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1963: THE YEAR THE TORCH WAS PASSED*

The year 1963 was one of progress, problems, and crisis. The progress came as the nation moved ahead to produce goods and services in record volume. Real gross national product, for example, increased by almost 4 per cent and the industrial production index rose 7 per cent. As a result, per capita personal income climbed to about $2,500 and corporate profits before taxes rose to a record level of over $50 billion.

Despite this progress, many problems remained. Unemployment clung stubbornly above 5-1/2 per cent of the labor force. Our balance of payments again showed a deficit.

But 1963 will not be remembered primarily for statistics nor even for our continuing and difficult problems. More likely, we shall remember it for tragedy and for the panic this tragedy could have carried in its wake. The year 1963 ended with the assassination of the President, and this tragic event had the potential to set off an international money panic of major proportions.

Yet it did not. Today I want to discuss the question of why it did not. The story is little known but of great importance, for it depicts the resources and techniques developed through the years both to deal with crisis and to aid in solving basic balance-of-payments problems. The story of crisis begins on the fateful day of November 22.

Shortly after 1:30 p.m., Eastern Standard Time, the world knew the President had been shot. At 2:36 p.m. Assistant White House Press Secretary Malcolm Kilduff announced that the President was dead.

*An address by Karl R. Bopp, President of the Federal Reserve Bank of Philadelphia, before the Monday Afternoon Session, January 27, 1964, of the American Bankers Association National Credit Conference held at the Bellevue-Stratford Hotel, Philadelphia, Pennsylvania.

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How would the world react? One of the first indicators was the stock market. The news hit the floor of the New York Stock Exchange about 1:40. There were rumors too that the Vice President had been shot. What happened then has become history. The market plummeted. To quote the New York Herald Tribune:[1]

> The only rationalization the brokers could find for the fantastic declines in some stocks was the fact that some panic sellers couldn't see what prices they were getting for their stocks in their desire to unload 'at the market.' Stop-loss orders obviously were triggered in machine-gun fashion and the situation seemed to be getting almost out of control when the Exchange decided to stop trading altogether Friday at 2:09 p.m.
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> 'I sat in the board room Friday,' said one large investor, 'and I was appalled at what I saw. I heard one individual tell his man, "Sell me out at any price" and I winced. What happens to people?'

In about 29 minutes, 2.2 million shares were traded, more than in many entire days in recent years. The Dow-Jones industrial average plunged about 24 points. High Voltage Engineering fell from a high of 41-1/2 to 28-1/4. Delta Airlines declined from an opening of 62 to 52.

Would the panic spread? What would officials do who were responsible for orderly world financial and economic conditions? What must be going on in _their_ minds?

Officials in the Fed, the Treasury, and other agencies reflected the universal and immediate emotion of shock, incredulity, disbelief. But a job was there and it had to be done. Action must replace shock. The possible sources of internation panic must be sorted out and the many methods and resources available to counter that panic must be considered.

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[1] David Deich, "After a Panic -- a Rebound," _New York Herald Tribune_, November 24, 1963, Section 3, p. 2.

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What, then, might precipitate an international money panic?

You, as bankers, are already familiar with the inner workings of panic. Bank runs are classical examples. As you know, runs have occurred when depositors fear that banks might not be able to pay off depositors in full.

The United States acts as a sort of international banker. Other nations hold dollars for many of the same reasons a family or business firm holds deposits -- as working balances to finance trade, to earn income, or as an emergency reserve against contingencies such as a crop failure. One of the reasons countries prefer to hold dollars as working balances and reserves is that the United States Treasury stands ready to redeem these dollars in gold for friendly foreign governments and central banks. Dollars are "as good as gold."

Yet once the fear spreads that the United States may not be able to redeem dollars in gold or in foreign currencies, or once foreigners fear that they may be able to redeem dollars in lesser and lesser amounts of their own currencies -- they may demand payment for their dollars just as your depositors demand currency for their deposits. Thus, it is possible to have a run on a currency just as it is possible to have a run on a bank. But what forces propel the pyramiding of fear and speculation that culminate in international panic?

The bedrock of such unreasoning fear is shock and uncertainty. Questions pile upon questions. The President is killed? The Vice President also may have been shot? Who will take command? What will be the policies of those who take command? Will the Soviet Union take some step during the emergency which might endanger world security? And a most important question, what if foreigners who own literally billions of U.S. dollars rush to convert these dollars into their own currencies and into gold; rush to do so because they fear

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this very rush, fear they must be first in line in order to get their funds out of a country that may not be able to maintain the value of its currency? To further propel the rush, will currency speculators add to the cascading stream of dollars descending upon world currency markets? And what if Americans themselves should join in the rush to get out of an asset which may decline precipitously in value, to get out of dollars and into foreign currencies?

These are the types of uncertainties which precede panic and the types of forces which propel it. As in most cases where supply exceeds demand at prevailing prices, the rush to unload dollars on world currency markets tends to drive the price of dollars down. If dollar exchange rates do begin to fall, then the panic may reach a second dimension. Dollar holders who at first stood steadfast may falter and add to the supply of dollars. Finally, if it seems that the United States and cooperating foreign nations and world organizations will be unable to hold out against the run, there is the chance that some foreign central bank which previously had been absorbing dollars might crack and demand gold for dollar holdings. There is the chance that other central banks might follow.

With panic and uncertainty in the air, world finance and world trade tend to grind toward a halt. Who wants to lend money to finance exports in such an atmosphere? Who wants to export for promises of future payment? As exports fall, jobs in export industries are lost and incomes decline. As jobs are lost and incomes fall, the world may plunge into the rancorous depths of depression.

Although central bankers must sort out in their minds the possible sources of panic, they must be quick to consider the methods and resources available to counter them -- methods and resources which have been worked out in the most minute detail over the years by governments and central banks. The basic question is this: how can we best absorb the avalanche of dollars which could conceivably descend upon the market?

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The first and most obvious resource is the huge United States gold supply. Though we have lost gold in recent years, we still have around fifteen-and-a-half billion dollars worth of the yellow metal and even during a panic (perhaps I should say especially during a panic) people and governments will accept gold. Thus we can sell gold to absorb dollars coming into the market. And the world may rest assured that we stand ready to sell gold -- down to the last bar if necessary -- to meet our international obligations. The Federal Reserve has ample power under the Federal Reserve Act to suspend statutory gold requirements against Federal Reserve notes and liabilities and thus to make any part or all of our gold holdings available to sell to foreign monetary authorities and international institutions.

But what other methods and resources are available to the United States to absorb dollars in time of crisis -- methods and resources which could supplement the sale of gold?

The United States may obtain foreign currencies from the International Monetary Fund. These may be used both to absorb dollars coming into foreign exchange markets and to buy those held by central banks and others in excess of what they wish to hold. In recent years, countries have obtained both gold tranch credits and additional funds in amounts up to 200 per cent of their quota. A theoretical drawing of this nature and magnitude by the United States would total a little over $5 billion.

Then there are the so-called "General Agreements to Borrow" concluded in Paris in 1961 by 10 member countries (including the United States). Under this agreement, the IMF may obtain the equivalent of $6 billion of group currencies and use this to extend additional credit to IMF members.

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The network of credit facilities available to defend the dollar is further augmented by the so-called "swaps" arrangements. Under these arrangements, the Federal Reserve and 11 foreign central banks (plus the Bank for International Settlements) have set up reciprocal "lines of credit." For example, the Bank of France will allow the Fed to draw up to 500 million francs, and the Fed in turn will let the Bank of France draw 100 million dollars. The Fed can use these funds to absorb dollars offered on the foreign exchange markets or to purchase dollars owned by foreign central banks. Swap agreements have added more than $2 billion to the funds available for defense of the dollar.

Another technique for absorbing dollars (though generally thought of as a form of medium-term credit), could be used for short-term accommodation in case of need. This technique is the issuance of the special securities popularly called "Roosa bonds" after the distinguished Under Secretary of the Treasury. Such bonds may be issued by the U.S. Treasury to foreign governments and central banks for payment in dollars. Such a sale of bonds for dollars would, of course, effectively remove dollars from foreign hands. At present, there are a little over $850 million of Roosa bonds outstanding.

Rounding out the international network of cooperative arrangements which could be called upon to absorb dollars in time of crisis are the ad hoc type of agreements which have been worked out to aid central banks in time of special need. A good example is the so-called "Basle credits" of more than $900 million extended by European central banks to the Bank of England during the 1961 sterling crisis. Such spontaneous agreements reflect the cooperative attitude and understanding concern of the world central banking community for those of their number caught in special situations of stress.

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Yet on the afternoon of November 22 there was even more to consider.

The United States economy is essentially viable and strong. The ability to produce and the demand for the fruits of production are the real strength of any economy. As long as we can produce efficiently in a world which has an effective demand for that production, there will be a basic demand for the dollar. This is not to say that we do not have problems -- among the most important, the persistently high rate of unemployment and the continuing balance-of-payments deficit. Yet essentially the economies of this nation and of the free world remain strong.

This basic strength, plus the network of defensive arrangements, and the cooperative attitude of the world's central bankers and governments -- these were the bulwark for the defense of the dollar, the bulwark which one considers at a time such as November 22, 1963.

But there was still another asset, one which -- though intangible -- may have been in retrospect as valuable in defending the dollar as any yet mentioned. That asset was a sudden intensification in awareness of the human condition, of the fragile nature of human life, the temporality of human existence -- the condition that binds us all together as human beings.

Perhaps it was the disproportion of the act of assassination that brought about this intensification of feeling -- that a man with a $12 gun could kill the President of the United States, could kill the head of a state whose immense power and resources place it supreme among nations.

Yet whatever the reason, the feeling existed, and it was buttressed by the cooperative network of dollar defenses. With this bulwark, the reaction of European central bankers contacted by the Fed on the evening of November 22 was this: "Tell us what we can do." Indeed, the Bank of Canada acted to support the dollar without even waiting to be asked.

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The type of environment in which the Fed operated on that November day is perhaps best illustrated by quoting the words of Charles A. Coombs, special manager for foreign operations of the Federal Open Market Committee. As reported in a recent article in the American Banker, Mr. Coombs has this to say:[2]

> I was having lunch in the dining room when there was a phone call. Someone told me the President has been shot. I jumped up and went over to talk with Al Hayes . . . .
>
> Then I rushed off to the trading room on the seventh floor. By that time the news was on the ticker and there seemed to be some suggestion that something had happened to Vice President Johnson.
>
> I thought that something had to be done immediately to prevent any 'bubbling up' in the foreign exchange market of the kind of panicky selling we were seeing in the stock market.
>
> So I put in a big block of one currency and said to sell at the prevailing rate. Then, I threw in two more blocks. This all happened, oh say, within a minute of my seeing the news on the ticker. . . .
>
> Almost simultaneously, I realized the Bank of Canada was in there supporting the dollar -- without our having asked for help . . . .
>
> ...Right away I was on the phone to Switzerland -- it was night there, of course, and I got Ikle at home . . . . We all have each other's home phone numbers . . . . We agreed to offer whatever Swiss francs were called for to keep the dollar firm.
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> Then I called the Bank of England and three or four more banks, alerting them, again reaching everyone at home. The reaction was the same everywhere: 'Tell us what we can do.'

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[2] James R. Hambleton, "Dollar's Defense -- Study in Cooperation," American Banker, pp. 1-2.

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The net result of the cooperative action: there was hardly a bump or ripple in the foreign exchange market. Quoting Charlie Coombs again, "It was the easiest (crisis) of all to handle."

I would like to take the next few moments to illustrate how the defensive measures just described are of great assistance in dealing with our basic balance-of-payments deficit. The defensive measures are not, of course, a solution to our balance-of-payments problem. They provide us rather with an important assist in the effort to solve our payments problem. The nature of that assist can be summarized in a single word: time.

We need time because the world in which we live and the payments difficulties we are experiencing are not of the classical mold. Traditionally, a payments deficit was associated with domestic overexpansion. A country which paid out to foreigners more than it received was assumed to be doing so because it was buying too large a volume of goods abroad on net balance and too many securities. It bought too large a volume of goods, the reasoning went, because domestic industry was producing at capacity and hence could not provide sufficient goods to meet demands. This tended to drive up wages and prices and thus to encourage imports of lower-priced foreign goods and discourage high-priced domestic exports. The result: a net outflow of funds on trade account.

A second source of imbalance in the classical model was a net outflow of funds to purchase foreign securities. The reason why such an outflow occurred, the reasoning went, was that interest rates abroad were higher than those at home.

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The way to right such a deficit seemed simple enough -- if prices were too high and interest rates too low, then take action to lower prices and raise interest rates. The policy measure which could accomplish the task: tight money.

The central bank simply made less money and credit available. With less money and credit pursuing a limited amount of goods, domestic prices would tend to fall. With less money to borrow, interest rates would tend to rise. Both trade and capital accounts would improve and balance-of-payments equilibrium would be restored.

This was the classical remedy. Tight money could be applied rapidly; it would help both the trade and capital accounts; it was consistent with both internal and external difficulties.

Yet our present deficit is not of this classical nature. We are not producing at capacity and forcing wages and prices up. Indeed, at the same time our international payments are in deficit, we have substantial unemployment; we are producing and consuming at less than our capacity. Moreover, much of the capital leaving the country is not induced by interest rate differentials. Hence a resort to the classical procedure of tight money, though the measure can be implemented quickly and efficiently, would be injurious domestically and of dubious utility on the international front.

But if we are not to use the classical measures, what avenues are open to an attack on the balance-of-payments problem?

To make a long story short, the measures must be consistent with our particular type of payments difficulties. Today we have a net export surplus and thus a net inflow of funds from abroad on trade accounts. But this is not enough to cover the outflow of funds for the network of military installations and attendant personnel abroad, and for other Government payments plus the flow of private investments to foreign nations.

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In short, the balance-of-payments problem today is not solely economic. In large measure it is the economic reflection of a socio-political problem. Such problems take time to solve. The cold war did not start nor will it end in a day. Thus the same defensive network which has served us so well in time of crisis -- from the Cuban missile threat to the assassination -- this network also helps us absorb dollars in the longer-run transition to balance-of-payments equilibrium.

Again let me emphasize the fact that we have not solved our payments problems. Indeed, there is much left to be done. Our network of defensive measures simply gives us time to diagnose our payments ills and apply the right medicine.

In closing, let me say that the year just ended was a trying one, a year of national grief, national introspection, and national trial. Yet our democratic institutions have so far measured up to this trial.

In his inaugural address -- that cold, windy day in January over three years ago -- President Kennedy said this, and I quote:

> Let the word go forth from this time and place, to friend and foe alike, that the torch has been passed to a new generation of Americans -- born in this century, tempered by war, disciplined by a hard and bitter peace, proud of our ancient heritage.... Let every nation know ... that we shall pay any price, bear any burden, meet any hardship, support any friend, oppose any foe to assure the survival and the success of liberty.

In the year 1963, the torch was passed again.

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