BENJAMIN M. ANDERSON

Economics & the Public Welfare

A Financial and Economic History of the United States, 1914-1946

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Foreword

BY HENRY HAZLITT

Benjamin M. Anderson, Jr., who died on January 19, 1949, was born on May I, 1886, i Columbia, Missouri. At the University of Missouri, from which he took his A.B. degree in 1906, h interests were predominantly intellectual and logical. He was active in the Athenean debating socie and soon earned a reputation there for his ability to pounce upon a logical or factual weakness in a opponent's position. He was one of the four presidents of the society for the year 1905-06. He als developed at this time a passion for chess, which he retained throughout his life. He became so good the game in these early days, indeed, that he seriously thought of making a career of it. Out of th interest came a warm friendship with José Capablanca, the world chess champion from 1921 to 192 at whose suggestion he contributed a brilliant twenty-five page preface to "Capa's" book, "A Prime of Chess," published in 1935.

Anderson took his master's degree at the University of Illinois in 1910, and his Ph.D. economics, philosophy, and sociology at Columbia in 1911. The wide range of knowledge an intellectual interests that he had developed at this time is indicated not only by the three subjects which he took his doctorate but by a glance at his teaching career. He became professor of history the State Normal School at Cape Girardeau, Missouri, in 1905. He was professor of English literatu as well as economics at the Missouri Valley College at Marshall, Missouri, in 1906. He was hea professor both of history and economics at the State Teachers College in Springfield, Missour between 1907 and 1911.

In the study in his home, when I first knew him, I remember two pictures—one of John Calhoun, and the other of John Bates Clark. He had been deeply influenced in his political thinking, told me, by the States' rights and other basic doctrines of "the master logician of South Carolina while he owed his greatest debt in economic thought to John Bates Clark, under whom he had studie and whom he considered the greatest economic theorist that this country had ever produced.

The first of his economics teachers to make a deep impression on Benjamin Anderson wa Professor Jesse E. Pope, in whose seminar, in 1904 and 1905, he began his investigations in th "quantity theory" of money. His "Social Value" was begun in Dean Kinley's seminar at the Universit of Illinois in the term 1909-10. In its first form this monograph won a $400 prize offered by Har Schaffner, and Marx. (The judges were J. Laurence Laughlin, John Bates Clark, Henry C. Adam Horace White, and Edwin F. Gay.) This study was elaborated and completed as a book at Columbi University in 1910-11, and Anderson submitted it to the Faculty of Political Science as his doctor dissertation. His chief obligations at Columbia University in that study, he declared in a preface, we to Professors Seligman, Seager, John Dewey, and Giddings.

It would be impossible to make even an adequate list of the writers who influenced Anderson thought more indirectly. In his early books there are frequent references to Böhm-Bawerk and Wiese Urban and Tarde, Jevons and Pareto, Wicksteed and H. J. Davenport, Wesley C. Mitchell and th sociologist C. H. Cooley. And among the practical men of the banking world with whom he later cam in contact he always expressed a particular admiration for A. Barton Hepburn.

"He that wrestles with us," wrote Burke, "sharpens our skill. Our antagonist is our helper." Th two writers whose work chiefly played this role for Anderson, by stimulating his criticism, we

Irving Fisher and John Maynard Keynes. It was mainly against the quantity theory of money formulated by Professor Fisher that Anderson's own exposition of "The Value of Money" wa directed. And his criticism of Fisher, vigorous as it was, involved a sort of admiration. He deliberatel chose Irving Fisher's "Purchasing Power of Money" as the chief target for his criticisms because was "the most uncompromising and rigorous statement of the quantity theory to be found in mode economic literature"; because it followed "the logic of the quantity theory more consistently than ar other work," and because it had received such enthusiastic recognition "as to justify one in treating as the 'official' exposition of the quantity theory."

In later years it was the influence of John Maynard Keynes that most provoked Anderson critical opposition. He never, unfortunately, wrote an entire book analyzing the Keynesian theorie But he replied brilliantly to one central Keynesian tenet in an 8-page appendix embodied in t symposium "Financing American Prosperity" (1945) entitled: "A Refutation of Keynes' Attack on th Doctrine that Aggregate Supply Creates Aggregate Demand."

He once told me an amusing story of a conversation with Keynes. In connection with the latter theory of stimulating consumption to cure a slump, Anderson asked him: "Why wouldn't it be a goo idea to raise white elephants in a period of depression?" And the British economist, quite unabashe replied: "That would be just the thing."

Anderson's contribution to economic theory is summed up in his two books: "Social Value (1911) and "The Value of Money" (1917: preprinted 1922, 1926, and 1936).

He originally thought of his "social value" concept as a *rival* of or *substitute* for th individualistic marginal utility theory as developed by the Austrian school. It seems to me that it i rather, an exposition of the social pre-suppositions necessary to the marginal theory. It is a explanation of the essentially social conditions which go to form both the individual's own margin valuations and prices in the market. His analysis, in other words, supplements rather than supersed the Austrian.

Anderson was clearly right in rejecting the notion of the isolated "individual monad"; emphasizing the intimate interrelation of the minds of individuals to each other, their inextricab interaction and interdependence. The thought process even within the "individual mind," as he pointe out, is a social process: "We think in words, and, indeed, in conversations." He was right emphasizing with Cooley that through the social apparatus of language, literature, music, custor tradition, conversation, "every thought we have is linked with the thought of our ancestors ar associates, and through them with that of society at large."

But the question may be raised whether, in going on to the conclusion that "there is a mind society, a psychical organism, a social mind" he was not perhaps hypostatizing a metaphor, taking heuristic simile too literally. However that may be, he made it clear that a purely individualist concept of marginal utility was inadequate, and that it was above all not an adequate tool of thoug when it came to the explanation of the value of money. And he was also explicit in emphasizing th the unity of the "social mind," as he conceived it, was "primarily a unity of *junction*."

Certainly this is an essential key to the understanding of many economic problems. Even relatively simple assembly job like an automobile cannot be understood merely by studying its par individually. The human body cannot be understood merely as an assemblage of its individual orgar or cells. Both the automobile and the human body function as a unit. A great society, with i institutions, mores, values, and elaborately interdependent division of labor, also to a large exte functions like a single organism and cannot be understood merely as a collection of the individua who compose it. It is true, of course, that we cannot solve many economic problems unless we make

our business to study the needs, preferences, and actions of these individuals; but in addition we mu
understand their functional interrelationships.

Anderson's great contributions to monetary theory in "The Value of Money" have bee admirably summarized in Professor Beckhart's foreword to the 1936 edition. He helped to bring abo a much needed unification of monetary theory with general value theory. He explained, in a clear way than any previous writer had done, the role of the *quality* as well as the *quantity* of money ar credit in determining the value of the monetary unit. He emphasized the basically *psychologic* nature of the value of money, with all the subtleties and complexities that this implies. He showed th particular prices as well as the so-called "general price level" must always be explained from the sid of the value of goods as well as from the side of the value of money. Its simplicity and allurin mathematical precision have still kept the rigid mechanistic form of the quantity theory alive, b Anderson subjected its gross over-simplifications to so searching and devastating a criticism that has never reconquered the prestige and almost undisputed sway that it held before he wrote.

"The Value of Money," in brief, is one of the classics of American economic writing. I can thin of few works in the field that are as consistently brilliant, rigorous, lucid, and engrossing. As contribution to the theory of money it stands easily among the foremost half-dozen works ev produced on this continent.

The present work is destined to take a similar rank among American economic and financi histories. It is already the outstanding economic and financial history for the period it covers.

An economic history that does not correctly interpret the events it describes is usually worse tha worthless. A writer who does not know how to interpret economic causation does not even know wh facts to select and present. Anderson knew which facts to select and which to emphasize. Fe economic histories have ever interlaced theory and interpretation so completely and successfully wi the record of the facts. The following pages are like a rich fabric in which the events constitute th warp and the theoretical interpretation the woof, the first supporting the second, and the secon illuminating the first.

Its sense of drama, its unfailing lucidity, its emphasis on basic economic principles, i recognition of the crucial roles played by outstanding individuals, its realistic detailed description the disastrous consequences of flouting moral principles or of trying to prevent the forces of th market from operating, combine to give this book a sustained readability seldom found in seriou economic writing, in spite of the admirable early model set by Adam Smith. Here is the econom history of the United States in the fateful period from 1914 to 1946. This history is quite properly see not in isolation but as an integral part of world economic history; for the true economic liberal, lik Anderson, is never an economic isolationist or nationalist.

Throughout most of the period of which he writes he was the economist of the Chase Nation Bank. He made several trips to Europe, and was one of the American group that negotiated th standstill agreements with the banks of Germany. This history, therefore, is written by a man uniquel qualified for the task. He combined a rare grasp of economic theory with an intimate knowledge of th events of these years gained as a close and privileged observer, and sometimes as an important advis and participant.

It is a pity that he did not live to see the publication of this volume. But those of us who wish understand the economic events of the great period that it covers can count ourselves fortunate that l lived to complete the composition of it.

Preface

This book is the outcome of studies which began in 1914 and have been carried throug
systematically since that date. As Assistant Professor of Economics at Harvard University, the autho
taught money and banking from 1914 to 1918 and, both in his lectures and in published articles ar
books, recorded the significant economic and financial developments of the First World War. A
summary of these studies appeared in his *Effects of the War on Money, Credit and Banking in Franc
and the United States*, published by the Carnegie Endowment for International Peace in 1919. Fro
1918 to 1939 he acted as Economist for the National Bank of Commerce in New York (1918-1920
and the Chase National Bank (1920-1939). During these years he was in intimate contact with banker
investment bankers, brokers, and industrialists throughout the country, and with bankers througho
the world, with the Federal Reserve System and with foreign central banks, with government officia
and leading journalists of many countries, as well as with academic students in the United States ar
abroad.

He wrote down and published *at the time*—first (1919-1920) in *Commerce Monthly*, issued by th
National Bank of Commerce in New York, and second, in the *Chase Economic Bulletin* (1920-1937
issued by the Chase National Bank of the City of New York—records and discussions of the perioc
And he recorded in confidential memoranda for the use of his associates—many of which are still to
confidential to be used except as background—the information that came to him from conferences
his own bank and from conferences as he traveled in Europe or to the leading cities of the Unite
States. His banking contacts in the United States included not merely the chiefs of great banks, b
also a multitude of American country bankers (an extraordinarily able group of men) who kept hi
informed regarding conditions in American agriculture and the industries of the smaller places.

As Professor of Economics at the University of California since 1939 he has retained clo
contact with American bankers and with men in public life and, to the extent that communication ha
been feasible during the war period, also with foreign bankers and men in public life. And he ha
continued to publish discussions of the developments of the second great World War and of postwa
problems, particularly in the *Economic Bulletin* issued by the Capital Research Company, Lo
Angeles, the *Commercial and Financial Chronicle*, the *Hearings* of the Senate Finance Committee ar
the Senate Committee on Banking and Currency, and in documents issued by the Economist
National Committee on Monetary Policy.

There is a great fraternity of bankers both in the United States and in the world outside. The
trust one another. They tell one another the truth regarding highly confidential matters. They go f
out of their way to be of service to one another and to one another's customers. The author is gratef
that they still include him in this great fraternity.

This book, therefore, represents, not the researches of a scholar remote from the field of activit
working primarily with the documents and the writings of other men, but rather, in very considerab
measure, the records and recollections of a participant in the history.

The field of the drama which the present volume undertakes to present is too vast for any man
say (as Aeneas said to Dido regarding the events of the Trojan War), "All of which I saw and a grea
part of which I was." Certainly the present writer could make no such statement. But he does fe
justified in saying, "Much of which I saw and of which I was a small part."

The volume contains a good many disclosures of information confidentially obtained, in cas
where the author feels sure that no harm can be done to the sources from which he obtained th

information. Where references are made to private conversations with men still living, either the names are not used or the author has reason to believe that they will not object.

The author is indebted to far too many men, for information and help, over the years, to make possible to list them. He has tried to make such a list and has found it to be a vast catalogue of nam in New York, in Washington, in virtually every other major American city, and in the financial center and capitals of Europe, Asia, and other parts of the world.

The author is deeply indebted to the President, Vice Presidents and junior officers of the Nation Bank of Commerce in New York (1918-1920), who initiated him into practical banking, taking hi into their intimate confidential relationships and having him sit with them in their conferences wi important industrial and commercial customers and with important visiting American and forei bankers.

His greatest debt, of course, is to the great Chase National Bank of the City of New York. Fo nineteen years (1920-1939) this institution was his laboratory. The successive Chiefs, the Vic Presidents, many of the Directors, most of the junior officers, and men in virtually every departme of the bank supplied him with information and opened their records freely to him. He could samp the routine or leave it alone. He was called into conferences where major questions of policy were be determined. Its foreign offices also were his laboratories. He will always retain a deep affection f this great institution and for the men in it.

The author gratefully acknowledges the help of his wife, who has given a critical reading to eve page of this book, through its several revisions, as she has done for virtually everything else he h written for over three decades, and who has saved him from many errors in form, tone, and substance

He wishes to acknowledge the help of his colleague at the University of California at L Angeles, Professor Warren Scoville, who has read critically every page of the manuscript of this boo and has made very helpful suggestions regarding it, and of Messrs. Melvin D. Brockie and Robert Smith, who, as graduate students in that institution, helped him assemble and check facts and figure He is much indebted also to his associates in the Capital Research Company of Los Angeles and in th investment companies served by it, particularly Mr. Henry S. McKee, President of the Pacif American Investors, and Mr. Jonathan Bell Lovelace, President of the Investment Company America, both of whom have read the manuscript and have given him the benefit of their criticism For the same service he wishes to thank Mr. Henry Hazlitt of *Newsweek* and Mr. Dwight W. Michen of the Chase National Bank. He thanks Dr. Ludwig von Mises, who has been good enough to give critical reading to the chapter called “Digression on Keynes.” He is grateful also to Dr. V. Orval Watt of the Foundation for Economic Education at Irvington-on-Hudson for a critical reading of the who manuscript and for many helpful suggestions.

It goes without saying that none of those who have given him help and information and opinio and advice are responsible for the views expressed in this book or for errors which it may contain.

Errors it must contain. Thirty-four years is too short a time in which to achieve sere perspective on the financial and economic developments of this momentous period! Sere perspective, moreover, is not easily achieved by a man who lived through this period, not merely as a observer but also as a fighting man trying all too ineffectively to alter the course of events. But th author has been well aware of his duty to be objective in his evaluation of the events that he h recorded, and his friendly critics have helped him to perform this duty.

BENJAMIN M. ANDERSO

Contents

Foreword
Preface
Table of Contents

Part I: World War I
- 1: The Prewar World, 1913
- 2: The Outbreak of the War in 1914
- 3: The War Prosperity
- 4: Our War Economic Policy
- 5: The Federal Reserve System, 1914-1918

Part II: The Postwar Boom, Crisis, and Revival, 1919-1923
- 6: The Postwar Boom, 1919-1920
- 7: The Causes of the Crisis of 1920
- 8: The Crisis—1920-1921
- 9: The Rapid Revival—August, 1921, to March, 1923
- 10: The Government's Contribution to the Revival, 1921-1923
- 11: The Money Market, 1920-1923—Renewed Bank Expansion
- 12: Our Foreign Policy, 1919-1924
- 13: Germany, 1918-1924
- 14: France, 1918-1924
- 15: The Dawes Plan

Part III: The First Phase of the New Deal, 1924-1932
- 16: Depression and Rally of 1924—The Beginning of the New Deal
- 17: Money, Bank Credit, and Capital
- 18: The Extent of Bank Expansion, 1922-1928
- 19: The Causes of and the Responsibility for the Excess Reserves
- 20: Germany, 1924-1928
- 21: France, 1925-1926
- 22: Great Britain, 1925-1927
- 23: The De Facto Stabilization of the Franc, and the Gold Exchange Standard
- 24: The Consequences of the Cheap Money Policy in the United States Down to the Summer 1927
- 25: The Conference of Governors and the Intensification of Cheap Money, 1927
- 26: The Stock Market Boom, 1927-1929
- 27: Mob Mind in 1928-1929
- 28: The Effect on Europe of Tight Money in the United States in 1929
- 29: The "New Era," and the Precautions of the Commercial Banks in New York
- 30: The Stock Market Crash of 1929
- 31: The New Deal in 1929-1930
- 32: Late 1930—Hitler Gains; Bank of United States Crashes

33: The Tragic Year—1931
34: 1931 Continued—England's Abandonment of the Gold Standard
35: The Year 1931 Continued—The First Foreign Run on the Gold of the United States
36: The Year 1932
37: The Upturn in the Summer of 1932—Five Favorable Developments
38: The Impact of Politics on the 1932 Revival
39: The Banking Holiday
40: The Intergovernmental Debts

Part IV: The New Deal In Maturity, 1933-1939
41: "My Father Also Chastised You with Whips, But I Will Chastise You with Scorpions
42: The Reopening of the Banks
43: The Mortality Among Small Banks
44: *Branch Banking* versus *Unit Banking*
45: Roosevelt's Abandonment of the Gold Standard
46: The Banking Act of 1938—Extreme Reform Bill, Not New Deal Measure
47: Contradictory Policies
48: The National Industrial Recovery Act
49: The London Economic Conference, 1933
50: The Strong Business Rally, March to July, 1933—Turns Downward With NRA
51: More Money Magic—The Gold Buying Programme
52: The Gold Reserve Act of 1934
53: The Spending Programme
54: The Silver Legislation of 1934
55: Governmental Confusion, Governmental Hostility, and Private Enterprise
56: Supreme Court Decision on Gold Clauses, February, 1935
57: First Successful Resistance to New Deal—Banking Act of 1935
58: Taxation Under the New Deal—The Redistribution of Wealth
59: The Undistributed Profits Tax of 1936
60: Digression on Keynes
61: Gold, Excess Reserves, and Money Rates, 1934-1941
62: Gold Remains Standard of Value
63: The British Equalization Account, The American Stabilization Fund, and The America
Sterilization Fund
64: The Tyranny of Gold
65: Governmental Coercion and the Value of Money
66: The Business Rally of 1935-1937 and the Major Crisis of 1937
67: The Causes of the Crisis of 1937
68: The Stock Market Crash of 1937—A Major Cause of Business Crisis
69: A Verdict on the S.E.C.
70: The Severe Depression, 1937-1938, and the Mild Rally, 1938-1939
71: The Turn in the Political Tide, 1938
72: International Political Relations in the Decade of the Thirties
73: The Effect of Governmental Economic Planning Upon Employment and the Utilization of O
National Productive Powers

74: Alternative Explanations of the Great Depression of 1930-1939

Part V: World War II
75: The Outbreak of World War II
76: Our War Economic Policy
77: War Taxation and Expenditures
78: Government Borrowing in World War II
79: Price Fixing in World War II
80: Government versus Private Financing of War Production in World War II
81: Lend-Lease, Bretton Woods, and the British Loan—England’s Postwar Position

Index

PART I

WORLD WAR I

Chapter 1

The Prewar World, 1913

Those who have an adult's recollection and an adult's understanding of the world which precede the first World War look back upon it with a great nostalgia. There was a sense of security then whic has never since existed. Progress was generally taken for granted. It was even necessary at times f scholars in addressing scholarly audiences—as, for example, Leonard T. Hobhouse in an address Columbia University in 1910—to make the distinction between progress and evolution and to poi out that evolution might not always be progressive. The theoretical distinction was recognized, but th experience of the preceding century, so far as social and economic evolution was concerned, had mad the distinction seem unreal. We had had a prolonged period in which decade after decade had see increasing political freedom, the progressive spread of democratic institutions, the steady lifting the standard of life for the masses of men. We had even come to the point where some were assertin incorrectly, that the problem of production had been solved, that enough was being produced, and th with better distribution everybody could be made comfortable.

In our economic life we had occasional sharp setbacks. Crises and depressions alternated wi relatively prolonged periods of active prosperity. We thought of these depressions as severe, but the did not approach in length or depth the depression of 1929-1939, or in depth the much less seve depression of 1921. Even in the midst of depression, moreover, it was axiomatic that revival wou come again, the question being simply when the bottom would be reached and when the turn wou come.

It was an era of good faith. Men believed in promises. Men believed in the promises governments. Treaties were serious matters.

In financial matters the good faith of governments and central banks was taken for grante Governments and central banks were not always able to keep their promises, but when this happen they were ashamed, and they took measures to make the promises good as far as they could. In th greenback period in the United States, the Federal Government was unable from January 1, 1862, January 1, 1879, to make good its promise to pay gold on demand for its paper money. But it did mak good its promises to pay interest and principal on. the public debt in gold, and it did, in 1879, resum payment of gold in redemption of its paper money. No country took pride in debasing its currency as clever financial expedient.

The world was incredibly shocked in 1914 when Bethmann-Hollweg, Chancellor of German characterized the treaty guaranteeing the neutrality of Belgium as a “scrap of paper.” In retrospec one may say that this was one of the most terrible things that has ever been said. The world is full scraps of paper today. The reference here is not to the brazen, cynical, contemptuous attitude of Hitl toward treaties and toward promises. Hitler made many promises with no intention of keeping the when he made them. But the world united against Hitler. His level of bad faith obviously could not b tolerated. The reference is, rather, to the attitude of some of the most decent governments of the wor toward many promises and treaties. Japan and Mussolini could never have started on their careers aggression if the great democratic nations had kept faith with one another. The reference is also to th broken promise of the British Government and the Bank of England in 1931 to pay gold on demand f Bank of England notes. If it be objected that England was forced to this, a view which is erroneous surely no such defense can be made for the Government of the United States, when, in 1933, with

billion dollars of gold in Federal Reserve Banks, it suspended gold payment and when, in 1934, with
~~billion dollars of gold in the Federal Reserve Banks, it reduced the dollar to 59.06% of the old~~ go
parity and repudiated the gold clause in its own bonds. In 1913 men trusted the promises
governments and governments trusted one another to a degree that is difficult to understand today.

The greatest and most important task of the next few decades must be to rebuild the shattere
fabric of national and international good faith. Men and nations must learn to trust one another agai
Political good faith must be restored. Treaties must again become sacred.

A world in which all men are upright and in which all nations are voluntarily decent in the
international relations is, of course, too much to expect, but a world in which the ill-intentioned fe
the condemnation of the well-intentioned we can rebuild. The same basic human nature which create
the fabric of national and international good faith on which we relied in the century preceding 191
exists today—just as we have discovered that the same human nature which animated the Assyria
conquerors and the hordes of Genghis Khan exists today. The raw stuff of human nature is immensel
plastic and can be turned in many different directions, depending on the cultural influences which pla
upon it. There is no certainty that we can recreate the fabric of good faith which we have destroye
but there is no higher duty than to make the effort.

The economic life of the world in 1913 went on in an atmosphere of good faith. Men with liqu
capital used the capital themselves confidently in business enterprises or loaned their capital at mark
rates of interest to others who would use it in productive operations. There were no billions of dolla
of “hot money” such as characterized the decade of the 1930’s, moving nervously about from o
financial center to another through fear of confiscation or through fear of further currency debaseme
—moving from countries which their owners distrusted more to countries which they distrusted les
but finding nowhere a place which they could really trust.

Industry, commerce, and finance depend on credit. Credit was in general soundly based o
movable goods which had dependable markets, on corporate securities, readily saleable in dependab
stock markets, and on governmental securities, usually moderate in volume, buttressed by balance
budgets.

Not all the great countries had safely balanced budgets. France, though enormously stro
financially, in 1914 had had chronically unbalanced budgets for many years. The balance in Russ
and in Italy was precarious.

But always the statesmen of these countries winced under criticism, and none of them boasted
their achievements in unbalancing the budgets or termed the deficit “investments.”

There were protective tariffs in the United States, France, Germany, and many other weak
countries. England held to a free trade policy, as did Holland, the Scandinavian countries, an
Switzerland. But the tariffs of those days were moderate in comparison with postwar tariffs. The
were subject to infrequent change, and trade lines were sufficiently open so that countries und
pressure to pay debts could do so by shipping out an increased volume of commodities.

The head of the Austro-Hungarian National Bank, Popovich, later the head of the Hungaria
National Bank, said in 1929 that in a prewar crisis Austria-Hungary had paid her adverse foreig
balance of indebtedness by shipping out an increase of timber down the Danube, through the Blac
Sea, into the Mediterranean, and up the Atlantic Coast to the Netherlands, at prices which made
effectively competitive with timber from the Scandinavian countries. All that it was necessary for hi
to do, as head of the Austro-Hungarian Bank, was to hold his discount rate high, compel a modera
liquidation of credit, and rely upon the merchants to find markets for Austro-Hungarian goods, whic
sold abroad, would produce foreign cash and turn an adverse balance of payments into a favorab

balance.

London was the financial center, but there were independent gold standard centers in New Yorl
Berlin, Vienna, Paris, Amsterdam, Switzerland, Japan, and the Scandinavian countries. There wer
many other countries on the gold standard, with some tendency for the weaker countries to substitu
holdings of sterling or other foreign bills for part of their gold, primarily as a means of gettin
increased earnings. For their purpose the sterling bill was quite as good as gold. They trusted it. The
could turn it into gold. The gold exchange standard was the primary standard of India. But, in genera
the great countries held their own gold. They relied upon themselves to meet their internation
obligations in gold. At times of great crisis a country under very heavy pressure would see
international coöperation and international assistance, and would get it—at a steep rate of interest.

In 1907, for example, we eased off our own money panic by importing approximately 100 millio
dollars of gold from London. At times London leaned on Paris. The Bank of France had a much larg
gold reserve than the Bank of England, and Paris was always ready to accommodate London—at
price—in an emergency. But these incidents were infrequent. In general each country went its ow
way and made its own financial policies and money market policies, subject always to the limitatio
that if it overextended itself the other great money markets would drain away its gold and force it
reverse its policies. There was no such thing in prewar days as the kind of international coöperatio
which we saw in the 1920's, under which a dangerous boom was prolonged and turned into an almo
uncontrollable inflation through the coöperation of the Bank of England and the Federal Reserv
System of the United States.

In the United States, with our inelastic currency system, we had several unnecessary mone
panics. The panics of 1873 and 1893 were complicated by many factors, but the panic of 1907 w
almost purely a money panic. Our Federal Reserve legislation of 1913 was designed to preve
phenomena of this kind and, wisely handled, could have been wholly beneficent. It is noteworth
however, that the money panic of 1907 had nothing like the grave consequences of the collapse o
1929. The money stringency of 1907 pulled us up before the boom had gone too far. There was n
such qualitative deterioration of credit preceding the panic of 1907 as there was preceding the panic
1929. The very inelasticity of our prewar system made it safer than the extreme ductility
mismanaged credit under the Federal Reserve system in the period since early 1924.

The whole world was, moreover, far safer financially when each of the main countries stood o
its own feet and carried its own gold. In the 1920's gold in New York was made the basis of deposit
in American banks which served as the gold exchange reserve of great European banks, an
overexpansion in New York did not lead to the prompt withdrawal of gold by foreign monetar
centers.

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[1] This point will be discussed at length in Chap. 34.

Chapter 2

The Outbreak of the War in 1914

The War Came as a Surprise to Most Informed Men. The war came as a great shock, not only to th
masses of the American people, but also to most well-informed Americans—and, for that matter, t
most Europeans. There had been no first-rate war since the Franco-Prussian War of 1870. Wars o
limited objectives there had been, as the Spanish-American War of 1898 and the Russo-Japanese Wa
of 1904-1905. Colonial wars there had been, as the very important Boer War of 1899-190
Intermittent fighting in the Balkans had existed, but the Balkans were looked upon as a special cas
But a great war involving the major nations of Europe was looked upon as something so terrible, s
catastrophic, and so dangerous to everybody involved that few expected it.

The present writer can recall only two men among those of his acquaintance for whose views h
had high respect, who really anticipated that Germany would force the pace and precipitate wor
conflict. One of these was Dean David Kinley of the University of Illinois (later President of th
University) who, in the winter of 1909-1910, analyzing the tendencies in German thought and polic
expressed the opinion that these tendencies would make inevitably for war in the near future. Th
other was Franklin Henry Giddings, the great sociologist of Columbia University, who, a year or tw
later, after conversations with some visiting German professors, expressed himself as aghast at th
rapid hardening of the German attitude and as feeling that an inevitable conflict was close at hand. B
to most of the informed American public the outbreak of the war in 1914 was a bolt from the blue.

A Surprise to the Financial World—Premonitory Financial Phenomena. To the banking world and t
the international bankers it came as a great surprise. There had been, indeed, financial phenomen
which foreshadowed it. There had been accumulation of gold by Germany, Russia, and France. Th
first manifestation came as early as 1912, as German bankers began to take steps to increase their go
supply. In order to take gold out of the hands of the people and carry it to the reserves of th
Reichsbank, fifty- and twenty-mark bank notes were issued to take the place of the gold in circulatio
German agents regularly appeared as bidders for gold in the London auction rooms. Gold was shippe
from the United States to Germany, and the famous Spandau Treasure was transferred to the vaults o
the Reichsbank. By 1914 Germany ceased to take much gold, having presumably decided that h
resources were adequate.

France and Russia made strong efforts to increase their gold reserves during the spring an
summer of 1914. In the eighteen months preceding the outbreak of the war the gold holdings of th
central banks of Germany, France, and Russia were estimated to have increased by 360 millio
dollars. The drift of gold to these great central reservoirs led to a tightening of the money markets
the rest of the world and to an unusually large drain on the gold supply of the United States.

Recognized by A. D. Noyes. Few, however, even among informed financiers, saw in this a forecast o
war. One notable exception among American observers was Mr. A. D. Noyes, then Financial Editor o
the *New York Evening Post*. In his annual summaries at the end of 1912 and at the end of 1913, h
called attention to the pulling in of gold by European central banks under the apprehension of war, an
explained the mild recession in business in 1913 in the United States by this phenomenon. Europe ha
ceased to lend to the United States and had begun withdrawal of funds. We had been accustomed t
rely on European capital for part of the funds needed for our own business expansion. We wer

ceasing to get it and were repaying part of it. Our industrial pace slowed down because of this fact.

The Causes of the War. There are not a few writers, overimpressed by the economic interpretation history and especially by Marxist versions of the economic interpretation of history, who have see the war of 1914 as the result of inevitable economic tendencies. There is no one principle of historic interpretation and there are few, if any, inevitable economic tendencies. Political, moral, cultural, ar religious forces are coefficients with economic forces in the determination of historical events, ar the influence of outstanding personalities in strategic positions is often far more significant than ar economic determinist will concede.

Views of Munroe Smith and Veblen. The two writers who seem to have explained the outbreak of th war in 1914 most clearly are Munroe Smith, Professor of Roman Law at Columbia University, ar Thorstein Veblen. Munroe Smith's explanation appeared in the *Political Science Quarterly* in Marc 1915, in an article called "Military Strategy Versus Diplomacy." Munroe Smith had previousl written a very interesting biography of Bismarck. In the article referred to he begins by saying that l assumes that he will not be accused of setting up utopian standards when he judges the course German diplomacy immediately preceding the war by the standards of Bismarck. Bismarck ha always respected the "imponderables." Bismarck had had a wholesome respect for world publ opinion. He had never gone into war without first seeing to it that his alliances were dependable, th neutral relations were assured, and that world opinion was on the side of Germany. He had sometim used devious tricks in creating a favorable world opinion, as in his falsification of the telegram Ems, but he had had a respect for the opinion of mankind, and he had compelled his generals to wa until public opinion was on his side. In the war with Austria von Moltke had pleaded with Bismarck let him strike at once, saying that every day's delay meant unnecessary military losses. Bismarc made him wait until the psychological atmosphere was right. By 1914, however, the diplomat Germany was no longer in the saddle—the military strategist was in the saddle. Bethmann-Hollwe later admitted this.[1] It is not correct to say, Munroe Smith contends, that Germany diplomacy failed 1914. The correct thing to say is that German diplomacy never had a chance.

Veblen's explanation came in an unpublished manuscript in 1915.[2] Veblen pointed out th modern war cannot be successfully carried on except by a highly industrialized country. Modern w calls for immense mechanical equipment and for a continuing supply of mechanical equipment. B industrialization involves the growth of great cities and the bringing together of great masses of th population, taking them away from the control of rural nobles and landlords and bringing the together under new conditions which promote the growth of democracy. Industrialization ar democracy in general grow together. But democracy makes for peace. The common man has nothin to gain from war. He will light to defend his country, but there is no glamor for him in aggressiv fighting against other countries. Primitive war often meant booty and women and adventure for th common man, but highly mechanized modern war has few attractions.

With industrial power and democracy developing together, it was thus to be expected that th countries powerful enough to precipitate war would be pacific enough not to do it. But Veblen note two dangerous exceptions to this rule. The first was Germany and the second was Japan. In each these countries industrial power had developed without the concomitant growth of democracy. In eac of these countries political power was in the hands of an oligarchy. Though the common man cou gain nothing from war, the oligarchy might gain and would gain from a successful war. Germany ar Japan, therefore, were two countries to which the world might look to force the pace in upsettin

international peace.

These two discussions seem to me to contain the most fundamental explanations of the rupturi of the peaceful world that came in 1914; and Veblen's principle that industrial power in the hands o an oligarchy is a menace to the peace of the world is startlingly prophetic of the developments th have come in the 1930's. Democracy is pacific, dangerously pacific, as France and England and th United States demonstrated in the four or five years preceding the outbreak of the war in 193 Woodrow Wilson had a profound insight when he said that we must "make the world safe fo democracy."

Only Vienna Bourse Makes Immediate Response to Assassination at Sarejevo, June 28, 1914. Th assassination of the Austrian Crown Prince at Sarejevo on June 28, 1914, did not at once alarm th world. It alarmed Austria. There was immediate heavy selling of securities on the Vienna Bours Paris was preoccupied with her own economic and political problems and did not take the episo seriously, although there was recognition that the situation called for tact and decorum. Paul Leroy Beaulieu, in the issue of *L'Economiste Français* next following the assassination, gave editori expression of sympathy for Austria and her venerable ruler, Franz Joseph, with a degree of courtes that makes one feel that he was performing an official duty.

Bourse Panics in Berlin and Paris, July 23. On July 20 Vienna had a further heavy decline in stocks. was July 23 before Paris and Berlin had real panic in the stock markets. There had meanwhile bee reflexes in the stock exchanges of London and New York. By July 25 selling in both markets o foreign accounts was very heavy. On July 27 the Vienna Exchange was closed. The next day Austri declared war on Serbia. Stock exchanges were closed on July 28 in Montreal, Toronto, and Madrid. O July 29 the Berlin Bourse discontinued. By July 30 the panic had reached London and bourses we closed in Saint Petersburg and all South American countries. The Coulisse (curb market) was closed Paris that day. On the same day the Parquet, the official bourse of Paris, virtually suspended sellin although it was not officially closed until September 3, when the French Government withdrew fro Paris to Bordeaux.

London and New York Stock Exchanges Close, July 31. On July 31 the London Stock Exchange w closed, and five hours later (the difference between London time and New York time), at four minute before ten—the time for the opening of the New York Stock Exchange—the authorities of th institution announced to the anxious brokers that it would not open. Enormous selling orders fro Europe and other frightened markets had accumulated in their hands overnight, selling orders "at th market" (meaning at any price obtainable); and it was clear that New York alone could not stand th strain of the concentrated selling of a frightened world.

On August 1 Germany declared war on Russia, and late at night on August 4 England declare war on Germany.

Danger, Uncertainty, and the Rush to Liquidity. Selling on the stock exchanges at the outbreak of th war was an illustration of a fundamental principle in economic life. When there is general confiden in the uninterrupted going on of economic life, confidence in the legal framework under whic economic life operates and in the essential integrity and fairness of governments, men with capit prefer to have their capital employed. They want income from it. They want capital to work with, giving additional scope to their personal efforts and their personal abilities. They are quite content have their capital embodied in physical goods destined for future sale, in shares in industri

undertakings, in real estate which brings in rentals, or in loans to active men engaged in industry a
commerce. But when grave uncertainties arise, and, above all, when unexpected war comes, m
prefer gold to real estate. The man who has his wealth tied up in lands can make no shift. He must
and take what comes. With the apprehension of war, however, the effort is made to convert illiqu
wealth into liquid form as rapidly as possible, even though heavy sacrifices are involved.

London Strong vis-à-vis the Outside World. London was the center for international payments in 191
and London, like all financial centers, was hard hit. But in its financial relations with the rest of t
world London was exceedingly strong. The world owed London. London did not owe the worl
Foreigners held sterling balances in British banks, but, on a vastly greater scale, foreigners ow
sterling on daily maturing quick obligations to the British money market.

For example, a French coffee importer in Havre buying coffee at Santos in Brazil would arran
with a London acceptance house to finance the transaction. The coffee would be priced, not in fran
or milreis, but in pounds sterling. The Brazilian exporter would draw, not on the French importer, b
on the London acceptance house, a ninety-day bill of exchange, attaching to it the documents givi
title to the coffee. The London acceptance house would accept the bill and turn over the documents
the French importer, who would then get the coffee. The Brazilian exporter would discount the bill
the London discount market and would use the sterling proceeds in buying milreis, because he want
milreis at home for his next turnover.

London would no longer owe anything to the outside world on this transaction, but the Fren
importer would still owe the London acceptance house, within ninety days, the sterling with which
pay a London bank or discount house when the bill matured.

In general, in financing international trade, London advanced cash in exchange for short-ter
obligations, and the world, on balance, was indebted to London on short-term in large amounts. Th
was the situation at the outbreak of the war. All the world owed money to London on short-term, a
maturities were coming every day. All the world needed pounds sterling with which to pay these dai
maturing debts.

But Internally Shaken—Weakness of Acceptance Houses. In the ordinary course of events new sterli
in foreign hands would be steadily created by transactions similar to the one above described. But t
outbreak of the war brought all these transactions to a sudden halt. First of all, with German cruise
on the seas shipments of goods were suddenly arrested. Second, with the shock of the outbreak of t
war the position of the London acceptance houses, which had seemed invulnerable, suddenly show
great vulnerability. They had felt safe in giving acceptances up to several times their capital, counti
on a steady inflow of funds to match their daily maturing obligations. But suddenly funds ceased
come to them. With the German armies invading France, the French importer of Santos coffee cou
not easily market his coffee, and even if he sold it for cash, could not certainly convert his francs in
the sterling needed to send to the London acceptance house. The foreign exchange markets we
suddenly demoralized. An acceptance house was certain that it could not collect the large amounts d
it from Germany, and everywhere in the world disorders of one kind or another arose which placed t
debtors of the London acceptance house in an awkward position. The acceptance houses we
therefore entirely unable to give any more acceptance credits.

A further resource for obtaining sterling would normally be to ship gold to London, but th
again, with hostile cruisers on the seas, was quite impossible. One great German ship, t
Kronprinzessin Cecelie, had started out from New York for England and France just before t

outbreak of the war with 10 million dollars in gold, but had promptly turned back with the news of th
outbreak of the war. The world owed London. The world could not pay in gold or in goods. The worl
could not get additional credit in London with the demoralization of the London money market. Ho
was the world to pay?

Sterling Rises to $7.00. The first effect was a startling rise in the price of sterling. Men who had n
option about paying their debts in London paid through the nose. Sterling rose from approximate
$4.8668 to $7.00, though this $7.00 quotation represented only a few transactions in a nominal marke

Emergency Measures—Paris and London. Emergency measures of various kinds were employed in th
principal financial centers. Paris was financially weak in any case. Prior to 1913 there had been man
bad foreign loans placed in the French market through the great French banks: loans to Russia, loan
to Latin America, loans to the Balkans. The weakness of the Balkan loans had been revealed durin
the Balkan wars in the two or three years preceding the outbreak of the great World War. Th
weakness of the Brazilian loans and of Latin-American loans in general had been revealed in the cris
that followed the collapse of the price of Brazilian coffee in 1913. With the outbreak of the wa
moreover, France had the added complication that the German armies were beating their way into th
richest of the French industrial provinces. The great banks of France were frightened and cowardl
They rediscounted their bills with the Bank of France and hoarded cash. The French Bourse w
demoralized. The Bank of France showed itself courageous and intelligent. Governmental interventio
seemed clearly indicated, but governmental intervention went much too far. Debtors were legal
relieved by moratorium from the payment of their debts when due, on a sweeping scale. Bour
transactions ceased, the giving and taking of commercial credits very largely ceased, an
governmental credit was extended in many places where private credits had previously been used.

Governmental emergency measures in England were much more moderate, though some seeme
necessary. The Bank of England came to the rescue of the acceptance houses, taking over from th
Joint Stock Banks, the discount houses, the bill brokers, and other holders their outstanding bills. Th
government later gave the acceptance houses, as a means of restoring their power to function, a clea
slate on which to write, in that new acceptances would have priority over the old acceptances as
claim upon their assets.

Emergency Measures—United States. The stories of London and Paris in 1914 are interesting.[3] Chi
attention is given here, however, to the way in which the shock was met in the United States.

No Government Intervention in United States. The American financial system met the shock with n
formal Government aid, although there was good coöperation and good understanding between Ne
York and Washington. The closing of the Stock Exchange was decided upon by the Stock Exchange i
conference with the New York Clearing House banks. The banks had large loans made to Stoc
Exchange firms against Stock Exchange collateral. By informal agreement they refrained from callin
these loans. These Stock Exchange loans the banks had ordinarily looked upon as one of the
principal sources of liquidity. Any bank needing cash could call brokers' loans, and the broker mu
pay before the close of the banking day. The understanding was absolute, and on strict brokers' loan
there was no question about it. The broker could get a loan from some other lender by paying th
necessary rate of interest, or the broker could, if necessary, compel his customers to sell securities t
pay off their loans to him so that he could pay off his loans to the bank. If the broker did not pay, th

bank could sell the collateral on the floor of the Stock Exchange and turn over the difference betwe
the face of the loan and the proceeds of the sale of collateral to the broker.

Frozen Stock Exchange Loans. With the closing of the Stock Exchange, however, these loans we
frozen, and were no longer a source of liquidity to the banks. It did no good to call the loan and try
sell the collateral if there was no market. The banks contented themselves with seeing to it that t
loans were properly margined. In valuing securities as collateral, the closing quotations of July 30, t
day before the New York Stock Exchange closed, were taken.

The timing of the closing of the New York Stock Exchange was skillfully managed. There we
some who had urged the closing a day or two before. It is the view of Professor O. M. W. Sprague a
Mr. H. G. S. Noble, President of the New York Stock Exchange, that it is fortunate the Exchang
stayed open as long as it did. Stock prices went low, but not so low that the banks and the broke
could not stand the strain. The market was pretty thoroughly liquidated. The reopening of t
Exchange was then made much easier than would have been the case had stocks remained at a high
level with many sellers anxious to liquidate while the Exchange was closed.[4] The control over selli
outside the Exchange during the period while the Exchange was closed would, moreover, have bee
much less effective had not the market been thoroughly liquidated. As Mr. Noble makes clear in h
interesting paper, the closing of the Stock Exchange was accompanied by a rigorous control ov
auction rooms, the Curb and all other outside markets, and the volume of security selling was he
within very narrow limits indeed during the period the Stock Exchange remained closed. The break
prices was pretty drastic, as shown by the following table:

New York Stock Prices			
	High, 1914	**July 30, 1914**	**Decline**
Atchison	100 3/8	89 1/2	10 7/8
Baltimore and Ohio	98 3/8	72	26 3/8
Brooklyn Rapid Transit	94 1/2	79	15 1/2
Canadian Pacific	220 1/2	156 1/8	64 3/8
Chesapeake and Ohio	68	41 1/2	26 1/2
St. Paul	107 1/8	85	22 1/8
U. S. Steel	67 1/4	50 1/2	16 3/4

These securities were favorites with Europeans, and they were subject to special pressure
foreign selling in the period that preceded the close of the Stock Exchange. But the declines we
really a good deal less drastic than might have been anticipated. Our Stock Exchange in those da
was pretty tough and resilient. The declines in the averages were heavy, but again moderate under t
circumstances. Twenty-five typical railway stocks had an average price of 78.18 at the end of Jun
1914. They declined to 66.8 for their closing price in July. Twenty-five typical industrial stocks had
closing price of 58.19 in June of 1914, and dropped to 48.76 by the end of July.

Break in Stocks Moderate in 1914 as Compared with 1937. If we contrast the break in security pric
at the outbreak of the war in 1914 with the break in security prices in the governmentally regulat
Stock Exchange of 1937, we may wonder whether governmental regulation designed to prote

investors has proved itself an unqualified success. The high price for the Dow-Jones industrial averag
was 194.40 in the summer of 1937, and this dropped to 98.95 in the early months of 1938. The high f
the Dow-Jones average of railroad stocks in 1937 was 64.46, and this dropped to a low of 18.00 in th
early months of 1938. The investor was safer in the unregulated market of 1914 than when protecte
by the S.E.C. in 1937.

Clearing House Certificates. In 1914 the New York banks, with liquidity suddenly impaired, thoug
with assets which they trusted for the long pull, found themselves under unusual pressure to expo
cash. During the week ending July 31 the Clearing House banks and trust companies of New York lo
56 million dollars in cash reserve, of which 20 millions represented withdrawals by American an
Canadian banks. Resort was promptly made to the use of Clearing House loan certificates, goo
between the banks, which had been used in New York also in previous extreme crises, namely, 190
1893, and 1873. These certificates were obtained by an individual bank through application to th
Clearing House Committee. The Clearing House Committee would take the notes of the applyin
bank, secured by approved collateral with proper margin, and bearing interest of 6%. The Clearin
House certificate was the obligation of all the banks in the Clearing House, and was acceptable to a
of them in lieu of cash in settlement of Clearing House balances. The bank which held the Clearin
House certificate received the interest which the borrowing bank paid. The Clearing House certifica
thus relieved the pressure on the cash resources of the weaker banks.

Aldrich-Vreeland Notes. In the three previous crises of 1873, 1893, and 1907 the New York banks ha
been obliged to restrict cash payments. We had in those years an inelastic currency, a currency whic
could not suddenly expand to meet emergencies or even to meet seasonal variations. It consisted
gold, silver dollars and silver certificates, United States Notes (greenbacks), and National Bank Note
Of these only gold could be increased, and a substantial increase of gold could come only throug
imports, impossible in the emergency situation of 1914 and slow in the crisis of 1907—at which tim
however, the import of 100 million dollars of gold from Europe did end the money stringency an
permit the resumption of unrestricted cash payments.

We were fortunate in having available a further remedy in 1914. The Federal Reserve Banks ha
not yet begun to operate, and the shock had to be met without this assistance. But the Federal Reserv
Act of 1913 had wisely saved and improved upon the provisions of the Aldrich-Vreeland Act of 190
which had been designed to enable National Banks to issue notes freely in a crisis. This Act was
have expired by limitation on July 1, 1914. But Carter Glass, Chairman of the House Committee o
Banking and Currency, had had the foresight to have it extended for another year to provide again
emergencies pending the inauguration of the Federal Reserve System, and had amended it by reducin
the tax on notes issued under the Aldrich-Vreeland Act from 5% to 3% during the first three month
of issue, thereafter increasing it 1/2% to a maximum of 10%.

No use had been made of the Aldrich-Vreeland Act prior to this emergency. The very term
“emergency currency” had been an obstacle. But at the outbreak of the war speedy resort was had to
and the new notes were issued in large volume. Of the 7,600 National Banks, 2,197 became membe
of the “Currency Associations” which issued these notes. The maximum amount of these note
outstanding was $386,616,990 on October 24, 1914. Redemption of this currency began as early
October, 1914. By December 26 redemption amounted to $217,000,000 and on July 1, 1915, all b
$200,000 of the authorized currency had been retired.

The crisis of 1914 was unique in our history in that it was entirely due to external causes. Th

internal situation was liquid and solvent. The crisis may be said to have ended in November, 191
except for the cotton-growing Southern States. Cotton was hard hit. There was a record crop of 1
million bales, largely dependent on the European market. Cotton broke when stocks did, and th
Cotton Exchange closed when the Stock Exchange closed, the closing price being 10 1/2¢ per poun
The Cotton Exchange reopened in November, 1914, with quotations at 7 1/2¢ per pound, while cotto
was being sold in the South for 5¢ to 6¢ a pound. An emergency loan fund was provided by banks
the Northern States of $100,000,000, while Southern banks provided $35,000,000. As it turned ou
very little use had to be made of this fund. Less than a quarter of a million dollars was applied for
New York City, and one great bank took all of this. There came a sharp increase in foreign demand fo
cotton early in January, 1915.

Gold and Foreign Exchange Problem. Perhaps the most acute problem that New York had to face wit
the outbreak of the war was the problem of gold and foreign exchange. There had been a drain on Ne
York's gold for a considerable time in connection with the German, French, and Russia
accumulations of gold in anticipation of war. Moreover, from March, 1914, to August, 1914, impor
of goods to the United States had exceeded exports in unprecedented amount. Europe was depresse
and had reduced its buying. Our imports were not unusually large, but our exports were unusual
small. Usually our heaviest imports would come in the spring, and our heaviest exports to pay f
them, agricultural commodities, would come in the autumn. It had been a longstanding practice
American bankers to tide over the period of low exports by drawing finance time bills on London
payment for imports, which they would later liquidate by documentary bills drawn on Londo
connected with our heavy autumn exports. Finance bills are pure credit instruments drawn by banks o
banks; documentary bills represent the actual movement of goods and are accompanied by the usu
shipping documents. There had been an unusually heavy volume of such finance bills drawn in the la
spring and early summer of 1914, which London was entitled to collect from New York. An additiona
heavy volume of payments due to London grew out of the selling of securities in New York b
frightened Europeans at the outbreak of the war.

A further unusual factor which complicated the situation was the fact that the government of Ne
York City, seeking to escape the discipline which New York bankers had sought to impose i
connection with the city's borrowing and their demand that expenditures be curtailed or revenues b
increased, had borrowed $80,000,000 on short term in England and France. With sterling exchang
almost unobtainable the city's obligations abroad were in danger of dishonor. The New York bank
came to the rescue of the city and undertook to provide the necessary sterling, but administered
spanking to the city officials which the latter accepted with due meekness.

Gold Pool—England Accepts Gold in Ottawa. A gold pool of $100,000,000 was organized by th
banks of New York and other principal cities under the guidance of the Federal Reserve Board, an
arrangements were made with the Bank of England whereby shipments of gold to a depository
Ottawa would be accepted in lieu of gold shipped across the ocean, thus obviating the dangers
capture by hostile warships. Sterling exchange promptly came down to a reasonable figure.

Exports Turned Tide of Gold Toward New York by December, 1914 . But the exchange situation wou
have been quickly straightened out in any case by the great increase of foreign demand for America
products for war purposes. In October the United States lost $44,000,000 of gold and in Novembe
$7,000,000, but in December the tide turned and the United States gained $4,000,000 net excess

imports over exports of gold. The explanation is the very heavy shipment of commodities on Europea account. From December, 1914, to May, 1917 (we entered the war in the middle of April), the Unite States gained gold at a rate never dreamed of before. In 1915 the excess of imports over exports gold was over $420,000,000, in 1916 over $520,000,000, and in the first four months of 1917, ov $180,000,000—a net gain of $1,111,000,000 in gold. The problem of exchange ceased to be how protect the dollar, but rather, how to protect the pound and other foreign exchanges. The war crisis the United States was over by November, 1914, and in early 1915 the war prosperity began.

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[1] Bethmann-Hollweg, *Reflections on the World War*, London, 1920, pp. 137-138; 147.

[2] I have not been able to find that this article was ever published. However, the reader will find muc of it in two books by Veblen: *Imperial Germany and the Industrial Revolution*, New York, 191 and *The Nature of Peace and the Terms of Its Perpetuation*, New York, 1917.

[3] See my book *The Effects of the War on Money, Credit and Banking in France and the United State* published by the Carnegie Endowment for International Peace, Oxford University Press, Ne York, 1919. For London, see the interesting articles by Mr. J. M. Keynes in the British *Econom Journal* in late 1914.

[4] O. M. W. Sprague: "Crisis of 1914 in the United States," *American Economic Review*, Septembe 1915; H. G. S. Noble: "The New York Stock Exchange in the Crisis of 1914," Garden City, N. Y Country Life Press, 1915. These two papers are classics of permanent value.

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