https://2001-2009.state.gov/r/pa/ho/frus/nixon/iii/5348.htm

170. Memorandum of Conversation/1/

London, August 16, 1971, 4 p.m.

/1/Source: Washington National Records Center, Department of the Treasury, Files of Under Secretary Volcker: FRC 56 79 15, France. Confidential. Drafted on August 23 by Cross and approved by Volcker. The meeting was held at Wychwood House.

PARTICIPANTS

U.S.:
Under Secretary Volcker
Governor Daane [Fed. Res. Gov.]
Sam Y. Cross

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France:
Mr. Pierre-Brossolette, Ministry of Finance
Mr. Clappier, Bank of France

Germany:
Dr. Schoellhorn, Ministry of Economics
Dr. Emminger, Bundesbank
Dr. Hankel, Ministry of Economics
Dr. Neubert, German Embassy

Italy:
Dr. Ossola, Bank of Italy

Japan:
Mr. Hara, Embassy of Japan
Mr. Iyami, Bank of Japan

U. K.:
Mr. Neale, HMTreasury

Mr. Morse, Bank of England

[https://www.bankofengland.co.uk/-/media/boe/files/annual-report/1971/boe-1971.pdf?la=en&hash=A0C1D2FD0A9D5AEDABFFA7134E9DA3331FD96554

Court of Directors
28th February 1971

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Sir Sidney Francis Greene, C.B.E.
William Johnston Keswick, Esq.
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SUBJECT
President Nixon's New Economic Program

Mr. Volcker said he had suggested the meeting because he thought it would be a good idea to get together promptly, to explain the reasoning behind the President's new economic program and hear any initial reactions of other participants. He had not come for the purpose of negotiations

and one question to be considered was what kind of negotiating group would be appropriate when it was time for negotiations. The U.S. did not presently have a fixed view on that question.

Mr. Volcker explained the reasoning behind the President's program. Everyone was familiar with the domestic background in the U.S. of excessive unemployment and an expansion which was proceeding but not with great speed. There was considerable pessimism about the strength of the expansion and bad psychology had developed about the inflation problem. Our progress on both the inflation and unemployment problems had been disappointing, and some measures which seemed to help on one of those problems hurt on the other. On top of this domestic situation, there was a difficult external problem. There had been a persistent erosion in the U.S. external position since the mid-1960's and this had been aggravated by two factors. First, our trade position had moved into considerable deficit in the second quarter, and even if the second quarter figures exaggerated the difficulty, the trade position was far from satisfactory. Secondly, protectionist pressures had increased in the past two years, and some had pointed to the difficult external situation as an excuse and justification for protectionist moves. We had been conscious of all these problems for some time but our concern had intensified in recent months. Thought had been given to various measures, particularly on the domestic side, for some time. The situation over the past couple of weeks had brought several of these problems into a single focus. The President had decided not to act in a piecemeal fashion dealing with each of these various problems but to adopt a comprehensive and integrated program. The most controversial measure was the convertibility decision. That decision was taken with the full knowledge of the President that one could not fully predict all the results and implications for the future. The President came to the conviction that now was the time to face the convertibility problem since if it were not faced now, it would have to be faced at another and perhaps more difficult time.

Mr. Volcker said he was impressed by the headlines in two adjoining articles which he had seen in this morning's *Times,* which expressed very clearly the U.S. situation as he saw it. The first was that "it was time for the U.S. to face facts," and the second was that "the U.S. needs growth and competitiveness." He could not improve on those two headlines as a theme for his view of the present situation.

Discussing the components of the program, Mr. Volcker said that the President had decided to go all the way on wage-price policy and establish a freeze. Even though the freeze was only for ninety days, it would have a psychological shock effect while the follow-on program was set up. The President had taken a few selective revenue measures which would spur the economy both now and in the long run. All three of the proposed tax cuts required legislative action, but the prospects for that action were good. On the expenditure side, the President had taken some measures which were politically very difficult in deferring his revenue sharing and welfare programs. These were his two prize domestic programs. While the tax and expenditure actions balanced in amount, the stimulation from the tax cuts would be greater than the drag from the expenditure changes.

On the external side, the Administration had felt that the strong domestic measures included in the new program alone would have stopped the speculation of the past couple of weeks. But the President had looked beyond the next few weeks or months and had decided to go ahead with the convertibility decision, which he felt would release some of the inhibitions and free the world's

hands to deal with matters of exchange rates and the monetary system, without such concern about speculation. It had been very difficult even to consider possible measures for reform of the monetary system when the possibilities of speculation were so great, and our move should remove some of these inhibitions.

On the surcharge, the Trade Expansion Act had been used for the authority since the President wanted to act by executive action rather than legislation. While it would not be difficult to get Congress to authorize a surcharge, it would be very difficult to get authority to end the surcharge when the time came.

On the international monetary system, all were conscious of the desire to restore a sustainable stable system. The U.S. had not spelled out any program in the President's message or elsewhere. The U.S., at this stage, had no program which it was going to spring on anyone. The background material explaining our new program said that some changes in exchange rates might take place and might be helpful to stable functioning of the system. From the U.S. point of view, after years of erosion, we wanted a fundamental strengthening of our position. We had balance-of-payments deficits for a number of years and a declining trade position for a number of years, and we would not be satisfied without a reform that could repair the erosion which had taken place in the U.S. position over the years. We did not want a short-run solution that would deal with the immediate market situation but not lead to long-term improvement. We want to restore stability to the system for a period of years. If we did not get a lasting solution, the problems would simply reappear in a month or six months or a year.

The President had instructed us to put clearly in our explanatory documents that there would be no change in the price of gold. We were aware that in the very immediate market sense, a change in the price of gold might temporarily restore exchange market equilibrium. But we were firmly opposed to that solution for three reasons, any one of which was sufficient to assure our opposition to the move: first, there was a political inhibition to such action in that some legislative action would be required. Second, even if there were no political problem we were opposed because what might look like a quick and easy solution would leave one vulnerable to the same problems in three months or six months or a year. Third, the world had been on a course of evolution which had gradually reduced the importance of gold in the system over the years and we were not going to move in the opposite direction of moving toward rebuilding a system based on gold. Although some argue that changing the price of gold is a clean and quick solution which would stabilize the system over night, that view did not prevail with us.

Mr. Volcker said investment restraints would remain in effect but their future disposition would be under review. Certain of the programs were crumbling. They were adopted as emergency measures and not expected to be sustained for a long period. Bills recently passed in Congress would decimate certain parts of the program. We don't like such restraints philosophically, and we would be reviewing this whole question.

Dr. Schoellhorn asked whether there had been any decisions on monetary policy.

Mr. Volcker said the discount rate had not even been discussed at Camp David. Since the President was announcing a freeze, he would not want to flaunt this by raising interest rates.

Governor Daane said that Chairman Burns fully supported the new program. On monetary policy the money supply had been growing more rapidly than we would like but the latest figures indicated progress in getting it under better control.

Dr. Emminger said he was impressed at the comprehensiveness of the program. He was concerned about reopening foreign exchange markets on a credible basis. The markets could not be reopened at present parities without large movements of dollars and the credibility of the fixed parity system would be in doubt. Also markets could not be kept closed for a long time. Although Germany was not tied to a parity at this time, the Japanese had apparently taken in $700 million today and the Swiss had taken in a large amount last week. How could those countries reopen on the old parity system without floods of dollars? Would it be possible to reopen the markets without changes in parities? Could we envisage these parity changes would come about in the next few days?

Mr. Neale asked what sort of changes were going to be required if the U.S. was to be free of its deficits? He agreed with the importance of building a lasting system but said this was a big agenda which went beyond the three or four days which markets could be kept closed.

Mr. Volcker said he had not come for the purpose of trying to negotiate changes in parities. We had worded our statement as mildly as possible to avoid prejudicing any more than necessary the position of other countries. It would not be credible for the U.S. to say there would be no changes in parity. In the end our view is that after years of deficits, the U.S. is entitled to run surpluses./2/ Our aim is to establish the conditions to run such surpluses. Apart from that basic proposition we were not going to say that one parity should change by this amount and another parity by that amount. The basic dilemma was with the entire system. We must repair the erosion that had taken place over a period of years in the U.S. position. Beyond that we did not want to prejudice what changes must be made. This quickly got into the question of what was the proper negotiating forum. He had talked to Schweitzer before leaving Washington. We made clear we did not want a new Bretton Woods conference. One potential group for negotiation was the Group of Ten. This had some defect in that there was no LDC participation and it was a little bit large but it certainly was a possible forum. He did not think the IMF Board was a possible forum since the Executive Directors in many cases did not have sufficient authority of their governments and there was probably too much LDC representation for this kind of negotiation. We would like to keep the IMF in the center as much as possible and perhaps one possibility would be a special committee of governors. The U.S. had no fixed view at this time on the question of the negotiating forum, but would like to know what others thought. Perhaps some ad hoc arrangements would be best.

/2/See Document 76, which sets out the U.S. balance-of-payments objectives adopted in September.

Mr. Volcker said that if the others present thought it was a good idea Secretary Connally would be receptive to inviting their Ministers to go to the U.S. and to talk these matters over during the coming weekend (August 21-22). Certainly we did not say that the problem could necessarily be resolved by the half dozen main countries in brief informal discussions but if there was a strong consensus that such a meeting would be useful, Secretary Connally would be prepared to host it.

Dr. Schoellhorn thanked Mr. Volcker for the elaboration of the U.S. views. He could give only a personal reaction since there had been only a few hours to think about the U.S. moves. On the wage price freeze, he thought the U.S. might find that 90 days may not be sufficient. The experience in Europe had been that it takes a longer time. He noted that monetary policy had apparently not been revised in a way which would increase U.S. interest rates and impede the flow of funds. Perhaps the most serious measure announced was the 10 percent surcharge. Germany had had a revaluation in excess of 7 percent and now an additional 10 percent resulting from the U.S. surcharge added up to a large amount. Germany already had strong pressures from German exporters for some form of export program, and these pressures would now become irresistible. Also it would be most difficult to find any willingness of countries to revalue their currencies as long as the U.S. 10 percent surcharge existed. And there might not be any positive proposal about what to do with the monetary system as long as there was the surcharge. The position of the dollar as a key currency was now unclear. When markets were reopened, the U.S. program might stop speculation but there were many dollars floating around and there could be many unquiet weeks. He wondered what would be decided in Washington at the September IMF meeting.

Mr. Volcker asked whether any markets were open at the present time.

Mr. Emminger said no markets were open in Europe. However, it would not be possible to keep the German markets closed for more than about three days unless there were going to be some major changes to announce.

Dr. Ossola said that it might be possible to keep the Italian market closed for about four days.

Mr. Volcker said there was no intention to keep the New York market closed for any extended period, but if one of the governments represented at the meeting felt that a day or two closing of the New York market would be essential to their decision making, we would ask that trading in New York cease for a day or two.

Dr. Ossola said that the urgent problem in Italy was tourism. Italy had a free market for bank notes and banks were buying dollars at 600 lire to $1. He asked whether Mr. Volcker was content to let the market set that bank note rate. Mr. Volcker indicated that he did not see the Italian bank note rate as a particular problem.

Mr. Morse said he was surprised at the timetable. Mr. Volcker seemed to envisage a period of weeks or months before a return to fixed parity. He thought the danger was that if there was no agreement within a week or so there would be a situation of general floating of all currencies, from which it would be very difficult to get back to a fixed parity system.

Mr. Volcker said there was a credibility problem which began with the devaluation of sterling and other currency changes. Markets could no longer be convinced that exchange rates would not be changed. In some cases letting the markets tell us what would be a credible rate might not be entirely bad. If all the questions could be resolved soon that was fine, but we did not want to be jumping from one financial crisis to another. We should not come out with an announcement that we had created a system as follows, and then six months later have it collapse.

Mr. Kirbyshire said it would be difficult for the markets to show what the proper rates were since there were many dollars floating around.

Mr. Volcker said there were tremendous problems of the monetary system and these questions were not going to be decided in a short-run time. A sustainable system implied a sizable change in the U.S. position. The U.S. position had been both weak and eroding.

Mr. Morse asked whether there was a pattern of exchange rate changes which would be sufficient in Volcker's mind to make the system a credible one within a short period of time so that the U.S. would reopen the gold window, or was there no such pattern.

Mr. Volcker said he had no little piece of paper in his pocket about what rate changes were needed. He recognized that it was conceivable that credibility in the immediate market might be temporarily restored by small revaluations by certain countries and by the U.S. domestic program, but would it make sense to restore convertibility in the same way we had it. The U.S. needed to reverse the long-term erosion in its position. Other countries might have other issues which they felt should also be considered, and these also should be on the table.

Dr. Emminger said this resolution of all these problems might take a year or two.

Mr. Volcker said that the basic condition was the system would have to be sustainable.

Dr. Emminger asked what the U.S. would do to maintain the parity of the dollar. Would we maintain parity in the same way as most other countries, e.g., market intervention.

Mr. Volcker said we would not do so immediately. We would be in the same position as Germany or Canada already was in.

Dr. Emminger reiterated the importance of the 10 percent surcharge. He asked how long was "temporary" and whether there was a connection between the surtax and the restoration of a credible system.

Mr. Volcker said the elimination of the surcharge did not depend on the restoration of the system. We needed to restore a strong U.S. position and the surcharge would go off as soon as we made the judgment that our position was the one we were seeking.

Dr. Schoellhorn said every government would be reluctant to revalue because of the surcharge. Even though the overall percentage of total German exports covered might not be so large, the surcharge would be very important in particular industries and regions in Germany.

Mr. Volcker said the problem of particular industries and regions was precisely the one the U.S. had had in its problems with protectionist pressures and had to be resisted aggressively. The surcharge was one action the U.S. could take unilaterally toward getting a strong position.

Dr. Emminger said there was a danger that we would be building the surcharge permanently into the system.

Mr. Volcker agreed that was a danger if the surcharge lasted too long. The President wanted to utilize his present authority to apply the surtax rather than seek new legislative authority in order to reduce the danger that the surcharge would be kept on too long.

Dr. Ossola said he shared Dr. Schoellhorn's views about the surcharge. He could understand the closing of the gold window as a measure, and he could understand the application of the surcharge as a measure, but he could not understand both since they seemed contradictory and countries might not move on the exchange rate.

Mr. Volcker said it was a sort of simultaneous equation. It was not clear that some countries would want to move on the exchange rate.

Mr. Morse said Mr. Volcker said the surcharge would be removed when the U.S. got a strong position and asked what that meant.

Mr. Volcker said the U.S. should have a period of surplus. We have had an extended period of basic deficits and we needed a period of surpluses. In addition there were questions of financing the defense shield and some trading arrangements and obstacles around the world which must be dealt with as well. One example was the agricultural arrangements in Europe which caused problems for the U.S. Agriculture was not the only problem. There were many outstanding issues of that sort on which we would like to work and see progress in developing the framework within which the U.S. could develop a strong balance of payments.

Dr. Schoellhorn said our governments did not know what was required to get rid of the surcharge. He asked whether there was any relationship to the non-tariff barrier discussions which were going on.

Mr. Volcker said it would not depend on those discussions.

Governor Daane said we were not looking at adjustment just for the short run but one that was sustainable for a long period of time.

Dr. Schoellhorn asked what we would do if others introduced surcharges.

Mr. Volcker said that we had been told for many years that the U.S. had a balance-of-payments emergency. We had a long period of deficits. No other country was in that position.

Dr. Emminger said all countries were interested in the restoration of strength of the dollar. They had found out that difficulty for the dollar meant difficulty for their own currencies and they understood that the monetary system could only be based on a common position. He was concerned about the immediate problem of how to reopen exchange markets on a credible basis that would not require first one country and then another to take measures to protect itself. We were all in a position of interdependence. The dollar position must be credible and the position of other currencies must be credible.

Mr. Neale referred to Mr. Volcker's discussion of a possible meeting of ministers in Washington. He said there should not be a meeting until we knew where we were going. There had to be preparations. It would be tragic if a meeting were held and nothing happened.

Mr. Volcker said the meeting he had suggested would not be designed to settle all problems necessarily though if problems could be solved that would be fine. He did not agree with Mr. Neale that we could not have a small and informal meeting of the kind he had envisaged. If we couldn't even meet on these problems because we think the problems are too difficult, we may never get them resolved. We in the U.S. have thought that one advantage of biting the bullet and suspending convertibility was that it would eliminate some of the inhibition and we would be freer to talk about the problems and try to solve them.

Mr. Morse said from the technical viewpoint he would expect to open the market on Thursday unless there was clearly something to expect very soon. If markets were reopened now, there was no chance that the old parity would be credible. He thought there was a grand prize in getting quick agreement to avoid that situation. He hoped the U.S. would want a quick solution.

Mr. Volcker said we would want a quick solution consistent with the premise within which we operate of needing a world-wide framework within which a sufficient strengthening of the U.S. position can take place.

Mr. Morse said the U.S. needed an effective and sizable devaluation relative to other currencies.

Mr. Volcker said he should make clear he had no authority to negotiate exchange rate changes and no intention of trying to do so.

Dr. Schoellhorn said he was in the same position.

Mr. Neale said the representatives other than the U.S. may want to talk among themselves about these matters.

Mr. Volcker said they were welcome to remain in the meeting room as long as they wished for any further discussion.

Mr. Iyami said the Tokyo market had been the only one open on Monday and the banks had bought $700 million. However, there was no inflow from abroad and the $700 million was purchased from local people and banks.

Mr. Morse said no answer could be given to Mr. Volcker's offer of a meeting in Washington until after the Monetary Committee meeting on Tuesday.

Mr. Volcker said he did not have in mind a grand and formal ministerial meeting with fixed agenda and large staff. It might be helpful in permitting Secretary Connally to express his views directly and get the views of others directly. If this would help resolve the issue that would be excellent, but we should not make any promise that such a meeting would resolve the issues.

(The U.S. representatives left and the others remained for further discussion.)

S.Y. Cross

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