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Book Review

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

Roger Lowenstein
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"The problem with economic historians," Murray Rothbard once quipped, "is that half of them are historians who don't know any economics and the other half are economists who don't know any history" (Rothbard, 1986, 0:01:05). After reading *America's Bank: The Epic Struggle to Create the Federal Reserve* by Roger Lowenstein, I was reminded of Rothbard's remark, which is as prescient as ever. Succinctly captured in the subtitle, Lowenstein's book is about the grand—and often secretive—story behind the founding of the Federal Reserve System. It is informative about the unique personalities and interests of the people involved and the historical steps, including various congressional

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maneuvers, leading up to the passage of the Federal Reserve Act in 1913. However, the book suffers some serious shortcomings when describing the economics of central banking (and economics without central banking), in particular the economy of the United States before and after the Federal Reserve. The consequences of this is that Lowenstein overlooks other potential reforms that were advocated to alleviate the contemporary monetary problems and simply assumes that a central bank was the only effective solution, which weakens his analysis of events and understanding of the personal motives of those involved.

To put bluntly, Lowenstein takes a particularly biased point of view regarding American economic history, namely that the country's monetary history in the 19th century was in shambles and wracked with chaos, and that this was due to the general *laissez faire* monetary environment fostered by the anti-central bank mentality of the bumpkin commoners. Lowenstein's view on monetary history and economic theory is succinctly encapsulated when he criticizes James L. Laughlin, who argued for an asset currency reform at the turn of the century, that "[He] and other theorists were supremely naïve; monetary management is far too complicated to submit to an "automatic" guide" (p. 25). In a footnote to this statement he describes Milton Friedman's computer to automatically increase the money supply as "an arbiter with similarly magical properties." While I do not support Friedman's rule, I am sure that if he were to read this he would shoot back that Lowenstein and others are supremely naïve because monetary management is far too complicated to submit to a *discretionary* guide run by imperfect humans! But more importantly to our purposes here, Lowenstein's argument is that monetary *laissez faire*, or free banking on a gold standard, was simply an insufficient institution in order to support a modern industrial economy, or "for societies too advanced to depend on the vagaries of mining gold" (p. 270) and it caused numerous problems for the country before the Federal Reserve.

The main problem with this historical interpretation is that the monetary problems of the country were overblown, and when they did occur, they were generally due to various government regulations that made the system more prone to credit booms and banking panics. And during the period when the federal government was least involved in regulating banking (1837–1861), the system was actually quite stable. Economic history work showing this, which started to really come out in force in the mid 1970s, is not cited by Lowenstein, which mars his historical overview in the beginning of the book on the monetary history of the United States before the Federal Reserve.

A brief review: first, Lowenstein misunderstands the periods of the First Bank of the United States (1791–1811) and the Second Bank of the United States (1816–1833) by arguing that they effectively restrained credit expansion and when they were removed banks could recklessly inflate credit (p. 3). In fact, the nation's first and second central banks enabled credit expansion and were supported by many state bankers. Excessive monetary creation following the demise of the first bank was due to the War of 1812, when the Treasury printed Treasury Notes which banks could use as reserves to expand credit and monetize the debt (Timberlake, 1978, pp. 13–28). Credit expansion following Jackson's removal of government deposits from the Second Bank and distributing them to state pet banks was not due to reckless credit expansion but instead due to increased reserves from specie inflows (Temin, 1969, pp. 68–82). His analysis of the so called "Free Banking Era" (1837–1861) is similarly erroneous when he describes it as "monetary chaos" (pp. 11–14) with fraudulent note issuance, excessive credit expansion, and numerous bank failures, seemingly relying on various contemporary accounts, including the reminiscences of Jay Cooke. In fact, as an entire literature starting with Rockoff (1975) uncovered, the situation was not nearly as bad as previously thought, and when there were problems they were due to prevailing state government interventions. Note issuance was actually fairly restrained, fraudulent issuance overblown, and losses to note holders actually quite small. Problems were due to the bond backing note requirement—that state banks insure their notes with state government bonds—and prohibitions on branch banking. The first made banks unable to effectively meet customer demands to convert deposits into notes and forced them to pay out specie reserves, which increased the illiquidity of the banks and hence encouraged bank runs. Branch banking prohibition prevented banks from competing across state lines and propped up inefficient poorly diversified banks that were very failure prone. These problems were exacerbated under the National Banking System instituted during the Civil War, because it encouraged credit expansion and a concentration of reserves in a small number of banks through its three tiered banking structure, which Lowenstein properly notes (p. 14–15). But then he misfires when he argues that the banking class abhorred the Civil War greenbacks and this new system led to a six year long depression from 1873–1879 (pp. 15–16). In fact, the bankers were strong early supporters because they could be used as reserves for the banking system, and the depression lasted only until 1875 (Hammond, 1970, pp. 246–250; Davis, 2006, pp. 106, 115).

Lowenstein continues to err when he writes how the gold standard from 1879–1896 "imposed severe hardships" on the common populace, in particular farmers, who had to deal with falling prices and crushing debt burdens (pp. 16–18). Farmer grievances were overblown, and decreases in nominal interest rates from anticipated deflation mitigated increases in farmer's debt burdens, most of whom were not heavily mortgaged (Higgs, 1971, pp. 96–102; Morris, 2006, p. 116). Lowenstein cites Friedman and Schwartz (1963, p. 41) for proof that post 1865 prices "skidded relentlessly lower" and fell by more than 50 percent. But then he borders on the disingenuous when he fails to acknowledge the sentence immediately following, where Friedman and Schwartz write, "Not only did it not produce stagnation; on the contrary, it was accompanied and produced by a rapid rate of rise in real income."

This of course, is not to deny that there were no monetary problems in the United States in the post Civil War era. As stated before, the National Banking System and the continuance of branch banking prohibitions caused difficulties. But these problems, along with others, were not caused by true free banking or an unadulterated gold standard, but rather by government interventions that stifled their self-regulating mechanisms. However, Lowenstein's poor theoretical framework and empirical evidence—that free banking would result in "monetary chaos"—causes him to miss this and thus give short shrift non-central bank reform plans, such as the Baltimore Plan of 1894, James Laughlin's asset currency reform from the 1897 Indianapolis Monetary Convention, and the 1902 Fowler Bill, which tried to alleviate the problems by allowing individual banks to better self-regulate the money supply (pp.

20, 25, 33). Not everyone saw that the solution was a further centralization and creation of reserves through a central bank, and this is an important aspect of the road to the Federal Reserve that commonly gets overlooked.

The rest of Part I of the book, "The Road to Jekyll Island" tells the story of how the initial bill to draft the Federal Reserve was created. Here Lowenstein chronicles how German investment banker Paul Warburg wanted an American central bank (and *not* to follow the more decentralized asset currency reform movement). Republican Senator Nelson Aldrich, who would later be crucial to the creation of the Federal Reserve, was initially against any type of central bank. However, after the Panic of 1907, Congress approved the Aldrich-Vreeland Act in 1908, which created a National Monetary Commission, and shortly thereafter Aldrich was convinced of Warburg's solution and a central bank. After a strategic mistake of waiting a couple of years, which the incumbent Republican Congress could ill afford, in November 1910 Aldrich organized a secret meeting with prominent Wall Street bankers at Jekyll Island in Georgia and drafted the Aldrich bill, which for all intents and purposes became the bedrock for the future Federal Reserve. To readers of the QJAE, the general outline of the story is not new, as Murray Rothbard wrote about it extensively in various publications (Rothbard 2008 [1983], 1984, 1994, 2005 [1999]). However, Lowenstein provides a detailed narrative that should be read by those interested in Aldrich and the New York bankers' plans to create a central bank.

In this narrative, when discussing the banker's motivations Lowenstein does say that they thought a central bank would favor powerful bankers, but ultimately, since they also thought it would further the public's interest, they were "conspirators, but patriotic conspirators" when drafting the bill at Jekyll Island (pp. 54, 119). Here is where a more proper understanding of the history of the United States banking system would have been helpful. If free banking actually worked better than previously assumed, was a central bank still the right direction? Couldn't the public interest have been to follow through with other reforms and not a centralized banking structure? Since the New York City bankers favored reform in the form of increased centralization but did not support the asset currency reform and removal of branch banking, which Lowenstein briefly touches upon from (pp. 54–55), then couldn't their self-interested benefits in favor of increased centralization have been a detriment to the public interest? These are important issues that have been at the center of the prior critics of the Jekyll Island meeting such as Rothbard's. When discussing these criticisms, Lowenstein, painting with a broad brush, characterizes all of them as "conspiracy theories" and the critics as "gold bugs, anti-Federal Reserve zealots, and flat-out cranks" (p. 117). For some of these naysayers, Lowenstein singles out Holocaust denier Eustace Mullins, G. Edward Griffin, and a paper presented by the Mises Institute's own Mark Thornton at a conference at Jekyll Island in 2010 (but does not include Rothbard)! A broad brush indeed! Lowenstein writes that Mark Thornton, a "contemporary naysayer," argued that the Federal Reserve is "nothing but a confidence game" and included his work as those against money and credit (p. 118). In reality, Thornton's presentation (2010) was about how Federal Reserve officials and supporters are always bullish on the economy, and about the ability of the Federal Reserve to swiftly and successfully get the country out of problems, even during the turbulent 2007 (something you don't have to be a crank to view as somewhat suspicious, given the Fed's prior track record).

Part II, "The Legislative Arena," deals with the post-Jekyll Island timeline of events leading up to the Federal Reserve, a narrative that Rothbard did not cover as much in depth. Here the older cast of characters, in particular Aldrich, fell out of significance as the bill passed into the hands of a Democratic Congress and got wrapped up in the tumultuous election of 1912. The final Glass bill was extremely similar to the older Aldrich plan and the differences were mostly nominal. While the most significant event, the meeting at Jekyll Island, had already passed, this part is still interesting because it describes how the idea for a central bank survived party transitions, populist criticisms, and various political maneuverings.

Ultimately, *America's Bank* is a mixed bag. Lowenstein tells an important story and describes many aspects of the narrative and the crucial cast in great detail. However, the overall narrative is weakened by the author's poor understanding of various economic events, and this causes him to write with a pro-central bank bias and be overly supportive of the proponents' motives, when a more proper understanding would have led to examining rival reforms in greater detail and be more skeptical of the need for a central bank.

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