

FEDERAL RESERVE ACT AMENDMENTS

HEARING
BEFORE THE
SUBCOMMITTEE ON
DOMESTIC MONETARY POLICY
OF THE
COMMITTEE ON
BANKING, FINANCE AND URBAN AFFAIRS
HOUSE OF REPRESENTATIVES
NINETY-FIFTH CONGRESS

SECOND SESSION

ON

H.R. 12621

A BILL TO EXPAND THE CLASS OF COLLATERAL ELIGIBLE
FOR USE AS SECURITY FOR FEDERAL RESERVE NOTES

H.R. 13148

A BILL TO INCREASE THE NUMBER OF CLASS C DIRECTORS
OF FEDERAL RESERVE BANKS

JULY 14, 1978

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Committee on Banking, Finance and Urban Affairs



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FEDERAL RESERVE ACT AMENDMENTS

FRIDAY, JULY 14, 1978

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON DOMESTIC MONETARY POLICY OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS,
Washington, D.C.

The subcommittee met, pursuant to notice, at 8:34 a.m., in room 2220, Rayburn House Office Building, Hon. Parren J. Mitchell (chairman of the subcommittee) presiding.

Present: Representatives Mitchell, Neal, Watkins, Hannaford, and Hansen.

Chairman MITCHELL. The hearing will come to order. It is now 8:34. It was called for 8:30. We are 4 minutes late.

This morning, the Subcommittee on Domestic Monetary Policy meets to consider H.R. 12621, a bill to expand the class of collateral eligible for use as security for Federal Reserve notes, and H.R. 13148, a bill to increase the number of class C directors of Federal Reserve banks from 3 to 6, which would increase the total number of directors from 9 to 12.

The first of these two bills would correct a small deficiency in current law regarding eligible collateral. The latter would help the Federal Reserve implement the spirit of the Federal Reserve Reform Act of 1977. In this legislation, Congress calls upon the Federal Reserve to expand both public and minority participation in Federal Reserve bank affairs.

[The texts of H.R. 12621 and H.R. 13148 follow:]

(1)

95TH CONGRESS
2D SESSION

H. R. 12621

IN THE HOUSE OF REPRESENTATIVES

MAY 9, 1978

Mr. MITCHELL of Maryland introduced the following bill; which was referred to the Committee on Banking, Finance and Urban Affairs

A BILL

To expand the class of collateral eligible for use as security for Federal Reserve notes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That the third sentence of the second paragraph of section
4 16 of the Federal Reserve Act (12 U.S.C. 412) is amended
5 by striking the words "direct obligations of the United
6 States" and inserting in lieu thereof the words "any obliga-
7 tions which are direct obligations of, or are fully guaranteed
8 as to principal and interest by, the United States or any
9 agency thereof".

I

1 (1) by striking out “three” in the first sentence
2 and inserting in lieu thereof “six”.

3 (2) by adding at the end thereof the following:
4 “Of the three new class C members appointed by the
5 Board of Governors of the Federal Reserve System after
6 the date of enactment of the Federal Reserve Bank
7 Public Directors Act, initially one shall be designated to
8 serve for a term ending December 31, 1979, one for a
9 term ending December 31, 1980, and one for a term
10 ending December 31, 1981, and thereafter each member
11 so appointed shall serve for a term of three years as
12 provided in paragraph 9 of section 4 of this Act (12
13 U.S.C. 302).”.

14 (c) The last sentence of the twentieth paragraph of
15 section 4 of the Federal Reserve Act (12 U.S.C. 305) is
16 amended by striking out “third class C director” and insert-
17 ing in lieu thereof “class C director designated by the
18 chairman”.

Chairman MITCHELL. This morning we have as our witness Gov. J. Charles Partee of the Federal Reserve Board, who is certainly no stranger to us, because of his frequent appearances before this subcommittee. As always, Governor, we are delighted to have you here, and we welcome you to the hearing. I want to thank you for an early-morning awakening, an early-morning departure from your house, and a prompt arrival at the subcommittee hearings.

**STATEMENT OF HON. J. CHARLES PARTEE, MEMBER, BOARD
OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM**

Governor PARTEE. Thank you, Mr. Chairman. I am pleased to have the opportunity to present to the subcommittee the views of the Board of Governors of the Federal Reserve System on H.R. 12621 and H.R. 13148. The Board appreciates particularly your timely consideration of these two amendments that we have proposed to the Federal Reserve Act.

Let me begin with H.R. 12621, a proposal to expand the class of collateral eligible to secure Federal Reserve notes. As this subcommittee is aware, the currency of the United States consists almost entirely of Federal Reserve notes, which are liabilities of the Federal Reserve banks. By law, these notes must be collateralized dollar-for-dollar by assets of the Federal Reserve, and only those assets specified in section 16 of the Federal Reserve Act are eligible as collateral. At present, the list of eligible assets is restricted to gold certificates and Special Drawing Rights certificates, direct obligations of the United States, banker's acceptances and other paper eligible for discount, and certain loans to member banks. H.R. 12621 would add the obligations of Federal agencies to the class of assets eligible to secure Federal Reserve notes.

A brief review of the balance sheet that follows of the Federal Reserve banks may help to illustrate the increasing need for the expansion of eligible assets. The major liabilities are member bank reserve balances, the deposits of the Treasury, and Federal Reserve notes. By far the largest and fastest growing item is the liability for currency outstanding, which represented 72 percent of total liabilities and capital of the Federal Reserve banks at the end of 1977, compared with about 59 percent of the total 10 years ago. Since total assets must by definition equal liabilities and capital accounts, this means the proportion of our assets pledged to secure Federal Reserve notes has also been growing significantly.

[The balance sheet referred to by Governor Partee follows:]

CONDENSED BALANCE SHEET OF THE FEDERAL RESERVE BANKS
In millions of dollars

ASSETS	December 31	
	<u>1967</u>	<u>1977</u>
Gold certificates-----	11,480	11,719
Special Drawing Rights Certificates-----	0	1,250
Loans to member banks secured by eligible paper-----	143	262
Acceptances-----	164	954
U.S. government securities-----	49,112	102,819
Federal agency obligations-----	38	8,455
Other Assets-----	14,393	14,267
Total assets-----	75,331	139,726
LIABILITIES AND CAPITAL ACCOUNTS		
Federal Reserve Notes:		
Outstanding (issued to Reserve Banks)-----	44,311	100,535
Less: Held by Reserve Banks-----	1,940	7,382
Federal Reserve notes, net-----	42,370	93,154
Member bank reserve accounts-----	21,000	26,709
U.S. Treasury deposits-----	1,123	7,164
Other deposits-----	797	1,514
Other liabilities-----	8,841	9,126
Capital accounts-----	1,200	2,058
Total liabilities and capital accounts-----	75,331	139,726

Details may not sum to totals due to rounding.

Governor PARTEE. Among the items on the asset side of the Federal Reserve's balance sheet are gold certificates, Special Drawing Rights certificates, U.S. Government and Federal agency securities, banker's acceptances, loans to member banks, and other miscellaneous assets. The largest single entry is, of course, the System's holdings of U.S. Government securities, which represented about 74 percent of total assets at the end of 1977.

Virtually all of the increase in the assets of the Federal Reserve over the past decade is accounted for by net acquisitions of U.S. Government and agency issues. In recent years, we have been able to conduct limited open market operations in the growing secondary market for agency issues, so that our holdings of such obligations—which under existing law are not eligible to secure Federal Reserve notes—now total about \$8.5 billion, compared with only \$38 million

a decade ago. The net result is that, over the last decade, while Federal Reserve notes outstanding have increased at an 8½-percent annual rate on average, eligible collateral has grown only at a 6¼-percent annual rate.

In the past few years, moreover, growth in the currency needs of the economy appears to have accelerated to an annual rate of about 10 percent on average. Experience has shown that the economy's currency requirements tend to be a fairly stable proportion of GNP. Thus, if nominal GNP—which reflects inflation as well as real growth—continues to rise at its recent rate of 10 to 11 percent per year, and if eligible assets grow at the 7-percent rate of recent years, it can be projected that the Federal Reserve's stock of eligible collateral will be completely pledged in 3 to 4 years, other things being equal.

A shortage of collateral is thus a very real possibility. Indeed, over the past 1½ years, the excess of eligible assets above collateral requirements has declined sharply. Excess Reserve note collateral averaged more than \$20 billion at yearend for the years 1970-76. It averaged only \$11 billion in the first half of this year. And with the introduction of the new note option to the Treasury's tax and loan account program at depository institutions, expected to become effective this fall, excess Federal Reserve note collateral is likely to decline considerably further. This will result from a reduction in the System's portfolio of Government securities associated with the transfer of Treasury balances from the Reserve banks to commercial banks and other depository institutions. If agency issues were to be made eligible to secure Federal Reserve notes, the more ample excess collateral cushion would permit greater operating flexibility during this transition.

It should be emphasized that the Federal Reserve holds assets far in excess of its notes outstanding. However, with a diminished level of excess eligible collateral, some technical operating difficulties can arise. For example, since each Reserve bank must individually secure its notes outstanding, the recent sharp decline in excess collateral has meant that, on occasion, a Reserve bank runs short of eligible assets. In such an event, that bank has had to borrow Government securities from another Reserve bank in order to meet collateral requirements. The System's operational flexibility would be enhanced by the passage of H.R. 12621, as the proposed expansion of collateral assets would likely eliminate the need for these loans between Reserve banks.

On occasion also, excess collateral can be reduced sharply by the need to offset sudden and unexpected increases in Federal Reserve float. Such an episode occurred this past January, when harsh winter weather conditions interrupted the transport of checks through the clearing process. As a result, float rose by about \$10 billion above its average level in a matter of just a few days. In such a situation, open market operations are automatically undertaken to offset the reserve effect of the increase in float. With the excess collateral cushion shrinking, there is growing danger that such smoothing operations might have to be constrained at times in order to avoid a corresponding reduction of assets eligible to secure Federal Reserve notes.

If the authorization to secure Federal Reserve notes with agency obligations is not enacted, we will have no alternative other than to take measures necessary to insure compliance with the law. The inventory of currency at Federal Reserve banks may have to be cut back, thereby reducing flexibility to meet unanticipated increases in the public's demand for cash. A developing shortage of eligible collateral could well force the System to cease purchases of Federal agency issues for the open market account, and to replace agency securities with other assets eligible as collateral. Since the volume of agency obligations has been increasing rapidly of late, it would not seem desirable, as a matter of public policy, to substantially curtail the Federal Reserve's participation in this active and growing secondary market. And in the extreme case, if all eligible collateral were to be pledged, the System would find itself unable to issue additional currency in response to the public's need, since the issuance of notes without collateral is unlawful.

The Board urges that H.R. 12621 receive the prompt attention of the Congress in order to avoid the unnecessary potential difficulties related to currency issuance that I have outlined. Passage of this bill will remove the inconsistencies in treatment that now exist in the Federal Reserve Act so that all securities eligible for open market operations would also be eligible to secure Federal Reserve notes. Moreover, it will correct the current anomalous situation whereby loans to member banks that are secured by agency obligations are eligible collateral for Federal Reserve notes, but direct System holdings of the agency securities are not.

Let me turn now to H.R. 13148, a bill to expand the number of class C directors of Federal Reserve banks from three to six.

Each of the 12 regional Federal Reserve banks has a board consisting of 9 directors who are to be chosen without discrimination on the basis of race, creed, color, sex, or national origin. The three class A directors are elected by, and must by law be, "representative of" the member banks of the district. The three class B directors, who represent the public, are also elected by member banks with due, but not exclusive, consideration to the interests of agriculture, commerce, industry, services, labor, and consumers. Class C directors are appointed by the Board of Governors to represent the public and are chosen with due but not exclusive consideration to the interests of agriculture, commerce, industry, services, labor, and consumers. All Reserve bank directors are elected for 3-year terms.

By statute, class C directors must have been residents of their Federal Reserve district for 2 years, and cannot be officers, directors, employees or stockholders in any bank. Beyond these statutory guidelines, the Board of Governors typically seeks other attributes in candidates for class C directors. Each of the bank boards need members with experience in managing an organization, since directors must oversee the operations of their respective Reserve banks. Other important responsibilities include voting on changes in the discount rate, reviewing loans and discounts to member banks in their respective districts, and providing important, timely, and valuable intelligence about economic conditions in their regions of the country. The Board believes it highly desirable to

select directors who will contribute to the fulfillment of these responsibilities.

The chairman of the board of each Reserve bank, as well as the deputy chairman, who serves in the chairman's absence, must be designated by the Board of Governors from among the class C directors. Thus, at present, most or all of the class C directors must assume—or have the potential for assuming—one of these roles. Under these circumstances, it is of particular importance that class C directors bring to the Federal Reserve a record of managerial capacity that is essential to the effective supervision of an operation as large and complex as a Federal Reserve bank.

The Board is keenly aware of the additional criteria for class C director selection specified by the Federal Reserve Reform Act of 1977. We fully support the intent of the Congress to broaden the representation of interests on Reserve bank boards. But in practice, we have come to recognize that it is difficult to provide representation of a wide diversity of interests among only three class C directors.

Moreover, since the directors serve staggered terms, only one class C vacancy occurs each year at each Reserve bank. And because the complexity of the bank's business has given special value to on-the-job experience, Board-appointed directors are typically reappointed to a second 3-year term. Thus, throughout the System only about six new class C directors are chosen in any given year. The Board's commitment to broader representation can be achieved only very gradually with such a limited number of new appointments. Of course, the class B director appointments also may well include persons of diverse backgrounds and interests, but their selection is a process over which the Board of Governors has no direct control.

In the interest of promoting broader representation of agriculture, labor, services, consumers and other groups among Reserve bank directors, the Board of Governors recommends the passage of H.R. 13148. The increase from 3 to 6 class C directors at each Federal Reserve bank will provide 36 immediate openings for which the Board can consider individuals with a variety of backgrounds and interests. And with the greater number of class C directors at each Reserve bank, it will be more feasible to carry out the provisions of the Federal Reserve Act that call for both broader representation among, and selection of the chairman and deputy chairman from, the class C directors.

In summary, I want to convey the Board's recommendation for prompt passage of these two bills. If enacted, the first of these proposals will enhance greatly the Federal Reserve's flexibility in meeting the collateral requirements for Federal Reserve notes, and the second will be of substantial benefit in helping to broaden promptly the diversity of backgrounds and interests represented on the boards of directors of our regional Federal Reserve banks.

Thank you, Mr. Chairman.

Chairman MITCHELL. Thank you very much, Governor Partee. Just one quick question on H.R. 12621. I assume there has been consultation between the Federal Reserve and the Treasury on this. I know of no problems that Treasury has with it.

Governor PARTEE. I know of no problems either, Mr. Chairman.

Chairman MITCHELL. Has there been consultation with Treasury?

Governor PARTEE. I just cannot recall. I will have to check that.

Chairman MITCHELL. I think for the sake of the record we ought to have correspondence from Treasury inserted. I know that the Treasury has no problems with the bill.

Governor PARTEE. I see no difficulty for the Treasury. But I just cannot recall specifically that the issue has been discussed in terms that can be referred to as consultation, Mr. Chairman.

Chairman Mitchell. For the matter of the record of the subcommittee, we will direct correspondence to the Treasury and ask that they reply for the record. (See page 40.)

Now, with reference to our second bill, H.R. 13148, I am encouraged by the statement you made this morning, and I must say it offsets a great deal of discouragement that I experienced earlier this year. I think the Congress was quite sincere when it said it wanted greater diversity of representation.

Governor PARTEE. Yes.

Chairman MITCHELL. At the beginning of 1977, I thought we had an excellent opportunity to increase the diversification of the Federal Reserve bank's boards of directors. Some selections were made for openings. But in my opinion, the selections that were made fell far short of the expectations of the Congress in terms of the kind of balance we hoped would follow passage of the Federal Reserve Reform Act of 1977.

If you will recall January 1 of this year, the 12 Federal Reserve banks had 37 directorships vacant; 12 were in class A, 12 in class B, and 13 in class C; 21 have been filled by new persons, 7 in each class. One class A directorship and one class B directorship are still vacant.

Governor PARTEE. Yes.

Chairman MITCHELL. What was so very discouraging to me, and seemed on its face to be in contradiction to what the Congress sought, was that there was no increased diversification at all in the class A directors.

Governor PARTEE. No.

Chairman MITCHELL. The information I have is that all seven selections—they have to be bankers—were white males.

Governor PARTEE. I am not aware of any women or minorities.

Chairman MITCHELL. That flies in the face of diversification. We also had an opportunity to diversify in class B director level. However, of the seven persons newly elected this year, there was only one woman.

Governor PARTEE. Yes.

Chairman MITCHELL. In that class B group, there were no blacks, no Hispanics, or any other minority elected. I am not at all sure that the present composition at that class B level can legitimately be said to represent the interests of services, labor, and consumers.

Finally, of the seven persons newly appointed as class C directors by the Board this year, only one is a woman. She also can be termed a consumer representative. But even at that level as of this year there are no blacks, no Hispanics, no other minorities. I suppose only one can be said to represent labor.

Now, I do not intend to lecture you, but it seems to me that that kind of selection process at least violates the spirit of section 203;

certainly, in terms of appearance, it seems to violate it. Let us hope that if we can move expeditiously to pass H.R. 13148—now that we have your full support for it. Let us hope we can begin to redress these kinds of inequities that I alluded to among the class A, class B, and class C directors.

Governor PARTEE. Mr. Chairman, I agree with what you have said. In defense of the record, I would point out that the Federal Reserve Reform Act was not passed until November 1977, at which time the representation for class B directors was expanded. You see, before then, effectively they all had to be businessmen. And the selection process for this year's director vacancies was pretty well completed by last November because of this process of the bankers voting for the class B members. Therefore, there was not a great deal of opportunity to turn around the situation in that class B group.

In class C, as I say, we are certainly doing everything we can to find good, eligible candidates representing a wide variety of interests in the country. But the difficulty, as I pointed out, is that we have only those three spots; and we have to have a chairman and a deputy chairman among the three designated, for which we think managerial experience is important. So we feel so constrained that it is difficult to move significantly in the direction of broader representation. Now, if we had these 36 new positions, I think we could bring about quite quickly a very considerable change in the composition of the directorships, while still paying very careful attention to the quality of people and the quality of advice we would likely be getting from the group.

Chairman MITCHELL. I think we ought to make the record clear that class B directors, in your interpretation, have in effect to be businessmen.

Governor PARTEE. Commerce, agriculture, and industry, I believe.

Mr. HANSEN. Men or persons?

Governor PARTEE. Persons.

Chairman MITCHELL. If I may recapture my time, I am trying to use the language that the Governor used. He said "must in effect be businessmen." I merely wanted to make the record very clear that even the present language does not make it so narrow, that persons in business, agriculture, services, labor, and others were included.

Governor PARTEE. That is right. Agriculture was included.

Chairman MITCHELL. Mr. Hansen, any questions?

Mr. HANSEN. Thank you, Mr. Chairman.

Governor Partee, I think that we need to have balanced representation so that we get the proper input, to serve any given area in the best way possible. I guess I am wondering where you really achieve balance. Can you have representation and balance at the same time without including the total population? What I am getting to is, take any example, the National Collegiate Athletic Association or anything else. They have boards. Fans are affected, just like the consumers. But how far can you go to gain a balance before you take the operation away from the pros in the business, so to speak? How far do you go to gain a balance before you end up with that so-called balance having people appointed arbitrarily

from Washington and have your institutions, your local representatives and your local situations outnumbered and hanging? Where does balance end and manipulation begin when you are appointing members to these boards? Is there not perhaps some merit to increasing each category by one person or something like this? Are you going to give away professionalism for tokenism or for a numbers game? I think there are some answers that we have to come up with here before we arbitrarily change what has been a fairly workable situation right now. Maybe you would like to address yourself to that.

Governor PARTEE. I think, Mr. Hansen, that we do have to pay careful attention to seeing that class C directors have the kind of managerial record that will make it possible for these boards to work effectively in overseeing the operations of the Reserve banks. That is a first requirement that we have for our director groups. I think it is also important that the group of directors be prepared to discuss intelligently and with some experience the question of proper discount rate setting, to discuss economic conditions in their region as they are developing and are likely to develop in the future, and in that way to be able to provide advice to their presidents and also—when they communicate on discount rates—to the Board of Governors. But I think that these functions can be performed with a more diverse group of people than we typically have had on many of the Reserve bank boards.

Mr. HANSEN. Forgive my interruption, but can we not also make some efforts toward insisting that maybe they broaden the variety of people in categories A and B? It seems to me that to load it with category C may not be as wise as to insist that maybe we do a better job in some of the other categories. I know some areas have pretty good representation of women, others don't. I just wonder if we are loading it too much in one category in an area of weakness where you do not have your expertise and overloading the expertise area of your board in order to achieve the so-called racial, ethnic or whatever balance we are talking about?

Governor PARTEE. I would not particularly favor an increase in class A, because those directors are bankers and I think we ought to keep it restricted to bankers. That is, those are the people who use in the first instance the services of the Reserve banks. I think that ought to be a banker group. Directors could be as easily added to class B as class C, but class C seemed the most reasonable thing to increase. We took this up with the presidents of the Reserve banks, and they approved this initiative. And, of course, you do recognize that as a practical matter there is involvement by the Reserve banks in proposing names for class C.

Mr. HANSEN. Are the member banks pretty much in accord with this?

Governor PARTEE. I really do not know about the views of the member banks?

Mr. HANSEN. All you know about is the Reserve banks?

Governor PARTEE. The presidents of the Federal Reserve banks, that is right.

Mr. HANSEN. Don't you think they are engaging in a little tokenism in this effort in category C in order just to kind of wave away a problem instead of really, again, as I say, doing the job of trying to

encourage a broader representation of races and ethnics, Mr. Chairman? By this, I mean in category B, as you mentioned, Governor Partee, or even category A? They are developing more expertise in category A across the country now, more people are moving into those areas, as we have insisted that they do so. I am wondering if, in a sense, this emphasis in category C is a copout.

Chairman MITCHELL. Will the gentleman yield to me just before the Governor responds?

Mr. HANSEN. Please.

Chairman MITCHELL. Thank you. I thought about this problem, too. Quite frankly, the Chair's opinion, and I would hope the opinion of the subcommittee and the full committee, would be to go further and expand the other classes at a later date. I look on this bill as the first step, the beginning of some impetus to show by model demonstration what can be accomplished at the C directorship level. Also, I asked the gentleman to yield because we have problems with words; semantic difficulties are frequently present. But I think rather than use the word "balance," what we are looking for is diversification. That is the term that we are really seeking. Because in the Chair's humble opinion, there is a difference between balance and diversification. I just wanted the record to be clear on that, that we are going for diversification.

I thank the gentleman for yielding.

Governor PARTEE. I was only going to say in response to Mr. Hansen that with class A, there is a limit on the variety of things to be represented. Typically, we expect the three class A directors, who represent the member banks, to represent large banks, medium-size banks, and small banks. As a matter of fact, in most districts one class A director is elected by each of those member bank size groups. The size groupings are determined by the Federal Reserve—that is, what constitutes large, medium, or small banks. It is pretty hard to also get broader diversity, while also achieving that kind of a size distribution.

I would anticipate in class B we will have more diversity. For example, just yesterday we received word that Chairman Miller's position on the Boston Reserve Bank board, which was a class B directorship, has been filled by vote of the member banks with a woman who is a businesswoman in New England.

We have many other cases where class B directors are coming to represent more broadly various groups. But I think it somewhat unlikely that we would have many class B directors at the banks who, say, represented consumer groups or other organizations of that kind. So I would think that we would just have more latitude to see that we get a better diversity if more directors were to be added to class C.

I might also say, Mr. Hansen, as to the matter of tokenism—you used the term—we expect everyone that we appoint to the Reserve banks to do a full, responsible, experienced job; to make a contribution to the work of the boards of directors.

Mr. HANSEN. I do not think, Governor Partee, that is the kind of tokenism I was talking about. I am talking about the tokenism of numbers that goes on in this country. We have gone to a system questioned by the *Bakke* case in some of these things, where we see the controversiality and the problems that are involved in playing

numbers games. What we really want is the full spirit of the law and the full spirit of participation. Mr. Chairman, to respectfully take issue with you, you mentioned that balance was not the word, that diversification was. Well, I see here, in a sense, still lingering the game of balance. We expand one general category in order to get more minority people there, and you get a balance—though only token balance.

If you really want diversification, it seems to me we must get minorities into the areas of expertise where you really can get the input you want, rather than only in the area of category C, which is weak as far as expertise is concerned. And I guess every one of us may be in the majority in some ways and in the minority in other ways. There are some minorities, because of the emphasis of the law and the times and so forth, that get more attention than others. But we all experience situations where we are in the minority.

Maybe it is from size. I can only shop in one men's store out of 10,000 because of the problem of size. People say go on, we can't do anything for you. It is just one of those things. Everybody has this kind of an experience in one way or another. I think we all have to be sensitive of the problems and situations of others, I think we have to be sensitive to including others. Fighting this battle is a struggle, Mr. Chairman, and as a leader here in the Congress to try to get things evened out, I know you recognize that. However, I think that sometimes because of this constant effort that many have to go through, that maybe there are times when you accept too little when you could take more, where you could move farther and faster.

I guess my only concern here is that this may be one of those times where you are taking a pat on the head, in a sense, when we really could be addressing ourselves effectively to solving the problem in this situation, which is to include minority people in the area of expertise as well as the general category so they can participate properly and get the banking situation properly broadened. We are talking about minority bank inclusion, the input of women, the input of ethnic groups. With this dwelling on category C, I am sure we are getting this done properly. I am hoping we can look at this legislation in broader perspective as we consider it and see if there is not a possibility to put emphasis on some of these other categories without getting into the problem of allocations addressed by the court so we can get this problem solved or at least on track, once and for all.

Chairman MITCHELL. Will the gentleman yield?

Mr. HANSEN. Yes.

Chairman MITCHELL. The Chair tried to state his position in relatively diplomatic terms.

Mr. HANSEN. You usually do.

Chairman MITCHELL. The Chair will try to be a bit more specific. Let me speak to two issues. First, the matter of balance and diversification. You took issue with my use of the word "diversification," giving that a higher preference. Although the House of Representatives is certainly not analogous to the situation that we are confronted with here, I think you would agree that there is not a balance in terms of the population of women in this country, as

represented in the House, nor blacks, nor Hispanics. Certainly, hopefully we are moving in that direction. Meanwhile, while moving in that direction, I think we seek diversification in representation rather than attempting to achieve the rigid balance which could only be accomplished by somehow changing the methods by which people are elected to the House of Representatives.

I said earlier that I tried to couch my response in very diplomatic terms. Let me assure the distinguished gentleman, Mr. Hansen, that for as long as at least one member of this subcommittee stays in the Congress, there will be a continuous push from at least one Member, that is this Member, to do something about class C, class B, and class A. I think my record is very clear that I will not countenance nor be a party to any part of tokenism, nor continuous exclusionary practice, and remain silent on it. I thank the gentleman for yielding.

Mr. HANSEN. I think my time is about up.

Chairman MITCHELL. Yes.

Mr. HANSEN. I might just make one statement, Mr. Chairman, that is, I do not think it is a healthy game to get into numbers, because there are certain types of people who by various patterns in this country have developed in ways where to include them by a numbers game in certain areas, whether it is banking or something else, still will not necessarily provide equitable or proper diversification. So I think it is a problem to rigidly call for quotas or whatever, because this does not allow for the flexibility of the system that ought to be there. But I do think that somehow we need to encourage areas where it has been rather stifled to move, without the force of law necessarily, more into the area of diversification, if that is the word, in representation on the various levels. My point is whatever we do here—and I don't believe loading the one area is the answer—but whatever we do, I think we ought to be saying this is not the end—we want the job of inclusiveness carried out successfully.

Mr. Chairman, I would not expect you to be one who would sit back on this vital matter so I think we as a committee ought to be saying we want you to be working more in these other areas to gain full diversification. I know there are current efforts but sometimes they get sidetracked and do not work as fast as if they were more conscious of these things. I would like to see that the emphasis remains on the front burner.

Chairman MITCHELL. Thank you.

Mr. Hannaford.

Mr. HANNAFORD. Mr. Chairman, I am a newcomer to this bill, so if I could ask a question: The legislation we are talking about is H.R. 13148 and its purpose is to expand the Federal Reserve bank boards to 12, allowing for 6 instead of 3 class C directors?

Governor PARTEE. That is right.

Mr. HANNAFORD. The present legislation requires class C be categorized as consumer—what is the category?

Governor PARTEE. It is a wide variety. It is a broad list.

Mr. HANNAFORD. Including minorities, women, consumers, so on?

Governor PARTEE. Service organizations and labor as well.

Mr. HANNAFORD. Well, I might comment on the difference between balance and diversification. I guess if you diversify with

precision it would be balanced, maybe. I do think that this is an important element to have. And I think, as to the chairman's concern, it is a fact that probably a black woman could understand the world of banking very well, but perhaps a white male banker could not understand the problems in the world of being a black woman. I think we could have a balanced board with all the diversification that the legislation calls for and still have it quite competent to deal with problems that the Board must deal with. I regret that I was not here for your testimony.

I have no further questions, Mr. Chairman.

Chairman MITCHELL. Thank you, Mr. Hannaford.

Governor Partee, we will move expeditiously to mark up both of these bills. I am unable to set a time today for their markup. However, I can assure the members of the subcommittee that the markup will not be on a Friday, because we will have not sufficient membership here, apparently, to mark up the Solar Bank Act bill. But we will move expeditiously on them.

Thank you very much for being here.

Governor PARTEE. Thank you.

Chairman MITCHELL. If I may have the attention of the members of the subcommittee for just a moment. On close checking, it appears that none of the Republican members of the subcommittee can be here for the markup. Though I might want to try to do it with all of them being absent, I do not think I could do it under the rules of the House. Anyway, I think there is a general consensus that we are moving in the right direction on the solar bill. However, in light of the fact that a quorum of the members are not present, I do not believe we can mark up the solar bill today. We will reschedule the markup for next Thursday, July 20, 1978, at 10 a.m.

Thank you very much. The hearing is now adjourned.

[Whereupon, at 9:15 a.m., the subcommittee was adjourned, to reconvene upon the call of the Chair.]

[The following letter with attached record of policy actions taken by the Federal Open Market Committee at its meeting on June 20, 1978, with emphasis in the discussion of "Operations in Federal Agency Securities" on pages 16 and 17, was submitted by Governor Partee for inclusion in the record:]



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

J. CHARLES PARTEE
MEMBER OF THE BOARD

July 21, 1978

The Honorable Parren J. Mitchell
Chairman
Subcommittee on Domestic Monetary
Policy
Committee on Banking, Finance
and Urban Affairs
U. S. House of Representatives
Washington, D. C. 20515

Dear Mr. Chairman:

You will recall that in my statement on H.R. 12621 before your Committee last week, I indicated that defensive actions might need to be taken by the Federal Reserve because of the recent marked decline in the "cushion" of excess collateral eligible to secure Federal Reserve notes. Among other measures necessary to ensure compliance with the law, I mentioned that the System might well be forced to cease purchases of Federal agency issues for the Open Market Account, and to replace agency securities with other assets eligible as collateral.

In this connection, you may be interested in the discussion of open market operations in Federal agency securities that appears on pages 16 and 17 of the enclosed record of policy actions of the June meeting of the Federal Open Market Committee. The need to de-emphasize open market operations in the secondary market for Federal agency issues would not have arisen if such obligations were eligible to secure Federal Reserve notes.

I want to express again the Board's appreciation for your Committee's prompt attention to this matter.

Sincerely,

Enclosure



July 21, 1978

The Board of Governors of the Federal Reserve System and the Federal Open Market Committee today released the attached record of policy actions taken by the Federal Open Market Committee at its meeting on June 20, 1978.

Such records for each meeting of the Committee are made available a few days after the next regularly scheduled meeting and are published in the Federal Reserve Bulletin and the Board's Annual Report. The summary descriptions of economic and financial conditions they contain are based solely on the information that was available to the Committee at the time of the meeting.

Attachment

July 21, 1978

RECORD OF POLICY ACTIONS
OF THE FEDERAL OPEN MARKET COMMITTEEMeeting held on June 20, 19781. Domestic policy directive

The information reviewed at this meeting suggested that output of goods and services had expanded rapidly on the average in the second quarter, reflecting the economy's rebound in late winter and early spring from the effects of the unusually severe winter weather and the lengthy coal strike. More recently, however, the rate of expansion appeared to have slowed. The rise in average prices--as measured by the fixed-weighted price index for gross domestic business product--accelerated markedly in the second quarter, due in large measure to substantial increases in food prices.

Staff projections continued to suggest moderate expansion in output over the year ahead. The anticipated rate of growth was slightly lower than that projected a month earlier, mainly because the assumptions regarding fiscal policy were modified to reflect the administration's decision to delay the proposed tax cut from October 1 to January 1 and to reduce its size. The projected rate of price advance had been raised slightly from that of a month earlier, but it was still well below the rate in the second quarter. The projections also suggested that the unemployment rate would decline a bit further over the coming year.

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Growth in production and employment moderated in May from the rapid rates of preceding months. Thus, the industrial production index increased 0.6 per cent, compared with gains of 1.2 and 1.4 per cent in March and April, respectively; and the rise in nonfarm payroll employment in May was less than one-half the average increase earlier in the year. In manufacturing, the gain in employment was relatively small and the average workweek declined. The labor force continued to grow substantially and the unemployment rate edged up to 6.1 per cent from 6.0 per cent in April.

Total retail sales were about unchanged in May, following 3 months of exceptionally large gains. Unit sales of new automobiles rose slightly further to a new high for the current expansion. It appeared that some consumers were buying new cars in anticipation of further price increases.

The latest Department of Commerce survey of business spending plans, taken in late April and May, suggested that outlays for plant and equipment would expand 11.2 per cent in 1978; this rate was marginally above that reported in the February survey. Other indicators of capital spending plans, such as manufacturers' capital appropriations, contracts for commercial and industrial buildings, and new orders for nondefense capital goods, appeared generally consistent with continued moderate expansion in investment outlays.

The index of average hourly earnings for private nonfarm production workers rose at an annual rate of about 3 per cent in

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May, following increases averaging close to 10 per cent in earlier months of 1978. For the first 5 months of the year the index had increased at a somewhat faster rate than it had on the average in 1977. The advance in the wholesale price index for all commodities also slowed in May, reflecting smaller increases in prices of farm and food products as of the time of the survey. Later in the month, however, prices of a number of farm products advanced. In April the consumer price index for all urban consumers rose at an accelerated annual rate of nearly 11 per cent, owing to further large increases in food prices and to higher service costs, especially those relating to home ownership. In general, prices had increased considerably faster in early 1978 than during the year 1977.

In foreign exchange markets the trade-weighted value of the dollar reached a peak for 1978 in late May. Subsequently the dollar declined by about 2 per cent, but it remained above the low for the year that had been recorded in early April.

The renewed downward pressure on the dollar appeared to reflect market concern about the high rate of inflation in the United States relative to rates in other industrial countries and about the continuation of large deficits in U.S. foreign trade and surpluses in the trade of Germany and Japan. The deficit in April was about the same as that in March but lower than the high level of the first quarter. Both exports and imports rose considerably in April.

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The rate of expansion in total bank credit, which had accelerated sharply in April, slackened somewhat in May but remained above the average for other recent months. Bank holdings of securities changed little, but total loans, led by a surge in business loans, grew at an exceptional pace. Outstanding commercial paper of nonfinancial businesses declined slightly in May.

Growth in the narrowly defined money supply (M-1) moderated in May to an annual rate of about 6-1/2 per cent from the extraordinarily rapid 19 per cent in April. Growth in M-2 and M-3 also slowed in May, reflecting the deceleration in M-1. Inflows of the interest-bearing deposits included in M-2 generally were greater than in April as commercial banks issued a substantial volume of large-denomination time deposits to finance the sharp increase in business loans. However, inflows of funds into savings deposits and small-denomination time deposits remained slow both at banks and at thrift institutions. Preliminary data for the first part of June suggested that growth in M-1 and M-2 would accelerate in that month.

At its meeting on May 16 the Committee had decided that the ranges of tolerance for the annual rates of growth in M-1 and M-2 during the May-June period should be 3 to 8 per cent and 4 to 9 per cent, respectively, and it had judged that such growth rates were likely to be associated with a weekly-average Federal funds rate slightly above the level of 7-1/4 to 7-3/8 per cent prevailing

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at that time. The Committee had agreed that if growth rates in the aggregates over the 2-month period appeared to be deviating significantly from the midpoints of the indicated ranges, the operational objective for the weekly-average Federal funds rate should be modified in an orderly fashion within a range of 7-1/4 to 7-3/4 per cent.

In accordance with the Committee's decision, the Manager of the System Open Market Account began after the May meeting to seek bank reserve conditions consistent with a firming of the Federal funds rate to around 7-1/2 per cent. Incoming data throughout most of the inter-meeting period suggested that growth in the monetary aggregates would be well within the ranges specified by the Committee, and the Manager continued to seek conditions consistent with a Federal funds rate of 7-1/2 per cent.

Data that became available a few days before this meeting suggested that M-1 would grow in the May-June period at an annual rate of about 7-1/2 per cent, close to the upper limit of its range. M-2 also was projected to grow in the 2-month period at a 7-1/2 per cent rate, in the upper half of the range specified for that aggregate. These data suggested the need for Committee consultation, and on June 16, in view of the proximity of the meeting scheduled for June 20, the Committee voted to direct the Manager to continue for the time being to aim for a Federal funds rate of 7-1/2 per cent.

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Other market interest rates had risen further in recent weeks. Reflecting not only the rise in the funds rate but also substantial business credit demands, market rates on short-term securities had increased from 30 to 60 basis points since mid-May, and commercial banks had raised the rate on loans to prime business borrowers in two steps from 8-1/4 to 8-3/4 per cent. Yields on long-term securities rose 5 to 20 basis points over the same period, apparently in response to the rise in short-term rates and investor concerns about the prospects for inflation.

Conditions in mortgage markets had continued to tighten recently as strong demands for credit pressed against reduced availability of funds at lending institutions. At savings and loan associations, net mortgage lending activity in April--the latest month for which data were available--was close to its reduced rate in the weather-affected first quarter, and mortgage commitments outstanding declined further. During the inter-meeting period there were further increases in interest rates on new commitments for conventional home loans at the associations and, in most regions, a tightening of nonrate terms as well. Yields in the secondary market for home mortgages also had generally increased in recent weeks.

In the Committee's discussion of the economic situation and outlook, the members generally agreed that the growth in real output of goods and services over the coming three quarters would be substantially slower on the average than it had been in the unusually

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strong quarter just ending. However, they still expected real GNP to grow at a moderate average rate during the year ending with the second quarter of 1979. While some members thought that average growth for that period would probably be at or a little below the rate projected by the staff, others expected somewhat faster growth. A majority feared that the rise in prices would be greater than the staff anticipated. Most members thought that the unemployment rate at the end of the period would be little changed from the rates recently prevailing.

With respect to the months immediately ahead, a majority of the Committee members thought that the economy was likely to show more strength than the staff projection suggested. These members noted that both consumer and business sentiment appeared to be strong, and they interpreted the latest data on consumer behavior as evidence that many households were adopting a speculative approach to spending--anticipating needs for housing and other durables, and in the process adding willingly to already heavy debt burdens. While these members acknowledged that national economic data did not yet suggest similar anticipatory spending on the part of businesses, several noted that many businessmen appeared to be optimistic about the prospects for their own firms and industries and that such optimism might soon be reflected in a step-up in over-all business inventory accumulation and investment outlays. A number of these members expressed

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concern about the indications that inflationary expectations were strengthening and that both business and labor were intensifying their efforts to protect themselves through price and wage increases.

Two of the members who anticipated relatively strong growth in the near term thought that the economy was likely to generate sufficient momentum to maintain a favorable rate of expansion beyond mid-1979. Others in this group were concerned, however, that insofar as near-term spending of consumers and businesses embodied speculative tendencies, the resulting economic distortions might lead to significantly slower growth in 1979.

Of the Committee members who anticipated less near-term strength in the economy, some suggested that current business optimism might well reflect an overemphasis on the sharp rebound that had occurred in recent months rather than a considered assessment by businessmen of prospects for the future. These members thought it unlikely that growth in consumer outlays would continue at the recent rate, and they saw no obvious source of offsetting strength. They expected outlays for housing to slacken; they noted that surveys of business investment plans did not reflect much ebullience; and they thought businessmen would follow a cautious approach to inventory expansion. Finally, they noted that Federal fiscal policy would be less stimulative than anticipated earlier in the year.

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Several members of the Committee observed that relatively slow economic growth would tend to dampen inflationary pressures and to bolster the position of the dollar in foreign exchange markets. One of these members noted that economic activity in major industrial countries abroad was expected to strengthen, and that such a development would help to limit any deceleration in the U.S. expansion. He added that a failure of activity abroad to strengthen as expected would increase the chances of unsatisfactory growth in the United States and would create additional problems with respect to the U.S. current account.

At its meeting in April the Committee had agreed that from the first quarter of 1978 to the first quarter of 1979 average rates of growth in the monetary aggregates within the following ranges appeared to be consistent with broad economic aims: M-1, 4 to 6-1/2 per cent; M-2, 6-1/2 to 9 per cent; and M-3, 7-1/2 to 10 per cent. The associated range for the rate of growth in commercial bank credit was 7-1/2 to 10-1/2 per cent. It had also been agreed that the longer-run ranges, as well as the particular aggregates for which such ranges were specified, would be subject to review and modification at subsequent meetings.

At this meeting, in discussing policy for the period immediately ahead, Committee members expressed considerable concern about recent rates of growth in the monetary aggregates, particularly in light of the continuing strength of inflationary pressures and

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expectations. The members agreed that open market operations in the inter-meeting period should be directed initially toward achieving slightly firmer money market conditions, and that later in the period the objectives of operations should depend on incoming data for M-1 and M-2.

As at the preceding meeting, there were differences of view with respect to the degree of firming that might be undertaken. These differences were reflected in opinions on such issues as the magnitude and speed of the initial move toward firmer money market conditions and the amount of leeway--in terms of the inter-meeting range specified for the Federal funds rate--for further firming later in the period.

As to the initial move, most members favored seeking an increase in the Federal funds rate to $7\frac{3}{4}$ per cent from the prevailing level of $7\frac{1}{2}$ per cent within a few days after this meeting. However, one member suggested that this quarter-point increase be achieved over a somewhat longer period, and another proposed that the initial increase be limited to one-eighth of a point. With respect to the inter-meeting range for the Federal funds rate, most members favored $7\frac{1}{2}$ to 8 per cent, but a number preferred $7\frac{1}{2}$ to $8\frac{1}{4}$ per cent.

There was greater diversity of views with respect to the ranges of tolerance to be specified for the annual rates of growth in M-1 and M-2 in the June-July period. Of the ranges

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suggested for M-1, the lowest was 3-1/2 to 8-1/2 per cent, and the highest was 6-1/2 to 10-1/2 per cent; for M-2 the suggestions covered a similar span. It was noted during the discussion that if the monetary aggregates accelerated in June, as suggested by the early data, growth over the June-July period at rates near the midpoints of some of the lower ranges proposed could be achieved only if there were to be a sharp slowing in July. Some members, who were inclined to stress the risks to the economy of rapid firming of money market conditions, saw this circumstance as an argument for specifying relatively high 2-month ranges for M-1 and M-2. Other members, who placed more stress on the importance at this time of limiting growth in the aggregates for the sake of moderating inflationary pressures and expectations, thought such firming would be called for if the growth in the aggregates did not in fact slow sharply.

At the conclusion of the discussion the Committee decided that the ranges of tolerance for the annual rates of growth over the June-July period should be 5 to 10 per cent for M-1 and 6 to 10 per cent for M-2. The Committee agreed that during the coming inter-meeting period operations should be directed initially toward a Federal funds rate of 7-3/4 per cent, slightly above the prevailing level of 7-1/2 per cent. Subsequently, if the 2-month growth rates of M-1 and M-2 appeared to be significantly above or below the midpoints of the indicated ranges, the objective for the funds rate was to be raised or lowered in an orderly fashion within

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a range of 7-1/2 to 8 per cent. It was understood that in assessing the behavior of the aggregates the Manager should continue to give approximately equal weight to the behavior of M-1 and M-2.

It was also understood that the Chairman might call upon the Committee to consider the need for supplementary instructions if the rates of growth in the aggregates appeared to be above the upper limit or below the lower limit of the indicated ranges at a time when the objective for the funds rate had already been moved to the corresponding limit of its range.

At this meeting the Committee considered certain proposed modifications in the language customarily employed in the concluding paragraphs of the domestic policy directive. It was noted that, perhaps because of the manner in which the directive was worded, the 2-month ranges of tolerance for M-1 and M-2 were subject to misinterpretation as embodying the Committee's short-run targets for these aggregates, intended to be achieved by appropriate changes in the Federal funds rate. In fact, however, the Manager could not be expected regularly to achieve 2-month growth rates in M-1 and M-2 within the specified ranges for various reasons--including the lag between changes in the Federal funds rate and changes in these growth rates, and the brevity of the period to which the operational paragraphs of any single directive applied.

It was noted in the discussion that the Committee's objectives for the monetary aggregates were embodied in the 1-year

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ranges established at quarterly intervals, and that the adjustments made from time to time in the Federal funds rate were intended to increase the likelihood that the longer-run growth rates would fall within these ranges. The purpose of the 2-month ranges was to provide the Manager with an indicator for determining when changes in the funds rate were appropriate; specifically, the Manager was expected to adjust the funds rate within its range when the latest projections of 2-month growth rates in M-1 and M-2 deviated significantly from the midpoints of their ranges (or, if the Committee so indicated in the directive, when the projections for the aggregates approached or moved beyond the limits of their ranges).

At the May meeting, following a preliminary discussion of this matter, the Committee had deleted one potentially misleading phrase from the language previously employed, to the effect that the Committee "expects" the 2-month growth rates to be within the indicated ranges. At this meeting the Committee agreed upon a more thorough revision of the customary language, in an effort to reduce the chances of misinterpretations.

The following domestic policy directive was issued to the Federal Reserve Bank of New York:

The information reviewed at this meeting suggests that real output of goods and services has grown rapidly on the average in the current quarter as activity rebounded from the effects of the unusually severe winter weather and the lengthy coal strike, but the rate of advance most recently appears to be slowing. Following substantial gains in March and April, increases in industrial production and nonfarm

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payroll employment moderated in May and retail sales changed little. The unemployment rate edged up from 6.0 to 6.1 per cent in association with a large increase in the civilian labor force. Average wholesale prices rose somewhat less rapidly in May than earlier in 1978, reflecting smaller reported increases in farm products and processed foods. So far this year prices have increased at a considerably faster rate than they had on average during 1977. The index of average hourly earnings also has increased at a somewhat faster pace so far in 1978 than during 1977.

Since the end of May the trade-weighted value of the dollar against major foreign currencies has declined about 2 per cent, but it remains above its early-April low. The trade deficit in April was down somewhat from its very high first-quarter rate.

Growth in M-1 moderated in May from the extraordinarily rapid pace in April, and as a result growth in M-2 and M-3 also slowed. Inflows of the interest-bearing deposits included in M-2 picked up somewhat as commercial banks increased their reliance on large-denomination time deposits to finance an unusually sharp increase in business loans. Market interest rates have risen somewhat further in recent weeks.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster monetary and financial conditions that will resist inflationary pressures while encouraging continued moderate economic expansion and contributing to a sustainable pattern of international transactions. At its meeting on April 18, 1978, the Committee agreed that these objectives would be furthered by growth of M-1, M-2, and M-3 from the first quarter of 1978 to the first quarter of 1979 at rates within ranges of 4 to 6-1/2 per cent, 6-1/2 to 9 per cent, and 7-1/2 to 10 per cent, respectively. The associated range for bank credit is 7-1/2 to 10-1/2 per cent. These ranges are subject to reconsideration at any time as conditions warrant.

In the short run, the Committee seeks to achieve bank reserve and money market conditions that are broadly consistent with the longer-run ranges for monetary aggregates cited above, while giving due

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regard to developing conditions in financial markets more generally. During the period until the next regular meeting, System open market operations shall be directed initially at attaining a weekly-average Federal funds rate slightly above the current level. Subsequently, operations shall be directed at maintaining the weekly Federal funds rate within the range of 7-1/2 to 8 per cent. In deciding on his specific objective for the Federal funds rate the Manager shall be guided mainly by the relationship between the latest estimates of annual rates of growth in the June-July period of M-1 and M-2 and the following ranges of tolerance: 5 to 10 per cent for M-1 and 6 to 10 per cent for M-2. If, giving approximately equal weight to M-1 and M-2, their rates of growth appear to be significantly above or below the midpoints of the indicated ranges, the objective for the funds rate shall be raised or lowered in an orderly fashion within its range.

If the rates of growth in the aggregates appear to be above the upper limit or below the lower limit of the indicated ranges at a time when the objective for the funds rate has already been moved to the corresponding limit of its range, the Manager is promptly to notify the Chairman who will then decide whether the situation calls for supplementary instructions from the Committee.

Votes for this action: Messrs. Miller, Volcker, Baughman, Coldwell, Eastburn, Gardner, Jackson, Partee, and Wallich. Votes against this action: Messrs. Willes and Winn.

Messrs. Willes and Winn dissented from this action because they favored more vigorous measures to curb the rate of growth in the monetary aggregates. Both preferred ranges of tolerance for the 2-month growth rates in M-1 and M-2 lower than those approved by the majority; in addition, Mr. Willes favored an upper limit for the funds rate range of 8-1/4 per cent.

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Mr. Willes, citing strong consumer and business credit demands at prevailing interest rates, felt that a further rise in short-term interest rates would not significantly damage economic prospects and that, to the extent that such a rise tended to moderate inflationary expectations, it would have a positive impact on the economy. Mr. Winn felt that if the Committee did not act now to assure a reduction in the rates of growth of the aggregates, an excessively restrictive policy would be required later on if the Committee's longer-range objectives were to be achieved.

2. Operations in Federal agency securities

At this meeting the Committee discussed its procedures with respect to open market operations in Federal agency securities. The discussion arose because of a potential problem posed by a statutory requirement that Federal Reserve note liabilities be collateralized by eligible assets, which included direct obligations of the Treasury but not Federal agency issues. At times recently, the margin of actual collateral over that required had been relatively small. The Board of Governors had proposed legislation that would make Federal agency issues eligible as collateral, but Congress had not yet acted on the proposal.

It was noted that the problem of maintaining sufficient collateral for Federal Reserve notes could become critical at some point before the enactment of such legislation if, for example, a need arose to sell a substantial volume of Treasury securities to absorb redundant member bank reserves. It was also noted that the

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problem would be mitigated by some slowing of the rate of growth in System holdings of agency securities and a correspondingly larger increase in holdings of Treasury securities.

Paragraph 1(a) of the Committee's authorization for domestic open market operations authorizes the Federal Reserve Bank of New York to sell, as well as to buy, Federal agency securities for the System Open Market Account. Historically, however, sales of such securities have been quite infrequent. It was the sense of the Committee that modest sales of agency issues would be appropriate from time to time, but only when market circumstances permitted and when sales of securities were consistent with the objectives of open market operations. It was noted in the discussion that, even apart from the problem of collateral requirements, occasional sales of agency issues would help enhance the flexibility of open market operations. The Committee also agreed that the Desk should reduce somewhat the volume of agency issues it purchased when supplying reserves, and that occasionally, when there was a need to absorb reserves, it should redeem maturing agency issues for cash rather than routinely exchange them for new issues.

3. Authorization for foreign currency operations

At this meeting the Committee approved a technical amendment to paragraph 1D of the authorization for foreign currency operations, under which the definition contained in the second sentence of that paragraph of "over-all open position in all foreign

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currencies" is given as "the sum (disregarding signs) of net positions in individual currencies" rather than as "the sum (disregarding signs) of open positions in each currency." This change was approved in the interest of clarity, and to make the language of this paragraph conform to certain new language concurrently introduced in the procedural instructions governing foreign currency operations, as described below.

With this amendment, paragraph 1D read as follows:

To maintain an over-all open position in all foreign currencies not exceeding \$1.0 billion, unless a larger position is expressly authorized by the Committee. For this purpose, the over-all open position in all foreign currencies is defined as the sum (disregarding signs) of net positions in individual currencies. The net position in a single foreign currency is defined as holdings of balances in that currency, plus outstanding contracts for future receipt, minus outstanding contracts for future delivery of that currency, i.e., as the sum of these elements with due regard to sign.

Votes for this action: Messrs.
Miller, Volcker, Baughman, Coldwell,
Eastburn, Jackson, Partee, Wallich,
Willes, and Winn. Votes against this
action: None. Absent and not voting:
Mr. Gardner.

Under the first sentence of paragraph 1D, which was not affected by the foregoing amendment, the Federal Reserve Bank of New York is authorized, for System Open Market Account, to maintain an over-all open position in all foreign currencies not exceeding \$1.0 billion, unless a larger position is expressly authorized by the Committee. On March 21, 1978, the Committee had authorized an open position of \$2.25 billion in view of the scale of recent and potential System operations in foreign currencies. On May 16, 1978, the

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Committee had reduced this limit to \$2.0 billion, in light of decreases in the System's open position. Against the background of further decreases in the open position, the Committee reduced the limit to \$1.5 billion at this meeting.

Votes for this action: Messrs. Miller, Volcker, Baughman, Coldwell, Eastburn, Jackson, Fartee, Wallich, Willes, and Winn. Votes against this action: None. Absent and not voting: Mr. Gardner.

4. Procedural instructions with respect to operations under the foreign currency documents

In December 1976 the Committee had adopted certain procedural instructions for the purpose of clarifying the respective roles of the Committee, the Foreign Currency Subcommittee designated in paragraph 6 of the authorization for foreign currency operations, and the Chairman in providing guidance to the Manager of the System Open Market Account with respect to proposed or ongoing foreign currency operations under the authorization and the foreign currency directive. Paragraph 1B of the instructions called for clearance of any transactions that would result in gross transactions in a single foreign currency exceeding \$100 million on any day or \$300 million since the most recent regular meeting of the Committee. At its meeting in March 1978 the Committee amended paragraph 1B to increase these dollar limits, which had occasionally hampered ongoing operations, and to remove an ambiguity in the language.

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At this meeting the Committee decided to discontinue the use of the concept of gross transactions in the procedural instructions. In its stead it introduced (a) a clearance requirement formulated in terms of daily and inter-meeting changes in the System's net position in a single foreign currency and (b) a requirement for clearance of any operation that might generate a substantial volume of trading in a particular currency by the System, regardless of the effect on the System's net position in that currency. The purpose of these changes was to improve the effectiveness of the consultation procedure. In addition, for the sake of clarity the word "transaction" was replaced by the word "operation" wherever the former had occurred in the instructions.

The two new provisions were identified as paragraphs 1B and 1C. Paragraph 1A, which refers to daily and inter-meeting changes in the System's over-all open position in foreign currencies, was retained, and the paragraph previously designated 1C, which relates to swap drawings by foreign central banks, was redesignated 1D.

With these changes, the procedural instructions read as follows:

In conducting operations pursuant to the authorization and direction of the Federal Open Market Committee as set forth in the Authorization for Foreign Currency Operations and the Foreign Currency Directive, the Federal Reserve Bank of New York, through the Manager of the System Open Market Account, shall be guided by the following procedural understandings with respect to consultations and clearance with the Committee, the Foreign Currency Subcommittee, and the Chairman of the Committee. All operations undertaken pursuant to such clearances shall be reported promptly to the Committee.

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1. The Manager shall clear with the Subcommittee (or with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available):

A. Any operation which would result in a change in the System's over-all open position in foreign currencies exceeding \$100 million on any day or \$300 million since the most recent regular meeting of the Committee.

B. Any operation which would result in a change in the System's net position in a single foreign currency exceeding \$100 million on any day or \$300 million since the most recent regular meeting of the Committee.

C. Any operation which might generate a substantial volume of trading in a particular currency by the System, even though the change in the System's net position in that currency might be less than the limits specified in 1B.

D. Any swap drawing proposed by a foreign bank not exceeding the larger of (i) \$200 million or (ii) 15 per cent of the size of the swap arrangement.

2. The Manager shall clear with the Committee (or with the Subcommittee, if the Subcommittee believes that consultation with the full Committee is not feasible in the time available, or with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available):

A. Any operation which would result in a change in the System's over-all open position in foreign currencies exceeding \$500 million since the most recent regular meeting of the Committee.

B. Any swap drawing proposed by a foreign bank exceeding the larger of (i) \$200 million or (ii) 15 per cent of the size of the swap arrangement.

3. The Manager shall also consult with the Subcommittee or the Chairman about proposed swap drawings by the System, and about any operations that are not of a routine character.

Votes for this action: Messrs.
Miller, Volcker, Baughman, Coldwell,
Eastburn, Jackson, Partee, Wallich,
Willes, and Winn. Votes against this
action: None. Absent and not voting:
Mr. Gardner.

[The following letter was received from the Department of the Treasury in regard to H.R. 12621. See also page 10 of the Hearing.]



DEPARTMENT OF THE TREASURY
OFFICE OF THE GENERAL COUNSEL
WASHINGTON, D. C. 20220

AUG 3 1978

Dear Mr. Chairman:

Reference is made to your request for the views of the Department of the Treasury concerning H.R. 12621, a bill "To expand the class of collateral eligible for use as security for Federal Reserve notes."

Under the second paragraph of section 16 of the Federal Reserve Act (12 U.S.C. 412) a Federal Reserve Bank applying for Federal Reserve notes must post collateral in an amount equal to the Federal Reserve notes applied for and issued. The collateral may consist of, among other things, "direct obligations of the United States." H.R. 12621 would amend that paragraph to expand the list of eligible collateral to include any obligations which are fully guaranteed as to principal and interest by the United States or any agency thereof.

This Department has no objection to the enactment of H.R. 12621.

The Office of Management and Budget has advised that there is no objection from the standpoint of the Administration's program to the submission of this report to your Committee.

Sincerely yours,

Deputy General Counsel

The Honorable
Parren Mitchell, Chairman
Subcommittee on Domestic Monetary
Policy
House of Representatives
Washington, D. C. 20515

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