Boston College

The Graduate School of Arts and Sciences

Department of Political Science

FOUNDING OF THE FEDERAL RESERVE SYSTEM: A POLITICAL HISTORY

a thesis

by

NINOS HANNA

submitted in partial fulfillment of the requirements for the degree
of

Master of Arts

December 2015

المنارة للاستشارات

www.manaraa.com

ProQuest Number: 1606369

All rights reserved

INFORMATION TO ALL USERS
The quality of this reproduction is dependent upon the quality of the copy submitted.

In the unlikely event that the author did not send a complete manuscript
and there are missing pages, these will be noted. Also, if material had to be removed,
a note will indicate the deletion.

ProQuest 1606369

Published by ProQuest LLC (2016). Copyright of the Dissertation is held by the Author.

All rights reserved.
This work is protected against unauthorized copying under Title 17, United States Code
Microform Edition © ProQuest LLC.

ProQuest LLC.
789 East Eisenhower Parkway
P.O. Box 1346
Ann Arbor, MI 48106 - 1346

المنارة للاستشارات

www.manaraa.com

© copyright by Ninos Hanna
2015

المنارة للاستشارات

www.manaraa.com

Title: Founding of the Federal Reserve System: A Political History
Name: Ninos Hanna
Advisor: Marc Landy

ABSTRACT

The Federal Reserve System has been the focus of significant scrutiny, but stakeholders educated as to its history and functions are aware that it serves as a crucial resource for preserving national (and by extension global) economic stability. This paper consists of a historical overview of the Federal Reserve and the many controversies, which have led to adjustments that improved the System and kept it effective throughout changing times. With discussion of its constitutional foundations, the establishment of the central bank of the United States, pertinent legislation, and political controversies, the Federal Reserve will be explained in a comprehensive way that can lead to accurate appreciation for the nature of the System, as it exists today – with greater transparency and importance than ever before.

المنارة للاستشارات
www.manaraa.com

"I walk slowly, but I never walk backward." – Abraham Lincoln

Introduction

Despite being neither the oldest nor largest federal agency, the Federal Reserve System has a greater impact on everyday economic life than any other regulatory agency. Surprisingly, however, the Federal Reserve System, or Fed, as it is often called, remains a largely misunderstood federal institution. Although transparent by design, the general public knows very little about the Fed's many functions and perhaps even less about its history. Janet Yellen, current Chair of the Board of Governors of the Federal Reserve System is the single most important figure in determining the state of the U.S. economy, which in turn, significantly affects economies around the world. And yet an astonishing seven out of ten Americans have no idea who she is.[1]

Perhaps the most recent and most public example of the average American's lack of familiarity with the Fed was witnessed in the aftermath that followed the so-called Great Recession of 2008-2009. Throngs of protesters took to the streets, and some boldly called for an end to the Fed. The irony is of course that the Fed, by design, as will be shown below, has several methods by which to fight such economic upheaval and maintain economic stability. Throughout its long and contentious history, the role and power of the Federal Reserve has grown and evolved. While the Fed has been granted greater authority over time, it has also experienced greater scrutiny by politicians and their constituents. As it currently exists, the Fed is entrusted with the power to raise or lower interest rates as economic circumstances require, sell and buy U.S. government debt, as well as extend cash and credit to various financial institutions. Now, one may

[1] Barry Ritholtz, "Janet Yellen? Janet Who?" Bloomberg View

المنارة للاستشارات
www.manaraa.com

argue the effectiveness of these methods on the recession, as economist John B. Taylor or Senator Rand Paul have,[2] but the public response to this crisis only underscored the extent to which most Americans lacked even a basic understanding of the Federal Reserve System.

While the general public remains largely ignorant of the workings of the Fed, contemporary scholarship is itself divided in regard to many important questions about the Fed. Essentially the study of American Central Banking offers two contradicting perspectives on political control of monetary policy. One camp espouses the subordinate status of the Fed. Political economists in this school of thought assert that the president gets what he wants from the Fed, in order to carry out the administration's economic policy. Nathaniel Beck and John Woolley are the leading theorists of this camp. In Woolley's view, the Fed is best understood as an agent of the Executive Branch, while in his seminal work, *"Partisan Manipulation of the Economy: Another Look at Monetary Policy with Moving Regression"*, he argues that monetary policy would thus be expected to vary as the party identity of the president changes and may be expected to respond to the proximity of elections. For example, there is some empirical evidence to support the claim that aggressively redistributive Democratic administrations demand large increases, while modestly redistributive Republicans demand smaller increases.[3] In both scenarios, however, the Fed is shown to be responsive to the demands of elected officials.

A second perspective, championed by individuals like Kenneth Rogoff and Mark Toma argues instead that the central bank is fairly autonomous. According to Rogoff,

---

[2] Taylor, John B., "The Fed and the Crisis: A Reply to Ben Bernanke". The Wall Street Journal. "Taylor believes the Federal Reserve was significantly responsible for the most recent economic recession due to their handling of the housing bubble.

[3] Corder, Kevin J., "Central Bank Autonomy: The Federal Reserve System in American Politics", p. 7

www.manaraa.com

this autonomy frees central bankers to pursue policies consistent with social welfare, while Toma has also highlighted instances in which autonomous central bankers have oversupplied inflation in order to enrich their agency. This "bureaucratic autonomy" theory claims that political constraints on the Fed's activity are weak. Economists observing legislative activity in the late 1970s concluded that congressional oversight was disorganized and ineffective, thus allowing central bank policy makers to leverage technology to prevent meaningful political oversight. Furthermore, high inflation in the 1970s confirmed the Fed's tendency to oversupply money in order to satisfy narrow organizational objectives.[4] Since the Fed's revenue is directly related to expansion of the money supply, budget-maximizing behavior would result in unexpectedly high inflation.

Perhaps the most controversial and misunderstood, non-elected component of the United States government, the Fed has been vilified by some voters, endlessly disputed by academics and attempted to be controlled by presidents and congressmen. The thesis of this essay, however, that the existence of the Federal Reserve System is in fact fundamental to the economic stability of the United States and, by implication, the world. In light of such widespread misunderstanding, this paper will examine the history of the United States Federal Reserve System, focusing on pivotal milestones in its evolution. To fully understand the nature of such an integral federal institution, one must first examine the contentious debate regarding National Banking beginning first with Alexander Hamilton, its undoing by Andrew Jackson, and the turbulence of the Civil War that was thus created by the lack of central banking. This essay will then move on to discuss the Panic of 1907 leading to the Federal Reserve's initial founding on December 23, 1914. As with many controversial elements of government, the development of the

[4] Ibid. 8

المنارة للاستشارات
www.manaraa.com

Fed does not end with its inception in 1913, as the long-lived crisis of the Great Depression led to many important modifications to the organization and oversight of the Fed in 1933 and 1935. This paper will conclude its historical overview with a brief discussion of important changes that occurred following the Second World War and the economic turmoil of the 1970s, so as to understand how these moments further shaped the stated purpose of the Federal Reserve System.

Constitutionality: The Necessary and Proper Clause

Although contested by many throughout United States history, the basis for a central bank does have its roots in the Constitution. Article 1, section 8 of the Constitution assigns responsibility for monetary policy to Congress by stating, "The Congress shall have Power… To coin Money, regulate Value thereof, and of foreign Coin." Congress was assigned this responsibility largely by default because the alternatives were deemed less desirable, and many countries would later follow suit, owing largely to the success of central banking in the United States. Based on experience abroad (especially England), the Executive Branch's control over monetary policy was perceived to be too risky. Indeed, in many European countries, the monarch had responsibility for monetary matters, which was often abused egregiously. When the government was facing a hard budget constraint—outlays were running well above receipts—the executive turned to money creation by issuing debased metal coins to finance the budget shortfall. This often occurred during times of unpopular war and the result was inflation—stretching the country's gold stock into more coins (debasement) while still chasing the same amount of goods, and thus pushing prices higher.[5]

[5] Simpson, Simon D. "Central Banking and the Federal Reserve", p. 185

المنارة للاستشارات
www.manaraa.com

The early United States was subject to a wide range of financial problems, many of which would ultimately prove ample reason to begin its experimentation in central banking. While the United States' victory against Britain ensured the halt in British restrictions on trade and industrial output, the nation nonetheless also lost its 'favored' status as a British trading partner. Additional financial problems which the nation faced in 1789 consisted of the *debts* which the United States had incurred as a result of the Revolutionary War. The inflation rate on continental currency was exorbitant, leading to that currency depreciating wildly following the founding and establishment of the United States. To this end, the primary focus of the U.S.' newfound government and economic leadership was to devise a means by which inflation could be reduced, currency value could be raised, and debts could be serviced.

Revolutionary debt was one of the most "intractable" problems faced by the newly-formed nation, and continued to pose a threat to the solvency and strength of the country even after Congress "[reduced] most of the nation's chaotic accounts to common equitable value"[6]. Despite that the debts had been reconciled against one another, servicing these obligations remained a highly difficult task for Congress, as neither the federal government nor the states had formal revenue powers at the time of the nation's founding. Worse yet for the fate of the *unified* United States, the states which had established revenue policies at the time of the signing of the Articles of Confederation strongly preferred to service their *own* debts rather than those which had been incurred by the nation. For this reason, the market value of those debts declined in open trading, leading to the value of American credit to be at the whims of foreign investors. As a result, while some powers – particularly the Dutch –purchased American debt and thus

[6] Buel, 2009, p. xxix

المنارة للاستشارات
www.manaraa.com

served to maintain the nation's credit, the failure of these debt partners to "win U.S. merchants access" to European commerce all but ensured that while America was an independent nation, its economy essentially remained a colonial one[7].

In the newly formed United States, however, Congress was not ideally suited for this responsibility, considering the two-year term of its representatives, but was considered to be the best alternative. However, the Constitution remained vague on how Congress should carry out these responsibilities, and did not explicitly call for the creation of a central bank. This lack of clarification on the part of the Constitution would thus lead to a very long and often heated debate within United States history.

The First Bank of the United States

The history of central banking in the United States began soon after the new nation won its independence in the last decades of the 18th century. The conflict between rural values and urban reality was one of the first major political controversies following ratification of the Constitution in 1789. Consequently, George Washington's presidency would deal with numerous issues regarding the monetary and fiscal powers of the newly established federal government. Washington's cabinet included two influential leaders; Alexander Hamilton was Treasury Secretary, and Thomas Jefferson was his Secretary of State. These powerful men, however, championed opposing sides of this contentious political debate. Hamilton favored a strong central government, while Jefferson insisted upon more power to the states. Hamilton was thus an early advocate of creating a central bank, insisting that a national bank would provide a standard currency that would promote trade between states. Such currency would also reduce dependence on foreign trade as a means to regulate the money stock. Money stock in the 18th century consisted

[7] Ibid.

للاستشارات المنارة
www.manaraa.com

mainly of gold and silver, and increasing these precious metals relied on exports to other countries that would, in turn, pay for the goods with gold. Thus, as Hamilton saw it, a national paper currency would eliminate the need to rely exclusively on gold and thereby promote commerce. Lastly, Hamilton envisioned a bank that would also serve as a means of housing government deposits of tax revenues and for making sure that funds were transferred between the states.[8]

Not everyone agreed with Hamilton's proposal for a National Bank, however. To appreciate why, it is helpful to keep in mind that America was founded by people who had fled Europe and had deep suspicion of centralized authority, especially in the financial sphere. Thus, if commercial banks and other financial institutions were necessary for development of the economy it was assumed that it would be best if they were smaller, local entities. Indeed, the chartering of banks, like other businesses, was considered the proper responsibility of the states. Thomas Jefferson, along with other Democratic-Republicans who opposed a large central government, vehemently opposed a National Bank arguing that the Constitution did not specifically empower Congress to create one. However, Hamilton countered this argument by pointing to Section 1, Article 8, of the Constitution which, in addition to assigning monetary policy to Congress as mentioned above, also gives Congress all powers "necessary and proper" to the exercise of its specifically enumerated responsibilities.[9] Since Congress had been granted monetary and fiscal powers, Hamilton affirmed it was proper to create a central bank for them to carry out this work.

[8] Hafer, R.W, "The Federal Reserve System: An Encyclopedia", p. xii
[9] Johnson, Roger T., "Historical Beginnings… The Federal Reserve System", p. 7

المنارة للاستشارات
www.manaraa.com

In the end it was Hamilton, not Jefferson, who got his way and The First Bank of the United States was created in 1791 when Congress passed, and Washington approved, legislation for a twenty-year charter. The Bank was headquartered in Philadelphia and performed basic banking functions such as accepting deposits and issuing bank notes, making loans, and purchasing securities. The First Bank thus fulfilled its role as government's fiscal agent and lender of last resort (lending money to a bank in a financial emergency). While the Bank's power proved useful to American commerce, it also frightened many people who were distrusting of Banks and politicians. Public sentiment for the Bank was mixed and the debate between politicians grew heated. Interestingly, a key element in the debate is one that would resurface frequently in the history of Central Banking in the United States: the notion that creating a central bank would grant the federal government monopoly control over the nation's money supply. This may seem like an odd controversy today, having long lived with, and thus taken for granted the idea that the federal government has the ability to print money. In the 18th century, however, "Many believed that money—currency—should be competitively provided, determined by the changing supply of gold and not left to the whims of government officials."[10] It is much more difficult, it was argued, for individuals to manipulate the money supply if it is based on a commodity such as gold. This debate would cast a dark cloud over the First Bank.

Another controversial issue surrounded the fact that foreign investors, primarily from Europe, owned large portions of the Bank's outstanding stock.[11] Although the Bank's charter clearly stated that only United States residents could hold positions of

[10] Hafer, R.W, p. xii
[11] Ibid, xii

www.manaraa.com

control within the Bank, some argued that the Bank was being used for the benefit of foreign owners over the U.S. public.

A series of objections were leveled against the First Bank of the United States in the years prior to and following its establishment. One primary objection was of prudence: Critics of the First Bank argued that the 20-year charter – which would be signed in 1791 – would contractually bind the United States to an entirely too-stringent commitment. Given how the nation was extremely young (with a Constitution that had only been in effect for two years in effect by the establishment of the First Bank), though proponents of the Bank argued from reasoning informed by their optimism, critics argued that a twenty-year minimum was entirely too long a period of time link the nation's finances to an untested institution[12].

Other objections to the First Bank of the United States often centered upon how the bank – which was, in its structure, based upon the Bank of England – had a strong potential to be marred by influence which might come from outside the United States. The key objection centered on the structure of the bank itself, which unlike the Bank of England, allowed voting shareholders to exercise power over banking operations reflective of the size of their investment.

Unlike the Bank of England, under which operations were a strongly enforced standard which mandated that each shareholder had one vote, Alexander Hamilton proposed a means by which the influence of each prospective shareholder would reflect their leverage into the bank itself. While this standard might seem appropriate, especially given the nature of the democracy under which the proposed First Bank would exist, questions arose with respect to the potential of the bank (and with it, a financial center of

[12] Kaplan, 1989, p. 30

المنارة للاستشارات
www.manaraa.com

American politics) to fall under foreign ownership. If voting ownership was to be determined by stake, critics feared that there would be little to prevent foreign entities from exercising a powerful, or even a majority, stake in American financial governance[13].

There was strong interest in American investments from the time of the War of Independence forward, largely due to the exorbitant cost and widespread economic disruption incurred by the former colonies as a result of their fighting the world's greatest military to a standstill. Many of the same reasons which made the fledgling United States such an attractive proposition with respect to central banking ensured that the nation would also prove attractive to foreign investors. As a result, foreign entities and governments embraced the chance that the First Bank presented: The bank would provide a means by which the new nation (for which foreign investment was tantamount to a vote of confidence) could be economically supported, and through which foreign entities could make a considerable return on investment in the resource-rich and active new democracy.

However, for the leaders of this young nation whose soldiers had so ardently resisted external colonial force, Hamilton's proposal would seem to be an invitation to the imposition of outside tyranny. Indeed, the figures seem to bear out this concern: by 1803, barely a decade after the First Bank's establishment, "62 percent of…stock" in that bank was foreign-owned[14]. By 1811, when it came time for Congress to decide whether to retain the services of the bank at the expiration of its original 20-year charter, and as the United States was preparing to yet again go to war with Great Britain, fully 70

[13] Ibid.
[14] Wilkins, 1989, p. 61

المنارة للاستشارات
www.manaraa.com

percent of such stock was foreign-owned, and a majority of such foreign owners were British.

Significantly, this concern of foreign entities exercising inappropriate political force over the direction of the First Bank, and as a result, over the United States itself, would be largely excised at the time of the bank's founding. Even during the years during which the First Bank was in operation and accruing foreign investment, such investors were bound by stipulations which argued that they would have "no directors on the board nor any voting power"[15]. Despite the fact that this law caused widespread and unfounded fears of foreign investors conspiring against the United States through banking influence, fears of foreign influence remained pervasive through the decades that the First Bank was in operation. Largely due to such fears, Congress would vote to not reincorporate the bank in 1811.

The ultimate force which would see the First Bank fail to be rechartered in the House of Representatives lied in its opponents' far more compelling argument. On one hand, those who advocated for the Bank might cite its 20-year track record of success in enhancing the fledgling American economy, and point to how export revenue had increased from $18 million in 1791 to $76 million in 1804, due in large part to the "increased activity of capital" which had been promoted by the First Bank[16]. However, the arguments against the First Bank, made at a time of increasingly anti-British fervor, found considerably more traction than the comparatively dry viewpoint advanced by the Bank's advocates.

[15] Ibid.
[16] Kaplan, 1999, p. 31

المنارة للاستشارات
www.manaraa.com

While the Bank's directors tried to launch early efforts in 1808 and 1810 to renew the bank's charter, by 1811's open Congressional debate these advocates are described as having "little passion for politics," and as private individuals who seemed to wish the whole affair "to end quickly so they could find other ways to make money"[17]. By the time that the bank's 20-year charter expired, amid a heightened atmosphere of anti-British sentiment – finding, for instance, that the First Bank, due to its majority-British stockholders, was being called the 'British Bank' – the First Bank's directors had come to view their stockholders as a major liability[18]. Despite this being unfounded, political fallout was inevitable, it would seem, and damage to the Bank's reputation only added to its controversy.

When the charter came up for renewal in 1811, James Madison (a fellow Virginian and good friend of Jefferson) was President. He too opposed the initial Bank charter but surprisingly subordinated his constitutional objections and instead favored the Bank's charter renewal on grounds of economic expediency.

Part of James Madison's approach to the Bank Bill proposed by Alexander Hamilton centered on flaws in that bill which were perceived to be of a *financial* nature. In speeches before Congress in 1791, James Madison cited his reservations regarding the bill's proposed abolition of precious metals as a basis for American currency, a factor that Madison believed would expose the American people to speculation and thus the heightened risk of a bank run[19]. In addition, Madison argued that the original proposed length of the charter, at eleven years, was too long and risked unleashing instability on

[17] Kaplan, p. 29.
[18] Kaplan, p. 32
[19] Staloff, 2005

www.manaraa.com

the American people which would easily metastasize during such a generous period of time.

The threat posed by central banking was best elucidated by Thomas Jefferson, who argued that banks *in general* did not provide a positive service to society. Instead, Jefferson and Madison argued that banking – particularly banking bound to government, as was the Bank of England and any institution modeled after it – was a malignant force. Jefferson argued that banks did not help people to achieve success in life, but were rather predatory forces which left debt in their wake and supported only exclusive luxury[20]. Moreover, to permit the chartering of a central bank from which national economic decisions would issue, to Madison, would be to open the nation to control by an institution given "a boundless field of power," and one which was "no longer susceptible to any definition," or any restriction under the law[21].

While Madison and Jefferson's fears and reservations regarding the establishment of the First Bank centered on concerns of unlimited federal power, their primary arguments were neither explicitly political nor financial in nature. Instead, these individuals' objections to the First Bank were primarily *constitutional*. As described by Brookheiser, this argument against the bank centered on the 10th Amendment to the Constitution, which argues that any powers which the Constitution specifically did *not* give to Congress would remain in the hands of the people. By using the power of the government to incorporate and charter a central bank, these framers argued that Hamilton would cede control of the nation's finances to an organization which was not controlled by the people. However, when this consideration was put to then-President George

[20] Merrill, 1970, p. 435
[21] Staloff, 2005, p. 436.

المنارة للاستشارات
www.manaraa.com

Washington, the first President sided with Alexander Hamilton. While the decision to charter the First Bank was made over Jefferson's objections, it appears that Hamilton's proposal was constitutional. Citing the Constitution, Hamilton argued that it was appropriate for the nascent federal government to contrive an institution which would help it to regulate trade as well as collect taxes in as expeditious a manner as possible. As Congress was constitutionally authorized to do so, the creation of a bank which would help to facilitate this power could not be constitutional.

George Washington would sign Hamilton's bank bill over Madison and Jefferson's objections on April 25, 1791. While the above arguments forms and reflects the conventional history of the founding of the First National Bank, and the arguments which prevailed, some research now indicates that despite the perception of Madison and Jefferson as stalwart defenders of the Constitution, their argument – and opposition to the First Bank – had less to do with these ascribed ideals than "political-legal concerns," and their argument along Constitutional lines was intended as a "ploy" designed to sink the bank before it was established[22].

The vote in Congress was extremely close but ultimately failed in both houses by the margin of a single vote. As if to underscore the politically contentious nature of the Bank, the tie-breaking vote in the Senate came from Madison's own Vice President, George Clinton (R-NY) whose vote was based on political, rather than economic, reasons.[23] Clinton had risen to that office on the strength of the Twelfth Amendment (which linked the futures of Presidents and Vice Presidents) and who helped secure Thomas Jefferson's presidential victory in 1808, would leave a lasting mark on American

[22] Mereminsky, 2012, p. 1.
[23] Johnson, Roger T., p. 8

المنارة للاستشارات
www.manaraa.com

economic history. As described by Nelson (2015), at the time of Clinton's placement on the Democratic-Republican ticket as a northern 'balance' to Jefferson's Virginian background, he was sixty-five and a man of "failing" mind and body[24]. While Clinton campaigned effectively and helped to secure Jefferson's reelection, he quickly found that his perceived "forgetfulness" as well as his "inattention to detail" precluded him from greater office than the Vice Presidency. Nelson (2015) explains that Clinton felt spurned by his party for these perceived slights, and cast the final tie-breaking vote against re-chartering the first bank as a result.

As history would show, the decision to not renew the Bank's charter in 1811 proved detrimental. Without a central bank the country had a difficult time financing the War of 1812.[25] This in turn led to a period of inflation that many believed was avoidable had there been a central bank to coordinate monetary policy. Support for a Second National Bank quickly gained momentum in the years following the war. Pressure to reconsider the National Bank began to mount on Congress and, after some debate, a charter for the Second Bank of the United States narrowly passed both houses and was signed by Madison in 1816.

The Second Bank of the United States

The Second Bank was structured identically to the First Bank. The federal government owned one-fifth of the stock and one-fifth of the directors were appointed by the President. Moreover, the charter for the Second National Bank was also to run for twenty years.[26] As if nothing had been learned, however, just like the First Bank the Second Bank immediately found itself embroiled in controversy, largely due to its

[24] Nelson, 2015, p. 1535
[25] Hafer, R.W, p. xiii
[26] Johnson, Roger T., p. 9

المنارة للاستشارات
www.manaraa.com

increased size and power. Its vast economic power made it politically vulnerable. Consequently, many people, including politicians and businessmen came to view the Second Bank as a serious threat to themselves and to democracy itself.

In 1819 the United States experienced a financial panic, which some attributed to the Bank. One such cause for trepidation surrounded the common practice of the Bank taking in the notes (currency) of state banks in exchange for its own. Because the state bank notes were backed by gold and silver specie, the Second Bank would redeem its holdings of the state bank notes in exchange for specie as a way to check any over issuance of state notes.[27] Some argued, however, that this policy led state banks to issue too few notes, which thus exacerbated the financial panic. Although the Second Bank managed to weather the storm of 1819, it became embroiled in constant turmoil thereafter. One man in particular, whose opposition to the Second Bank would ultimately lead to its demise, was Andrew Jackson.

During the presidential campaign of 1828, Jackson, who saw himself as an advocate for Western frontiersmen and agrarian interests, voiced his mistrust and displeasure with the Second Bank and banks in general. Although the Bank's charter still had seven years remaining at the time of Jackson's inauguration, he intensified his efforts against the national bank. This began the so-called Bank War, wherein Jackson discredited the Bank by suggesting it was run by self-interested urban elitists who did not care for the needs of ordinary citizens.

By the election of 1828 and the presidency of Andrew Jackson, there was considerable reason for the Second Bank of the United States (which had been in place for well over a decade) to draw criticism. In the first place, prior to its establishment and

[27] Hafer, R.W, p. xiii

www.manaraa.com

following the original means by which the bank was established – to solve the financial woes and correct for the inflation caused by the war of 1812 – there was strident criticism. Critics commonly the reinstatement of central banking precisely because the Second Bank as proposed would bear a strong resemblance and play a similar role to the purpose and focus of the First Bank.

This direct similarity between the two banks precipitated a long and strenuous fight in the Congress over the role and propriety of again turning to central banking as a means of rectifying national financial difficulty. However, by 1816 the compounding debts from the war of 1812, as well as the ensuing economic instability of those years helped proponents to push for its establishment. The Second Bank of the United States was largely modeled on the charter which had paved the way for the first, and established under a 20-year charter, under which it would be up for renewal in 1836.

During the years before the bank's charter was up for renewal, it would face considerable opposition to its place and prominence in American governance, a controversy and debate which would reach a fever pitch by 1836. As described by Seavoy (2013), President Andrew Jackson, who was elected in 1828 and reelected in 1832, was a tireless opponent of centralized banking, and often described the Second Bank as being "unconstitutional", and publicly announced his intention to oppose its reincorporation at the time of its charters' expiration[28]. In this instance, Jackson's opposition to the reincorporation of the Second Bank is notable for Jackson's intense focus on the national debt, and on measures that he could put into place to pay down that debt. To this end, Jackson's presidency was notable for its 'war' on central banking in general, and took two primary forms: The first was by its focus on the elimination of the

[28] Seavoy, 2013, p. 122

المنارة للاستشارات
www.manaraa.com

national debt which Jackson viewed as a force for beholding the United States to central banking itself, as well as to bankers. To pay down the debt, it was shown to be not only necessary to reduce spending, but to increase revenue paid into the federal government. In particular, Jackson's 'bank war' would come to a head with regard to an 1828 tariff law which was known as the 'tariff of abominations'.

As described by Northrup and Turney, the 1828 bill which would lead to the establishment of a major protectionist tariff (against which the federal government might pay down its debts), was designed to fail, and as such was made as "obnoxious" as possible, including a duty on pig iron of 50 percent[29].

The point of designing this bill to fail is described in political terms: Turney (2003) explains that by the designed failure of the bill, the Jacksonans would appear to be pro-tariff (despite their unrealistic proposal), and their Whig opponents would appear weak on trade. However, much to the surprise of Jackson's supporters, the bill went on to see major support in the Congress, and was signed into law by President John Quincy Adams in 1828. The years during which this tariff was in place were ones of extraordinary high duties on a wide range of goods. While this led to high income for the federal government, in keeping with Jackson's plans to pay down the debt, this tariff came at the expense of southern states' (who viewed the tariff as confiscatory) support for the federal government and the increased risk of secession.

With regard to his opposition to central banking, Andrew Jackson was principally influenced by Martin Van Buren, the future President who campaigned for the interests of smaller state and municipal banks, independent business entities, as well as "slave states

[29] Turney, 2003, p. 364

المنارة للاستشارات
www.manaraa.com

who wanted to diminish the power of the central government"[30]. Through these two points of view – with Jackson's advocacy leaning toward constitutional arguments similar to those who had opposed the First Bank – and with Van Buren's siding with the business and smaller banking community, a major force for the opposition of the Second Bank was formed by the late 1820s.

While it is not unfathomable that Jackson's opposition to the Bank was formed on constitutional grounds, a stronger argument is presented by Armstrong (2015), who proposes that Jackson only opposed the Second Bank because it was controlled by his political rivals. This author explains that Nicholas Biddle, the President of the Second Bank of the United States, would "routinely [use] lending practices for political gain," including using the Bank's funds to "publish newspaper attacks on opponents", as well as openly favor the National Republicans (later the Whig Party), including Jackson's rivals such as Daniel Webster and Henry Clay[31]. Because Biddle was misusing the bank in this manner, Armstrong (2015) argues that it was appropriate that Jackson pose his opposition through opposing the banks' reincorporation.

From an economic standpoint, Jackson and Van Buren's opposition to the Bank centered on the bank's restricting of credit practices, an unpopular policy which fell upon the states in as disparate a manner as the tariffs. This would form the crux of Jackson's public argument against the bank. To this end, a congressional faction which supported the bank would attempt to reincorporate it in 1832. Finding political opposition to be insurmountable, these opponents decided to instead make the manner of the Second Bank – and Jackson's opposition – the central issue of the 1832 Presidential Election. Public

[30] Seavoy, 2013, p. 122
[31] Armstrong, 2015, p. 1

المنارة للاستشارات
www.manaraa.com

opinion was on the side of the President, though, during whose administration the public debt was reduced to zero for the first time in American history. When Henry Clay and other bank supporters rushed a bill through Congress which would result in reincorporation, Jackson threatened and then went through with a veto of that bill. The veto proved popular, and Jackson was reelected president in November of 1832. Flush with victory in that election, Jackson then withdrew federal assets from the Second Bank, effectively ruining the institution four years ahead of its planned expiration.

In 1832, despite such opposition, both houses narrowly passed the third charter. However, it was quickly vetoed by Jackson who, unlike Madison, deemed it unconstitutional. In his veto message to the Senate on July 10, 1832, Jackson acknowledged the convenience of having a national bank but ultimately stated that, "some of the powers and privileges possessed by the existing bank are unauthorized by the Constitution, subversive of the rights of the States, and dangerous to the liberties of the people." In Jackson's opinion, the Bank was incompatible with not just the Constitution, but also indeed the founding principles of the United States.

Unable to override the president's veto, the bill to renew the Bank's charter failed. Jackson quickly began to gut the Bank of any influence and directed the federal government to withdraw its deposits from it. In the presidential campaign of 1832, Jackson's opponent Henry Clay circulated Jackson's veto message as a means to attract voters. However, much to his astonishment, the public was overwhelmingly in favor of Jackson's decision. Jackson would go on to defeat Clay handily and win reelection, and a second term for Jackson ensured an end to the central bank until the creation of the Federal Reserve in 1913.

المنارة للاستشارات
www.manaraa.com

From 1836 to 1863 America's banking would be handled by myriad state-chartered banks absent of federal regulation. Unfortunately, as was foreseen by advocates of The Second National Bank, this would lead to unstable currency, the birth of so-called "Wildcat Banks," and dozens of different banks issuing their own currency. Such problems eroded confidence in the banking industry itself, and added greatly to the difficulty of financing the Civil War.[32]

In keeping with Jackson's policy of withdrawing the nation from central banking, 1832 saw the United States set out on a path under which federal funds were distributed among state banks. For a thirty-year period to follow, states issued their own currencies, and without a central bank and clearing house – and no federal regulation – saw rampant speculation and misuse of banking resources. One key example lies in those years' rampant speculation in land sales propped up by the unregulated state banks. In response, one of Andrew Jackson's last acts before he left office in 1836 was to pass the Specie Circular Act, which mandated that land purchases be made in gold or silver. This act led directly to the Panic of 1837, when irresponsible loans made by the state banks were called and borrowers' had insufficient gold or silver to service the loans made in banknotes alone. The result of the Panic of 1837 was a six-year economic depression, during which many states attempted to bail out their banks by issuing debt, but would then often default on that debt, leading to multiple states undergoing independent sovereign debt crises.

The years between 1837 and 1862 are known as the 'free banking' era, and many of the banks which were established during those years – in absence of federal regulation – took great liberties with their customers and with the public. As different states carried

[32] Moore, Carl H., "The Federal Reserve System: A History of the First 75 Years", p. 4

المنارة للاستشارات
www.manaraa.com

different levels of regulation, states where regulation was comparatively low would attract actors who may seek to open banks with as little overhead or regulation as that which was necessary to purchase state bonds. The era of 'free banking' saw a wide proliferation of banking practices across the United States, but also widespread customer exploitation, as well as an unprecedented level of currency counterfeiting. During the era of 'wildcat banking', of the "thirty thousand notes in circulation" in the U.S., one third were counterfeit[33].

The National Banking Act of 1863

Following the dissolution of the Second Bank, states quickly established the legal framework within which banks could operate. The rules varied from state to state, inevitably leading to considerable confusion. Many state banks over-issued bank note liabilities and did not have sufficient amounts of gold to back the notes.[34] Consequently, these notes were exchanged at discounts that varied not only from bank to bank, but also over time. For example, bank notes from an individual bank carried its name and if the bank was noted for trustworthiness and good management its notes would trade for a premium relative to others.[35] The currency problem got so bad that people would rely on various magazines that included photos and descriptions of the various bank notes and information about whether the issuing bank was sound. This was perhaps not without some benefits, however, as it put immense pressure on banks to maintain a clean reputation. Consequently, it also forced market participants to carry books that provided the market exchange value of each bank's notes to avoid being stuck with near-worthless notes. This led to high transaction costs, which in turn significantly reduced trade and

[33] Dufries, 2011, p. 36.
[34] Simpson, Simon D., p. 186
[35] Hafer, R.W, p. xiv

www.manaraa.com

overall economic activity. Moreover, the banking system was fettered by inadequate bank capital, risky loans, and insufficient reserves against the bank notes and demand deposits.

The onset of the Civil War delivered the final blow to the free banking system, and by 1862 it came to an end. In an effort to respond to the gross inadequacies of the free banking system and to finance the war, Congress passed the National Banking Act of 1863. This legislation brought greater clarity and security to American banking and finance. It called for the creation of nationally chartered banks, and imposed a significant tax on state bank notes.[36] Federally issued bank charters were meant to diminish the power of state banks. State banks were unable to tolerate the high tax imposed on issuance of notes and eventually this ended their existence. Consequently, this strengthened the national bank note and helped unify the nation's currency. Furthermore, the National Banking Act also introduced some basic aspects of modern banking but fell just short of establishing a central bank. For example, national banks were required to hold reserves against their customers' deposits at specified reserve city banks located in New York, Chicago, and St. Louis. However, the problem of elastic currency remained a major dilemma.

Although the Act specified what reserves would consist of (gold and gold certificates, greenbacks and U.S. Treasury currency), it did not provide easy access to funds for financial institutions in times of crisis to meet the unexpected deposit demands. Instead those funds were held in reserve city banks and not readily available to meet customers' demands. Therefore, when customers were not able to access their funds expediently, fear of bank failure spread quickly and bank runs occurred.

[36] Johnson, Roger T., p. 12

المنارة للاستشارات
www.manaraa.com

Although everyone felt the negative effects of this inadequate system, it was farmers who felt the biggest brunt. They were usually unable to obtain enough credit to supply the seasonal needs of their customers. Following the harvest season, farmers' surplus funds held in local banks were sent to the money center banks in larger cities like New York, where they earned interest. In turn, money centers would lend those funds to speculators in the stock market, but when farmers called on these loans the banks lacked the reserves to pay and money panics often resulted.[37] In some cases, farmers would lose their surplus or wait long periods of time to have access to those funds. This was especially problematic for farmers because their business generated funds on a seasonal basis. Not being able to access funds at a specific time could ruin the farmer's opportunity to make a profit for the entire year.

Although the National Banking Act provided for the national chartering of banks and national bank notes, it still lacked the essential features of central banking, such as elastic currency that was able to meet the demands of consumers. Absent a central bank, America's financial structure was increasingly disturbed by inelastic currency and immobile reserves.[38] Rather than responding to the requirements of American business, national bank notes, which were secured by government bonds, grew or contracted in response to the realities of the bond market.[39] In the waning years of the nineteenth century, America's industrial economy was becoming larger and more complex. In such an environment the inelasticity of currency, immobility of reserves, and the lack of a lender of last resort became increasingly important to address. Commitment to the gold

[37] Moore, Carl H., p. 4
[38] Johnson, Roger T., p. 14
[39] Ibid. 14

المنارة للاستشارات
www.manaraa.com

standard following the Civil War meant that prices, especially agricultural prices steadily declined.

By 1896 the economic decline was so steep that politicians and economists began to seriously debate the merits of the gold standard over a free coinage of money by allowing silver to be used. Some believed the gold standard was to blame for the economic recession because it limited the money supply, and that introducing silver coinage could help recovery by expanding our currency. However, special interests (especially farmers and miners) also played a role in the advocacy of silver coinage. Farmers sought to boost the economy and cause inflation, which would allow them to repay debt with cheaper dollars. Indeed, the debate was so central that it was at the forefront of the presidential election in 1896. William Jennings Bryan (Democrat) campaigned on a platform that called for dual coinage ("Free Silver Movement"). However, his opponent and subsequent victor, William McKinley (Republican) professed stronger central government, building American industry through protective tariffs, and staunchly backed a Dollar based on gold.[40] McKinley's victory established the gold standard as the monetary standard for the next forty years. However, given the many deficiencies of the national banking system and the lack of elasticity of the gold standard the country continued to face financial strains.

Although generally referred to as the Gilded Age, due to the booms in many important industries and the creation of so-called captains of industry such as John D. Rockefeller and Andrew Carnegie, economic turmoil gripped the United States as the nineteenth century drew to a close. Certainly some sectors of the economy experienced momentous technological advances, most notably in the field of transportation with the

[40] Williams, Hal R., "Realigning America: McKinley, Bryan and the Remarkable Election of 1896", p. 77

المنارة للاستشارات
www.manaraa.com

invention of the locomotive, while other sectors remained completely stagnant. This uneven progress led to political squabbles, not only between Republicans and Democrats, but also between entire regions of the nation, many of which were still reeling from the effects of the Civil War and Reconstruction.[41] Struggling to find a solution to the problems, politicians and bankers debated several suggested programs. Politicians agreed the current system was broken and demanded immediate attention but battled for many years to find a viable solution.

The Panic of 1907

The first decade of the twentieth century witnessed the rise of the Progressive Movement. Progressivism was a political ideology and movement born out of the desire to eliminate corruption in government. Progressives were educated, urban, and sophisticated in their use of political power, and were successful in obtaining political control through winning a significant number of local, state and federal elections from 1890-1920. Although the Progressive Movement took a variety of forms and was comprised of a diverse group of leaders, its major purpose was to limit and regulate the new combination of economic and political power, which the growth of industrial America had spawned.[42]

It is also necessary to consider the progressive movement in the context of labor and banking reform. The period between 1870 and 1930 was rife with reform to working standards for which proponents fought hard. For these reformers, the industrial age had brought with it not a sense of expanding possibility for all people, but rather a sense of contraction, and a newfound exposure to an intense disparity between the wealthiest and the poorest. The workers' rights and anti-monopolist movement would form in the late

---

[41] Hafer, R.W, p. xv
[42] Johnson, Roger T., p. 17

المنارة للاستشارات
www.manaraa.com

19th century. A meeting in 1892 of grassroots activists who referred to themselves as the Industrial Conference led to the formation of the People's Party. This movement committed themselves to "speaking to and for the millions of Americans…alienated from the corporate order that had grown to maturity since the Civil War"[43].

Chief among the criticisms levied against the industrial establishment was that it treated workers like cogs in machines and as mere grist for the mill of profitable exploitation. While the politics which would follow the progressive movement were intense in their emotional appeal, there is substantial evidence to indicate that these advocates were appropriate to claim that the older methods of labor had been supplanted by a system which was altogether more exploitative in nature. In the years prior to the Civil War, an industrial factory system had just begun to supplant artisans and apprenticeships, but after the war the nature of labor began to change on a national level. Mass production brought with it the phenomenon of craftsmen replaced with impersonal assembly lines upon which workers were required to move at a machine's pace. With the increasing impersonal nature of such labor (and lower level of skill necessary to complete atomized tasks), industrial facilities would often be staffed with cheaper labor, including immigrants, women, and children. Facing problems which were massive in their scope and which had arisen in a brief period of time, populist-minded progressives proposed systems of radical reform which would offer "salvation" from the machinations of an "elite whose power appeared both monstrous and seamless," offering to replace such power with a return to "egalitarian principle" and a sense of harmony which would unite all social classes[44].

[43] Kazin, 1998, p. 27
[44] Ibid., p. 29

المنارة للاستشارات
www.manaraa.com

Perhaps paradoxically, the progressive movement would support central banking and would form one of the strongest points from which advocacy for the Federal Reserve would be launched. As described by Rothbard (2009), while there is considerable evidence to indicate that the progressive movement began as a ‘grass roots’ effort through which labor flexed its muscle and pointed policy its own favor, there is also much evidence to indicate that the movement was coopted by businesses who sought a more statist and monopoly-friendly approach to government regulatory and monetary policy. Despite the massive gains which were made by large business interests in the latter years of the 19th century, the market always resisted attempts to monopolize through mergers. Beginning with the failed railroad monopolies sought by J.P. Morgan, new and active competition – whether internal or external – would consistently hamper businesses’ efforts to cartelize.

A solution to this problem was proposed in the form of what is now known as ‘regulatory capture’, but which was proposed as a direct ‘solution’ to these industrialists’ difficulty in forming monopolies, launched in the name of preventing further worker exploitation through monopoly. Through a rapid expansion in federal regulatory power over industry which would follow during the early years of the 20th century, worker protections, safety standards, and other important oversight were put into place, but Rothbard (2009) argues that the intention behind this regulatory push was to produce an environment which would be conducive to monopoly.

Despite the high-profile ‘trust busting’ which took place under the presidency of Theodore Roosevelt, the progressive movement hid a force for expanding state power to protect workers in a wholly unprecedented manner, but also abandon *laissez-faire*

المنارة للاستشارات
www.manaraa.com

governance altogether. While the progressive movement would ideally oppose the concepts of central banking – in keeping with Jacksonian or Madisonian approaches to central banking's constitutionality, or the potential of centralized banking to lead to worker exploitation, instead the progressive movement led to an attitude of appreciation and acceptance for a stronger central government. Though it is possible to see this era as one of victory for workers' rights, these victories came at the expense of a hands-off federal government. Through progressivism, Rothbard (2009) argues that workers' needs were coopted by the private sector, and through private actors' collusion with the government, monopoly control was ensured through a paradoxical influx of regulation. Such control would culminate in 1913 with the establishment of the Federal Reserve.

The Progressive Movement's response to the Panic of 1907 (also known as the 1907 Bankers' Panic or the Knickerbocker Crisis) also paved the way to the founding of the Federal Reserve System. Questionable practices by some of the country's major companies led to a series of stock prices declining in the spring of 1907. This was further exacerbated by a reduction in gold inflows, which caused the money stock to decline. As a result, by fall of 1907 the economy was in full-fledged panic and uncertainty about the stock market was wide-spread. Bank runs, as well as substantial declines in the stock market and overall economic activity resulted. Evidently, government regulations of the era could not prevent the same type of bank panics that had prevailed in earlier times. Luckily, the panic was short-lived, as a consortium of financial institutions led by financer J.P Morgan, came to the rescue of troubled banks and trust companies. The public's confidence was quickly restored and depositors returned to banks. By February

المنارة للاستشارات
www.manaraa.com

1908, the panic had subsided and the economy once again began to expand.[45] However, the event left a permanent mark on the country's financial and economic landscape. It further demonstrated the need for a central bank and much needed reform in bank regulation. Most importantly, the crisis made it clear that breaking the link between banks and the stock market was paramount.

The first push for reform took shape when Congress passed the Aldrich-Vreeland Act of 1908. The Act had two major areas of focus. One was the creation of a national clearinghouse to deal with the inelasticity of currency, and the other was the creation of the National Monetary Commission, chaired by the Republican Senator Nelson Aldrich from Rhode Island. The Commission's task was to study and analyze various banking systems of the United States and the world, primarily Europe, and report their findings back to Congress. The Commission was to determine if a "best practices" model could be developed. Following their research, the Commission made three recommendations: the formation of a central bank that would create and hold reserves; creation of a coordinated system of check clearing and collection; and the establishment of a fiscal agent that could satisfy the needs of the federal government.[46]

As if the previous one-hundred years had not changed the debate at all, Congress was still stuck between two extremes. On the one end were the proponents of a single central bank, owned by the commercial banks and run by bankers. On the other end were those who opposed a central bank of any kind on the assumption that it would monopolize the industry and exist only for the benefit of the bankers. As for legislation, there were two very different central banking models that emerged at this time. One was

---

[45] Hafer, R.W, p. xv

[46] Ibid, xv

المنارة للاستشارات
www.manaraa.com

spearheaded by individuals such as Senator Aldrich that served the interest of big banks in the northeast by creating a bank similar to the Bank of England. The bank would be headquartered in New York City, with various branches scattered across the country, privately owned and highly centralized. The other model was that of the Progressive Party and individuals such as William Jennings Bryan. They favored a central bank system, without a central headquarters, having a federal component. Although President Wilson would make certain compromises, the final legislation would retain the distinct imprint of the Progressive Movement.[47]

In 1911, the Aldrich Commission proposed the creation of a privately owned national bank, with fifteen branches across the country that would become "Bankers Banks," dealing only with banks, not with the public. Senator Aldrich called this proposed organization the National Reserve Association. Ordinary banks would deposit a set portion of their reserves, both in cash and in borrowers' promissory notes, otherwise known as "commercial paper." In this way, the reserve fund would be available to support member banks in times of crisis. The association would also be authorized to issue a new paper currency, to be called National Reserve Notes, and since the currency would be based in part on commercial paper, the amount in circulation would expand and contract in accordance with the business cycle. The notes would be a privately issued currency, backed by the National Reserve Association not the federal government.[48]

Aldrich's proposal for a National Reserve Association was formally introduced as a bill for Congress to vote on by Senator Theodore E. Burton (R-OH), and although it had much support the bill ultimately failed. While bankers generally applauded the

[47] Simpson, Simon D., p. 186
[48] Clements, Kendrick & Cheezum, Eric "Woodrow Wilson: American Presidents Reference Series", p. 109

المنارة للاستشارات
www.manaraa.com

Commission for their economic research and supported the National Reserve Association bill, many members of the general public were suspicious and opposed Burton's bill. Although the bill seemed to fix many of the problems that had led to the 1907 panic, many viewed it as perpetuating control of the nation's financial system by the big banks of New York. They believed the bill would serve the narrow interests of the banking community rather than the interests of the American people. Furthermore, the bill did not provide adequate control of the banking system, and instead if it had passed it would have enhanced the power of the larger banks and the influence of Wall Street.

Aldrich's bill, once introduced by Senator Burton, was well on its way to becoming law until the election of 1912 put the Democrats into power for the first time in fifty years.[49] The election of President Woodrow Wilson gave the Democratic Party controlling majorities in both the Senate and the House, changing the political dynamic of the central bank movement. As is frequently the nature of politics, no loyal Democrat would support a bill devised by Republicans, and thus nothing became of Senator Aldrich's bill. Instead, the Democrats began working together with many independent economists to draft and pass a bill that would address the primary long-standing inadequacies of inelastic currency, the creation of a lender of last resort for the banking system, and a modern reserve system.

Woodrow Wilson had been elected on a Progressive platform and had pledged himself to financial reform, but without the creation of a central bank. However, Wilson's knowledge of economics was thin and academic, and his grasp of finance was sophomoric.[50] He had to rely heavily on his advisors to counter Aldrich's plan and shape

[49] Moore, Carl H., p. 5
[50] Brands, H.W., "Woodrow Wilson", p. 35

المنارة للاستشارات
www.manaraa.com

his own reform proposal. More specifically, Wilson turned to Louis Brandeis, *enter title/credentials here*, and his Secretary of State William Jennings Bryan for guidance. Brandeis advised that although private banks may participate in the national system, ultimate control, especially over the money supply, must rest with the government and the banks. According to Brandeis, business must be sure that "the Government will control the currency…and whatever money is available, will be available for business generally, and not subject to the control of a favored few."[51] Bryan, who had a strong following in rural states and was a vocal leader among the anti-Wall Street Democrats, also shared this opinion. Their arguments stressing equality of opportunity for all parts of the country and for all business sizes had a strong appeal for Wilson. Seeming to have sufficiently addressed the concerns of both sides then, Wilson and Bryan together played a decisive role in shaping the financial reform program that later paved the way for the Federal Reserve System.

The Federal Reserve Act

With a few modifications to Aldrich's plan, the Federal Reserve Act was presented to President Wilson by Senator Robert Owen (D-VA), Rep. Carter Glass (D-VA) and former economics professor H. Parker Willis in May 1913. The proposal called for the creation of privately controlled regional reserve banks that would hold a portion of member banks' reserves, perform necessary central banking functions, and would issue currency against commercial assets and gold.[52] Wilson modified this model by adding a central board to control and coordinate. Together with the work of Owen, Glass and Willis, important pieces of the skeleton of the Fed were being put into place.

---

[51] Clements, Kendrick & Cheezum, Eric, p. 109
[52] Johnson, Roger T., p. 21

المنارة للاستشارات
www.manaraa.com

On June 23, 1913 Wilson presented his plan for the Federal Reserve Act. Conservatives who felt this was a radical break from the nation's laissez-fair economic policy quickly attacked it, insisting on a central bank under the control of bankers. Wilson would not compromise on this detail. He believed private banks should be the instruments of a central bank and not the masters. As a concession to bankers, however, Wilson included a provision for a Federal Advisory Council, which would be comprised of one bank representative from each Federal Reserve district. Wilson's blueprint became a hallmark for his administration. To implement this vision, however, Wilson and his party faced powerful opposition, and in the summer and autumn 1913 the Federal Reserve bill moved slowly through Congress.

Bankers and their legislative allies threw one hurdle after another in front of the president's plan, calling it socialistic, proposing spurious amendments, and delaying the bill from making it to the floor of the House until defeat became inevitable.[53] Southern and Western members of Congress also slowed progress for the bill by attaching an amendment making receipts for warehoused agricultural products as well as commercial paper part of the system's reserves.[54] Even with these proposed changes, however, rural suspicion of the proposed system was so great that it took all of Bryan's influence to win passage of the bill. The bill ultimately passed in the House on September 18, 1913 with overwhelming numbers (287 to 85 votes). The Senate proved to be a little more complicated. The conservative delegation pushed back and insisted on Wilson's original idea of a private system under federal supervision.[55] A few weeks after the House passed the bill, while Senate hearings continued the American Bankers Association held its

---

[53] Brands, H.W., p. 35
[54] Clements, Kendrick & Cheezum, Eric, p. 111
[55] Ibid, p. 111

المنارة للاستشارات
www.manaraa.com

annual convention in Boston and passed a series of resolutions denouncing the Federal Reserve bill. Being the shrew diplomat that he was, however, Wilson espoused agreement with them and suggested the bill would have to be amended further. This proved to be enough to pacify dissident senators and on December 19, 1913, the bill finally passed the Senate (54 to 43 votes).[56] After extensive political debate and compromise the administration prevailed, and the Federal Reserve Act was ready for the president's signature.

In what the press dubbed "a Christmas present for the president," the Federal Reserve Act was signed into legislation on December 23, 1913. Thus ended the often bitter debate of how the United States should handle its monetary affairs, although, as shall be discussed below, many other questions remained unanswered. Following the passage of the Federal Reserve Act, the Wilson administration was tasked with taking the bare bones of the new law and putting the substance of a functioning institution upon them. The first, and most important, issue to be addressed was determining the appropriate number of regional reserve banks, their location, and jurisdiction. The Act gave little direction on this matter. It simply called for "not less than eight nor more than twelve cities to be known as Federal reserve cities, and shall divide the continental United States, excluding Alaska, into districts, each district to contain only one of such Federal reserve cities" (Section 2; Section 2; 12 U.S. Code 222). Furthermore, the Act stated that the division of the nation into Federal Reserve Districts should be done, "with regard to the convenience and customary course of business and shall not necessarily be coterminous with any state or states" (Section 2; 12 U.S. Code 222). To this, Senator Shafroth (D-CO) also added into the Act that, "No bank should be more than one night's

[56] Johnson, Roger T., pp. 30-31

المنارة للاستشارات
www.manaraa.com

train ride from its Federal Reserve bank."[57] This was meant as a further safeguard against bank runs.

The Act established a Reserve Bank Organization Committee (RBOC) to select locations for Reserve Banks and draw district boundaries. The RBOC comprised Secretary of the Treasury William G. McAdoo, Secretary of Agriculture David F. Houston, and Comptroller of the Currency John Skelton Williams. They held hearings in nearly fifty cities vying for a Reserve Bank district headquarters. Following the hearings, however, one very important question remained unanswered: Would national banks, which had opposed mandatory membership in the system, elect to give up their national charter rather than support the new system? Because the prospect of the banks rejecting a national charter was frightening to politicians, the RBOC polled banks to determine which cities with which they sought affiliation. Their responses gave the committee confidence that national banks were ready to accept the Federal Reserve System.[58]

To avoid the appearance of one central monetary authority, twelve Federal Reserve Banks were established around the country. To quell public suspicions that favoritism played a role in determining the Reserve Bank cities, the committee publically released the results of their survey. Although some critics remained unconvinced, it appears the committee made sound choices in selecting the twelve cities and defining their boundaries –a century later the cities and the district boundaries remain essentially intact, as the outline of these twelve districts has continued to prove practical. The reserve banks opened for business in November 1914, in the following twelve cities: Boston, New York, Philadelphia, Richmond, Cleveland, Chicago, Atlanta, St. Louis,

---

[57] Moore, Carl H., p. 11
[58] Ibid. 15

المنارة للاستشارات
www.manaraa.com

Kansas City, Dallas, and San Francisco. These district Federal Reserve Banks were to be owned by the member banks in their district, with each one buying stock in the Federal Reserve Bank equal to three percent of its capital and surplus, and each member bank would receive a six percent dividend on this stock.[59]

To further diminish fears of monetary authority being too centralized, it was determined that each Federal Reserve Bank would have their own board, consisting of nine outside directors.[60] These directors would oversee the operations of each Bank and be subject to the supervision of a Board of Governors. Furthermore, these directors would establish the discount rates and appoint the Bank President and Vice President all subject of course to final approval by the Board of Governors. As provided by the Act, three Class A directors were to represent member banks from within the district; and three Class B directors were to represent the public and elected by member banks in each Federal Reserve District. Further oversight called for The Federal Reserve Board of Governors to appoint three Class C directors, who would also represent the interests of the public. The Board of Governors would also designate one of these three as Chairman of the Bank's Board, and another as Deputy Chairman. Moreover, as an attempt to minimize any conflict of interest it was determined that no Class B or Class C directors may be an officer, director, or employee of a bank, nor may Class C directors be stockholders of a bank.[61] In 1914, once the organization committee had officially identified the Reserve Bank cities and boundaries, Wilson was ready to announce his choices for the Board. Since only one of the appointed members could come from any

[59] Board of Governors of the Federal Reserve System, "The Federal Reserve System: Purposes & Functions", p. 9
[60] Ibid, p. 7
[61] Wallace, W.H., "The American Monetary System: An Insider's View of Financial Institutions, Markets and Monetary Policy", p. 171

المنارة للاستشارات
www.manaraa.com

one Federal Reserve district, he waited until the lines were drawn before making appointments. On August 10, 1914, the first Federal Reserve Board was officially sworn into office.[62]

To be sure, many individuals contributed greatly to engineering the structure and outlining the purpose of the newly formed Federal Reserve System, and the bill's passing required cooperation and compromise at every level of congressional development. Be that as it may, President Wilson arguably deserves the lion's share of credit. Still early into his first term, Wilson withstood the contrary demands of both private bankers and agrarian lobbyists, while skillfully commanding Democratic support to lead the bill through the congressional thicket. Indeed, the passage of the Federal Reserve Act of 1913 serves as a prime historical example of wise and skillful presidential leadership over Congress, and gave birth to a government entity over a century in the making.

Politicians succeeded in establishing an institution that would not be dominated by greedy bankers nor the government. However, it created an institution that would pose many difficult policy questions for its operators. For instance, shortly after beginning its operations there was already discussion as to whether the Reserve banks should seek to make a profit. Heavily influenced by the values and philosophies of the Progressive Movement, those who had devised the Act believed the system should make decisions on the basis of what was good for the country and not on what would return a profit. Thus, it was determined that the Federal Reserve Banks would derive their earnings primarily from interest earned on their share of the System's holding of securities acquired through open market operations and, to a much lesser extent, from

[62] Johnson, Roger T., p. 54

المنارة للاستشارات
www.manaraa.com

interest on System holdings of foreign currencies and loans to depository institutions.[63] To further discourage the Fed from being a profit driven entity, it was also decided that any earnings of Federal Reserve Banks were to be allocated first to the payment of expenses. These would include assessments by the Board of Governors to defray its expenses, the statutory six percent dividend on Federal Reserve stock that member institutions are legally required to purchase, as well as any additions to surplus necessary to maintain each Reserve Bank's surplus equal to its paid-in capital stock. Any remaining earnings were to then be paid into the United States Treasury. History has shown that these early stipulations have largely succeeded; roughly ninety-five percent of the Federal Reserve Bank's net earnings have been paid into the Treasury since the Federal Reserve System was established.[64] Indeed, in 2014 the Fed paid a record amount of approximately $98.7 billion, out of their net income of $101.5 billion, to the U.S. Department of Treasury.[65]

The Banking Acts of 1933 & 1935

The Great Depression in the 1930s led to breadlines, bankruptcies, unemployment, and labor unrest, and many have criticized the Fed for not taking more decisive action during this turbulent period.[66] The reality is of course much more complicated. In its pre-Depression iteration, influencing the business cycle was not one of its stated purposes. Rather, it was designed to stabilize the currency and provide a source of credit to facilitate the marketing of goods. However, as part of his larger initiatives to address the long-lived crisis, President Franklin D. Roosevelt sought to

---

[63] Board of Governors of the Federal Reserve System, "The Federal Reserve System: Purposes & Functions", p. 9
[64] Ibid, p. 9
[65] Honea, Brian "Report: Fed Paid Record $98.7 Billion to Treasury in 2014", Daily Dose News
[66] Moore, Carl H., p. 75

المنارة للاستشارات
www.manaraa.com

reform commercial banks, signing into law two Acts that would drastically change the basic organization, power structure, and stated purpose of the Federal Reserve System as engineered under the Wilson administration. These Acts revived the banking system following the crisis of 1929 established the Federal Reserve as an authority in the oversight of the banking industry, and as the source of monetary policy. It also centralized the power of the Federal Reserve System in Washington, D.C.

The Banking Act of 1933 created the Federal Deposit Insurance Corporation (FDIC) to provide deposit insurance as a means to ward off future bank failures arising from bank runs by depositors. Most importantly it led to a significant institutional change by creating the Federal Open Market Committee (FOMC), which is the policymaking arm of the Federal Reserve. Like the Federal Reserve System itself, the FOMC has an unusual public/private character. It is responsible for guiding the Open Market Desk's sale and purchase of government securities, a monetary policy known as open market operations.[67] The FOMC also determines the target rate for the Federal Funds interest rate, known also as the Fed Funds rate.[68] The Fed Funds rate is the rate at which commercial banks make overnight loans to other commercial banks, and it is an important indicator of the cost and availability of short-term liquidity.

The FOMC is composed of the seven members of the Board of Governors of the Fed, and five of the regional reserve bank presidents. The reserve bank presidents represent the private components of the FOMC. These presidents are chosen by the shareholders of the institutions that they represent, though their selection is subject to the advice and consent of the Board of Governors. Conversely, the members of the Board of

[67] Morris, Irwin L., "Congress, the President, and the Federal Reserve: The Politics of American Monetary Policy Making", p. 2
[68] Ibid, p. 2

المنارة للاستشارات
www.manaraa.com

Governors represent the public side of the FOMC. To further ensure the predominance of the public component of the FOMC, only five of the twelve reserve bank presidents have voting rights on the FOMC at any point in time. Therefore, the governors always enjoy a seven to five, public versus private, majority.[69]

Shortly thereafter, the Banking Act of 1935 was also passed, which further changed the organization and function of the Federal Reserve System. It centralized policy decision-making authority within the newly named Board of Governors. Headquartered in Washington, D.C., the Board of Governors is the organization's head, and its prime functions are the formulation of monetary policy. However, it was also given supervisory and regulatory responsibilities over the activities of banking institutions, as well as over operations of each of the Federal Reserve Banks.[70] Furthermore, the Board of Governors was entrusted with reviewing and approving discount rate actions of the individual Federal Reserve Banks, and charged with issuing regulations which would govern the administration of the discount window.[71] The Board was also given the ability to use reserve requirements as a monetary policy instrument by exercising its authority to vary certain reserve ratios of depository institutions within ranges prescribed by law. Moreover, the 1935 Act also gave the Board the responsibility of overseeing the nation's payments on their own debt, as well as governing federal consumer credit regulations.[72]

The Banking Act of 1935 also strengthened the Federal Reserve's independence from the government by removing the Secretary of the Treasury and the Comptroller of

---

[69] Ibid, p. 2
[70] Board of Governors of the Federal Reserve System, "The Federal Reserve System: Purposes & Functions", p. 4
[71] Ibid. 5
[72] Ibid. 4

المنارة للاستشارات
www.manaraa.com

the Currency as members of the Board of Governors. Furthermore, it established terms for the Chairman of the Board (4 years) and proscribed the number of governors (7) and their terms (14 years). The Act also set a voting pattern of seven governors plus 5 of the 12 District Bank presidents (the New York Bank president was given a permanent vote).[73] By allowing the FOMC to make policy decisions it maintained the Board of Governors majority position while giving the process some degree of openness and allowing the District Bank presidents to have a voice.

Despite the crisis of the Great Depression adding further proof to the necessary existence of the Federal Reserve System as well as its strengthening, even the turmoil of the 1930s was not enough to finally quell its controversy. The centralization of Federal Reserve System responsibilities in the Board, as history has shown, helped improve accountability, which was certainly the intent of Roosevelt and his administration. However, such centralization has also run against the grain of longstanding American suspicions of the centralization of power, especially in the financial realm. Moreover, although the 1933 and 1935 Acts did more to provide oversight and centralization, it was also understood to be crucial that the Fed maintain its independence, relative to other agencies of the federal government. Thus, both more centralized and independent the Fed has continued to be a point of political squabbling in the decades since the 1930s, resulting in tensions, which have led policymakers to demand even greater accountability and transparency from the Board of Governors. As an effort to promote public trust, therefore, the Board has responded by opening many of its meetings to the public, and submits numerous reports to Congress. Furthermore, members of the Board routinely

[73] Hafer, R.W, p. xviii

المنارة للاستشارات
www.manaraa.com

testify before Congress on policies and operations, publishes the Fed's balance sheet weekly, and regularly subjects itself to public audit.

The Treasury-Fed Accord (aka The 1951 Accord)

Following the attack on Pearl Harbor in 1941, America entered into World War II and policymakers were committed to providing whatever money was needed to win the war. To do so, the nation was risking runaway inflation as spending exceeded income for the federal government, and the federal debt jumped from $45.5 billion in 1941 to $263 billion by the end of the war.[74] This significant increase in debt was the result of lingering effects of the Depression compounded by the immediate need of financing World War II. The very life of the nation was at stake, however, and so the prevailing political mindset was to first win the war and then worry about inflation.

It was in this political climate that the role of the Federal Reserve System vis-à-vis the spending power of the federal government was further expanded. The Federal Reserve System's main objective regarding monetary policy during the war was to peg the interest rates on U.S. government securities at the request of the Treasury, so as to allow the federal government to engage in cheaper debt financing for the war.[75] However, this policy remained in effect following the war as well, because it was feared that unemployment would increase sharply as the war-induced production of goods subsided. Pegging interest rates at artificially low levels meant that the Fed was expanding the money supply at rates that put upward pressure on prices in the economy. As the rate of inflation began rising, due in part to the removal of war-time price

---

[74] Moore, Carl H., p. 94
[75] Ibid. 4

المنارة للاستشارات
www.manaraa.com

controls,[76] Federal Reserve officials argued that pegging interest rates precluded them from following policies to fight inflation, which had historically been one of the Fed's most basic responsibilities. To maintain the pegged rate, the Fed was forced to give up control of the size of its portfolio and money stock, and conflict between the Treasury and the Fed came to the fore when the Treasury directed the Central Bank to maintain such artificially low rates as the United States embroiled itself in yet another war in Korean in 1950. Caught between two competing responsibilities—its historic role of tempering inflation, or its relatively newer responsibility to regulate government lending and spending—the Fed found itself in the middle of yet another crisis of identity.

President Harry Truman and Secretary of the Treasury John Snyder were both strong supporters of the low interest rate peg. The President felt that it was his duty to protect citizens who purchased bonds during the war by not lowering their value.[77] Since bond prices vary inversely with bond interest rates, a rise in interest rates would have made bonds purchased at the lower interest rates worth less on the government securities market. However, the Federal Reserve was more concerned with the need to contain inflationary pressures in the economy caused by the intensification of the Korean War. They understood that the forced obligation to maintain the low peg on interest rates produced an excessive monetary expansion that caused the inflation.[78] Consequently, an intense debate between the Fed and the Treasury ensued, as both vied for control over interest rates and U.S. monetary policy.

In early 1951 the controversy came to a showdown between the Truman administration and the Federal Reserve. In January 1951 the Treasury Secretary

[76] Hafer, R.W, p. xviii.
[77] Kramer, Amanda L. "Treasury Fed Accord" p. 1
[78] Ibid. 1

www.manaraa.com

announced that government securities would be issued with interest rates no higher than two and a half percent. The implication was that the Federal Reserve would follow policies necessary to keep rates at this level. This also meant that instead of the Fed dictating monetary policy, as was its responsibility following the Acts of 1933 and 1935, now it was being forced to bend to the pressures of the current administration. The Federal Reserve had not, in fact, agreed to such a policy and made this point publicly. After a series of internal meetings and some public finger pointing, the Treasury and the Federal Reserve came to an agreement, and on March 4, 1951, the Treasury and the Federal Reserve issued a joint statement, which became known simply as the Treasury-Fed Accord of 1951.[79] This agreement eliminated the obligation of the Fed to monetize the debt of the Treasury at a fixed rate. Furthermore, it became essential to the independence of central banking and laid the foundations for the monetary policy pursued by the Federal Reserve today.

The Dual Mandate

Originally, the Federal Reserve Act of 1913 did not specifically task the Fed with economic stabilization, although this had been implied by its various responsibilities. In 1913 its primary objective was to provide liquidity to the banking system. However, in 1946 with a large number of soldiers returning from World War II and in need of jobs, Congress passed the Employment Act of 1946 which made the federal government—and, by necessary implication, the Federal Reserve System— responsible for the economic stability of inflation and unemployment.[80] For the first time, Congress had mandated the Federal Reserve to pursue maximum employment, price stability, and economic stability

[79] Hafer, R.W, p. xix
[80] Norton, Hugh S. "The Employment Act and the Council of Economic Advisers, 1946-1976", p. 12

www.manaraa.com

through moderating long-term interest rates. The first two of these tasks have become so primary to the function of the Fed that they are frequently referred to simply as the Dual Mandate. Although the Fed understood these tasks to be their responsibility prior to 1946, it was not until the passage of the Employment Act that Congress officially assigned the task of economic stability to the Fed.

As has always been the case, as more responsibility and monetary authority was handed over to the Fed, many critics argued over this enlarged role. Even economists were quick to point out that the objectives espoused by Congress were inherently incompatible. For example, some experts pointed to evidence given by the Phillips Curve, a theory that claimed achieving full employment and low inflation at the same time is impossible (although this theory would later be disproved).[81] Moreover, it was left unclear in the Employment Act of 1946 what exactly Congress meant by full employment or what a reasonable metric for economic stability should be. Instead, in keeping with its autonomy, it was left to the Fed to decide what these variables meant. Although this autonomy would later lead to further modifications to the activity of the Fed, as some of the actors in Congress became uneasy with the power granted to the Fed by the Dual Mandate.

Fast-forwarding two decades to the economic malaise of the 1970s, the stubborn problem of inflation throughout the period motivated Congress to curb the Fed's independence while increasing the accountability of the Federal Reserve. Congress also wanted to explicitly spell out the mandate for Fed policy. So, in 1977, Congress amended the Federal Reserve Act to include the following statement: "The Board of Governors of the Federal Reserve System and the Federal Open Market Committee shall

[81] Hafer, R.W, p. xix

المنارة للاستشارات
www.manaraa.com

maintain long-run growth of the monetary and credit aggregates as to promote effectively the goals of maximum employment, stable prices and moderate long-term interest rates." Congress enacted this policy under the assumption that the actions of the Federal Reserve directly impacted the market's climate. Given the power over the stability of the economy that the Fed had been granted during the 1930s and solidified by the Dual Mandate in 1946, Congress wanted to now be able to keep track of the Federal Reserve's attempts to alter it. Federal Reserve officials balked at this amendment; however it was not out of a desire to maintain secrecy. The Fed was concerned that disclosing their intentions regarding changes in monetary policy or interest rates would make plans more difficult to realize in the future, because markets would respond to their intentions, which would, in turn, alter the Fed's projections.[82] In other words, certain market actors would use the Fed's disclosures to engage in profitable investments, which would alter market outcomes and neutralize the Federal Reserve's actions. For example, if the Fed were to announce a four percent increase to the interest rate six months ahead of schedule, the market would react within twenty-four hours, creating volatility.

Even with both the Employment Act of 1946 and the Federal Reserve Act Amendment of 1977, Congress stopped short of quantifying the objectives imposed on the Federal Reserve and much of its necessary autonomy was thus preserved. Efforts to further clarify the Fed's mandate have been revisited a number of times since the 1977 Amendment (most recently in 2011), however no action has yet been taken, and the dual mandate of maximum employment and stable prices remains intact. Although Congress has entertained proposals to follow suit with other countries and assign supervision and

[82] Moore, Carl H., p. 34

المنارة للاستشارات
www.manaraa.com

regulation to other agencies, rather than the Federal Reserve System, it has never moved any such proposal forward because the current system works.

Chairmen of the Federal Reserve

The Federal Reserve System maintains a system under which seven governors are nominated by the President of the United States and confirmed by the senate, to serve a term of fourteen years. These terms begin on February 1st of even-numbered years, and any member who serves for that full fourteen-year term may not be reappointed. During the history of the Federal Reserve System, the governors, and particularly the Chairman, of that system have had a considerable influence over American monetary and financial policy. Though this work has considered the history of the Federal Reserve System and American policy with respect to finance from a generalized perspective, the following section will consider the line of leadership at the Federal Reserve, through a consideration of each of the fourteen Chairmen (and one woman) who have led this prestigious and influential institution.

Charles Summer Hamlin (1861-1938), the first Governor of the Federal Reserve System, was a Boston lawyer and onetime unsuccessful candidate to be Governor of Massachusetts. He was a supporter of William Jennings Bryan during his 1908 Presidential bid, and a member of the United States Commission for the Limitation of Armaments prior to the First World War. His time as head of the Federal Reserve, which lasted from 1914 to 1916, and is described as being – while not a "dynamic executive" in this role, a diplomatic one who was able to help shape the formative organizational structure that the Fed required to sustain during its formative years[83]. In a 1915 speech to the New England Bankers' Convention, Hamlin was a strong advocate for the entry of

[83] Fed, 2015, p. 1

www.manaraa.com

state banks into the Federal Reserve System, and lauded the major power of the System, particularly its ability to issue bank notes of between $400 and $500 million, if necessary[84].

Hamlin's successor, William Harding, would serve as Fed Chairman from 1916 to 1922. The native Alabaman Harding, who was appointed by President Wilson in 1913, rose to the position because Wilson prized the "geographic diversity" that he brought to the position[85]. Nonetheless, under the advocacy and leadership of Governor Harding, the U.S. Treasury, which had once used commercial banks and various 'sub-treasuries', switched to the Federal Reserve as its primary "fiscal agent"[86]. Additionally, under Governor Hardling, the New York Federal Reserve would come to hold all treasury gold reserves, as well as provide the Treasury with assistance in issuing and retiring securities.

Daniel Richard Crissinger would succeed William Harding, and once nominated by President Warren G. Harding, would serve as Federal Reserve Chairman from 1923 to 1927. A veteran and longstanding veteran of private industry in Marion, Ohio, Crissinger had served as director or president of a wide variety of companies before entering banking, including the Marion Steam Shovel Company, the Marion Union Stock Yards, and the Marion County Telephone Company. In 1927, Crissinger's tenure was marked by controversy, when his Federal Reserve asked the Chicago Federal Reserve to lower its discount rate, in an action which would follow similar actions taken by the banks in Boston and Cleveland. Following Chicago's refusal to do so – citing there being "no

[84] Fed Archive, 2015
[85] Wells, 2004, p. 30
[86] Ibid.

المنارة للاستشارات
www.manaraa.com

basis or necessity" to do so – Crissinger and the other board members acted to lower the Chicago rate without waiting for the Chicago directors to respond or act[87].

Crissinger's successor was Roy A. Young, who was nominated by President Calvin Coolidge, and served as Governor of the Federal Reserve from 1927 to 1930, a period which would include Black Monday and herald the start of the Great Depression. While the first years of Young's tenure at the Federal Reserve were characterized by the rapidly-contracting and illiquid economy following the stock market crash, and policies characterized by *protectionism*. In the years before Young resigned his position to become Chairman of the Boston Federal Reserve, Young was a consistent advocate for policies through which the Fed might protect its reserve position, which would put it in a stronger position to lend to member banks at a later date. Young's posture – that even if the Fed were to lend generously in the face of this crisis, that banks to which it lent would then hoard these funds themselves – would be the first of a series of decisions which would exacerbate this crisis. The number of bank failures between October of 1929 and March of 1933 would come to number 9,000[88].

The successor of Roy Young was named Eugene Meyer, who was appointed by President Herbert Hoover during a Congressional Recess in September of 1930. This appointment would be blocked by the populist Congress, who opposed Meyer on the grounds that he had made a fortune during the 1920s as a Wall Street investor. Meyer would eventually come to lead the Fed by February 1931, but the early months of his time there were marked by such strong conflict with regional banks that a further contraction in the money supply (as well as bank deposits) could not be prevented,

[87] Meltzer, 2010, p. 221
[88] Wells, 2004

www.manaraa.com

especially as bank failures were "worsened by problems in Europe"[89]. Meyer's successor, Eugene Robert Black, was Chairman of the Federal Reserve for just over a year, serving from May of 1933 to August of 1934, during which he promoted a policy of direct loans made to businesses and industry, as well as spearheaded the Reconstruction Finance Corporation[90]. This was a tool by which the Fed purchased and sold open-market securities to increase money and credit flows.

Black was succeeded by Marriner S. Eccles, who served as Chairman of the Federal Reserve from 1934 until 1948. Under his tenure as Chairman, Eccles spearheaded a major Depression-era restructuring policy, as well as was pivotal in the drafting of the Banking Act of 1935. In 1944, near the close of the Second World War, Eccles was U.S. delegate to the Bretton Woods Conference, which would be crucial in forming the postwar economic world[91]. Eccles' successor, Thomas B. McCabe, served as Chairman from 1948 to 1951, a tenure for which McCabe is best known for his 1951 resolution of a dispute between the Federal Reserve and Treasury, during which the Fed was no longer obligated to monetize the Treasury's debt according to a fixed rate. McCabe's successor, William M. Martin, served from 1951 to 1970, famously elucidated the Fed's purpose to correct for inflation or deflation, whenever either occurs. In 1965, Martin disagreed with President Lyndon Johnson over the discount rate, and raised it over the President's wishes[92].

William Martin was succeeded by Arthur Burns, who served as Federal Reserve chairman from 1970 to 1978, during a period of major inflation and recession, a task

[89] Ibid., p. 51
[90] Field, 2008
[91] Wells, 2004
[92] Hester, 2008

www.manaraa.com

which the Federal Reserve with Burns as leader was inadequate. Burns' successor, G. William Miller served from March of 1978 to August of 1979, and pursued monetary policies of expansion, even when such policies continued to contribute to the recessionary inflation which gripped the nation during those years. The Federal Reserve was able to aid the nation in escaping the grip of inflation under the early years of Paul Volcker's period as Chairman, years during which interest rates were raised as a means of staving off inflation. While these rates saw massive protests of the Federal Reserve building by indebted farmers and construction workers, inflation (which was 14.8 percent in 1980) was reduced to below 3 percent in 1983[93].

Volcker's successor Alan Greenspan was the second-longest serving Chairman of the Federal Reserve, second only to William M. Martin, and served from 1987 to 2006. Greenspan was appointed Fed Chairman by four presidents across two decades, and faced many crises, including the 1987 stock market crash, which occurred weeks after he was appointed to the post. Greenspan's tenure was also marked by the 1997 Asian financial crisis, as well as the financial aftermath of the terrorist attacks of September 11, 2001[94]. Greenspan is credited with facilitating the longest major economic expansion in U.S. history, during the 1990s, but is also known for keeping interest rates low, a policy which contributed to the speculative housing market bubble which would lead to the 2008 financial crisis.

Greenspan's successor, Ben Bernanke, served as Fed Chairman from 2006 to 2014. During that time, Bernanke spearheaded the Fed's response to the financial crisis, including implementing wide-reaching quantitative easing policies, through which the

---

[93] Field, 2008
[94] Woodward, 2012

المنارة للاستشارات
www.manaraa.com

bank purchased mortgage-backed securities to stimulate growth. Bernanke's tenure as Chairman was marked by anti-inflationary policy, as well as quarterly press conferences toward greater Fed transparency[95]. Bernanke's successor, Janet Yellen, is the first female Fed Chairman, and was appointed in 2014.

Conclusion

Entire volumes have been written about the function and purpose of the Federal Reserve System, and thus this short essay has chosen to simply highlight the historical development of its major functions to help create a general understanding of a largely misunderstood, and yet very influential, arm of the federal government. Moreover, as this brief history has illustrated, the country cannot function without the help of the Fed and its policies. In the early years of the American Experiment, Hamilton and Jefferson hotly debated this point and Hamilton won, leading to the emergence of the First National Bank. However, as the public remained skeptical of centralized monetary authority, its charter was not renewed, but the economic turmoil in the aftermath of the war of 1812 again proved the necessity of a central banking authority and a Second National Bank emerged. Still slow to learn the necessity of a centralized bank, Andrew Jackson, seeing himself as a champion for the common man fought again for its demise. It would take the economic turmoil of the Civil War and Reconstruction, and the near-meltdown of the Panic of 1907 to finally confront the nation with the necessity of a centralized banking system, and in 1913 the Federal Reserve System is born. Although its controversy has continued, and the needs of the Great Depression and a World War amended its functions and responsibilities, the Federal Reserve System has remained intact for more than one hundred years.

---

[95] Harris, 2013

المنارة للاستشارات
www.manaraa.com

As has been shown, the Federal Reserve System and all of its regulatory bodies and boards have been given the authority and responsibility to set monetary policy, supervise and regulate banks, as well as to provide financial services to both the banking system and to the U.S. government. This includes the clearing and settlement of payments, paper and electronic; the issuance of currency and coin to banks, and destruction of unfit currency; the provision of banking services to the government, such as the processing and settlement of government payments through the Treasury's account that is maintained by the Federal Reserve Banks; the original issue and final redemption at maturity of Treasury as its fiscal agent.[96] Although originally devised to respond to the basic need for a central banking body, over the course of the twentieth century the setting of monetary policy has become the single most important, and controversial, of the Federal Reserve's many functions.

In recent years, the public has become increasingly interested in monetary policy, which has subsequently led to increased media coverage and greater transparency from the Fed. Although much of this essay has concerned itself with the Fed's role in relation to the federal government and the overall banking system, the growth of credit and the increased sensitivity to movements of interest rates, both affecting private citizens, account for much of the mounting attention being paid to the activity of the Fed in recent years. For example, the increased use of adjustable rate debts (especially in response to the housing market) has caused many to be more attuned to the potential consequences an unexpected increase in interest rates could have on their total individual debt. Moreover, reductions in interest rates can also substantially impact private citizens by impacting income garnered from savings or investments, and can substantially reduce retirement

[96] Wallace, W.H., p. 169

المنارة للاستشارات
www.manaraa.com

savings. As these two examples illustrate then, although the policies of the Fed are directed at macro level economic needs, such policies, while indirect, can still have a dramatic effect on the lives of average citizens. There are also global consequences of the Fed's monetary policy, which has not only Americans, but also the global community paying close attention to decisions of the Fed. Thus the Fed must enact monetary policy with this global system in clear view, understanding that achieving stability in America's financial market may inadvertently contribute to instability elsewhere in the world.

The Fed generally implements monetary policy that is countercyclical in nature. In other words, if inflation is a concern the Fed responds by either reducing the supply of money and credit available or diminishing its demand by raising interest rates. Conversely, if the economy is sluggish and requires a boost (as has been witnessed in the economic recession of 2008) the Fed will expand the money supply and lower interest rates.[97] Each of these situations requires some level of discretion, making such decisions of monetary policy always controversial. Despite such controversy, however, the alternative to discretionary monetary policy would be rule-based monetary policy which would limit the Fed's actions to a predetermined course set by Congress, or some other authority outside the central bank. Such rule-based policy would run the risk of allowing individuals (especially politicians) to make shortsighted, self-serving monetary decisions whose ripple effects would be far reaching and long lasting. Such has been the philosophy that has long protected the autonomy of the Federal Reserve System, although various attempts have been made to bring the Fed into closer relationship with Congress.

Due to complex market forces that may prove too difficult for the Fed to offset, the Federal Reserve cannot guarantee successful monetary policy. The Fed can only steer

[97] Ibid. 177

المنارة للاستشارات
www.manaraa.com

the proverbial ship in a particular direction through its monetary policy. However, it is the winds of the market that ultimately determine where the ship eventually ends up. Although, generally speaking, actions to restrain the economy are usually easier and more effective than actions to boost it. Which is perhaps why so many are quick to cast judgment on the Fed during difficult economic cycles, as was seen in response to the recession of 2008 when many even called for the end of the Fed.

Due to the singular nature of the Federal Reserve's power and character, it should come as no surprise that it has generated considerable controversy since its inception. Indeed, the Fed occupies a unique place in American government, owing greatly to its continued misunderstanding. The Federal Reserve System, specifically its Board of Governors, derives its power from Congress and exercises monetary policy on its behalf. Yet it remains largely free from Congressional appropriations and Presidential oversight and its autonomy has routinely been upheld.

As for those who would call for an end to the Fed, Wilson Carey McWilliams said it best when he wrote, "Human beings are political animals, and democratic politics has its own vitalities."[98] That is to say, much of the resentment deflected onto the Fed stems from economic frustrations rather than a genuine understanding of the nature of the Federal Reserve System and its policies. Indeed, as many lost their jobs during the economic crisis of 2008 and its aftermath, much of the political debate was colored by the stress and anxiety of financial insecurity. The political realm gave it a voice. As history has proven, however, an end to the Fed is a recipe for economic disaster. As history illustrates, the Federal Reserve System may be progressing slowly, but it never moves

[98] McWilliams, Wilson C. "The New Politics of Public Policy", p. 276

المنارة للاستشارات
www.manaraa.com

backward. America's central bank continues to evolve and serve as a vital institution within the country's bureaucratic system.

المنارة للاستشارات
www.manaraa.com

BIBLIOGRAPHY

Armstrong, M. "Understanding Jackson's Bank War." Accessed September 2, 2015. http://www.armstrongeconomics.com/archives/29505

Brands, H.W. "Woodrow Wilson." New York, NY: Henry Holt and Company, 2003.

Brookheiser, R. "James Madison". Basic Books, 2013.

Buel, R. "The A to Z of the Early American Republic." Rowman and Littlefield, 2009.

Clements, Kendrick A. and Eric A. Cheezum. "Woodrow Wilson: American Presidents Reference Series." Washington, DC: CQ Press, 2003.

Corder, Kevin J. "Central Bank Autonomy: The Federal Reserve System in American Politics." New York, NY: Garland Publishing Inc., 1998.

Dufries, C. "Ten Lessons Bankers Never Learn: How Banks Operate and Why Bankers Screw Up." iUniverse Press, 2011.

Federal Reserve Archive (2015). Hamlin, Charles S., Address at the New England Bankers' Convention, June 19, 1915. Accessed August 12, 2015. https://fraser.stlouisfed.org/scribd/?item_id=7603&filepath=/docs/historical/hamlin/hamlin_19150619.pdf#scribd-open

Federal Reserve History (2015). *Charles S. Hamlin*. Accessed August 12, 2015. http://www.federalreservehistory.org/People/DetailView/17\

Field, A.J. (2008). "Research in Economic History." Emerald Group Publishing, 2008.

Hafer, R.W. "The Federal Reserve System: An Encyclopedia." Westport, CT: Greenwood Press, 2005.

Harris, E.S. "Ben Bernanke's Fed: The Federal Reserve after Greenspan." Harvard Business Press. 2013.

Hester, D.D. "The Evolution of Monetary Policy and Banking in the US." Springer Science and Business Media, 2008.

Honea, Brian. "Report: Fed Paid Record $98.7 Billion to Treasury in 2014." DSNews. January 9, 2015. Accessed May 4, 2015. http://dsnews.com/news/01-09-2015/report-fed-paid-record-98-7-billion-treasury-2014.

المنارة للاستشارات
www.manaraa.com

Johnson, Roger T. "Historical Beginnings… The Federal Reserve System." Boston: Federal Reserve Bank of Boston, 1989.

Kaplan, E. "The Bank of the United States and the American Economy." ABC-CLIO, 1999.

Kazin, M. "The populist persuasion: an American history." Cornell University Press, 1998.

Kramer, Amanda "Treasury Fed Accord." Federal Reserve Bank of Richmond. 1995 http://www.richmondfed.org/publications/research/special_reports/treasury_fed_accord/background.

Markham, J.W. "A Financial History of the United States: From Christopher Columbus to the Robber Barons." M.E. Sharpe, 2002.

McWilliams, Wilson C. "Two-Tier Politics and the Problem of Public Policy." In *The New Politics of Public Policy*. Baltimore, MD: John Hopkins University Press, 1995.

Meltzer, A.H. "A History of the Federal Reserve, Volume 1: 1913-1951." University of Chicago Press, 2010.

Merrill, P. "Thomas Jefferson and the New Nation." Oxford University Press, 1970.

Moore, Carl H. "The Federal Reserve System: A History of the First 75 Years." Jefferson, NC: McFarland & Company Inc, 1990.

Morris, Irwin L. "Congress, the President, and the Federal Reserve: The Politics of American Monetary Policy Making." Ann Arbor, MI: University of Michigan Press, 2000.

Nelson, M. "Guide to the Presidency." Routledge, 2015.

Northrup, C.C., and Turney, E.C.P. "Encyclopedia of Tariffs and Trade in U.S. History." Greenwood Publishing Group, 2003.

Purcell, S.J. "The Early National Period."Infobase Publishing, 2009.

Ritholtz, Barry. "Janet Yellen? Janet Who?" BloombergView. March 11, 2015. Accessed May 4, 2015. http://www.bloombergview.com/articles/2015-03-11/janet-yellen-is-great-unknown-to-most-amercans.

Rothbard, M.N. (2009). Origins of the Federal Reserve. *Quarterly Journal of Austrian Economics 2*(3): 3-51.

المنارة للاستشارات
www.manaraa.com

Seavoy, R. “An Economic History of the United States: From 1607 to the Present.” Routledge, 2013.

Simpson, Simon D. “Central Banking and the Federal Reserve” Wiley Finance, Financial Markets, Banking and Monetary Policy, Somerset, NJ, 2014.

Staloff, D. “Alexander Hamilton: The Enlightenment Fulfilled.” Hill and Wang, 2005.

Taylor, John B. (10 January 2010). "The Fed and the Crisis: A Reply to Ben Bernanke". The Wall street Journal. Retrieved 19 November 2012.

“The Federal Reserve System: Purposes & Functions,” 7th Ed. Washington D.C.: Board of Governors of the Federal Reserve System, 1984.

Wallace, W.H. “The American Monetary System: An Insider’s View of Financial Institutions, Markets and Monetary Policy.” Switzerland: Springer International Publishing, 2013.

Wells, D.R. “The Federal Reserve System: A History.” McFarland, 2004.

Wells, W.C. “Economist in an Uncertain World: Arthur F. Burns and the Federal Reserve, 1970-78.” Columbia University Press, 1994.

Wilkins, M. “The History of Foreign Investment in the United States to 1914.” Harvard University Press, 1989.

Williams, Hal R. “Realigning America: McKinley, Bryan and the Remarkable Election of 1896.” Lawrence, KS: University Press of Kansas, 2010.

Woodward, B. “Maestro: Alan Greenspan and the American Economy.” Simon & Schuster, 2012.

المنارة للاستشارات

www.manaraa.com