"The Making of the Money Masters"
Inside the Creation of the Federal Reserve System in the United States

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Abstract

In 1913 the United States Congress passed, and President Woodrow Wilson signed into law, the Owen-Glass Federal Reserve Act. The act granted a government backed monopoly to a group of specially designated private banking firms with relation to the nation's money supply and its regulation of the financial markets. The declared intention of the organization is to insure a prosperous national economy by avoiding excessive inflation and deflation through control and manipulation of the banking and credit industry. The Federal Reserve has overseen a century of prosperity and influence unrivalled in modern times. Despite its apparent success, the system has had many detractors and has been shrouded in controversy since the moment of its inception.

The notion of a privately owned bank receiving a government mandated monopoly over a nation's money supply sounds like an Orwellian concept out of *1984*.[23] If such an idea is difficult to grasp, then surely the intended function of such an institution would be even harder to understand. Yet in 1913, with the passage of the Glass-Owens Bill, the legislative foundation for just such an institution was constructed. In determining how the Federal Reserve System came into prominence in the United States, one must deal with the key issues involved. These issues revolve around the idea of who would want to form a central bank in the United States, and for what purpose. A thorough analysis demonstrates that the true origins of the Federal Reserve System lie not with the lawmakers who voted on the 1913 legislation, but in the volition and interest of the business leaders and their associates who drafted the legislation.

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[23] Orwellian - of or like the society portrayed by Orwell in his novel *Nineteen Eighty-four*, in which a totalitarian state exercises almost total control over the public and private activities of the citizens - http://www.yourdictionary.com/orwellian

HISTORY

In order to understand the perceived necessity of central banks in developed countries, it is important to understand the history of such institutions. By no means was the United States the first country to implement a central bank. The Swedish Riksbank, widely accepted as the first true central bank, was chartered in 1656 and was in ruins just eight years later, due in large part to bad loans made to members of the government.[24] The bank restructured several times, and several times it failed. In each occurrence the culprit was the Swedish government, who consistently defaulted on its loans, causing panic amongst the general population.[25] By 1897 the bank had undergone its final transformation, and had furnished a model for what the United States Federal Reserve Bank would become. It was an entity unto itself. There would be little involvement, and no direct decision making, by the federal government. Author Martin Mayer summarizes the notion of a central bank succinctly when he states:

> A central bank is, first of all, a "bank of issue"—that is, it stands responsible for the currency. This is profitable work, known in the history books as "seignorage."[26] The coin was worth more than its gold content (if it was worth less than the gold content, somebody would melt it down). The difference between the price of the "bullion" in the coin and its purchasing power accrued to the mint that stamped the emperor's face in the metal. When the world moved to paper currency, the seignorage became very large.[27]

A central bank was a contrarian idea when viewed in the light of the economic landscape of the late 19th century. The Federal Reserve System, or the Fed, was not the first central bank in the United States. The original central bank, introduced in 1782, was the Bank of North America. This bank was headed by Robert Morris, who was also a Senator from Pennsylvania, and a founding father in every sense. Some historians have argued that his move to create this first central bank stemmed directly from personal interests, as well as "...to confer a vast subsidy on speculators who had purchased the public debt at highly depreciated values."[28] Most notable among these speculators was Morris himself, who over time came to be known as the "Financier of the Revolution."[29] The motives behind this first central bank became transparent, and the experiment was over in only a year. A second central bank was instituted in 1791, and this time with the full support of newly appointed Secretary of the Treasury, Alexander Hamilton. This bank, the First Bank of the United States, was almost entirely privately owned. The stated mission of the bank was to provide credit to

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24 Martin Mayer, *The Fed* (New York, NY: Free Press, 2001), p. 58

25 *Ibid,* p. 58-59

26 Seignorage -The difference between the cost of producing a coin and the actual face value of that coin. It is the profit the mint makes on a coin, so to speak. http://en.mimi.hu/numismatic/seignorage.html

27 Mayer, p. 56

28 Murray Rothbard, *A History of Money and Banking in the United States: The Colonial Era to World War II* (Auburn, Alabama: Ludwig von Mises Institute by Old World Prints, Ltd., 2005), p. 62

29 Rick Brainard, "The Men Behind the American Revolution: Robert Morris," *The Men Behind the American Revolution: Robert Morris,* http://www.history1700s.com/articles/article1141.shtml

the government, which would then use this credit to give subsidies to selected manufacturers. The result of the bank's activity was an increase in inflation of 72 percent in just five years.[30] When the bank's twenty year charter ran out in 1811, it was not renewed by either house of Congress. Over time, and as a result of increased political fervor, an adequately wide spectrum of the United States citizenry either forgot, or ignored, the problems caused by previous central banks in the United States. As the 20th century loomed, financial crisis at home had set the stage for a third, and more enduring, central bank in the USA.

In order to implement a centralized banking system in the United States it was essential to first change public opinion. The United States, as envisioned by its founding fathers, would run on the steam of capitalism and near laissez-faire government. This move toward monetary centralization, and the implementation of the Federal Reserve System, was brought about by popular support of the Progressive Party's platform, which "transformed the American economy and society from one of roughly laissez-faire to one of centralized statism."[31]

While most Americans view the Progressive platform as one that illuminated the desires of the working class and farmers, history suggests that the party was actually controlled and manipulated to serve the interests of big business. In fact, JP Morgan and Company used this platform of sympathy to discourage upstart business from encroaching on their power and revenue. Morgan and other successful businesses had been trying to form cartels for some time, particularly in the area of railroading. In the past, these attempts had been thwarted by either internal bickering and money grabbing, or by external competitors entering the market. These cartels thus had two obstacles to overcome: they had to find a way to work together, and they had to conjure up a system in which it was no longer possible for outside competition to deteriorate their power.

The push for Progressivism was backed by intellectuals, academics, social scientists, technocrats, engineers, social workers, physicians, and occupational 'guilds' of all types. Their goal was to achieve government backed unions which could guarantee increases in pay and prestige. They claimed that there was a better way than strict capitalism or Marxism. This harmonious 'middle-ground' could be achieved by "big government, staffed by intellectuals and technocrats, steered by big business and aided by unions organizing a subservient labor force, (which) would impose a cooperative commonwealth for the alleged benefit of all."[32]

After the failure of the Progressive Party in the election of 1912, the reformers needed a new party to back their efforts. It was at this time that they turned their attention to the Democrats. Initially, the bankers met with expressed opposition. Indeed, the Democratic Party, who in 1912 won the

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[30] Rothbard, p. 68
[31] *Ibid,* p. 183
[32] *Ibid*, p. 185

Presidency for the first time in twenty years, included in its election platform, "We oppose the so-called Aldrich bill or the establishment of a central bank...All legislation should have for its purpose the complete protection from the misuse of the power that wealth gives those who possess it."[33] Oddly enough, it would be Democrat Woodrow Wilson, along with his administration, who would take the reigns of such legislation from Aldrich and the Republicans, and one year later make it law. Years later Democratic Congressman Carter Glass, one of the authors of the Federal Reserve Act, said:

> We intended to preclude all idea of central banking, we designed that the Government...should keep a strict supervisory control of the system...and we appointed a Government agent...whom we intended to be the head officer of the bank. He has been literally brushed aside. He is a mere custodian of evidences of credit. (*Congressional Record,* 72d Congress, 1st Session, Vol. 75, 1932, p. 9884-85)[34]

Certainly, the representatives who drafted the legislation for the Federal Reserve were unaware of any ulterior motives by the bankers who formulated the bill. To coerce the lawmakers into enacting the Federal Reserve Act, the promulgators used their financial leverage to generate a general monetary scare that would serve as the basis for the system's infusion into the American economic archipelago.

A renewal of interest in the financial panic in 1907, during which banks refused to give cash payments on depositors' dollars, opened the floodgates for new legislation.[35] In particular, the failure of the Knickerbocker Trust Company, which was a large New York based trust, initiated the run on the banks.[36] When the dust settled, JP Morgan, one of the main advocates of a central banking system, portrayed a benevolent philanthropist by offering to put up his own money as an insurance instrument against such runs on capital.[37] This idea of private individuals and their corporations as insurance providers of state and local banks and trusts was a new concept in America. In the past the U.S. Treasury, under the leadership of Secretary Leslie Shaw, had acted to curtail such panics.[38] Shaw's efforts were never trusted by his compatriots, and the vigor for reform continued.

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[33] *Ibid,* p. 68

[34] Jane W. D'Arista. *The Evolution of U.S. Finance: Federal Reserve Monetary Policy, 1915-1935* (Armonk, New York: M.E. Sharpe, Inc., 1994) p. 194

[35] Donald Wells, *The Federal Reserve System: A History* (Jefferson, NC: McFarland & Company, Inc., 2004), p. 16

[36] Bank Run - A bank run takes place when the customers of a bank fear that the bank will become insolvent. Customers rush to the bank to take out their money as quickly as possible to avoid losing it. http://economics.about.com/cs/economicsglossary/g/bank_run.htm

[37] Wells, p. 15

[38] *Ibid,* p. 15

In 1908 Congress passed the Aldrich Vreeland Act, which allowed the creation of a commission of experts to investigate future potential problems in the American monetary system.[39] This commission was named the National Monetary Commission. In addition to nine senators and nine congressmen, two "experts" were selected by the act's author, Senator Nelson Aldrich, to oversee and advise the commission.[40] The two virtuosos chosen by Aldrich were investment banker Paul Warburg and Henry Davison, a partner of JP Morgan.[41] Of the two, Warburg was "...extremely influential, being a strong advocate of a central bank based on the German model. Most of the work was Warburg's; he wanted to disguise the idea of a central bank by having decentralized regional banks."[42] Although legislation allowing for a central bank was passed on December 23rd, 1913, the implementation of what is now known as the Federal Reserve System would not occur until November of 1914.[43]

Consistent with the theme of illusion, as mentioned in Warburg's attempt to 'disguise' the true notion of the central bank, it is clear that the promulgators of the legislation did not want their work to be attributable to themselves. A gaggle of historians have written about a "secret meeting" that took place on Jekyll Island, Georgia with the intention of "drafting a bill for a central bank."[44] This meeting has become so infamous that a book called *The Creature from Jekyll Island*, by G. Edward Griffin, was published in 1998. Those present at this meeting included Paul Warburg, Henry Davidson, Senator Nelson Aldrich, Frank Vanderlip of the National City Bank, Charles Norton of the First National Bank of New York, and Professor A. Piatt Andrew of Harvard.[45] Most interestingly, the meeting took place at the invitation of JP Morgan himself, who again sent Henry Davidson in his stead. The desire of these individuals to remain secretive was again apparent. As historian Murray Rothbard reports:

> The cover story released to the press was that this was a simple duckhunting expedition, and the conferees took elaborate precautions on the trips there and back to preserve their secrecy. Thus, the attendees addressed each other only by first name, and the railroad car was kept dark and closed off from reporters or other travelers on the train. One reporter apparently caught on to the purpose of the meeting, but was in some way persuaded by Henry P. Davison to maintain silence.[46]

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39 *Ibid,* p. 17
40 *Ibid,* p. 17
41 *Ibid,* p. 17
42 *Ibid,* p. 17
43 D'Arista, p. 17
44 Wells, p. 17, Rothbard, p. 252-253
45 Wells, p. 17
46 Rothbard, p. 252-253

So on November 22, 1910, on this island in Georgia, at the Jekyll Island Club, of which JP Morgan was a member, these powerful individuals set forth the legislation that was the final piece of a long effort to reinstitute a central bank in the United States. Despite the romanticism surrounding the events on Jekyll Island, this process was by no means completed overnight. In fact, the birth of this organic movement began fourteen years earlier in Indianapolis, Indiana.

The Indianapolis Monetary Convention (IMC) of 1896 is the best public display of the economic reform movement that would eventually lead to the creation of the Federal Reserve. It was at this time that occurred the uniting of, "...two generally clashing financial aggregations: the previously dominant Morgan group, which had begun in investment banking and expanded into commercial banking...and the Rockefeller forces, which began in oil refining and then moved into commercial banking."[47] The IMC consisted of men from both the Morgan and Rockefeller ambit. The delegates of the convention sent questionnaires to hundreds of experts concerning monetary reform. The hope was that they could garner enough favorable responses to then group them all together, dismissing any negative responses, and propose that the nation's leading financial experts agreed that reform was needed. They made their work widely known in both the public and private corridors in order to give the appearance that they were diligently working to achieve necessary reform. It was crucial that the public buy into this monetary transformation.

To ensure that their message was conveyed to the right people, the commission included James Laurence Laughlin, editor of the heralded *Journal of Political Economy* and head professor of political economy at the University of Chicago.[48] The University was newly founded by the Rockefellers. The IMC worked feverously to cement public support by including their so-called 'findings' in as many public manuscripts as possible. Jules Guthridge, general secretary of the commission, bragged in letters to his IMC colleagues that through "careful manipulation" he had succeeded in including their report "in nearly 7,500 newspapers, large and small."[49] They also sent letters to newspapers from as many supportive academics as they could muster. The group was successful in getting a great deal of these letters published as well, giving further credence to their cause.

Having successfully roused public awareness, the IMC would meet again in January 1898. This time they brought together 496 of the nation's corporate leaders, most of whom were members of either the Morgan or Rockefeller ambit.[50] The purpose of this meeting can best be described by former Treasury Secretary Charles S. Fairchild. In his address to the gathering he stated, "If men of business give serious attention and study to these subjects, they will substantially agree upon legislation, and thus agreeing, their influence will be prevailing. My word to you is, pull all

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[47] *Ibid,* p. 188

[48] *Ibid,* p. 195

[49] *Ibid,* p. 196-197

[50] *Ibid,* p. 197

together."[51] From his words it is obvious that the meeting was a collaboration of lobbying efforts aimed at Washington, D.C. Not only were these men gathering to discuss financial matters, they were meeting to construct legislation which they would then propose to the nation's legislators. In short, these powerful men were doing the work which should have been done by a public commission appointed by the President and overseen by Congress. So while the nation's elected representatives saw no need for monetary reform, the nation's wealthiest men clearly did. The difference of opinions, no doubt, stemmed from the beneficiaries of such reforms.

The final report of the commission came out with large support in the corporate and financial communities. It detailed the desire for a central bank, which would be given a monopoly on the issuance of currency, or bank notes. The aforementioned *Journal of Political Economy* would publish a thirty page article, praising the commission's findings, claiming that it was "one of the most notable movements of our time – the first thoroughly organized movement of the business classes in the whole country directed to the bringing about of radical change in national legislation."[52] From its very inception in 1896 it is clear that the Indianapolis Monetary Commission was the beginning of this movement that would finally culminate in the Glass-Owens Bill, also known as the Federal Reserve Act of 1913.

History also details the familial corroboration of the nation's financial powerhouses and academic elite. Paul Warburg, one of the uber-rich experts assigned to advise the NMC in 1914, was married to Nina J. Loeb. Nina was the daughter of Solomon Loeb, who just happened to be the founder of the New York investment firm of Kuhn, Loeb & Company.[53] Solomon's other daughter, Therese, was married to the famous Jewish Zionist and financial elitist, Jacob Schiff.[54] Warburg and the Loebs were also related by marriage to the Seligman clan, of which Edwin Seligman was an outspoken advocate of central banking, and also the President of Columbia University.[55] This was a common theme in the Rockefeller family as well. For instance, John D. Rockefeller's two nieces were married to the two sons of James Stillman, the chairman of the board of National City Bank.[56] All of these individuals, organized in politics, finance, and academia, worked earnestly toward the installation of a central bank in the United States.

Aside from the familial ties of these financial elites, there exist dozens of links between these groups and powerful politicians, including Presidents William McKinley, Theodore Roosevelt, William Howard Taft, Woodrow Wilson, and Warren G. Harding. In historian Murray Rothbard's

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[51] *Ibid,* p. 198
[52] *Ibid* p. 200
[53] *Ibid* p. 235
[54] *Ibid* p. 235
[55] *Ibid* p. 215
[56] *Ibid* p. 207

words, "The Transformation of 1896 and the death of the third party system meant the end of America's great laissez-faire, hardmoney libertarian party. The Democratic Party was no longer the party of Jefferson, Jackson, and Cleveland."[57] This is not to say that all, or any, of these Presidents were *controlled* by the Morgans and Rockefellers, but is apparent that they were all influenced by them on some level. For instance, when a delegation of Morgan led bankers went to President Wilson to coerce him to pledge that the board of the Federal Reserve Banks would consist of bankers, not bureaucrats, Wilson replied, "Which of you gentlemen thinks the railroads should elect the members of the Interstate Commerce Commission?"[58] Unfortunately, the Federal Reserve operates in just such a manner.

It is clear from their own words that the elected leaders of the United States never intended to create an economic monstrosity such as the Federal Reserve System. A clever entente between wealthy and powerful corporate leaders allowed for the necessary societal changes that would convince the nation's lawmakers to pass a centralized banking act. The reform legislation was drafted and then promoted by the very organizations and individuals which would benefit most greatly from their enactment.

[57] *Ibid* p. 178
[58] Mayer 67

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