of others might be significantly diminished. Nevertheless, the impact of such changes would probably not be such as to permit any significant lowering of the degree of change in the rates of the major OECD countries which must occur in order to restore a sustainable world payments equilibrium.

IV. Contributions of other measures to the achievement of equilibrium

It would not be necessary to achieve the entire amount of the balance of payments adjustment required through a realignment of exchange rates if other nations were prepared to assume greater responsibilities for the Free World defense, to open up their domestic markets, and in other ways to pursue more equitable trade and industrial policies. Contributions of up to the following amounts might be made in that way.

	Millions of $
(a) Through the assumption by other NATO countries of budgetary costs of maintaining U.S. military forces in Europe	1,000 to 1,500*/
(b) The opening up of the Japanese market by removal of import quotas (Removal of the administrative guidance system might provide a further gain.)	250
(c) Modification of the Canadian automotive agreement and cessation of Canadian Government pressure on U.S. firms to construct plants in Canada for the purpose of supplying their U.S. market	100 to 200
(d) Access for U.S. agricultural products to the markets of the EC through elimination of the variable levy system	250
(e) Elimination of EC subsidies for agricultural exports in U.S. traditional third markets	150 to 200

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*/ Currency revaluations by countries in which military expenditures are incurred will increase the balance of payments costs of these expenditures.

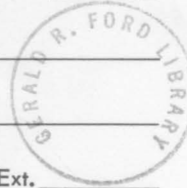
FR 468
(Rev. 3-63)

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

MEMO Date 8/20 Time

To: Chairman Burns

From: Ralph Bryant



Tel. No. Ext.

- [ ] Please call
- [ ] Returned your call
- [ ] Will call again
- [ ] Phone me re attached
- [ ] See me re attached
- [ ] For your approval
- [ ] For your information
- [ ] Note and return
- [ ] For comments and suggestions
- [ ] Preparation of reply

MESSAGE:

As Dewey will tell you, we spent quite a lot of time at the Treasury discussing these subjects. We also had an hour with Jack Polak and others at the Fund.

Although there are of course many tenuous judgments embodied in this paper, we have confidence that these estimates are at least as soundly based as those prepared at the Treasury. There are significant differences between the Treasury staff view and our own, which we can explain if that would be helpful to you.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date August 19, 1971

To Chairman Burns and Governor Daane

Subject: The Magnitude of the U.S. Imbalance and the Changes in Exchange Rates Required

From Ralph C. Bryant, George B. Henry, Helen B. Junz, and Samuel Pizer

~~Confidential~~ (FR)

This note summarizes, as of tonight, our best judgment on the following three questions: (a) How large is the underlying disequilibrium in the U.S. balance of payments? (b) At what balance-of-payments target should we be aiming? and (c) What realignment of exchange rates might enable the United States to reach this target?

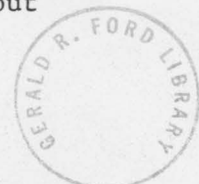
Size of Disequilibrium

We estimate the disequilibrium in 1971 to be between $7-8 billion on a high-employment basis. For 1972, we believe the high-employment deficit to be $1 billion higher, that is about $8-9 billion.

Our judgment of the size of the disequilibrium is based on calculating what the U.S. payments balance might have been if the United States and other industrial countries had been at high employment in 1971 and were to be at high employment in 1972. The calculations are based on 1970 rates of exchange and assume that capital controls remain in place.

The Appropriate Target

In our judgment, the adjustment should be sufficiently large to give us a high-employment official settlements balance somewhere between a $ 1/2 billion deficit and a $1 billion surplus. This would imply an improvement in the official settlements balance of about


GERALD R. FORD LIBRARY

$8-10 billion based on the 1972 estimated shortfall.

Although a small improvement could be expected for the capital account after realignment of exchange rates, we judge that the lion's share would need to take place in the current account. Hence we judge the needed improvement in the current account to amount to $7-9 billion, of which about $6-8 billion would have to come in merchandise trade. Removal of capital controls would require a somewhat greater adjustment, but probably no more than $1-2 billion.

Treasury estimates tend to target on the 1973-75 period, but this exaggerates the amount of change needed to remedy the present imbalance. An attempt to offset now the deterioration that might come from divergent economic trends or policies in the period after 1972 might well abort the adjustment process. The problem of adjusting possible future payments imbalances would best be handled by greater flexibility of exchange rates.

<u>New Pattern of Exchange Rates</u>

The accompanying table indicates a pattern of exchange-rate changes that we believe would produce an improvement in the U.S. trade balance in the required $6-8 billion range (a target of $7 billion is used in the calculations). When these changes are weighted by countries' shares in world exports, the depreciation of the U.S. dollar vis-a-vis the entire world would be roughly 4 3/4%; weighted by U.S. import shares, it would amount to 7 3/4%. If the rate changes are weighted by countries' shares in OECD exports to the world, the average appreciation of the revaluing countries would amount to 9%.

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Exchange-Rate Adjustments Needed to Achieve a $7 billion Improvement in the U.S. Trade Balance

	Percentage Revaluation 1/				Estimated Effects on U.S. Trade Balance ($ billion)
	Total	Already Effected 2/	To be Effected		
Japan	15	--	15	15	1.50
Germany	12½	5	7½	13.4	1.25
BLEU	7½	--	7½	10.0	.30
Netherlands	6	1	5	7.3	.25
France	6	--	6	7.3	.35
Italy	6	--	6	9.4	.30
Switzerland	9	7	2		.25
Austria	7½	5	2½	7.2	.05
United Kingdom	5	--	5		.50
Canada	12½	5	7½	12.1	1.50
Other OECD 3/	5	--	5	9	.25
			9% -	11%	
Non-OECD					.50
				Total	7.00

Note: Total balance-of-payments improvement required is estimated to be $8-10 billion. Of the $8-10 billion, $6-8 billion would need to come in the trade balance. Devaluation benefits in the capital and invisibles balances might yield an improvement on the order of $1 billion.

1/ From mid-1970 parities.
2/ As of mid-July 1971.
3/ Australia included with non-OECD.

IMF - above 8 Billion

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We estimate that the largest part of the impact of these exchange-rate changes on the U.S. trade balance would occur some time between 12-24 months after the changes were effected. If fewer countries revalued, the total effects would be more than proportionately smaller. A large amount of the improvement in the U.S. trade balance occurs in third markets.

At the present time the current-account positions of the countries listed in the table are such that the implied deteriorations in their positions would not put intolerable strains on them. (A possible exception to this judgment might be made for the United Kingdom and the Scandinavian countries.) If the postulated exchange-rate changes were of a much greater order of magnitude (e.g., over 20 per cent for Japan, over 10 per cent for France and the Benelux countries, over 5 per cent for the U.K.), we strongly doubt that the resulting deteriorations in other countries' positions would be tolerable.

Impacts of the 10 Per Cent Import Surcharge

We will shortly have ready a detailed analysis of the estimated effects of the surcharge on U.S. imports. Our preliminary judgment is that a full year's effect, based on the fourth quarter 1971 level of imports, would fall into a range of \$ 3/4 to 1-1/2 billion.

The countries hardest hit by the surcharge will be Japan and Canada, as the following table suggests:

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	% of total exports affected
Japan	29.3
Canada	14.4
Italy	9.2
Germany	8.6
United Kingdom	8.4

While the import surcharge is a powerful factor in the forthcoming negotiations, its force depends largely on the expectation that it would in fact be removed. It does not have great effect by itself on the trade balance, as compared with a change in exchange rates. An average depreciation of the dollar by any given percent would yield an improvement in the trade balance alone several times greater than an import surcharge of the same amount maintained on a permanent basis.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date August 20, 1971.

To Chairman Burns

Subject:

From Samuel Pizer

The attached memorandum regarding the yen revaluation and long-term foreign credits prepared by Mr. Emery is for your information.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date August 19, 1971

To Mr. Reed J. Irvine

Subject: Yen Revaluation and Long-term Foreign Credits.

From Robert F. Emery RFE

This memo is in response to your request for additional information on one of the main factors that has caused some hesitancy on the part of the Japanese authorities to revalue the yen upward. This is the large amount of long-term credits outstanding denominated in foreign currencies.

According to a New York Federal Reserve Bank Research Memorandum prepared by Mrs. Patricia Kuwayama ("Is the Yen Undervalued?" August 5, 1971), the Japanese Government made a survey of the long-term foreign credits outstanding of 48 major Japanese corporations as of June 30, 1970. This survey indicated that 90 per cent of these firms were not covered by any clause protecting them against losses from yen revaluation on the $7.9 billion in long-term foreign credits which they had outstanding on June 30, 1970.

The two industries most likely to suffer heavy losses if the yen were revalued were shipbuilding and industrial-equipment manufacturers. The survey indicated that almost $3 billion of the $7.9 billion consisted of assets of the shipbuilding companies, while an additional $2 billion in foreign credits outstanding were those of the industrial-equipment manufacturers. If one were to assume a 12.5 per cent revaluation, the loss in yen repayments would be approximately $1 billion.

More recent information provided by the United States-Japan Trade Council (Council Report No. 49, July 30, 1971, "Japanese Trade Organizations Strongly Oppose Yen Revaluation") indicates that the amounts involved are probably much larger than those reported in the 48-corporation survey. The Japan Shipbuilders Association reports that the shipbuilding industry in March 1971 had $8.4 billion in outstanding foreign credits of which only $2.7 billion were hedged against revaluation. This left a balance of $5.7 billion. The Association estimates that a 10 per cent revaluation in September of this year would result in a loss of $540 million to the industry. Two other industries that would be hard hit by a revaluation are electric machinery and shipping. The Japan Electric Machine Industry Association reports that in June 1971 the industry had $570 million in outstanding foreign credits, mainly deferred payment export credits. A 10 per cent revaluation would presumably result in a foreign exchange loss of about $57 million. Lastly, the Japanese Ship Owners' Association estimates that the loss on long-term contracts combined with losses on three other types of

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operations (liners, tramps and miscellaneous operations) in the event of a 10 per cent revaluation would amount to $143 million this year, plus $310 million over the years until all the long-term contracts expired. Thus the total loss for a revaluation would be $453 million.

The amount of potential loss is being steadily reduced since an increasing number of firms have been insisting on yen-denominated export contracts. The Japanese authorities would undoubtedly like to delay any move to revalue the yen until more credits have been shifted to a yen-denominated basis. It is also likely that the recent U. S. economic actions of August 15 will accelerate the trend toward a shift to yen-denominated credits.

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date August 20, 1971

To Board of Governors

Subject: Memorandum on System foreign-currency liabilities

From Samuel Pizer

STRICTLY ~~CONFIDENTIAL~~ (FR)

The attached memorandum prepared by Mr. Katz is an attempt to provide guidance on the basic elements of the problems associated with System foreign-currency liabilities outstanding at the time the U.S. Treasury gold window was closed on August 15. This piece is being circulated, although it is still somewhat tentative, since it is expected that the Special Manager will touch on elements of these problems in his report to the FOMC on August 24th.

SP

Attachment

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STRICTLY CONFIDENTIAL (FR)

August 20, 1971

To: Board of Governors (Thru Mr. Pizer)

From: Samuel I. Katz

Subject: Problems Associated With Foreign-Currency Liabilities of the Federal Reserve and Treasury.

This memorandum is intended to provide basic information on the question of potential dollar-currency losses on the foreign-currency liabilities of the Federal Reserve and Treasury which were outstanding at the time of the closing of the gold window on August 15. It is intended to summarize:

a. The foreign-currency assets of U.S. agencies;

b. The foreign-currency liabilities of the Federal Reserve and U.S. Treasury currently outstanding;

c. An approximation of potential losses in each of the major European currencies; and

d. The repayment options open to U.S. agencies.

These topics will be treated in turn.

The estimates of U.S. foreign-currency liabilities and assets used in this memorandum are approximations of the position as of August 15 (adjusted for transactions initiated but not completed by Sunday evening). Of course the magnitudes are altered daily as we learn of new transactions. However, these estimates can serve as an approximation of the magnitudes involved.

Foreign-currency assets of U.S. agencies

When the gold window was closed on August 15, the U.S. gold stock (adjusted for transactions in process) stood at $10,229 million and SDR holdings at $1,097 million.

There remained $570 million in the United States gold tranche at the Fund.

U.S. agencies also held about $250 million in convertible-currency balances primarily in the form of:

(in million of dollars equivalent)

	Treasury	System
DM	227.0	12.0
Swiss francs	0.2	8.3

U.S. agencies: foreign-currency liabilities

The combined foreign-currency commitments of the Federal Reserve and U.S. Treasury at the time the gold window was closed were about $4.5 billion or equivalent to nearly 39% of U.S. holdings of gold, SDRs and convertible currencies: $3.0 billion in Federal Reserve swap liabilities and about $1.4 billion in (net) Treasury foreign-currency liabilities. (See Table 1.) The currencies-of-denomination of these liabilities are shown in Table 1. Excluded from this table are the $ 34.3 billion of uncovered dollars held by foreign central banks. (See Table 2.)

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Table 1.
Federal Reserve and U.S. Treasury: Foreign-currency liabilities by currency of denomination as of August 18, 1971
(in millions of U.S. dollars equivalent)

	Pound sterling	German mark	Swiss francs (BNS)	Belgian francs	BIS (swiss francs)	Total
1. Liabilities outstanding:						
a. Federal Reserve swaps	750	60	1,000	635 a/	600	3045
b. Net Treasury liabilities b/	--	448	832	--	158	1438
c. Total outstanding liabilities	750	508	1,832	635	758	4483
2. Potential dollar-currency loss per 1% appreciation of foreign currency (millions)	7.5	5.1	18.3	6.4	7.9	45.2
3. Computed loss in dollars at exchange market rates on August 18, 1971						
a. Approximate exchange rate c/ at time of drawings	241.97	27.548	24.585 d/	2.0151	24.630	
b. Exchange rate c/ Wed. Aug. 18 (2:30 pm call)	246.25	29.450	25.106	2.0800	25.106	
c. Foreign-currency appreciation (%)	1.77	6.90	2.12	3.22	1.93	
d. Computed losses in terms of dollars on: (millions)						
Federal Reserve swaps	13.3	4.1	21.2	20.4	11.6	70.6
Net Treasury liabilities	--	30.9	17.6	--	3.0	51.5
Total losses	13.3	35.0	38.8	20.4	14.6	122.1

a/ Includes $35 million in Belgian francs drawn on BIS.
b/ Treasury foreign-currency securities less a balance of $227 million in DMs. Treasury balances in other currencies less than $500,000.
c/ U.S. cents per unit of foreign currency.
d/ Weighted average rate.

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STRICTLY CONFIDENTIAL (FR)

August 19, 1971

Table 2

Estimated Total Reserves, Dollar Reserves, and Uncovered Dollar Holdings of Major Foreign Central Banks, as of August 19, 1971

Central Bank of:	Net Reserve Assets 1/	Dollar Assets Total	Dollar Assets covered by F.R. swaps	Uncovered Dollar Holdings
Germany	16,483	10,253	--	10,253
Italy	6,383	2,421	--	2,421
Netherlands	3,452	371	--	371
France	6,962	3,369	--	3,369
Belgium	3,525	830	635 2/	195
United Kingdom	5,166 3/	4,763 3/	750	4,013
Canada	4,954	3,338	--	3,338
Japan	11,083	9,152	--	9,152
Switzerland	6,691	2,867	1,600	1,267
Total	64,609	37,274	2,985	34,289

1/ Reserve assets net of official liabilities; based upon central bank data as of the end of July 1971, adjusted for reported exchange market purchases of dollars during August 1 - 19.

2/ Of this amount, $35 million is covered by a System drawing on the BIS matched by a swap between the BIS and the National Bank of Belgium.

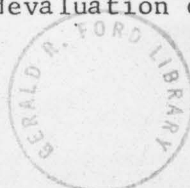
3/ Including $1.79 billion held with the BIS under a special transaction.

Nature of System liability under swap network

There are complications in assessing the exposure to dollar-loss of the Federal Reserve on its drawings (at the request of our swap-partners) under the terms of the reciprocal-currency agreements because of uncertainties about the interpretation of the revaluation clause.

Protection of revaluation clause - Under the swap arrangements, the Federal Reserve has always been obligated to settle outstanding balances by delivering on maturity a given amount of foreign-currency to the swap-partner. The primary risk assumed by the System in accepting foreign-currency liabilities (when swap-partners asked us to draw on the credit lines) was that of a revaluation of the other currencies against the dollar. The solution to this danger was to introduce a revaluation clause into the reciprocal-currency arrangements. Under the standard clause, the swap-partner accepted a standing order to be executed (when necessary) to purchase its currency at the parity in effect prior to revaluation to repay any Federal Reserve obligations in that currency. This indirect procedure of the standing order to obtain foreign currencies had to be followed because there were legal obstacles which made it impossible to incorporate formal exchange-rate guarantees against revaluation into the swap agreements.

European dissatisfaction with revaluation clause - Increasingly, European officials came to the view that the swap agreements, in this formulation, protected their dollar holdings only against a risk they no longer regarded as likely: that is, a devaluation of the dollar in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the form of a formal increase in the U.S. Treasury buying price for gold. But, as they saw it, the terms failed to protect them against two risks which they came to anticipate as more likely possibilities: (a) the formal suspension by the U.S. Treasury of gold sales without any change in the $35 gold price; and (b) their need to revalue their currencies on the basis of urgings by the United States.

European officials had conversations with Federal Reserve personnel interpreting the terms of the reciprocal-currency agreements to cover such contingencies. Swiss officials have proposed/ compensation for any losses suffered by the Swiss National Bank (and also by the Swiss Confederation and the Bank for International Settlements) on covered dollar balances because a partial or total suspension of gold redemption by the U.S. Treasury "would not be regarded by us as a revaluation of the Swiss franc in the sense of that clause."

In response, Federal Reserve officials stated that "we would anticipate dealing with any contingency in the spirit of cooperation and are confident that you would do the same, taking into full account the specific facts and circumstances." There could be a question of interpretation in the light of the facts in each specific U.S. drawing; but the FOMC Special Manager and Assistant General Counsel have expressed the opinion that the Swiss National Bank "was on sound legal ground" in their interpretation.

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Estimate of Federal Reserve dollar-currency losses on foreign liabilities

Federal Reserve exposure to dollar-losses on outstanding drawings is calculated in Table 1 at some $71 million on the basis of the exchange rates which prevailed at 2:30 p.m. on Wednesday (August 18). The exposure is concentrated mostly in Swiss and Belgian francs and in sterling. (See Table 1.) The loss-exposure would be much larger if U.S. agencies assumed liability for any of the uncovered dollar holdings of any foreign central bank. (See Table 2.)

The estimate will be increased when the further appreciation of foreign currencies, now being expected, materializes. For estimating purposes, the potential dollar-currency losses are shown in Table 1 in terms of a 1% appreciation of each European currency.

To what extent does the revaluation clause apply to outstanding balances? - The calculations in Table 1 must remain uncertain until the extent of the protection of the revaluation clause to specific Federal Reserve drawings has been agreed upon with our swap-partners. At least five different types of situations can be distinguished:

Situation I. Obligations incurred in European currencies which revalued prior to the gold-window action: that is, the Swiss franc. There were no Federal Reserve liabilities in Swiss francs at that time.

Situation 2. Obligations incurred in European currencies which floated upward prior to the gold-window action: that is, the Dutch guilder and the German mark. The facts differ in these two cases.

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- Guilders - There were $250 million drawings outstanding in guilders when the guilder floated upward in May. At that time, the Dutch authorities agreed that the revaluation clause applied and provided the System with $250 million-equivalent of guilders at (or close to) the guilder's former upper limit. Shortly thereafter, however, these $250 million (which were uncovered dollars) plus other uncovered dollars held by the Netherlands Bank were funded by a U.S. drawing on the Fund and an SDR sale to them.

- D-mark - The Dutch episode may establish the precedent that System obligations in a floating currency prior to the gold-window action would be protected by the revaluation clause. Unfortunately, the facts as to the $60 million System obligation to the Bundesbank differ from the Dutch case. The DM drawing did not cover German dollar accruals at the time but provided the Federal Reserve with DM balances in order to make delivery on DM-forward contracts (which we arranged in April for value in July). To the extent that the Dutch precedent were applicable, however, the $4.1 million loss shown in Table 1 would be reduced.

Situation 3. Obligations incurred in European currencies which floated upward after the gold-window action: that is, virtually every major European currency. As of Friday, August 20, it is understood that the European markets will reopen on Monday and that most European currencies will be allowed to float. It is expected that the dollar/value of System liabilities in DM, Belgian francs and perhaps Swiss franc and pounds could be affected by subsequent upward movements in these market quotations.

Situation 4. European currencies which will later be formally revalued. An interpretation will have to be made whether the Federal Reserve is, or is not, protected by the revaluation clause on any balances outstanding when the new parities are announced for the major European currencies. But there are cooperative as well as legal considerations involved in this situation: System officials must recognize that some European officials feel that they are morally entitled to compensation because their revaluations have been "forced" on them by the United States. An unwillingness of the Federal Reserve to recognize this obligation could leave a residue of bad feeling.

Situation 5. European central banks which held uncovered dollars over the August 15-16 week-end. Total uncovered dollars in the hands of the major central banks exceeded $34 billion on August 19. The Federal Reserve has no legal obligations on these dollars but it is to be expected that foreign officials might raise a question about whether the System would provide coverage on some parts of these holdings. The President has instructed the Federal Reserve not to make new swap drawings but the Swiss and the Bank of England are already seeking cover on portions of their uncovered holdings.

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Liquidation options available to U.S. agencies

There would seem to be essentially five different ways by which the United States could pay off remaining Federal Reserve and Treasury foreign-currency liabilities. Some of them involve a dollar-currency loss and others would not. These are:

Option I. Wait for a reversal in market flows

Option II. Use U.S. reserve assets (gold or SDRs);

Option III. Draw foreign currencies from the Fund;

Option IV. Fund through a medium-term U.S. Treasury obligation; or

Option V. Purchase foreign currencies in the open market against dollars.

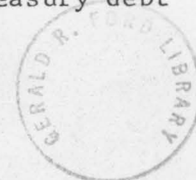
We will consider each of these options in turn.

Option I. We can regard as unlikely repayment through exchange-market proceeds on the ground that the private funds are not likely to be returned to dollar-denominated assets until new parities are established. Once they are established, however, inflows could occur before the swaps finally mature; in that case, the question of compensation to swap-partners could arise.

Option II. If the United States were to repay through the use of reserve assets, the repayment would be at the $35 parity and there would be no dollar losses to be accounted for by any U.S. agency.

Option III. The United States could obtain only marginal amounts of foreign currencies from the Fund unless it was prepared to make a "first credit-tranche" drawing. Such a drawing would require formal consultations with the Fund on terms and conditions.

Option IV. Funding through a medium-term U.S. Treasury obligation has (i) legal and (ii) negotiating limitations. Foreign-series Treasury obligations are specifically under the Treasury debt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ceiling. This restriction is not a material limitation, however, since dollars obtained from foreign-currency issues can be used to finance the debt as a substitute for borrowings in dollar-denominated securities. On the other hand, there is the cost that the Treasury would assume additional foreign-currency liabilities in a period of exchange-rate uncertainty.

On the negotiating side, there would always be the question of the willingness of foreign official dollar holders to accept a Treasury obligation. Foreign officials would very likely press to obtain some U.S. reserve assets as part of a tied-in package which included some Treasury funding. Similarly, they might accept Treasury obligations if U.S. officials would include in the package a funding of additional uncovered dollars. (See Table 2.)

Option V. There would be an identifiable dollar-currency loss on repaying swap balances if, under Option V, U.S. agencies should to into the exchange market and buy foreign currencies against dollars at market rates. The difference between the amount of dollars needed to buy the foreign currencies at some future date compared with the (lower) amount of dollars covered in the original drawing would then have to appear as a financing cost on the books of some U.S. agency.

There seem to be four sub-options if this approach to repayment were followed. That is, the losses could:

a. Appear as a loss in terms of dollars in the accounts of the Federal Reserve Banks;

b. Become a charge against the resources of the Stabilization Fund;

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c. Become a charge against some other Treasury account; or

d. Be covered by a specific Congressional appropriation to the Treasury.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Date August 20, 1971

To Chairman Burns

From J. Dewey Daane

This is draft put together by McCracken and myself just prior to his departure for upstate New York.

J. D. D.

P. McCracken/Aug. 20, 1971
Second Draft

DECLASSIFIED
E.O. 12958 (as amended) SEC 3.3 ; Treasury ltr. 8/22/06
NSC Memo, 3/30/06, State Dept. Guidelines
By ___ NARA, Date 9/24/09

The immediate position, for operating purposes seems to be about as follows:

1. Negotiations should begin now on a new pattern of exchange rates, looking toward an early return to stable rates.

   a. The change in exchange rates must be large enough relative to the dollar to give promise of a clear surplus in our basic balance.

   b. A part of the package would be our rescinding the surcharge generally, or selectively if necessary. The average exchange rate adjustment must ~~exceed~~ be at least equal, the 10 percent surcharge. It is essential that we take a hard line on the magnitudes of exchange rate adjustments that are required as a condition of returning to a position of stable rates. There is, however, an advantage for us to get rid of the surcharge promptly -- the longer we have it, the more securely it will be fastened on us.

   make clearer

   c. Accompanying this restoration must be provision for more flexibility -- wider bands, transitional floats, etc.

2. Gold -- No change in the dollar price of gold.

3. Convertibility initially would be limited to supporting the dollar up to the gold tranche.

4. Potential systemic questions.

   a. Is the United States willing to give up its reserve currency role for the dollar and move to a consolidation of reserve assets in the Fund?

   b. If it becomes clear that to achieve other needed adjustments it could be necessary for us to go for a small change in the price of gold (e.g., 5-10%), would we accept this as a part of some otherwise acceptable total package. If this were the case should we then also include in the request for legislation authority for some subsequent discretionary capability to initiate an exchange rate adjustment for the dollar.

5. Fallback position -- If it is impossible to achieve exchange rate adjustments of the needed magnitude, what then? In that case other currencies continue to float against the dollar as is now the case. The import surcharge remains.

   What kind of a world will then be shaping up? How do we minimize dangers of multiple rates, currency blocs crunching against each other, etc?

GERALD R. FORD LIBRARY

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

August 20, 1971

To: Federal Open Market Committee

From: Arthur L. Broida

Enclosed is a copy of a press release issued by the International Monetary Fund today.

Arthur L. Broida
Deputy Secretary
Federal Open Market Committee

Enclosure

GERALD R. FORD LIBRARY

INTERNATIONAL MONETARY FUND

Press Release No.

For Immediate Release:
August 20, 1971

The United States authorities, in a letter from the Secretary of the Treasury to the Managing Director, have notified the International Monetary Fund that, effective August 15, 1971, the United States no longer, for the settlement of international transactions, in fact, freely buys and sells gold. The United States will continue to collaborate with the Fund to promote exchange stability, to maintain orderly exchange arrangements with other members, and to avoid competitive exchange alterations. The Fund notes that exchange transactions in the territories of the United States have been occurring outside the limits around par, and the actions taken by the United States authorities do not at the present time ensure that transactions between their currency and the currencies of other members take place within their territory only within the limits around par.

The Fund notes the circumstances which have led the United States authorities to take the actions described above. The Fund emphasizes the undertaking of members to collaborate with it to promote exchange stability, to maintain orderly exchange arrangements with other members, and to avoid competitive exchange alterations, and therefore welcomes the intention of the United States authorities to act in accordance with this undertaking.

The Fund will remain in close consultation with the authorities of the United States and the other members with a view to the prompt achievement of a viable structure of exchange rates on the basis of parities established and maintained in accordance with the Articles of Agreement.

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Q+ Mont. Policy

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

August 20, 1971

CONFIDENTIAL (FR)

TO: Federal Open Market Committee

FROM: Mr. Broida

Attached for your information are copies of messages dated today, from the Managing Director of the International Monetary Fund to the Governors of the Fund and to the Ministers of the Group of Ten.

Arthur L. Broida

Arthur L. Broida,
Deputy Secretary,
Federal Open Market Committee.

Attachment

GERALD R. FORD LIBRARY

Confidential

FOR IMMEDIATE RELEASE
August 20, 1971

Statement by the Managing Director of the
International Monetary Fund, Mr. Pierre-Paul Schweitzer

Following is the text of a cable that Mr. Pierre-Paul Schweitzer, Managing Director of the International Monetary Fund, sent to all Governors of the Fund last night:

"The recent developments which have overtaken the international monetary system give great cause for concern but at the same time create the opportunity for strengthening the system. Unless prompt action is taken, the prospect before us is one of disorder and discrimination in currency and trade relationships which will seriously disrupt trade and undermine the system which has served the world well and has been the basis for effective collaboration for a quarter century. We must not sacrifice the efforts and achievements of the postwar period, which I fear are in jeopardy.

Piecemeal approaches to change are not likely to yield beneficial results even for a single or a few countries and much less for the whole community of countries represented in the Fund. In my view it is vitally important to take prompt collective and collaborative action in the interest of the prosperity of all members.

This is the assigned task of the Fund which is in a position to make a contribution of great importance to the establishment of a better monetary system. I intend to press for rapid action to reach agreement on appropriate exchange rates and other measures which will restore the system to effective and lasting operation."

cc:; Chairman Burns
Governor Daane
Messrs. Holland and Broida
Officers in the Div. of Int. Fin.

Malony

GERALD R. FORD LIBRARY

August 19, 1971

Message from the Managing Director for Transmittal to the Ministers of the Group of Ten

Following up on the message to all Governors which I have just sent I would ask you to convey to your Ministers a somewhat more detailed exposition of my views and of the action to be considered in present circumstances.

1. I would first like to stress again the deep concern I feel about the deteriorating international situation which is liable to degenerate into serious economic and financial disorder. This situation carries with it real risks of both currency warfare and trade warfare--the very dangers which the Fund was established to prevent.

2. It is clear to me that a solution to the various issues cannot be found piecemeal. For example, in addition to all the other weaknesses that attach to floating rates, one cannot possibly see how such rates, operating while the U.S. surcharge is in effect, could function as indicators of the rates of exchange that would be appropriate in the absence of such a surcharge.

3. Any hope of moving out of the present difficulties within a reasonably short period must, therefore, rest on a decision being taken on a number of issues at the same time. In my opinion, the most effective first step would be a meeting of the Group of Ten. Such a meeting at the earliest possible date is, therefore, in my opinion imperative. That is why I have requested the Chairman of the Group of Ten to call such a meeting as soon as possible.

DECLASSIFIED
E.O. 12958 Sec. 3.6
MR 92-29 #31; st ltr 6/18/00
By dal NARA, Date 2/23/01

4. I have indicated previously that I think it would be desirable for such a meeting to be held in Washington at the Fund's Headquarters, which would provide the best opportunity to coordinate the interests of all other countries with those of the main industrial countries. This is still my strong view, but I consider the question of venue secondary to the overriding question that a meeting be held.

5. At such a meeting I will be prepared to put before Ministers and Governors concrete proposals dealing with the following interrelated issues:

(a) Relative rates of exchange.

(b) The price of gold in terms of currencies.

(c) Temporary wider margins;

(d) The U.S. import surcharge.

(e) A transitional regime for convertibility.

6. These issues must be resolved to reestablish an effective international monetary and trading system, and it is, therefore, essential that we make every effort toward this end.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

DATE 8/20

TO Chairman Burns

FROM ROBERT SOLOMON

GERALD R. FORD LIBRARY

IMF

FOR IMMEDIATE RELEASE
August 20, 1971

Statement by the Managing Director of the
International Monetary Fund, Mr. Pierre-Paul Schweitzer

Following is the text of a cable that Mr. Pierre-Paul Schweitzer, Managing Director of the International Monetary Fund, sent to all Governors of the Fund last night:

"The recent developments which have overtaken the international monetary system give great cause for concern but at the same time create the opportunity for strengthening the system. Unless prompt action is taken, the prospect before us is one of disorder and discrimination in currency and trade relationships which will seriously disrupt trade and undermine the system which has served the world well and has been the basis for effective collaboration for a quarter century. We must not sacrifice the efforts and achievements of the postwar period, which I fear are in jeopardy.

Piecemeal approaches to change are not likely to yield beneficial results even for a single or a few countries and much less for the whole community of countries represented in the Fund. In my view it is vitally important to take prompt collective and collaborative action in the interest of the prosperity of all members.

This is the assigned task of the Fund which is in a position to make a contribution of great importance to the establishment of a better monetary system. I intend to press for rapid action to reach agreement on appropriate exchange rates and other measures which will restore the system to effective and lasting operation."

GERALD R. FORD LIBRARY

August 19, 1971

Message from the Managing Director for Transmittal
to the Ministers of the Group of Ten

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1. I would first like to stress again the deep concern I feel about the deteriorating international situation which is liable to degenerate into serious economic and financial disorder. This situation carries with it real risks of both currency warfare and trade warfare--the very dangers which the Fund was established to prevent.

2. It is clear to me that a solution to the various issues cannot be found piecemeal. For example, in addition to all the other weaknesses that attach to floating rates, one cannot possibly see how such rates, operating while the U.S. surcharge is in effect, could function as indicators of the rates of exchange that would be appropriate in the absence of such a surcharge.

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6. These issues must be resolved to reestablish an effective international monetary and trading system, and it is, therefore, essential that we make every effort toward this end.

GERALD R. FORD LIBRARY

CONFIDENTIAL (FR)

August 23, 1971

The attached reports were presented to the Board during the briefing session on Monday morning, August 23.

Samuel Pizer

GERALD R. FORD LIBRARY

CONFIDENTIAL (FR)

BOARD PRESENTATION
Samuel Pizer
August 23, 1971

The actions taken by the President a week ago marked the end of an era for the international monetary system. At the same time the stage was set for a wide-ranging review of many inter-related issues. The key issue for us at the moment, of course, is to get a realignment of exchange rates sufficient to establish an equilibrium for the U.S. balance of payments, and to couple that with progress toward a better adjustment process.

We have done considerable work in the past week on the question of the extent of the U.S. disequilibrium and the size and shape of the exchange rate adjustment that is called for. Some reports on that subject have already been prepared, and you will be hearing more from us on it.

This morning, we would like to begin with some comments by Mr. Smith on the situation in exchange and other markets abroad as trading is resumed.

* * * * * * * *

While the exchange markets are functioning, they are far from being in the position the European countries would ultimately prefer to establish. Mr. Siegman has prepared some comments on the issues faced by the Europeans in establishing a new exchange rate regime.

* * * * * * * *

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Finally, one element of the President's actions that can have very serious immediate and longer-run consequences is the 10 per cent surcharge on dutiable imports. Mrs. Junz has prepared an analysis of that measure.

* * * * * * * *

I believe there is a very strong case against retention of the import surcharge. We have chosen to emphasize it this morning because we believe it is especially important to recognize that retention of the surcharge could cause us to miss an opportunity to achieve a sufficiently large realignment of exchange rates and make real progress toward a more rational international system.

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~~CONFIDENTIAL~~ (FR)

Foreign Exchange
Board Briefing
Ralph W. Smith
August 23, 1971

All European exchange markets are officially open today, with the exception of the Swiss market, under a wide variety of national exchange rate policies:

1. U.K. -- upper limit suspended, lower limit in force, *de facto* upward float; will not intervene above the old upper limit. Sterling is currently about 1.8 per cent over par.

2. Germany -- continues to float; still wants to sell dollars if rate low enough, but would buy dollars if DM appreciated sufficiently. DM is currently about 7 per cent above par, and the Bundesbank *sold* $22 million early today.

3. France -- two-tier system with fixed rate (old parity) for commercial transactions, floating rate for other transactions. Currently the commercial franc is at the ceiling, and the financial franc at about 2.3 per cent over par. The Bank of France has not intervened in the commercial market yet today.

4. Italy -- suspended upper limit; will not intervene within the old margins, but may intervene from time to time if rate moves too high. Lira currently about 1.8 per cent over par.

5. Netherlands -- continues to float;

Belgian -- two-tier float;

Will support each other's currency within old bands of old cross

GERALD R. FORD LIBRARY

rates, forming a separate currency bloc within the EEC; neither will intervene in dollars. Guilder currently 4.2 per cent over par; Belgian franc, 3.6 per cent.

6. Switzerland -- central bank not operating in market for time being, waiting to see how other markets are operating and rates moving; de facto upward float; has indicated to FRBNY that it would like to sell dollars if rate moved low enough (presumably within old band). Franc currently about 2.5 per cent over par.

The Japanese market has remained open. On Saturday the Bank of Japan purchased $343 million, and, today, $11 million. Today's smaller intake was a result of a further tightening of Japanese exchange controls, aimed at reducing the "leads" in conversion of export proceeds by Japanese exporters. Last week it purchased $2-1/2 billion. Revaluation rumors produced another sharp decline on the Japanese stock market this morning, around 4 per cent, bringing the total decline since August 15 to about 20 per cent. Reuters carried a report this morning that Japan's Cabinet will met tomorrow to discuss a purported American offer to drop the 10 per cent import surcharge in return for a yen revaluation.

To summarize, the general picture this morning is one of most major currencies floating against the dollar, the chief exception being Japan, with a partial exception in the case of France. Only

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Japan, France, and Germany are prepared as of now to intervene in dollars, with Germany being willing to either sell or buy dollars.

Activity in the markets is picking up, and may be expected to return gradually to more or less normal level as dealers and commercial customers become used to operating under more than just very temporarily floating rates.

The dollar is somewhat stronger, on this morning's quotes, than on most days last week. We must emphasize, however, that today's rates are not at all representative of long-run equilibrium rates. Leads and lags in commercial payments, which probably accounted for a good part of the selling pressure against the dollar prior to August 13, may be beginning to be reversed, lending some support to the dollar. In general, we should expect to see major European currencies appreciating further in coming weeks or months, more so if the Japanese yen were to float or be revalued. In addition, we should note that the 10 per cent import surcharge is a partial substitute for appreciations of foreign currencies, and the latter would be greater in the absence of the surcharge.

There have been no announcements of revaluations of other currencies. Israel, however, announced, a devaluation of its currency by 16-2/3 per cent, a development only remotely related to recent U.S. moves.

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Euro-dollar rates declined somewhat further this morning from the peak rates of early last week. Three-month deposits were quoted at 8-3/8 per cent, down from a peak of 10 per cent, one-month deposits at 8 per cent, down from 13 per cent. Liabilities of U.S. banks to their foreign branches rose by $285 million in the week ended last Wednesday, difficult to explain in view of the very high levels of Euro-dollar rates in this period.

Gold was fixed at $43.25 this morning in London, little changed from levels prevailing last week.

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BOARD PRESENTATION
Charles Siegman
August 23, 1971

Inability of the European Communities to reach a joint position to deal with U.S. economic measures

1. Internal divisions within the European Communities (EC) on measures to cope with consequences of U.S. actions announced last week were great, and, to some extent, exceeded differences of opinion between the United States and individual European countries. But, at the same time, it is important to note that this was not the first serious crisis which the EC has encountered, and, somehow, the European Common Market has managed to survive.

2. To deal with the new exchange rate conditions resulting from the U.S. actions the EC faced four main options:

(a) The EC countries could have adopted a joint float -- either controlled or uncontrolled; or

(b) they could have revalued their currencies outright -- at a uniform rate or through individual parity adjustments; or

(c) they could have adopted a joint two-tier exchange rate system -- a fixed or controlled rate for commercial transactions and a free market for other transactions, principally capital movements; or

(d) they each could have pursued independent national policies.

3. For a number of reasons, the EC countries opted for the path of independent action.

(a) The immediate concern was the need to reopen the markets by today. For several of the EC countries it technically would have been impossible to introduce a joint two-tier exchange-rate system

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that quickly. For the EC countries to float their currencies jointly against third countries, while maintaining fixed rates among themselves, it would have been necessary to form a pool from members' central banks reserves for intervention purposes. In addition, if a joint EC float against third countries were to be a managed float, it would have been necessary to formulate procedures and criteria for joint intervention policy. The Common Market countries simply were unprepared to deal with these matters by today.

(b) France stubbornly opposed revaluing her currency for commercial transactions. She feels that her current account is not strong enough to absorb a franc revaluation, and she appears eager to retain the trade advantage derived from the recent German, Swiss and Dutch currency appreciations. It should be noted, however, that if a large number of countries would revalue their currencies vis-à-vis the United States, a small franc revaluation against the dollar still might turn out to be an effective devaluation of the French franc in third markets.

France also favored the two-tier solution in order to protect her interests in the EC Common Agricultural Policy, which requires fixed exchange rates for its smooth operation.

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Finally, France opposed a revaluation or appreciation of the franc except one that would result from a direct devaluation of the dollar.

(c) Germany, on the other hand, strongly opposed the adoption of a common EC two-tier exchange-rate system principally on ideological

grounds. A two-tier system would involve exchange controls. In addition, a uniform Common Market two-tier system would require the coordination of exchange controls among EC members -- a system even more difficult to erect and manage than national exchange controls.

(d) Besides France's opposition to an immediate revaluation of her currency, other EC countries also preferred taking a cautious attitude before fixing new parities. None was quite sure what would constitute an equilibrium exchange rate for its currency, especially given the uncertainty regarding the duration of the 10 per cent U.S. import surcharge. In addition, since foreign countries were not certain what kind of exchange rate system or structure of exchange rates the United States had in mind as its final objective, foreign countries considered it premature to fix new parities. They may be treating the fixing of their exchange rates as a bargaining element in future negotiations. Finally, the EC countries are keeping a watchful eye on Japan; they are reluctant to give Japan any permanent competitive advantage from their exchange rate actions, and, in fact, undoubtedly prefer that the existing trading advantages enjoyed by Japan should be reduced by a yen revaluation.

4. There are a number of implications of the failure by the EC to act as a unit.

(a) The inability to act jointly is a serious set-back to the long-range objective of forging the EC into a full economic and monetary union and of enabling the EC to act as a counterweight to the United States.

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(b) The failure to reach a joint exchange policy gives the Common Agricultural Policy another severe shock. With exchange rates of individual EC countries moving independently, the unit-of-account pricing system becomes increasingly difficult to operate. If the exchange rates of EC countries continue to move independently for a longer period, the Common Agricultural Policy may suffer a fatal blow and eventually may have to be dissolved. Although the Common Agricultural Policy was considered a major achievement of the EC, its dissolution, in our opinion, would be beneficial on welfare grounds for most EC countries and for the United States. The protectionist orientation of the EC agricultural policy is detrimental to EC consumers as well as to agricultural producers in non-EC countries. The budgetary costs of the Common Agricultural Policy for EC countries are becoming exorbitant. Replacing the Common Agricultural Policy with a more rational system of assistance to farmers in the EC would benefit most parties concerned, although France clearly would be a net loser should this occur.

(c) The decision to act independently probably will result in a smaller revaluation of foreign currencies on average than could be expected with a common EC upward float. In the case of France, for example, only a quarter of her international transactions will take place in the free market (and even this will be subject to capital controls), and, in fact, this free rate might even depreciate. All commodity trade will continue to be transacted at the existing dollar exchange rate.

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BOARD PRESENTATION
Helen B. Junz
August 23, 1971

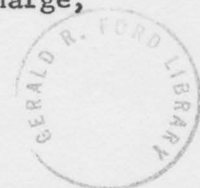
The import surcharge is important both, because of what it does and what it does not do.

It does not necessarily have an impact of any significance on U.S. employment; it does not yield a trade balance improvement anywhere near even the lower end of the range of adjustment thought necessary; however, it does -- if not truly temporary -- make it more difficult to obtain the sort of exchange rate adjustment thought necessary to achieve a viable balance of payments position for the United States.

On the domestic side, the surcharge will affect the quantity of U.S. imports and of U.S. consumption expenditures on imports. In a paper to be distributed to the Board shortly, Mrs. Lowrey estimates the potential effect of the surcharge on U.S. imports -- on a full year basis -- to be around $3 billion.

How much of this potential effect actually materializes depends in the first instance upon how much of a price effect can be expected. This in turn depends upon three major factors:

First, the extent to which suppliers and consumers expect the surcharge to be temporary. If expectations are for a relatively short period of duration, effects will depend largely upon the size of dealers inventories. Further, the size of expected exchange rate changes will influence buying decisions: for example, if there is an expectation that exchange rate changes may exceed the surcharge, imports may even be stimulated temporarily.


GERALD R. FORD LIBRARY

A second factor determining the effectiveness of the surcharge is the cyclical situation in supplying countries: if they have spare capacity, suppliers are likely to absorb a significant share of the surcharge in their profits; if export sales provide them with large profit margins relative to sales at home, they will do so in any event.

A third factor is the importance of the U.S. market to the foreign producer and his ability to shift sales to other markets.

Assuming for the moment that the public expects the surcharge to stay on for longer than six months or so, we can say something about what a reasonable pass-through assumption for prices might be. The cyclical situation abroad is such that producers in a number of industrial countries probably would accept smaller profit margins: this would be true for Japan, Canada, France, Italy, the United Kingdom and even for Germany as far as capital goods and automobiles are concerned. Given this situation, and also looking at past experience with temporary changes in border taxes -- which are akin in their effects to import surcharges -- it might be reasonable to assume that foreign suppliers would absorb something like one fourth of the surcharge; assuming also that distributors in the United States would scale their profits down a bit, we might, at best, get a price effect on imported goods amounting to around 70 per cent of the surcharge. We estimate that an increase of almost 7 per cent in the price of imports subject to the surcharge would affect total

GERALD R. FORD LIBRARY

imports by only $2 - $2-1/4 billion, as compared with the potential effect of $3 billion.[1/]

It is important at this point to distinguish between the effect of the surcharge on the balance of payments and its effect on the domestic economy. Under our assumptions, the import account in the balance of payments would improve by $2-1/4 billion. But, the U.S. consumer would pay only about $1/4 billion less (and the U.S. distributor would have a smaller profit). A bit over $2 billion, the amount of the surcharge, would accrue to the U.S. Treasury. In other words, the amount of spendable income that U.S. consumers could shift away from imports to domestically produced goods would be negligible: $1/4 billion, which might create 20,000 jobs at best.[2/] Thus, the effect on employment resulting from the surcharge depends almost entirely upon the decision of the fiscal authorities about what to do with the surcharge revenue.

The price effect of the surcharge on the domestic price level, given the price freeze, would be quite small -- about 0.3 per cent on the goods GNP deflator and somewhat more on the goods component of the CPI.

1/ The price change is somewhat less than a full 7 per cent because there are some items, notably automobiles, on which there is no authority to increase tariffs by a full 10 per cent ad valorem.
2/ This estimate is optimistic because it assumes that there is 100 per cent substitutability between domestically produced goods and imports. To the extent that this is not true -- given the small margin of spendable income freed to shift to U.S. sources of production -- the effect on employment could even be negative.

The net effect on the trade balance depends not only on the expected change in imports, but also on how exports might be affected. This relates partly to the deflationary impact the surcharge would have on activity abroad. It is, of course, quite true that a shift of $2 billion or so -- as compared to world output -- is very small indeed and that it would make relatively little difference to aggregate activity. However, the impact on particular countries could be quite significant and varies widely among countries, depending upon the importance of the U.S. market to each country. Calculations of the share of countries' exports affected by the surcharge and of the relative importance these exports have in their total exports show that industrial countries are affected only moderately. Only two major industrial countries: Japan and Canada, are hit relatively severely: the share of their total exports subject to the surcharge is 29 and 25 per cent, respectively. The deflationary effect on industrial production could be roughly around 1-1/3 per cent for Japan and 3/4 of a percentage point for Canada. But some of the lesser developed countries are equally, or more severely, affected: Mexico, with 52 per cent of total exports, Korea, Taiwan, Hong-Kong, Macao and Haiti, all with more than 30 per cent, and the Philippines and Israel with 16 per cent each. The devaluation of the Israeli pound probably would have occurred anyhow, but its size is not entirely unrelated to the importance of the U.S. market to the Israeli economy.

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Thus, with the possible exception of Japan and Canada, it seems that the import surcharge affects a significant number of countries whose exchange rates are not necessarily out of line with the U.S. dollar relatively more severely than it does those countries which are in disequilibrium vis-à-vis the U.S. dollar, or even in fundamental disequilibrium vis-à-vis the world. Consequently, the import surcharge distributes the burden of adjustment in a way which is severely out of line with the sort of exchange rate adjustment line-up that seems needed.

The negative effect of these deflationary surcharge consequences on U.S. exports, however, is not the most significant offsetting factor. Much more important is the fact that countries will be seeking alternative outlets for their products and that U.S. exporters, therefore, will be facing keener competition abroad -- at a time when exchange rate relationships (assuming they do not change for the duration of the surcharge) already put them at a disadvantage. The employment effect -- because of the adverse impact on exports -- may now indeed become negative. And, the net effect of the surcharge on the trade balance -- not even allowing for the fact that other countries are likely to retaliate after some time -- is reduced further below the $2 billion or so figure cited earlier.

It is thus clear that the positive effect the surcharge could have on the U.S. trade balance -- even under the most optimistic assumptions -- can at best be no more than a fraction of the improve-

GERALD R. FORD LIBRARY

ment needed if the United States is to achieve a viable current balance position. Further, the geographic distribution of the surcharge effects shifts a large part of the burden of even this small an adjustment away from the countries who should bear most of it.

These obvious facts are likely to be just as clear to other countries as they are to us. Consequently, the usefulness of the import surcharge as a negotiating tool will erode rather quickly. Foreign producers faced with the choice of a revaluation, which will open their domestic markets as well as their export markets to U.S. competition -- as well as to competition from countries whose currency values change less -- may advise their governments that they can live with the surcharge. Thus, one positive effect of the surcharge -- namely that it eased the political problem foreign governments had vis-à-vis their export lobbies in deciding on revaluation -- will erode quickly and could even be counterproductive. This is particularly true in the case of Japan, where we would like to achieve a revaluation in excess of the surcharge. However, in this case, the surcharge may produce a helpful secondary effect: since the Japanese exchange rate is in general disequilibrium, attempts by Japanese producers to recoup in other markets what they may lose in the U.S. market, is likely to increase pressure outside the U.S. for a yen revaluation.

Still, as time goes on, the surcharge is likely to have an increasingly negative effect in any negotiation of exchange rate realignment. So far, foreign governments have announced no intention

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of retaliatory measures and will probably confirm this in the GATT meeting, which is to take place tomorrow. But the foreign press is telling its readers more and more that the surcharge is likely to be a medium-term measure -- if only because of the seductive effect on budget revenues. If this were to become a widely held belief, retaliation -- which is legal according to GATT rules -- would be more likely. In addition, a hardening of positions on exchange rate changes might quickly follow.

GERALD R. FORD LIBRARY

BOARD PRESENTATION
Helen B. Junz
August 23, 1971

The following notes were not part of my formal presentation, they attempt to clarify some of the points raised during the discussion:

(1) The question of the price pass-through as related to anti-dumping: experience with surcharges, border taxes and parity changes shows that suppliers can, and indeed will, absorb some of these costs. As long as the price changes are sufficiently small, or are subsumed as part of a general price change, they have never given rise to anti-dumping charges. Some of the differentials that now exist between prices charged in some markets and those charged in others could well be used as a basis for anti-dumping actions, but relatively little initiative has been taken by U.S. producers. Although the U.S. Government can initiate action without waiting for producers to do so, they have not used this authority widely.

(a) The pass-through question is not really fundamental to the conclusion that direct employment effects of the surcharge would be negligible. On a full pass-through assumption, spendable income freed to shift to domestically produced goods would still, given our elasticity assumptions, amount to only $800 million on a full year basis (some 65,000 jobs as estimated by the Research Division). The basic point is that the decline in dollar receipts of foreign producers is almost offset by surcharge payments to the U.S. Treasury (about $2.1 billion). Consequently, if there is to be a discrete impact on domestic activity from the surcharge, discretionary action

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by the fiscal authorities, to either increase expenditures or decrease taxes, over and above what they would have been otherwise, is required. We did not estimate any multiplier effects because of the smallness of the overall changes.

(3) It is our judgment also that if the surcharge were to stay on for any length of time beyond ninety days or so, it would become very hard to remove. Our calculations were based on medium-term, i.e., 1-1/2 years, assumptions in order to demonstrate the largest reasonable effect.

GERALD R. FORD LIBRARY

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date: September 23, 1971

To: Chairman Burns

Subject: Foreign Exchange Markets -- 11:30 A.M. conditions.

From: Michael P. Dooley

CONFIDENTIAL (FR)

After purchasing $41.9 million spot and $62 million forward early today, the Bundesbank withdrew from the market at about 11:00 A.M. our time. The reversal of the Bundesbanks policy, coupled with further leaks on proposed revaluations from the IMF, has resulted in a new speculative flurry in favor of most European currencies.

The mark has firmed to 30.275 cents, 10.8 per cent over par.

The Netherlands guilder is 7.3 per cent over par in New York; the Swiss franc 3.1 per cent over par in New York.

cc: Governor Daane, Governor Brimmer, Mr. Holland, Mr. R. Solomon and Mr. Pizer

GERALD R. FORD LIBRARY

FEDERAL RESERVE BANK OF NEW YORK
NEW YORK, N.Y. 10045
AREA CODE 212 732-5700

CHARLES A. COOMBS
SENIOR VICE PRESIDENT

CONFIDENTIAL

November 5, 1971

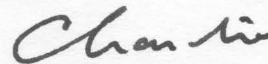
Honorable Arthur F. Burns
Chairman
Board of Governors of the
Federal Reserve System
Washington, D. C. 20551

Dear Mr. Chairman:

In response to your request at the last Open Market Committee meeting, I am enclosing a chronological listing of the steps taken by various foreign governments since August 15, to restrain the appreciation of their exchange rates. We shall keep you regularly posted on new developments in this area.

With best regards.

Sincerely,



Charles A. Coombs

Enclosure

GERALD R. FORD LIBRARY

MISC. 3.3– 8/71

FEDERAL RESERVE BANK
OF NEW YORK

OFFICE CORRESPONDENCE

DATE November 5, 1971

TO Mr. Coombs

FROM H. David Willey

SUBJECT: Response of foreign authorities to the United States measures of August 15

CONFIDENTIAL

Since August 15 all major industrial countries have taken steps to limit, and in some cases to reverse, the appreciation of their exchange rates against the dollar. The French have had perhaps the most notable success, by introducing a split rate system and a set of controls which effectively forced the unwinding of leads and lags built up in July and early August. Consequently, the rate for French trade transactions has been below its official ceiling and the Bank of France has sold a substantial amount of dollars from reserves. Initially, the Japanese authorities also tried to hold the line by tightening an already stringent set of exchange controls, but widespread violation by their own banks and trading companies led to a breakdown in that mechanism and left the authorities with little choice but to float. Further controls have been applied since the float and the Japanese authorities have continued to intervene heavily--in excess of $1 billion so far--to keep the yen rate from rising. The British authorities set the pound sterling free once the market was reopened on August 23, but have since made changes in their exchange controls which have effectively closed London as an international money market to residents of countries outside the sterling area. The Bank of England has intervened heavily in the exchange market to keep the sterling rate from rising, also taking in more than $1 billion so far. The German authorities, still in process of developing a set of restrictions on private borrowing in the Euro-dollar market, also went heavily into the exchange market, purchasing a total of about $1 billion spot and forward, in response to the outcry from German export interests over how high the mark rate had floated. Finance Minister Schiller, who last spring helped precipitate the mark float, has made many recent statements in an attempt to keep the rate down. Spokesman from other governments have also tried to talk their rates down by exhortation or by unusually candid statements about how weak their external position really has been. Most countries have, in addition, reduced their official bank rates. These reductions, while justified in part on domestic grounds, were also made to discourage inflows from abroad that might push up their currency rates. (A chronology of exchange control measures and bank rate actions since August 15 is attached.)

HDW/jl

Attachment

GERALD R. FORD LIBRARY

CHRONOLOGY OF OFFICIAL ACTIONS TAKEN ABROAD SINCE AUGUST 15 THAT HAVE AFFECTED THE FOREIGN EXCHANGE MARKETS

GERALD R. FORD LIBRARY

Austria

August 16 - Official foreign exchange market closed.

August 24 - Official foreign exchange market reopened, with prescribed upper intervention point suspended.

- Agreement concluded with credit institutions, providing for the sterilization of 75 per cent of the foreign exchange inflows that occurred since August 13.

- Schillings purchased by non-residents for purposes not related to current-account payments may be credited to bank accounts only with the permission of the authorities.

Belgium

August 16 - Official foreign exchange market closed.

August 23 - Official foreign exchange market reopened, with prescribed intervention points suspended. Under an agreement with the Netherlands, the cross rate between the Belgian franc and the guilder is to be kept within limits of 1.5 per cent on either side of their parities.

August 24 - Trade in farm products and foodstuffs with Germany, Italy, and France subjected to licensing; a deposit requirement is introduced on imports of such goods from France and Italy.

Sept. 10 - Special export tax selectively reduced, effective October 1, to help industries most affected by U. S. import surcharge.

Sept. 15 - National Bank suspends its request of last June that any increase in the banks' net external liability positions be matched by non-interest bearing deposits with it, and the funds blocked under that measure are released. The National Bank's earlier request, of March, that the banks exercise restraint in operations that could lead to a deterioration in their net external positions is likewise suspended.

Sept. 23 - National Bank's lending rates reduced for domestic

considerations by 1/2 percentage point, the basic discount rate being cut to 5 1/2 per cent.

Sept. 30 - Quantitative restrictions on expansion of short-term bank credit allowed to expire.

Canada

Sept. 7 - Introduction of Employment Support Bill, which provides Can.$80 million for payments of up to two-thirds of U. S. import surcharge to individual companies meeting certain conditions.

October 15 - Can.$1 billion package of expansionary fiscal measures aimed at fighting unemployment introduced in Parliament.

October 25 - Discount rate lowered by 1/2 percentage point to 4 3/4 per cent, "because...the new rate was considered to be more suitable with respect to both the domestic and external situation".

Denmark

August 16 - Official foreign exchange market closed.

August 23 - Official foreign exchange market reopened, with prescribed upper intervention point suspended.

October 20 - Import surcharge of 10 per cent introduced. Applies to a little over half of total imports; rate to be reduced to 7 per cent on July 1, 1972, to 4 per cent on January 1, 1973, and surcharge to expire on April 1, 1973.

October 26 - Parliament asked to authorize official borrowings abroad of some $130 million (in addition to unexpired authorization of over $100 million), in order to bolster foreign exchange reserves.

France

Early in August the authorities moved forcefully to ward off further reserve gains. Exchange controls were relaxed to some extent for outpayments, and drastically tightened for inflows. In particular, the banks were instructed not to increase their net external indebtedness or decrease their net claims on non-residents from the levels prevailing on August 3, and to refrain from selling francs to non-residents acting for speculative considerations.

August 16 - Official foreign exchange market closed.

GERALD R. FORD LIBRARY

August 17 - Interest payments on non-resident franc deposits of less than 91 days prohibited, thereby giving legal force to informal ban agreed to by the banks on August 5.

August 21 - Two-tiered system introduced:
- Official market (with franc rate defended at prescribed intervention points) for trade, trade-related, and official transactions
- Financial market (with floating franc rate) for all other transactions except those restricted to the security currency market.

- Payments for French exports prior to date required by contract prohibited.

- Imports must be paid for within 3 months of their entry (except for imports of capital goods, where period can extend up to two years, if so provided for in contract), and importers given one month to comply.

August 31 - French banks prohibited from lending foreign currencies to importers; also to exporters unless there is a comparable conversion into financial francs.

- Export proceeds received prior to contractual date must be converted in the financial market.

Sept. 2 - Banks reminded that distinction between official and financial markets applies to forward transactions as well.

- Forward purchases of francs in official market in excess of export payments due to be received must be annulled by September 30.

Sept. 5 - French corporations allowed to export unlimited amounts of capital to finance foreign investments, provided investment projects are approved by authorities. (Hitherto, annual ceiling of some $0.9 million.)

- Foreign investments in France must be financed with funds from abroad to the extent of at least half of the percentage of foreign ownership in the project.

Sept. 24 - Individual banks may be allowed to purchase, if the Bank of France agrees and under its supervision, limited amounts of foreign currencies in the financial market for investment abroad.

October 20 - Security currency market abolished, and French residents allowed to buy foreign-held securities freely with currencies purchased in the financial market. (Hitherto, they could use for this purpose only the foreign exchange that became available in the security currency market from sales by residents to non-residents of French or foreign securities held abroad.)

- All loans by residents to non-residents subjected to prior approval by the authorities; hitherto, requirement applied only to bank loans.

October 28 - Bank of France cuts by 1/4 percentage point its discount rate (to 6 1/2 per cent) and its rate against secured advances (to 8 per cent). Also reduces for the fourth time in October its domestic money market intervention rates by 1/8 percentage point (to 5 5/8 per cent for one-month private paper).

<u>Germany</u>

August 16 - Official foreign exchange market closed.

August 23 - Official foreign exchange market reopened, with mark rate floating as before.

Sept. 21 - Bundesbank announces it is prepared to buy forward dollars.

Sept. 27 - Economics Minister Schiller indicates anew that the German government intends to impose reserve requirements against the foreign borrowings of German firms. Says that the current rate of the mark is too high.

October 14 - Bundesbank's discount rate cut from 5 to 4 1/2 per cent, and "Lombard" rate against secured advances from 6 1/2 to 5 1/2 per cent; reserve requirements against domestic liabilities reduced by 10 per cent across-the-board, effective November 1. Bundesbank President Klasen states that these steps were taken to "assist the domestic economy" and also in the hope that they would "contribute to a firmer dollar on the exchange market". (However, reserve requirements against liabilities to non-residents were left unchanged at twice the old rates applying to domestic liabilities, and the additional marginal reserve requirement on non-resident liabilities was maintained at 30 per cent.)

October 21 - Economics Minister Schiller confirms that the discount rate cut and the plans to impose reserve requirements against the German firms' borrowings abroad are designed to put pressure on the dollar value of the mark, and adds that exporters can expect further relief through a scheme now being worked on to provide them with insurance against foreign exchange risks.

Italy

August 16 - Exchange markets closed.

August 23 - Exchange markets reopened, with a controlled float of the lira.

- The banks are requested to bring their net external positions into balance by September 15 and to rigorously maintain a balanced position thereafter.

Sept. 10 - It is announced that the Italian Electricity Authority (ENEL) will prepay in November a $300 million Euro-dollar loan. Small Euro-dollar loans also being repaid by other Italian entities.

Sept. 30 - Government approves a massive, $5 billion, public sector investment program for 1972, aimed at fighting economic stagnation and unemployment.

October 14 - Discount rate cut from 5 to 4 1/2 per cent and "Lombard" rate from 5 to 4 per cent in view of "recent trends in economic and financial conditions abroad and in Italy".

Japan

August 19 - Banks prohibited from increasing their total gross external liabilities--including borrowings, other Euro-dollar liabilities, and free-yen deposits. (Formerly, ceilings had applied only to the total of net Euro-dollar liabilities and free-yen deposits.) Banks and trading firms also warned that existing exchange controls would be strictly enforced.

August 25 - Guidelines for banks' net yen conversions (i.e., spot dollar positions) during August eased by an estimated $1 billion.

August 28 - Controlled yen float begins.

August 31 - Prepayments of exports virtually prohibited.

- Volume of free-yen deposits frozen at August 27 level.

GERALD R. FORD LIBRARY

Sept. 1 - Daily (instead of monthly) enforcement begins for guidelines governing yen conversions by banks.

Sept. 2 - Securities firms warned not to allow use of their free-yen accounts for speculative purposes.

Sept. 6 - Legal force given to previously "voluntary" guidelines for banks regarding their free-yen deposit volume, total foreign liabilities, and overall net dollar positions.

Sept. 10 - Banks' free-yen deposit ceilings may be exceeded by up to 5 per cent in cases involving the maturing of previously entered into contracts to sell forward yen.

Sept. 25 - Bank of Japan sets aside $300 million to buy export bills of small and medium-sized industries.

- Ministry of Finance deposits $350 million with Japanese commercial banks in order to facilitate their purchases of dollar-denominated export bills, $50 million of which is earmarked for small and medium-sized industries. Such total deposits outstanding amounted to approximately $1.2 billion on October 1 (following the maturing of $200 million of deposits made in June).

Sept. 29 - Conversion of dollars into yen by foreign banks in Japan more severely restricted.

October 1 - Import quotas on 20 items liberalized, but tariff rates on several of them simultaneously raised.

October 11 - Government approves supplementary budget for current fiscal year, providing for some $1.2 billion in additional expenditures and for some $0.5 billion in personal income tax cuts.

October 22 - Ministry of Finance deposits additional $100 million with commercial banks to facilitate their purchase of forward export contracts of small and medium-sized industries.

Netherlands

August 16 - Official foreign exchange market closed.

August 23 - Official foreign exchange market reopened, with guilder continuing to float, but an agreement with Belgium specifies that the cross rate between the guilder and the Belgian franc is to be

GERALD R. FORD LIBRARY

kept within limits of 1.5 per cent on either side of their parities. Operating under this agreement during the following weeks, the Netherlands Bank buys francs, thereby pulling the franc rate up while limiting the appreciation of the guilder.

August 26 - While maintaining the official discount rate at 5 1/2 per cent, the Netherlands Bank lowers all its other rates by 1/2 percentage point.

Sept. 6 - A "closed circuit for bonds" introduced, whereby non-residents may buy guilder-denominated bonds from residents only with the guilder proceeds of sales of such bonds by non-residents to residents.

Sept. 15 - Discount rate lowered by 1/2 percentage point to 5 per cent "in support of the measures directed at countering foreign capital inflows".

Sweden

August 16 - Foreign exchange market closed.

August 23 - Foreign exchange market reopened, with prescribed upper intervention point suspended.

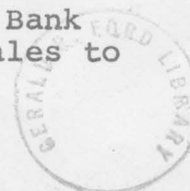
Sept. 10 - Discount rate cut from 6 to 5 1/2 per cent in view of "the domestic business recession and new signs of a trend towards lower rates abroad".

Switzerland

August 16 - Official foreign exchange market closed, and kept closed even after August 23; the National Bank suspends its exchange operations. Swiss franc rate in effect allowed to float, since Swiss banks remain free to trade in foreign currencies.

- "Gentlemen's agreement" between the National Bank and the Swiss Bankers Association comes into force. The National Bank immediately avails itself of the powers given to it by the agreement to:
    - Impose a 100 per cent reserve requirement against increases in the banks' foreign liabilities (net of placements abroad) over the July 31 level, and
    - Prohibit interest payments on non-residents' deposits of less than 6 months' maturity made after July 31.

(The August 9 agreement whereby the National Bank blocked for 10 days the proceeds of dollar sales to it is concomitantly repealed.)



August 26 - The three big banks agree to limit purchases from any one customer to $2 million when the spot rate is between SF3.95 and SF3.96, and to $1 million at rates of SF3.95 or less. Franc proceeds of any sale in excess of these amounts to be blocked for 3 months in non-interest bearing accounts.

August 27 - The interest payment ban on foreign funds deposited since July 31 is extended to all maturities.

Sept. 29 - Parliament passes legislation granting the cabinet the additional powers it had requested in early September to defend the franc against future speculative inflows. The bill empowers the government to declare the voluntary agreement between the National Bank and the major commercial banks to be legally binding on all Swiss banks, and to impose negative interest rates on certain categories of deposits. The bill came into effect October 15.

United Kingdom

August 16 - Foreign exchange market closed and British banks prohibited from dealing in foreign exchange. (As an interim measure, banks allowed on August 19 to lend foreign currencies to residents for payment to non-residents.)

August 23 - Exchange market reopened, with prescribed upper intervention point suspended.

August 31 - Interest payments on increases in sterling bank deposits of non-Sterling Area residents prohibited.

- Local authorities, building societies, and the various types of savings associations prohibited from accepting additional deposits from non-Sterling Area residents.

- Non-Sterling Area residents prohibited from buying additional Treasury bills and British government, British government-guaranteed, or local authority securities, as well as sterling C.D.'s, maturing before October 1, 1976.

- Authorized banks prohibited from converting foreign currency deposits into sterling on a swap basis if net short spot positions in foreign currencies (covered by net long forward positions) were to ensue.

Sept. 2 - Bank rate cut from 6 to 5 per cent, in a move "consistent with the exchange control measures...intro-

GERALD R. FORD LIBRARY

duced...to discourage speculative inflows from abroad".

Sept. 14	-	Exemptions from interest payment ban made under certain conditions for personal accounts and for official foreign and international accounts.
Sept. 23	-	Authorized banks' individual limits on spot foreign exchange balances held to cover forward foreign currency liabilities doubled, to £200,000.
October 7	-	Non-Sterling Area residents prohibited from purchasing sterling acceptances, commercial bills, and promissory notes, and may not reinvest proceeds of such maturing obligations.
	-	August 31 prohibition on additional purchases by non-Sterling Area residents of specified securities extended to all such securities, irrespective of maturity; permission for the reinvestment of the proceeds of maturing obligations continues.

Federal Reserve Bank
of New York
November 5, 1971

GERALD R. FORD LIBRARY

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date November 9, 1971

To Chairman Burns

From Robert Solomon RS

Subject: Measures of Other Countries in Reaction to the August 15 Program

Attached is the latest weekly report on measures taken by other countries in reaction to the August 15 program of the United States.

No new measures have come to our attention since the previous report dated November 1, 1971.

Attachment

GERALD R. FORD LIBRARY

November 9, 1971

MEASURES OF OTHER COUNTRIES IN REACTION TO THE AUGUST 15 PROGRAM

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BELGIUM

Week of September 5-11. The Government announced that, effective October 1, the export tax rate -- currently 1.75 per cent -- would be reduced to 0.5 per cent for industries that export over 15 per cent of their production to the United States, and to 0.75 for industries for which such a percentage is 5 - 15 per cent.

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BRAZIL

Week of August 29-September 4. The government instituted additional tax and other incentives for exports to all countries in order to offset the estimated effect of the U.S. 10 per cent import surcharge.

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CANADA

Week of September 5-11. The Government introduced in Parliament the Employment Support Bill under which it could compensate Canadian exporters for about two-thirds of the increase in the U.S. dollar price of their exports that would result from the U.S. surcharge. This compensation would not be automatic, but would depend on certain other conditions being met, one of which is that our surcharge is causing (or is likely to cause) significant plant layoffs. The bill became law on October 14.

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FRANCE

Week of August 15-21.

1. French banks were told, effective August 17, not to pay interest on additions to French franc deposits owned by nonresidents with maturities up to 90 days.

2. On August 20, delays in payments for imports other than equipment goods were limited to 90 days from date of customs clearance. Payments for imports effected prior to June 21 could be delayed until September 21.

Week of August 22-28. Effective August 23, a two-tier exchange market came into being. Payments for imports and exports, payments for trade-related services, and payments by and to governments (the French Government and foreign governments) would continue to be made in the official market (sometimes called the "commercial franc" market), where the official parity of the franc would be maintained. Most other transactions would be carried out on a newly-created free market (sometimes called the "financial franc" market), where the exchange rate would be allowed to float. Purchases of foreign securities by French residents would continue to be confined to a third market, the devise-titres (security franc) market.

Week of September 5-11. On September 6 French companies were given permission to finance direct investments abroad by unlimited capital transfers from France (through the financial franc market). Previously, a company could transfer only 5 million francs a year for this purpose, and had to raise the rest of the funds abroad.

FRANCE
(continued)

Week of September 19-25. Effective September 24, French banks desiring to increase their net position in foreign currency could, with the permission of the Bank of France, purchase the necessary foreign currency on the financial franc market. (No change was made in the regulation of August 4 prohibiting banks from decreasing their combined net position in foreign currency and French francs vis-à-vis nonresidents.)

Week of October 17-23. The devise-titres (security franc) market was abolished on October 19. Residents' purchases of foreign securities were transferred to the financial franc market.

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JAPAN

Week of August 15-21. Banks were prohibited from increasing above the August 18 level the sum of their gross foreign currency and free yen liabilities to nonresidents. Existing ceilings on the sum of banks' net Euro-dollar and free yen liabilities to foreigners were retained.

Week of August 29-September 4.

1. Banks were prohibited from increasing their free yen deposits owed to nonresidents above the level on August 27.

2. Effective September 1, banks were prohibited from purchasing export bills or more than six-months maturity without specific approval.

3. Effective September 1, banks were required to observe daily ceilings on conversions of foreign currency into yen, instead of ceilings covering one-half of a month.

Week of October 3-9. The Finance Ministry announced that, to facilitate exports by small- and medium-sized enterprises, it would make 4-month deposits with banks in amounts related to banks' purchases of export bills from small- and medium-sized firms.

Week of October 10-13. The Ministry of Labor reportedly decided to establish a new system for paying workers compelled to leave their jobs temporarily because of the U.S. August 15 measures and the appreciation of the yen. The workers would receive at least 60 per cent of their average normal pay.

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NETHERLANDS

Week of September 5-11. A two-tier exchange market was instituted effective September 6. Purchases by foreigners of guilder-denominated bonds from Netherlands residents can now be made only with guilders obtained from other foreigners who have sold such bonds. This is to prevent foreigners' acquisitions of guilders to buy guilder-denominated bonds -- which have been heavy this year -- from pushing up the (floating) rate for the guilder in the main foreign exchange market.

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SPAIN

Week of October 17-23. Banks were subjected to a 100 per cent marginal reserve requirement on increases after October 20 in non-residents' convertible peseta deposits of three-months maturity or less.

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SWITZERLAND

Week of August 15-21.

1. Under a gentlemen's agreement effective August 16, banks agreed not to pay interest on additions after July 31 to foreign-owned Swiss franc deposits of up to six-months maturity. The agreement was extended to funds of longer maturity effective August 29.

2. Under the same gentlemen's agreement, the banks agreed to keep a 100 per cent reserve (a noninterest-bearing deposit at the Swiss National Bank) against increases in liabilities to foreigners above the level of July 31.

Week of August 22-28. On August 26 the three largest commercial banks agreed, subject to certain exceptions, to block for three months, in noninterest-bearing accounts, additions to nonresident customers' Swiss franc deposits acquired, for reasons judged to be speculative, by the sale of foreign currency at a depreciated exchange rate. If the Swiss franc rate is between approximately 3.1 and 3.4 per cent above parity, the banks will block all purchases of francs in excess of $2 million equivalent per customer per day, and if the rate is higher, the amount of the purchases exempt from blocking is $1 million equivalent per customer per day.

Week of September 5-11. On September 8 the Federal Council announced it would ask the Federal Assembly for general emergency powers for three years to deal with future capital inflows and to give legal force to existing voluntary measures to discourage inflows. The legislation

GERALD R. FORD LIBRARY

SWITZERLAND
(continued)

was passed October 7. It gives the Council the power _inter alia_ to make existing voluntary agreements with the Swiss National Bank binding on all banks and to impose negative interest rates on non-resident deposits.

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UNITED KINGDOM

Week of August 29-September 4.

1. Effective August 31, nonsterling area residents were barred from acquiring any of a great number of short-term investments denominated in pounds sterling, including Treasury bills, government and other public sector bonds maturing before late 1976, and deposits with savings banks, building societies (akin to our savings and loan associations), and local authorities.

2. Effective August 31, banks were prohibited from paying interest on new deposits in pounds (or additions to existing deposits) that are owed to nonsterling area residents.

3. Effective August 31, banks were restricted as to the amount of dollars or other foreign currency they could convert into pounds.

Week of October 3-9. Sterling acceptances, commercial bills, and promissory notes were added, effective October 7, to the list of short-term investments that nonsterling area residents are prohibited from buying. Effective the same date, the prohibition on purchases of government and other public sector bonds was extended to bonds of all maturities.

Arthur F. Burns
November 12, 1971

Realignment of Currencies

U.S. - 5 or 6.

France, Britain, Italy, Scandinavian countries -- stand still.

Germany - up 6.

Japan - up 9.

Convertibility

1. 18 to 24 months: to enable IMF to function.

2. After that -- guide convertibility into gold, SDR, IMF position.

   This under IMF. Its decision at request of other countries.

3. Trade and defense burden sharing - something positive.

X X X X X

Report in writing without identification of date or author.

X X X X X

The gold price to be handled through IMF - no commitment beyond.

To hear from X about this, as to French, etc., promptly.

X X X X X

Room for some U.S. bargaining.

DECLASSIFIED
AUTHORITY Ltr. 11/16/82; State guidelines Treasury ltr. 8/22/06
BY NARA, DATE 9/29/09