NEWS RELEASE

FEDERAL DEPOSIT INSURANCE CORPORATION

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FOR RELEASE TO NEWS MEDIA
FRIDAY P.M., APRIL 3, 1964 PR-28-64 (4-1-64)

Bold policy pronouncements by President Kennedy in 1961 and the imaginative leadership of the Treasury and the Federal Reserve in our foreign monetary relationships have strengthened the prestige of the American dollar and reduced U.S. gold losses, declared Joseph W. Barr, Chairman, Federal Deposit Insurance Corporation, in a speech today on the "Balance of Payments Record: 1961-1964", before the 70th annual convention of the Florida Bankers Association at Miami Beach.

Mr. Barr said that at that time when losses of gold reserves were running at the rate of $5 billion a year and a dollar crisis threatened, President Kennedy, using the "jaw-bone" technique familiar to the "1920 banker," pledged to the world that this country would defend the dollar; live up to its international agreements and retain its position as the focal point of the free world's financial mechanism.

Through foreign exchange measures worked out, the Treasury and Federal Reserve System in cooperation with world monetary agencies under the Bretton Woods and Basle agreements, the late President's pledge has stood unshaken despite several world financial shocks, Mr. Barr said, though he cautioned that it is no time for complancency.

While expressing confidence that the stability of the dollar will be maintained, Mr. Barr declared that there is no illusion at the Treasury or the Federal Reserve System that these measures are a substitute for the underlying deficit in our balance of statements. Continuing, he said: "It was recognized from the first that lasting balance of payments improvement would have to be achieved within the framework of an international financial system secure from speculative threat and waves of currency liquidation. We have benefited from the active and willing assistance provided by foreign monetary authorities who recognize the key position the dollar occupies and the great productive strength upon which it rests.

"The record of responsible financial cooperation is a good one and one which I am proud to have been associated. Recent balance of payments trends have been extremely encouraging. No doubt the first quarter of this year, just now concluded, will have seen the balance of payments deficit on regular transactions again reduced very sharply. The task now is to maintain the momentum of that improvement and remove our balance of payments deficit altogether.

'The fundamental lesson of these past years is the pre-eminent importance of active international cooperation. We have learned domestically that financial institutions must have the freedom to compete, but that we must also cooperate to insure that the overall national financial structure is secure. Similar lessons are being learned internationally. As a competitive international economy and the free flow of currencies have been achieved, it has also been essential to cooperate in the evolutionary development of a more secure international financial system.

"There is an obvious lesson here for the American financial community. It has always been fiercely competitive, but I am convinced of the need to keep this competition within bounds. As internecine war between State banks and national banks; between commercial banks and savings and loans; between banking and branch banking -- waged unrelentingly, could bring disaster to all of us."

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BALANCE OF PAYMENTS RECORD: 1961 - 1964

Address of

JOSEPH W. BARR, CHAIRMAN

FEDERAL DEPOSIT INSURANCE CORPORATION
Washington, D. C.

at the

70th ANNUAL CONVENTION

of the

FLORIDA BANKERS ASSOCIATION

at the

Fontainebleau Hotel

Miami Beach, Florida

Friday, April 3, 1964

BALANCE OF PAYMENTS RECORD: 1961 - 1964

When President Johnson swore me into my present office with the Federal Deposit Insurance Corporation, he instructed me to remember 1933 and 1934. The President had come to Washington as Assistant to Congressman Dick Kleberg of Texas in those terrible days and he remembered vividly the financial crisis that gripped the country. Unfortunately, I can only vaguely recall some boyhood memories of those days and rereading the history never really captures the flavor of the occurrence. However, I have recently completed three years with the United States Treasury as Assistant to the Secretary and the international financial problems that we faced in those years gave me some insight into the problems that were faced by the banking community before the creation of the Corporation which I now head.

I am certain that the waves of bank failures and the almost complete loss of confidence in the domestic banking system will not occur again. I am just as certain that the international stability of the dollar will be maintained. But the past three years in the Treasury taught me firsthand some of the lessons that an earlier generation of bankers learned so well in the 1930's. Though my experience was concerned with international rather than domestic finance the potentialities in the different settings followed much the same pattern, commencing with vague fears developing into apprehension and panic, the ensuing scramble for funds, and then the necessary countermeasures of marshalling resources to meet withdrawals and thereby maintain confidence. In their entirety both experiences demonstrated that the vigor of a financial system depends on the soundness of each of its component.

Now that I am away from the Treasury, I think it is appropriate and proper to review with you this three-year period in our international financial history and to pay a special tribute to two men who helped bring this country through a difficult period of economic and financial adjustment -- Secretary of the Treasury Douglas Dillon and Under Secretary for Monetary Affairs Robert V. Roosa.

The history of this period really begins not in 1961, but with the Bretton Woods Agreement, reached by the United States and most of the free world in 1944. The two principal instruments of the Bretton Woods Agreement: The World Bank and the International Monetary Fund were designed to bring some order into a disrupted world economy, and to work toward an eventual restoration of an international financial system in which currencies could move freely between nations. This freedom of circulation had ceased during World War I. The interwar restoration of currency convertibility rested upon shaky foundations which were carried away by the Great Depression. Hence, the task at Bretton Woods was to recreate an environment within which both domestic and international objectives could be achieved -- an environment which had not flourished for some three decades.

The Bretton Woods Agreement probably succeeded far beyond the expectations of any of the people who participated in its creation. Europe and Japan, with the help of the World Bank and our aid program recovered to an amazing degree and by 1959 most of the nations of Western Europe had subscribed to Article VIII of the International Monetary Fund Agreement formally providing for free convertibility of their currencies.

This was a milestone in the postwar establishment of a competitive international economy but it had rather unexpected repercussions. The most unexpected was that it revealed for the first time that the United States could no longer expect to continue its policy of spending and lending more in the world than it earned. This country had consistently run an overall deficit in its international accounts during the decade of the Fifties but it excited no particular concern because in effect we were merely redistributing the monetary reserves of the world. Unless we had kept these reserves in circulation, we would have ended up with all of them, and no country would have had the means to buy from us. In other words, the game would have been over. However, by 1959 the countries of Western Europe and Japan by their vigorous recovery and by their accumulation of our reserves were in a position to take their old place of power in the international financial scene.

We had a certain amount of difficulty in this Nation recognizing that we had accomplished the goal of the Bretton Woods Agreement and that now a certain amount of prudence in our financial affairs was called for. The deficits of 1958, 1959 and 1960 finally shocked the country into an understanding of the new order in which we were living. These deficits totaled over $11 billion and our loss of gold reserves during the same three years amounted to $4.7 billion. This was the background for the Inaugural week of 1961.

The country had passed through an extremely close and hotly contested election -- a quadrennial phenomenon that always seems to amaze and distress our friends in Europe and Japan. We had lost a total of almost $1 billion gold reserves in the months of October, November and December and our losses by the third week of January were running at an annual rate of $5 billion a year. Unquestionably something had to be done in a hurry. The first weapon used by the late President Kennedy was one that would be completely familiar to a 1920 banker -- this was the "jaw bone" technique. He announced firmly to the world that the United States would defend the dollar; live up to its international agreements and retain its position as the focal point of the free world's financial mechanism.

The effect of this announcement was electrifying. Speculation on a breakdown in the relationship between gold and the dollar faded away. In October 1960 the London gold market had become temporarily unhinged and the price of gold shot up to $40 an ounce. The gold market had remained jittery, but following President Kennedy's pledge, the London gold price declined steadily and stabilized around $35.08 -- approximately the U.S. Treasury selling price of $35.00 an ounce plus 1/4 percent service charge. The first serious crisis had been surmounted; the new Administration had met its first financial responsibility. It should be noted, in passing, that the outgoing Eisenhower Administration acted forthrightly in issuing an Executive Order designed to prevent speculation in gold by U.S. citizens, rather than simply passing the buck to the new Administration. Fortunately, both of our political parties closed ranks in defense of the dollar.

The next shock to international financial stability was not long in coming. Over the weekend of March 4-5 the German mark was revalued (i.e., its gold value was increased) by 5 percent and the Dutch guilder followed suit. The mark had been very strong in exchange markets. In seeking to prevent domestic inflation, the West German monetary authorities had earlier raised their interest rates. However, the only effect was to attract a flood of foreign capital and further strengthen a mark that was already too strong for the comfort of many other countries. Finally, the Germans decided to raise the external value of their currency and the Dutch followed because of the closeness of their trading relationship.

The comparatively small size of the German revaluation led many to expect a further revaluation in the near future and caused them to buy marks for present and future delivery. Others in the market felt that the change in the value of the mark was bound to weaken sterling and possibly cause its devaluation. There was a massive movement of funds from England to the Continent. The dollar, itself, was not under speculative attack. However, the bulk of exchange market trading does take place through the use of dollars. In the spring of 1961 the fact that the dollar was being used as a vehicle currency meant that it came under heavy pressure in German exchange markets as it was sold for marks. While the German central bank stabilized the spot exchange market by supplying marks against foreign currencies, the postwar IMF agreements made no explicit provision for stabilization of the forward exchange market -- the foreign exchange equivalent of a commodity futures market.

The U.S. Treasury, operating through the New York Federal Reserve Bank, in close cooperation with the German monetary authorities, undertook to stabilize the forward market in marks and dollars. This market had temporarily been subject to severe strains growing out of the mark revaluation and the uncertainties that followed. The appearance of sizable discounts on the dollar in the forward exchange market tended to cause extra accumulation of dollars by the German central bank and a potential claim on our gold stock. The precedent-shattering intervention by the U.S. Treasury was entirely successful in calming the market and preventing speculative forces from gaining momentum. Perhaps as important as the technical success of the forward exchange operation, repeated later in 1961 with the Swiss franc and subsequently with other currencies in a variety of different circumstances, was the important fact of mutual cooperation between U. S. and foreign monetary authorities. Speculation was dampened and the position of the dollar safeguarded.

The main backwash of the German revaluation engulfed the pound sterling and threatened to force its devaluation. In view of the importance of sterling as a trading and banking currency this meant that the entire structure of international exchange rates was jeopardized. Had it been the dog-eat-dog situation of the 1930's, there is no doubt what the outcome would have been. But the United Kingdom and the European countries were resolved to defend the currency convertibility they had only recently and laboriously established.

The result was the Basle Agreement. Its name arose from the fact that governors of the various European central banks met monthly at the Bank for International Settlements at Basle, Switzerland. The European central bankers agreed in effect to relend to the British the massive flow of hot money which was disrupting international financial networks. It was estimated at the time that more than $900 million of support was given to the British under the informal Basle Agreement. Because the countermeasures were so swift and their scale so impressive, the speculative attack was thwarted and international monetary cooperation had won another impressive victory. The short-term credit originally extended under the Basle Agreement was later refinanced, in part, by a British drawing upon the International Monetary Fund. The overwhelming need had been for prompt action. Given collective recognition of this need, the details of the refinancing could be worked out later, as they were, very successfully.

Developments in the first half of 1961 testified to the effectiveness of cooperative action between countries. They also revealed that with currencies freely convertible, destabilizing capital movements could pose a real threat to international financial stability. The Basle Agreement had been an inspired piece of improvisation but many financial experts felt that more permanent arrangements would be useful in meeting future threats.

From early spring 1961 until the end of the year, negotiations were conducted between ten industrial countries: The United States, West Germany, United Kingdom, France, Italy, Japan, Canada, Netherlands, Belgium, and Sweden. Extensive discussion of ways in which any impairment of the international monetary system might be forestalled also took place at the 1961 meeting of the international Monetary Fund in Vienna. These discussions led to the decision taken by the Executive Board of the International Monetary Fund in January 1962 to provide for supplemental standby exchange resources of $6 billion to be loaned, under clearly specified circumstances, by the ten industrial countries. This agreement known as the General Arrangement to Borrow insured that if the need should arise the International Monetary Fund could speedily mobilize extra resources to cope with serious speculative disturbances.

Just a month after the IMF decision on the General Arrangements to Borrow, another important strengthening of the international financial mechanism occurred when the Federal Reserve System, itself, decided to undertake foreign exchange operations. While the Treasury forward exchange operations were exceedingly valuable, they were necessarily somewhat limited in potential scope by the comparatively modest resources of the Treasury's Exchange Stabilization Fund. Federal Reserve officials, with the full approval of the Treasury, examined the possibilities of reactivating Federal Reserve exchange operations. After careful study, the Federal Open Market Committee in February 1962 authorized open market transactions in foreign currencies. This meant that the weight and prestige of the Federal Reserve were fully committed to protect the external value of the dollar, just as they have long been committed to the protection of its internal value.

The basic technique of Federal Reserve foreign exchange operations has been the establishment of a network of central bank reciprocal currency agreements, the so-called "swap" network. The details of these swap arrangements can become extremely complicated but I will stick to the essentials. They simply involve an agreement between the Federal Reserve and a foreign central bank to exchange each other's currencies up to certain amounts for a specified term. The agreement itself only places the swap on a standby basis. If a drawing is actually made under a swap agreement, the central banks cross credit each other's accounts and agree to reverse the transaction, usually in three months' time. The proceeds -- say, the dollars received by the Bank of England in exchange for sterling -- may then be used in temporary exchange support operation. Nothing would prevent a swap drawing from being rolled over several times. However, it has ordinarily seemed more desirable to use the swap technique only for reversible operations.

Just four swap agreements of $50 million each had been concluded with France, England, Netherlands, and Belgium by June of 1962. During June 1962 the Canadian dollar came under very heavy selling pressure in the exchange markets. Between June 1 and June 25 almost half of Canada's gold and dollar reserves were used up. This threatened the newly established par value of the Canadian dollar and could easily have led to a world-wide burst of speculation against other currencies.

Within four days, and very busy days they were, a combined program of over $1 billion in short-term credits was developed for Canada. The new swap technique played a pivotal role as the Federal Reserve and the Bank of Canada concluded an agreement for $250 million. In addition, the Export-Import Bank granted Canada a $400 million standby credit, the Bank of England opened a $100 million credit for the Bank of Canada, and the Canadians arranged a $300 million drawing upon the International Monetary Fund. This massive display of financial solidarity, along with monetary and fiscal measures announced by the Canadians, broke the speculative attack and the reflow of funds to Canada soon began in large volume.

By February of this year the network of Federal Reserve swap arrangements had grown to an aggregate amount of just over $2 billion involving twelve different foreign monetary institutions. Most of these arrangements were simply standby in character, available for reciprocal use if needed. During the period from March 1962 through February 1964, total drawings under swap agreements were just over $1.6 billion, while total repayments were just under $1.3 billion. The net debtor position at the end of February of the Federal Reserve System was $145 million. As I mentioned earlier, it has been our policy not to use the swap credit except for very short-run financing.

Instead, beginning late in 1962, the U.S. Treasury has issued medium-term securities payable in local currencies to foreign monetary authorities. These "Roosa bonds" as they are frequently termed in the press, provide foreign central banks with a medium-term interest-earning asset and play a valuable role in holding the drain upon our gold stock to minimum proportions. Each issue of these bonds, ranging in maturity from 15 to 24 months, is the outgrowth of close consultation and discussion between our own and foreign monetary authorities. There is no compulsion involved, simply a recognition that there is a need for a medium-term credit instrument attractive to foreign dollar holders during the transitional period until our balance of payments deficit is removed. The aggregate amount of these foreign security issues outstanding at the end of February 1964 was $730 million. Along with other special transactions, the sale of these bonds has played a crucial role in conserving our gold stock.

Cooperative efforts with foreign governments to stabilize the London gold market have forged a final link in the chain of our financial defenses. The initial steps were taken in the autumn of 1961. On both sides of the Atlantic there was recognition of the need to avoid disorderly conditions in the gold market. Any repetition of the October 1960 gold scare was sure to shake the foundations of the entire international financial system. When some pressure did again begin to build up in the gold market in late 1961 an informal gold pool agreement was reached between this country and Belgium, France, Germany, Italy, the Netherlands, Switzerland, and the United Kingdom. This called for each country to ante up a certain amount of gold -- the U.S. share was 50 percent of the total -- to be used in making net sales in the market if required to hold the price down.

The initial experiment was highly successful. In 1962 when it became apparent that there would temporarily be a surplus of gold on the market instead of a shortage, the United States approached the same countries and suggested that a gold buying arrangement be initiated as well. This met with approval. The net result has been that official gold buying and selling operations have been coordinated to achieve a common goal -- the effective stabilization of the London gold market. This, in turn, has meant that the crucial relationship between gold and the dollar has been protected. The fixed price of gold is the keystone upon which the entire postwar international financial system has been built. In cooperation with foreign monetary authorities, we have succeeded in stabilizing the gold market even when it has been subjected to severe shocks -- shocks which, in the absence of cooperative efforts, might have sent the price of gold skyrocketing.

The effectiveness of cooperative action by our own and foreign monetary authorities in exchange and gold markets has been impressively demonstrated upon a number of recent occasions. After the stabilization of the Canadian dollar in the summer of 1962, exchange and gold markets remained somewhat uneasy, partly because of world-wide declines in stock market prices. As things began to return to normal, the Cuban confrontation leading to the eventual removal of Soviet missiles, set the hot money flows to moving. The extensive system of international cooperation was very effective in minimizing the disturbance to financial markets and preventing any snowballing speculative movements from occurring.

Late in January 1963 the British bid for membership in the Common Market was rejected and sterling came under pressure in the exchange markets. Previously, sterling had been relatively strong and the Federal Reserve had actually been drawing sterling under the swap agreement for routine support of the dollar. Quickly the Federal Reserve switched and purchased sterling. The Federal Reserve also stood ready to increase the credit available to the Bank of England under the swap agreement. However, from all indications, the speculative flow of funds away from London was going to the Continent. Consequently, the Bank of England negotiated $250 million of short-term credit directly from Continental central banks. The mere announcement of these credits was sufficient to stabilize sterling which soon strengthened. One outgrowth of the 1963 experience was the agreement announced on May 29 of the increase in the swap line between the Federal Reserve and the Bank of England from $50 to $500 million. This was tangible evidence of firm agreement between this country and the British that the dollar, sterling, and gold would be defended against speculative attack.

The strength and resiliency of present international financial arrangements in the face of severe shocks to public confidence were amply shown in the somber hours and days that followed President Kennedy's assassination. European exchange markets were closed at the time of the tragic news. The Federal Reserve Bank of New York, acting for the System, placed sizable offers for foreign currencies to demonstrate the continuity of U.S. policy. Welcome cooperation from the Bank of Canada insured that Canadian as well as our own exchange markets remained calm. Telephone contacts with European central banks quickly established the plan for a joint program of official intervention. When European exchange markets opened on Saturday, there was no panic selling of dollars. The fact of cooperative official action itself, when known to the market, was sufficient to allay anxieties, and the dollar remained strong.

Just last month the ability of prompt countermeasures to stem speculative tendencies was again demonstrated -- this time in the case of the Italian lira. Italian productivity has grown very rapidly but domestic inflation has contributed to the development of a sizable balance of payments deficit. The Italian government has stated that Italy's program to correct its balance of payments is expected to become fully effective this year. However, when speculative pressures against the lira began to develop strength last month, it was considered to be prudent to strengthen the Italian position so that short-term disturbances would not impede the effectiveness of the Italian programs. A package of credits totaling about $1 billion was made available to Italy from the U.S. Treasury, the Export-Import Bank, the Commodity Credit Corporation and from other nations. The lira improved sharply and there is every reason to believe that the Italians will now be able to move ahead successfully with their balance of payments program.

No one at the Treasury or the Federal Reserve System has been under the illusion that the financial measures I have described were in any sense a substitute for removal of the underlying deficit in our balance of payments. However, it was recognized from the first that lasting balance of payments improvement would have to be achieved within the framework of an international financial system secure from speculative threat and waves of currency liquidation. We have benefited from the active and willing assistance provided by foreign monetary authorities who recognize the key position the dollar occupies and the great productive strength upon which it rests.

The record of responsible financial cooperation is a good one and one with which I am proud to have been associated. Recent balance of payments trends since the program announced by President Kennedy last July was set in motion have been extremely encouraging. No doubt the first quarter of this year, just now concluded, will have seen the balance of payments deficit on regular transactions again reduced very sharply. The task now is to maintain the momentum of that improvement and remove our balance of payments deficit altogether.

The fundamental lesson of these past years is the pre-eminent importance of active international cooperation. We have learned domestically that financial institutions must have the freedom to compete, but that we must also cooperate to insure that the overall national financial structure is secure. Similar lessons are being learned internationally. As a competitive international economy and the free flow of currencies have been achieved, it has also been essential to cooperate in the evolutionary development of a more secure international financial system. Much more remains to be done. But when I reflect upon the distance we have come, and the trying times through which we have moved, I am confident of our eventual success.

There is an obvious lesson here for the American financial community. It has always been fiercely competitive but I am convinced of the need to keep this competition within bounds. An internecine war between State banks and national banks; between commercial banks and savings and loans; between unit banking and branch banking--waged unrelentingly--could bring disaster to all of us. This thesis, I might add, applies with equal force to the regulatory agencies.

Most of the basic problems in banking emerged in an aggravated form and demanded attention in the 1930's. As I see it, these problems are not amenable to complete and financial solution: they are continuing rather than unique. Though I do not claim firsthand knowledge of banking in the 1930's, my three years of experience with the Treasury has given me a financial background with comparable problems and situations. And it is against this background that I can discharge the President's order to remember the dark times of the Great Depression.