WHEN WASHINGTON SHUT DOWN WALL STREET: THE GREAT FINANCIAL CRISIS OF 1914 AND THE ORIGINS OF AMERICA'S MONETARY SUPREMACY

WILLIAM L. SILBER

BOOK REVIEWS

FINANCIAL TIMES
MARCH 5, 2007

The men who kept America afloat

By Krishna Guha

From today's vantage point, the rise of the US to global financial leadership last century seems inevitable, much like China's apparently pre-ordained rise to economic superpower status this century. Yet history rarely marches in a straight line, and the interplay of men and events matters, even in the realm of international economics.

The US breakthrough as a global financial powerhouse came only during the chaotic years of the first world war, when Great Britain, the incumbent centre of world finance, was consumed by a life-or-death struggle with Germany. Moreover, as William Silber reminds us in his book When Washington Shut Down Wall Street, it was not obvious at the time that the US would emerge from Europe's bloody tragedy as a global financial leader.

Indeed, when the clouds of war gathered in July 1914, the dollar fell sharply against sterling, even though the two were supposedly locked together by the gold standard, through which each currency was exchangeable for a fixed quantity of gold. It remained below parity for four months until mid-November 1914. During those four months, the US had to master a brewing financial crisis at home triggered by the onset of the war in Europe and prove its ability to stand by the gold standard.

Its success in doing so affirmed international confidence in US credit and US currency and provided the platform from which it assumed Britain's place as a global financial hub a year later.

The US in 1914 was a curious hybrid of developed and emerging market. In many respects -- per capita output, industrial production -- it was already the leading global economy. Yet in others it remained an emerging market, prone to domestic financial crises, with weak monetary institutions and vulnerable to a sudden withdrawal of capital by European investors.

When the crisis of 1914 broke, the US did not even have a central bank. The Federal Reserve, authorised by Congress in 1913, was still on the drawing board. The Bank of England had been in existence since 1694. In the absence of institutions, Silber shows, it fell to individual policymakers, above all William McAdoo, the entrepreneurial Treasury secretary, to keep the US financial ship from being overturned by the waves from Europe.

The book is the story of his brilliant improvisation. First McAdoo shut down the New York Stock Exchange to prevent European investors from selling their $4bn investments and demanding gold in exchange. Then he flooded the US with emergency currency, to forestall a domestic run on the banks. Along the way, a coterie of bankers led by J.P. Morgan, Jr. agreed to bail out the city of New York, which came close to defaulting on $82m in foreign debt.

Finally, recognising that extraordinary measures could not provide a lasting solution, McAdoo raced to create the Bureau of War Risk Insurance, which allowed the US to resume exports to war-torn Europe, creating demand for dollars.

It is an engaging story; part economic history, part how-to manual on dealing with financial crises. Silber, a professor of economics at New York University's Stern School of Business, restores McAdoo, a largely forgotten figure, to a deserved position of prominence in US economic history.

One attractive feature of the book is that it uses contemporary market prices to assess what policy measures were effective. Its main flaw is that it pleads its case too strongly. The contribution of McAdoo and other policymakers in mastering the US financial crisis of 1914 was significant. But it takes second place to the duration and extent of the war in shutting Britain out of global markets and destroying the foundations of its financial leadership: the world's greatest stock of foreign assets and low domestic inflation.

The dollar crisis, although intense and dangerous, always had a solution in Europe's desperate need for supplies. Indeed, the dollar may never have fallen in the summer of 1914 if investors had anticipated the extent of the war that was about to unfold. Instead, it appears that they, like the politicians and generals of the day, expected a short war, one that might be over by Christmas.

If the war had ended even in 1916, McAdoo's contribution might have made the difference to the post-war struggle for financial leadership between the US and Britain. But the war dragged on until November 1918. By then, even if the US had been knocked off the gold standard in 1914, it would probably have gained pole position in international finance, particularly given the underlying force of its rising share of world trade.

Silber's main contention, though, is well taken. It takes a lot to uproot an incumbent world financial leader. Potential rivals need to be smart enough to take advantage if and when a moment of opportunity arises a moment that almost by definition will be one of global financial crisis.

If, for instance, global confidence in the dollar is ever shaken by an abrupt fall in the US currency, will there be a McAdoo in Beijing or Frankfurt, Tokyo or London to step in and offer a viable alternative?

When Washington Shut Down Wall Street by William L Silber, Princeton University Press, $27.95

The writer is the FT's chief US economics correspondent

The Washington Post Company, Jan 21, 2007

Remember how U.S. financial markets closed for an unprecedented four business days following the terrorist attacks of 9/11? Well, not so unprecedented, it turns out. In his fascinating work of financial history, When Washington Shut Down Wall Street (Princeton), William L. Silber recounts the heroics of Treasury Secretary William McAdoo, who closed the New York Stock Exchange for more than four months -- four months! -- in 1914 to avert a larger economic crisis. European powers had begun to sell off their U.S. stock holdings and convert their dollars into gold, which they shipped back home to finance World War I. But rather than let the desperate Europeans force the United States off the gold standard, the Treasury secretary brandished the NYSE "like a sledgehammer" against the gold drain and simply shut down the exchange. It was, as Silber explains, a brilliant exercise of arbitrary power that helped propel the United States toward global financial supremacy.

-- Carlos Lozada

Irish Times

How crisis became opportunity for dollar's supremacy.

7 May 2007

Business books: This readable history tells how one man rescued the US from monetary crisis at the outbreak the first World War and made the dollar the dominant currency, writes Richard Keatinge

When I first picked up this book, I wondered whether it described events so long ago that they were irrelevant today and whether it would be written in such an academic fashion as to be turgid and unreadable for the ordinary mortal interested in business and a good read.

Well, I was wrong on both counts. As a history it explains the origin of the financial system we have today, although many of the events described (most notably the closure of the New York Stock Exchange (NYSE) for 4Â½ months) simply would not happen today thanks to electronic trading and the globalisation of share dealing.

As a story, it manages to tread the fine line between financial thriller and academic treatise. The quality of the academic background gives credibility to the tale, but the way it is told - tight, succinct and to the point - gives it pace and makes it an eminently readable piece of financial history.

In essence this is the story of how one man - US treasury secretary William G McAdoo - almost single-handedly succeeded in ensuring that the US dollar survived a potential run caused by the outbreak of the first World War and laid the foundations for that currency becoming the dominant medium of international exchange for the rest of the 20th century.

"William G McAdoo paved the way for the dollar to dislodge sterling as the world's currency by remaining true to gold."

How he did so is well summarised in the introduction, a quick read of which will tell you whether this book is for you.

In August 1914 McAdoo - only a year in office - presided over an economy in which the dollar had a fixed exchange rate with gold into which it was freely convertible. Sterling likewise was linked to gold and, by virtue of its strict adherence to this link and the fact the British banking system under the supervision of the Bank of England had avoided the crises that had periodically engulfed the American system, was recognised at the outbreak of the war as the main international trading currency.

Moreover, unlike Britain, McAdoo had no central bank to influence the market and control the activities of commercial banks, although the creation of a federal reserve board had been much debated in congress.

In the absence of such an entity, McAdoo, as the book explains, had to improvise. His strategy had five main elements. Firstly, he suspended dealings on the New York Stock Exchange, which meant that foreign investors could not sell their US stock and exchange the proceeds for gold. "The British could not drain American gold without the dollar proceeds from sales of US stocks and bonds."

Secondly, as ordinary bank customers feared a repeat of the 1907 collapse of the US banking system, he flooded the system with paper currency to ensure the banks had adequate liquidity, just as Alan Greenspan did after the 1987 stock market crash.

Thirdly, he orchestrated the financial bale-out of New York city, thereby ensuring foreign investors in the city's bonds were repaid. Fourthly, he promoted the acceleration of US agricultural exports to earn the foreign exchange reserves needed to offset the outflow of gold to Europe. And finally, in November 1914 he set up the Federal Reserve board despite the heated opposition of several experienced bankers. (In the midst of all this, incidentally, he found the time to marry president Woodrow Wilson's daughter.)

Gradually, the financial world came to believe that the US would not abandon the gold standard, and by early 1915 foreign governments began to issue substantial quantities of dollar-denominated bonds for the first time. Since then, the dollar went from strength to strength.

Along the way, a few interesting precedents were set. For instance, the bale-out of New York city was the first example of the idea that some entities are just "too big to fail" if the banking system is to survive. As recently as 1998 we saw this again with the bale-out of Long-Term Capital Management orchestrated by the Fed, so brilliantly described in Roger Lowenstein's book, When Genius Failed.

One precedent was short-lived. McAdoo was adamant that he should be a member of the Federal Reserve board and that its members should be compatible with him - a bit like Brian Cowen being chairman of the Central Bank and picking his follow board members. But since 1932 this has no longer been the case, as a result of which people like Paul Volcker and Greenspan have been able to pursue a sound money strategy irrespective of political considerations.

What, if any, relevance does all this have today? Perhaps not a lot in terms of markets. Flexible exchange rates mean that nowadays the problem of maintaining a gold standard simply does not exist, and electronic trading and the globalisation of stock exchanges mean closing the NYSE as a means of stopping a currency crisis is irrelevant.

However, at least two broader lessons seem to be relevant.

Firstly, strong, credible monetary authorities that can materially influence the broad economic parameters have become essential to our financial well-being, and McAdoo saw this. Secondly, at times of crisis, it is courage, decisiveness and leadership that count. McAdoo was no academic but he understood markets and had the guts to take unpopular decisions to achieve his objective.

He was some operator.

The Washington Times
23 December 2007

The unlikely hero who shut down Wall Street

James Srodes, SPECIAL TO THE WASHINGTON TIMES

Let me confess at the outset that I have never understood the mythology of gold as a superior form of money to, say, paper money or, in some societies, cowerie shells or belts of wampum. Gold is just as easily counterfeited, thugs can take it away from you when chaos erupts, it's dead weight, it only increases in value when someone else is willing to pay more (of what? Wampum?) of something else for it.

Yet to deny the power of gold is to deny the pull of the tides. So "When Washington Shut Down Wall Street" is more than just a ripping yarn - and it is that - it is a cautionary tale of how humankind can get suckered into so believing economic myths that they take on a dangerous reality. That is especially important as a lesson for today's investor, who has not yet come to grips with our current crisis. The collapse of the housing and related credit markets stems in large part from our dogged faith that land-related investments and housing in particular always rise in value and never decline because that's the way it has been since World War II.

William L. Silber tells his story with authority. A monetary economist who teaches at New York University, Mr. Silber has also been a senior economic adviser to the White House's Council of Economic Advisers, the Federal Reserve and key Congressional committees. Among his other credentials is that as a 23-year-old assistant professor he taught a course on the advanced theory of money to a class that included the even-then-well-known economist Alan Greenspan.

William Gibbs McAdoo makes an unlikely hero, but he most certainly is the hero of this tale. A Tennessee lawyer who turned into a New York transit developer, McAdoo was an early backer of Woodrow Wilson's presidential ambitions, and as a reward he was made treasury secretary after the 1912 election. Nothing in his background hinted at his capacity to understand the crisis that was just 18 months away when he took office, let alone his ability to act so promptly.

The international monetary system that existed in that palmy summer of 1914 had many obviously fatal flaws but the single virtue that it seemed to work. Major trading nations promised to redeem their domestic currencies in so many ounces of gold bullion. Since the gold holdings of those nations were public knowledge, the system acted as an effective check on governments printing more paper currency and thereby devaluing their currencies beyond internationally acceptable limits. Mr. Silber notes that the exchange rate for the British pound had remained essentially unchanged in early 1914 from what it had been since 1714 when Sir Isaac Newton ran the royal mint.

So it was that huge American shipments of grain to European buyers were assured of payment in predictable sums. British and French investors in American railroads by the same token were comfortable that their holdings held their value. American citizens also had the false assurance that they could go to their hometown bank with $20.67 in bills and coins and receive one ounce of gold either from the bank or from a U.S. Treasury sub-branch.

But as Mr. Silber notes, "The gold standard provided protection against inflation but not against crises." Commercial banks held only a small quantity of gold against their checking account deposits, about $1 billion in all. Yet foreigners held roughly $4 billion in U.S. securities, which in theory they could sell at any time and demand payment in gold. If even a quarter of the foreign share holdings were sold off, it would wipe out the bank gold backing and ignite a national banking collapse.

That is what began to happen suddenly when the European powers, to their own amazement, began to choose up sides and rush headlong into war. European investors adhered to the myth of gold as a refuge and fled their American securities for gold bars, which were rushed across the Atlantic. Stock values on Wall Street fell nearly 4 percent on Tuesday, July 28, and another 6 percent on Thursday, July 30. This was the worst drop since a similar panic in 1907, so the scars were still visible.

In this accessibly written thriller, Mr. Silber argues that McAdoo did have options. While the Federal Reserve System had been enacted into law in 1913, it was not yet functioning, so there was no American central bank to act as a buffer. Still, as treasury secretary he could have simply suspended convertibility into gold. But McAdoo recognized that America did not have the international reputation for stability that the pound and other European currencies had. A suspension would have ruined the dollar's status.

His final solution was breathtakingly daring in that he simply shut down the U.S. financial system. He coerced Wall Street's banking powers into closing the New York Stock Exchange on Friday, July 31, and keeping it shut until Dec. 12. No American shares could be sold off, hence no dollar claims could be presented by panicky Europeans or Americans for gold. There was no repudiation of the dollar's worth - it was just frozen in place for a time.

In playing for that time, McAdoo gambled that the need for even greater shipments of American grain and guns for the warring Europeans would quickly reverse the gold flow back into American coffers. By the time the markets did open at the end of 1914, the crisis was over.

It is said that at the Paris Peace Conference of 1919, British Prime Minister David Lloyd George used a gold sovereign coin as his official seal when he signed the Versailles Treaty. French Premier Georges Clemenceau admired the coin and asked his colleague if he could have it as a souvenir. Lloyd George demurred.

"This is the only one I have," he said wistfully. "All the others are in New York."

James Srodes has served as Washington bureau chief for both Forbes and Financial World magazines. He currently is a financial commentator for the BBC World Service.

https://slate.com/business/2007/03/the-amazing-story-of-william-mcadoo-an-american-financial-superhero.html

SLATE

MONEYBOX: COMMENTARY ABOUT BUSINESS AND FINANCE.

The Unknown Financial Superhero

THE AMAZING STORY OF WILLIAM MCADOO, AND HOW HE SAVED THE AMERICAN ECONOMY.

By Daniel Gross
Posted Thursday, March 22, 2007, at 1:51 PM ET


William McAdoo

The list of American government financial superheroes is relatively short. The vast majority of the 74 Treasury secretaries and 14 Federal Reserve chairmen lie in musty repose. After Alexander Hamilton, immortalized on the $10 bill and by Ron Chernow's fine biography, very few financial public servants captured the public's imagination. Yes, Treasury secretaries at times of war and crisis, like Salmon Chase, Andrew Mellon, and Henry Morgenthau Jr., were famous in their time and remain appreciated by historians. But they weren't hailed as heroes, as was cigar-chomping Federal Reserve Chairman Paul Volcker, who single-handedly killed off inflation in the late 1970s, and Alan Greenspan, who licked the business cycle and plain English syntax.

Greenspan was joined as a popular figure for a period in the 1990s by the economic policy Superfriends, Treasury Secretaries Robert Rubin and Lawrence Summers, who helped make the United States an island of stability amid global financial crises.

But a lively new book by New York University economist William Silber, *When Washington Shut Down Wall Street: The Great Financial Crisis of 1914 and the Origins of America's Monetary Supremacy,* makes a convincing plea for the inclusion of William McAdoo in the Dollar Pantheon.

McA-who? Most New Yorkers think the only McAdoo worth knowing is Bob McAdoo, who lit up Madison Square Garden as a power forward for the Knicks in the mid-1970s. But William McAdoo, who also plied his trade in New York, had even sweeter inside moves. He was president of the Hudson & Manhattan Railroad, which built the tunnels that house today's PATH trains. Then, Silber argues, as Woodrow Wilson's Treasury secretary, McAdoo executed a series of maneuvers in the chaotic fall of 1914 that turned America into the global financial leader. Combining Hamilton's penchant for mercantilism, Rubin's sangfroid, and Volcker's practicality, McAdoo enabled the United States to seize the mantle of economic leadership from London. Almost a century later, the crown remains ours, if tenuously.

When war broke out in Europe in the summer of 1914, the U.S. economy was still immature, a global debtor with an unloved currency that was subject to recurring panics. After a particularly nasty one in 1907, the United States decided to join the rest of the developed world and create a central bank. But by 1914, Congress and the president had yet to hammer out all the details.

In the summer of 1914, panicked Europeans, who supplied much of the capital to the United States, were cashing in their U.S. stocks and bonds and dollars for gold, and repatriating the precious metal. That was bad news for U.S. securities, for the dollar, and for American banks, which didn't have enough gold to meet their commitment to redeem paper currency for hard metal. There was no Federal Reserve that could protect the dollar by raising interest rates. And J.P. Morgan, who had functioned as a sort of private Federal Reserve during his long career, had died the previous year.

McAdoo, essentially devising monetary policy on the fly, sprung into action with a series of unprecedented measures. First, to stop foreigners from cashing in their U.S.-based assets for gold, he essentially ordered the New York Stock Exchange to close its doors on July 31, 1914.

The NYSE would remain shut for nearly four months. Brokers were unhappy, but the draconian move halted capital flight.

Next, to stop a run on the banks, he flooded the system with new currency. The Aldrich-Vreeland Act of 1908, which authorized the creation of the Federal Reserve, had established an emergency currency that banks could access in times of need. McAdoo made a big public show of chartering armored convoys to deliver gold, and then emergency currency, to the New York Subtreasury building across from the New York Stock Exchange. These actions, Silber argues, allowed banks to hold on to their supplies of gold while providing borrowers with access to capital.

There was more. As he worked to get the Federal Reserve system up and running, McAdoo helped orchestrate a bailout for New York City, which owed huge sums to foreign creditors. And he quickly developed the strategy that would help bring gold back into the country, thus allowing the banks to retire the emergency currency and the stock exchange to reopen. There was significant demand in Europe for U.S. agricultural commodities, especially cotton. But given the hazards of the Atlantic during wartime, shippers weren't eager to book cargoes. At McAdoo's urging, Congress in August 1914 created the Bureau of War Risk Insurance, which would allow shippers to obtain government-backed insurance for their cargoes.

By the late fall of 1914, things were falling into place. The Federal Reserve Banks formally opened in November 1914. The dollar rallied against the British pound. Shipping traffic revived, and foreign buyers paid in gold, which allowed American banks to start phasing out the emergency currency. The New York Stock Exchange reopened on Dec. 12, 1914. And as the United States stuck to the gold standard and emerged as a peaceful hub of trade, the dollar gained greater, um, currency and respect. The United States, for so many years a global borrower, was well on the way to becoming a global lender. In October 1915, J.P. Morgan & Co. sold a landmark $500 million bond issue for Britain and France to U.S. investors.

It's possible to make too much of this four-month period. The final transfer of power from London to New York wouldn't come until after the war, when Great Britain suspended the gold standard. And the performance of the Federal Reserve and economic policy-makers in the 1920s and 1930s showed that the United States was hardly ready for global leadership (see: Great Depression). It's also possible to make too much of the role played by any single person in this process. The flow of financial leadership westward had been underway for several centuries. Events in the fall of 1914 may have helped speed the process, but the transfer of economic power from Europe to the Americas had its own massive inertia.

Why did McAdoo triumph? Silber argues that it's because the former railroad executive, who had no formal economics education, thought like a businessman. He acted quickly and decisively, and focused on an exit strategy. Of course, McAdoo could not have succeeded without the support of President Woodrow Wilson, who happened to be his father-in-law. In March 1914, McAdoo had made one of the smartest career moves any executive can make: He got engaged to the boss's daughter.

Francis H. Mc Adoo, Jr.
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September 14, 2008

Dear Professor Silber:

As the only grandson of William G. McAdoo still extant I would like to tell you how much I appreciated your recent book, "When Washington Shut Down Wall Street". You incidentally provided me with a great deal of new detail about my grandfather's struggles and activities during the critical period of which you write The result of your research is certainly fascinating even to one who comprehends only the fringes of the world of Economics.

Having been born in 1916, the period of which you write was well behind us during my growing years. I was probably six years old when I first remember meeting grandfather on one of his occasional visits to New York City. He strode into our parlor, six feet three inches tall, straight as an arrow. After an introduction by my mother he pulled a dollar bill from his wallet and asked me whose was the portrait on the face. Not having a clue, I received quite a lecture.

My next memory of him would be during his attempt for the Democratic Party's nomination for President. At that time the name McAdoo seemed to appear in the newspapers every day. My practical-lawyer father told me that it wouldn't matter who the Democrats nominated, the Country would get Coolidge because the nation's economy was booming.

Your book brings back to me his interminable energy, and his huge ambition for himself and for his Country. As my father used to say, "It's a shame some historian hasn't written a good biography of father". Your book covers a fascinating period of this crowded life.

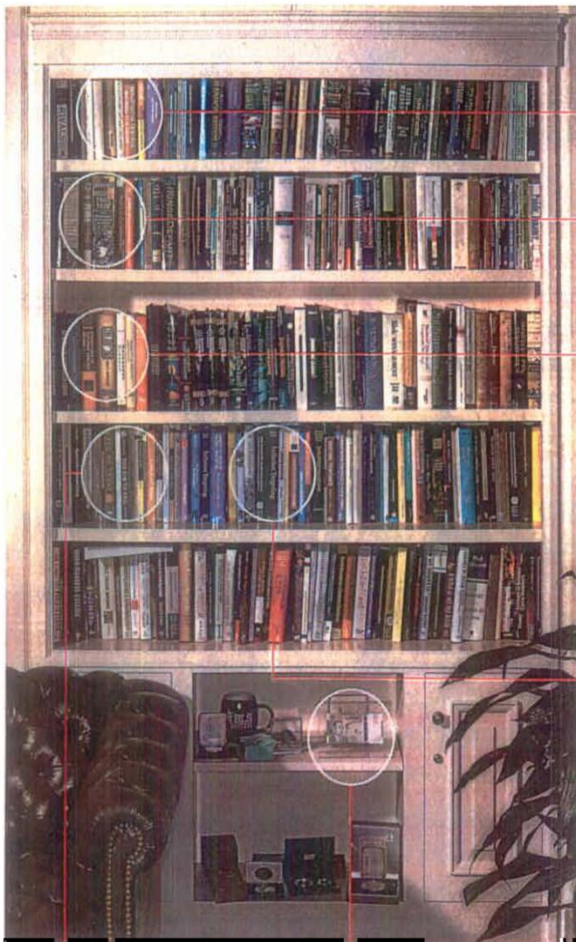
Yours most sincerey,

F. McA.

Francis H. McAdoo, Jr.

THE CHAIRMAN'S OFFICE

Advice within reach Bernanke's bookshelf is a virtual A-to-Z history of modern monetary policy, with books he studied, books he wrote—and books that have now been written about him



Crisis bible *A 1914 panic made the U.S. a monetary power, explains* When Washington Shut Down Wall Street, *by William Silber*

The worst hard time *Bernanke's outlook was influenced by the lessons of the 1930s, a tale told in David Kennedy's* Freedom from Fear

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