THE FED’S PATERNITY

By Edward L. Morris

There is a good case for naming either Paul Warburg or Carter Glass the “father” of the Federal Reserve. Through their independent efforts — Warburg’s largely between 1906 and 1912 and Glass’s between 1912 and 1913 — each was key to the formation of America’s only enduring central bank. But they were strange bedfellows and didn’t care much for each other — and each was loath to give the other credit for the Fed’s creation.

Warburg was part of a prominent German banking family and immigrated to America to join the powerful Wall Street partnership of Kuhn, Loeb & Co. He played an important role in raising money from international investors to finance American business, and was, purportedly, the inspiration for the Daddy Warbucks character in the Little Orphan Annie comic strip.

Paul Warburg (left) and Carter Glass (right) may be considered reluctant co-fathers of the Federal Reserve.

By contrast, Glass was a combative, self-educated Democratic congressman who grew up in the South during the hardscrabble years of Reconstruction. His views were closely aligned with the anti-banking populist William Jennings Bryan; he referred to Wall Street bankers like Warburg as “money devils.”

From the time he came to the United States in 1902, Warburg was mystified that the country, on its way to becoming the largest economy in the world, had no institution to provide liquidity and orderliness to its banking system, and, most worrisome, there was no lender of last resort to quell the crescendo of financial panics that plagued the country during the latter half of the 19th century. He used his prominence on Wall Street to sound warnings about the escalating dangers of operating without a central bank, and, in a prescient 1906 speech before the New York Chamber of Commerce, he spoke of a coming financial catastrophe: “I do not like to play the role of Cassandra, but mark what I say. If this condition of affairs is not changed, and changed soon, we will get a panic in this country compared to which those which have preceded it will look like child’s play.”

Later that year the financial catastrophe Warburg warned of appeared in the form of the Panic of 1907. That panic, like those that preceded it, started small but grew in virulence and quickly spread throughout the banking system until it was finally quelled by the 70-year-old J. Pierpont Morgan. Operating from the library of his midtown home, Morgan acted as a *de facto* central bank for the nation, assembling emergency funding and commitments from other bankers and from the US Treasury Department.

Morgan limited the panic’s damage and halted its spread to Wall Street’s largest banks, but finally the consequences of operating without a central bank became apparent to many lawmakers, including Republican Nelson Aldrich, the chairman of the Finance Committee of the US Senate. After the harrowing but ultimately successful resolution to the Panic of 1907, Aldrich stated what was increasingly obvious: “Something has got to be done. We may not always have Pierpont Morgan with us to meet a banking crisis."

As a first step towards reform, Aldrich pushed the passage of the Aldrich-Vreeland Act through Congress in May 1908, with one of its key provisions being the establishment of the National Monetary Commission to study central banking practices in other countries. He also made it a point to meet with Warburg and, after hearing his views on central banking issues, Aldrich invited him to address his commission at a meeting at New York's Metropolitan Club. Although Warburg was a proponent of European-style currency management that allowed for sensible adjustments of the money supply to safeguard the financial system and promote the economy, he did not argue that a US central bank, like those in Europe, needed to operate independently from the federal government. And with the geographic expanse of the country, he suggested setting up a network of central banks rather than a single bank in New York or some other money market city.

Aldrich embraced Warburg's ideas and brought him and a group of leading American financiers to a secret, several day meeting in November of 1910 at the stately Jekyll Island Club off the barrier reefs of Georgia. The purpose of the meeting, where Warburg was a "first among equals," was to structure an American style central bank, and by the time the conferees boarded Aldrich's private railroad car for the return trip from Georgia, the first version of the so-called Aldrich Plan had been created.

The plan envisioned a National Reserve Association that would conduct its business through a string of 15 interconnected banks throughout the United States. Under the Aldrich Plan the governance of the National Reserve would be controlled by a mix of private bankers and government policy makers. The association would, in accordance with Warburg's conception, rediscount commercial paper offered to it by member banks to provide enhanced liquidity and increase the elasticity of the money supply. And it would serve as a fiscal agent for the US Treasury in gathering reserves held at the association's banks in the event a lender of last resort was needed.

In early 1912, a little over a year following the Jekyll Island meeting, Aldrich presented the National Monetary Commission's final report, with the Warburg-inspired Aldrich Plan as its spine. The Aldrich Plan became the Aldrich Bill, but, with none of the three presidential candidates endorsing it, the bill went nowhere in Congress during the 1912 election year. Teddy Roosevelt, who ran under the Bull Moose Party, had earlier expressed support for a central bank and suggested that Warburg would be the ideal person to run it: "Why not give Mr. Warburg the job? He would be the financial boss, and I would be the political boss, and we could run the country together."

But not long after, Roosevelt pulled his support, citing a belated concern that the Aldrich Plan would place the country's currency and credit system in private hands, not subject to effective public control. Even the Republican candidate, Howard Taft, in his unsuccessful run as the incumbent, failed to endorse the plan.

But the most vehement opposition to the Aldrich Bill came from the Democrats. Bryan was a powerful force at the party's stormy 1912 convention, and he viewed central banking as an activity that benefited only the interests of the Eastern banking elite. As a condition for releasing his delegates to Woodrow Wilson, he promoted a plank in the party's platform that stated, "The Democratic Party is opposed to the Aldrich Plan or a central bank."

After Wilson trounced Taft and Roosevelt, with his fellow Democrats gaining firm control of both houses of Congress, it appeared to Warburg that the efforts for bank reform had been for naught. He was certain that the Democrats — belonging to a party, in Warburg's opinion, that was controlled by "a powerful wing wedded to the wildest monetary and banking doctrines" — would let the Unites States operate for the indefinite future without a central bank.

But Warburg was wrong. Glass understood the financial perils the country would face without a central bank and emerged as a champion of a banking reform. He identified the "Siamese twins of disorder" — an inelastic currency and a fractionated reserve system — and believed that, without a central bank, it was just a matter of time until the next financial panic surfaced. (Glass knew the country needed a central bank, but, given his party's well-known position on central banking, he avoided calling it that. Even much later, when writing about the creation of the Federal Reserve, Glass clarified that "wherever the term 'central bank' occurs in this narrative it means a 'central bank of banks' dealing only with the member bank of a system and not a central bank in the European sense, transacting business with the public.")

Glass didn't wait long after the 1912 elections to move on bank reform. He traveled through snow on the day after Christmas, from Lynchburg, Virginia to Wilson's home in Princeton, New Jersey, to present the president-elect with an alternative to the Aldrich Plan. After Wilson gave his approval in principle, Glass went to work in earnest. He received assistance from able committee members and staff, but any tracing of the bill's progress shows Glass pulling the laboring oar. The passage of the Federal Reserve Act (initially the Glass-Owen Bank and Currency Act) was in large part a Glass production with a fairly quick — if sometimes heated — reconciliation achieved between the House and Senate versions. Wilson signed the Act into law in December 1913, almost one year to the day that Glass raised the central bank topic with him.

Glass's legislative accomplishment was remarkable not just for its speed, but for the re-evaluation of the central bank issue he prompted among his fellow Democrats. Perhaps only Glass, with his populist bona fides could have engineered such a policy turnaround. The five-foot-four Glass had long established himself among his fellow Democrats as a self-proclaimed David up against the banking Goliaths. His maiden speech in Congress, in fact, was a denunciation of the 1908 Aldrich-Vreeland Act, and he was steadfast in his opposition to the 1912 Aldrich Plan.

Yet it is hard to refute the notion that much of the final legislation that Glass championed was merely a refashioned Aldrich Plan. The name of the new banking system was changed from the National Reserve as conceived by the Republicans to the Federal Reserve, and the number of reserve banks was reduced from 15 to 12. Furthermore, two of the major differences of substance between the Aldrich Plan and the Federal Reserve Act — the Fed's governance and the backing of the currency — resulted not from Glass's initiatives, but from those of Wilson and Bryan.

Glass, like the Republicans, felt strongly that a board composed *entirely* of government officials and appointees would subject the Federal Reserve to undue political influence. But Bryan, now Secretary of State in Wilson's administration, was still an important voice on banking in Wilson's cabinet and he argued strenuously that *any* representation from the business community on the Federal Reserve board was inappropriate.

Wilson was eventually brought in as a tie-breaker to make the final decision on the composition of the board. In a meeting convened to win over Wilson's support for a balanced board, Glass summoned prominent members from the American Bankers Association to visit with the president in the White House for the purpose of reinforcing Glass's arguments. Each had his say, with an approving Glass looking on. But at the end of their presentations Wilson asked: "Will one of you gentlemen tell me in what civilized country on the earth there are important government boards of control on which private interests are represented?" There being no effective rejoinder from the bankers, the progressive arm of the Democratic Party carried the day and the Federal Reserve wound up with a board composed entirely of presidential appointees — and with its headquarters in Washington, DC.

Glass and Bryan remained at loggerheads over other issues during the crafting of the Federal Reserve Act, and Wilson was again brought in as a tie-breaker. When Senator Robert Owen, heading the Senate's legislative efforts, sided with Bryan on the matter of a US backing of the currency, as opposed to relying on the inherent security of the proposed Federal Reserve notes, the issue wound up on President Wilson's desk.

Glass believed that Bryan's stance showed a profound lack of understanding about the more than ample safety of the proposed Federal Reserve note, and he pleaded earnestly with the president to withhold his support for formal government backing. Wilson listened attentively to Glass's argument and concurred with his reasoning, but, in a nod to Bryan's intransience on the issue, suggested that the congressman "surrender the shadow but save the substance" by preserving the full faith and credit government guaranty. Glass was not happy on this issue but ultimately agreed to go along with the "innocuous camouflage."

Even with these changes, the Federal Reserve Act still owed much to the structure that Warburg and the Republicans had shaped as the Aldrich Plan. And the gentlemanly Warburg would have likely lived out the rest of his life comfortable in the knowledge that he had made significant, if not widely appreciated, contributions to his adopted country through his early work in the creation of the Federal Reserve.

But in 1927, 14 years after the passage of the Federal Reserve Act, Glass wrote *An Adventure in Constructive Finance*, a memoir that recalled the behind-the-scenes politics required to craft the legislation creating the Federal Reserve System. Glass, who is better known today as one of the two sponsors of the 1933 Glass-Steagall Act, opened his book by stating, "It's not especially important to have it precisely determined who was the author of what is known as the Federal Reserve Act." But in the following chapters of the book he laid out a highly charged argument for himself — or, alternatively, in a polite demurer, for Woodrow Wilson — as the rightful father of the Federal Reserve.

Warburg found it galling to read Glass's rhapsodic and self-aggrandizing account of the Federal Reserve's creation without ascribing any contribution from others. So in rebuttal to Glass's slapdash and hyperbolic *Adventure,* Warburg spent much of the following three years writing a massive and scholarly retort titled, *The Federal Reserve System: Its Origin and Growth.* He created a two-volume tome, with each volume exceeding 800 pages, and there is little doubt what motivated his writing it: "Miss Clio, the Muse of History," Warburg wrote, "is a stubborn lady, entirely devoid of a sense of humor, and once she has made up her mind, it is exasperatingly difficult to alter her verdict. It is inadvisable, therefore, to delay too long the correction of inaccuracies, particularly in cases where silence might fairly be construed as assent."

In Warburg's *Federal Reserve System* he sought to set the record straight. Taking on Glass's assertion that the Act was a one year, Democratic creation, Warburg made a more expansionary case, stating, "In order to be accorded its proper place, the reserve system must be looked upon as a national monument, like the old cathedrals of Europe, which were the work of many generations and of many masters, and are treasured as symbols of national achievement."

Warburg traced the origins of the Federal Reserve to the seminal November 1910 Jekyll Island meeting at which the Aldrich Plan was hatched. Then in a methodical style much like an extended lawyer's brief, Warburg provided a side-by-side comparison of the Aldrich Bill with the Federal Reserve Act. It's doubtful that many readers, then or since, have taken the time to study Warburg's section-by-section analysis, but even a cursory review shows that the bills are remarkably similar.

So who is the rightful father of the Fed? The evidence is strong that the substance of the Federal Reserve Act of 1913 may owe more to Warburg than to Glass. Yet the evidence is equally strong that the Act would not have been passed without Glass's political skills. Perhaps the paternity should be shared, with Warburg the intellectual father of the Federal Reserve and Glass its political father.

President Wilson's actions after the Act's passage would seem to support the shared arrangement. He appointed Warburg as the Fed's first vice chairman — and it is likely that he would have been appointed chairman, but for the requirement at the time that the Secretary of the Treasury serve in that capacity. A few years later, Wilson appointed Glass as his Secretary of the Treasury. The two appointments were not just honoraria, of course, but they no doubt reflected Wilson's recognition of the crucial roles Warburg and Glass played in the Fed's creation. $

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