



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

By Roger Lowenstein



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A tour de force of historical reportage, *America's Bank* illuminates the tumultuous era and remarkable personalities that spurred the unlikely birth of America's modern central bank, the Federal Reserve. Today, the Fed is the bedrock of the financial landscape, yet the fight to create it was so protracted and divisive that it seems a small miracle that it was ever established.

For nearly a century, America, alone among developed nations, refused to consider any central or organizing agency in its financial system. Americans' mistrust of big government and of big banks—a legacy of the country's Jeffersonian, small-government traditions—was so widespread that modernizing reform was deemed impossible. Each bank was left to stand on its own, with no central reserve or lender of last resort. The real-world consequences of this chaotic and provincial system were frequent financial panics, bank runs, money shortages, and depressions. By the first decade of the twentieth century, it had become plain that the outmoded banking system was ill equipped to finance America's burgeoning industry. But political will for reform was lacking. It took an economic meltdown, a high-level tour of Europe, and—improbably—a conspiratorial effort by vilified captains of Wall Street to overcome popular resistance. Finally, in 1913, Congress conceived a federalist and quintessentially American solution to the conflict that had divided bankers, farmers, populists, and ordinary Americans, and enacted the landmark Federal Reserve Act.

Roger Lowenstein—acclaimed financial journalist and bestselling author of *When Genius Failed* and *The End of Wall Street*—tells the drama-laden story of how America created the Federal Reserve, thereby taking its first steps onto the world stage as a global financial power. *America's Bank* showcases Lowenstein at his very finest: illuminating complex financial and political issues with striking clarity, infusing the debates of our past with all the gripping immediacy of today, and painting unforgettable portraits of Gilded Age bankers, presidents, and politicians.

Lowenstein focuses on the four men at the heart of the struggle to create the Federal Reserve. These were Paul Warburg, a refined, German-born financier, recently relocated to New York, who was horrified by the primitive condition of America's finances; Rhode Island's Nelson W. Aldrich, the reigning power

broker in the U.S. Senate and an archetypal Gilded Age legislator; Carter Glass, the ambitious, if then little-known, Virginia congressman who chaired the House Banking Committee at a crucial moment of political transition; and President Woodrow Wilson, the academician-turned-progressive-politician who forced Glass to reconcile his deep-seated differences with bankers and accept the principle (anathema to southern Democrats) of federal control. Weaving together a raucous era in American politics with a storied financial crisis and intrigue at the highest levels of Washington and Wall Street, Lowenstein brings the beginnings of one of the country's most crucial institutions to vivid and unforgettable life. Readers of this gripping historical narrative will wonder whether they're reading about one hundred years ago or the still-seething conflicts that mark our discussions of banking and politics today.

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## America's Bank: The Epic Struggle to Create the Federal Reserve By Roger Lowenstein Bibliography

- Rank: #103687 in eBooks
- Published on: 2015-10-20
- Released on: 2015-10-20
- Format: Kindle eBook

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### Editorial Review

#### Review

“As Roger Lowenstein tells it in ‘America’s Bank,’ an illuminating history of the Fed’s unlikely origin story, the central bank represented an ambitious — and not entirely successful — effort to resolve several long-standing tensions that lay at the heart of the American experiment in self-government: East Coast vs. the interior, urban sensibilities vs. rural ones, mercantile vs. agrarian interests, Wall Street vs. Main Street. It is still working out the kinks.”—*Washington Post*

“The fun of the book — and its enduring value — lies in the rich details about the cranks, pawns and prophets who jostled with one another in the days of Teddy Roosevelt, William Taft and Woodrow Wilson.” – *Forbes*

“Roger Lowenstein tells, vividly and compellingly,...the remarkable tale of the politics, disagreements, decisions and crises that culminated in the Federal Reserve Act...But Lowenstein, the author of several works on economics and finance, builds off it to describe the history of the era, the rise of the Progressive movement, the compromises and machinations that were critical to Congressional passage and the key figures in the drama of creating the Federal Reserve System.”—Robert Rubin, *New York Times Book Review*

“Depicting the effort to create a central bank, *Fortune* contributor Lowenstein tells a gripping tale with a trove of vivid characters and period details; you can almost see the handlebar mustaches and smell the oyster stuffing. And the broader cultural conflicts he describes—distrust of centralized authority, tension between Main Street and Wall Street—are just as relevant now as they were in the era of Taft, Teddy, and Woodrow Wilson.” – *Fortune Magazine*

“Important and intriguing ...Lowenstein skillfully shows the connections between past and current events.... Readers seeking a comprehensive history of the Federal Reserve from its conception to modern times will find this work especially appealing.” – *Library Journal*

“Lowenstein vividly recounts the key moments in this hard-fought battle, from the Panic of 1907 to the 1912 presidential campaign to Wilson’s impassioned declaration to a joint session of Congress. Captivating and enlightening, this book brings a pivotal time in American history to life.” -*Publishers Weekly*

“His well-researched account for general readers takes us from Aldrich's secret meeting with leading Wall Street figures on Jekyll Island, off the Georgia coast, to plot banking reforms, to Woodrow Wilson's Princeton bedchamber, where the ill president persuaded Virginia Congressman Carter Glass of a key compromise to ensure creation of a national bank. Lowenstein doubts the Federal Reserve Act could be passed in today's volatile political climate, but he provides an unusually lucid history of our nation's central bank.” - *Kirkus Reviews*

“America’s Bank, Roger Lowenstein’s lively account of the creation of the Federal Reserve in 1913, resonates today as we debate the conduct of monetary policy and financial regulation. Washington against the bankers, central authority against dispersed decision-making, rules against discretion, independence against accountability – it was all there, a century ago, resolved by political ingenuity into compromises that

have stood the test of time.” - *Paul Volcker, former chairman of the Federal Reserve*

"The Federal Reserve feels as permanent a part of American life as, say, Mount Vernon or Monticello, but as Roger Lowenstein argues in this engaging and illuminating book, the central bank is, historically speaking, a relatively recent arrival. With grace and insight, Lowenstein takes us inside the creation of the Fed, a story of twists, turns--and lessons for our own time."- *Jon Meacham, author of Thomas Jefferson and American Lion*

“A highly engaging historical account of the personalities and politics behind the creation of the Federal Reserve.”- *Ben Bernanke, former chairman of the Federal Reserve*

“Set in the waning years of the Gilded Age, America's Bank tells the fascinating story of how an unlikely and often fractured coalition of Wall Street bankers and progressives, Southern Democrats and establishment Republicans came together to tame a chronically unstable financial system and create the Federal Reserve. Incisive and brilliantly researched, this is an important and original book about one of the most consequential pieces of legislation in our history with lessons aplenty for today.”  
- *Liaquat Ahamed, author of Lords of Finance*

“The birth of the Federal Reserve is a fascinating and almost unknown story, with lessons even for today. In the hands of a master storyteller like Roger Lowenstein, it is also a page-turner.”  
- *Alan S. Blinder, American economist and the author of After the Music Stopped: The Financial Crisis, the Response, and the Work Ahead*

“Roger Lowenstein has accomplished a small miracle in America’s Bank: The Epic Struggle to Create the Federal Reserve. A masterful story-teller, Lowenstein has made sense of the Federal Reserve System for those of us who never quite understood how it worked or where it came from, and done so in a taut page-turner that is hard to put down. (I read it in two sittings.) His book provides new insights into progressive-era reform; explains why, then and now, credit is more important to the economy than cash; and reintroduces us to three presidents and the remarkable group of bankers, businessmen, and congressmen who left their mark on one of the twentieth century’s most important pieces of legislation, the Federal Reserve Act of 1913.”- *David Nasaw, author of The Patriarch and Andrew Carnegie*

#### About the Author

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*. He has three children and lives with his wife in Newton, Massachusetts.

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## Chapter One

## The Forbidden Words

*I am in favor of a national bank.* —Abraham Lincoln, 1832

When Carter Glass was born in 1858, the United States was an industrializing nation with a banking system stuck in frontier times. As the country put up factories and laid down rails, the tension between its antiquated finances and its smokestack-dotted towns grew ever more acute. Heated battles over “the money question” came to dominate the country’s politics, but no matter how unsatisfied the people, any solution that tended toward centralization was, due to the prevailing prejudice, off the table.

America was a monetary Babel with thousands of currencies; each state regulated its own banks and they collectively provided the country’s money. Officially, America was on a hard-money basis, but the amount of gold in circulation was insignificant. In any event, as a contemporary would write, it was impractical for a traveler “to carry with him the coin necessary to meet his expenses for a protracted journey.” If he traveled with notes of any but a few of the biggest banks in New York, Boston, and Philadelphia, his money was likely to be refused, or greatly discounted. If he did carry gold, then, “at the hotel, in the railroad car, on the river or lake,” he would be offered slips of engraved paper that, in the words of a western banker, might include “the frequently worthless issues of the State of Maine and of other New England States, the shinplasters of Michigan, the wild cats of Georgia, of Canada, and Pennsylvania, the red dogs of Indiana and Nebraska, the miserably engraved notes of North Carolina, Kentucky, Missouri and Virginia, and the not-to-be-forgotten stump tails of Illinois and Wisconsin.”

In theory, these notes were redeemable in gold or in state bonds, but notes from western banks were notoriously unreliable. Bankers, not surprisingly, sought to circulate their paper as far as possible from the point of issue. That way, the notes might never—or not for a very long while—return and the bank avoided the annoying detail of having to redeem its debts. There was no institution to regulate either the quality or the quantity of money, and after states adopted so-called free banking, a promoter needed little more than a printing press to set up shop. In 1853, Indiana’s governor lamented, “The speculator comes to Indianapolis with a bundle of banknotes in one hand and the stock in the other; in twenty-four hours he is on his way to some distant point of the union to circulate what he denominates a legal currency, authorized by the legislature of Indiana.” The system was certainly democratic—almost anyone could issue “money”—but it was just as certain to lead to credit booms and inevitable busts.

According to Jay Cooke, a Philadelphia financier, some banks issued notes equal to twenty-five times their capital “with no other security than the good faith of their institution.” Since such faith was often short-lived, Cooke hardly needed to add, “confusion . . . was the order of the day.” During the Civil War, the Chicago Tribune counted 1,395 banks in the Union states, each with bills of various denominations—some 8,370 varieties of notes in all. Even for the careful bank teller, scrutinizing this profusion of paper became an almost hopeless task. In addition to bank failures, the country was plagued by con men whose note forgeries could be worthy of a Rembrandt. So widespread were phony notes that “Counterfeit Detectors” were published, and these guides were widely circulated.

This monetary chaos formed the tableau for late-nineteenth-century reformers, and it is key to understanding

how people of Glass's generation thought about money. Money—generally, gold or silver—was something of intrinsic value. Circulating paper, even though it served as a medium of exchange, was but a token, a promise of the real thing, discounted according to the degree to which people feared that the promise might not be kept.

Legislation during the Civil War provided a remedy—somewhat. With the government desperate for credit, Lincoln's Treasury secretary, Salmon P. Chase, was left no choice but to propose, and Congress to approve, a new system of nationally chartered banks, which were permitted to issue circulating paper money in the form of National Bank Notes. These notes were to be a new, and mercifully uniform, currency, with a standard engraving on one side and the bank's name on the other.

However, note circulation was tightly controlled. National banks had to hold a reserve and submit to federal banking examinations. Also, to issue notes, they had to invest in a proportionate amount of government bonds and deposit them with the Treasury as collateral. This requirement heightened the demand for government securities—which was, of course, Chase's purpose. By giving banks an incentive to invest in government debt, the United States contrived a means of financing the war. National banks were formed at a rapid clip, and many state banks converted to federal charters so they could qualify to circulate notes.[i]

The new notes were surely an improvement, but they had the drawback of arbitrariness. The quantity in circulation was determined by the level of investment in government bonds, and this bore no relation to the needs of trade. Perversely, circulation often fell as business activity expanded and banks found better outlets for their capital. Just as worrisome, the note supply was inelastic—banks held the quantity of bonds that they held, and no new notes could be issued in a crisis. The modern notion of a central bank to supply extra liquidity when needed simply did not exist.

It is hard to overly blame Chase because, as he said, his goal was “first to provide for the vast demands of the war.” Chase was lauded for standardizing the currency and blunting the prior ability of banks to create inflation by circulating worthless paper. William G. Sumner, an influential economist at Yale, fairly rejoiced: “This system of currency has put an end at once and forever to the old bankers' trick of expansion and contraction.” That economies do expand—and that currency needs to expand with them—was largely overlooked.

Also overlooked, for the moment, was the precarious manner in which the National Banking Act marshaled the country's reserves. In Great Britain or in France, reserves were stored in the central bank. In America, the Banking Act introduced an intricate and fragile system, with the reserves of one bank piled upon another.

The law recognized three distinct tiers of banks. The smallest, so-called country banks, had to either keep reserves in their vaults or deposit a portion with middle-tier banks in the city. The latter, in turn, could hold cash in the vault or deposit a portion of their reserves with banks in the highest tier, those in the “central reserve cities” of New York, Chicago, and St. Louis. In practice, since banks did not want to hold idle cash, reserves flowed to New York. And since the New York banks did not want idle money either, they lent their spare cash to the stock market. Thus, America's banking system was perched on a speculative pyramid. Whenever credit was in short supply, the entire chain backed into reverse, with country banks calling their loans, by means of urgent telegrams, to banks in reserve cities and thence to New York. This could precipitate panicky selling in the stock market. As Glass was to write, the system was a “breeder of panics,” with the idle funds of the nation “congested at the money centres for purely speculative purposes.”

This defect quickly became apparent. In 1873, when the new era was not quite a decade old, Jay Cooke's firm, having improvidently speculated on railroad bonds, collapsed. The failure touched off a depression,



which lasted six years. In a telltale sign of the system's defects, note circulation sharply declined. Even when business recovered, the country was visited by periodic shortages of cash, or "stringencies," when interest rates would soar to as much as 100 percent. The problem was most acute in the fall, when farmers needed cash to move the crops. Farmhands had to be hired, horses fed, machinery operated, shipping procured. The agrarian economy, as it were, sprung to life and required bundles of cash. This imbalanced the relative currency demands of city and farm, resulting in regular shortages. No central reservoir existed to smooth out the seasonal lumpiness. In short, the system suffered a serious deficit: it consistently failed to generate enough money.

One obvious solution was to supply more money, but that begged the question "Who should supply it, and what kind of money?" Though the new National Bank Notes served as walking-around money, the United States actually had seven different mediums of exchange circulating in varying amounts.[ii] During Glass's early life (the first few decades after the Civil War), Americans of every station fiercely debated how to bring order to this fiscal cacophony. In particular, they argued bitterly over whether gold should be supplemented by additional currency of some other type, including "greenbacks," the colloquial name for the paper notes issued by the federal government during the Civil War. Because greenbacks were not supported by any metal or tangible asset, the banking class considered them abhorrent. They were mere paper, "fiat" money (exactly what circulates today) and, to nineteenth-century bankers, an unpardonable blasphemy. In time, Congress decided to make greenbacks exchangeable for gold, and people who wanted to add to the currency shifted gears and proposed that the money supply be enhanced with notes that were backed by silver, which was more plentiful than gold. To supporters of the gold standard, silver, too, would merely cheapen the currency; it was both morally and economically repugnant.

Gold's champions tended to be creditors—people with capital. They didn't want the currency debased because they didn't want to be repaid in cheaper coin. Gold being scarcer than silver, it was more valuable. In the 1870s, much of the world had joined Britain and gone on a gold standard (agreeing to back their currencies with gold). In 1879, the United States did so as well. But Congress, trying to appease the farm lobby, directed the Treasury to also mint limited amounts of silver dollars, and at the historic ratio to gold of 16 to 1. Since the bullion value of a silver "dollar" was, by then, appreciably less, owing to a divergence in the metals' prices, bankers and Republicans regarded silver as a profane dilution. Grover Cleveland, a "gold Democrat" elected president in 1884 and again in 1892, spoke for Wall Street and for respectable opinion generally when he observed that if America went to a silver standard, "we could no longer claim a place among nations of the first class."

As a practical matter, bankers were correct that the bimetallic system of gold and silver was inherently unstable, since people would seek to cash in the poorer coin (in this case, the silver) for the richer one. But the gold standard imposed severe hardships on a great many Americans. In plain terms, the production of gold was not sufficient to support an adequate supply of money.

The issue was extremely divisive, because money shortages affected Americans unevenly. American farmers, de Tocqueville noted, were less peasants than little businessmen. They took out loans for seed and equipment. When prices fell, their debts became crushing. Credit in farm communities was exceedingly scarce. The rigid rules of the Banking Act proscribed lending on real estate, which undercut the usefulness of national banks in rural areas. Cash was even scarcer. There were fewer bank notes issued in Iowa, Minnesota, Kansas, Missouri, Kentucky, and Tennessee combined than in the tiny Eastern Seaboard state of Connecticut.

The hardship, and its palpable inequity, spawned a political awakening—a cry for redress. People blamed the

money scarcity on Wall Street or on its British equivalent, Lombard Street. Carter Glass was one of those. His sense of grievance was nourished by his difficult beginnings. Glass had been born in Lynchburg, Virginia, three years before the Civil War. His mother died when he was two, and his father, a publisher and a major in the Confederate ranks, suffered painful setbacks during the war, when he forfeited a vast quantity of cotton and had to sell his newspaper. After the war, he was offered the job of postmaster but refused to work for the federal government. Major Glass also had political ambitions, but these were frustrated by Reconstruction. For his son, it was a bitter inheritance, compounded by the sight of federal troops occupying Virginia. Carter, though, was a determined lad. Frail, with sallow skin and thin lips, often sickly with digestive problems and only five foot four, he was known as “Pluck” owing to his stubbornness and fiery temper. At age fourteen, he was forced to quit school but continued his studies at night, reading his father’s copies of Plato, Burke, and Shakespeare by kerosene lamp. Although Glass found work at a newspaper, his prospects were dimmed by the depression that ensued in 1873. Glass’s view of this calamity was informed by his hostility to northern banks. For six straight years, as he tried to make his way in the world, the money stock shrank. Where did the money go? Gold had sucked it up—so he believed. New York and London were in on it together. He reckoned that a malign conspiracy of financiers was to blame. Because he mistrusted power, he did not want more power. He did not want a central bank.

In 1880, Glass finally got the job he wanted—newspaper reporter. Rising to publisher within a decade, Glass ceaselessly editorialized for silver. “Why should gold be minted free [in unlimited amounts], any more than silver?” he thundered in the Lynchburg News. Glass’s crusade was as much emotional as deductive. “I confess that with all I have read on both sides of the currency questions, I understand very little about it,” he confided to a comrade. “But when I see the merciless forces of corporate and individual wealth arrayed on one side, and the working, toiling masses on the other, I can but feel that you and I are right in the stand we have taken.”

Silver-money advocates are often portrayed this way—as emotional and ignorant. But their distress was real. Over the course of three decades—beginning when Carter Glass was a boy—prices in America steadily declined. No American born after the Great Depression has ever experienced even two consecutive years of deflation but, astonishingly, from 1867 to 1897 prices skidded relentlessly lower, and over the whole of that period they tumbled well more than 50 percent. In 1867, when the future congressman was nine years old, a bushel of winter wheat fetched \$2.84; thirty years later it was selling for a mere 90 cents.

Although the price of goods was falling, it is equally true, and more illuminating, to say that the price of money was rising. This was occurring for the expected reason—money was scarce. Representative Joseph Sibley of Pennsylvania noted that gold was the only commodity whose price was appreciating. “You do not want an honest dollar,” he said in rebuke to President Cleveland. “You want a scarce dollar.”

As America industrialized, sectional divisions in the country widened. Corporations listed on the stock exchange were able to tap capital; manufacturing firms were protected by the tariff. The system of high tariffs and a strong dollar served the Northeast reasonably well but it left farmers and debtors impoverished.

Yet the people who might have benefited most from monetary reform were also the most resistant to it. The notion of establishing a bank to regulate the money supply, although common in other countries, aroused deeply held fears of monopoly, especially in the South and West. Farmers agitated for a cruder solution: printing more greenbacks. When that crusade faded, agitators shifted their energies to silver. The point was to mint more money—any kind of money.

Bowing to the pressure, in 1890 Congress committed the Treasury to purchasing the sizable sum of 4.5 million ounces of silver a month (double its prior rate). Since the government also backed its paper in gold, a problem developed. As predicted by Gresham's Law,[iii] miners and others exchanged their inflated silver for gold at par, the latter disappearing from circulation. As gold drained out of the Treasury, foreign investors feared that the United States would be forced to abandon gold and rushed to sell American securities.

The gold stampede bequeathed a banking panic. Depositors withdrew savings, and country banks desperately demanded their reserves from the city banks where they were parked. The system was too brittle to handle the freight. "Actual money," a commentator noted, "cannot be shipped from New York to Denver in a day, and forty-eight hours' delay may easily settle the fate of the Western institution."

The Panic of 1893 exposed, beyond a doubt, the system's flaws as well as its geographic asymmetry. Of 360 banks that failed, all but 17 were west or south of Pennsylvania. Robert Latham Owen, president of the First National Bank of Muskogee, in Oklahoma Territory, saw half his deposits run out the door in a matter of days. A future legislative partner of Glass, Owen became convinced, then and there, of the need for reform.

Cleveland persuaded Congress to repeal the silver-purchase act, but the silver lobby kept up a steady pressure for resumption, and investors remained in an agitated state. The government repeatedly borrowed gold only to see it drain away. A. Barton Hepburn, the comptroller of the currency, was to write, "Fear of a silver basis prevailed, especially abroad, and every express steamer brought in American securities and took away gold." With gold supplies dwindling, in 1895, the President was forced to go hat in hand to J. P. Morgan, who accepted thirty-year government bonds (which he syndicated to investors) in exchange for gold to bail out the Treasury. This was a highly embarrassing demonstration of Washington's subservience to Wall Street. The private nature of the negotiations and the fact that, as it turned out, Morgan turned a profit on the syndication gave rise to charges of a conspiracy. Glass believed, on no evidence, that bankers such as Morgan had fomented the gold shortage to profit from subsequent bond sales. The Morgan deal was probably the best that Cleveland could have managed, but it left his party deeply divided.

Astonishingly, no one—least of all Glass—suggested that the government might want to supplant Morgan: that is, become its own banker. Although a central bank presumably would have provided more circulation, the mere suggestion of it stirred cries against the discredited Second Bank in the time of Jackson. That was enough to damn it. After Cleveland vetoed a measure for coining silver, Glass raged at Wall Street for urging the veto. "It is just the money power that the old United States [Second] bank used to exercise over the finances of the government," he editorialized in the Lynchburg News, "and would exercise at this day had not General Jackson in his might crushed out its charter."

Trying to look forward and not, for once, to General Jackson, bankers and businesspeople met in Baltimore in 1894 and proposed reforms. The phrase "central bank" was studiously avoided. However, to the conference-goers, it was plain that the Civil War banking structure had outlived its useful life. The Panic had devolved into a full-blown depression. Railroads had failed by the dozen. Thousands of factories had shuttered and unemployment had soared. In rural areas, farmers could not pay their mortgages. Virginia's farmers were ruined by debt; four in ten were forced into tenancy.

Although the depression was America's worst to date, it did not occur to Cleveland to offer federal relief. The son of a Presbyterian minister, as honest as he was corpulent, Cleveland held that people should support the government, not vice versa. This was the Democrats' laissez-faire credo. But Glass was struggling to reconcile this philosophy with the plight of his state's farmers.

The moment was highly polarizing. Populists agitated for an income tax, tariff reform, regulation of railroads, and direct election of U.S. senators (who were chosen by the legislatures). Workers erupted in sometimes violent strikes—notably, the Pullman strike of 1894, which halted much of the nation's rail traffic and led to rioting and acts of sabotage, and was ultimately suppressed by federal troops.

Discontent with the currency was the glue that united these disparate rebellions. In the same year as the Pullman strike, Jacob Coxey, an Ohio businessman, led an army of the unemployed to Washington. Remarkably, they demanded increased circulation—the first popular protest to focus on the monetary system. Meanwhile, over country hill and dale, Americans bent over oil lamps to peruse their copies of William H. Harvey's fetching parable, *Coin's Financial School*, published in 1894. Harvey was a failed silver miner turned proselytizer for silver coinage. He sold hundreds of thousands of copies.

In the next presidential election, silver was the overwhelming issue. With America mired in a depression, increasing the money supply was the perceived tonic. William McKinley, the Republican nominee, was wary of alienating the silver forces, but party bosses insisted that he stand for gold.

The Democratic convention was held in Chicago. Carter Glass, a member of the platform committee, boarded the overnight train for the Midwest in an emotional state, having buried his father only six weeks earlier. He must have ruminated on the last convention attended by Major Glass—in 1860, when the Democrats had debated slavery. This convention seemed similarly momentous, and Glass felt ready to play a part in great events. Despite the hard times, Glass enjoyed a rising prominence, having acquired the three newspapers in Lynchburg and obtained the fastest printing press in the state. His editorials, a daily barrage for free silver, were read in the highest circles in Virginia. Other social and economic issues were coming to the fore, such as labor reform and monopolies, but neither Glass nor the majority of Democrats were ready to embrace them. Glass was a conservative reformer, wary of measures that might divide the party and weaken the solid South. Southern democracy was founded on racial segregation, and he earnestly editorialized in support of this system. To Glass, any sort of federal interference (such as a central bank) also threatened an end to white supremacy, and was out of the question.

The Democrats, therefore, coalesced around silver as an encompassing solution for America's ills and also as a safe, unifying mantra for the delegates' lengthy list of grievances. An air of nativism, a Jacksonian Anglophobia, hung over the delegates, for whom gold represented a policy of enslavement by Britain. The platform inveighed against "financial servitude to London" and "trafficking with banking syndicates." It was a farmers' convention, steeped in the issues that mattered to farmers, and it turned to the son of an avid Jacksonian, who himself had been raised on a farm, for inspiration.

William Jennings Bryan, only thirty-six years old, had practiced law, worked as an editor, and served two terms in Congress, representing Nebraska. He was a teetotaler and a fundamentalist Christian. Many of his positions were prescient (he favored an income tax and public disclosure of campaign contributions), but his chief qualification for public life was a talent for oratory. Bryan did not analyze issues so much as feel them. While easterners judged him a dangerous radical, Bryan was driven by a yearning for the past as much as by a vision for the future. He was animated by a conservative nostalgia for small towns, religion, and *laissez-faire*. His early campaigns had been backed by the liquor interests, who were grateful to have found a non-drinker opposed to Prohibition. Now, he was financed by the silver interests.

Addressing the convention on the warm afternoon of July 9, 1896, Bryan recognized that leadership of the silver crusade was up for grabs, and while some of the phrases he employed had been tested in earlier

speeches, never before had his rhetoric been so poetic, or so rousing. He spoke to the delegates, and to the country, as fellow farmers and rural inhabitants—as, indeed, more than six of ten Americans were. He serenaded farmers—“those hardy pioneers,” he called them—“who braved all the dangers of the wilderness, who have made the desert to blossom as the rose.” Indeed, Bryan spoke as a representative of “our” farms, not of “your” cities, a dichotomy he associated with silver versus gold, poor against rich, even good against evil. He paid the obligatory homage to Jefferson and Jackson, and he claimed to speak for the “producing masses,” the “commercial interests,” the “laboring interests,” and “all the toiling masses”—only Wall Street was excluded. To bankers and to all defenders of the money system he exuded biblical wrath. “You shall not press down upon the brow of labor this crown of thorns,” he bellowed in climax. “You shall not crucify mankind upon a cross of gold.”

Eyewitnesses reported a momentary silence followed by a tremendous roar. The delegates erupted in cheers; they stood on chairs, gestured wildly, paraded about the hall—a few with Bryan on their shoulders. Glass felt his passions stir and joined the throng. When the frenzy broke, he dashed off a wire to his paper reporting that Bryan had secured the nomination.

The campaign that fall was bitter. McKinley had no trouble raising a war chest on Wall Street. Even some Democrats were appalled by Bryan’s populism and supported a splinter candidate. Among those who voted for the gold Democrat rather than Bryan was a noted Princeton professor, Woodrow Wilson.

Nearly eight of ten eligible adults voted, one of the highest turnouts ever. Bryan lost the popular vote by a margin of only 4 percent—not a bad showing, considering that his financial support came almost exclusively from silver mines. Having polled 6.5 million votes, Bryan was now the uncrowned king of a political movement. Not coincidentally, within a fortnight of the election, business people made arrangements for a conference in Indianapolis to consider reforming the monetary system. The organizers saw that the system was outmoded—just as plainly, they were afraid that the silverites would hijack the public debate. They wanted to reform the system before Bryan beat them to it.

The six-hundred-page report that the Indianapolis Monetary Convention was to issue bore a single, offhand reference to a “central bank.” The delegates were headed in the other direction—they wanted the government out of banking, not mixed up with high finance. Morgan’s bullion deal with the Treasury had left a sour aftertaste.

Rather than a currency based on government bonds, the Indianapolis report proposed that each bank issue its own notes, backed by the loans that it made to farmers, merchants, and factories. In this way, the quantity of currency would expand and contract with ordinary business. Let a bank issue credit on a shipment of cotton and the bank’s note would incrementally add to the money supply. Let the cotton shipper repay the debt and the currency would contract.

Loans to cotton merchants and such were dubbed “real bills,” to distinguish them from speculative credit supplied to stock market traders. According to the real bills theory, such loans were inherently sound because they were backed by a tangible asset—the cotton.

A chief attraction of the real bills theory was that it took decisions regarding the money supply out of human hands. John Carlisle, Treasury secretary under Cleveland, maintained that issuing notes “is not a proper function of the Treasury Department, or of any other department of the Government.” The task was just too difficult. Rather, Carlisle said, currency should be “regulated entirely by the business interests of the people and by the laws of trade.” By the “laws of trade,” Carlisle was invoking a nineteenth-century notion of natural law—of an Edenic order in which the volume of money would self-adjust.

The Indianapolis convention was guided toward this doctrine by James L. Laughlin, head of the economics department at the new University of Chicago, and the author of the Indianapolis report. According to Laughlin, an asset currency (based on each individual bank's loans) would "adjust itself automatically and promptly" as the level of trade, and therefore of bank loans, expanded and contracted to meet demand from business.

Laughlin and other theorists were supremely naïve; monetary management is far too complicated to submit to an "automatic" guide.[iv] And they appeared not to notice that America's growing financial strength was tugging the U.S. Treasury away from the laissez-faire principles they held so dear. Indeed, various Treasury secretaries had begun to experiment with lending government reserves to banks. This is what central bankers do. Lyman Gage, secretary of the Treasury under McKinley, was a perfect illustration: even though he preached the gospel of noninterference, in practice he began to act like a forerunner of Ben Bernanke.

Born and educated in upstate New York, Gage was a former president of the First National Bank of Chicago and an enthusiastic supporter of the Indianapolis idea of getting the government out of banking. However, McKinley's high-tariff policies tended to augment Gage's power. Higher tariffs meant more government revenue to throw around in money markets. Secretary Gage, fashionably coiffed in a full beard and mustache, may not have wanted a government bank but, with tariff collections streaming into the Treasury, he had one.

What further amplified the Treasury's influence was an economic boomlet, spurred by a combination of bumper wheat crops at home and a string of gold discoveries, including in the Klondike region of the Canadian Yukon. With wheat sales surging and gold more plentiful, money growth soared; deflation was finally over. In a sense, Bryan was vindicated: more money had indeed fostered prosperity. It was Bryan's ill luck that the additional metal, as it happened, wasn't silver, but gold.

Gage now faced a question unknown to his predecessors: What to do with the Treasury's surplus? As Gage was aware, the bullion stowed in the Treasury's vaults was idle; it wasn't out stimulating trade. His solution was to increase deposits in the national banks. In other words, he began to try his luck as a central banker.

War with Spain, launched by McKinley in 1898, raised the profile of the Treasury even more (wars inevitably involve governments in banking). To finance the battle of San Juan Hill, Gage offered \$200 million in bonds, to which the public eagerly subscribed. The war spending ignited a genuine boom. Arthur Housman, a stockbroker who traveled the country by rail in 1899, testified to good times in a report to J. P. Morgan. "Money is plentiful throughout the country," Housman wrote in June. "In the smallest towns, money is freely offered at 5." Chugging across the prairie, Housman approvingly observed that farmers were building new fences and barns and that ranchers were improving their breeds of cattle.

Yet the McKinley prosperity did not disguise the underlying weakness in the banking system. In the fall, country banks, needing cash for the harvest, pulled their deposits. Liquidity in New York suddenly evaporated. The city's banks had whittled their reserves to the legal minimum; now, they had little—or nothing—to lend. "The cry everywhere," said the lawyer and investor Henry Morgenthau, "was for money—more money—and yet more money."

Gage did not have to ponder long before deciding on a use for the Treasury's reserves. He loaned them to banks. Gage's idea, again, was to get the Treasury's money into circulation. Although he still affirmed the desirability of reducing the government's profile, he observed with alarm in his report for 1899 that "havoc

was wrought in the regular ongoing of our commercial life.” This he would not abide. The “periodical regularity” of autumnal shortages grated on him. The lack of “stability” in the currency, the want of flexibility for “needful expansion,” suggested a profound inadequacy in the system.

By 1900, Gage had deposited more than \$100 million of the American people’s money in four hundred different banks. Outraged, Congress investigated. Legislators were irate that Gage had distributed a disproportionate sum, in particular, to National City Bank of New York. Such coziness between Wall Street and Washington inflamed old fears of bankers’ conspiracies. The *Coming Battle*, a populist tract by M. W. Walbert, warned that money dealers had formed “a gigantic combination” to thwart the interests of the people.

Impervious to the criticism, the restless Treasury secretary plowed ahead. In the same year that saw Walbert’s attack on banks, Gage averred, “It is a popular delusion that [a] bank deals in money.” For the most part, Gage elaborated, banks deal in credit. Expounding on this theme, he pointed out that no more than 10 percent of a bank’s daily receipts are in the form of cash. The rest consists of checks or, as Gage precisely put it, “orders for the transfer of existing bank credits from one person to another.”

This 90 percent—the credit network—was where the breakdowns occurred. That credit could dry up at a time of prosperity and rising gold reserves was especially troubling. No sooner do the symptoms of trouble appear, Gage observed, than banks, guided by the “ruling principle of self-preservation,” suspend or greatly inhibit their loans.

At that point, people carrying goods and securities are obliged to sell with little regard to cost. “Contemplated enterprises are abandoned; orders for future delivery of goods are rescinded.” Finally, what should be an orderly contraction becomes “a disorderly flight, an unreasoning panic.”

Fearing such a panic, Gage intervened in the spring of 1901, when a raid on Northern Pacific Railway shares roiled the stock market, and again in September, after President McKinley was assassinated. At the start of 1902, uncomfortable with the meddlesome style of his new boss, Theodore Roosevelt, Gage resigned. His final report was a parting shot at the venerable National Banking system. After five years in office, he had concluded that the system, admirable in many respects, had been “devised for fair weather, not for storms.” He lamented that individual banks stood “isolated and apart, separated units, with no tie of mutuality between them.” He lamented, too, that no association existed “for common protection or defense in periods of adversity and depression.” Not since Alexander Hamilton had a Treasury secretary come so close to demanding a central bank.

Gage even spoke the forbidden words. Perhaps, he mused, the time was ripe not for a “large central bank with multiplied branches”—in view of the sure opposition it would arouse—but for a more modest institution, one restrained by constitutional-style checks. He had in mind a bank, privately owned, with authority to loan reserves from areas of the country where credit was plentiful to regions where it was scarce. Such an entity could become the object of a “perfect public confidence,” he said hopefully—if its powers were properly circumscribed. “We justly boast of our political system, which gives liberty and independence to the township and a limited sovereignty to the State. . . . Can not the principle of federation be applied,” Gage wondered, “under which the banks as individual units, preserving their independence of action in local relationship, may yet be united in a great central institution?”

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[i] A legacy of the National Banking Acts, adopted in 1863 and 1864, was that banks in the United States were, even until recent times, typically denoted as the “First National,” “Second National,” and so on, in their respective cities.

[ii] The seven national currencies were National Bank Notes, gold coins and gold certificates, silver dollars and silver certificates, greenbacks, and Treasury securities.

[iii] Informally stated as “Bad money drives out good.”

[iv] Milton Friedman would later propose an arbiter with similarly magical properties to regulate the money supply—“a computer.”

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