

When Washington Shut Down Wall Street: The Great Financial Crisis of 1914 and the Origins of America's Monetary Supremacy

By William L. Silber

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At the beginning of World War I, the US Treasury secretary closed the New York Stock Exchange to stop the sale of dollar-denominated securities. Then, as chairman of the Federal Reserve Board he embraced the “Too Big to Fail” doctrine orchestrating a bailout of New York banks by flooding the nation with paper currency. This pragmatic future Senator was also a major beneficiary of one of the greatest banking enterprises in America.

Professor William L. Silber contends these actions teach an important lesson about crisis management: those in power should “not hesitate to bludgeon the crisis with a sledgehammer.” His book is worth reading for the questions it raises about the Fed as a political institution, but not for his own interpretation of the 1914 financial crisis.

Silber paints an incomplete portrait of his hero, Treasury Secretary William Gibbs McAdoo (1863–1941) and his relationship with the House of Morgan, a key banking power in the effort by financial interests to impose a central bank upon the American people. Rothbard found Morgan interests among the financial elites were responsible for organizing the Fed “as a governmentally created and sanctioned cartel device to enable the nation’s banks to inflate the money supply in a coordinated fashion, without suffering quick retribution from depositors or note holders demanding cash” (Rothbard 1999, p. 50).

Rothbard (1995) showed that McAdoo was a “failing businessman” when he was bailed out and befriended by the House of Morgan. His first venture, in Tennessee in the 1890s, failed and wiped out his life savings. But in 1908 he launched the Hudson & Manhattan Railroad Company, a passenger rail service between New York City and New Jersey. Silber attributes this heroic feat to McAdoo’s attention to detail. However, this interpretation must be contrasted with McAdoo’s (1931) own account, which tellingly reveals how he personally sought financing from J.P. Morgan, Sr.

McAdoo was more than Democratic President Woodrow Wilson's son-in-law: he was a politician-in-training as Secretary of the Treasury and Chairman of the Fed. He later contested twice for the Democratic presidential nomination and served as a US senator from California (1933–1938). This later history is relevant for understanding the political influences on the Fed and for McAdoo the man and therefore is important for understanding of the crisis of 1914.

Episodes revealed in Meltzer (2003) clearly show that the Fed is prone to playing politics and is not the “neutral umpire” proclaimed by its employees and supporters. McAdoo, the first Fed chairman by virtue of his position as treasury secretary, was no exception. In fact, McAdoo provided the following memoir of the day the NYSE closed:

The breaking-out of the World War in the last week of July, 1914, caused an immediate crisis in American financial circles. About nine-thirty on Friday morning, July 31, J.P. Morgan (Jr.), of New York, called me on the telephone. He said that in view of the demoralized condition of the market the Governors of the New York Stock Exchange would meet at ten o'clock that morning to consider the question of closing the Exchange. He went on to say that they would be glad to have my advice as to whether or not this should be done. I replied that I did not consider my opinion of much value on a matter of that sort and that I hesitated to offer any suggestions. Morgan assured me that they would do whatever I thought was best. I did not exactly relish the thought of assuming any part or the responsibility, but after some reflection I said, “If you really want my judgment, it is to close the Exchange.” He said it would be done, and it was done that day. (McAdoo 1931, p. 290)

It was financial elites who decided to close the New York Stock Exchange. McAdoo simply put his political finger into the wind. Later in his career when he sought the Democratic presidential nomination he used the same political finger to determine his position on a clear moral evil: the Ku Klux Klan. Allen (1963) and Prude (1972) note McAdoo did not repudiate the Klan at the 1924 Democratic National Convention. Chalmers noted the following:

McAdoo, representing both the liberalism and the Klan forces of the South and West, was no bigot. His chief strategist, Bernard Baruch, was a Jew; his floor manager, former Senator James Phelan, was an Irish Catholic, but if McAdoo did not personally favor the Klan, he felt that he could not afford to alienate its support. (Chalmers 1965, p. 204)

McAdoo based decisions on political calculation, whether it meant following Morgan's lead on closure of the stock exchange in 1914 or adopting neutrality toward a Klan that controlled a bloc of delegates at the 1924 Democratic convention. McAdoo's courting of top bankers like the Morgan's allowed him to contest for the presidency, but ironically his pragmatism cost him dearly because the Democrats ultimately nominated a compromise candidate on the 103rd ballot, after the convention became hopelessly deadlocked between McAdoo and Alfred E. Smith, a Roman Catholic.

Silber's incomplete portrait of McAdoo is unfortunate because the book provides a great service by examining the gold standard in detail. The discussion is sweeping and erudite. Benjamin Anderson, the chief economist for Chase National Bank, made the Austrian point that the international gold standard was integral to the pre-World War I monetary order:

London was the financial center, but there were independent gold standard centers in New York, Berlin, Vienna, Paris, Amsterdam, Switzerland, Japan, and the Scandinavian countries....(I)n general, the great countries held their own gold. They relied upon themselves to meet their international obligations in gold. At times of great crisis a country under very heavy pressure would seek international cooperation and international assistance, and would get it—at a steep rate of interest. (Anderson 1949, p. 6)

The onset of World War I interrupted this state of affairs and the most useful part of Silber's book is the favor it bestows upon Austrians like Rothbard who favor a pure gold standard. In 1914, each government on the gold standard maintained a fixed price of gold in terms of its own currency. The US Treasury had fewer gold reserves than potential paper obligations when McAdoo ordered the closure of the New York Stock Exchange. Silber writes, "Anything less than one-to-one gold backing against paper is not enough once a run turns into a panic." Observers including Conant (1915) discounted warnings of a bank run, yet elite bankers who were mindful of potential US financial hegemony, wanted to prevent Europeans from selling dollar-denominated assets and demanding gold in exchange to finance their war.

McAdoo's action meant Europeans could own a piece of America, but not sell it. According to Silber, McAdoo reasoned that sustained credibility could help the dollar break into the upper echelon of world finance and that McAdoo "behaved as though he had trained with Keynes" (p. 90). Keynes (1971) advised the British government to preserve "the future position of the City of London as a free gold market" (p. 90) during World War I. He also convinced Britain's Treasury "to maintain specie payments so as to meet foreign demands, while making it extremely difficult and inconvenient for the ordinary man to get gold" (p. 90).

McAdoo's action against the New York Stock Exchange "like a sledgehammer against the gold drain" (p. 104). also affected Americans who wanted to trade securities. Interestingly the USA was already in the straits of a 23-month recession (January 1913–December 1914), according to the NBER, a fact overlooked by Silber. As a result, some traded securities on the New York Curb Market, located outdoor on Broad Street near the New York Stock Exchange. "McAdoo," Silber writes, "did not have the staff or the expertise to suppress them. He left that task to Henry Noble and the New York Stock Exchange but that was like putting Willie Sutton in charge of security at Fort Knox" (p. 105). Curb trading also bothered leading newspapers including the *New York Times* and *Wall Street Journal*. They embargoed New Street quotations as though they were privileged military communiqués.

Ultimately McAdoo was forced to pursue a policy of benign neglect toward the trading violations because the makeshift markets deflected pressure to reopen the

New York Stock Exchange. In essence, the Treasury tolerated an underground market because it served its purpose. It gave the appearance of no stock market crash and kept investors from open rebellion—it provided in Noble's words "a safety valve." Before the exchange reopened in mid-December, trading in these makeshift markets was less than one-sixth of the previous normal levels.

Gold exports did not disappear after World War I began, they were reduced by McAdoo's action, to \$15 million (August), \$19 million (September), and \$44 million (October). However, Silber estimates that McAdoo's policy of shutting down the Exchange prevented a potential outpouring of gold to the tune of \$62 million per month, because in August of 1914, the New York banks only held \$308 million in gold.

Silber argues that the actions McAdoo took in 1914; including flooding the market with emergency currency authorized by the Aldrich-Vreeland Act, enacted in response to the Panic of 1907; led to New York replacing London as the world's financial center: "American capital, by itself, could not buy the credibility needed to challenge sterling as international money—only the gold standard could" (p. 168). The gold standard was the foundation that allowed New York City to emerge as the world's financial center, and the US dollar to supplant the British pound sterling as the international reserve currency.

The analogy drawn to Federal Reserve Chairmen Paul Volcker, in the book's epilogue, is weak. Volcker was decisive in confronting inflation but never meddled in financial markets on the scale of McAdoo. The more appropriate comparison is to Volcker's successor, Alan Greenspan whom Silber also describes as a leader. As Fed chairman, Greenspan, a former corporate director of J.P. Morgan & Co. was a member of the President's Working Group on Financial Markets, created in 1988 after the 1987 stock market crash. The unit was designed to intervene in financial markets during financial crises. In 1998, the Fed intervened on behalf of politically connected money center institutions, including Morgan, who were doing business with Long Term Capital Management, a failed hedge fund.

Federal Reserve scholarship, in the tradition of Rothbard (1999), should be cognizant of any relationships between financial elites and central bank policy-makers. Silber's book is weak on this issue, but is still noteworthy for the important light it casts on the role of gold and the politically motivated meddlesome policies it follows.

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