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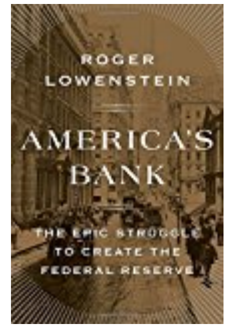
Roger Lowenstein. *America's Bank: The Epic Struggle to Create the Federal Reserve.* New York: Penguin Press, October 20, 2015. 368 pp. $29.95, cloth, ISBN 978-1-59420-549-1.



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The Creation of the Federal Reserve Bank

The US Federal Reserve System was born at 6:02 pm on December 23, 1913, when President Woodrow Wilson signed his name to Congressional Legislation H.R. 7837, popularly known as Glass-Owen, after its two main sponsors Representative Carter Glass and Senator Robert Owen, chairmen of the House and the Senate Banking and Currency Committees. When Glass died in 1946, his obituary in *The New York Times* claimed he was "generally regarded as the father of the Federal Reserve Act", but as Roger Lowenstein makes clear in his new book, *America's Bank: The Epic Struggle to Create the Federal Reserve*, assigning paternity to the Federal Reserve (for short, the Fed) is a far more complicated and fascinating story than that. Lowenstein shows that numerous individuals—Wall Street and Midwest bankers, academic economists, and politicians both Democratic and Republican—played an active role over a period of many years in the conception and birth of the now more than one-hundred-year-old central bank.

Lowenstein divides his book into two roughly equal halves. Part 1 ("The Road to Jekyl Island") will have particular appeal to economists and economic historians as it traces the intellectual origins of the Federal Reserve System, a uniquely American institution, crafted out of a desire to create a modern central bank that could create an elastic currency, coordinate the flow of bank reserves, and end the recurring cycle of financial panics, balanced against an historical distrust of vesting too much power in either Wall Street or Washington. Part 2 ("The Legislative Arena") will appeal more to students of American history and politics as it focuses on the period 1912-13, when control of Congress and the White House shifted from badly splintered, pro-business Republicans to a Democratic Party slowing shedding its traditional rural roots and small-government idealism in favor of a new spirit of progressivism, modernization, and urban reform.

The cast of characters in Lowenstein's story of the epic struggle to create the Federal Reserve is a large one (and this reader would very much have appreciated a detailed annotated list of players), but Lowenstein wisely focuses much of his attention on four men at the heart of the action. In the first half of the book, German-immigrant banker Paul Warburg and Republican Senator Nelson Aldrich are the dominant players in a real-life drama that culminates with their secret meeting off the coast of Georgia to hash out the details of their banking proposal; in the second half, President Woodrow Wilson and Virginia Democrat Glass take over the leading roles as they put shape to the final legislation creating the Fed.

Sweden established the Riksbank, the world's first central bank in 1668; the Bank of England followed in 1694. The Bank of the United States was established in 1791, but lasted for only twenty years. A Second National Bank soon followed, but in 1836 President Andrew Jackson vetoed attempts to recharter that institution, effectively putting an end to central banking in America for the next seventy-eight years. In its absence, states regulated their own banks (or not), and thousands of competing paper currencies (bank notes, but rarely gold) circulated, many without gaining wide acceptance. Money was often in short supply, and between 1867 and 1897, the general price level fell by 50 percent. Compared to their European counterparts, American banks felt compelled to hold high levels of reserves, and found themselves unable to expand credit in times of financial stress Lowenstein notes that while England suffered no serious bank panics after 1820, America experienced five severe and twenty lesser ones, coming about every three years after 1887.

German-born Paul Warburg, one of the heirs to the Hamburg banking firm M. M. Warburg, came to the United States with his American wife in 1902 to join his father-in-law's financial firm Kuhn, Loeb & Company. He was said to be shocked by the primitiveness of American banking, and diagnosed the key problem as the lack of a common reserve whose supply could be adjusted in time of crisis. Over the next decade, Warburg rallied his Wall Street colleagues and penned a series of letters, articles, and pamphlets in favor of the creation of a European-style central bank. Lowenstein portrays Warburg as economically astute, but politically naïve for failing to fully comprehend his new country's long-held aversion to centralization of power or even its currency. He would go on to be one of the first governors of the new Federal Reserve Board and to write a two-volume history of its early years.

Warburg's harangues gained greater acceptance after the financial panic of 1907, a crisis so severe that it nearly toppled American banking. Without a central bank, there was no Walter Bagehot-style lender of last resort to rescue illiquid firms.[1] Even J. P. Morgan, whose remaining days were limited, found his resources strained by the magnitude of the crisis. Lowenstein's recounting of the causes and consequences of the 1907 panic make fascinating reading, particularly in light of its striking parallels to the more recent 2008 financial crisis. Like modern unregulated shadow banks with their MBSs and CDOs, in 1907 it was highly leveraged Wall Street secret trusts investing in risky assets that proved the lynchpin of the crisis. The stock market dropped some 40 percent, credit froze, and for many lenders illiquidity quickly turned into insolvency and bankruptcy. There is also an eerie similarity in the public's reaction to the crisis, from a widespread distrust of Wall Street to cries of moral hazard when Democrats (led by its perennial populist William Jennings Bryan) advocated government-backed bank deposit insurance.

By 1907 Nelson Aldrich had been a Republican senator from Rhode Island for more than twenty-five years and was at the height of his power as chairman of the Senate Finance Committee. He was a strong ally of business interests (especially protective tariffs) and the status quo in banking, and like many in his party, was loathe to any form of government regulation. But, over the next five years before his retirement from the Senate in 1912, Aldrich would undergo a remarkable transformation, becoming the Republicans' primary advocate of central banking. Lowenstein dates this epiphany to Aldrich's 1908 two-month-long fact-finding tour of European central banks, as head of an eight-member delegation of the National Monetary Commission, established by Congress in the wake of the 1907 panic to study defects in American banking.

A year after this European trip, over Thanksgiving week in 1910, Aldrich, Warburg and four others met secretly at a private club on Jekyl (today spelled Jekyll) Island, Georgia to hash out the details of a formal plan for an American central bank. For many readers, this clandestine meeting, disguised as a duck hunt, will be the most intriguing part of Lowenstein's long story (once again proving Oscar Wilde's quip that "even these metallic problems have their melodramatic side"). In January 1911, in declining health, Aldrich formally released his plan for a "Reserve Association of the United States" with fifteen regional branches (each governed by a board elected by local member banks) and headed by a Reserve Association in Washington that would set a single interest rate for the entire nation. Warburg came out in strong support of the proposal, without ever divulging that he had been one of its principal authors. Lowenstein quite rightly calls the Aldrich plan a first draft for the future Federal Reserve Act, though it would take another three years for it to be enacted, and not by Aldrich's own party, but by the newly elected Wilsonian Democrats.

The second half of Lowenstein's book is likely to interest readers more inclined to political science than political economy. Here his main focus is the run-up to and aftermath of the turbulent 1912 presidential campaign, which saw a badly divided Republican Party, split between Taft and Roosevelt, battling an equally fractious Democratic Party, which took forty-six convention ballots to nominate Wilson. In terms of monetary policy, Taft supported the Aldrich plan, while Roosevelt is portrayed as uninterested in the entire issue. Monetary reform was not high on the agenda of the Democrats either: the new progressive wing of the party saw it as ceding too much power to Wall Street, while rural voters still loyal to Bryan remained suspicious of any and all attempts to centralize monetary authority. Wilson pledged publicly to Bryan that he would not support the creation of a central bank, but privately he seemed to be in favor of the idea. Pragmatically, Warburg supported Wilson in the campaign, seeing him as more electable than Taft and as more open to monetary reform than Roosevelt.

With Wilson's election, Democrats racked up large majorities in both the House and Senate. The final part of Lowenstein's story recounts the protracted and downright tedious legislative maneuvers in Congress to fashion a central banking bill, efforts led by Representative Glass and Senator Owen. Of the two men, Lowenstein focuses more of his attention on Glass and his protracted struggles with President Wilson over the extent of banking centralization. It is ironic that Glass, better known today as the father of financial regulation (due to the 1933 Glass-Steagall Act) was the one who resisted Wilson's efforts to vest too much power in the Washington. One final figure who played a major role in shaping the Fed is Wilson's treasury secretary, William G. McAdoo. It was McAdoo who provided the name "Federal Reserve" for the new institution, determined the number of districts (twelve) and their locations.

Lowenstein quite rightly calls the final passage of Glass-Owen "less an ending than a truce," noting that "Congress's internal quarrel over how much power to vest in the Fed endures to this day" (p. 257). Over the next 100 years, the US Federal Reserve would go on to become the most powerful global institution of its kind, taking on new responsibilities and developing new policy tools never envisioned by its creators. Its ever-evolving story remains an incomplete one, but its difficult birth is well told here in Lowenstein's new book.

Note

[1]. Walter Bagehot, ***Lombard Street: A Description of the Money Market*** (London, 1873).