Dollar Still Almighty, For Now

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ABSTRACT (ABSTRACT)

It would now be heresy to suggest that a country could gain international stature by closing its capital markets for a prolonged time, but an insightful new book by William L. Silber, an economist at New York University, argues that the closing of the New York Stock Exchange at the outbreak of World War I played a critical role. The exchange remained closed for four months.

"The dollar overhang makes us vulnerable," Mr. Silber said when I called him this week, "the same way Britain became vulnerable at the outbreak of the Great War."

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FULL TEXT

Is New York's status as financial capital of the world in danger?

As the rhetoric has heated up in Washington, that idea has been bandied about. There is talk that London's stock market will get more new listings, and that Chinese companies will go there rather than to New York to raise capital. There are pushes to relax American regulations and make it harder to file lawsuits against companies.

But there are other signs that nothing of the sort is happening. American investment banks are coining money as never before, whether in New York, London or other places, and still have their pick of the best and brightest young graduates the world over.

Detroit and Pittsburgh can only dream of their major industries suffering as New York's is.

And the role of the dollar in international trade and finance -- the real sign that New York is the world's financial capital -- is still taken for granted. If a Brazilian company agrees to buy something from a company in Japan or Turkey, chances are that the contract will be in dollars. If one of those companies needs to tap the international capital markets, the chances are good that it will borrow dollars. The central bank of its country is likely to hold the bulk of its reserves in dollar-denominated assets.

Such dominance is not, however, guaranteed. Less than a century ago, a suggestion that the United States would attain that status would have seemed odd, if not foolish. Memories of the Panic of 1907, in which the American government stood helpless and J. Pierpont Morgan had to step in to stem the crisis, did nothing to reassure overseas investors.

It would now be heresy to suggest that a country could gain international stature by closing its capital markets for a prolonged time, but an insightful new book by William L. Silber, an economist at New York University, argues that the closing of the New York Stock Exchange at the outbreak of World War I played a critical role. The exchange remained closed for four months.

The conventional view was that the exchange was closed to keep share prices from plunging. But the book, "When Washington Shut Down Wall Street," asserts that historians -- and contemporary observers -- had it wrong.

Mr. Silber argues that prices would have recovered quickly, and that Washington knew it. But with Europeans selling shares to raise money for the war, America faced an outflow of gold.

By delaying the reopening of Wall Street and making sure that American grain was ready to be exported to Europe to bring in gold, the United States was able to stay on the gold standard and become an alternative to London as a financial capital. By late 1915, Britain and France were borrowing money in New York, denominated in dollars.

The war was not decisive. Even after it was over, London remained the financial capital, and the British pound the major world currency. But by the late 1920s, New York was a clear and close alternative, and it was ready to assume unquestioned leadership after World War II.

The dollar now has its problems. It has weakened against major currencies, the United States is all but begging China to allow the dollar to shrink against the renminbi, and the current-account deficit keeps rising.

"The dollar overhang makes us vulnerable," Mr. Silber said when I called him this week, "the same way Britain became vulnerable at the outbreak of the Great War."

But inertia is great in such markets. "The dollar will not lose its role as international money anytime soon, even though we are vulnerable, because you need a credible alternative to topple the king," Mr. Silber said.

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Still, even with its disadvantages, the euro has come on strong. Figures kept by the International Capital Market Association indicate that the outstanding total of international corporate bonds in euros is now greater than the total in dollars. Central banks are starting to diversify their reserves.

The United States has profited greatly by having a printing press for the currency the world wants. Efforts to protect that position -- by slowing the erosion of the dollar and reducing the balance-of-payments deficit -- are barely on the political radar.

A generation from now, Americans may marvel at the complacency that assumed the dollar's dominance would never end.

DETAILS

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