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‘Too Big to Fail’ Started in New York in 1914

A New York default would have been a blow to Treasury Secretary McAdoo’s efforts.

The Senate banking bill’s reclassification of investment-grade municipal bonds as high-quality liquid assets (“The Art of a Banking Deal,” Review & Outlook, May 24) is in the end designed to reduce borrowing costs for financially stretched state and local governments but compromises the effort to ensure rigorous capital standards for the money-center banks.

It is instructive to note that the U.S. Treasury first provided such concessions to the municipal market as far back as August 1914. New York City, even then living beyond its means, was unable to roll over sterling and French franc denominated revenue-anticipation notes issued in the London and Paris money markets that were disrupted by the outbreak of war. As documented by NYU Prof. William Silber, Treasury Secretary William Gibbs McAdoo (later Woodrow

Wilson's son-in-law) permitted major New York banks to count New York City securities as reserve collateral to underwrite an emergency note issuance to plug the New York City funding gap.

With America's financial reputation still smarting from the Panic of 1907, McAdoo was desperate to keep the dollar on the gold standard and maintain the country's international financial standing. A New York default would have been a blow to those efforts.

Mr. Silber points out that those extraordinary 1914 measures on behalf of New York marked the birth of the "too big to fail" doctrine in American finance. A century later, the Senate bill has again cut a deal with the major banks that will continue to kick the municipal credit can down the road.

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