HOW AMERICAN FINANCE FACED THE EUROPEAN WAR PANIC

Compelled to Meet Alone the Torrent of Foreign Selling of Our Securities and the Pressure for Gold—Strength of Our Gold Resources—Effect of the New Currency Law in Checking the Loss of Gold.

THE American money market passed through conditions on the bursting of the European war-cloud such as have never been paralleled in financial history. There have been other great crises in money and credit, but never before since the modern extension of industry and the close inter-relation of different markets, has there come a crisis in which none of the nations which are financially strong was able to help any other, and in which the strain of a violent crash in the market for securities fell with such crushing force upon the United States.

Commerce and finance were gravely interrupted during the Napoleonic wars, more than a century ago; but international commerce was then a drop in the bucket to what it is today, and the international market for securities was hardly in existence. In an ordinary crisis, when the nations are at peace, such as the crisis of 1907, the financial powers of other nations are prompt to go to the aid of the market in distress. London has forwarded gold to New York; France has discounted English bills in order to place gold at the command of London, and even Russia has lent gold upon French securities to prevent a crisis in the Paris markets.

All these familiar features of co-operation in time of peace broke down under the menace of universal war. England could give America no help when her debtors on the Continent were unable to forward gold to meet their maturing bills: France was helpless to extend aid abroad when her own people were hoarding all the gold they could withdraw from circulation and filling the narrow passages of the Rue la Vrillière in a long queue seeking to change the notes of the Bank of France for the precious yellow metal. Germany, facing the greatest military and financial crisis of her career, could not if she would, and would not if she could, aid other markets with a gold reserve less than half that of the Bank of France, and with the great powers of Europe massing their armies on all her frontiers.

Under such conditions, it is not surprising that European owners of foreign securities began to throw them over in order to strengthen their resources in free cash and be prepared for the worst. This silent liquidation by bankers familiar with the secrets of European cabinets had been going on for many weeks before the current of returning securities became a torrent. The American market, unable to find the capital or credit to pay for its longtime loans in such a summary manner, saw quotations on the Stock Exchange drop by points at a time, without any reason in the condition of American industries to justify it. On the eve of actual war, moreover, it became evident that the credits of American bankers in Europe would be curtailed or withdrawn and that the only means of paying for such securities as were taken back was by the export of gold.

Then came the interruption to ocean transportation by the fear of capture of ships and their cargoes on the high seas, and the seizure of vessels for Government use. Rates for the insurance of gold shipments became prohibitive under the threat of capture at sea, and for a few days remittances from New York to Europe, even in small sums, came almost to a standstill. The man who owed £10 in London and expected to buy a draft for the amount with about $48.90 in American money, found only a few bankers willing to deal with him even on such terms as $55 or even $60.

Resolute Steps of the Treasury and the Bankers.

It is to the credit of American banks and the administration of the United States Treasury that these conditions were met with a promptness and energy which nipped panic in the bud, and restored sanity and serenity to American markets. Within a week from the violent break in Stock Exchange prices which occurred on Thursday, July 30, these measures were taken to avert disaster and provide an adequate currency supply:

Friday, July 31.—The New York Stock Exchange closed, promptly followed by the closing of all other important stock exchanges in the country.

Saturday, Aug. 1.—The Treasury Department made shipments of new currency, already prepared under the Aldrich-Vreeland law of 1908, to the national banks of New York, and announced that under the law $500,000,000 would be available for this purpose.

Sunday, Aug. 2.—The Secretary of the Treasury, Mr. McAdoo, appeared in New York, and at a long conference at the Vanderbilt Hotel with leading bankers agreed upon important amendments to liberalize the Aldrich-Vreeland law and to co-operate in every proper way to check the needless outflow of gold.

Monday, Aug. 3.—The New York Clearing House Committee decided to permit the issue of Clearing House certificates by the New York banks and to make "available in payment of balances all forms of currency issued under authority of the National Government."

Tuesday, Aug. 4.—President Wilson, during the evening, signed a bill agreed to by the two houses of Congress, amending the Aldrich-Vreeland law of 1908 so as to permit the issue of additional currency to the amount of more than $2,000,000,000 if required.

Thursday, Aug. 6.—The Hon. Charles S. Hamlin, Assistant Secretary of the Treasury, announced that up to noon applications from New York banks for $50,824,950 in the new currency had been approved and $38,780,000 had been actually issued to twenty-six banks.

A Gold Stock Like Gibraltar.

The crisis of 1907 taught American bankers some important lessons. The crisis of 1914 found the United States in a stronger position than ever before in her financial history to meet the strain. Even on the Stock Exchange the liquidation due to business uncertainty and to the war cloud in Europe left a comparatively small number of weakly margined accounts to be thrown over under the relentless pressure of falling prices. The total gold stock of the country was more than $1,600,000,000. The condition of the Treasury was vastly different from that of 1895, when it was necessary to make a contract with the Morgans and Rothschilds to obtain gold abroad to replenish the legal tender reserve and prevent the suspension of specie payments. Such a device as was then adopted—a pool among the exchange houses to maintain high rates for exchange and prevent exports—would have been futile under the conditions of this year.

Fortunately the United States was in a position where she could afford to lose twice as much gold as was involved in the Morgan-Rothschild contract of 1895 and hardly feel the effect. The pressure for the yellow metal did not fall, as in previous crises, upon the legal reserve, which was fixed at $150,000,000 by the gold standard law of March 4, 1900, but fell almost entirely upon private gold holdings which were represented by certificates of deposit issued by the Treasury. Between April 30 and August 6, the amount of gold certificates outstanding fell from $1,158,997,869 to $999,587,869.

This loss of $159,000,000 would have had appalling results if it had occurred in any of the years from 1895 to 1899, when the net amount of gold certificates outstanding was less than $45,000,000. In default of this great fund of private gold, the storm would have broken upon the Treasury reserve fund of $150,000,000; but the Treasury can afford to stand by with comparative indifference while the outstanding volume of gold certificates is reduced, because such a loss of gold does not reduce the legal tender reserve nor the fund of "free gold" in the Treasury cash.

The legal reserve of $150,000,000 established by the gold standard law of 1900 has not been reduced below this legal minimum for a single day since it was established. When greenbacks come in for redemption, in the ordinary course of business, they are redeemed first from the gold standard fund, but are then promptly paid into the general fund of the Treasury in exchange for the "free gold," which has always been there in considerable amounts since the law of 1900 took effect. This fund of "free gold," whether in the form of certificates which the Treasury has the option of cancelling in exchange for coin or in the form of coin itself, forms an outpost of defense to the gold reserve proper, possessing much of the resisting power, in case of attack, of the Belgian Army which checked the German advance upon the French frontier by way of Liege. The amount of "free gold" in the Treasury cash on Aug. 6 stood at more than $125,000,000. It was increased rather than diminished during July by reason of the heavy payments on account of the income tax. Under these conditions the Treasury has remained practically immune from any run upon its own gold, and the reduction in the volume of outstanding gold certificates has had no effect upon the gold standard reserve or the "free gold" in the current cash.

Charles A. Conant.

Why New Currency Was Needed.

Why should Europe's troubles create the necessity for large issues of new currency in the United States?

The answer is twofold: First, to supply the void left by the export of gold; secondly, to protect the gold which is left against further foreign raids. It was not fear for the soundness of American finance nor pressure for additional credit at home which brought Secretary McAdoo to New York on the Saturday after the closing of the Stock Exchange. It was the fact that Europe had been dipping her arm up to the elbow in the only stock of free gold left in the world, and that some defensive measures should, if possible, be devised. One of these measures was the issue of clearing house certificates for the settlement of balances between the banks in New York. The other was the issue of currency under the Aldrich-Vreeland law of 1908.

The law of May 30, 1908, passed under the sobering influence of the panic of 1907, provided for the formation of currency associations by banks for the issue of bank notes based upon commercial assets. This law would have expired on May 30, 1914, if it had not been extended for another thirteen months by the forethought of Senator Owen, Chairman of the Senate Committee on Finance, in giving final form to the new Federal Reserve law of Dec. 23, 1913. The mechanism provided by the Federal Reserve law itself had not yet been put in working order, because of the long contest over several of the nominees of the President for membership on the Federal Reserve Board. It was as well, perhaps, that the hurricane of foreign liquidation and pressure for gold did not break upon the banks during the period of transition from the old system to the new. It was possible to meet the fear of deficiency in the currency supply and the impairment of bank reserves under the provision of the Aldrich-Vreeland law, which was promptly amended in several particulars to make the process of relief more complete and less costly.

While Congress has authorized the issue of notes under the law to the amount of 125 per cent. of the capital and surplus of national banks, which would amount to more than $2,000,000,000, there is no indication that any part of this great sum will be used for the purpose of expanding loans or inflating the circulation. The notes are being taken out by the New York banks in order to enable them to retain their gold and restore their reserves. With this object, they pay out the new notes to meet demands for currency, while retaining the gold in their vaults. In a sense, the new notes merely take the place of the exports of gold to the amount of $130,000,000, which have taken place during the Spring and Summer.

The pressure of monetary stringency always falls upon the banks of New York because New York is the centre of dealings in foreign exchange. A single trust company there deals in a larger volume of exchange than the entire export trade of the United States. Hence, upon the New York banks fell the demand for gold for export, with the result of reducing in a corresponding degree the reserve of 25 per cent. which they are required to hold against their deposit liabilities. These reserves, which stood for the week of July 25 at $466,577,000, were reduced on Aug. 1 to $444,436,000, and on Aug. 8 to $386,589,000, falling on the latter date $43,116,000 below the legal requirement. The effect of the issue of Aldrich-Vreeland notes by these banks will be to enable them to retain the legal tender money which comes in to them in the ordinary course of business, and thereby to restore their reserves, instead of being called upon to impair them by constant payments of gold and United States notes for ordinary currency purposes.

In some respects the authority for the issue of notes under the new law is precautionary rather than a matter of immediate necessity. It removes the motive for hoarding currency by making it clear that currency can always be had for good assets. In this direction it supplies the banks with a means of meeting the legitimate demands of their clients for moving the wheat and cotton crops without reducing their reserves in gold and other legal tender money. It is not probable that more than a few hundred millions of the new currency will be issued at most; but the fact that it can be had, and had promptly, affords insurance against the needless calling of loans, the hoarding of currency, monetary panic, and suspension of currency payments.

Can the Crops Be Moved and Paid For?

One of the most important problems arising from the war is the stoppage of ocean traffic and the breakdown in foreign exchange. Commercial vessels of the belligerent powers are liable to capture at sea, and gold cannot be shipped in either direction except at insurance rates which are so high as to be prohibitive. The question of shipping will probably be solved in part by the contending powers themselves, who will be in more desperate need of American food products than America will be of finding a market for them. Already there is talk that the Governments of Great Britain and Belgium will insure shipments of grain, or, in other words, will themselves assume the loss in case of capture.

The breakdown in foreign exchange seemed for a few days after the outbreak of war to be more complete than at any time since the beginning of the era of steamships and ocean cabling. Many American houses had sold bills of exchange "short" before the panic became acute, with the expectation of "covering" by the purchase of grain and cotton bills coming into the market in the Autumn. Others had sold exchange against intended shipments of gold which could no longer be made when the metal was exposed to seizure by hostile cruisers. In the meantime, securities were on their way from Europe running up into the tens of millions of dollars, which had been sold in advance on the New York Stock Exchange, and which had demand drafts attached to them, to be collected upon the delivery of the securities. For a moment, it seemed almost as if a moratorium would be necessary in such transactions. Leading banking institutions refused to buy even small drafts on Europe or to sell exchange at any price.

Such a situation, however, could not long resist the ingenuity of American financiers nor the far-sighted policy of European bankers. The same house which had come to the rescue of the Treasury in 1895, by the bond syndicate contract, Messrs. J. P. Morgan & Co., announced on Thursday morning, Aug. 6, that they had made an arrangement with the French Government by which obligations due in Paris to New York could be cleared against those due in New York to Paris. The French Government deposited with the Morgan house in Paris the sum of $6,000,000, half of which was in gold, and which was placed to the credit of the French Ambassador in Washington. This enabled the Ambassador to pay for supplies for the French Army, so far as they were not contraband of war, by drawing against the fund in Paris and thereby enabling the Morgan house to apply an equal amount to the payment of obligations due by Frenchmen to Americans at home. It was intimated that this fund of $6,000,000 was only a beginning and that it would be replenished from time to time at Paris by the French Government as it was drawn down by drafts in America.

Thus by the promptness and energy of the banking community and the assistance of the Treasury Department, the American market has been protected from serious harm, safeguards have been thrown around the gold stock of the country, and steps are being taken to reopen the channels of communication with our largest foreign customers, whose need for American food products and other articles is likely to be intensified by the waste of their own energies in war.