A Bank for America

The making of the Federal Reserve

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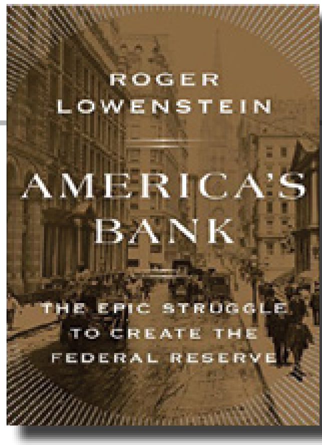

Perplexed foreigners trying to understand the American Tea Party and 'Audit the Fed' Movement may be interested to learn that, far from being aberrations, these phenomena have deep historical roots and reflect concerns that date right back to the founding of the Republic. At bottom lies a deep suspicion of centralised authority and large banks.

In his masterful book, *America's Bank – The Epic Struggle to Create the Federal Reserve,* Roger Lowenstein, the American journalist and author, chronicles the events leading up to the creation of the Federal Reserve, and the political compromise that led to its current structure – a centralised board of governors and 12 decentralised regional banks. It is a gripping story, rich in historical detail and informative minutiae.

Few people know, for example, that while Federal Reserve notes (dollar bills) make up more than 99% of US currency in circulation today, there are still outstanding some US notes (greenbacks), National Bank Notes, and silver certificates, all of which remain legal tender.

The first part of the book provides a brief monetary history of the US up to the Panic of 1907. Alexander Hamilton, the first secretary of the Treasury, was able to persuade George Washington, over the intense objections of Thomas Jefferson, to establish the first US central bank – the First Bank of the United States, chartered in 1791. The charter lapsed in 1811. President Andrew Jackson, a soldier and Indian fighter, reflecting the deep suspicion of federal power among the pioneer settlers of the American West, vetoed in 1832 legislation rechartering the Second Bank of the United States. For a formative period in its history, America was without a central bank.

In the ensuing decades after the veto, the American economy witnessed violent booms and busts, financial panics, and a proliferation of currencies – some 8,370 varieties of notes in the Union states alone at the time of the Civil War. The National Bank Acts of 1863 and 1864 unified the currency but did not provide for the pooling of bank reserves. And America experimented with both a gold and combined gold and silver standard. From 1867 to 1897 prices fell relentlessly, imposing particular hardships on farmers and debtors. The financial panics and bank failures of 1893 and 1907 gave impetus to the creation of an institution that could serve as a lender of last resort and provide an 'elastic' currency (a currency that automatically increases or decreases in volume with the demands of business).

Policy positions and compromises

In the second part of the book, Lowenstein outlines the policy positions and compromises of five principal architects of the Federal Reserve Act of 1913: Paul Warburg, a German banker (and later naturalised American citizen); Nelson Aldrich, a self-made man, Rhode Island Senator and Chairman of the Senate Finance Committee; Carter Glass, son of a Confederate soldier, ardent 'states' rights' activist, and Congressman from Virginia; William Jennings Bryan, 'The Great Commoner', Nebraskan, three times Democratic nominee for President, and champion of farmers and working class Americans; and Woodrow Wilson, the only President in American history to hold a Ph.d, and who astutely observed that, 'Every nation is renewed out of the ranks of the unknown men.'

Lowenstein also outlines the contributions of many other thinkers who influenced the debate: for example, Victor Morawetz, a railroad man and the first to propose a system of independent regional banks; Congressman Charles Lindbergh (father of the aviator), who called for an investigation of JP Morgan and the 'Money Trust', 'a vast and growing concentration of control of money and credit in the hands of a few men'; and Robert Owen, chairman of the Senate Banking Committee, who demanded that control over the Federal Reserve rest in the federal government. And many others.

After extended study trips to Europe to understand central bank practices, and after a secret meeting on Jekyl Island in Georgia with three top bankers, Aldrich came up with the 'Aldrich Plan'. This was designed to create a more unified banking system as well as a more logical basis for the currency and liquid markets for bank paper. The legislative debate raised many objections and counter-proposals, including a Glass-Owen proposal. Wilson cited three principles for banking reform. These included an elastic currency, mobilisation of reserves (effectively a lender of last resort function), and abolishing the concentration of monetary resources in just a few banks. After an intense period of horse-trading, the legislators agreed on the current structure of the Federal Reserve. On 23 December 1913, Wilson signed the Federal Reserve Act into law. Not long afterwards the dollar began its ascent as the world's principal reserve currency.

This book is highly relevant to today's world and captures many debates that resonate throughout American history: centralised authority versus local control; Wall Street versus Main Street; Washington versus the financial services lobby; and East versus West. ■

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