

# THE POLITICAL CLIMATE IN AMERICA FROM 1908 TO 1913

## The Birth of the Federal Reserve System

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The issue of central banking was not new to Americans by the 1913 establishment of the Federal Reserve. At the time, economic conditions were unstable and wealthy industrialists and investment bankers were prominent fixtures of society. The late nineteenth and early twentieth centuries saw the rise of John D. Rockefeller, Andrew Carnegie, and J. Pierpont Morgan. All were men of great wealth, visibility, and influence. Rockefeller held a near monopoly over oil refinement, as did Carnegie over steel, and Morgan over investment banking. The financial condition of the United States however, had been less than stellar with panics in 1857, 1873, 1893, and 1907, and it seemed clear to the public that these industrial tycoons were at the least partially responsible for the mess. This animosity underpinned what came to be known as the Progressive struggle in American politics. The defining economic legislation adopted during this era was the Federal Reserve Act, also known as the Glass-Owen bill, which created a central Bank of the United States.<sup>1</sup>

1. G. Edward Griffin, *The Creature from Jekyll Island: A Second Look at The Federal Reserve* (Westlake Village, CA: American Media, 2002), 461.

How was the institutionalization and centralization of the nation's banking and currency passed into law during this era of Progressive populism? It was a highly controversial proposition that had failed on two previous occasions, though it was finally passed in 1913. It was sold to the American public as a way to stabilize the economy and create a more "elastic" currency to enable expansions of credit during crises, thus protecting the common man from economic recession. What will be made clear is that the American congress was fighting a deep ideological war, and the bankers won. The question is how: what tactics were used to make political progress? What were the characteristics of the political climate that made it possible to establish a central bank in America? It is important to understand several things about banking reform, as it was a primary issue of congressional consideration during this time of progressivism in American politics.

A rather conspicuous cast of protagonists in the public arena enabled the passage of the Glass – Owen bill on December 23, 1913.<sup>1</sup> The men that lobbied in support of centralized currency reform at some point included John D. Rockefeller, J. Pierpont Morgan, Senator Nelson Aldrich, and others. One might not think that this patrician assortment of wealth would represent the populist and progressive outlook of the common man, but nevertheless these men were some of the driving forces behind the Federal Reserve System being enacted into law. Upon observation of the circumstances preceding the creation of the Federal Reserve, it becomes clear that the bill was written by a group of unelected powerful businessmen with the intent of securing their own fortunes.

## FINANCE AND GOVERNMENT

Over one hundred years after its founding, current criticisms of the Federal Reserve often include accusations of its role in enabling political influence over monetary policy. This is neither new criticism, nor is it baseless. During the earliest debates of currency reform, in Congress and among public, politicians and laymen alike were concerned about the politicization of the nation's economy. James J. Hill expressed this in a critique that made newspapers across America on October 10, 1913. Hill became wealthy in the railroad industry, and was in frequent competition with the other industrialists of his time. He frequently and publically opposed government favors for industry. "Naturally," Hill said "the [Federal Reserve] board being a political instead of a financial body by the law of its constitution,



its seat is placed in Washington.”<sup>2</sup> Hill’s complaints were based on what he claimed was “political discrimination” against his industry, the railroads, and their exclusion from a bond issuance subsidy included in the currency reform bill that was currently being debated in congress. His motive of receiving government privilege does not draw much sympathy. However, this highlights just one of the potential controversies regarding centrally appropriated wealth.

Senator Nelson Aldrich, a leading political proponent of currency reform, proposed the first plan regarding banking and currency reform in January of 1911 entitled the Aldrich Plan.<sup>3</sup> Nelson Aldrich had close business and personal relationships with some of the most powerful – and unpopular – banking dynasties in the world. The marriage of his sister, Abby Greene Aldrich to John David Rockefeller Jr. on October 9<sup>th</sup>, 1901 would cement this relationship in the public eye.<sup>4</sup> Rockefeller Jr. was the son of oil tycoon J.D. Rockefeller of Standard Oil, whose reputation was less than stellar with the average middle class American by 1910. The unpopularity of the Rockefeller dynasty was shared by many other wealthy industrialists and bankers, including John Pierpont Morgan, Frank A. Vanderlip, and A. Piatt Andrew. This negative sentiment largely resulted from what the public saw as an active role in monopolizing vast amounts of wealth and therefore causing the credit contraction crises of 1897, and more recently 1907. The banker’s response to credit contraction, however, was of much greater importance to the future of currency reform in the United States.

There was much currency and banking legislation written and enacted between 1907 and 1913. This was in the midst of the Progressive Era, spanning the end of William Howard Taft’s presidency and the beginning of Woodrow Wilson’s years in office. Americans had Teddy Roosevelt fresh in their minds, and his rhetoric of trust busting was still deeply entrenched in the political arena. After the Panic of 1907, banking reform took center stage on the Progressive agenda.

## WHAT ABOUT 1907?

In January 1910, the *Morning Oregonian* printed an article entitled “The Big Six of Finance;

The Most Powerful Group in the World.”<sup>5</sup> According to this piece, the group, including J.P. Morgan of banking fame and John D. Rockefeller of Standard Oil, represented a combined 800 million dollars of net worth. During this period of national economic hardship following the panic of 1907, the public was outraged by so much wealth concentrated in so few hands. The author of the article quipped, “someone recently told Senator Aldrich, when he was advocating the creation of a great, central National Bank ‘We already have practically a central bank, it is the allied financial institutions controlled by the big six.’”<sup>6</sup> The sentiment here was not lost on the American people, and thus trust in large banking firms was declining. The causes and effects of the Panic of 1907 were important, but politics dictated the course. In grasping public opinion, the narrative presented by the media is of utmost importance. In politics, perception is everything.

In 19<sup>th</sup>-century America there were two primary, but opposing schools of economic thought. The “hard-money” advocates supported a solely gold or silver-backed currency, whereas “soft-money” advocates preferred bank notes backed by the government. The soft-money advocates had been winning the ideological war since the issuance of emergency currencies during the Civil War. Successive Panics in 1873, 1897, and 1907 resulted in a lack of political pressure to remove National bank charters, perhaps signaling the victory of fiat, or government backed, currency. The debate was no longer about the fundamentals of currency and banking. It was no longer whether Americans should have a central bank, or whether government should be involved, but *how* government was to be involved in said central bank.

The Panic of 1907, otherwise known as the “Knickerbocker Crisis,” was integral to the formation of the Federal Reserve. According to the contemporary mainstream press, the “Knickerbocker Crisis” was not vastly different from the panics of 1873 or 1897. In 1908, NYU economist Joseph French Johnson published an influential article in *Political Science Quarterly* that shaped mainstream opinion. In the article, “The Crisis and Panic of 1907” he described the events of 1907 and lobbied for a central bank. Johnson wrote, “that which will probably appear to historians the most important is the great increase in the gold supply with the resultant

2. “Hill Denounces Currency Bill as Socialistic,” *Boston Journal*, 10 Oct 1913, accessed 12 Oct 2012, America’s Historical Newspapers.

3. “No Central Bank, but a Federation, Is Aldrich Plan. His Reform is Sweeping Liberalization of Present,” *The Philadelphia Inquirer*, 17 Jan 1911.

4. “Rockefeller’s Bride Gets a Fortune in Wedding Gifts,” *Boston Morning Journal*, 10 Oct 1901.

5. “The Big Six of Finance; World’s Most Powerful Group,” *Morning Oregonian*, 16 Jan 1910.

6. “The Big Six of Finance; World’s Most Powerful Group,” *Morning Oregonian*, 16 Jan 1910.

rise of prices.”<sup>7</sup> While Johnson interpreted the increase in gold production as paramount, what has drawn the studies of historians was not the increase, but the subsequent contraction in the money supply and its effects in the United States.

Since the Civil War, government-chartered banks (known as National Banks) had been an increasingly important fixture of American economic life.<sup>8</sup> The method used by government banks to maintain the value of paper currency was to peg the value of the notes to the value of gold and silver, both of which had enjoyed a long history of relative price stability. Despite the relative price stability, gold production was frequently able to influence the price of gold and gold-backed currencies. According to Johnson, “the average price of commodities in gold-standard countries rose some forty percent” between 1897 and 1907, and “in the stock market the upward movement of prices during those ten years was even greater.”<sup>9</sup> The resultant rise in stock market prices reveals the relationship between gold production and gold-backed currencies. That is, some portion of the economic growth seen from 1897 to 1907 was attributable to increased market value of the economy, and some attributable to the increased supply of gold. It does not tell us how much growth was attributable to credit created out of thin air by bankers unsatisfied with their shrinking market shares.

Rising prices in the preceding decade as not in itself a direct cause of the Panic of 1907. Johnson wrote that, “it is very difficult to escape the conclusion that all this advance of prices and expansion of credit must in the main be attributed to the great increase in the world’s stock of gold.”<sup>10</sup> But where, then, did the credit come from, and what happened to it in 1907? There were several factors leading to the mass credit expansion, but without the system of government backed fractional reserve banking it could have never occurred.

Fractional reserve banking is the prevailing banking system in the modern world and has long been a subject of serious study. The primary characteristics of a fractional reserve system are the disproportionate “reserve requirements,” or capital requirements, in relation to liabilities that a bank may carry. An average reserve requirement as established by the government

could be, for example, ten percent. This means that a bank is required to carry only ten percent reserves (gold, silver, assets, etc) in relation to the amount of liabilities, loans, and any potential payouts. Reserve requirements in the United States were set at a five percent requirement by a standardization process through the issuance of National bank charters beginning in 1864.<sup>11</sup> Compliance with the reserve minimum and a multitude of other regulations were required to qualify for a National Member Bank Charter, which implied solvency and placated investor concerns. Accounting measures were slightly altered in 1874 and again in 1902 with congressional acts, but the reserve requirement hovered at the five-percent mark throughout the duration of the late nineteenth and early twentieth centuries.<sup>12</sup> This appears steady but when the exponential fractional reserve effect of increased credit is applied, the potential for mass expansion of credit is better understood.

By 1907 the price of gold had been rising for over a decade. This created the opportunity for unprecedented growth and investment of capital. As money made its way from large National banks, to smaller banks, and eventually to the investor, the sum created opportunities for the banks to extend credit in a ratio of twenty to one (five percent requirement minimum) at each step of the way. Once in the hands of the borrower, a particular sum of money had generated additional money available for other borrowers at a rate of ninety-five percent. In a fractional reserve system banks are encouraged by market and other forces to lend the maximum amount of money that they can maintain legally sufficient reserves for. This increases profit, as interest is the primary income source for all investment institutions. The more borrowing that occurs within an economy, the more plentiful the money supply becomes. An increase in the supply of money requires a corresponding decrease in the price of money, otherwise known as interest. This is an incentive to keep interest rates high and provides the only market force that checks the otherwise endless expansion of credit and inflation. If banks were not given government charters to legalize their system of fractional reserve banking, they would be subject to a reputation of solvency or insolvency in the market, and thus be incentivized to have a sufficient reserve to liability ratio. This was not the case in 1907.

Additional factors contributing to the

7. Joseph F. Johnson, “The Crisis and Panic of 1907,” *Political Science Quarterly* 23, no. 3 (1908): 455-67, accessed 19 Nov 2012, JSTOR.

8. Griffin, 12-14

9. Johnson, 455 – 467.

10. Johnson, 455 – 467.

11. Philip Cagan, “Determinants and Effects of Changes in the Stock of Money, 1875 – 1960,” (National Bureau of Economic Research, 1965), 151-233.

12. Cagan, 151 – 233.

mass expansion of credit included some very destructive developments. Johnson wrote, “what is much more significant is the fact that the absorption of capital during the last ten years in railroads, ...industrial plants, in subways and tunnels, ... [and in] South American enterprises, combined with *the positive destruction* of capital in three very costly wars...”<sup>13</sup> Referring to the Spanish American war of 1898, the Boer War of 1900, and the Russo-Japanese War of 1904 – 1905, Johnson termed these events “positive destruction.” The only positive he could have been referring to was the increased economic activity and credit expansion resulting from the *destruction* of capital during the wars. This had a negative immediate impact on net worth, but the credit expansions created as a result of massive expenditures helped to lower interest rates and therefore increase borrowing. So it can be concluded that the so called “positive destruction” of the decade preceding the panic was yet another contributing factor to the credit expansion experienced.

*After 1897 there was a considerable increase in the total of banking capital and surplus in the United States, but it was not proportionate to the immense expansion of banking liabilities*  
- J.F. Johnson

## EASY MONEY

Many twenty-first century economists agree on the significance of “positive destruction,” long-term modest investments in industry, the inflationary nature of the fractional reserve system, and an increase in the gold supply as precipitants leading to credit expansion. What is it about credit expansion, then, that leads to a panic? How can a more plentiful money supply be so potentially damaging to the economy? Answers to these questions can be found by looking at the Panic of 1907.

The “Knickerbocker Crisis” of 1907 was on its face nearly identical to the panics that had come to be expected. Its significance lies in the fact that it was the last major economic crisis before the creation of the Federal Reserve. The Panic of 1907 set the table for banking and currency reform in America. The crisis began in January of 1907 marked by a steady decline in stocks that lasted months.<sup>14</sup> When stocks decline across all sectors of industry, as was the case in the first quarter of 1907, it is necessarily caused in part by currency devaluation, or inflation. As Johnson noted, there had been heavy investment

in railroad and mining stocks, which had been barely scratching a profit even in the “boom” years of the preceding decade. The Hepburn Rate Bill that established government enforced cartel regulation on the industry was passed in 1906, but confidence was already shaky.<sup>15</sup> Due to the low rate of return, there was a decreasing rate of investment, and so the industrialists we mentioned earlier were struggling to raise capital. Johnson also wrote that, “during 1906, on account of needs that seemed imperative, railroads and other corporations had subjected the money market to intense strain by their issues of new stocks and bonds.” When stocks and bonds are issued against currency, either the value of the stock, or the value of the currency must correspondingly decrease if there is no value added to offset the increased nominal value. This contributed to an exhaustion of capital that made new investment more difficult.

With the currency artificially and arbitrarily allocated, demand for money outgrew the corresponding supply. This does not represent an over investment, but a misallocation of capital ushered in by the false prosperity signaled by the mass credit expansion. Again according to Johnson, “this meant that a more painful and probably longer period of liquidation was necessary...”<sup>16</sup> This period of liquidation is what we call a recession, or crisis. Investors trying to take advantage of the market conditions will always drive interest rates higher as the money supply becomes strained. The Knickerbocker Trust in New York City was rumored to be insolvent and the panic began.<sup>17</sup> When banks were subject to “bank runs”, prior to 1907 their only option has been to close their doors and declare “cash payment suspensions.” This created further panic and usually did not remain contained to one bank, but spread throughout the market. What set this particular panic apart from the rest was the response.

*To combat depression by a forced credit expansion is to attempt to cure the evil by the very means which brought it about; because we are suffering from a misdirection of production, we want to create further misdirection—a procedure which can only lead to a much more severe crisis as soon as the credit expansion comes to an end.*

- Friedrich August von Hayek

15. Johnson, 456.

16. Johnson, 462.

17. “Knickerbocker Trust Co. is Compelled to Suspend. Act Occurs after 8,000,000 Have Been Paid out to Depositors,” *Wilkes-Barre Times*, 22 Oct 1907, accessed 11 Oct 2012, America’s Historical Newspapers.

13. Johnson, 457.

14. Johnson, 455.



The exact details of the financial predicament that the Knickerbocker trust had gotten into are uncertain. As reported in newspapers in October 1907, the Knickerbocker trust had been borrowing money from the government at privileged interest rates for months, via Secretary of the Treasury Cortelyou.<sup>18</sup> What happened next has gone down in history as the time J.P. Morgan bailed out the U.S. Government. We have seen things were a bit more complicated, but the narrative presented by the press was simple. The news coverage can be summed up fairly by this headline of the Baltimore American Newspaper: "J.P. Morgan is In Command. Directs Campaign And Saves The Day. Millions Poured In... Rockefeller Will Help."<sup>19</sup> This was in effect a multi-million dollar public relations campaign.

In March 1908, the Senate took up discussion of the causes of the panic. Senator James P. Clarke identified the incredible credit expansion as key. He reminded the Senate that, "the Knickerbocker Trust Company, of New York, with a capital of only \$1,000,000, was able to make loans to the amount of \$50,000,000. So the proportion of capital to loans was not that of one to five, as the Senator from Rhode Island suggests, but was the relation of one to fifty."<sup>20</sup> There is no debating that the Knickerbocker trust was experiencing a crisis, whether truly solvent or not we will likely never know. The fundamental causes of the Panic we have been over, the immediate consequences were made public by the failure of the Knickerbocker trust, and the response would determine the course of United States monetary policy.

At first it is difficult to see how the Knickerbocker Trust Company and others like it managed to stay "solvent" for so long under such a fragile system, but throughout much of modern history, the ten percent reserve requirement has been almost always sufficient. According to economic historians G. Edward Griffin and John Klein, the Knickerbocker Trust Company experienced a "currency drain." In short, a currency drain occurs when a lending institution loans money disproportionately with its reserve, thus causing a disproportionate amount of required payments to other banks via

check payments.<sup>21</sup> The corresponding drain on the reserves of the initial bank then incites panic, and the remainder of the financial institutions and customers attempt to settle payment with the troubled institution, usually resulting in a cash payment suspension followed by a bankruptcy. According to Griffin, "the banks did not fail because the system was weak. The system failed because the banks were weak."<sup>22</sup>

Responding to the panic, Rockefeller stated publicly: "every man with the good of his country at heart should, by word and deed, lend a hand now to reestablish confidence, and I propose to do my part to the full extent of my resources."<sup>23</sup> Why were Rockefeller and Morgan willing to inject their own resources when Secretary of the Treasury Cortelyou was consistently affirming that he would continue to "assist...in every proper way legitimate business interests?"<sup>24</sup> The number of banks in the United States had been on the rise since the turn of the century, and by 1910 the amount had doubled to 20,000 banks, the majority of which were formed in the expanding West and South. By 1900, the number of non-federally chartered banks was over sixty percent. By 1913 the number of non-federally chartered banks was up to seventy one percent, holding a majority of the nation's reserves.<sup>25</sup> Morgan and Rockefeller both had financial interests located in New York, and this geographical decentralization of reserves was a threat to their market share.

The crisis created opportunity for this financial consortium. Bailing the banks out was a fail-safe venture. The hard money advocates in the political arena of the United States had long since lost the war, and the public had all but resigned to the "complicated" economic policies of government planning. There was little to no influence of sound money economists on how to handle a fiat currency crisis, as could be expected. When the currency drain was in full force, we saw that Morgan and others loaned massive amounts of money to banks that were in less than perfect condition.<sup>26</sup> These men were no slouches when it came to the world of business, as their fortunes would attest, and they could not have suspected the Knickerbocker Trust to repay the funds in a timely manner if

18. "Rich Concern Goes to Wall in Panic. Knickerbocker Trust Company Closes Doors," *Albuquerque Morning Journal*, 23 Oct 1907, accessed 21 Oct 2012, America's Historical Newspapers.

19. "J.P. Morgan In Command," *Baltimore American*, 24 Oct 1907, accessed 11 Oct 2012, America's Historical Newspapers.

20. Knickerbocker Trust Co. is Compelled to Suspend," *Wilkes-Barre Times*.

21. Griffin, 14.

22. Griffin, 15.

23. "J.P. Morgan In Command," *Baltimore American*.

24. "J.P. Morgan In Command," *Baltimore American*.

25. Griffin, 13-14.

26. "Rich Concern Goes to Wall in Panic," *Albuquerque Morning Journal*.

they were to survive at all. Morgan and others could simply have let the bank fail and relied upon the Treasury of the United States, but that would have been a missed opportunity. Not only did they receive many praises in the public sphere for their “generosity”, but they obtained a large chunk of the market share in the process. The official death of the Knickerbocker Trust went largely unnoticed in the national press, but was noted in the hometown newspaper of C.T. Barney of Tucson, Arizona, former head of the Knickerbocker Trust Company. “Former Banker Deposed From Position, Ends Life,” noted the paper.

To quote Johnson again: “the October panic made perfectly clear two great banking needs: (1) an elastic currency; (2) financial solidarity.”<sup>27</sup> He explains elasticity in currency as banks having the legal right to “utilize their credit as common medium of exchange” as opposed to having to package and sell their debt to investors, he insists banks should be able to sell debt to themselves and lend it again.

Economist Arthur Reynolds penned a report for the Academy of Political Science in New York in October 1913, entitled “The Centralization of Banking and Mobilization of Reserves,” that encouraged reform towards central banking, in America. As part of the campaign to soften public opinion on central banking Reynolds simply redefined it to leave room only for benevolent disinterested public servants, he wrote:

*The mere formation of an institution with immense capital and authority to hold the reserves will accomplish centralization and concentration. In a way, indeed, we have this in our present system; but instead of considering it a benefit, we complain of it as an abuse and a disturbing factor. This suggests the error in present popular conceptions relative to a central bank. The people regard the main feature of such an institution as purely centralization and therefore they fear its power, whereas, when properly organized and administered, its main feature is responsibility and disinterested public service. This fact is clearly shown by experience in other countries extending over a long term of years.*<sup>28</sup>

But, proponents of a central bank found it difficult to agree on what such a bank would look like. Writing on the first edition of the Aldrich

Banking Plan, E.D. Hulbert of the University of Chicago argued that, “the adoption of such a plan would lead almost immediately to unexampled prosperity and business activity I have no doubt, but would not be the kind of dangerous prosperity and activity that always follows a period of inflation?”<sup>29</sup> Hulbert warned of a period of malinvestments resulting from inflation that had contributed to so many crises, including the most recent panic in 1907. Hulbert continued, “when the plan was first published, many leading bankers who are now supporting it, said there should be some safeguard against the expansion of credit. If on further study of the plan they have found some safeguard that was first overlooked, they should give the rest of us, who are unable to find it; the benefit of their discoveries.”<sup>30</sup> This is a valid point, and it was made frequently by critics of central banking, but not the most important takeaway from the debate over currency and banking reform. In the midst of his scathing and irreconcilable criticisms of the inflationary tendencies of central banks around the world, he interjected a qualifying statement that captures the framework of the debate. “That there should be a plan, however, to enable banks to use their credit when the necessity for it arises is admitted by everybody. The idea embodied in the Aldrich plan of combining all the banks into local associations is ideal, and so clearly in the line of development that it ought to be adopted whether the plan as a whole is adopted or not.”<sup>31</sup> That even the fiercest of critics viewed the “easy money” strategies employed by Morgan and others as the only way to manage a fractional reserve system makes clear that central banking was winning the ideological war, and soon it would win the political struggle as well.

## STRATEGY OF REFORM

The decentralization of financial reserves in America went largely unnoticed by the general public and was accompanied by a period of financial growth that helped the largest industries maintain their unprecedented levels of growth. When Johnson referred to financial solidarity, he was referring to a centralization of reserves. He explained the need for currency elasticity, saying it would ease interest rates in times of uneasy credit. It is this point of the Aldrich banking plan, and later of the Glass – Owen Bill, that makes currency manipulation and interest rate suppression remotely possible, creating

29. E.D. Hulbert, “Some Points in Opposition to the Aldrich Plan,” *Journal of Political Economy* 20, no. 1 (1912): 25-32.

30. Hulbert, 27.

31. Hulbert, 29.

27. Johnson, 465

28. Arthur Reynolds, “Banking and Currency in the United States,” *Proceedings of the Academy of Political Science in the City of New York* 4, no. 1 (1913): 118 - 126.

what is unmistakably a cartel arrangement between banks. It is no stretch of the imagination to perceive as a threat the centralization of such vast wealth under the direction of a few powerful bankers. These fears would have to be allayed in order to gain popular support for cartelization, albeit under a different name.

Senator Nelson Aldrich appeared with Assistant Secretary of the Treasury A. Piatt Andrew at the American Academy of Political and Social Science in Philadelphia on December 8, 1910, to introduce their plan to the public. They each gave remarks on "The Need for Currency Reform." Aldrich noted, "my studies have led me to believe that this question of reorganization of credit is...of immediate importance."<sup>32</sup> He softened the blow of advocating for centralization of reserves by referring to "credit" because in a fractional reserve system, they are indistinguishable. Aldrich continued to make one of the more superficial arguments in favor of centralization put forth by the reformers. He said, "elsewhere reserves are concentrated and used in any direction needed, and the resources of all are available for any...No system in any country has a system as antiquated as...the United States"<sup>33</sup>

A. Piatt Andrew joined Aldrich in his condemnation of the current system, and in praise of European central banks. Americans were told at the time, in Andrew's speech and countless other commentaries on the subject, that European central banks were not just necessary, but desirable. Economist E.D. Hulbert summed up the financial conditions of the great European banks with a more skeptical eye and convincing statistics:

*Since the Imperial Bank has been in operation Germany has enjoyed an era of industrial expansion and prosperity unequalled in history. For some years past, however, symptoms of overexpansion have grown more and more acute. Instead of recovering rapidly from the crisis of 1907, the situation there has been getting more and more out of hand, until today, with a world-wide condition of ease in money, the Imperial Bank of Germany is apparently unable to cope with the situation. Both the German government and the great German banks are borrowing immense sums of money at high rates from the despised American banks, and the Ger-*

*man banks have been obliged to announce a partial suspension of payment at the times of quarterly settlement. Those who have been allured by the vision of cheap money in the Aldrich plan should consider carefully the fact that our banks are today loaning money to the great German banks at rates which are higher than they are charging at home to ordinary commercial customers. Statistics show that for the past ten years interest rates in Germany have averaged higher than in either France or England, and that financial operations have been conducted there with greater difficulty in times of trouble.*

*- E.D. Hulbert<sup>34</sup>*

Hulbert shared an inconvenient truth in his report, that the European central banks were not immune to such a crisis, but it went largely unanswered. Johnson, by contrast, provided an alternative and more appealing description of centralized reserves in his commentary, writing that the system, "on account of its immense reserve of gold, its note-issuing power and its prestige as a government institution, it would seem an indestructible bulwark of finance, an unassailable guardian of solvency."<sup>35</sup>

Besides the obvious advantages to cartelized bankers of having amassed reserves under centralized control, there was yet more to be gained by this centralization. We saw that the Panic of 1907 was exacerbated by a loss of confidence in the bank's ability to meet its liabilities, thus resulting in a currency drain. Economic historian G. Edward Griffin wrote, "if all banks could be forced to issue loans in the same ratio to their reserves as other banks did, then, regardless of how small that ratio was, the amount of checks to be cleared would balance in the long run. No major currency drains would ever occur."<sup>36</sup> The simplest way to require all banks to issue loans in the same ratio is to centralize and control the majority of reserves and have federal enforcement of cartel regulations. Griffin calls this a "Bankers Utopia."<sup>37</sup> That, in a nutshell, is the Federal Reserve.

## HOW DID THIS MOVEMENT RESULT IN THE FED?

The process started with a duck-hunting trip to Jekyll Island, Georgia in November 1910. It was a secret meeting, not wholly confirmed to the public until Paul Warburg revealed that he had indeed been present, in his 1930 publication

32. L.S. Rowe, N. Aldrich, T. Burton, A.P. Andrew, and G. Roberts, "The Need for Currency Reform," *Annals of the American Academy of Political and Social Science* (1911): 1, 3-32.

33. Rowe, Aldrich, and Burton, "The Need for Currency Reform," 1, 3-32.

34. Hulbert, "Some Points in Opposition," 29-30.

35. Johnson, "The Crisis and Panic of 1907," 467.

36. Griffin, 15.

37. Griffin, 15.



*The Federal Reserve System, Its Origin and Growth*.<sup>38</sup> Paul Warburg was a German-born immigrant to the United States and an investment partner with Kuhn, Loeb & Company. He was most widely known as the brother of Max Warburg, who, according to Griffin, represented the Rothschild Banking Dynasty in Germany and the Netherlands. In *The Federal Reserve System*, Warburg wrote, “the results of the conference were entirely confidential. Even the fact there had been a meeting was not permitted to become public...Though eighteen years have since gone by, I do not feel free to give a description of this most interesting conference concerning which Senator Aldrich pledged all participants to secrecy.” Warburg’s testimony was confirmed by Frank Vanderlip’s writing in the *Saturday Evening Post* February 9, 1935. Vanderlip, Acting President of the New York branch of National City Bank, represented the investment interests of the Rockefeller dynasty wrote a similar account, explaining, “there was an occasion, near the close of 1910, when I was as secretive – indeed as furtive – as any conspirator...I do not feel it is any exaggeration to speak of our secret expedition to Jekyll Island as the occasion of the actual conception of what eventually became the Federal Reserve System...”<sup>39</sup> Senator Aldrich’s biographer Nathaniel Wright Stephenson also confirmed much of this story, giving lie to the “duck hunt”: “Mr. Warburg...gives an amusing account of his feelings when he boarded a private car in Jersey City, bringing with him all the accoutrements of a duck shooter. The joke was in the fact that he had never shot a duck in his life, and had no intention of shooting any...”<sup>40</sup> Again in an effort for secrecy, according to Vanderlip’s article in 1935: “we were told to leave our last names behind us. We were told further, that we should avoid dining together on the night of our departure.” If the necessity for all this secrecy was in doubt, let us only examine Vanderlip’s closing argument. He stated, “if it were to be exposed publicly that our particular group had got together and written a banking bill, that bill would have no chance whatever of passage by Congress.”<sup>40</sup>

The reason for all the secrecy is made clear by the reports of the National Monetary Commission. The National Monetary Commission was established in response to the Panic of 1907 by the Aldrich-Vreeland law, which was passed in 1908. University of Northern Iowa

Economist and future co-sponsor of the Federal Reserve bill Robert Owen wrote in 1913 an article titled, “The Origin, Plan, and Purpose of the Currency Bill” featured in *The North American Review*. He refers to the National Monetary Commission as a subcommittee intended to, “study the financial system of the United States and ascertain what remedy is necessary to make it serve its high and proper purpose.”<sup>41</sup> The Aldrich-Vreeland law also made legal the issuance of emergency currency for use in time of panics. It was admittedly a temporary measure to be of use until further reform could be agreed upon. Even as temporary measure however, it was not unanimously supported in congress. Senator Robert LaFollette argued in a filibuster speech, “the Aldrich bill would only serve to strengthen this great money power of Wall Street.”<sup>42</sup> In this speech, LaFollette argued against the concentration of wealth in the United States. Referring to his prior assertion that American industry was controlled by only one hundred men, LaFollette warned that he had been “too conservative and in fact a much smaller number of men dominate industry.” The first two men on this list were of course J.P. Morgan and J.D. Rockefeller, and regarding the perceived frosty, competitive relationship between the two, LaFollette said, “the old fights between these two great powers have been put aside. Mr. Morgan’s picture adorns the wall of the inner room of the Rockefellers at 28 Broadway.” It was clear that Senator LaFollette did not feel that the proposed National Monetary Commission was to be of much benefit, perhaps because the chairman was to be Senator Nelson Aldrich, a friend of the banks.

In the meantime, the National Monetary Commission established a subcommittee with the mandate to determine if a “money trust” existed in the United States. The majority report authored by Louisiana Congressman and Committee Chair Arsène Pujo reported the following:

*If, therefore, by a ‘money trust’ you mean ‘an established and well-defined identity and community of interest between a few leaders of finance which has been created and held together through stockholdings and interlocking directorates and other forms of domination over banks, trust companies, railroads, public services, and industrial cor-*

38. Paul M. Warburg, *The Federal Reserve System, Its Origin and Growth* (New York: Macmillan, 1920).

39. Griffin, 9.

40. Griffin, 9.

41. Robert L. Owens, “The Origin, Plan, and Purpose of the Currency Bill,” *The North American Review* 198, no. 695 (1913): 556-569.

42. “Morgan’s Picture Adorns John Rockefeller’s Wall,” *Macon Telegraph*, 25 Mar 1908, accessed 1 Dec 2012, America’s Historical Newspapers.

porations and which has resulted in a vast and growing concentration of the control of money and credit in the hands relatively few men...your committee...has no hesitation asserting as the result of its investigation up to this time that the conditions thus described exists in this country today.<sup>43</sup>

Congressman Pujo's unequivocal belief that such as money trust did exist was featured prominently in the papers of the day. Headlines from March 1, 1913, were equally unequivocal: "Money Trust Does Exist, and Should be Curbed."<sup>44</sup> Similarly featured in *The Cleveland Gazette* a headline read "Money Trust Brandies Says Three Banks Control Large Sum."<sup>45</sup> Also featured in Pujo's majority report is a list of the "most active agents in bringing about the concentration of money and credit." The report lists "J.P. Morgan and Co., First National and National City Banks, Kuhn, Loeb and Company out of New York..." This makes it clear why Paul Warburg was so sure that public knowledge of the Jekyll Island 'conference' would be so disastrous. The Money Trust itself had written the banking reform legislation that was meant to curtail the aggressive strategies that they employed.

There were six men who participated in drafting the Federal Reserve System at Jekyll Island in November of 1910.<sup>46</sup> Senator Nelson Aldrich was of course there, as was Frank Vanderlip. Vanderlip was President of National City Bank in New York, and thus represented the investment interests of the Rockefellers. Abraham Piatt Andrew Assistant Secretary of the Treasury at the time, was also present at Jekyll Island, as were Henry Davidson and Benjamin Strong, both representatives of the J.P. Morgan dynasty. Strong would later serve as the first chairman of the Federal Reserve. Paul Warburg was also present, representative of German and Dutch investors and the well-known Rothschild banking dynasty in Europe. The group featured some of the most influential

43. US Congress. House. Committee on Banking and Currency. Money trust investigation. Investigation of financial and monetary conditions in the United States under House resolutions nos. 429 and 504, before a subcommittee of the Committee on Banking and Currency. Washington, Govt. Print. Off., 1913.

44. "Money Trust Does Exist, and Should Be Curbed," *Montgomery Advertiser*, 1 Mar 1913, accessed 10 Oct 2012, America's Historical Newspapers; "Discusses the 'Money Trust.' Brandies Says Three Banks Control Large Sum," *Cleveland Gazette*, 29 Nov 1913, accessed 10 Oct 2012, America's Historical Newspapers.

45. "Discusses Money Trust Brandies Says Three Banks Control Large Sum." *Cleveland Gazette* 29 Nov. 1913 *America's Historical Newspaper* Web. 10 Oct. 2012

46. Griffin, 5.

financial empires of the day, so perhaps it is no surprise that the Aldrich plan was one of centralization and institutionalization. The Aldrich plan contains all necessary legal measures to eliminate competition between banking, and thus eliminate panics caused by credit contraction. There were still no checks for credit expansion in the Aldrich plan or the subsequent Federal Reserve System.

## THE REST IS HISTORY

Congressman Charles Lindbergh, an American luminary in his own right, was a fierce opponent of centralized currency reform, and no fan of Senator Aldrich. On the floor of Congress he accused that, "Wall Street brought on the 1907 panic, got the people to demand currency reform, brought the Aldrich-Vreeland currency bill forward, and if it dares will produce another panic in order to pass the Aldrich central bank plan."<sup>47</sup> Lindbergh was a fierce opponent of centralized currency reform, and no fan of Senator Aldrich. In the same report to congress he declared it "a broad challenge to the government by the champion of the money trust. It means another panic, if necessary to intimidate the people. Aldrich, paid by the government to represent the people, proposes a plan for the trusts instead." Lindbergh was one of the few legislators to maintain this view, and he incited a storm of criticism. Senator Elihu Root was a Democrat from New York who joined Lindbergh in criticizing the Aldrich plan. In testimony on the senate floor, Senator Root said, "without statutory limitation on the issuance of the proposed new currency, it could bring about an inflation of credit that would result in a dreadful financial catastrophe."

In 1912 Senator Nelson Aldrich was voted out of office, and Progressive Democrat Woodrow Wilson was elected president. Although Wilson's election officially killed the Aldrich banking plan, the push for banking reform was still in full force. One critic of the Aldrich plan, Senator Carter Glass, gave a speech entitled "Opposition to the Federal Reserve Plan." His criticisms included this outline of what he considered the three most critical problems of the Aldrich plan:

*first, that the bill confers dangerously autocratic powers upon the Federal Reserve Board, an alleged political board, and that the banks should be given direct representation upon this board; second, that it*

47. "Lindbergh Files Minority Report," *Duluth News Tribune*, 7 Sept 1913, accessed 20 Oct 2012, America's Historical Newspapers.

*is unjust and confiscatory to require national banks to join the system on penalty of forfeiting their national charters if they fail to do so; third, that it is unreasonable and contrary to the best banking practice to deny to banks joining a regional reserve bank the privilege of counting deposits with reserve agents as lawful reserve money.*<sup>48</sup>

Senator Glass subsequently became primary sponsor of the Glass-Owen Bill, which passed into law December 23, 1913, creating the Federal Reserve System. There were few differences between the Aldrich plan and the Glass-Owen bill. Paul Warburg wrote that, “brushing aside then, the external differences affecting the ‘shells,’ we find the ‘kernels’ of the two systems very closely resembling and related to one another.”<sup>49</sup> Economic historian G. Edward Griffin fundamentally agreed with this assessment. The Glass-Owen bill was, he wrote, “in every important detail... merely the old corpse of the Aldrich Bill pulled from its casket, freshly perfumed, and dressed in a new suit.”<sup>50</sup>

There was a combination of factors that resulted in the creation of the Federal Reserve System, the most important of which included the Panic of 1907 and the subsequent cornering of the reserves by J.P. Morgan and Company. Followed by a congressional subcommittee that was chaired by Senator Nelson Aldrich, whose connections introduced a conflict of interest at best. Congressman Lindbergh and others rejected legislation that would only further the interests of the “Money Trust”, but they were unsuccessful. A piece of legislation was written by a small group of the world’s wealthiest men in secret for the purpose of gaining further control over the finances of a nation by creating a pure cartel. This “lender of last resort” has enabled over 16 trillion dollars in debt by the very government that established it.

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48. Carter Glass, “The Opposition to the Federal Reserve Bank Bill,” *Proceedings of the Academy of Political Science in the City of New York* 4, no. 1 (1913): 12-19.

49. Warburg, *The Federal Reserve System*, 10.

50. Griffin, 14.