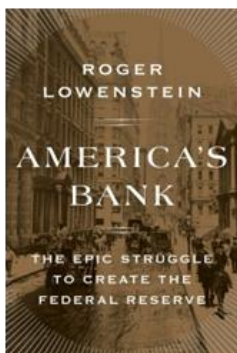




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America's Bank: The Epic Struggle to Create the Federal Reserve Lawrence Goodman Interviews Roger Lowenstein¹ October 27, 2015



The Center for Financial Stability (CFS) thanks Roger Lowenstein for ***America's Bank: The Epic Struggle to Create the Federal Reserve***. ***America's Bank*** is a gift for anyone interested in understanding the nuances and struggles behind the creation of the Federal Reserve. The book is extraordinarily well researched. Strong personalities of individuals central to forming the Fed come to life.

Perhaps, of greatest importance, ***America's Bank*** highlights lessons for today's Fed stretching from governance to the size of the institution relative to the economy.

We are grateful to Roger Lowenstein for sitting down with Lawrence Goodman² and CFS friends. The following are excerpts from the conversation.

Q. Roger, what was your motivation for writing America's Bank?

I thought the history of the period—in particular, the extreme reluctance of Americans in the early 1900s to accept a central bank—would illuminate the present day, and the controversies surrounding the Fed today. I also thought the history itself, and the characters of that earlier time, would make a fascinating study.

Q. How did you learn so much about the characters? Where did you find such detailed stories and quotes?

Most of the major characters—Carter Glass, Paul Warburg, Nelson W. Aldrich, various bankers of the era, and others—left collections of letters; these collections are housed at major university libraries (and in some cases at the Library of Congress) and are available to researchers. The letters of Woodrow Wilson are published. In addition, many of the characters wrote memoirs or accounts of their role in the making of the Fed.

Q. Senator Aldrich – under the auspices of the National Monetary Commission – spent a tremendous amount of time visiting and studying central banks in Europe. Which lessons were most important? Did the founders try to emulate a specific bank or create a uniquely American institution?

¹ Roger Lowenstein reported for *The Wall Street Journal* for more than a decade. His work has appeared in *The Wall Street Journal*, *Bloomberg*, *The New York Review of Books*, *Fortune*, *The New York Times Magazine*, and other publications. His books include *Buffett*, *When Genius Failed*, *Origins of the Crash*, *While America Aged*, and *The End of Wall Street*.

² With thanks to John Feldmann and Kurt Schuler.



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Aldrich truly went to Europe, I believe, with an open mind. The most important lesson he learned—one that Paul Warburg had been trying to persuade him of—was the value of a central reserve, which could act as a sort of insurance policy for the larger community. He discovered that thanks to the existence of a central banking reserve in each of the countries he visited, individual banks could lend more freely, without having to guard their reserves in their vaults.

I don't think Aldrich wanted to copy the French or the German bank or the English central bank per se; his aim was to replicate important features from any of them, and adapt them to American soil.

Q. The National Monetary Commission studied the Canadian system, which suffered no nationwide banking panic after 1837. Why didn't the Canadian system gain more traction in the US?

Well, Warburg, a German, was focused on Europe, and Aldrich had made a habit (before the Monetary Commission) of traveling to Europe, and he was oriented in that direction as well. Also, Wall Street was very responsive to—in some ways it was the financial stepchild of—the Bank of England. So the reformers looked to England and to Europe. They were actively hoping to compete with Europe, that is, they wanted the US to assume some of the leadership in international finance enjoyed by Europe. So while you're correct that Canada (and also Japan, and also other countries) were studied, Europe was the model they were thinking about.

Q. Paul Warburg seemed to have the most comprehensive forward looking view of a central bank in the United States. In your research, did you encounter ideas from Warburg that the Fed's primary role would ultimately be striving to reach maximum employment and stable prices via setting interest rates?

He certainly was aware that the Fed (and before it, his planned National Reserve Association in the Aldrich Plan) would be responsible for adjusting discount (interest) rates. But that wasn't, to use your phrase, what he envisioned as the Fed's "primary role." Its primary role, as he saw it, would be discounting bank loans in return for Fed. Reserve notes—that is, substituting central bank credit for the credit of individual banks. He certainly did not anticipate that the Fed would manage its policy to achieve "maximum employment" (the phrase, then, did not even exist). More loosely, though, he thought a central reserve would lead to more freely flowing credit, certainly a boon to economic output and to employment.

Q. As the founders contemplated the formation of the Federal Reserve, was there any discussion regarding the possible size of the institution relative to the economy? Certainly, some of the founders were aware of future risks. For instance, Frank Vanderlip commented that the "law is full of indirect and implied powers" during the week of passage. How would this compare with Chairman Bernanke's recent statement that there is "no logical limit to the size of the balance sheet"?

Bernanke's statement would have shocked them. The founders envisioned two discrete checks on the Fed's power to lend. One was the gold standard. The Act mandated a 40% reserve, that is, Reserve Banks had to keep gold equal to 40% of notes in circulation. Also, the Act stipulated that only certain types of credit could be exchanged for reserve notes, basically according to the "real bills" approach. In their view, money growth would be limited by the level of "real" (as opposed to speculative) activity in the economy.



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Q. Warburg was heavily influenced by the Reichsbank, which was managed by “trained professionals.” What sort of trained professionals did Warburg contemplate to run the Fed?

He wanted bankers such as himself, or commercial bankers such as Frank Vanderlip, who ran National City. He was avidly opposed to political appointees on the Reserve Board—which is what President Wilson decided upon—because he thought it would lead to politicized monetary policy.

Q. America’s Bank nicely highlights how trusts in 1907 were akin to shadow banks in 2007. Are their lessons for regulating shadow banking activities today?

I think it’s the familiar lesson that speculative or risky activity will morph to the *least*-regulated corner of finance. Therefore, as important as it is to monitor regulation in well-regulated sectors such as commercial banks, assessing regulation in lesser-regulated spheres may be even more important.

Q. What did you learn from research and writing the book that was unexpected?

I was amazed at the extent of the parallels between the period I wrote about and today—heavy eras of growth and financial innovation (and risk-taking) in each period, shadowed by rising economic equality, then followed by financial collapses and banking panics, and followed in turn by popular loathing for bankers, and by efforts at reform, some well-intentioned and some frankly demagogic. And in each period the divisions were both partisan and geographic—people from the west and south, in particular, were (and are) highly suspicious of both Washington and of New York bankers. This made it extremely difficult to assemble a national consensus in favor of a central bank in 1913, and the Fed is confronting a similar lack of public trust today.

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