Book Review: America's Bank: The Epic Struggle to Create the Federal Reserve

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By Roger Lowenstein
Watershed events in public policy are often reduced to a few paragraphs or pages. Such treatments necessarily focus on social movements, the actions of political parties or voting blocks, and major economic events. The policy changes thus gain an air of inevitability in terms of their occurrence, timing, and final shape.

It’s the usual treatment given to the founding of the Federal Reserve System in 1913. But the Federal Reserve was not inevitable, nor were its decentralized structure and governance details. Creation of the Fed is typically clustered with other legislative actions and tagged “Progressive Era reforms,” representing “progress” in the US banking system, though leading lights of Progressivism might disagree with that designation.

Roger Lowenstein’s America’s Bank: The Epic Struggle to Create the Federal Reserve is an outstanding book on the founding of the Fed, accessible to the lay reader and satisfying to the expert. Focusing on the primary actors in bringing the Fed into being and on the period of 1907 to 1914, Lowenstein dispels the air of inevitability surrounding the Fed and its structure. The book’s great contributions come from examining the individuals involved and through mining primary materials such as letters, diaries, memoirs, early versions of the Fed proposal, and the records of congressional hearings.

Among the notable figures in the book are Nelson Aldrich, the US senator who guided the proposal during 1908–1912, and Paul Warburg, a German-born banker who generated many of the ideas that, diluted and modified, form the basis of today’s Federal Reserve Act. Other important figures in the book include Frank Vanderlip, JP Morgan, Carter Glass, and Woodrow Wilson. By focusing on individuals and their actions rather than on social movements, Lowenstein is able to answer many questions about the founding of the Fed.

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The Panic of 1907 did start a process that ended with the creation of the Fed, but the Aldrich–Vreeland Act of 1908 was the immediate policy response. It took 6 years from the October 1907 Panic for the Federal Reserve Act to pass and 7 years to establish the Reserve Banks. Lowenstein demonstrates that key figures found the Panic of 1907 especially frightening because of its small beginnings and subsequent depth and breadth. Within weeks of the failure of a single New York bank, clearing houses in more than 250 cities around the US had suspended or restricted cash withdrawals from checking accounts, and many clearing houses had issued “scrip” as substitutes because cash supplies were unavailable.

Lowenstein demonstrates that figures such as Aldrich, Warburg, and Vanderlip exploited the reform opportunity of the Panic and began the march toward a US central bank, the first since 1836. There had been strong reform sentiment among bankers from large and small banks since the 1880s, but this sentiment hadn’t gained traction in Congress. Large New York-based banks were more sympathetic with Paul Warburg’s early proposal, modeled on the centralized, mostly-banker run models then in place in Europe. Banks outside of New York, especially small-town banks, did not view the New York banks as their natural allies. However, Aldrich was able to gain support from these disparate bank groups. This behind-the-scenes coalition building was much like the United States’ recent experience in which long-time supporters of more coherent consumer protection in banking took advantage of the Panic of 2008 and its aftermath to embed the Consumer Financial Protection Bureau into the Dodd–Frank Wall Street Reform and Consumer Protection Act.

The final version of the Federal Reserve Act was similar to the bank-led Aldrich Plan in terms of the Fed’s structure. Lowenstein shows that the group around Nelson Aldrich, and Aldrich himself, was very aware of the political forces around banking and bank regulation in the United States, as well as the constraints American political culture and geography imposed on any design. The Aldrich Plan envisioned many offices across the US—semi-autonomous in some respects, including their clearinghouse (check) and cash distribution activities and, possibly, discount window lending—all reporting to a central office and a largely banker-led governance structure.

As the Aldrich Plan moved into Congress, a governance structure of bankers-only quickly transformed into one with bankers, other community and business leaders, and the federal government. The core group involved in the Jekyll Island conference, where the Aldrich Plan was drafted, was sympathetic to this change; members understood political realities and the need for compromise to create a central bank. A regional structure with many branches was changed into a regional structure with 12 semi-autonomous Reserve Banks.

An almost complete version of what became the Federal Reserve Act was thus in shape in 1912, waiting for the right moment in Congress. With Woodrow Wilson’s gaining the presidency, the stage was set. Lowenstein shows that Wilson was not a typical Democrat of his day, but a closet Hamiltonian, believing Andrew Jackson’s destruction of the previous US
central bank in the 1830s was bad policy. But having secret sympathy for a central bank was not enough to overcome opposition in Congress, mostly from Wilson’s own Democrats.

Yet Wilson was masterful, convincing influential congressional leaders and his own secretary of state, William Jennings Bryan, to support the bill. Bryan was especially turned to support by Wilson’s adding a capstone to the structure, the Board of Governors.

America’s Bank is an important read for Federal Reserve staff, for bankers, and for the general public. It helps the reader understand the political reasons for our central bank and its 13 separate legal entities, the 12 Reserve Banks and the Board, and provides perspective regarding how the Fed makes policy and business decisions. The process from the Panic of 1907 to passage of the Federal Reserve Act is peppered with compromises and negotiations by leaders who understood the value of such approaches, even if the final outcome wasn’t precisely what they had in mind. This is the lesson of most landmark bills that have made their way through Congress over the last 250 years—and it’s a lesson Washington-watchers should keep in mind.

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Meet the Author
Daniel A. Littman
Policy Advisor
Dan Littman’s work focuses on applied research on payment systems and payment innovations.

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Headlines

Custom Comparison Groups in the Integrated Postsecondary Education Data System
Peter L. Hinrichs
This Economic Commentary studies the behavior of colleges when they are asked to list a set of comparison group colleges in annual data reporting for the US Department of Education but are given little direction on how to do so. I find that, relative to themselves, colleges tend to list for comparison colleges that are more selective, are larger, and have better resources. One possible interpretation of these findings is that colleges overestimate where they stand relative to others, although an alternative interpretation is that colleges have accurate views but list comparison institutions based on aspirations.

What Is Behind the Persistence of the Racial Wealth Gap?
Dionissi Aliprantis | Daniel R. Carroll
Most studies of the persistent gap in wealth between whites and blacks have investigated the large gap in income earned by the two groups. Those studies generally concluded that the wealth gap was “too big” to be explained by differences in income. We study the issue using a different approach, capturing the dynamics of wealth accumulation over time. We find that the income gap is the primary driver behind the wealth gap and that it is large enough to explain the persistent difference in wealth accumulation. The key policy implication of our work is that policies designed to speed the closing of the racial wealth gap would do well to focus on closing the racial income gap.

Why We All Should Care about Lead
Treye Johnson
Though the need to remediate lead seems to be a public health issue with a housing-based solution, the impacts of this crisis are far-reaching. Lead poisoning impacts all of us. The more people and organizations see themselves as part of the solution, the more likely we’ll find success.

Upcoming Events

Inflation: Drivers and Dynamics Conference 2019
The economic conference will provide researchers from academia and central banks an opportunity to exchange new ideas on modeling inflation and inflation expectations and their relationship to the macroeconomy.

Policy Summit 2019: Connecting People & Places to Opportunity
Offering the latest research on and best practices for promoting the economic mobility and resilience of low- and moderate-income individuals, families, and communities.