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THE UNITED STATES TREASURY AND THE MONEY MARKET.

THE PARTIAL RESPONSIBILITY OF SECRETARIES GAGE AND SHAW FOR THE CRISIS OF 1907.

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Everyone is conversant to-day with the peculiarities and shortcomings inherent in our independent treasury system. The frequently embarrassing withdrawals of money from circulation in periods of prosperity, when currency is in urgent demand, the reinjection of the treasury hoards into the circulation when the currency is already redundant, the exaggeration of these embarrassments on account of the lack of a balanced budget,—these have become commonplaces too trite to require illustration or proof.

These obvious and admitted deficiencies of the system have, however, been much appealed to in recent years to justify interventions of the government in the money market and perversions of the law, which were in no way necessitated by the deficiencies in question. For more than fifty years after the establishment of the independent treasury, successive secretaries had from time to time been confronted with the awkward consequences of the system, and had tentatively dealt with them by expedients of one sort or another that were in accord with the letter and spirit of the statutes, but without attempting to intervene in the financial world other than to remedy the difficulties arising from the treasury system. Within the first decade of the treasury's existence, Secretary Guthrie found himself confronted with an accumulating surplus, and proceeded in 1853 to its reduction by the purchase of government bonds in the open market. Secretary Cobb adopted the same remedy for a similar situation in 1857, and several of the later secretaries, when the government revenues proved superabundant, have followed their example. Secretary Fairchild, in the period of the great surplus of the eighties, resorted to this method upon a larger scale than any other secretary, and used the surplus in the year 1888 for the redemption of government bonds in advance of their maturity to the extent of some ninety-four millions of dollars.

After the establishment of the national banking system another method of reducing an uncomfortable surplus was offered in the provision that the public money (except customs dues) might be deposited in the national banks. This, however, was regarded as an exceptional measure only to be employed in peculiar emergencies, and no considerable resort was ever made to the banks as depositaries for ordinary revenue until within the last decade. In the course of the war the banks which assisted in the placing of loans were allowed temporarily to retain the funds obtained from bond sales, sometimes to the extent of thirty or forty millions. Throughout the seventies, however, the public deposits seldom amounted to as much as ten millions, except during the refunding operations of 1879, when the proceeds of new bond sales were left in the banks pending the repayment and withdrawal of old bonds. During the eighties the deposit of public funds did not rise above fifteen millions, until the years of the great surplus, 1887 and 1888, when Mr. Fairchild, in desperation because of the treasury's absorption of money, allowed the accruing revenues to be deposited in the banks, and in April, 1888, the public deposits reached sixty-one millions. Up to that time the maximum amount entrusted to any one bank (except on loan account in the case of bond subscriptions) had been $500,000, but Mr. Fairchild raised the allowable deposit to $1,000,000. For these acts he was vehemently attacked in the public press, in campaign speeches, and later by his successor in the treasury department. Under Secretary Windom deposits were again brought down to a working balance of less than twenty millions, and there they remained until the later nineties.

Until within the last decade the use of national banks as depositaries had been treated as an exceptional measure. The national banks had been in existence for more than thirty years, but the federal treasury and sub-treasuries were still regarded as the normal custodians of the government money. In one period of heavily redundant revenues, Secretary Fairchild had gone so far as to deposit a little more than one-sixth of his total balance with the banks, but this policy had provoked general criticism, and had at once been reversed by his successor in office. Until within the last decade, also, the treasury had never ventured to intervene in the money market, except in moments of really great distress, such as the outburst of an unreasoning panic. Secretary Cobb, during the great crisis of 1857, and Secretary Richardson, in the memorable crash of 1873, had helped to restore confidence by buying government bonds on the market, but, aside from such utterly exceptional occasions, one can say with approximate accuracy that the treasury, since the establishment of its independence in 1846, had held aloof from the permutations of the market, and had made no effort to control it in one way or another. Nor had any secretary ever attempted, or probably ever thought of attempting, to render the currency responsive to the changing needs of trade by the deliberate manipulation of the public funds.

During the administration of Secretary Gage one begins to note the transition to a new view of the treasury's functions and a new use of the secretary's power. For the first time the treasury's policy appears to be influenced by the rate of interest prevailing in the financial centers, and by the condition of the stock market. In the course of Mr. Gage's period in office, the balance in the treasury, partly as a result of good times, partly as the outcome of Spanish war taxes and bonds, once more mounted to high levels. It did not, however, reach the record heights it had touched during the administration of Secretary Fairchild. Nevertheless, during the acute stringency in the financial market in the autumn of 1898, Mr. Gage not only attempted to relieve the situation by prepaying the interest and capital of bonds, but he saw fit to allow the deposits with the banks to rise from about twenty-eight millions to ninety-five millions. Again, in the stringency of the following autumn, 1899, although the treasury balance was no larger than the year before, the public deposits were increased to one hundred and eleven millions, which constituted more than one-third of the treasury's total balance. Mr. Gage's deposits were thus almost double the maximum reached under Secretary Fairchild, although the treasury's absorption of money had not been so considerable. Moreover, it later appeared that a single institution, the National City Bank of New York, was made the recipient of more than fifteen and a half millions at a time, while another affiliated New York institution, the Hanover National Bank, was given the use of deposits amounting to more than four and a half millions. The largest award to any one bank in Mr.

Fairchild's time, it will be remembered, was limited to one million.

The change in policy foreshadowed and initiated by Secretary Gage became a full-fledged reality with Secretary Shaw. With him it became the avowed endeavor of the department to check every incipient stringency, and to prevent any contraction of credit, no matter what might have been its cause. During the five years of his service the traditions of a half century were completely set aside. The laws which had been carefully framed to limit the relations of the treasury were twisted and violated, now this way and now that. The independent treasury system became practically extinct. Mr. Shaw apparently could conceive of but three evils in the financial world, high interest rates, a decline in the prices of stocks, and a contraction of credit, but these evils, in his opinion, were so serious that they were to be corrected at whatever cost. Whenever any of these evils seemed imminent, nothing could prevent him from forestalling them. In the autumn stringency of 1902, he anticipated interest payments and bought bonds in the open market, as many of his predecessors had done; but when these measures proved insufficient to bring interest rates down, he also launched two new experiments of doubtful legality, one of which at least was of very questionable expediency. He offered to accept other than government bonds as security for deposits of public money, in the hope that he could stimulate an enlargement of the public deposits and of the note issue at the same time. He also informed the depositary banks that they need no longer keep cash reserves against their holdings of public funds. This measure at once affected about one hundred and thirty millions upon deposit throughout the country, of which forty millions were in New York. The ruling would, if it had been carried out, have added ten millions in New York City alone to the amount held as reserve against other deposits, or the basis for forty millions of new loans, while in other parts of the country it would have justified a credit expansion of ninety millions. In New York, however, the Clearing House Association conservatively and wisely agreed not to accept the offer, and have continued the old reserve requirements against their members down to the present time. By the end of December, 1902, Mr. Shaw had increased his deposits with the banks to such an extent that they totalled over one hundred and fifty millions.

In the following summer, that of 1903, Mr. Shaw repeatedly assured the public that he would allow no stringency in the autumn, and toward the end of August he revealed the reasons for his assurance. Up to this time it had been the unquestioned belief of the department that revenue once turned into the treasury could not be taken out and deposited with the banks. When Mr. Fairchild and Mr. Gage had made large deposits with the banks, they had merely allowed the internal revenue to accumulate there as it was collected. This was a slow process, and limited the secretary's power of relieving the market to about half a million a day. On August 27, 1903, Mr. Shaw announced that, according to his ruling, money could be transferred *en bloc* from the treasury vaults to the banks, and that he had on hand about thirty-eight millions available for that purpose. In other words, he announced to the banks before any panic had occurred, that he intended to assist them if they were in need, and that he was ready to assist them upon a scale never before conceived possible. He held the entire treasury balance ready to use in support of what he took to be the needs of business. No statement could have made more explicit his notion that it was the function of the government treasury to guard and protect the money market, to keep interest rates down and to prevent credit contraction. During the autumn of 1903 the government deposits rose to one hundred and sixty-eight millions.

In the course of the presidential year, 1904, trade slackened; there was no tension in the money market; Mr. Shaw's ingenuity was put to no further tests; his paternal policy was not brought into requisition.

In the autumn of 1905, however, business had resumed its prosperous advance, the stock market was buoyant, and money rates ran high again. In the face of severe tension, stocks nevertheless continued to rise, the general belief at the time being that the secretary contemplated his usual assistance to the banks. For some reason, however, on this occasion, Mr. Shaw abstained from his accustomed intervention. It may have been because of a natural aversion to doing what he was expected to do; it may have been because the treasury balance had declined to the lowest point it had touched since he had assumed office; it may have been because the administration was sensitive to the criticisms that had been raised against his earlier practices; it may have been because of the continued advance in the stock market which seemed to render treasury assistance superfluous. Whatever the reason for his apparent change of policy, the period of his abstinence from the money market was not destined to last long.

Early in the next year, 1906, the bank reserves in New York revealed a deficit; many stocks began to decline; there were unmistakable signs of impending contraction. Mr. Shaw once more resumed his policy of supporting the market, first of all more or less surreptitiously, then openly. His first step was a private arrangement with the most influential of the New York banks, by which that institution was to import gold, and be allowed to count the metal in transit as part of its reserve. This peculiar and unannounced arrangement went on for several weeks, possibly months, before a similar privilege was openly extended to the other banks. Not until April 14th did Mr. Shaw make virtually the same offer publicly and without discrimination. He then announced that he would deposit government money with any bank which engaged to import gold, so that interest would not be lost during the period of shipment. Mr. Shaw claimed that in this way approximately fifty millions were brought from abroad, and at any rate forty-nine millions were deposited in the New York banks, or the basis for a loan extension of nearly two hundred millions. Of these forty-nine millions of public funds it is worthy of passing note that thirty-one were placed with a single institution, the National City Bank.

In the late summer the stock market entered upon its last ill-advised upward swing, under the lead of influences that are well known, and in September the bank reserves again revealed a deficit. Once more Mr. Shaw poured oil upon the fire and repeated his operation of the previous spring. This time forty-four millions of government money were turned into the New York market (of which twenty-five went to the National City Bank), ostensibly as an artificial stimulus to the import of gold. They represented Mr. Shaw's last effort to prevent a contraction of credit, his last contribution to the advance of the stock market, for before another period of money tension had arrived, Mr. Shaw had withdrawn from public life, and had been welcomed to other fields of usefulness.

Events have moved rapidly since Mr. Shaw left office, and we are already in a position from which we can survey some of the consequences of his policy in perspective.

For an entire decade banking credit had been expanding with scarcely a momentary halt. The movement in its duration and extent was doubtless in large part attributable to the vast additions made during the period to the money supply in the way of gold and banknotes. Nearly a billion dollars had been added to our supply of gold and about three hundred millions to our bank circulation, which meant an average annual increase for ten years of about one hundred and thirty millions. A considerable part of this increase had passed into bank reserves and had naturally formed a basis for enlarged credit. But the community's credit as registered in bank deposits had increased far more rapidly than the money supply. The total of individual deposits in all of the banks, according to the Comptroller's figures, had increased at the rate of about five hundred and ninety millions per year. Nor did this result merely from the fact that upon a given basis of money a multiple quantity of credit can always be created. It meant more than that. It meant that the proportion of credit to the currency in the country had also been increasing, for the ratio between the country's money and the bank deposits in 1896 had been as 100 to 182, but in 1906 credit had increased, so that the proportion stood as 100 to 310.

It is worth while also to examine the relative proportion in which different classes of bank credit had increased, especially in New York, where Mr. Shaw's operations had been most extensive. Here one can see most plainly the traces of his policy of stock market relief. If we compare the classification of loans in the national banks of New York City in September, 1896, with the same classification in September, 1906, we find an altogether disproportionate and enormous increase in the loans to the stock market, as compared with industrial loans. Loans on time against commercial paper had increased by seventy-three per cent., but loans on time secured by stocks and bonds had increased by one hundred and seventeen per cent., and loans on call secured by stocks and bonds had increased by as much as one hundred and seventy-five per cent.

Much the same story of disproportionate credit in the security market is told by the statistics of price movements during the period. The index numbers constructed by the Bureau of Labor registered a rise between 1896 and 1906 in the prices of raw commodities of forty-nine per cent.; in the prices of manufactured commodities of thirty-seven per cent., and an average increase among all commodities of thirty-five per cent. To the average weekly wages of workingmen an increase of eighteen per cent. was attributed. If, however, we set alongside of these figures the movements in the prices of securities as tabulated by the *Wall Street Journal,* we find a most startling contrast. In the case of twenty leading railroad stocks, the increase in price amounted to two hundred and twenty-eight per cent., and among the twelve leading industrials the rise in prices reached even as high as two hundred and sixty-eight per cent. Security prices had been carried upward beyond all reason, and beyond all proportion with their earning capacity. Figures recently published show that the dividends of twenty leading railroads at the topmost prices of 1906 averaged a yield of scarcely more than three per cent. Some, like the Philadelphia and Reading, offered less than two and a half per cent., or below the normal yield of a gilt-edged first mortgage bond. These rates, it must be remembered, were particularly low because they occurred in a period when money was depreciating, and when interest rates would naturally have been high. One of the reasons for this anomalous condition unquestionably was that Mr. Gage and Mr. Shaw had for the greater part of ten years resisted with all the vast resources of the government treasury the natural tendency of interest rates to follow the rising level of prices. They had, in fact, succeeded in keeping the money rate of interest below the rate which would have been "normal" or "natural" with a depreciating currency. They had kept alive a continuously excessive demand for credit, by making it available at less than the normal cost. They had sown the wind and their successor was to reap the whirlwind. They had helped to raise the tower of credit to a tottering height, and now the slightest agitation of any sort was sure to bring collapse.

Mr. Cortelyou became secretary of the treasury on March 4, 1907, and before he had had time to settle himself in his new office, or to outline any general policy, the fiduciary structure fostered by his predecessors began to waver. Within ten days of his assumption of office the stock market experienced the most severe recession of several years, and Mr. Cortelyou found himself swept along by the precedents of Mr. Shaw, now extending to the banks' relief in the form of more government deposits, now offering again to accept railway bonds as security for such deposits, then offering to anticipate interest payments and also to redeem bonds in advance of their maturity. In thus retracing Mr. Shaw's footsteps he apologetically explained that this action must not be regarded as a precedent. It was even implied that eventually he hoped to arrange the affairs of the treasury so that the department would not have such close relations with the New York market. This idea seemed to be confirmed early in May by the announcement that he had appointed a commission of five to consider the whole question of the deposit of public funds in the national banks.

In August, however, came a second and more severe setback in the stock market, and Mr. Cortelyou by this time seems to have adopted his predecessor's theory as to treasury responsibilities, for on the 23d he came forward with a plan which may almost be said to have out-Shawed Shaw. He announced that, beginning with the first week in September, he would make deposits with the banks regularly for a period of at least five weeks, and that while so doing he would publish no information as to the amount of these deposits, or as to the manner of their distribution. He also suggested that, in his opinion, this was a plan which might with advantage be followed annually in the weeks of autumnal stringency. In the course of the next six weeks the deposits of the treasury with the banks increased by about nineteen millions, and in the middle of October they totalled one hundred and seventy-six millions.

Toward the end of October came the third great break in the market, and the actual outburst of the panic, the details of which are too fresh in memory to bear repetition. It suffices to say that in its three opening days, between Wednesday, October 23d, and Saturday, October 26th, Mr. Cortelyou turned more than thirty-one millions of the public funds over to the banks of New York City, carrying the total of government deposits in the national banks of the country to the enormous level of two hundred and nine millions. The power of the federal treasury to support the tottering edifice of credit had, however, at last reached its limit. The props snapped under the overwhelming weight. The financial framework collapsed, and on Monday, October 28th, the vast majority of the banks in the country suspended payments. Of the efforts of the secretary in subsequent weeks to reërect the fallen structure, of his increase of the government deposits to two hundred and forty-two millions, and of his preposterous plan to borrow one hundred and fifty millions additional in order to turn them over to the banks, nothing need be said, except that they proved futile, and that the latter plan was generally condemned as ill adapted to afford either immediate relief or future safety.

Such is the story of the treasury's decade of paternalism. Beginning modestly under Secretary Gage, it developed flamboyantly under Secretary Shaw, and reached its logical and helpless end under Secretary Cortelyou. It is a story of arbitrary and lawless meddling, sometimes involving favoritism, on the part of the treasury. It is a story of resultant improvidence on the part of the banks, involving in the case of the New York banks the lowest average reserves of any of the four decades since the national banks were organized. In the stock market it is a story of the most extravagant speculation since the Civil War. The end of the story has been the most general and prolonged collapse of the country's credit system in the history of the national banking system.

The completed record of these ten years shows very clearly the importance for the future of again divorcing the treasury from the money market. One cannot but hope that, with the return of settled conditions, either the commission which Mr. Cortelyou appointed last year, or Congress itself, will see the wisdom of putting aside the unhappy legacies of Secretaries Gage and Shaw, and will once more establish relations between the government treasury and the banks which are automatic and involuntary.

This end might be attained in various ways. It could, I believe, be best attained if the secretary were required to deposit with the banks daily all receipts in excess of a fixed balance, and if the deposits were made available upon the same terms to all national banks. The treasury would then be relieved from any possible charge of discrimination or of market favoritism; and the banks would be debarred from the unwholesome expectation of outside relief, the existence of which is to-day a continual incentive to unpreparedness. A solution of this sort involves, of course, the working out of various questions of detail in distributing the deposits, such as the question as to how far from the place of its collection surplus revenue shall be distributed; the question as to the relation between the amount to be deposited and the capitalization or resources of the individual banks; the question whether the government shall charge a fixed rate of interest, or allow the banks to bid for the privilege of receiving the public funds; and the question whether the government deposits shall be given any peculiar security. None of these questions, however, will be found insoluble, if subjected to earnest inquiry.