Founding the Federal Reserve:
Narrative Institutional History and Central Banking in the United States, 1789 - 1955

Peter Conti-Brown

A dissertation presented to the faculty of Princeton University in candidacy for the degree of Doctor of Philosophy

Recommended for Acceptance by the Department of History

Adviser: Julian Zelizer

June 2017
ABSTRACT

This dissertation attempts to make two contributions. First, it is a historical investigation of pivotal points of inflection in the history of the U.S. Federal Reserve System, from the long nineteenth century through 1955. Second, it attempts to give content to the ill-defined sub-discipline of institutional history beyond organizational biography, historical institutionalism, and new institutional economics. Instead, by taking up the history of the U.S. Federal Reserve System, the dissertation seeks to bridge a divide between different versions of the concept of “institution” that permeate both common language and academic discourse, namely, institutions as “rules, laws, and norms,” institutions as organizations, and institutionalization as a historical process. The dissertation argues that institutions are both rules and organizations, and that the historical process of “institutionalization” is both more fragile and more random than most previous accounts suggest. I call this kind of institutional history “narrative institutional history” to distinguish it from the study of institutions associated with quantitative economic history.

In service of both substance and theory, I tell the Fed’s story through multiple “foundings,” a pluralization meant to invoke periods of intense institutional change. We cannot understand the Fed’s creation as the legislative compromises of the Progressive Era, as the story usually goes. Instead, the Fed is a moving target, an institution that goes through fallow periods of institutional inertia and sudden bursts of institutional change. This early history of the Fed tells us not only about how U.S. society grappled with the perennially thorny problem of defining the national and international basis for money, functionally and structurally, but also how laws, norms, rules, and organizations
struggled to solve those problems—and how actors well after the fact sought to reinterpret past history to justify and legitimize their own preferred policies. In the process, the dissertation asserts the independence of institutional history as a viable subdiscipline, distinct from, if related to, cognate subdisciplines such as political, economic, intellectual, legal, social, and cultural history.
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Preface and acknowledgments

My path to this dissertation has been an unconventional one that is worth briefly retelling for the intellectual context it offers for the overall project. After graduating law school, I spent a year in a research fellowship at Stanford’s Law School and Graduate School of Business. While there, I continued writing law review articles in banking and financial regulation. The 2008 crisis had created new interest in the field of financial regulation, a field that had long dwindled in the shadows of corporate finance (in business schools) and corporate law (in law schools).

Even so, my early work on financial regulation bore the attributes common in some kinds of legal scholarship of being heavily proposal-oriented. For example, after I graduated from law school, my first two academic articles studied the capital structure of banks and the way that structure can influence the spread of systemic risk.1 I loved the research and writing process behind these articles, but they also left me intellectually unsatisfied. I didn’t see myself as a policy entrepreneur, but as an academic who wanted to understand the bases for these institutions: where did banking and bank regulation come from, what problems are banks and regulators trying to solve, and how did public and private power intersect to cause or prevent the kinds of crises we saw in 2008?

Two answers became clear to me as I investigated these questions. First, the burgeoning field of financial regulation was a promising one for exploring these questions, but only if it could stand on its own bottom as a subfield in law distinct from the study of Delaware corporate governance that dominated business law scholarship.

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1 Conti-Brown (2012); Admati, Conti-Brown, and Pfleiderer (2012).
And second, law itself was neither necessary nor sufficient to study how these institutions sprang into action, nor how they changed. I loved my law as my first academic discipline, but I knew I needed more disciplinary training. Without it, the risk that I would spend my career writing one-off proposals for sweeping legal reform (as I had already done) was lamentably high.

With these concerns stirring, toward the end of my fellowship in June 2011 I attended a conference the Stanford Finance Forum, a conference at the Stanford business school that brought together a group 150 practitioners and academics to discuss the topics of the day. The year was financial regulation, a timely topic given that Dodd-Frank had been passed the year before and was set to go online the following month. That legal scholars were underrepresented in the room—besides me, there were only two others—didn’t surprise me: I knew that the legal perspective on financial regulation was still relatively narrow. The biggest discussion at the conference, after all, was about the economic incentives for changing bank capital structures, not about the regulatory structure that Dodd-Frank had created.\(^2\) Part of the appeal of joining the legal academy as a financial regulation specialist was precisely that there was so much to contribute in discussing so new a system as this.

What surprised me was how much of the conversation wasn’t about law or even economics, but about history. Every speaker drew on history for legitimizing support of various proposals, and every discussion referenced what came before as offering insight

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into what would come next. As I looked through the program of participants, there was a notable absence: there wasn’t a single historian in the room.

Shortly after this conference, I reached out to historians whose work I admired for advice. I felt an inexpert passion for it, but knew too little to teach myself what I would need to get at the deeper questions that motivated me. These historians—three of whom are now on my dissertation committee—provided exceptional advice about what history could offer, what it couldn’t, and what it would mean to try to write at the intersection not only of law and history, but indeed primarily history, economics, and politics (with law an important but secondary concern). With the patience of a supportive family, I eventually ended up at Princeton where my advisers allowed me to chart a course in financial and political history that was two parts history, one part economics, and provided precisely the basis I needed to get at these essential questions.

This dissertation is a consequence of those early decisions, and reflects the ambition to say something about questions of present-day significance through the rigorous study of topics from the past. During graduate school, I wrote and published a book that sets the stage for this work. In *The Power and Independence of the Federal Reserve*, I wrote about the need to understand the governance of this singularly powerful and opaque set of institutions, the Federal Reserve System. As I wrote in 2016, the book wasn’t a work of history per se, but “an analytical argument about the Fed’s governance, its external relationships, and the ways it makes national and international policy.”\(^3\) I recognized that there was a tremendous need for doing serious history of the Federal

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\(^3\) Conti-Brown (2016, xiii).
Reserve, but the first book was not the vehicle for it. Still, I wrote in a footnote something of a promissory note: “An accessible, single-volume narrative history of the Federal Reserve has yet to be written.”

This dissertation is the first step toward fulfilling that promissory note. It draws in small part on some of the writing and sources used in Power and Independence, but stands alone as a new inquiry into the nature of institutional change more broadly and the history of the early Federal Reserve System. From it, I hope to develop ideas about what I call “narrative institutional history” and, eventually, to write that narrative institutional history of the Fed that historians of the administrative state have otherwise neglected.

* * *

While I am least able to objectively comment on the success of the enterprise, I can say that it is precisely the kind of work I had in mind when I embarked on this journey six years ago, and now I take the opportunity to thank those who have guided my path along the way. My first thanks are to my methodologically diverse dissertation committee in Julian Zelizer, Harold James, Alan Blinder, Naomi Lamoreaux, and Nicholas Parrillo. Nick and Naomi, my outside readers, may not remember doing those post-Stanford Finance Forum conversations, but they helped me think through the risks and rewards of the course I imagined. They have been willing interlocutors on substance and strategy since. I look forward to many more such conversations in the years ahead.

The coursework I took with Alan, whether his macroeconomics seminar at the

\[4 \text{ Ibid at 278, n3}\]
Woodrow Wilson School or our one-on-one seminar about the history of economic thought as it pertained to central banking, profoundly shaped my approach to what central bankers imagined themselves to be doing across these multiple founding moments.

Harold instructed me directly and modeled for me implicitly what it means to straddle the worlds of financial history and economics from the historian’s side of the divide. In many important respects, he has been my co-adviser and an intellectual godfather to this and my other projects in financial history. Indeed, even as I call myself an “institutional historian,” I identify too as a financial historian, something I can only do because of Harold’s guidance and instruction.

Julian, my primary adviser at Princeton, is everything I can imagine an adviser should be. If I sent him an email when you started reading these acknowledgments, chances are strong that he would have responded to it before you finished reading them. His comments on many drafts, other book projects, and this dissertation have made my intellectual life vastly richer than it would otherwise be. I look forward to our many years ahead as colleagues.

A number of other professors at Princeton and elsewhere have helped guide my thinking on these subjects. I’m grateful to long conversations with Stephen Kotkin about central banking in a global context; Jon Levy, now at Chicago, has helped sharpen my thinking about late 19th century trends in political economy; and conversations with Kevin Kruse taught me a lot about politics between the New Deal and the Great Society. Ezra Suleiman in Politics has been a mentor, friend, and instructor par excellence. His warmth and welcoming approach to interdisciplinary work has shaped my thinking about
international bureaucracy in ways that are reflected in this dissertation. I’m also grateful to my fellow historians in the graduate program, especially my friend and co-author Sean Vanatta. I can’t think of a serious substantive or stylistic issue broached in these pages that I didn’t clear at some point with Sean Vanatta. Although he (nor anyone else, for that matter) is not responsible for anything in this dissertation that doesn’t reflect well on him, he can take credit for much that does.

The most important lessons in methodology I’ve learned since making the jump from law to history are not in the seminar room, but in the physical and digital archives that present the body of primary sources on which this dissertation was written. I thank the archivists at the Federal Reserve Bank of New York (especially Julie Sager); the Allan Sproul papers at the University of California, Berkeley; the Harry Truman presidential library; the Carter Glass papers at the University of Virginia; and the Library of Congress.

One of the great delights of writing history about the Federal Reserve is the extraordinary set of primary documents available online through the Federal Reserve Bank of St. Louis’s FRASER system. Writing this dissertation, as with the book before it and the book to come, would have taken months in sheer travel time alone but for these extraordinary resources, constantly expanding. While I have often lamented the stingy access to other documents limited by my (usually unsuccessful) FOIA requests and have a bone in my throat regarding the policy of essentially blocking historians from the archives at each of the Federal Reserve Banks except for the Federal Reserve Bank of New York, FRASER has been an extraordinary resource. I’m aware of nothing else like it
in governmental research. (Perhaps here I disclose that I am on an advisory board for FRASER.)

I’ve been fortunate to present the ideas in this dissertation extensively during the years leading to its publication. I thank participants at the following conferences and workshops for their support: Business History Conference; Boston University Center for Finance, Law & Policy; Princeton University, Politics Department seminar; Queen’s University Belfast, Economic History Seminar; Queen Mary, University of London; Princeton University, Class of 1968 Seminar; Heritage Foundation; Bank of England; Williams & Connolly; American Enterprise Institute; Organization of American Historians; Wharton Public Policy Initiative; Yale Law School, American Constitution Society; Columbia Law School, Financial Regulation Roundtable; Wharton Seminar for Business Journalists; Politics & Prose; Princeton University, Julis-Rabinowitz Center for Public Policy and Finance; Cornell Law School; George Mason Law School; Fondo Latinoamericano de Reservas, Bogota, Colombia; U.S. Senate Committee on Banking, Housing, and Urban Affairs; Brookings Institution, Hutchins Center on Fiscal and Monetary Policy; Stanford Graduate School of Business; Princeton University, Monetary Policy and Central Banking; Max Planck Institute for Collective Goods, Bonn, Germany; Institute for New Economic Thinking; George Washington University; Stanford Graduate School of Business, Finance Faculty Workshop; Stanford Law School, Stanford Constitutional Law Center; U.S. Treasury, Treasury Historical Society Speaker Series; Ohio State Law School; Social Science History Association; George Washington University Law School, Center for Law, Economics, and Finance; MIT Sloan School of Business. I thank my hosts and other participants for their feedback.

My colleagues at the Wharton School of the University of Pennsylvania have been exceptional collaborators on this project, too. I’ve gotten substantive feedback on chapter drafts in our inimitable junior faculty workshop and had the benefit of expert insight from colleagues, especially Vince Buccola and David Zaring. My thanks, too, to the stellar research assistants who have worked on this and related projects, Tanner Bowen, Sean Egan, Molly Hessel, Shivani Komma, and Richard White.

My research was facilitated by the Princeton History Department, the Dean’s Fund at the Wharton School of the University of Pennsylvania, and the Policy History Conference.

My family and friends deserve my deepest gratitude. Dana Boehm, Paul Boehm, Nicholas Hall, and Britton Olson are family to me. My mother and six siblings and their spouses and children have been steady companions. And most of all, the Conti-Browns: Nikki, Gabriel, Caleb, and baby Nico. I love you more than words.
In private and academic life, one accumulates mugs, and I have had a haul of them from law firms and alumni events and kids’ summer camps. My favorite, though, was a gift from a friend of mine who works at the Fed’s Board of Governors in Washington, DC. According to my friend, the Governors—at the time, Ben Bernanke and his colleagues—decided to honor the centennial of the Federal Reserve System by commissioning these mugs for employees. The mug carries the seal of the Federal Reserve System—much like the seal of the U.S. President, an eagle over the semi-circular stars and bars, but with both feet gripping olive branches instead of arrows—wrapped by its formal name, “Board of Governors of the Federal Reserve System.” Underneath it all, the mug boldly declares its purpose in big gold letters: 100 Years.

I love this mug, and not because it holds my pens (on this front, the mug isn’t a terribly exceptional performer). I love the mug because it announces a widely believed lie. The Board of Governors of the Federal Reserve System is not 100 years old. The Board of Governors wasn’t created until 1935, in the Roosevelt Administration-backed Banking Act of 1935. The parties celebrating the centennial announced on my mug won’t begin until 2035. The old Federal Reserve Board created by the Federal Reserve Act of 1913—whose centennial my mug meant to announce—no longer exists. The Roosevelt Administration abolished it.

Telling the story behind this often forgotten, dramatic institutional redesign of the nation’s central bank is part of a broader effort to provide what I call a narrative institutional
history of the Federal Reserve. But it is not merely the story of major pieces of legislation, although the Federal Reserve Act of 1913 and the Banking Act of 1935 figure prominently in this story (as do other pieces of legislation like the McFadden Act in 1927). It is the story of the Fed’s institutional, gradual then sudden changes in its first half-century more broadly. In that sense, it is an antidote of the prevailing view of Fed and institutional history generally. In many cases, a sort of mythos evolves to celebrate the “founders” of institutions. A quest to capture and understand these founders’ wisdom becomes the mission of those who want to understand that mission.

Without question, knowing what happened in 1913, why, and according to whom, is a key part of the Fed’s history. But my dissertation stands for a broader proposition: an institution is constantly, but unevenly, on the move. To understand institutional change, we need to look more deeply at periods of historical inflection that have mattered for the shape the institution takes. The effort is to make the question “when was the Fed founded?” essentially incoherent, depending on the meaning. If the question means, when was the Federal Reserve Act of 1913 passed?, the answer is easy and obvious. But if the question is “when did the Fed become the institution we know today?” the answer requires more than reciting the details of a legislative battle a century-old.

Indeed, this very act of mythologizing key founding moments long after the fact is a key part of the process of institutionalization that an institutional history should capture. Institutionalization is a process that is both history and historicity. In other words, to understand institutional history we must both identify historical moments as they occurred—a broader but similar effort to “founders’ history”—and the process of later
generations seeking to make use of historical moments in a process to justify or legitimize current courses of action. The narrative institutional history of the Federal Reserve contains both kinds of institutionalization.

From that perspective, it makes little sense to privilege a “founding” moment in a single point in time. It is better to focus on founding moments. Such a focus on the Federal Reserve’s institutional evolution challenges an old paradigm of institutional historical analysis, what I will call the founders’ fallacy. Rather than tell only the story of the Fed at its beginning—a story that has absorbed most of the historical literature on the Fed—my dissertation will focus on a variety of important events, both as they occurred originally and as they were reinterpreted after the fact. This history is the story of the Federal Reserve Act of 1913, and all that surrounded it, including the historicization of previous rejections of central banking. It is the story of the Banking Act of 1935 and the singular role of Marriner Eccles (often in response to Father Charles Coughlin and Senator Carter Glass), but also the way that the Great Depression became a founding moment decades after it was left at the feet of the Hoover Administration, not the Federal Reserve; and it is the story of the “Treasury-Federal Reserve dispute” in 1951 that eventually became the “Fed-Treasury Accord of 1951,” a vaunted event that existed primarily in its reconstruction after the fact.

In each case, the questions motivating the historical inquiry will be: Why was this event important? Who was interested in it? What were the alternatives? What were the political issues at stake? How was law used—or, as importantly, not used—to accomplish

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5 On the “Founder’s Fallacy,” I am influenced by David Sehat’s excellent recent historicization of founding fathers’ generation, see Sehat (2015). For a recent example of founders’ history and the Fed, see Lowenstein (2015).
these goals? What was the financial reality of the nation’s banking system, and how was the legislation aimed at addressing that reality?

The dissertation provides rough answers to these and related questions. It is a work of financial, political, and above all institutional history that seeks to make connections between different periods—from the Progressive Era to the New Deal to the Cold War—and different threads of focus, from the intellectual history of economics to the legal history of regulation to the political history of institutions at various periods of enormous volatility and experimentation.

The long introduction that follows will lay out some of the key themes in Fed history that this dissertation will explore. It will also do the theoretical heavy lifting by explaining what I mean when I describe institutional history as a separate subdiscipline in need of rejuvenation. To make sense of this new movement requires making sense of what has come before, especially new institutional economics, the organizational synthesis, and historical institutionalism.

Themes in Founding the Federal Reserve: Money, Structure, “Independence”, and Historical Institutionalization

Four themes about central banking thread through the events described in the dissertation below. First is the question of what is “money.” It is a venerable debate, one that precedes recorded history. Where humans have gathered, eventually “money” has come to play a role in economic, social, cultural, and political life.6 And when it has, controversy has followed. The fights over the Banks of the United States in 18th and 19th

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6 See Goetzmann (2016) for an overview.
century America involved these controversies, and the question was one of the most important in the debates preceding the creation of the Federal Reserve System. But the Fed didn’t answer this question once and for all; it merely pushed the debate into a different framework.

Second is the question of who gets to decide what money is and how it should be regulated. This question is, in many respects, the existential question of central banking, but it is also a question that the Fed’s institutional framework didn’t answer once and for all. After the Federal Reserve Act was signed on December 23, 1913, the question of power within the system began its tumultuous history, a history that continues into the present. The basic contest was between the Federal Reserve Board (eventually, the Board of Governors) and the Federal Reserve Banks, but the many internal actors within the Federal Reserve System—the Governors at the Board, the presidents at the Reserve Banks, and the professional staff in both locations—vied for dominance within the System at various stages.

Third, we see from the beginning Fed officials grappling with a concept originally described as “autonomy” and, eventually, “independence.” Eventually, the concept of central bank independence would become highly stylized as the legal structure separating the Fed from the President so that the Fed could fight inflation without partisan interference. But the period covered in this dissertation looks at how that “independence” was described in very different ways. Political interference with banking activities was always a concern, but so was the question of whether bankers would have undue influence

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7 Conti-Brown (2016)
over the system. By the end of this dissertation, we start to see the nascent beginning of a central banker as a self-conceived technocrat, dominated by neither banks nor politicians.

And finally is, again, the meta-concept of how these disputes should be resolved. The arguments were often about economics, law, and politics: what was for the economic good, what was appropriate given statutory mandates, what was politically possible. But these debates were also about what had occurred in the past. The historicization of central banking disputes is also a constant theme of how people debated these structures and functions during the time covered in this dissertation (and continuing well beyond that history).

The dissertation ahead is not a comprehensive history of the Fed through 1955, if such a book could be written: all history is selective. My selections are oriented toward points of inflection that I think reflected at the time and came later to mean in the future, points that reoriented the Fed, structurally, functionally, or both. But the overall theoretical and historiographical argument in this dissertation is that such founding moments are not as limited as I have selected. The Fed is, today as much as ever, undergoing at irregular intervals institutional change. A broader account of the Federal Reserve must reckon not with the handful of founding moments I address here, but dozens or hundreds of them. Dissertations have to end, though, and mine ends by using especially the periods leading to the 1913 legislative enactment, the period between that enactment through the Depression, the legislative reorientation during the Second New Deal and subsequent war finance period, and finally the uneven resolution of the Fed and Treasury’s responsibilities to that war finance apparatus.
The dissertation aims to not only speak to financial and political historians interested in the Federal Reserve as a historical subject, or even those historians interested in the Fed for what it can tell us about other topics. It is also a modest effort to synthesize and provide evidence of a new kind of history that can present an exciting new subdisciplinary effort on par with revolutions in cultural, social, political, and gender history. That effort is in narrative institutional history.

**New Directions in Narrative Institutional History**

It may seem odd to introduce institutional history as something new, given its long pedigree. In 1889, an increasingly renowned Princeton scholar named Woodrow Wilson wrote a book review of the English aristocrat James Bryce’s *American Commonwealth*. Wilson didn’t love Bryce’s literary stylings—“[i]ts strength does not lie in its style, although that, while lacking in distinction, is eminently straightforward and clear”—but he celebrated the focus on “institutions” and “institutional history.” Bryce succeeded because he did not “treat the institutions of the United States as experiments in the application of theory,” but as an application of “comparative institutional history and life.”

History as an academic profession is barely as old as this book review. It’s safe to say, then, that “institutional history” is, in a sense, as old as professional historiography in the United States itself. It would seem, then, that “institutional history” might have fit alongside its subdisciplinary brothers and sisters of social, economic, cultural, political,

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8 Wilson (1889), reviewing Bryce (1888).
or legal history. But if Google can be relied upon to give us a global sense of its usage, we see something very different.

Social history is referenced almost 10 million times. Cultural history not far behind at 8 million. Political and economic history each have about 6 million hits, with legal, intellectual, and global history (if we include international, transnational, and global as a unit) at 1-3 million each.

Institutional history has, by contrast, but 230,000 mentions.

The task ahead—and one I won’t accomplish in this dissertation alone, but will hopefully trigger a useful theoretical and methodological debate⁹—is to reengage that effort such that historians interested in institutions can sit at a common table the way that

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⁹ For useful edited volumes touching on similar themes, see Mahoney & Thelen (2010) and Bucheli & Wadhwani (2014)
other historians of other broad concepts such as politics, ideas, culture, or law have already succeeded in doing.

To set that table, the first work is definitional: what are institutions, and how do we tell their history?

Given the amount of time that historians like Woodrow Wilson have been thinking about institutions, one would think these questions have ready, universally accepted definitions within historiography. One would be wrong. The problem with these predecessors, and why I think PhD students rarely apply to graduate school to be “institutional historians” the way they would to become social or economic or cultural historians, is that there hasn’t been enough theoretical work in history to define our terms. Institutions are, to use a perhaps overused and over-loved term, undertheorized.

This chapter—and the dissertation generally—provides a theoretical framework for thinking about institutional history as something related to but distinct from other kinds of history. That framework doesn’t spring ex nihilo, but seeks to remedy weaknesses at the intersection of three methodological movements that have the greatest claim on defining institutional history as a definitional matter: First, in what came to be known variously by distinct if overlapping names like “new institutionalism,” “new institutional economics,” or less often “new institutional history,” economists and like-minded historians began to apply the methodologies of theoretical and empirical economics to historical questions to understand how institutions in society arose over time.10 Second,

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10 For an overview of the depth and diversity of “new institutional economics,” see Menard & Shirley (2008).
Louis Galambos, in three influential essays in the *Business History Review*, defined and redefined (and redefined) an organizational synthesis whereby political historians started to ask and answer harder questions about the development of the firm, the state, and its various constituent actors. And third, sociologists and organizational theorists have developed an approach to “historical institutionalism” that provides a useful if incomplete jumping off point for the study of institutional history.

These movements arose together in time, but not together in space: the larger institutional economics revolution paid essentially no attention to the sociologists, the sociologists paid some bitter attention to the economists (for “discovering” what they had long been discussing), and most everyone ignored the historians, who in turn mostly spoke to each other. The failure of engagement is largely epiphenomenal: the fact is that the disciplines are separate because they are motivated by different kinds of questions, however close in intellectual proximity they may appear. New institutional economists were unapologetically interested in the full breadth of human history extending millennia to understand deep truths about economics. Theirs was an assault on the existing order in economics. Sociologists were interested in institutions as primarily social phenomena. Organizational historians, for their part, were originally just trying to reinterpret the Progressive Era in the United States of America.

_Institutions in Economics, Old and New_

“Institutions” in economic thought enjoy a storied history and were, arguably, there at the beginning. Adam Smith was, after all, consumed with thinking through the limitations to a mercantilist system, and had plenty to say about institutional features such as banks. But as the Ricardian revolution took hold, the effort was to reason deductively in search
of universal truths about human behavior.\textsuperscript{11} Marshall and Mill sought to combine both approaches, making economic policy both deductive and sensitive to its historical and policy contexts. This was the initial fight: institutionalists, such as they were, wanted economics to be more than abstract formulations of profit maximization. To be an institutionalist meant to be mindful of history, context, and society.

Two schools of institutional thought arose in reaction to Ricardian economics (often called “classical economics”), one as a consequence of the other. First, the German historical school of economics, active from the 1840s into the early 20\textsuperscript{th} century, with Max Weber as perhaps the most famous proponent, but also including its major founder, Gustav Schmoller.\textsuperscript{12} The critique focused less on the meaning of institutions and more on the idea that economics as an abstraction failed to accurately describe the way people made decisions. Institutions, in that broad sense, essentially meant historical context.

Through its educational dominance—graduate training for academics was heavily oriented toward the German model and to German universities into the early 20\textsuperscript{th} century—German historicism had a profound effect on American institutional economics as that school took root in the first half of the 20\textsuperscript{th} century. The term “institutional economics” was first used by Walter Hamilton at a meeting of the newly formed American Economic Association, in 1918. Again, as with Marshall, “institutions” meant only the broader historical context that served to reorient individual efforts to economize. The early institutionalists didn’t engage very carefully in a definitional game. Weber was

\textsuperscript{11} For a good recent overview of institutions in early economic thought, see Farkas (2016)
\textsuperscript{12} For an overview of the German historical school of economics, see Tribe (2002)
slightly more specific, thinking through the implications of “institutions” like bureaucracy and culture, but the term evaded easy definitions.

The wave of classical deductive abstractionism and historically contextualization continued through the late twentieth century until the “new institutionalists” sought to combine the approaches and, in the process, given the term more analytical content than it had had before. “Institutions” for the new institutional economists—pioneered by Douglass North, Oliver Williamson, and later Avner Greif, among many others—were something very specific, in North’s words: the “humanly devised constraints that structure political, economic and social interaction” that “consist of both informal constraints (sanctions, taboos, customs, traditions, and codes of conduct), and formal rules (constitutions, laws, property rights).” Greif later pushed back against this conception, thinking of institutions instead as “equilibria,” more or less stable patterns of useful human behavior. But the idea is the same: institutions are the “rules of the road,” not the organizations that operate within those rules.

Given the success of institutional economics within mainstream economics—it is responsible for at least five Nobel Prizes, depending on how one is counting—it is perhaps easy to forget how radical new institutional economics (NIE) was when it began its life in the 1970s. Institutions were controversial because these kinds of patterns of behavior weren’t supposed to matter in economic development. Markets carried their

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13 North (1991, 97)
14 Greif (2006)
15 They are: Coase (1991), Fogel (1993), North (1993), Ostrom (2009), and Williamson (2009). Despite the citation’s reference to “institutions”, I’m not counting the 1974 prizes to Hayek and Myrdal. For more, see Offer and Soderberg (2016)
own logic, and agents should have found their best expression through these markets. If anything, under a classical economic sense, “institutions” if they exist at all could only be implied by market liberalism, or must be harmful interferences with that liberalism.

The institutionalists’ idea was that institutions were not simply the reflexive expression of (or interference with) market clearing, but that something different and more significant was in play. In what essentially amounted to his own 95 theses nailed to the neoclassical economists’ church door, North identified seven key but flawed underlying assumptions that kept economists from understanding economic development. He’s worth quoting in full:

1. The economic world is reasonably viewed as being in equilibrium.
2. Individual economic actors repeatedly face the same choice situations or a sequence of very similar choices.
3. The actors have stable preferences and thus evaluate the outcomes of individual choices according to stable criteria.
4. Given repeated exposure, any individual actor could identify and would seize any available opportunity for improving outcomes and, in the case of business firms, would do so on the pain of being eliminated by competition.
5. Hence no equilibrium can arise in which individual actors fail to maximize their preferences.
6. Because the world is in approximate equilibrium, it exhibits at least approximately the patterns employed by the assumptions that the actors are maximizing.
7. The details of the adaptive process are complex and probably actor and situation specific. By contrast, the regularities associated with optimization equilibrium are comparatively simple; considerations of parsimony, therefore, dictate that the way to progress in economic understanding is to explore these regularities theoretically and to compare the results with other observations.16

While North emphasized that these assumptions had been “a very effective model for analyzing economic phenomena,” the edifice of institutional economics he built was to

show how the assumptions ultimately failed. Instead, institutions show why equilibria fail, why choices can be idiosyncratic, preferences unstable, maximization incomplete, and optimization sometimes complex.

Institutions, in North’s view, were not merely theoretical propositions: they were intimately connected with history. In one of his most important articles, for example, North (with Barry Weingast) confronted the puzzle of how Britain could transform from an unstable economy where investors could only participate in financing the sovereign through force to one of the most economically developed models of the state in history. More specifically, they asked why investors came to trust British institutions—the rules of the game—when (1) the sovereign with a monopoly on violence was involved in the game, and (2) the sovereign made up the rules himself. In other words, how can the sovereign who seeks voluntary participation from others credibly commit to playing by the same rules as everyone else? As North & Weingast put it, “Because the state has a comparative advantage in coercion, what prevents it from using violence to extract all the surplus?”

North & Weingast argued that the structural changes wrought as part of the Glorious Revolution—in particular, the assignment of governmental powers to an independent judiciary, a sovereign Parliament that is separate from the sovereign King—are evidence of this kind of institutional change. For evidence of the value proposition for institutional change to assist with market functions, they also cite the dramatic success the Crown had

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17 North & Weingast (1989, 806).
in raising funds through the capital markets following the Glorious Revolution, an increase by an order of magnitude.

These changes are interesting for history, but also “provide[] an endogenous role for political institutions. Restrictions on the \textit{ex post} behavior of the state improve the state’s ability to maintain its part of bargains with constituents, for example, not to expropriate their wealth.”\textsuperscript{18} The innovation of the Glorious Revolution was to use rules that would make this commitment credible. These new rules included parliamentary supremacy (including especially in fiscal and financial matters), an independent judiciary, and the securing of political rights for citizens, especially property holders. The Constitution is the thing: it places the authority to contract obligations in one set of hands, but the authority to withdraw from them in another.

Northian definitional conceptions of institutions were not the only order of the day. Writing at the same time but focusing his definitional effort a little later, economist Oliver Williamson laid out the contribution more schematically. His famous view of institutionalism is reproduced in Figure 1.\textsuperscript{19}

\textsuperscript{18} \textit{Ibid.} at 808.  
\textsuperscript{19} Williamson (2000, 597)
Under this schematic, changes like the Glorious Revolution were key events that could change all levels of institutional historical inquiry. But the purpose of institutional history for these economists was what Williamson calls here first, second, and third order economizing—that is, understanding how rules in long gestation and rare disruptive events change the rules that shape human behavior.
A generation later, new institutional economics was only gaining steam as a matter of economic theory and empiricism. The most important of the second generation of NIE is, arguably, Avner Greif, especially his *Institutions and the Path to the Modern Economy: Lessons from the Medieval Trade*.\(^{20}\) For the purposes of understanding narrative institutional history and the Federal Reserve, what is most important about Greif’s contribution is definitional. Greif viewed “institutions-as-rules” as “very useful in examining . . . the rules that politicians prefer and the contractual forms that minimize transaction costs.” But he also sees in this view of institutions a key flaw: people don’t always follow rules, and knowing on the basis of rules alone why some people follow and others ignore doesn’t tell us much. This kind of approach “merely pushes the question of institutional effectiveness one step backward, by assuming that those who are supposed to enforce the rules do so. Why would this be the case? Who watches the watchman?”\(^{21}\)

From here, Greif moves institutional economics past “rules of the game” and toward a theoretically informed behaviorist approach that looks at institutions as game theoretic equilibria or, if not exactly equilibria, the “shared beliefs motivating equilibrium play.”\(^{22}\) This move allows Greif to bring the methods of game theory to the study of institutions, but also points toward the need to relax the focus on formality in these rules.

\(^{20}\) Grief (2006). It is difficult, perhaps impossible, to adequately summarize this ambitious book. At the highest level, this book is probably the most methodologically ambitious work of institutional history on either side of the economics and history divide. In it, Greif outlines a theory of institutions and institutional change that draws on formal game theory to work through why strategic agents—his Muslim and European traders participating in the late Medieval commercial revolution. But it is also a sophisticated piece of history based on the analysis of primary documents—essentially unheard of in institutional economics.

\(^{21}\) Ibid.

\(^{22}\) (Greif 2006, 10).
and look instead at patterns of behavior rather than rules per se. Constitutions might matter in some cases, but informal relationships among strangers can matter even more.

Scholars focusing on the role of custom and convention in shaping human behavior might feel a sense of exasperation if Greif’s contribution were summarized only by noting that sometimes informal relationships matter more than the expression of the monopolized violence of the state. After all, Bernstein’s influential 1992 study of the non-state adjudicative process resolving disputes in the diamond industry predates Greif, and Greif makes clear throughout his intellectual debts and contributions to concepts of informality. The point is not that Greif is the first to put stress on the idea that institutions could be informal, but that he showed why informal institutions can function so effectively in ensuring compliance, even if the boot of the state couldn’t be deployed toward enforcement.

_The Limits of New Institutional Economics in Institutional History_

As we can see, Greif and North show that NIE is far from a homogenous field. And NIE’s approach to institutional history is a valuable one that will likely long continue to yield important insights. But there are three ways that NIE is an insufficient lens to help understand an institution like the U.S. Federal Reserve System. First, it is insufficient at the definitional level. The attempted clarity at differentiating organizations from institutions—and especially institutionalization of organizations as a historical process—in the new institutional economics literature takes for granted the very

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23 Although the debt goes unacknowledged, Greif owes something to Samuel Huntington’s idea of institutions as “stable, valued, recurring patterns of behavior.” Huntington (1968, 12).

boundaries of organizations—what divides one organization from another. To take a question that will occupy some attention in the pages ahead, is the Fed public or private? Do its activities reflect an exercise of governmental power or market power? If that balance changes over time, has the institution changed? The point is, the Fed has had the same name for 100 years—the U.S. Federal Reserve System. Organizationally, there have been a few changes (including some I discuss in the chapters ahead). But institutionally—from the perspective of what, exactly, are the rules, norms, and social patterns of central banking—the Fed in 2017 (or 1955) bears little relationship to its 1913 legislative creation.

Although scholars in the new institutional economic tradition are keenly attuned to questions of human behavior, humans in their model are agents who seek to magnify influence through organization and change institutions to maximize (or optimize) their various goals according to simple utility calculations. In this approach, organizations function within institutional frameworks, seeking to influence those frameworks, to be sure, but still subject to them all the same. Narrative institutional history looks beyond this narrower field and wants to know not about the rules at the broadest level of society, politics, or economy, but the narrow rules that define those organizations themselves. Institutions are rules, organizations, and networks.

Second, the NIE approach as articulated by Williamson and endorsed by many others is too certain of a time frame that is longer than its theory of history can support. Consider again Williamson’s schematic, from Figure 1. A new institutional historical approach to these same questions would not feel settled with the assumption that
institutional change happens over a slow drip over the course of millennia. Instead, the historical question would be to drill deeply into these periods of acute change, recognizing that these periods of acute change can happen far more often than at the level of regime change. The Glorious Revolution surely matters, as North & Weingast note. So too does the Federal Reserve Act of 1913. But so do scores of others that slowly, but acutely, influence the shape of the space within which individuals and organizations operate to accomplish their goals, from the Fed’s legislative redesign in 1935 to the informality of the Treasury-Fed dispute and the mythology that became the Fed-Treasury Accord. In the frequency column of Figure 1, we can and should note that change at every level is constant, even if sometimes random. As James Mahoney and Kathleen Thelen wrote against this tradition of seismic institutional change, “institutions often change in subtle and gradual ways over time. Although less dramatic than abrupt and wholesale transformations, these slow and piecemeal changes can be equally consequential for patterning human behavior and for shaping substantive political outcomes.”

Big Bang institutional changes matter, but so too do the smaller changes that can, sometimes only through historical revisionism, change institutional trajectories.

Finally, NIE conceptions of institutions rely too heavily on the idea that rules, relationships, and organizations are planned strategies, where agents seek to change the rules of play in order to accomplish some specific goals. Even if this is an accurate description in some cases, it is not true in all. If institutions are “humanly devised constraints,” as North argues, the importance of contingency in setting the organizational

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25 Mahoney and Thelen (2010, 1).
and institutional stage is lost in an apparatus too wedded to game theory and utility maximization. In the pages ahead, we’ll see some exquisite planning by historical actors. We will also see in fuller display the whims of historical caprice. Had this Roosevelt Brain Truster not attended that banking convention, had this Secretary of the Treasury not had gout, and had that Fed Chairman not offended this member of Congress: well, then, the institutions of central banking in the 20th century United States would look very different. The idea that almost “complete, totalized contingency,” as Christopher Tomlins has put it, is central to the historical process isn’t a new one. But it is not a part of the new institutional economics, and the lack of attention to such randomness at the institutional level is a weakness. NIE cannot, by itself, function as the theoretical backdrop for understanding institutional change at the U.S. Federal Reserve, nor can it adequately provide the theoretical bottom for institutional history as a subdiscipline.

_Institutions in the Organizational Synthesis_

If the new institutional economics isn’t the theory for thinking through institutional change at the Fed, then perhaps the “organizational synthesis,” another primary institutional frame for thinking about institutions, is. Galambos first articulated this proposed lens in three influential essays over thirty-five years. In these essays, Galambos outlined the organizational synthesis as a lens that could account for the rise and development of the U.S. state across public, private, and nonprofit sectors. Galambos’s “institutional” view of history emphasized a certain kind of agnosticism: economic and political development didn’t march nobly and teleologically toward greater

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26 Tomlins (2012, 164)
efficiency (contra some of the new institutional economists) or equity (contra some of the Progressive historians), nor even necessarily toward the stability or equilibria favored by later NIE scholars. But neither did development degenerate into an exploitative and malevolent distribution of goods, governmental services, and political participation. Sometimes institutional change just was.

As Galambos described it in the first essay, institutional/organizational history “abandon[s] the heroes and villains of the progressive synthesis and the New Left” in favor of a dispassionate, almost clinical exploration of social, political, and economic structures.28 Indeed, under Galambos’s formulation, there would be no heroes or villains at all largely because there would be so few individuals: “Organizational history will . . . stress the role of environmental forces acting on the individual. Less emphasis will be placed on the individual’s efforts to shape his own historical context.”29 Although Galambos references NIE only in a passing footnote in his third essay, this individual-less conception of history’s march would be comfortable within that tradition. Indeed, Galambos saw the organizational synthesis as sitting comfortably at the intersection of social science into history. (Here, Galambos was following Hofstadter’s lead from twenty years before.)30

As with the new institutional economics, the organizational synthesis came at a disorienting time in U.S. historiography. The liberal presidential synthesis was collapsing as New Left historians found so much to despise in the presidential politics of Vietnam.

28 Galambos (1970, 289)
29 Ibid. at 288.
30 Galambos (2005, 11n.31). See Hofstadter (1952) for his iconic application of psychology to history.
The presidential synthesis had been an attractive lens for viewing U.S. history. Franklin Roosevelt—and, in a different way, his uncle/cousin Theodore—had placed power and agenda setting in the White House in a way that historians accepted, even celebrated. Some of these historians gave personal witness to the power of the Presidency: for example, Arthur Schlesinger, Jr., wrote to celebrate “The Age of Roosevelt” even as he advised the Kennedys.

The presidential synthesis failed for intellectual and methodological reasons. Intellectually, it wasn’t defensible to periodize U.S. history in stubs of four- and eight-year administrations. No serious question in U.S. history starts and begins in perfect sync with the presidential electoral cycle. More importantly, presidents can’t set the agenda and drive history as well as many historians assumed they could. At first, the collapse of Johnson’s Vietnam policy—and with it, his popularity—led to historical longing for the FDR years, with the view that LBJ was an aberration. But Roosevelt may have been the exceptional president with social and political values to celebrate by academic historians. Indeed, subsequent historians have questioned whether Roosevelt was in even as good as Roosevelt. For example, conservatives in Congress thwarted his agenda after the two bursts of the first Hundred Days and the Second New Deal (during the legislative session in 1935). After 1938, new social legislation was dead. The sturdiness of presidential power to dominate history proved illusory. Nixon’s collapse in 1974 sealed the doom of the presidential synthesis as a viable, enduring historical lens.31

31 For more on this discussion, see Patterson (1967) and Brinkley (1995)
Methodologically, the 1970s saw the trickles that would become a roaring stream in social and cultural history that continues to dominate the academic history today. Deriding presidential history as a “Dead White Men” approach, social and cultural historians of race, gender, sexuality, and even politics rejected the notion that we can understand the past when limited to the doings and sayings of white elites. This social and cultural revolution in history meant that a president-focused history had little-to-no place in the historiography of the age. The new approach was “fractured,” in Daniel Rodgers’s term. The age of presidents was over.32

The institutional/organizational histories surveyed (and anticipated) by Galambos came at the beginning of these junctures. His movement past heroes, villains, even individuals, is an effort to take institutional history in the opposite direction of history’s mainstream.

The rendezvous of modern history still appears to be with bureaucracy in the private, public, and nonprofit sectors. In art, architecture, design, and related fields, there are trends in style that are distinctly postmodern. But in all those aspects of society that involve power and money, including the marketing of postmodern products, bureaucratic and professional organizations and their distinctively cultures remain dominant.33

Rather than embracing the move toward social and cultural history, Galambos and others were striving to understand the bigger picture of corporations, Congress, bureaucracies: in their words, “institutions” and “organizations.”34 This was the methodological and substantive approach Galambos and his successors sought to synthesize.

32 See Rodgers (2011)
33 Galambos (2005, 4).
34 There are two veins in history that arose as institutional/organizational alternatives to both top-down presidential and bottom-up social approaches to political and economic history, in tandem but with no clear intellectual debt to Galambos. First came the revolution in business history instigated by Alfred Chandler, Jr. and his followers, historians who embodied the organizational synthesis better than any but with no obvious
Galambos chose his label carefully: unlike new institutional economics, the organizational synthesis isn’t a carefully organized school of thought but an external imposition of an explanation for the modern development of public and private life in 20th century United States. As such, the organizational synthesis has always been vulnerable to the critique that it is simultaneously both too broad and too narrow. By focusing on structures of society, and not on the people behind them, it excludes “vast
segments of society to the periphery of historical analysis.”35 Too much history is missed when the conception of the 20th century includes only the faceless and massive organizations that arose during that century.36

My critique of the organizational synthesis is related to these, but goes to a more definitional level and is similar to the problem with NIE as the foundation of institutional history. Organizations, structures, bureaucracy, institutions—these terms become synonyms, leaving us with an account of history that only looks at marble buildings and the businessmen and politicians who build them. We gain something important from the organizational approach to institutional history—a biographical sense of the big founding moment and development of specific entities like the Fed (or General Motors, the FDA, a professional society, or a specific technology).

But they tell us not much at all about institutional change. Institutional history cannot be reduced to organizational biography. By focusing institutional history on these proper nouns, we can abuse historical narratives to place an organization at the center of a history that is about so much more. Narrative institutional history is richer and much more defensible when it focuses on the near constant pressure—external and internal—to change, disappear, reinvent, and progress that characterizes so much of institutional development the world over. Such pressures are never confined to a single organizational entity and are unlikely to be understood if historians require them to be.

35 Brinkley (1984, 134)
36 For other critiques of the organizational synthesis, see Balogh (1991).
This failure to understand these pressures more comprehensively is similar to the critique that the organizational synthesis fails to account for so much of society. For example, no serious scholar would presume to tell the history of the New Deal by focusing exclusively on the legislative process that created the slew of administrative agencies, as important as those agencies may be. We have to understand how people at the core and the periphery sought to influence these ideas and structures. These individuals and these structures came to points of contention. Sometimes they created these changes, sometimes they reacted to them. Sometimes change occurred slowly, sometimes rapidly. And sometimes these changes were to create new organizations, sometimes new rules of the game, sometimes new relationships. And often these changes redefined the boundaries that separated one kind of organization from another.

This definitional departure matches colloquial usage. Think both the institution of marriage and the Brookings Institution. Or that an individual person has reached such heights that she has become “an institution,” even as we each refer to our professional affiliations as institutions of higher education, by which we mean collections of buildings with proper names like Wharton or the University of Pennsylvania.

*The Promise and Challenge of Historical Institutionalism*

The third and most promising vein for the historical understanding of institutions has been called “historical institutionalism.” Historical institutionalism distinguishes itself from “new institutionalism” in organizational theory, by which I mean the

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37 See Suddaby et al (2014). The authors offer the best articulation of historical institutionalism in the literature, and come closest to the kind of narrative institutional history I have in mind. For reasons discussed, however, there are still significant differences between their approach and mine.
explanations for organizational behavior that “are not necessarily rational in an economic sense, but are consistent with ‘rules, norms, and ideologies of the wider society.””

Again, the focus, like new institutional economics, is not on abandoning theories of deductive rationalism. Indeed, new institutionalism in organizational theory, perhaps in an effort to gain better scientific credibility, has abstracted away from the role of history, contingency, and personality to argue not that institutions are shaped primarily by people, but that people are shaped primarily by institutions.

New institutionalism (or sometimes, neo-institutionalism) is also very much about the study of process. As Selznick explained,

Institutionalization is a process. It is something that happens to an organization over time, reflecting the organization’s own distinctive history, the people who have been in it, the groups it embodies and the vested interests it has created, and the way it has adapted to its environment.

What historical institutionalism offers is the best of an older vision of organizational theory that is self-consciously historical. The classic example of this kind of institutional, organizational history is Selznick’s 1949 study of the Tennessee Valley Authority.

Selznick was a sociologist, but his view of (at the time, recent) history was methodological as well. It was the use of what he called “life histories” to animate discussions of how organizations became institutions, what today organizational theorists might call “case studies.”

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39 Meyer and Jepperson (2000) discuss this conceptual change.
40 Selznick (1957, 16)
41 Selznick (1949).
42 Suddaby et al (2014, 102) discuss the phenomenon of sociologists using life histories and provide several examples, including on a gypsum plant, a clerical agency, political parties, and a medical school.
As organizational theorists grew into their conception of institutions as more consistent with aberrations from the rational choice model, their theoretical and causal claims became less focused on nitty-gritty historical claims and more on what could be abstracted away from them. The consequence has been, to quote Suddaby et al,

the new institutionalism has become ahistorical. That is, in search for scientific legitimacy—that is, the ability to make broad theoretical generalizations and claims of universal knowledge—contemporary organizational institutionalists have minimized or obscured the role of history.43

In their efforts to bring back history into new institutionalism—what they call historical institutionalism—Suddaby, Foster, and Mills argue for four propositions that should motivate the historical study of institutions. First, the nature of the truth claims is “particularist and localized, rather than universal.” Second, “historical studies of institutions focus on complex, rather than unitary causality.” Third, the “motivations for historical studies of institutions tend to be driven by empirical phenomena or puzzles rather than gaps in theory.” And finally, historical institutionalism is focused on “endogenous rather than exogenous explanations for institutions.”44

This new and growing trend to think through organizational theory from the methodological perspective of history is an important departure point for the narrative institutional history proposed in this dissertation. Certainly, the attention to complex causality—central related to the importance of contingency and historical “accidents” as drivers of historical change—is crucial to the study of institutional history. And thinking of “institutions” as a process whereby organizations develop some sort of social stickiness

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43 Ibid. at 106.
44 Ibid. at 104-105.
is important, too. Throughout this dissertation, the process of institutionalization—both in history and historicity—will play a central role in the narrative institutional history I espouse.

But there are important differences, not least in the idea that history can be abused into providing more of an explanation for the present than can be justified. In rising to the defense of history, some historical institutionalists commit the founders’ fallacy of privileging initial founding events over subsequent ones. For example, Khurana argues that an appreciation for history is an appreciation of founding moments.

[It] is essential to examine an institution’s birth—its emergence out of an interaction with the larger society and culture, the evolution of its internal dynamic and the interface between the two . . . The key here is to show organizations responding to particular problems posed by history.45 Narrative institutional history is as interested as historical institutionalists in the “evolution” of internal institutional dynamics as they interact with outside social and cultural pressures, but this articulation of history—in Khurana’s case, the history of the American business school as an institution—is question begging. Did institutionalization occur at the founding moment? Did durability of specific institutional arrangements become institutional because of founders’ ambition for such? Or did the process of institutionalization come more gradually than that?

Narrative Institutional History, in Theory and Practice

It’s tempting to say that these broad uses of “institutions” are just different. Homographs abound in the English language. Words can be different; they can even be the opposite. After all, a government can sanction gay marriage (that is, give it official

approval) or sanction gay marriage (that is, impose a penalty on it). Perhaps institutions are organizations, rules, and processes at different times and in different places.

This dissertation argues, through the tumultuous institutional history of the Federal Reserve, that these conceptions of institutions are in fact related, and that a new kind of institutional history can profitably mine these separate conceptions for a robust, subdisciplinary approach that brings together insights from cultural history, economic history, political history, legal history, and intellectual history, and much else besides. Indeed, so conceptualized, one can wonder whether narrative institutional history is the main lens for viewing broad sweeps of history. Perhaps we as financial, cultural, social, economic, legal, and political historians are all describing different parts of the elephant in the dark. Perhaps institutions are the elephant itself. And perhaps narrative institutional history, done with an eye toward both organizations and broader rules and social patterns, and the processes by which organizations become permanent, can bring together these subdisciplinary historians who otherwise don’t have much to say to each other.

If that idea is correct—that institutions are the full elephant—then we need to understand better what institutions are. And these leading definitions—institutions-as-rules, institutions-as-organizations, and institutions as the process by which organizations become permanent—are too narrow a definition to capture the phenomenon of institutions—and especially institutional change—generally. If institutions are rules, organizations, and processes, we can use them to uncover the ways that social, cultural, economic, and political forces express themselves through organizational nubs with porous boundaries that are themselves defined by rules, formal and informal.
“Institutions” aren’t simply broad themes like elections, governmental regimes, property rights, the enforceability of contract, or the independence of the judiciary, but nor are they static organizations with proper names like the Federal Reserve or the Food and Drug Administration or General Motors. Instead, in the narrative institutional history I describe here and expound below, institutions like the Federal Reserve are the organizations whose boundaries are constantly changing through human effort and historical contingency, wrapped around specific but changing sets of problems.

To operationalize this argument, my approach to narrative institutional history makes five arguments.

First, **individuals matter.** People with specific policy aims are at the heart of institutional formation and institutional evolution, even and especially when these individuals’ policy aims conflict. So it was with Salmon Chase creating a national banking system to meet the demands of war finance, Paul Warburg seeking to impose a more rational system on his adopted homeland, Marriner Eccles refusing to serve in the Roosevelt Administration until he could rewrite the Federal Reserve Act. This dissertation recounts dozens of these examples—people are everywhere in institutional history. This idea is in tension with both the organizational synthesis and new institutionalism that would focus on exogenous events, and with trends in social history that would deemphasize the role of policymakers in shaping the institutional context in which they operate.

Second, **people act through organizations.** These actors operate not in a vacuum, but through formal collaborations, existing and new organizations. In each example above
and in the many others that follow, individuals organize. The name themselves, the band together with others likeminded, the try to create something not only as the ultimate goal, but as the intermediate one.

Third, conflict defines institutionalization. These organized efforts are not unopposed. Sometimes institutional moments can occur because of a subtle change that is adopted without much fanfare—rendering the Federal Reserve Bank of New York a permanent member of the Federal Open Market Committee in 1942 is a good example of this. But much more often, there is opposition—Carter Glass and Charles Coughlin on opposite sides against Marriner Eccles in 1935, Harry Truman and John Snyder against the Fed in 1951, and Allan Sproul and the New York Fed against William McChesney Martin in the early 1950s. This opposition comes to define institutional moments, because it is here that winners and losers declare victory and defeat on new and old ways of doing things.

Fourth, predicting founding moments is difficult. Not all such collisions will be obvious for the broader process of institutionalization, which makes predicting the importance of specific moments hard to do beforehand. Sometimes this is easy to do—the Fed’s legislative founding in 1913 is plainly one such moment. But Congress’s quiet retirement of the Fed’s reauthorization provision didn’t command near the same attention as the identical action in 1836, and even the legislative recreation in 1935 didn’t generate near the attention at the time.

And finally, institutionalization is both historical and historicized. By historical, I mean that institutionalization takes place in history by the actors and organizations on the ground. By historicized, I mean that the power of institutionalization only comes later,
sometimes by the same actors seeking to revise the historical record in a way that favors them, other times by subsequent actors who had nothing to do with the institutionalized moment. Carter Glass’s role during the Second New Deal was to historicize a federalist reserve system that could do no wrong; economists and economic historians used theories of monetarism to delegitimize Keynesian economics by linking the Fed and the Great Depression much more completely than was done contemporaneously, and the Fed-Treasury Accord only became the Fed-Treasury Accord years after that curious and indeterminate skirmish receded from public view. In these ways, events like the Fed’s legislative founding, the Great Depression, the Accord, and much else only gain the power of institutionalization through the process of historicization.

This principles guide the kind of narrative institutional history in the dissertation ahead. It varies from those adopted by the new institutional economists, organizational historians, and historical institutionalists because it recognizes that organizations both influence and are influenced by the rules that not only govern their conduct, but also give them organizational meaning. It is focused on exogenous and endogenous phenomena. It recognizes that the process of institutionalization of norms and organizations can move toward more and less institutional stickiness. And it recognizes that the norms and traditions of institutional moments continue to be written long after the events described.

To put it in terms of the Federal Reserve, compare the way that the three groups might study central banks. An institutional economist might look at the institutions of “central bank independence,” an amorphous label that they have come to regard as the
separation of monetary policy from electoral politics, arising in the late 17th century and continuing to the present with a few twists and turns along the way.

An organizational historian would study the U.S. Federal Reserve System and seek to give the organization its biography. That historian would devote a lot of attention to the “founding” period, say, the Federal Reserve Act of 1913, as the apotheosis of institution building in the U.S. This kind of organizational history focuses on that Big Bang and then sees what mysteries can be discovered as the institution finds its way. Indeed, to take the Fed as an example, most of the historical effort will be in recovering the intellectual basis for that Big Bang. This approach, again, has been the overwhelming focus of historians who have taken the Fed as their subject. And historical institutionalists would also be anchored to founding moments and then internal dynamics of the organization thereafter. The idea of deinstitutionalization—or the process whereby organizational ambitions to permanence, even if realized, don’t succeed—isn’t part of that structure.

This dissertation, as a work of the narrative institutional history I’m describing, adapts from all three approaches. To mix science metaphors, my focus isn’t on a Big Bang founding, but on a kind of punctuated equilibrium whereby institutional change—change as significant as the founding organizational moment—happens often but irregularly. The effort is to look at those bursts of institutional change without losing sight of either the “rules of the road” and broad patterns and equilibria, or of the ways that these individuals use organizational forms to accomplish these goals and change these rules. So, it is that we begin with the backdrop to the inarguably important Federal Reserve Act of 1913. But we don’t stop there, and don’t presume that the 1913 founding
bears an outsized influence on the way the institution changes further along its trajectory.\textsuperscript{46}

\textit{Narrative Institutional History and the Federal Reserve}

If I have spent more time than is customary in an introduction delving into the theoretical frame this dissertation seeks to advance, it is because the rest of what follows is simply a demonstration of this theory of institutional history. Writing in 1986, political scientist Donald Kettl called the rise of the Federal Reserve the “most remarkable bureaucratic metamorphosis in American history.”\textsuperscript{47} My argument in the pages and chapters ahead is that this metamorphosis is best understood through the theory of institutional history described above, as a slow then sudden transformation of both rules of the road and organizational structure.

The approach historians have taken to the Fed illustrates the weaknesses of the methodological approach to date. These historians have focused mostly on the Fed’s founding, to the extent that historians have paid attention at all. Central banking, generally, and the Federal Reserve, specifically, have been topics of fascination for macroeconomists and, increasingly, political scientists, but historians—especially those of the Progressive Era and the New Deal—haven’t had the same interest. Thematic and chronological histories of those periods barely touch the Federal Reserve.\textsuperscript{48} Leading presidential and other political biographies are similarly uninterested.\textsuperscript{49} Narrative history on the Fed is

\begin{footnotesize}
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\item \textsuperscript{46} For more on the punctuated equilibrium, see Gould (1980).
\item \textsuperscript{47} Kettl (1986, 9).
\item \textsuperscript{48} Katzenelson’s (2013) history of the New Deal includes only the most passing of references to the Fed; Kennedy (1999) includes more detail, but the Fed does not play an important role in that history. Brinkley (1995) pays more attention, but it is still quite limited.
\item \textsuperscript{49} The majority of references to the Federal Reserve in McCullough’s biography of Harry Truman are to Truman’s post-presidential offices in the Federal Reserve Bank of Kansas City. McCullough (2003). Andrew
\end{itemize}
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provided instead by economists and bankers writing documentary history, work that reflects their methodological interests—and their methodological limits.50

This dissertation’s task is to situate within the institutional framework developed above the four instances of profound institutional change that occurred in 1913, 1935, 1951, and in the early 1950s as Martin consolidated authority in Washington, DC. My argument is that the Fed succeeded because it adapted institutionally either under the guise of legal reform, or through subtle, extra-legal processes that kept Congress—and the anti-bank public that voted in congressional elections—out of the business of institutional design. Something important happened in the 1935 legislation that completely undid the compromises that supported the passage of the first Federal Reserve Act of 1913, and something important happened again when the Truman Treasury and the Fed reached a handshake agreement that any lawyer would recognize as a stunning accomplishment of opacity and indeterminacy that somehow still called warring factions to peace.

Put differently, and in the terms of institutional history articulated above, my argument is that the Fed has been founded and refounded and refounded again, but not in the politically acrimonious way associated with the epic Congressional efforts to charter and recharter a central bank. The approach was much subtler, in the form of “amendments” to the original act that in fact represented an abolition, and in the form of non-statutory efforts to stake out the Fed’s institutional space in a way that Congressional sponsors of either the 1913, 1927, or 1935 Acts most likely did not intend. Indeed, my effort is to call

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50 See, for example, Friedman & Schwartz (1963), Meltzer (2003), Meltzer (2010a), Meltzer (2010b), Ahamed (2009), Bremner (2004), Shull (2005)
into question that very inquiry: whether “founders” “intended” anything should be almost beside the point, institutionally speaking. The founders’ institution rarely exists beyond a short time, after which institutional evolution seeks a new institutional equilibrium.\footnote{This argument about institutional change is similar to Ackerman’s argument about constitutional change. See Ackerman (1991, 1998, 2014).}

\textit{Plan of the Book}

The book proceeds as follows: Chapter one provides the context of the battle for the Federal Reserve Act. But it doesn’t begin in 1913, or even at the Panic of 1907. This fight in the United States begins in 1789, and even before. This chapter therefore traces the history of banking and central banking in the long 19\textsuperscript{th} century in the United States, with twin focuses on the nature of money and the structure of those organizations that would regulate it. Chapter one argues against the idea that central banking in the United States consisted of the First and Second Banks of the United States, followed by fallow decades until the creation of the Federal Reserve System in 1913. Instead, it argues that the functions of central banking migrated to other platforms, including clearing houses, state banks, and the U.S. Treasury.

Chapter one, of course, also tells the story of the Fed’s legislative founding after this context. It is not a tick-tock chronological treatment of that legislation, but a selective one.\footnote{See Lowenstein (2015) for the best play-by-play history of the Fed’s founding.} It focuses on how the Fed’s legislative framers linked the creation of the Fed to the Panic of 1907, challenging the idea that the Federal Reserve Act is a piece of “crisis legislation,” as is often assumed. It also focuses on the question of the Fed’s structural organization as a decentralized, quasi-private set of institutions, and the debates not made about the nature of money. Those who debated the necessity of the Federal Reserve
System often took for granted the basis of money that the Fed would regulate, leaving an expectation of money that would shortly be abolished. In a real sense, the Federal Reserve System created in 1913 never got a chance to function as intended on that basis.

Chapter two discusses what I call the First Federal Reserve System, with a nod toward the distinction between the First and Second Banks of the United States. It begins by looking closely at the process of creating the Federal Reserve Banks by the Reserve Bank Organizing Committee to make the fundamentally political determination of where to locate the “eight to twelve” Reserve Banks required by statute, despite the insistence that nothing but the economic and financial well-being of the U.S. motivated these decisions. Chapter two also discusses the debate that wasn’t: in 1927, President Coolidge signed into law the McFadden Act that, among other things, rechartered in perpetuity the Federal Reserve Banks, removing the twenty-year sunset clause that the authors of the Federal Reserve Act of 1913 had written into it as a source of future democratic legitimacy. Chapter two also includes a discussion of the Fed’s role during the Great Depression.

Chapter three introduces the history of the abolition of the First Federal Reserve System by the legislative act, the Banking Act of 1935, the least debated of the pieces of legislation that came to be known as the Second New Deal. The legislation was not presented as an abolition of the first system, but by fundamentally rearranging the allocation of power between Washington and the Federal Reserve Banks, and by removing the Secretary of the Treasury from the Federal Reserve Board, the Act—and its main agitator, FDR confidant Marriner Eccles—reordered the system.
Chapter four presents the aftermath of World War II and a Fed increasingly asserting itself against a Truman Administration who sought the same fiscal and monetary arrangement that had facilitated the military state during the war. The Fed-Treasury Accord that emerged from this debate has been described as a hallmark of the Fed’s “independence,” but this is a gloss on history. As chapter four describes, the Fed-Treasury Accord was much more about parity than independence, and the sheer act of a governmental agency—even one as curious as the Federal Reserve System—against a war-time president is underappreciated in the historical literature. The reality is that the Fed cut off the fiscal apparatus for waging war in Korea. It is not an exaggeration to lay some of the blame for Truman’s public image failures at the feet of the Federal Reserve System.

Chapter four also discusses the immediate aftermath of the Fed-Treasury Accord, for only in that aftermath do we understand why the Accord reached its iconic status. The focus is on consolidation of power in the hands of the Fed Chair, William McChesney Martin. This is a story not just about Martin, but also about Allan Sproul, the president of the Federal Reserve Bank of New York. In their debates about power centers, operations, and the nature of central banking generally we see an assertion of priority in Washington that legislation (in the form of the Banking Act of 1935) couldn’t accomplish.

The conclusion notes not the end of the Fed’s evolution—the argument in the dissertation, of course, is that institutional change is at times slow, at times sudden, but always present. The story of the Fed is one of constant change; even the institutional momentum in place in favor of technocratic dominance by Washington bureaucrats over
private bankers and public politicians is not and would not be a permanent one. Telling
the story of the Federal Reserve requires working with definitions of institutions that
make room for rules, organizations, and processes. It emphasizes contingency, but also
recognizes individual agency. Indeed, humans aren’t powerless to shape institutions.
Whether as a function of design or contingency, very little else does.
Chapter 1: Creating American Money: The Long Founding of the Federal Reserve, 1789 - 1913

“There is no help for us in the American system; its very essence and principle are faulty.”

Walter Bagehot, 1873

“Fiat money! Why, sir, never since the world began was there such a perversion of terms.”

Carter Glass, 1913

On December 26, 1912, a young Virginian Congressman named Carter Glass made the trek to Princeton, New Jersey to visit President-elect Woodrow Wilson. Wilson’s political rise had been meteoric; just two years before, Wilson had ended his largely successful but ultimately controversial presidency of Princeton University, and was now headed to the White House. Wilson came to power not because of American enthusiasm for his platform, but because of a split in the more popular Republican coalition that had dominated U.S. politics in the postbellum era. If former president Theodore Roosevelt hadn’t bolted the party in that fateful election, chances are high that Congressman Glass would be visiting someone else (if he would have been involved in the process at all).

This visit wasn’t a courtesy call by a social climbing Congressman eager to win the new president’s favor. It was instead the continuation of an effort by Glass to bring the “currency question” to Wilson’s attention and gain a commitment for Glass’s vision.

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53 Bagehot (1873)  
54 Congressional Record 51, no. 17 (December 22, 1914): 563.
of reform that would devolve power away from New York bankers and Washington politicians alike.

Glass was right to target Wilson for persuasion. While Wilson considered himself something of an intellectual heir of James Madison—a constitutionalist, a politician, a statesman—he was no financial expert. So much was clear from the campaign. Beyond repeating party bromides that the “money trust . . . is no imaginary thing,”55 his views on the question of reforming the banking system were inchoate. Glass wanted to secure from Wilson assurances that he was not going to adopt the Republican line of pushing for a European-style central bank: centralized, private, and all-powerful.56

To combat this, Glass and the House Democrats had devised a scheme that would place the control of the nation’s monetary reserves in a “system” of far-flung outposts with numbers to be decided (perhaps one for each state, perhaps more). The governmental role would be limited: the national banking system, with the Comptroller of the Currency at the helm, would supervise these private institutions. Beyond this relatively minor position, the government had no role to play.

Wilson was sympathetic, but also took the view of a visionary: “it needs a capstone,” he said, some board or committee that would guide the policies of these reserve banks. The very idea was anathema to Glass, and smacked of the banker-control formulated by his Republican predecessors in the congressional majority. The table for

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55 Wilson (1913, 45).
56 Glass (1927, 81-82)
debate was set, and Glass anticipated—correctly, events would prove—that he would be working against Wilson on this point, not with him.

This romantic version is told mostly from the perspective of Carter Glass, a fierce defender of what he and Wilson both regarded as one of their greatest legacies, the creation of the Federal Reserve System. And there is no reason to doubt most of the broad strokes of that discussion. What this chapter will demonstrate, though, is that these obsessions over the institutionalized structure and function of money, the organizations and processes that govern its administration, and the ends to which it is put, are very old indeed. This discussion did not arise out of the mind of Carter Glass or Woodrow Wilson or Paul Warburg or any of the many others involved in the legislative founding of the Fed. Indeed, the efforts to think about the Federal Reserve System as a product of the Progressive Era and a solution to the problem of the Panic of 1907 has been oversold.

In place of that narrative, this chapter traces not only the rise of the Federal Reserve System from the ashes of the 1907 Panic through three national elections—in 1908, 1910, and 1912, but also the deeper history of money as a “a mode of mobilizing resources, one that communities design for that end and individuals appropriate for their own purposes,” as Christine Desan put it. We must start somewhere, of course, but not in 1913. The story of the Federal Reserve begins at least in 1789, in not earlier.57

Institutional money is also the about the rules, organizations, and processes that make specific features of money enduring. This framework includes, but is not limited to, the debates about government-sponsored banks. There was hardly a more consuming

[57 Desan (2014, kindle location 463).]
question in the first half century of the nation’s history, and the implications of these political, economic, and cultural questions would dominate the questions of money well into the 20th century. As the 19th century financial historian Albert Bolles put it, “[w]hen the smoke of the contest [over government banks] had cleared away, two political parties might be seen, whose opposition, though varying much in conviction, power, and earnestness, has never ceased.”58 That central conflict through the long 19th century is key to understanding the institutional history of the Federal Reserve System.

In reciting this history, the point to emphasize is that the institutionalization of the Federal Reserve—with respect to the rules that would govern the Fed, the organization itself, and the process whereby these rules and organizations would become sticky—long preceded the debates at the early 20th century about the nature of American money. The Fed isn’t merely the inheritor of the mantle of the Banks of the United States; it inherited, too, the functions of the Treasury, private banks, clearing house associations, the Comptroller of the Currency, and more. The functions of the Fed weren’t invented from scratch, but borrowed heavily from a long history, with important adjustments along the way.

Once this historiographical table is set, we begin to dive into the early 20th century context that gave birth to the Federal Reserve Act. This is familiar terrain for historians of the Fed, and while I will summarize some of the important features of the Federal Reserve System, this summary will not be comprehensive, intentionally so.59 Part of the

58 Bolles (1894). I choose the term “government bank” carefully. Although frequently indulged, the temptation to refer to the first and second Banks of the United States as “central banks” is to engage in a kind of prochronism that is without defensible intellectual basis.
59 Interestingly, the economic historians that engage Fed history collectively yawn at the Fed’s
aim of this chapter, and the dissertation more broadly, is to deemphasize this legislative moment. Instead of provided the blow-by-blow of the currency debates, I make two contributions to understanding the shape the Fed would ultimately take. First, this chapter corrects the mistake—albeit a widely-shared one by historians, economists, and other commentators—that regards the Federal Reserve Act as a piece of “crisis legislation” passed in a congressional attempt to right the wrongs exposed by a financial panic. While the panic of 1907 loomed large over the debates about the form and function of the Federal Reserve System, the ultimate shape the Fed took had more to do with the politics of money in 1912 than the economics of money in 1907.

Second, this chapter argues that this first founding of the Federal Reserve was essentially a failed experiment that belongs to another era. The structure it created does not look like the Federal Reserve System today; the ideas of what constituted “currency” have also fallen away. Any lessons to learn from the historical record must be refracted through this lens: in the institutional evolution of the Federal Reserve, the Federal Reserve Act of 1913 represented a moment in time that subsequent events would leave behind. This chapter therefore emphasizes the structural and functional conceptions of central banking in the Federal Reserve Act to show that the system imagined by these framers belonged so completely to its own time.

—depending on how one counts, the two main histories of the Fed by Friedman & Schwartz (1964) and Allan Meltzer (2003) devote just 20 pages out of nearly 3,000 to the Fed’s beginning. The focus on the Fed’s founding by historians has more to do with the Federal Reserve Act’s means to understanding the end goal of the Progressive Era, whereas economic historians tend to view the Federal Reserve as the end itself.
Central Banking in the Long 19th century: Money and the Revolution

Writing the history of central banking is difficult for many reasons, not least the basic institutional argument that motivates this dissertation: what “central banking” meant was constantly changing. At the outset of the American Revolution, the concept, referred to by Hamilton as a “National Bank,” and most contemporary observers like Adam Smith or Henry Thornton referred to the individual central banks, such as the Bank of England. In all cases, the idea essentially meant one thing: some bank with a formal, legal connection to the public fisc, given some form of quasi-monopoly in that relationship, and usually modeled after the Bank of England.60

The Bank of England has been the subject of significant histories over its 300+ year history, but scholars agree on the basic contours. Following the Glorious Revolution, the English system—very shortly thereafter the British system—changed from one where sovereignty and sovereign prerogatives devolved from the King to what Montesquieu described as the separation of political power.61 Douglass North and Barry Weingast argue that these institutional changes—including an independent judiciary and parliamentary supremacy—were a way for the government to make “credible commitments” to creditors that the government was a trustworthy borrower.62

It was in this context that Alexander Hamilton, that polymath West Indian emigrant who took the new American Republic’s financial system by storm, entered the fray. Hamilton had been tutored in a merchant house in St. Nevis, an island in the West

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60 For overviews of banking and central banking in the U.S. and beyond, see Desan (2014), Wood (2005)  
61 Montesquieu (1748/1989)  
62 North and Weingast (1989)
Indies, and gained a scholarship to study at King’s College (later Columbia) in the British colony of New York. During his service in the Revolutionary War as General Washington’s aide-de-camp, Hamilton observed first-hand the sorry state of colonial finances. The problem was one of political theory as much as economics, and the system of continental currency led to a hyperinflation during the Revolutionary War that called into question the very financial well-being of the new Republic.  

The Bank of the United States and its Demise

Part of the problem of the government’s woeful finances was the failings of the government itself under the Articles of Confederation. After the Constitutional Convention of 1787 and subsequent ratification by the requisite nine states, the new government—driven by the indefatigable Hamilton—set about to accomplish the work of better financial integration, with an eye toward the structure and functions that institutionalized money would take.

This work set the stage for the conflicts over institutionalized money that would repeat themselves again in the writing of the Federal Reserve Act, and again and again throughout the Fed’s subsequent history. And it is not an exaggeration to state that Hamilton’s “preternatural speed” and “Mozart-like” ability to “transpose complex thoughts onto paper with few revisions” set the stage for the debates that would follow well into the 21st century.

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63 For more on the state of American finances at the end of the Revolutionary War, see Bezanson (1951). Hamilton’s background comes from Chernow (2004).
64 Chernow (2004, 251)
The Bank of the United States was Hamilton’s conception, based on his understanding of the Bank of England. He described it in his Second Report on the Public Credit, written to the House of Representatives at its request in December 1790. He had alluded to the need for a national bank to accomplish the goals of a federal assumption of state debts incurred in the conduct of the Revolutionary War, but he put off the full plan for nearly a year. By the Second Report, Hamilton described a “national bank” that would “be of the greatest utility in the operations connected with the support of the public credit.” To accomplish those goals, the new bank—called the Bank of the United States—would be chartered as a private corporation, but by federal rather than state legislation. The charter would be for twenty-years, with an initial capitalization of $10 million. The Bank would be privately run by twenty-five directors who would be, Hamilton expected, “keen” and “steady,” to be “composed of some of the most discreet, respectable and well informed citizens.” They would be elected by the stockholders. Because the government would own 20% of the stock, the government would have a hand in selecting these directors, but they would have to rotate, and the President of the Bank would be a director, not a politician.

Hamilton’s conception of the Bank of the United States met with only limited opposition in the House and Senate, where his proposal passed by strong margins. Once the bill reached President Washington, however, the debate was joined as an intra-administration affair: the Secretary of State, Thomas Jefferson, opposed the very

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65 See Hamilton, First Report on the Public Credit, January 14, 1790. For more discussion, see McCraw (2012, 111-121).
67 Ibid.
existence of this kind of concentrated authority and sought the President’s veto. The
debate defending the constitutional legitimacy of the Bank of the United States was
intense, and portended the beginning of the party system in the early Republic.
Eventually, Hamilton’s blizzard of arguments carried the day and the Bank opened for
operations in 1791.

The Fall of the Bank of the United States

Hamilton’s time bomb on the charter went off in 1811. By then, Jefferson was
president of the United States. Some aspects of presidential prerogatives had changed
once Jefferson took residence in the White House—his securing the Louisiana Purchase
from the French without the constitutional authority to do so is ironic in light of
Jefferson’s hostilities to the conception of broad federal authority. But his hostility to
Hamilton’s banking system remained firmly in place. When Jefferson’s own Secretary of
the Treasury, Albert Gallatin, sought a branch of the Bank of the United States in the
newly acquired New Orleans port, Jefferson exhibited his characteristically eloquent
disdain:

This institution is one of the most deadly hostile existing against the
principles and form of our Constitution . . . What an obstruction could not
this bank of the United States, with all its branch banks, be in time of war?
It might dictate to us the peace we should accept, or withdraw its aids. Ought
we then to give further growth to an institution so powerful, so hostile?68

Gallatin, no fan of the Bank during the Hamilton-Jefferson debates, had been won
over by Hamilton’s program once he saw it in action. When the bank’s stockholders
petitioned Congress for an early charter renewal, Gallatin gamely asked to wait

68 As quoted in McCraw (2012, 290)
until after the presidential election in which Jefferson’s successor would be determined.69

When the recharter debate did finally come to a head, the new President, James Madison, was noncommittal. He didn’t maintain Jefferson’s implacable anger to the Hamiltonian system, but nor would he be its champion. Gallatin had become convinced that the Bank was vital to the economic and financial success of the young country, but the old divides and the political tensions of 1811 meant that “the bank’s near indispensability and its long record of brilliant success did not guarantee its recharter. After a spirited debate, the Bank’s recharter died by a single vote in both houses. The proposal never made it to the president’s desk.”70

*The Second Bank of the United States and the Bank Wars*

Gallatin was furious about what he regarded an abnegation of presidential duty. He wrote a scathing letter to Madison telling the president that “your present Administration is defective, and the effects, already sensibly felt, become every day more extensive and fatal.”71 Gallatin tendered his resignation, not wanting to participate in what he thought would be a financial implosion (although he was convinced by Madison to remain).

If Gallatin couldn’t convince Madison to defend the Bank of the United States on the merits, the financial consequences of the War of 1812 did. The Jeffersonian Republicans had longed to retire the debt, but the war prevented it, causing other

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69 Hammond (1957, 209)
71 Ibid at 297
“embarrassments” in Madison’s term. Unlike the old Bank, the new one sailed through Congress. The new bank again had the twenty-year time bomb, pushing the question of permanence to a future generation. But the Bank itself was structured largely on the same basis as Hamilton’s design. The difference this time was a much larger public commitment: the new bank’s capital would be $35 million, not $10 million. More importantly, the political support was much deeper. Whether because of partisan support or agricultural support, delegations from the South and West—those very delegations, sometimes the very politicians, who had opposed the first Bank—were now widely in favor. Almost no one mentioned the constitutionality issues that plagued the first bank. “I seem to be the only person,” complained Nathaniel Macon, “that still cannot find the authority for a bank in the constitution of the U.S.” Eventually, the Supreme Court would put the constitutional question temporarily to rest in *McCulloch vs. Maryland*, a wide-ranging opinion by Chief Justice John Marshall that had more to say about the substantially federal authority to legislate even where the Constitution is silent as to specifics.

That rechartering provision, however, proved again to be the Bank’s undoing. Or better, it provided a mechanism for government banking’s biggest political foe, Andrew Jackson, to upend that system. “That the modern twenty-dollar Federal Reserve Note should bear Andrew Jackson’s portrait is richly ironic,” writes historian Daniel Walker

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72 Howe (2008, 81).
74 Ibid. (quoting sources)
75 17 U.S. 316 (1819)
Howe. “Not only did the Old Hero disapprove of paper money, he deliberately destroyed
the national banking system of his day.” 76

The problem was a trifecta that will become a dominant theme in the institutional
history of money in the United States: structure, functions, and personalities. Jackson’s
foe in the ordeal was Nicholas Biddle, a Jeffersonian Republican appointed by Madison
in 1816 as one of the first Republican directors of the new Bank. In time, he dominated
the new institution. “Brilliant, versatile, public-spirited, and a gracious host, Nicholas
Biddle seemed Philadelphia’s answer to Virginia’s Thomas Jefferson.”77

Functionally, the Bank thrived on various features of its system. It issued notes,
like any bank, but its notes were deemed legal tender and the notes could be exchanged
for gold and silver. It also received the government’s tax receipts, marketed the
government’s debt, and was responsible for almost all of foreign exchange transactions in
and out of its currency. Eventually, the bank became the largest corporation in the
country.78

The Biddle versus Jackson controversy was far in the future when Old Hickory
was a presidential candidate in 1828. But Jackson was a foe of banking generally, not
national banking in particular, perhaps due to early financial mismanagement in his
youth. “I do not like your bank any more than all banks,” he said to Biddle at one early
point.79 That disdain would eventually become unique in what has been called the Bank

76 Ibid at 373.
77 Ibid.
78 Ibid.
79 Ibid at 375.
Wars. Jackson started agitating early against the Bank, and Biddle thought his and the Bank’s popularity could handle the conflict. He sought to make the popularity of the Bank a subject of the 1832 presidential campaign, four years earlier than the statute required. At first, this strategy succeeded. “Memorials poured into Congress from all over the country, especially the West, supporting recharter.” Somewhat surprisingly, most state banks also supported recharter.80

Congress sided with Biddle, passing the recharter by large margins. Jackson was ready: “The bank is trying to kill me, but I will kill it!” he declared to Martin Van Buren.81 Despite the large margins of victory in the Congress, there was not enough support to override Jackson’s veto, what Howe called “the most important presidential veto in American history.”82

The veto message is an extraordinary document, 8,000 wide-ranging words in its multi-faceted rejection of structure, functions, and constitutionality of the Bank of the United States. The last point is perhaps the most important: the veto message is statement of political philosophy, a conservatism that urged the country to return to the “legitimate objects of Government by our national legislation,” not those espoused by the wealthy interests in Congress.83 Jackson lambasted the bank stockholders from seeking a “gratuity” of $7 million, given how much the rechartering law would raise the value of existing governmental stock without option of sale.

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80 Ibid at 378.
81 As reported in Van Buren’s memoirs. Van Buren (1857/1920, 625)
82 Ibid at 379.
83 Jackson, Bank Veto Message, July 10, 1832.
The president critiqued the structure of the bank, too. “Is there no danger to our liberty and independence in a bank that in its nature has so little to bind it to our country?” he asked, but not because he wanted complete governmental control. It was also a statement about how much the government required the constitutional curtailment of federal authority, not its expansion.

It was also a call to class-based arms. The denouement would reverberate in future discussions of the Federal Reserve, and is worth quoting in full.

The rich and powerful too often bend the acts of government to their selfish purposes. Distinctions in society will always exist under every just government. Equality of talents, of education, or of wealth can not be produced by human institutions. In the full enjoyment of the gifts of Heaven and the fruits of superior industry, economy, and virtue, every man is equally entitled to protection by law; but when the laws undertake to add to these natural and just advantages artificial distinctions, to grant titles, gratuities, and exclusive privileges, to make the rich richer and the potent more powerful, the humble members of society— the farmers, mechanics, and laborers— who have neither the time nor the means of securing like favors to themselves, have a right to complain of the injustice of their Government.84

So it was that Jackson not only abandoned the Bank of the United States, but also reinforced institutions of federalism, local autonomy, and small-market private control that would dominate the discussions of the Federal Reserve.

The Free Banking System

After the collapse of the Second Bank of the United States, the U.S. saw the rise of what has been called “free banking”. The term itself has been used in a variety of ways. Economists like Lawrence White, George Selgin, or Richard Timberlake view free banking in the same way they view free markets generally, not with money as an

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84 Jackson, Bank Veto Message, July 10, 1832.
exception to free market principles but as providing a good or service much like any other. Under this theory, free banking stood as the antithesis of the institutionalized money discussed in this dissertation: that is, the structure and functions of money would be anything the market said they could be, so long as governmental coercion was not in play.

Free banking as an institutional historical phenomenon, not as an intellectual historical phenomenon, is something different. Free banking in this context is “generally used to refer to a very specific set of legal conditions for opening a bank defined by New York state law of 1838,” and widely adopted thereafter, as a kind of “Madisonian polity in which state governments ceded as little power to the federal government as seemed practicable.” Free banking in that sense answered the twin questions of institutionalized money in this way: money would be defined by the state, and would be managed by small private banks chartered by the states.

The debate about the efficacy of free banking continues to the present, but the prominence of the free-banking movement away from centralized, federal charters and towards the decentralized proliferation of state banks played an important role in shaping how the Federal Reserve Act would eventually be debated.

*The Civil War and National Banking System*

The conflict of the American Civil War had important monetary dimensions that would color prominently how southern Democrats—a political coalition at the center of

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86 Bodenhorn (2003, 5)
87 This section is derived in part from chapter one of Conti-Brown and Vanatta (Harvard University Press, forthcoming)
the debates about the Federal Reserve two generations later—viewed the institutions of
money. The archipelago of 1,601 state-chartered banks that floated on the eve of the
Civil War was not equipped to endure four years of sustained and terrible armed conflict,
on either side of the divide.

There was never any doubt about the North’s economic and financial superiority.
Indeed, the very concept that the South would seek this war has been part of a Southern
mystique for generations. In William Faulkner’s words, “Who else would have declared a
war against a power with ten times the area, and a hundred times the men, and a thousand
times the resources?” But the monetary and financial mismanagement of the South
proved devastating to the effort.

While the North had more resources, the financial system that it had inherited
during the free banking era wasn’t vastly superior. When Abraham Lincoln assumed the
presidency in March 1861, South Carolina troops were already laying siege to Fort
Sumter and the U.S. Treasury lay virtually empty before the first Northern volley. The
federal government, still reflecting the fragile peace of the Jacksonian era, was permitted
to deal only in hard currency, not bank credit. To meet the massive costs of waging war
across a continent, the Northern States needed to quickly develop a robust and centralized
financial system. What it created instead was a clumsy hybrid. Although the Civil War is
often portrayed as a conflict pitting the centralized Union against the states’ rights
Confederacy, American political traditions of decentralized power remained firmly in

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89 Faulkner (1942, 288-89).
90 Beckert (2014)
place in the Northern States throughout the conflict. The National Banking Acts of 1863 and 1864 gave birth to a system of privately-owned, nationally chartered banks and were Congress’s attempt to preserve the same kinds of structural traditions that had animated previous discussions, and would dominate the conversation during the Fed’s legislative debates. The compromise retained the “combination between the interests of private individuals and the government”92 that had typified the antebellum financial regime, to quote the bill’s sponsor, John Sherman.

To finance the war, Treasury Secretary Salmon P. Chase developed a simple solution: The federal government would sell bonds for gold. The not very simple problem: The nation’s bullion largely sat in vaults of its state-chartered banks outside of immediate federal control, providing the solid foundation undergirding the national money supply, a combination of note-issue and checkable deposits. Chase’s plan would and did remove this foundation, and in short order New York’s banks suspended specie payments.93 By December, the federal finances were in worse shape than when the war began.94

The inability to control the nation’s money focused Chase’s mind sharply, despite his lack of obvious fit for the role Lincoln had assigned him (Chase was a constitutional lawyer and former governor of Ohio and although he had guided free banking in Ohio, he had little financial experience. Undeterred, Chase proposed a new national bank-note currency, issued by private, federally-chartered banks and secured by federal bonds.

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92 Hammond (1957, 727). See also Sherman (1895, 269-300); Sherman argues that the greenback and national banking questions were so entwined that they had to be discussed together.
93 Hammond (1970, 60).
94 Ibid. 168-169.
Chase imagined this system would generate ready money for the government: Bankers would buy the government’s bonds with specie, while bankers’ own notes would be backed by government promises, not gold reserves.

The war put Chase’s plans on hold. In the crisis of December 1860, with the nation floundering to pay its soldiers, sailors, and suppliers, Congress took the lead, authorizing Chase to directly issue national legal tender notes—the notorious greenbacks—which were deeply unpopular. Chase though, did not give up on his national currency plan, which he advanced again in December 1862, this time with success. The national banking system Chase envisioned and Congress enacted in February 1863 guaranteed private control of the financial system in line with the nation’s long-standing political institutions, adopting a decentralized system of private banks that enabled the federal leviathan to avoid the politically fraught question of centralizing the control of money in another Bank of the United States. The first National Banking Act was instead a free banking measure, one based largely on New York’s 1838 banking law. The 1863 Act provided a streamlined administrative process for chartering national banks and required these new “national bankers” to deposit with the Treasury an amount of federal bonds equal to their note circulation. It also required fractional reserves against their deposits. Initially few associations and even fewer prominent state banks secured or converted to national charters.

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95 Hammond (1957, 718-725).
97 Hammond (1957, 727); Robertson (1995, 41).
98 Hammond (1957, 727-728); Robertson (1995, 47-48).
In light of this failure of demand for national charters—key to the success of the entire enterprise—Congress substantially reformed the law. Building on recommendations of its administrator, the new Comptroller of the Currency Hugh McCulloch, Congress passed a revised National Banking statute in June 1864, and levied a crippling tax on state bank notes in March 1865. (It is a nice bit of irony that federal banking officer Hugh McCulloch, champion of the use of federal taxing power on state bank notes, would share the name of federal banking officer James McCulloch, who sued Maryland over its use of state taxing power over federal bank notes. This was a coincidence, not the fulfillment of a generational grudge.)

The national banking system created by Chase and McCulloch, then, bore some important resemblances to the institutional functions that the Fed would later adopt, not least some marginal control over a flexible monetary instrument and a decentralized structure, if the virtually unlimited nature of national charters can be called a “system” similar to the Federal Reserve System.

What it lacked, however, was a functional ability to govern the financial system in the face of panics. Here, the national system was incomplete.

*Lending as a Last Resort: Bagehotian Central Banking* 99

This oversight was not for want of examples: the United States had been plagued by financial panics throughout its existence. In the late 1860s, an Englishman named Walter Bagehot began a series of articles in the new magazine, *The Economist*, decrying the role of the Bank of England not in failing to respond to crisis, but in failing to be

99 Adapted portions of this section were published in Conti-Brown (2015).
transparent about its singular role. The situation arose from the collapse of the wholesale
discount bank Overend, Gurney, and Company, which Bagehot regarded as such an
“astounding instance” of financial mismanagement, with losses “so reckless and so
foolish[] that one would think a child who had lent money in the City of London would
have lent it better.”

Bagehot’s concern was anchored in the Bank Charter Act of 1844, often called the
Peel Banking Act after Prime Minister Robert Peel, a statute that engendered so much
“fierce controversy . . . that a single sentence representing it is far more interesting to
very many than a whole book on any part of the subject.” The particular question that
animated Bagehot was that the Peel Act had innovated the question of institutionalized
money structurally and functionally, both defining what money could be and who would
get to decide. Structurally, it had created within the Bank of England a department called
“the Issue Department of the Bank of England,” to be “wholly distinct from the general
banking business” that the Bank primarily practiced. This very division gave rise to the
idea that the Bank of England had purely private functions (the Banking Department) and
purely public functions (the Issue Department). What Bagehot wanted was clarity on the
division between them, and especially the obligation to perform the task of a maintaining
the “banking reserve,” as he described it.

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100 Bagehot (1873, 19).
101 Ibid. at 2.
102 Bank Charter Act of 1844, 7 & 8 Vict. c. 32
103 Bagehot (1873, 62).
There was nothing conceptually new about Bagehot’s critique, although the historical details had changed. Although *Lombard Street* doesn’t acknowledge the debt, Bagehot’s conception that there should be a readily acknowledged banking backstop in the event of crisis comes not from his pen, but from Henry Thornton’s. Thornton, a lawyer, banker, and economist, fleshed out the idea in his 1802 treatise, *An Enquiry into the Nature and Effects of the Paper Credit of Great Britain*. Thornton just didn’t write as well, and perhaps for this reason has missed out on much of the credit. In any case, it is surely central banking’s most prominent example of Stigler’s law of eponymy.

If not original, Bagehot did capture a conception of central banking that would animate discussions of the Federal Reserve’s proper role through much of its early history. And that question has come to be known as Bagehot’s dictum (or sometimes Bagehot’s rule, or Bagehot’s law). As it has been summarized by former Deputy Governor Paul Tucker, “to avert panic, central banks should lend early and freely (i.e. without limit), to solvent firms, against good collateral, and at ‘high rates.’”

In yet another instance of the process of institutionalization as a backward-looking claim for historical legitimacy—a theme that dominates the institutional history of the Federal Reserve and is, I argue, central to understanding the process of institutionalization itself—Bagehot never wrote Bagehot’s dictum. Instead, he cited the three elements of the dictum—that a central bank should, in a crisis, lend freely, against good collateral, at a penalty rate—over the course of the book, but with disproportionate

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104 I go into more detail in reading, and misreading, Walter Bagehot in Conti-Brown (2015).
105 Thornton (1802)
106 Stigler (1980)
107 Tucker (2009, 5).
emphasis on the first prong: a central bank should, in a crisis, lend freely. The other two prongs are given short shrift: they appear only briefly and in passing as two provisos to his rather sweeping explanation of “free lending.” For example, in one of *Lombard Street*’s most famous passages, Bagehot wrote that “[a] panic, in a word, is a species of neuralgia, and according to the rules of science you must not starve it. The holders of the cash reserve must be ready not only to keep it for their own liabilities, but to advance it most freely for the liabilities of others. They must lend to merchants, to minor bankers, to ‘this man and that man,’ whenever the security is good. In wild periods of alarm, one failure makes many, and the best way to prevent the derivative failures is to arrest the primary failure which causes them.”

Lending freely, “to this man and that man,” then, is the point of the Bank of England, Bagehot argued. The Bank needed to provide the kind of liquid generosity aimed at flooding the market with the reassurance that there is no scarcity. Only in this way can the financial “neuralgia” be arrested and calm restored.

*Lombard Street* is not only a paean to a central bank’s lender of last resort function, and a diatribe against those central bankers who refused to acknowledge it. It was also a running commentary on the state of central banking in the mid-to-late nineteenth century, including an exploration of a key question that would motivate the construction of the Federal Reserve System: central bank governance. That is, who would control the central bank at the level of appointment and why?

Bagehot took a dim view of the governance structure of the Bank of England, but not because of the “ancient controversies” around public versus private control of money.
His skepticism was about the “system of entrusting all our reserve to a single board,” especially one dominated by young directors with little or no banking experience, as Bagehot conceived the Bank’s board to be. But it was a private system, and this Bagehot essentially favored. He just thought the concentration in a single board threatened the functioning of the money market in a way that a “many reserve system” would not.

The Bank of England stood at one extreme; the Banque de France at the other. There, the Governor and Deputy Governor were appointed by the National government. “In theory,” Bagehot wrote, “there is much to be said for this plan.” The function he described was a “national function,” so it was ‘at least plausible to argue that Government should choose the functionaries.” But such a system would not work in England, he concluded, in part because to the British public control over private banking would be “palpably absurd”: “A trade peculiarly requiring consistency and special attainment would be managed by a shifting and untrained ruler.” This, he thought, the British system could not abide.

Bagehot’s ideas migrated to the United States, but mostly not as central banking theory: while Paul Warburg had read Lombard Street and cited him briefly in his papers, few others of the Fed founders did. Bagehot himself was a much better known figure for his ideas on parliamentary and constitutional government. Ironically, Bagehot exercised enormous influence over Woodrow Wilson, one of the political architects of the Federal

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108 Bagehot (1873, 66)
109 Bagehot (1873, 208). All of chapter 8 is a wicked excoriation of the “Government of the Bank of England.”
110 Ibid at 70.
111 Ibid at 71.
112 Warburg (1930, 54).
Reserve System. Indeed, Wilson quoted Bagehot’s injunction against bachelorhood when he proposed to his first wife (She accepted the proposal, although we don’t know whether because of or in spite of Bagehot invocation.).\textsuperscript{113} It just had nothing to do with central banking; it was Bagehot’s \textit{The English Constitution} that fired the imagination of the scholar and president, not \textit{Lombard Street}. As Allan Meltzer has written, “Bagehot’s work was well known at central banks,” but didn’t have “a major influence on the conduct of policy.”\textsuperscript{114} This was true in the 19\textsuperscript{th} and 20\textsuperscript{th} centuries, though quite emphatically not true in the 21\textsuperscript{st}, when Bagehot was invoked constantly to defend the actions central banks took in response to the 2008 financial crisis.\textsuperscript{115}

\textit{Currency Wars and the election of 1896}

While Bagehot was lecturing the Bank of England on its central role in maintaining the value of the currency and preserving the international banking system, the United States was once again engaged in paroxysms of currency debates. In the immediate aftermath of Bagehot’s writings, a question he took essentially for granted—the “cast iron system” of the redeemability of paper currency into gold—became a consuming question in the United States. Litigating the question of money put significant strain on the party coalitions and controlling presidential elections until the election of 1896, “a watershed in international monetary developments, signaling the triumph of the gold standard and paving the way for its adoption in most of the rest of the developing world.”\textsuperscript{116}

\textsuperscript{113} Berg (2013, 91) \\
\textsuperscript{114} Meltzer (2003, 22). \\
\textsuperscript{115} Bernanke (2015, 116) describes the prominent placement of his copy of \textit{Lombard Street} in his Fed library, for example. \\
\textsuperscript{116} Friedan (2014, 49)
But that ultimate conclusion was far from certain. Indeed, between the Bank Veto, the Civil War, and the final resolution in 1896, the functional aspect of institutionalized money was a constant debate, in part because “the country’s economic structure made both of the principal sets of protagonists powerful.” On the one hand, bankers integrated into international markets were eager for the resumption of some kind of redeemability in specie. On the other were businesses outside the coasts (whose international exposures were more limited), and the railroads. As one Chicago merchant put it, “These gentlemen on the seaboard base all their calculations on gold, to bring them to par with foreign countries, leaving us in the West to take care of ourselves.” Because of the geographical distribution of these interests, they took on regional and, correspondingly, partisan tones.

In 1873, the hard money coalition scored an important victory. The Coinage Act passed that year dropped silver coins from the list of those minted by the U.S. Government. These farmers and Midwestern business interests (to say nothing of prominent silver miners) called the Act the “the crime of 1873.” The crime motivated a generation of the most colorful rabble-rousers, including one man writing and teaching under the single pseudonym “Coin” through his “school of finance” in Chicago. The Coinage Act, Coin wrote, was:

A crime because it has confiscated millions of dollars’ worth of property. A crime because it has made thousands of paupers. A crime because it has made tens of thousands tramps. A crime because it has made thousands of

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117 Ibid. at 54.
118 Unger (1964, 157)
119 See Brands (2007, chapter 5) for an overview of Coin and his movement.
suicides . . . A crime because it has brought this once great republic to the verge of ruin, where it is now in danger of tottering to its fall.\footnote{120}

These were fiercely held views, and they dominated the political landscape for decades.

In 1879, the silverites won reprieve by legislating the minting of up to $4 million in silver and in 1890, the bimetallism was expanded even further. Under the Sherman Silver Purchase Act of 1890, Congress committed the Treasury to purchase 4.5 million ounces of silver and then issue certificates redeemable in silver or in gold. As anticipated by the Act’s opponents, the consequence was that the less valuable commodity (silver) would drive out the more valuable (gold). Eventually, the political valuation of silver and gold on a fixed exchange rate, despite the varying quality and availability of either commodity, led to an extraordinary financial panic in 1893 and an assault on the U.S. government’s gold reserves.

The Panic of 1893 and its aftermath matter for the institutional history of the Federal Reserve not only because it figures into the debates about what money should be, but because of the role of the financier J.P. Morgan in saving the U.S. government from financial and fiscal collapse. As we will shortly see, this is a narrative that continued in 1907, but only in exaggerated form. In 1893, though, the aide was real.

After the financial panic of 1893, the Treasury’s gold supply had been dwindling to a point that could trigger another panic not only on the banking
system, but on the entire U.S. government and its currency. Because the U.S. had committed to gold redemption, its failure to do so would lead to a collapse of the dollar and a pariah status among the international financial community.\footnote{See Chernow (1990) and Brands (2007)}

By early 1895, the pressure was leading to a self-fulfilling prophecy: the more redemptions depleted the Treasury’s gold reserves, the more redemptions currency holders would seek. It was a classic run, but on the currency, not on the banks.

For many, the collapse of gold redeemability provoked a yawn at best, outrage at the outrage at worst. The \textit{Atlanta Constitution} editorialized that “the people of this country, outside the hotbeds of gold-buggery and Shylockism, don’t care how soon gold payments are suspended.”\footnote{As quoted in Nevins (1934, 657)} But those coastal (and other) bankers with deep connections to the international financial system did care, and cared a lot. As Morgan would later describe his actions in 1895, the preservation of the gold standard was essential “to build up such relations of confidence between the United States and the money markets of Europe, that capital from there could be secured in large sums for our needs.”\footnote{As quoted in Sinclair (1981, 98)}

Whatever his motivations, and to some humiliation to the hard money Democrat Grover Cleveland, Morgan rode (with other international bankers, including the House of Rothschild) a gold stallion to secure the unimetallic future of the United States. Morgan brought $65 million worth of gold, half from Europe,

\footnote{121 See Chernow (1990) and Brands (2007)}\footnote{122 As quoted in Nevins (1934, 657)}\footnote{123 As quoted in Sinclair (1981, 98).}
to the U.S. Treasury, which issued gold-backed bonds—not bimetallic bonds—and, in the process, stopped the staunch. The bonds sold out almost immediately. As Chernow notes, “[i]n just twenty-two minutes, the bankers had booked $6 to $7 million in profits.”

The reaction to this feat of financial wizardry was bimodal. To some, Morgan was the hero, having saved the nation’s currency. To populists, it was indicative of a cabal of international financiers of the kind that Jackson had warned the nation about in his veto message. For many, too, the outcry was transparently anti-Semitic. The New York World called the bond syndicate a pack of “bloodsucking Jews and aliens.” And then-Congressman William Jennings Bryan “asked the clerk [of Congress] to read Shylock’s bond from The Merchant of Venice.”

The reactions to the panic of 1893-1895 led to a face-off in the 1896 presidential election between the hard money Republican, William McKinley, and Bryan, “the Great Commoner” and strong advocate for liberating currency from the gold standard. The Election of 1896 brought the question of the functional aspects of institutional money to the fore in a way that no other election has, before or since (including the election that preceded that passage of the Federal Reserve Act).

Bryan, a young but already famous orator, delivered over and over again his “Cross of Gold speech” decrying the efforts by eastern financiers to run roughshod

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124 Chernow (1990, 77).
125 As quoted in Chernow (1990, 70)
over the indebted farmers of America. In the speech, Bryan presented the cause of bimetallism and agricultural support as “a cause as holy as the cause of liberty—the cause of humanity.” And that cause was “the money question”: how would American money be determined, and in whose interests. The speech, like the Bank Veto message, has become an iconic document in political history. Most famous for its concluding lines—“we shall answer their demands for a gold standard by saying to them, you shall not press down upon the brow of labor this crown of thorns. You shall not crucify mankind upon a cross of gold”—the document was a litany of complaints against elites in both parties.

It was also a self-consciously Jacksonian, repeatedly invoking the former president to defend against charges of rabble-rousing (Bryan was frequently compared to Robespierre). He issued a warning to those who feared the masses: “in this land of the free you need fear no tyrant who will spring up from among the people. What we need is an Andrew Jackson to stand as Jackson stood, against the encroachments of aggregated wealth.” To those who insisted that gold was vital to the cities, Bryan replied with a rhetorically dazzling non-sequitur: “great cities rest upon these broad and fertile prairies. Burn down your cities and leave our farms, and your cities will spring up again as if by magic. But destroy our farms and the grass will grow in the streets of every city in the country.”

It was a dazzling performance that left its audience thunderstruck, over and over again. But it wasn’t enough. This assault on the institutional functions of

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money failed as McKinley won the 1896 election with 51% of votes cast (to Bryan’s 47%) and 271 of the needed 224 necessary electoral votes. Although Bryan would not give up so easily—he ran for president as the Democratic standard-bearer three times, a record for someone who never won—the cause of bimetallism suffered a staggering blow.

*Paul Warburg’s Confusion, Paul Warburg’s Solutions*

This was the state of American finance when Paul Warburg, a German financier from the Warburg family of Hamburg, Germany, moved to New York City to begin a career in banking. Love had brought him to the United States—he had married Nina Loeb, the daughter of an American financier, who longed to be with her parents in New York.127 When he arrived, he was stunned by what he encountered. When he arrived, there were roughly 20,000 banks with “no organic cohesion” among them. “Individualism in banking was the gospel of the country.” The problem with this kind of patchwork, from Warburg’s view, was that any minor exogenous shock would send the entire system reeling as indeed had occurred throughout the 19th century. American industry had not stayed so “provincial,” in Warburg’s view. American economic life by the start of the 20th century was “a lively and intimate daily exchange of goods and funds began to develop, not only between the several sections of the country, but between ourselves and all the rest of the world.” In this environment, “the national banking system, with the state banking system superimposed upon it, was bound to show the fatal consequences of its inadequate structure.”128

127 Chernow (1993)
128 Warburg (1930, 11-12).
Warburg’s memoir, from which the quotes above are drawn, is aimed in some sense on settling scores. He’s transparent about this aim. But he does not exaggerate his early warnings about the creakiness of the American financial system. In a 1907 op-ed for the New York Times, he wrote, somewhat hyperbolically, that the United States was “in fact at about the same point that had been reached by Europe at the time of the Medicis, and by Asia, in all likelihood, at the time of Hamurabi. […] Our immense National resources have enabled us to live and prosper in spite of our present system, but so long as it is not reformed it will prevent us from ever becoming the financial centre of the world. As it is, our wealth makes us an important but dangerous factor in the world’s financial community.”

Warburg’s vision of banking reforms was thus about the structure of institutionalized money, about who would control the money supply, and to what ends. The battles over currency had ended: Warburg was profoundly committed to the gold standard. But it wasn’t simply about an organizational commitment to a central bank, but about the provision and regulation of bank reserves with an eye toward stemming the risk of panic. While Warburg cited Bagehot but once, his was partially a Bagehotian conception of the central bank’s role.

Warburg wasn’t simply making the case that the U.S. needed to panic-proof its system. He also wanted to create an institutional context—both in terms of organizational and legal change—to put the U.S. squarely within the international financial system. And to do so, the U.S. needed to enter the 20th century—or, to be fair, the 19th century—by

130 Ibid at 445.
creating primary and secondary markets in “bankers’ acceptances.” The failure to create these markets was, in Warburg’s view, “one of the main causes of the immobilization of the resources of American banks.”

A bankers’ acceptance is a form of commercial paper that allows transacting parties to “borrow” the credit-worthiness of their bank, thereby rapidly improving the availability of trading partners. The very purpose of a medium of exchange is to allow for transacting parties to do business without resorting to some form of barter. But promises to pay are expensive to verify, and can be little better than a local barter economy, especially as time and distance extend between the provision of goods and their receipt. When a bank of some reputation has guaranteed the transaction, then the challenge to verify creditworthiness diffuses among counter-parties and banks (and their international correspondents) more quickly and easily. As Warburg wrote in 1907 (subsequently published in 1914, after the passage of the Federal Reserve Act), the aim should be “to transform our commercial paper from a non-liquid asset into the quickest asset of our banks.”

The liquidity that an acceptances market was meant to provide was not only to facilitate currency elasticity, or the availability of currency in times of greatest demand. Warburg’s vision for the United States was also about making its financial resiliency match its economic might and raise its stature among the community of nations. A secondary market in bankers’ acceptances not only meant more liquidity, it meant an increase in the “amount of trade financed in its currency and, thus, to the amount of trade

131 Warburg (1930, 22).
132 Warburg (1914/1907, 412)
invoiced in that currency.”133 There was money to be made in financing trade in the local currency; American financiers and industrialists were not keeping up.

Some scholars, political scientist Lawrence Broz principal among them, view the drive to create a market in bankers’ acceptances as the animating force behind the Federal Reserve Act.134 Warburg would have agreed with that assessment. In some sense, he wasn’t troubled as much by the multiplicity of currencies in the United States—a fact of institutionalized money that would long survive the creation of the Federal Reserve System—as he was about precisely this issue. When he would subsequently seek to take credit for the Federal Reserve System, it would be to point out this feature of the Federal Reserve Act, an idea that flowed from his pen in these days before and after what would become a defining event in the pre-history of the Federal Reserve: The Panic of 1907.

*The Panic of 1907*

As historian Harold James would write about Warburg’s January 1907 op-ed, the “Cassandra warning about the danger posed by the American financial system would make Warburg look like a true prophet after a renewed period of tension after October 1907.”135 The Panic of 1907 would became a flashpoint of controversy, immediately thereafter and well beyond. Because the event has been so fully historicized for institutional purposes—it is seen as the sine qua non of the creation of the Federal Reserve System—it is worth understanding how this global panic began, and how it was treated.

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133 Tavlas and Ozeki (1992, 41).
134 Broz (1997).
135 James (2014)
An exogenous shock to the financial system proved destabilizing. The San Francisco earthquake and fire of 1906 led to a rush of gold from New York banks to San Francisco, weakening the national system. The panic was also a function of market structure: the rise of trust companies that functioned as banks, but outside both the national banking system and the state systems for chartered banks, played a key role.\textsuperscript{136} When the largest of these banks, the Knickerbocker Trust, failed, a general run on the trust system resulted in the panic, with contagion spreading throughout the system.\textsuperscript{137}

In the usual retelling of the Fed’s history and its links to the 1907 panic, the Fed came as Congress’s answer to the problem of JP Morgan’s mortality. The 1907 panic was a dark one, but luckily for the U.S. financial system, Morgan—the great Jupiter of American banking and hero/villain of 1895—saved the day, stemmed the panic, and the system lived to fight another day. Congress recognized that it couldn’t count on Morgan forever, so it got its central banking act together after nearly a century in the wilderness and passed the Federal Reserve Act of 1913. The U.S. has had a central bank ever since.

The problem with that story is that while some of the bare facts are true, the arc of the narrative is not.\textsuperscript{138} There was a financial panic in 1907, Morgan was involved, and the Federal Reserve Act was passed in 1913. What the story misses is just how much the government was involved in that crisis response, and how much activity intervened between the Panic of 1907 and the signing ceremony on December 23, 1913.

\textsuperscript{136} For more on the follow-on effects for businesses banking in the trust system, see Hilt et al (2015)
\textsuperscript{137} For more on the Panic of 1907, see Bruner & Carr (2009).
\textsuperscript{138} I’m not the first to attempt to debunk these links. See Goodhart (1969).
The nature of Morgan’s participation, though, is exaggerated. Some historians repeat the dramatic scene of an “indispensable” Morgan rising to the occasion. After days of panic, Morgan took his collection of bankers into a library adorned with his collections of art and rare books. Morgan, it was reported by his associates at the time, was “the man of the hour,” whose pronouncements—bland and obvious in retrospect, such as “[i]f people will keep their money in the banks everything will be all right”—assumed talismanic significance. A sleepless night of Morgan’s banking associates, locked by Morgan in his smoky library, led to the salvation of the U.S. financial system. It may have been sleepless for his associates, but Morgan himself was able to doze a little. At one point, as a banking associate of Morgan’s reported, Morgan’s sleep caused everyone to wait respectfully: “We sat quietly, saying nothing. The only sound that could be heard was the breathing of Mr. Morgan.”

Morgan’s role in staunching the Panic has not been invented, but it has been exaggerated, perhaps in part to emphasize the essentially private, banking nature of performing the functions he is presumed to have functioned. The hostility toward Morgan in 1895 and his celebration of 1907 also showed how much the politics of the day mattered. By 1907, the gold standard was not up for debate, and the failing entity was not the U.S. government. (It probably helped the anti-Semites prominent within both parties that Rothschilds was not part of the Morgan effort this second turn of the wheel.)

139 Lowenstein (2015, 65).
140 Herbert Satterlee—Morgan’s son-in-law, business associate, and attendant to the events of that fateful fall—was an early chronicler of the Morgan mythos. Satterlee (1939). The memoirs of others, like Frank Vanderlip (from whom the quote about a sleeping Morgan is drawn) also helped cement the view. Vanderlip (1935, 174-75). Newspapers widely reported Morgan’s involvement at the time. For example, The Washington Post, “How and Why J. Pierpont Morgan Stopped the Panic of 1907,” November 10, 1907.
But while the Treasury was not the one facing the run, it was also not a silent bystander. In fact, the Secretaries of the Treasury under William McKinley, first, and Theodore Roosevelt, second, provided significant infrastructure and liquidity to combat precisely these kinds of panics. The Panic of 1907 was not a new kind of phenomenon; there had been devastating banking panics for years after the Jacksonian Bank Wars, including in 1837, 1857, essentially throughout the Civil War, 1873, 1884, 1893, 1895, and 1901. Not all were created equal, but 1907 was hardly a once-in-a-century event.141

In response to these panics, Secretary of Treasury Leslie Shaw had used the “independent treasury system” to deploy funds in precisely a fashion envisioned by Bagehot—to stave off panics and reassure a jittery business public that the government had things well in hand. And during the Panic of 1907, Shaw’s successor, George Courtelyou, deployed millions of dollars to support the failing trusts and worked hard to coordinate with Morgan and other New Yorkers. Indeed, part of the reason that Courtelyou didn’t do more is likely because of the intense criticism that Shaw received for doing the same years before. In a critique written by Piatt Andrew just a few months before the 1907 panic, Shaw was lambasted for “stretchings of his constitutional powers.” Andrew’s conclusion was that “no treasury official since the Civil War [had] so shaken the accepted traditions of that department.”142

The criticism wasn’t only from academic commentators. Some bankers thought Shaw’s deployment of public funds to support the banking system was no better than plain corruption: Shaw was in the business of giving public money to his greedy friends under

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141 For more on the banking panics of the era, see Wicker (2000) and Hammond (1957).
142 Andrew (1907).
the guise of public policy. One Chicago banker groused that the public “had begun to smell kerosene on [Shaw’s] wardrobe,” an allusion to the idea that Shaw was funneling money to support those banks connected to or dominated by Standard Oil.\textsuperscript{143}

Whatever the reason, when the Panic of 1907 came, Courtelyou was skittish about taking responsibility for his provisions of liquidity and policy. This reticence may explain why so little contemporaneous newspaper coverage included the Roosevelt Administration in its praise of containing the panic, focusing instead on the role of Morgan and his associates.

There are two points, then, to note about the Panic of 1907 and the Federal Reserve. First, that Morgan’s role in preventing catastrophe has been oversold, including at the time. And second, as far as we’ve come in discussing the institutional context of the Fed’s legislative beginning, there is still much more story to tell. The direct link between the Panic and the Fed has also been grossly oversold.

\textit{The Aldrich-Vreeland Act and the National Monetary Commission}

If the Federal Reserve Act cannot be called a piece of “crisis legislation,” the Aldrich-Vreeland Act can. After Morgan, Courtelyou, and Roosevelt—among the many others—worked put out the temporary fires of the 1907 Panic, Congress went to work and passed the Act within a few months, sending the bill to Theodore Roosevelt’s desk by May 1908. The bill passed on a mostly party line vote. There was initial enthusiasm for precisely the kind of debates on structure and function that had dominated every other discussion of institutionalized money that had preceded them, but the issues were deemed

\textsuperscript{143} As quoted in McCulley (2012, 123)
too controversial. The compromise solution was to allow national banks, chartered by the Comptroller, to band together to issue notes that would be more readily available than had been the case under clearing houses or smaller national banks (or state banks).

The key component, though, was the creation of a new bureaucracy, the National Monetary Commission, a creature of Congress consisting of nine members each from the House and Senate. The Commission was to “inquire into and report to Congress at the earliest date practicable, what changes are necessary or desirable in the monetary system of the United States or in the laws relating to banking and currency.” The Act in general wasn’t universally loved; one commentator called it a “curious compound of conflicting views, compromise, haste, and politics.” But it largely avoided the controversies these questions usually engendered by putting off to a Commission the hard conversations that Congress seemed unlikely to resolve on their own. Even the substantive provisions, such as they were, had a time limit: they would expire in 14 years.

*The National Monetary Commission and the Creature from Jekyll Island?*

Nelson Aldrich himself chaired the NMC, which also commissioned over thirty volumes of original research that covered banking and central banking from every major global jurisdiction and several different epochs of U.S. history. Most of these volumes have not been widely consulted, but the point may have been to give the Commission’s final proposals the patina of expertise: as Roger Lowenstein writes, “Aldrich sensed that

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146 Laughlin (1908)
an ambitious project required a proper foundation, a bibliographic heft, to be treated with the requisite gravitas.\textsuperscript{147}

From the beginning, Aldrich, already closely aligned with industry, consulted closely with bankers from Morgan’s and elsewhere. Given how close to the 1908 presidential election the Panic of 1907 was, it’s remarkable that the issue wasn’t more central to the campaign (especially given that the Great Commoner was making his third and final appearance as the Democratic candidate). The issue was certainly debated: the Democrats answer to the Panic of 1907 was “legislation under which the national banks shall be required to establish a guarantee fund for the prompt payment of the depositors of any insolvent national bank, under an equitable system which shall be available to all State banking institutions wishing to use it.”\textsuperscript{148} In other words: deposit insurance as would become federally adopted in 1933.

Republicans balked at the idea. Laurence Laughlin, one of the key monetary theorists behind what would become the Aldrich Plan, dismissed the Democrats’ ideas as an effort to “make men good by law. It is purely populistic and socialistic.” The depositors would be better served by relying on “the skill, integrity” and “good management” of bankers.\textsuperscript{149} Republicans were intent on seeing the Monetary Commission through to its final report, although they did favor a postal banking system.\textsuperscript{150}

\textsuperscript{147} Lowenstein (2015, 79).
\textsuperscript{148} Democratic Party Platform, July 7, 1908
\textsuperscript{149} As quoted in McCulley (1992, 160)
\textsuperscript{150} Republican Party Platform, June 16, 1908
During the election season, Aldrich and other members of the NMC, plus staff, started a global tour. Through fifty-eight meetings with “central bankers as well as with diplomats, editors, and local financiers,” the Commissioned concluded that the common denominator in each regime was the idea of a *systems*. There was a coherence to them, an institutional design, that the haphazard nature of the U.S. financial system—filtered as it was through the factionalism of the 19th century—could not and did not match. Although Aldrich had opposed Warburg’s ideas of importing some comparable system to the United States, by the end of his trip, he was converted to the idea. When Aldrich and Warburg met after the voyage, the discussion included Warburg’s peremptory conclusion that no central banking system could work in the United States. “Mr. Warburg, I like your ideas,” Aldrich said. “I have only one fault to find with them. . . . You are too timid about it. You say we cannot have a central bank, and I say we can.” Warburg was stunned by the reversal: Aldrich had been the one to oppose, on political principle, the idea. “It is easy to imagine, but hard to describe,” Warburg wrote, “the mixed feelings of joy and bewilderment into which this remark threw me, for suddenly I found our roles reversed.”

Aldrich’s political strategy appeared to be delay. He wanted to stay above the political fray and let the NMC do its work while emotions died down. But as attention moved from the currency question, so too did Aldrich’s popularity. He had been the subject of scathing reporting regarding the nature of his fortune, all earned through close

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151 Lowenstein (2015, 87).
152 Warburg (1930, 56-57).
contacts in industry while he was a sitting member of the Senate. Aldrich, at the helm of
the plan appeared more and more like a liability rather than a highly placed asset.

It was in this context that Aldrich, Warburg, and others in banking made their
fateful trip to Jekyll Island, an island off the coast of Georgia frequented by the wealthy.
Sometimes, it seems, conspiracy theories are true. The meeting on Jekyll Island was one
such meeting, where participants traveled in disguise and under pseudonyms, taking an
oath of silence until decades later. Warburg described it in his 1930 memoir only as “a
small group of men who, at Senator Aldrich’s request, were to take part in a several days’
conference with him, to discuss the form that the new banking bill should take.”\footnote{153 Warburg (1930, 58).} No
mention of the secrecy, location, or the rest—that would only come from Frank
Vanderlip’s subsequent memoir.\footnote{154 Vanderlip (1935).} The secrecy was to prevent the press from getting
wind of their plans for a central bank, still an anathematized concept in American
political life, by their calculations. It has become yet another instance of one institutional
moment defining the perceived character of the institution long after the fact.

The proposal that emerged from the Jekyll Island meeting became known as the
Aldrich Plan. The centerpiece was the “National Reserve Association,” a national
association with local branches that allowed individual banks to pool reserves under
common control of a purely private governance structure. It wasn’t a central bank in the
sense of total control by a single central bank governor, but nor was it just the National
Banking System redux, nor private clearing houses. It would have government support,
and the U.S. President would appoint the NRA governor, but only from a list of forty directors. It was, as Warburg put it, “strictly a banker’s bank.”

Unfortunately, no amount of secrecy or international travel or banker enthusiasm could dictate the political process and the swirl of events that had overtaken the nation since the 1907 panic. By measuring his time in years rather than months, Aldrich had lost momentum: the Democrats were on the rise, and wanted nothing to do with Aldrich or his plan.

*The Money Trust*

A major turning point happening roughly at the same time as the Aldrich Plan’s release were hearings on the so-called “money trust,” led by Louisiana Democrat Arsene Pujo (himself a former member of Aldrich’s National Monetary Commission). In these hearings, led by famed lawyer Samuel Untermyer, JP Morgan himself appeared to answer the charge that the nation’s money and credit were subject to the same kind of monopolistic control as its sugar, steel, oil, or railroads had been. The charge was that these New York bankers were using “other people’s money,” to quote the title of the book that Louis Brandeis published in the wake of the hearings, to enrich themselves at the expense of the rest of society.

Morgan compelled to appear at the hearings. In one of the most famous exchanges of the hearings, Untermyer asked Morgan to explain the basis on which someone can get a loan, on what security or collateral, on the theory that only the wealthy would qualify for loans through Morgan’s banks. Morgan refused to concede the point. The provision of

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155 Warburg (1930, 59-60)
156 Brandeis (1914)
credit had “no relation . . . whatever” to do with the net worth of the man requesting it. An incredulous Untermyer pressed Morgan, “is not commercial credit based primarily upon money or property?” Came the improbable answer: “No, sir: the first thing is character . . . A man I do not trust could not get money from me on all the bonds in Christendom.”157 And later, somewhat fantastically, Morgan averred: “I have known a man to come into my office, and I have given him a check for a million dollars when I knew that they had not a cent in the world.”158

These gems of apothegmatic wisdom are widely and frequently reported, by historians and commentators. But the hearings themselves were not always so colorful. As Ron Chernow, one of Morgan’s biographers, wrote Morgan’s “epigrammatic sayings . . . appear against an arid backdrop of denials and monosyllabic grunts, as if he wouldn’t concede the hearing’s legitimacy.”159

It is worth emphasizing how much bankers of the era regarded this kind of publicity as anathema. One of JP Morgan’s closest banking confidantes, George Baker of First National Bank, is a good example. He was director for over forty companies—emblematic of the accusation that Pujo and Untermyer lodged at bankers they viewed as wielding too much power over industrial America—but stayed assiduously in the shadows. He gave his first interview to the press in 1863; his second came sixty years later, in 1923, and then only when the interviewer convinced him to take pity on her, as an interview with Baker would land her a job. In that second interview, he explained his philosophy: “Businessmen

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157 For more on the Pujo hearings and the Money Trust hearings, see Geisst (2012). For the quote, see Morgan (1912, 49-50).
158 U.S. Congress, House, Testimony before the Money Trust Investigation, December 18 and 19, 1912 p. 92.
159 Chernow (1990, 154)
of America should reduce their talk two-thirds. Everyone should reduce his talk. There is rarely ever a reason enough for anybody to talk.”\textsuperscript{160}

Morgan shared this philosophy, which is why his presence in the Senate hearing was so remarkable. On one thing, Morgan and his critics shared a view: that he genuinely was an important man playing a singular role in the American economy, whether as the villain of 1895 or the hero of 1907 or the villain again in 1913. But as quotable as Morgan was, he was humiliated by the hearings and angry that his character had been tarnished. He would die just weeks after the hearings, the victim (according to his family and partners) of Untermyer’s cross-examination.\textsuperscript{161}

The Money Trust hearings straddled the 1912 election, extending into the congressional session that would enact Wilson’s most ambitious pieces of legislation. The most direct consequence of the “money trust” hearings was the passage of the Clayton Antitrust Act, which, among other changes, prohibited investment bankers from serving on the boards of the firms they advised.\textsuperscript{162} But the hearings also helped guide the discussion of how to resolve the “currency question” that the Republicans had been debating in earnest through legislative and administrative channels since 1907. That shift in tone proved decisive: The final governance structure of the Federal Reserve System owed itself to that transition.\textsuperscript{163}

\textit{The Election of 1912}

Interlaced with the money trust hearings was the election of 1912. Few presidential

\textsuperscript{160} Cruikshank (1987, 100)
\textsuperscript{161} Chernow (1990, 157).
\textsuperscript{162} For a test of the economic consequences of the Clayton Act, see Hilt et al (forthcoming)
\textsuperscript{163} See Chernow (1990, 149-159).
elections in U.S. history match it for its drama. Gone was the staid front porch campaigns between two senior partisans. Instead, the election pitted two U.S. presidents, Theodore Roosevelt and William Howard Taft, against Woodrow Wilson, a college president who had entered politics just two years before. On the edge, but not the fringe, was the most popular socialist in American history, Eugene Debs, who captured 5% of the vote. Historians have debated how much policy daylight stood between the three main candidates—although there was little doubt that Debs represented something very different than the others—the perception at the time and continuing today was that the aspirations of each candidate represented distinct approaches to the role of government in society. In Cooper’s words, the 1912 election “verged on political philosophy.” To Milkis, the election was host to the “central political events of the 20th century: the rise of direct democracy and the expansion of federal administrative power.”

That political philosophical moment in American history intervened between the 1907 panic and the Federal Reserve Act in ways that were essential in shaping the System’s curious governance structure. Conspiracy theorists get close to their target in noting the existence and significance of the Jekyll Island meeting—the leading popular account of the conspiracists is called The Creature from Jekyll Island, an exposé that “set[s] off into the dark forest to do battle with the evil dragon.” But they don’t quite hit it. The reality is that the “creature” established in that fateful meeting and sponsored by the Republicans in

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164 On the variety (or not) of the candidates’ political ideologies, Smith (1999, 410-11), who views the candidates on a right-center-left Progressive spectrum, with Taft on the Right, Roosevelt in the center, and Wilson on the left (Smith isn’t as interested in Debs, but still locates him within this spectrum). Smith is disputing Kolko’s (1962) conception that clumped the candidates rather narrowly as so many conservatives.
165 Cooper (1983, 141). For a modern example of attention to the 1912 election, see Goodwin (2014).
166 Milkis (2009, ix)
167 Griffin (2010)
1910 had much in common with respect to the *functions* of institutionalized money, but very little with respect to the *structure* of institutionalized money. That is, what the bankers and politicians agreed about the ways that money should be regulated largely survived unscathed in the eventual passage of the Federal Reserve Act. Who would govern that process, on the other hand, did not.  

The consequences of the election were important, but only for partisan reasons. The question of money was rarely debated during the election, with much more focus on the problem of trusts and corporations generally. The party platforms reflected fealty or hostility to the Aldrich Bill, by name for the Democrats and Progressives, by concept for the Republicans. “We oppose the so-called Aldrich bill or the establishment of a central bank,” the Democratic platform declared, and sought legislation that would protect against “control of dominion by what is known as the money trust.”

Whether by luck, or because their ideas were in fact much more in line with the direction that Wilson would guide the legislation during the subsequent legislative session, the Rooseveltian Progressive Party came the closest to the final proposal: “The issue of currency is fundamentally government function,” with control “lodged with the Government and should be protected from domination manipulation by Wall Street or any special interests.” For that reason, the Progressives were “opposed to the so-called Aldrich currency bill, because its provisions would place our currency and credit system in private hands, not subject to effective public control.”

The Republicans were vaguer about their support. “The Republican party has always stood for a sound currency and for safe banking methods,” the platform declared in its opening line on the subject. But the methods for reaching that sound currency and safe methods were not apparent, except in broad commitments to prevent panics, protect farmers, and otherwise protect the “the independence of individual banks, whether organized under national or State charters” against “any possibility of domination by sectional, financial, or political interests.”

The scant attention paid to legislative specifics in the party platforms matched the speechmaking of the campaign. The campaign was not focused on the question. And yet, the consequences of the election were enormous.

The Legislative Debate: The Functions of Institutionalized Money

Given the general indifference the presidential candidates seemed to display on the question, what made the final Federal Reserve Act such a partisan affair? In the early glow of the Federal Reserve System’s perceived successes, the actors themselves published memoirs either claiming that the Act looked essentially the same as the Aldrich Bill—Paul Warburg, principally—and those that attempted to discredit the Aldrich bill entirely. What is remarkable is the nature of the legislative fight over ontology: the very stuff of money became part of the contest. Intriguingly, it was only a smaller part of that contest, largely because the previous generations’ debates along these lines had already

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172 Warburg (1930) presents an entire second volume of a memoir devoted to defending the parallels. The effort motivated his 800 page, two-volume account.
173 Willis (1924) and Glass (1927)
satisfied so much. When Bryan lost the 1896 (and 1900, and 1908) elections, the quest for bimetallism was over.

When the Federal Reserve Act was passed, then, the idea of a “fiat currency,” or a currency not backed by gold or some other fixed exchange, was anathema to the system’s legislative sponsors. To combat the temptation to follow Salmon Chase’s “greenbacks” example, or the hyperinflation of the Confederacy—both still part of the conversation for these veterans and children of veterans of that political, military, and financial conflict—two prevailing monetary doctrines were seen as providing the protection: the gold standard, and what would come to be called the “real bills doctrine.” Both were seen as a central justification for the new system. Importantly for a historical understanding of the institution of the Federal Reserve and central banking, both would be discarded while the organization of the Federal Reserve remained.

As the legislative framers sought to put their vision in place, the industrial world was at what would turn out to be the end of the classic gold standard. Under this standard, gold was the legal tender of international commerce. National money—the U.S. dollar, the British pound—was issued against gold, meaning that paper money could be redeemed for gold (although the regulatory requirements of that conversion varied from country to country). Governments that had committed themselves to the standard did not have complete discretion in determining the value of their currency. Keeping the commitment meant making hard choices, both domestically and internationally.

Bagehot referred to it not as the “gold standard” but the “cast iron system,” because it locked the countries and their central banks into a commitment that would
prevent them from printing money with reckless abandon. The gold standard prevented such monetary shenanigans because those engaged in international commerce based on that currency would start to demand gold convertibility, and if more paper IOUs were circulating than could be redeemed, the country’s currency would plunge in value and its access to the international markets would collapse along with it.\textsuperscript{174}

Bryan had left behind his former intensity for silver. Now the Secretary of State in the Wilson Administration, he largely took a hands-off approach to the legislative debates, with an important exception. Republicans inserted an hortatory amendment to the House bill that would reaffirm the U.S. commitment to the gold standard. There were enough Bryanites in the House for this to become problematic. But when Glass called on the Great Commoner for his support, Bryan freely gave it. Silver had become “irrelevant,” he said. The gold standard amendment was inserted into the House bill, which soared through on a vote of 285 to 85.\textsuperscript{175}

The Senate debates were more dubious on a variety of fronts, but the gold standard was, again, only of passing importance. All had embraced it as the basis of the nation’s currency, even if some critics of the new system worried that the Act would set up an apparatus that could steer currency away from that sound basis (a fear that proved well-founded, but for the failure to anticipate congressional complicity with these new interpretations).

\textsuperscript{174} Bagehot (1873, 210)
\textsuperscript{175} Glass (1927, 153). See also Lowenstein (2015, 230)
The second aspect of the money question was the basis on which the new banks would present loans. Gold redeemability was not enough to condition conservatism among bankers; there had to be a sense that loans would only be made on “commercial bills,” not speculative bills. This would lead eventually to what Lloyd Mints, writing in 1945, called the “real bills doctrine,” a shorthand for the “commercial loan theory of credit” that he adopted “largely because it is shorter.” The real bills doctrine was as widely adopted during the legislative debates as the basis for money creation in the new system. To understand how it functioned, we need to know more about the practices of commercial banking at the time the Fed was founded.

As Meltzer described it, “the main business of a banker” during the late nineteenth century “consisted in issuing notes and discounting bills of exchange.” Scholars trace the emergence of the bill of exchange to the thirteenth century, although there is evidence of an analogue in the Roman Empire. This “discounting” function was a kind of loan. A standard loan involves two parties: the lender and the borrower, who agree on the amount of money loaned, the cost of that loan (that is, the interest rate), and the terms of that loan. The debtor and creditor become involved in each other’s affairs during the life of that loan, until the borrowed money is repaid.

Then as now, a two-way loan is limited by how much the lender knows about the borrower. It also requires geographic proximity. A bill of exchange is an answer for these limitations. A bill is a financing mechanism that involves four parties, not two, and is

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176 Mints (1945)
177 Meltzer (2003, 24).
essential for the facilitation of “new ways of doing business and new types of commerce.” At the time of the enactment of the Federal Reserve System, the primary businesses were across the vast stretches of the United States, to facilitate bringing agricultural products to market, and hopes of participating in a dollar-denominated international trading system. In either case, the four parties are the exporter and importer of specified goods, and the two corresponding banks at either end of that transaction.

In 1913, commercial banks were already actively engaged in the discounting of commercial paper. What was different about the Federal Reserve Act was the sheer volume of discounting that could be done, on whose behalf, and with what relationship to the banking system generally. Private discounting of commercial paper, including bills of exchange, is a profit-generating exercise that can be necessarily laborious and costly. The cost of validating the credit of the importer—the one who has to ultimately pay off the bill at the due date—is high, perhaps insurmountably so, if the secondary discounter has to know about the importer’s business, creditworthiness, and so on. If, on the other hand, the counterparty is a single institution, backed in part or in full by a trustworthy government, then the transaction cost of the secondary discount is reduced only to the cost of verifying the creditworthiness of the single institution. That was the benefit of the kind of system imagined by Aldrich and Warburg (and that continued into the Owen-Glass bill) at the turn of the twentieth century.

But a key part of the debate was exactly what kinds of bills could be discounted. Under the doctrine, not called the real bills doctrine until 1945, the only bills that could be discounted were those that represented an actual transaction that had already occurred
and would be paid off in short order. The funding of speculative bills was the alternative, or those transactions that had not yet occurred and may never occur. The real bills doctrine—endorsed by Bagehot as essential to the functioning of a proper central bank, and disputed by few at the time of the Act’s passage—meant that central banks would discount my bill, but not that of the other coffee enthusiast. This view of the world was placed directly into the Federal Reserve Act, which required that a “Federal reserve bank may discount notes, drafts, and bills of exchange arising out of actual commercial transactions,” excluding “notes, drafts, or bills covering merely investments or issued or drawn for the purpose of carrying or trading in stocks, bonds, or other investment securities.” The Federal Reserve Banks would be limited by both the gold standard and the requirement that they could not fund speculative activities: only real bills would do.

Both features of institutionalized money—the gold standard and the real bills doctrine—were seen as essential to the Federal Reserve Act’s legitimacy. The debates about these concepts were not about their virtues vel non. They were about whether the Act would in fact honor those commitment. The claim that the new “Federal Reserve Notes” would represent “fiat money” was a widely spread objection to the Act. The always colorful Carter Glass’s defense on the House floor against the charge is quotable at length:

Fiat money! Why, sir, never since the world began was there such a perversion of terms; and a month ago I stood before a brilliant audience of 700 bankers and business men in New York City, and there challenged the president of the National City Bank to name a single lexicographer on the face of the earth to whom he might appeal to justify his characterization of these notes. I twitted him with the fact that not 1 per cent of the intelligent bankers of America could be

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179 Federal Reserve Act of 1913, sec 12.
induced to agree with his definition of these notes, and asked him to name a single financial writer of the metropolitan press of his own town, to whom he might confidently appeal to justify his absurd charge. . . .

“Fiat money” is an irredeemable paper money with no specie basis, with no gold reserve, but the value of which depends solely upon the taxing power of the Government emitting it. This Federal reserve note has 40 per cent. gold reserve behind it, has 100 percent short-term, gilt edge commercial paper behind it, which must pass the scrutiny, first, of the individual bank, next of the regional reserve bank, and finally of the Federal Reserve Board. 180

Note Glass’s twin reliance on the 40 percent gold-reserve ratio, and the invocation of the “short-term, gilt-edge commercial paper” (although he exaggerated, perhaps intentionally, the role that the Federal Reserve Board would play in approving individual discounts). The gold standard and real bills doctrine were the selling points for the framers of the Fed.

Glass was not alone in this enthusiasm. Woodrow Wilson felt the same way. “Let bankers explain the technical features of the new system,” he said. “Suffice it here to say that it provides a currency . . . which comes into existence in response to the call of every man who can show a going business and a concrete basis for extending credit to him, however obscure or prominent he may be, however big or little his business transactions.”181 Wilson’s rhetoric, here as it so often was, was egalitarian in nature, but practical in implications: the “concrete basis” meant that the Fed couldn’t just issue money out of nothing. It needed a “real bill” to cue the printing press.

180 Congressional Record 51, no. 17 (December 22): 563.
181 As quoted in Kettl (1986, 22).
As we will see in the next chapters, both the real bills doctrine (in the 1920s) and the gold standard (initially in the 1930s, eventually in the 1970s) would fall away. But what matters for the institutional history of the Federal Reserve is just how much of the functional work of defining money had already occurred, with great if by then historical controversy, by the time the legislation was passed.

Wilsonian Compromise

Unlike the debates through much of the 19th century, the fight over the institutional nature of money—its functions—weren’t a partisan affair, but only because the Democrats had so fully coopted Republican ideology. Some Democratic members of Congress resented the party’s change: the platform had, after all, rejected the Aldrich bill, and now it seemed the Democratic Congress was poised to enact it. But through masterful use of his popularity, Wilson—with the assistance of Carter Glass running the political scene through the House of Representatives—succeeded in bringing the Democrats into line. Those who viewed the Federal Reserve Act as a dressed up version of the Aldrich Bill were convinced or compelled to keep silent. 182

What proved much more difficult—and was indeed an innovation—wasn’t the functional nature of the new legislation, but its structural basis. That is, the question of who should control the new system was of paramount importance and a question of intense, partisan, and ultimately uncertain character. The question became oriented toward two poles: whether the structure would be private or public, and whether it would be centralized or decentralized. Paul Warburg, focused as he was on the provision of liquidity throughout

the system in case of panics, feared public influence over what he, a private banker in the old-school European banking tradition, viewed as an inherently private function.

Glass didn’t disagree about the nefarious influence of government: he was much more worried about the centralized versus decentralized aspect of the governance problem than the private versus public one. As much as the Republican bankers distrusted politicians in control of banks, Glass and the Democrats feared the bankers’ control of politicians. The best solution from the Glass perspective wasn’t to give the keys of the financial kingdom to the politicians; it was to take the keys away from the New York City bankers. Thus, Glass’s answer to the governance problem was a private, decentralized sea of central banks spread throughout the country.

This preference is what prompted the “capstone” discussion that opens this chapter, and where Wilson’s influence was so influential. He wanted the private Reserve Banks, a real difference from the National Reserve Association in the Aldrich Bill, to have their autonomy but also be supervised by a governmental bureaucracy.

This student of governmental structures saw the opportunity for constitution making in the tradition of one of his heroes, James Madison. Wilson wanted public control, but recognized the need to compromise among the various factions. His proposal: a Washington-based, government-controlled supervisory board that he preferred on top of the essentially private, decentralized central banks flung by Carter Glass throughout the country.

Glass retells the key story of how Wilson came to embrace this “capstone” event in the legislative discussions. When bankers and Glass both protested the idea that a public board should govern the private reserve banks, Wilson imperiously asked, “Will one of
you gentlemen tell me in what civilized country of the earth there are important government boards of control on which private interests are represented?” Hearing no objection, he followed up: “Which of you gentlemen thinks the railroads should select members of the Interstate Commerce Commission?” While the bankers continued to protest, Carter Glass was “converted to Wilson’s position before they had even exited the office.” For all his love for Walter Bagehot, Wilson had clearly not looked very carefully at this question: had he done so, he would have known more about the structure of central banks in other jurisdictions, including the Bagehotian view of central bank governance. Why the bankers didn’t correct him is not recorded in Glass’s memoir.

Wilson carried the day in what might be called the Wilsonian Compromise of 1913. Before Wilson, this hybrid institution did not exist in paper or in thought. The result was the leanly staffed Federal Reserve Board, based in Washington. The Board would include Secretary of the Treasury as the *ex officio* Chair of the System, with the Comptroller of the Currency—until then, the exclusive federal banking regulator—also serving on the Board. In addition to these two political appointees, the Board consisted of five Presidential appointees, serving ten-year terms each. The rest of the system consisted of “eight to twelve” Reserve Banks—the initial legislation didn’t set the definitive number. These Reserve Banks would each have a “Governor” and a nine-person board of directors. They would be the essentially private features of the System.

The term Wilsonian Compromise comes from Wiebe, and refers to Wilson’s

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184 For the statutory details, see House Report on Glass Bill (reprinted in Glass 1927). Note that in the Glass Bill that passed the House of Representatives, the Secretary of Agriculture would also be an *ex officio* member, with each member of the Board serving six years. The House version would have set the floor at twelve, and put no limit on the final number. Glass (1927).
185 Wiebe (1966, 221)
According to these grand theories, then, the Federal Reserve System would not be dominated by either Board or Bank. The emphasis, at least to some of these early legislative framers, was on the *Federal* in the Federal Reserve System. That meant that the balance of power was between local and national figures, much as the U.S. Constitution had done with states and national governments. That balance was at the core of Glass’s conception of the new System. “In the United States, with its immense area, numerous natural divisions, still more numerous competing divisions, and abundant outlets to foreign countries,” he said, “there is no argument, either of banking theory or of expediency, which dictates the creation of a single central banking institution, no matter how skillfully managed, how carefully controlled, or how patriotically conducted.”186 To that end, the Federal Reserve System was “modeled upon our Federal political system. It establishes a group of independent but affiliated and sympathetic sovereignties, working on their own responsibility in local affairs, but united in National affairs by a superior body which is conducted from the National point of view.” To drive the point home: “The regional banks

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186 Glass House Report, H.R. 7837, reported H. Rpt. 63-69 at 12 (1913);
are the states and the Federal Reserve Board is the Congress.

It is difficult to reject the idea that the designers of this new system intended there to be a muddle about who would actually have the authority within the system. Indeed, Glass—without apparent contradiction from Wilson—spoke of the Federal Reserve Board as but a reassignment of authority, not the creation of something new:

Nearly every power conferred by this bill on the Federal reserve board . . . has been for half a century vested by the national-bank act in the Secretary of the Treasury and the Comptroller of the Currency, to be exercised in the conduct and control of the national banking system. It does not seem necessary here and now to enumerate these powers; they relate to examination, regulation, publication, and control. Strictly speaking, the Federal reserve board performs no banking function; the banking business of the system is within the exclusive jurisdiction of the regional reserve banks, owned and operated by an aggregation of individual member banks.

Glass’s view, then, was of the Reserve System as a series of central banks with minimal participation from an “altruistic” Federal Reserve Board, the latter lacking any kind of substantive banking authority. Glass wasn’t alone in this emphasis. E.W. Kemmerer, an early observer of the creation of the Fed, called the arrangement of “twelve central banks with comparatively few branches instead of one central bank with many branches” the “most striking fact” about the System. Wilson also agreed: “We have purposely scattered the regional reserve banks and shall be intensely disappointed if they do not exercise a very large measure of independence.”

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187 Glass (1927)
188 Congressional Record, vol 50 point 5 (Sept 10, 1913), p 4644
189 Kemmerer (1922, 64).
190 Glass House Report, H.R. 7837, reported H. Rpt. 63-69 at 12 (1913). Kettl (1986, 32). After the Federal Reserve Board took a stronger hand in setting discount rates in 1927, Glass sought to clamp down on the Board’s authority. For more about how these kinds of disputes between the Reserve Banks and the original Federal Reserve Board came about, see Meltzer (2003, 62-75); Clifford (1962, 66-67).
The final result of a Board with “eight to twelve” Reserve Banks, discounting bills under the real bills doctrine and the gold standard, was the Wilsonian Compromise. Perhaps the most notable aspect of it is that it wasn’t actually a compromise anyone but Wilson sought.

*The Federal Reserve, Interest Groups, and the Progressive Era: The Historiographic Context*

My focus on the two features of institutionalized money—the nature of money, and the structure that will regulate that nature—is not the focus of the historiography of the Fed, which consists more of an intellectual and political history of the legislative process (and one reason I do not summarize the legislation on that basis). That focus, if we can call it a focus, is instead on what the Fed tells us about the Progressive Era as a period of intense experimentation with state-making in the early 20th century.¹⁹¹ This view also seeks to understand the Federal Reserve’s original conception as an exercise in interest-group politics, and historians that have tried to flesh out the nature of the Fed’s origins have done so mostly with that conception in place.

There is much to learn from these previous accounts. Gabriel Kolko is one of the leading voices in this conception of Fed origins. Writing in the early 1960s, Kolko hoped to place the founding of the Federal Reserve System within the context of the Progressive Era reform movements generally. In that context, Kolko wrote against a consensus that, as he described it, viewed “the development of the economy as largely an impersonal, inevitable phenomenon.”¹⁹² Under that view, historians assumed—erroneously, in Kolko’s view—that “concentration and the elimination of competition . . . was the dominant

¹⁹¹ See, for example, Skowronek (1982), Carpenter (2001)
¹⁹² Kolko (1963, 7).
tendency in the economy.”193 The Progressive Era reforms, including the Federal Reserve Act, were meant to address those tendencies.

Kolko rejected that conception of the Fed and related reforms. Whereas most historians had viewed federal economic legislation as “a reaction against the power of the giant monopoly, or a negative response to the very process of industrialism itself by a threatened middle-class being uprooted from its secure world of corporate capitalism,”194 Kolko saw the use of federal legislation and policy by those very industrial concerns as a mechanism of private control. It was, he concluded, “business control over politics . . . rather than political regulation of the economy that is the significant phenomenon of the Progressive Era.”195 He calls this phenomenon “political capitalism,” very similar to the European conception of “corporatism,”196 which he defines as “the utilization of political outlets to attain conditions of stability, predictability, and security—to attain rationalization—in the economy.”197 As Kolko put it later, “Progressivism was not the triumph of small business over the trusts . . . but the victory of big business” itself.198 Institutional history, from Kolko’s perspective, was about interest-group politics and rhetorical strategies.

Wiebe stands as the counterpoint to Kolko. In his view, the Progressive reforms indicate a Wilsonian compromise whereby a more or less unified populace sought systematization of a chaotic economic world by means of the reforms, the Federal Reserve Act included. In Wiebe’s account of the statute, “[t]he magnates of Wall Street” had “little

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193 Ibid.
194 Ibid.
195 Ibid. at 3.
196 big footnote on corporatism
197 Kolko
198 Ibid. at 284.
direct effect,” and instead saw it as the result of a Wilsonian compromise that “made currency a function of commercial and industrial credit and provided a rough unity to national finance through twelve regional reserve banks and a Federal Reserve Board.”

Wiebe’s Federal Reserve was much more about public spirit and technocracy, a vision that certainly Carter Glass and Woodrow Wilson would have embraced.

A generation later, Livingston saw Kolko as too weak—the Fed was not simply an exercise in conservative policymaking and state building, but about bourgeois class consciousness. More recently still, Sanders has given voice to the important changes to the early banking reforms debated in Congress wrought by representatives of the radical agrarians. Sanders’s argument is an argument about structure, not function, and may be the most enduring of all these accounts, given the many ways that the System’s functions have continued to evolve.

Political scientist Laurence Broz steps beyond these debates to engage in what Kolko somewhat dismissively called “the exegetical problem” that must be taken up in any description of the Federal Reserve in history. As Broz points out, what was new about the Federal Reserve were the kinds of features that would be of most interest on the international stage: the focus on the domestic political interests of various factions misses what was most new about the Federal Reserve Act.

This chapter has sought to look beyond these blow-by-blow accounts by making the argument that what historians have missed about the Federal Reserve is how it fits within

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199 Wiebe at 219-220. The term “Wilsonian compromise” is from Wiebe 221.
200 Livingston (1989)
201 Sanders (1999)
202 Kolko at 222.
a much broader arc, that the legislative founding was about reinforcing or abandoning ideas already battled about the nature of money, and presenting a new structure, however ill-defined. Just as public officials had faced accusations of corruption in the face of using public authority on behalf of private markets, the Fed provided a kind of cover that we hadn’t seen before in the “federal” structure. Part public, part private, part political, part bank, the Federal Reserve System emerged from the din of 1913 as something unlike anything that had come before.

The passage of the Federal Reserve Act in 1913, and the structural and functional goals that it embodied, are at the core of nearly every debate about institutionalized money, in the United States and abroad. What is money and who decides are the twin questions debated throughout the 19^{th} century, and debated again during the legislative season.

But the perennial nature of the questions doesn’t mean that they never change. What we see instead are two aspects of narrative institutional history at play in the long incubation of the Federal Reserve Act. First, the phenomenon of institutional layering, best discussed by Kathleen Thelen.\textsuperscript{203} The Fed was built on foundations that preceded it. The 1913 Act didn’t come from nothing, so speaking of the Act as the “founding” of the Fed can obscure how much the legislative designers depended on, and borrowed from, other examples. But we also see the role of contingency and personality in moving in directions that were new. Although the Federal Reserve System was meant to accomplish very similar, even identical goals as the National Reserve Association envisioned in the

\textsuperscript{203} Thelen (2004)
Aldrich Bill (and the Bank of England), the “capstone” idea of the Federal Reserve Board and the decentralized nature of the Reserve Banks were new. Bagehot had envisioned a model that would function similarly to this, waxing eloquent about the virtues of its features but the unattainability within the British system. Creating that system has been reinterpreted as “quintessentially American,”204 but there was no American quintessence in this kind of system. Its structure was new. As we shall see later, it would not remain.

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204 Kocherlakota (2010)
Chapter 2: The First Federal Reserve System: From Political Implementation to Great Depression

It is not possible . . . for the Committee to give consideration to questions merely of local pride or prestige. What we seek are facts which bear upon the economic problem itself, and we desire to have the witnesses, as far as possible, confine themselves to such facts. It is not oratory we want, but facts.

Reserve Bank Organizing Committee, 1913.205

To the governor of this bank: Never forget that it was created to serve the employer and the working man, the producer and the consumer, the importer and the exporter, the creditor and the debtor; all in the interest of the country as a whole.

Benjamin Strong, 1914206

There is a tragicomic scene in the Fed’s early history when the members of the D.C.-based Federal Reserve Board struggled with an awkward question of social protocol. The newspapers had dubbed the new board “the Supreme Court of Finance,” and the board thought they were “entitled to a pretty high place in the social scale.” How high wasn’t exactly clear, but William McAdoo—the secretary of the treasury, first ex officio chair of the Federal Reserve Board, and the one who begrudgingly had to field these questions—understood sardonically that these bankers and bureaucrats did not want to be “pale and distant stars, lost in a Milky Way of obscure officialdom; they must swim in the luminous ether close to the sun!”207

The keepers of the official protocol at the State Department gave an apparently unsatisfying answer, at least to the new board members. The members of the Federal Reserve Board, said the State Department, would sit in line with the other independent

205 Reserve Bank Operating Committee, New Orleans, La. February 11, 1914, page 3504
206 As quoted in Chandler (1958, 1)
207 McAdoo (1931, 286)
commissions in chronological order of their legislative creation. That meant that the board would follow the Smithsonian Institution, the Pan-American Union, the Interstate Commerce Commission, and the Civil Service Commission. When this didn’t satisfy the status-conscious members of the board, the question was taken to President Wilson. As Secretary McAdoo reported it, “the shadow of a frown pass[ed] over [Wilson’s] face” as the nature of the question of the Fed’s social standing dawned on him. “I can do nothing about it,” the president remarked. “I am not a social arbiter.” When McAdoo pressed him, the president retorted: “Well, they might come right after the fire department.” McAdoo, evidently pleased by this recounted exchange decades later, explained that he “never told the members of the Board what the President had said. It would have caused them needless pain.” The State Department’s view of protocol carried the day.\footnote{This account comes from William McAdoo, Woodrow Wilson’s Secretary of the Treasury (and therefore the first Chairman of the Federal Reserve) and was written nearly twenty years later, so there’s reason to wonder whether it is the convenient story of a bureaucratic infighter. McAdoo (1931, 286).
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To put it bluntly, the Federal Reserve Board—that Wilsonian “capstone” to the model of multiple central banks—wasn’t off to a great start. But during this crucial period that we will call the First Federal Reserve System, actors in Washington, New York, and beyond began to lay the institutional framework for how Fed insiders interacted with each other. It is the story of how strong personalities asserted themselves, and the perennial tangle of national and international interests. And it is a story that illustrates well the themes of this dissertation, about the changing nature of money and the battle for institutional supremacy over who got to decide.
This is also a chapter about intense institutional change, but not about acute periods of dramatic institutional innovation. Indeed, this chapter illustrates the fragility of the concept of discrete foundings, since so much changed sometimes imperceptibly in the process of development. The history recounted below represents important institutional developments in their own right that serve to highlight the dissertation’s basic theoretical argument about the nature of institutional change: it is constant, but unexpected. It is not a steady drip, but flows with greater and lesser points of institutional inflection. And sometimes, institutional change is what doesn’t happen, as in the case of the failure of the Federal Reserve Act’s sunset provision to be triggered, as had occurred with the First and Second Banks of the United States.

This chapter covers the period following the legislative enactment of the Federal Reserve Act through the election of 1932. Because this dissertation is not a chronological history per se, this chapter is necessarily highly selective. In particular, it focuses on five major events (or non-events) in the First Federal Reserve System’s history. First, it covers the political and legal creation of the Federal Reserve Banks, as part of a “10,000 mile listening tour” by the Secretaries of the Treasury and Agriculture and the Comptroller of the Currency to decide the all-important question: how many Federal Reserve Banks would there be, and where would they go? Second, we note the advent of the New York-dominated Federal Reserve System, led by the banker Benjamin Strong. The ironic reality of the Federal Reserve System in this first epoch was that, despite the scattered Reserve Banks and the Federal Reserve Board “capstone” helmed by the Secretary of the Treasury and the Comptroller of the Currency, New York nevertheless retained dominance for most of this period.
Third, the chapter discusses the intense internationalism of the Fed’s posture, especially toward the question of the resumption of the gold standard. Drawing howls of protest from many corners, the Federal Reserve asserted independence even from the domestic political tradition of the day, where internationalism took uneven forms. Fourth, I discuss the public debate that wasn’t: the quiet decision not to subject the Federal Reserve System to the promised rechartering debate guaranteed by the original Federal Reserve Act in 1913. In 1927, six years ahead of schedule, Congress passed the McFadden Act, a hugely important piece of legislation for the banking industry generally, but included within it the decision to put the Federal Reserve System on a more permanent basis.

Finally, I summarize briefly the sometimes all-consuming question in Fed historiography: what was the Fed’s role in causing the Great Depression, and what was the reaction to this question at the time? The sense that the Fed was in the thick of things was not alien to discussions at the time; indeed, President Hoover put much of the blame at the feet of the Fed itself. But the reasons for blaming the Fed have changed over time, including the enduringly influential critique from Milton Friedman and Anna Schwartz that the Great Depression was, in fact, almost entirely a monetary phenomenon. The point of discussing the Fed and the Depression is not to provide that history, back to front, but to meditate on the institutionalization process whereby future actors reinterpret the past in ways that have a deep impact on subsequent institutional development. We’ve already seen this in action with Jackson and Bagehot; we will see it again with the Fed and the Depression.
One of the more curious features of the Federal Reserve Act was not in Wilson’s “capstone,” curious though that was. It was in the intermediate administrative agency Congress created, the Reserve Bank Organizing Committee (RBOC), to consist of the Secretary of the Treasury, the Secretary of Agriculture, and Comptroller of the Currency, established to “designate not less than eight nor more than twelve cities to be known as Federal reserve cities.”209 The RBOC had essentially untrammeled authority to make these selections, provided only that it would give “due regard to the convenience and customary course of business.”210

The Comptroller of the Currency and the Secretaries of the Treasury and Agriculture are not obvious candidates for this task. Most obvious would, of course, have been Congress itself. The question of where the Federal Reserve Banks would land was to be a consuming one. That Congress wouldn’t resolve the question entirely tells us something about the delegation itself. The Senate preferred delegating this task to the soon-to-be constituted Federal Reserve Board, but the conference resolution opted for the version passed by the House of Representatives (even as it permitted the Board to exercise a veto on the RBOC’s decisions).211

The RBOC started its work soon after the Act was signed in December 1913. With a relatively large $100,000 appropriation,212 it started by pursuing a “10,000 mile listening tour” by its members, William McAdoo at Treasury, David Houston at

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210 Ibid.
211 Federal Reserve Act of 1913, sec 2.
212 Annual Report of the Secretary of the Treasury on the State of the Finances for the Fiscal Year Ended June 30, 1914
Agriculture, and Comptroller of the Currency John Williams (who would be confirmed only after the RBOC’s activities had begun).

In all, thirty-seven cities applied to be among the “eight to twelve” permitted by statute. The transcript from the RBOC meeting in New Orleans is typical of how the RBOC saw its role:

The Federal Reserve Act devolves upon this Committee the duty of dividing the country into not less than eight nor more than twelve districts and the location within each one of a Federal Reserve Bank. The Committee is required by the Act, in laying out these districts, to have due regard to the convenience and customary courses of business . . . . This is a national problem, it is an economic problem, and one which relates to the country as a whole, and the districts have to be considered with reference to the country as a whole.\(^{213}\)

That the RBOC would face charges of parochialism or playing crass politics was readily known to them, and to the participants. The quote used in the chapter’s epigraph was read at the beginning of these meetings: “It is not possible . . . for the Committee to give consideration to questions merely of local pride or prestige. What we seek are facts which bear upon the economic problem itself, and we desire to have the witnesses, as far as possible, confine themselves to such facts. . . . . It is not oratory we want, but facts.”\(^{214}\)

The three-man committee received both. The documentary record, housed at the National Archives, contains file after file of letters from bankers, manufacturers, grocers, politicians, and many others. Where arguments on banking centrality didn’t carry the day—for example, the Philadelphia letters were cursory on their pride of place as the second largest banking center of the east—locals used more creative arguments, such as


\(^{214}\) Ibid.
advertising “40 miles of paved streets, 80 miles of sewers, a most efficient and well-equipped police and fire department, a low rate of insurance, 64 miles of street railway, an excellent school system, a very complete public library, and a very fine system of public parks and recreation center.” Perhaps unsurprisingly, the length of pleas and size of the city’s banking sector appear to be roughly inversely correlated.

The ultimate result of the RBOC’s efforts was in designing the statutory maximum of twelve Federal Reserve Districts. Some of the choices were obvious—New York, Chicago, San Francisco. Some looked to an industrial past that would not prove as mighty as it seemed—Cleveland, St. Louis. Some verged on the idiosyncratic, such as Richmond or Kansas City.

The RBOC’s announcement was subject to immediate criticism. John Weeks, a Republican Senator from Massachusetts (home to the new Federal Reserve Bank of Boston), was pointed in his criticism. Acknowledging that the effort was bound to be sensitive—“It is almost impossible to make an arrangement that some one will not criticize”—Weeks still questioned “the propriety of locating two banks in the home State of one of the members”—in reference to Secretary of Agriculture David Houston, from Missouri—“and one in each of the home States of the other members, especially when in

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215 Reserve Bank Organizing Committee, Location of Reserve Districts in the United States,” Letter from the Reserve Bank Organization Committee Transmitting the Briefs and Arguments to the Organization Committee of the Federal Reserve Board Relative to the Location of the Federal Reserve Districts, May 28, 1914, page 35.

216 I haven’t tabulated these results, but the letters from Philadelphia bankers are often quite cursory. For example, the cashier of the First National Bank of Philadelphia writes nearly in toto, in a not unrepresentative letter in the file of correspondence on the subject that “Philadelphia should have a Regional Bank, because of the central location of the large number of banks which it would serve and the large industries of the state.” Letter to Samuel McCracken, January 13th, 1914, National Archives, Box 2644, Folder 3, item 8. The Baltimore letters—seen as Philadelphia’s main rival, despite being a much smaller banking center—were much more fulsome. See, e.g., the 130 page legal brief on behalf of the City of Baltimore, National Archives, Box 2661, Folder 1.
two, if not three, of these cases they are not the natural location for reserve banks.”

Weeks also questioned the entire enterprise of trying to steer banking business away from New York at all: “The apparent and confessed attempt to limit the business which naturally goes to New York may properly be criticized, not only because it is unfair, but it is so unscientific that in the end it will not be effective.”

The RBOC, of course, saw things differently. In the annual report of the U.S. Treasury for 1914, McAdoo described the task as “a prodigious one” that “involved an immense amount of hard work, a thorough study of unusual problems, and the decision of many trying and difficult questions.” The entire process was “most careful and painstaking,” with ultimate decisions not motivated by “local or political considerations.” The “ill-considered criticism . . . directed at the committee’s findings” were the consequence of the “keen dissatisfaction” of those cities not selected.

The scattered lines of the Federal Reserve Districts have prompted questions and reactions since their inception. It also raises the important question: Were the results of this exercise entirely based on “facts,” and not on some other calculation?

It is hard to justify that conclusion, or even understand what it means. The Reserve Bank Organizing Committee was a political entity that was constrained by the politics of 1914, a charge made as early as 1924 by H. Parker Willis, Carter Glass’s legislative aide, who also worked on the RBOC: the reader should “draw his own conclusions concerning the degree to which the principles . . . had been put into

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218 Annual Report of the Secretary of the Treasury on the State of the Finances for the Fiscal Year Ended June 30, 1914, page 28
application in any given place,” leaving the clear implication that there was room to doubt it. The allocation of cities was not based exclusively on economic logic, but on a political one. Although some scholarly accounts have sought to justify this allocation based on the level of economic activity, Binder and Spindel, in their forthcoming book, have found otherwise, reconstructing the economic map of the country based on contemporary sources to determine whether or not the twelve cities were located according an economic logic or a political one. The conclusion is clear: the Federal Reserve Districts were part of a Democratic political strategy that helped shore up constituencies that the Wilson Democrats would need in the 1916 election.

This political structure helps explain anomalies in the Fed’s structure: the South was solidly Democratic, despite not being solidly financial. This is arguably why Baltimore was not selected as a Federal Reserve city, but Richmond was. As Binder and Spindel write:

Financial business in Baltimore was nearly twice that in Richmond. And bankers barely preferred Richmond to Baltimore. So why did the RBOC place a reserve bank in Richmond? If the RBOC wanted to dilute the historic concentration of capital in the Northeast, selecting Richmond over Baltimore would have been a reasonable choice. Drawing a single reserve district to encompass Baltimore, Washington, and Richmond and placing the reserve bank in Richmond would have allowed the RBOC to push the center of financial activity beyond the northeastern seaboard and into the South.

219 Willis (1923, 586-87)
220 Binder and Spindel (2017, 54-58)
221 Ibid. at 64.
Building up the South, especially in time for a 1916 election where Democrats were unlikely to enjoy the benefit of splintered opposition, would have been a useful political strategy.

The result of the Reserve Bank Organizational Committee, and the content from their mandate creating the dispersal of authority away from both Washington, DC and New York City, have been evaluated as a masterstroke in institutional design.222 The brilliance in design was that the constituencies for central banking redounded to the periphery, not to the center where the political winds would shift in one direction or another. As Binder and Spindel write, “Ultimately, by administering the flow of credit through respective regional discount windows, the district banks invented a uniquely American central bank nearly a century after Jackson’s veto. And its federal system of reserve banks was the linchpin.”223

But was it such a stroke of genius? The authors of the Federal Reserve Act certainly regarded the Federal Reserve Banks as a linchpin, but not as a mechanism for the enduring power of central banking in the United States. It indeed stood for very nearly the opposite proposition: that with the location of the Federal Reserve Banks scattered unevenly throughout the country, the demons of centralization and public abuse of the credit system would end forever. Time quickly overtook that institutional conception by changing the very nature of both the structure of central banking and its functions. What the concept and location of the Federal Reserve Banks allowed was the

222 Faust (1996); Jeong, Miller, and Sobel (2010); Binder and Spindel (2017)
223 Binder and Spindel (2017, 50).
political continuation of a constituency carrying the banner for this new kind of American institutionalized professional: the central banker.

The Rise of Benjamin Strong and the International Orientation of the Federal Reserve

Once the Reserve Banks opened their doors for business in late 1914, the question of geographic distribution gave way to the problem of bureaucratic control. The Wilsonian compromise that created such an unwieldy structure was more a feat of conceptual design than institutional clarity. As Allan Meltzer noted, tensions “between the Board and the reserve banks began before the System opened for business.”

Because the statute—in the tradition of many great political compromises—left room for divergent interpretation for competing factions, the legislative authors of the Federal Reserve Act never defined a number of key terms and largely did not specify the power relationship between and among the Federal Reserve Board and the Reserve Banks. In the two places where the Fed exercised the most power—the proactive purchase of securities in the open market and the reactive discounting of securities brought to the doors of the Reserve Banks—rivalries arose immediately, both between the Board and the Banks and among the Banks themselves.

Benjamin Strong, governor of the Federal Reserve Bank of New York and confidante of JP Morgan and member of the Jekyll Island group, arose early to fill that gap. Strong had long been viewed by the New Yorkers as the best option for the new Federal Reserve Bank of New York. Strong hadn’t wanted the job, in part because of the poor comparative salary. He would earn $30,000 a year—twice the salaries of the

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224 Meltzer (2003, 73)
Governors of the Federal Reserve Banks of Boston and San Francisco, and a princely sum by comparison to a day laborer.\textsuperscript{225} But it was a fraction of what he could earn if he continued on his path as a private banker. Strong had also just moved into an 8,000 square foot apartment that rented for $15,000.\textsuperscript{226}

Nevertheless, Strong accepted, and quickly became the most influential member of the Federal Reserve System, dominating nearly every feature of Fed policy. This was in part by strategic design. The Federal Reserve Act never mentioned the position of “governor” of the Federal Reserve Banks, although it did mention the “governor” of the Federal Reserve Board. Strong knew that an institution with so much left undefined would require careful leadership, and he aimed to be that leader.

That he succeeded so completely shouldn’t be taken for granted. The Federal Reserve System had other strong personalities, not least Paul Warburg as a member of the Federal Reserve Board. But Warburg shared Strong’s sense, forged through their common membership in the banking circles of New York, that the Reserve Banks would be the central banking features of the system, with New York most central of all. The Federal Reserve Board, despite the lack of its defined responsibilities, would be the political end, a supervisory institution.\textsuperscript{227} Warburg, in his memoirs, mentions Strong but once, and the tribute is emotional and glowing. “Governor Benjamin Strong of the Federal Reserve Bank of New York, has died since this book was completed,” he wrote in the preface. “I may safely confess that while writing these chapters, his picture often

\textsuperscript{225} Annual Report of the Federal Reserve System for the Year Ending December 31, 1914.
\textsuperscript{226} Ahamed (2009, 59).
\textsuperscript{227} See Chandler (1958, 39); Warburg (1930).
stood before my eyes as the prototype of splendid men who, with utter disregard of self, give their lives and souls to the task of making our Federal Reserve System an efficiently and harmoniously functioning organization,-a heartbreaking undertaking under a law that, structurally, pits against one another forces which should be united in a common effort towards a common aim.” 228 Warburg, in other words, was not likely to challenge Strong for supremacy within the system, but support him in his quest for that supremacy.

There were three primary ways that Strong wielded extraordinary influence on the Federal Reserve System during his tenure as Governor: in international coordination with the Bank of England, in the rejection of the “real bills doctrine” that underlay the Federal Reserve Act, and in first pursuing and then coordinating the Fed’s open market operations.

The policy that earned him the ire of Herbert Hoover and, despite the other aspects of his competence, may have accelerated the spread of contagion during the Great Depression, was Strong’s enthusiasm for the international gold standard. In particular, his enthusiasm for returning the post-war order to that standard. Here, he was aided by his long-time friend, the mysterious and brooding Montagu Norman.

There was no theoretical problem with returning to the gold standard, at least not for Strong. It was seen as key to the survival of the new order, as it had been to the old. And World War I represented a significant drain on the gold resources of the Allies, except the United States. Toward the end of the war, the Allies were shipping gold to the United States and receiving loans in return. By the end of the war, the U.S. had one-third

228 Warburg (1930, viii).
of the world’s monetary gold stock, and went from being a net debtor to becoming a substantially creditor.

From a zero-sum view of international trade that some had, all was fair in international finance. But from the perspective of getting the United Kingdom back on the gold standard, this was a problem. Benjamin Strong and Montagu Norman were in the latter camp, and sought to resolve it.

The restoration of the gold standard was a significant political issue in interwar Britain, a decision made at the highest political levels. Winston Churchill, then Chancellor of the Exchequer, was the one to make the decision (one he would come to regret). In the United States, the decision to support the effort was made by Benjamin Strong. It was for this reason that Hoover regarded him as a “mental annex of Europe,” hardly a complimentary endorsement.229

Strong’s efforts to restore gold was in keeping with the assumptions about the institutionalized functions of money that motivated the Federal Reserve Act. His efforts to organize the Reserve Banks as a center gravity away from the Federal Reserve Board, however, was not. The Federal Reserve Act sent conflicting signals on that front, but Strong’s own prior support for a proper central bank in the United States left him without doubts: the Reserve Banks, and especially the Federal Reserve Bank of New York, were to be paramount in those deliberations.

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229 For more on the restoration of the gold standard and Strong’s role in it, see Ahamed (2009) and Eichengreen (1992). For a more sympathetic view than either of these, see Timberlake (1993).
The first chance to establish that priority came when the Federal Reserve Board summoned the governors to Washington in 1914 to confer on system-wide policies. Strong took the opportunity to meet with the governors separately and form the “Governors’ Conference,” a forerunner to the Federal Open Market Committee. Through it, the Governors—free of any intermeddling from politicians—would not only discuss common problems, but also coordinate interest rate policy. It was an effort to centralize the central banking function that the Fed had only ambiguously been created to provide. The Federal Reserve Board often found itself playing catch-up to these efforts, but there was little to do about them. While the Board had to be consulted in advance of interest rate changes, Strong could be dazzling in his command of the issues and his refusal to brook dissent on them. This dominance motivated the only academic economist on the Federal Reserve Board, Adolph Miller, to create a Division of Research and Statistics within the Board: Miller and the other members of the Board wanted to be able to counter Strong’s read on the markets.

The gold standard had a strong basis in the Federal Reserve Act; the autonomy and coordination of the Federal Reserve Banks under New York was an open question. Strong’s third innovation, however, was a direct repudiation of the principles and policies of Congress in creating the Federal Reserve System. This was in the abdication of the “real bills doctrine.”

Recall the discussion from the previous chapter about the consuming importance of this, conceptually. If the Federal Reserve Banks could only discount self-liquidating paper, it wouldn’t be in a position of fueling speculative bubbles, enriching financiers at
the expense of the general public. But the enthusiasm for real bills wasn’t just for the populists: bankers widely believed in its value. And so did the new central bankers. “Probably the most important effect of the Federal Reserve Act,” the Governors’ Conference reported in 1922, “was to set up the machinery necessary to provide elastic currency; elastic in that it would be based on self-liquidating credit instruments arising out of the production and distribution of commodities.” Any effort to use the Fed to buy any other kind of asset—from speculative bills to, importantly, U.S. Treasury bonds—would amount to the dreaded “fiat currency.”

As the 1920s developed, though, a greater split on the issue began to come to the forefront. Strong had come to regard “real bills” as essentially futile. Once loans were made on “real bills,” they could be lent to stimulate speculative trade as the money created swirled within the system.

Here, Strong’s efforts to remove those limits proved decisive. By 1928 and his untimely death, real bills were no longer the dominant policy of the Federal Reserve System, though it retained some of its enthusiasts at various Reserve Banks and on the Board. When Hoover and others later blamed the Federal Reserve System for the Great Depression, they largely had the abandonment of this policy in mind.

Subsequent analysis has proven Strong’s instinctual feel to be correct. Strong’s influence on the System was not absolute, nor was he the only figure who advocated abandoning “real bills.” The governors of two neighboring Federal Reserve Banks,

230 See, for example, Warburg (1930)
231 Meltzer (2003, 70), quoting Governors Conference, May 1922, 143-44.
Eugene Black of the Federal Reserve Bank of Atlanta and David Biggs and William McChesney Martin, Sr., at the Federal Reserve Bank of St. Louis (Biggs and Martin changed in 1929) provide an interesting contrast. Black, in part because of early bank panics that preceded the panics of the Depression, took a strongly Bagehotian/Strongian view of central banking whereby they lent liberally into various panics, ranging from a collapse of cotton prices in 1920 to a rumored run on Cuban correspondent banks in 1926.\textsuperscript{232} The Atlanta Fed, with Strong, abandoned the idea of discounting only against “real bills” because of the limitations that the doctrine would impose in precisely these kinds of panics.\textsuperscript{233}

The St. Louis Fed was quite different. In an early banking panic of the Great Depression, Martin and the St. Louis Fed not only didn’t extend greater support to ailing banks, but may have withheld many of those funds, with total credit outstanding in the district declining by almost $12 million, a large sum for an area with relatively poorly developed banking.\textsuperscript{234} The culprit was simple: Martin and the St. Louis Fed continued to take a “real bills” view of credit and deemed the decreased economic activity associated with the Depression as requiring more limited extension of credit. That the RBOC divided the state of Mississippi in half, between the St. Louis and Atlanta Feds, the different treatment of the doctrine has provided an elegant quasi-experiment. And as Strong predicted, the real bills doctrine didn’t fare well. As Richardson and Troost report,

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\textsuperscript{232} For more detail, see Richardson and Troost (2006, 6). \\
\textsuperscript{233} For an extensive overview of the Federal Reserve Bank of Atlanta, see Gamble (1989) \\
\textsuperscript{234} Wicker (1996, 54)
\end{flushright}
“In Atlanta, banks survived at higher rates, lending continued at higher levels, commerce contracted less, and recovery began earlier.”

Strong has continued to dominate scholarly and public discussion of the Fed during this period. Some have even mused that with a central banker of his quality at the helm—the “über-competent governor of the Federal Reserve Bank of New York,” Barry Eichengreen called him—perhaps the Depression would not have occurred. That is very possible; of all the early central bankers, Strong had the closest appreciation for Bagehotian principles of emergency lending. Whether true or not, Strong provides an example of how much individuals matter in shaping institutions. The preeminence of New York City surely provided him a better basis for his dominance than if he were the Governor of the Kansas City Fed. But that doesn’t explain everything. Washington, DC was more dominant in many ways, but Strong managed to navigate those waters extraordinarily well, even against presidents, Senators, and certainly members of the Federal Reserve Board. As occurs throughout the Fed’s institutional history, personnel is policy. The identity of the individuals who sit in the big chairs can shape the course of institutional history. We can’t be certain of how the Fed would have been different in this initial phase without Benjamin Strong, but we can be confident that it would have been different indeed.

The Dog that Didn’t Bark: The McFadden Act of 1927

Baked into the cake of banking and political history is the very idea that the rechartering of central banks is a thorny exercise. As we saw in the previous chapter, the
rechartering of both Banks of the United States failed. The Federal Reserve Act contained
the same time bomb, seen as a legitimizing feature of the system: the Federal Reserve
Banks created under the statute would see their charters last “for a period of twenty years
from its organization unless it is sooner dissolved by an Act of Congress.”

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It is worth pausing to consider what a rechartering debate in 1933 would have
meant. The question might well have become an important one in the 1932 campaign,
with the pugnacious, populist tradition of the Democracy still in the position of
demanding something more of international bankers like Benjamin Strong. Following the
Depression, those demands would have been about causation: as we will shortly see, the
Fed had no shortage of powerful critics who laid blame for the Depression at the Fed’s
feet.

Instead, the sunset provision of the Federal Reserve Act was quietly retired in the
McFadden Act, with almost no controversy. This lack of controversy was probably due to
three independent factors. First, the Federal Reserve System was widely viewed as a
success in 1927. Marriner Eccles, then a private, conservative banker in Utah, gave a
speech in 1928 in praise of the system: “The best tribute to the efficiency of the Federal
Reserve System is that no panic has developed since its inception,” he asserted
(erroneously).238 Perhaps unsurprising is that an original enthusiast for the Federal
Reserve System, Jekyll Islander Frank Vanderlip, advocated a permanent recharter, even
if his views brooked no dissent: “It is doubtful if there is any one whose opinion would

237 Federal Reserve Act of 1913, Sec. 4
238 For more on the panic of 1914, see Silber (2007); for discussions of panic of the early 1920s, see
Tooze (2014)
be respected who would not freely admit that the Federal Reserve Act has been a great success,” wrote Vanderlip. In his view, the Fed was responsible for navigating the challenges of the World War and the “depression of 1922, rocks on which we might readily have broken under the old system.” What is more surprising is that prominent Republicans such as Andrew Mellon (then serving as Secretary of the Treasury) were also enthusiastically in favor. And while there was some opposition, most opinions were supportive.

The second reason is that the Fed had an uncommonly powerful patron in the Senate in the person of Carter Glass, the legislative sponsor in the House of the original Federal Reserve Act, Secretary of the Treasury in the last years of the Wilson Administration, and now the Senator from Virginia. Indeed, the idea of an early recharter for the Reserve Banks was not part of the original discussion of the McFadden Act; it was a late-breaking amendment to the Senate version of the bill that Glass, in conference, made sure survived. “Next to my family,” Glass wrote, “the Federal Reserve System is nearest to my heart.” Glass showed that paternal affection for the First Federal Reserve System in countless ways, but perhaps none so important for its future than here.

And finally, the rechartering amendment was able to pass because so much else about the McFadden Act was controversial. The bulk of the McFadden Act wasn’t about the rechartering at all, of course—this is why Glass could slip the rechartering

242 As cited in Schlesigner (1960, 296)
amendment in at the last minute. It was instead about instituting branch banking, a revolutionary breach in the way that banking was done in the United States. Branch banking—or the ability for a bank to open branches, supervised by headquarters—was already permissible in some states. The McFadden Act allowed branch banking by banks chartered by the Comptroller of the Currency. It was this feature of the Act that occupied the country’s attention, not the rechartering debate, such as it was.\textsuperscript{243}

Regardless of why it occurred, the McFadden Act added an extraordinary durability to the institutionalization process of the Federal Reserve System. The System was still in its infancy; the McFadden Act moved away from existential debates about the Fed to broader questions about how and when it should be reformed. While enthusiasms for “ending the Fed” still remain a part of the political zeitgeist, the vision of the 1913 legislative designers in forcing that existential debate through a rechartering provision never occurred.

\textit{Did the Fed Cause the Great Depression?: The Historical and Historicized Account}

Just two years after the McFadden Act, the stock market crashed, taking with it hundreds of millions of dollars in U.S. wealth. Emerging in fits and starts, most of the Hoover Administration was spent mired in what would become the Great Depression, the period of the greatest economic contraction and unemployment in U.S. history.

Ben Bernanke, then a professor, called diagnosing the Great Depression the “Holy Grail” of macroeconomics.\textsuperscript{244} Some histories of the Federal Reserve devote hundreds of

\textsuperscript{243} Hammond (1957).
\textsuperscript{244} Bernanke (2000).
pages to the question, and the recent financial crisis has made the topic a fresh one for historians from a comparative perspective.

From an institutional historical perspective, the interesting question to ponder is how the Great Depression has shaped the structure and functions of the Federal Reserve System. I will discuss the chronological history of the post-1932 consequences, especially the passage of the Banking Act of 1935, in the next chapter. This chapter will conclude by looking instead at a question that transcends the history of the Great Depression. The question is about how the Great Depression has become central to subsequent institutionalizing of the Federal Reserve, its structure and functions.

This difference highlights one of the key themes of institutional history. Historical events can shape the norms, structure, and functions of an organization long after they occur. In many respects, the Fed emerged from the immediate aftermath of the Depression essentially unscathed, institutionally. But in time, the blame for the Depression fell squarely on the Fed’s shoulders, with consequences for the way the Fed would see itself in and after the financial crisis of 2008.

The idea that the Fed was to blame for the Depression emerged almost immediately. Adolph Miller blamed Benjamin Strong, and argued that those who thought “that mistakes committed by the federal reserve system from 1927 to 1929 were due to the Federal Reserve Board” were wrong: the fault lay in fact with “the 1927 easy money policy [that] was initiated by the New York reserve bank.” This view was shared, in

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245 Friedman & Schwartz (1963); Meltzer (2003)
246 Eichengreen (2015)
247 Miller (1935, 442).
part, by Herbert Hoover. In his 1952 memoirs, he blamed the “orgy of stock speculations” that came as “the result of the Federal Reserve Board’s pre-1928 enormous inflation.” He admitted few competitors to the Fed’s failures: “I do not attribute the whole of the stock boom to mismanagement of the Federal Reserve System. But the policies adopted by that System must assume the greater responsibility.” The Fed itself blamed “the rapid growth in the demand for credit to finance speculative activities in many lines and in different sections of the country,” but didn’t take responsibility for that rise.

As we will see, the New Deal was in many senses the public reaction to the crisis, an effort at experimentation to weed out what few understood. Eventually, Keynesian ideas of failures of aggregate demand—and the corresponding need for swift governmental action—became a more familiar explanation for the Depression.

In 1963, however, Friedman & Schwartz published their *Monetary History of the United States*, arguing against the coherence of that Keynesian view. In their words,

> The contraction shattered the long-held belief, which had been strengthened during the 1920’s, that monetary forces were important elements in the cyclical process and that monetary policy was a potent instrument for promoting economic stability. Opinion shifted almost to the opposite extreme, that “money does not matter”; that it is a passive factor which chiefly reflects the effects of other forces; and that monetary policy is of extremely limited value in promoting stability.

Friedman and Schwartz squarely rejected that argument and argued instead that “these judgments are not valid inferences from experience. The monetary collapse was not the

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248 Hoover (1952, v)
249 Ibid at 13
251 Friedman & Schwartz (1963, chapter 7)
inescapable consequence of other forces, but rather a largely independent factor which exerted a powerful influence on the course of events. The failure of the Federal Reserve System to prevent the collapse reflected not the impotence of monetary policy but rather the particular policies followed by the monetary authorities and, in smaller degree, the particular monetary arrangements in existence.” Rather than reflecting a failure of governmental action and the collapse of aggregate demand, “the contraction [was] in fact a tragic testimonial to the importance of monetary forces.”

The influence of this view has been extraordinary. Ben Bernanke credits the book with piquing his interest in the Great Depression. “After reading Friedman and Schwartz at MIT,” he wrote, “I had become a Great Depression buff in the way that other people are Civil War buffs, reading not only about the economics of the period but about the politics, sociology, and history as well.” In an obituary after Friedman died, former Treasury Secretary Lawrence Summers announced that Friedman had essentially won the debate about the Great Depression. Riffing on Friedman’s 1970 announcement that “we are all Keynesians now”—he said he was taken out of context—Summers wrote that “any honest Democrat will admit that we are now all Friedmanites.”

Indeed, in what was meant to be a lighthearted birthday speech to Friedman in 2002, then Governor Ben Bernanke made a stark confession: “Regarding the Great Depression, you’re right. We did it. We’re very sorry. But thanks to you, we won’t do it

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252 Friedman & Schwartz (1963, chapter 7)
253 Bernanke (2015, Kindle loc 556)
The speech would be cited again and again after Bernanke became Fed Chair himself and the subprime mortgage crisis of 2007 became the Global Financial Crisis of 2008.\textsuperscript{258}

This isn’t to say that research has stood still. There are still quests for this Holy Grail, with significant research on topics such as the consequences of international trade tariffs,\textsuperscript{259} the gold standard,\textsuperscript{260} and the collapse of credit.\textsuperscript{261} The point is that the reinterpretation of the Fed’s culpability during the Great Depression has led to a fundamentally different understanding of the institution, its power, its responsibilities. Any full institutional history of the Fed would have to address the connection between the Fed in 2008 and the Great Depression, as Eichengreen\textsuperscript{262} and Bernanke\textsuperscript{263} have each done. The point is that these connections can take time, even decades, to come to fruition. But they are still part of the same process of institutionalization.

The process of connecting the Fed to the Great Depression has been slow, and not without controversies. In 1995, Whaples surveyed economists and economic historians on how strongly they agreed or disagreed with a list of statements including “Monetary forces were the primary cause of the Great Depression.” and “Throughout the contractionary period of the Great Depression, the Federal Reserve had ample powers to cut short the process of monetary deflation and banking collapse. Proper action would
have eased the severity of the contraction and very likely would have brought it to an end at a much earlier date.”\textsuperscript{264} He found that “[e]conomists are almost evenly split on this question, whereas about two-thirds of the historians reject the monetarist proposition.”\textsuperscript{265} There was broad consensus on the second statement.

We’ll return again in the following chapter to our chronological history, to the institutional moments as they were experienced. What matters for this part of the institutional analysis is an understanding of how these institutional moments are created. They are not purely exogenous events, nor are they purely endogenous strategies. Those do occur as part of the historical process of institutionalization. But institutionalization takes place across divides in time. Invoking and reexamining history continues to shape institutions, long after the critical juncture under examination has completed.

\textit{Conclusion}

If political and social historians favor the Fed with attention on the Fed’s beginning, economic historians spend more time with the Fed in the Great Depression. This chapter has sought to deemphasize that obsession by placing the Great Depression into the broader context of this First Federal Reserve System’s history. It was a period of politics, high and low, and a time when the Fed was finding its feet as a major player in international finance even as it failed to have a clear sense of what, exactly, it was meant to be. The innovations of the Governors’ Conference and its successors and the steady, if

\textsuperscript{264} Whaples (1995)
\textsuperscript{265} \textit{Ibid} at 150.
fragile leadership of Benjamin Strong helped in the quest for prominence, and by the time of the McFadden Act, the Fed’s permanence—absent a congressional revolt—appeared secure.

What we see emerge from the First Federal Reserve System is the first hint of a new creature of professional, neither politician nor banker nor academic economist (the dominance of economists on the Federal Reserve System was still in the future). We see the rise of the central banker, an identity that had been bubbling for decades but saw its realization in the U.S. at the Federal Reserve Banks. This professional identity matters because, as we will see in subsequent chapters, carving out a niche separate from banking and politics alike would become an important obsession of Fed officials in the time ahead. Indeed, in an institutional world constantly shifting and evolving, declarations of prudent independence are one of the few constants in Fed history.

[Marriner Eccles’s] five-point plan is simplicity itself. He would have Uncle Sam hang up his starred and striped suit and masquerade as Lady Bountiful tripping gaily around the country scattering tax money with carefree abandon to make everybody happy. . . Mr. Eccles failed to state to the committee whether or not he had a plan afoot to bring back Midas reincarnate to become secretary of the treasury.

Editorial, Salt Lake Telegram, February 28, 1933

Introduction

Over a century after the Fed’s legislative creation in 1913, central bankers, historians, and others still turn to 1913 to tell us how to perceive what the Fed should be in the present. Jeffery Lacker, the president of the Federal Reserve Bank of Richmond, for example, gave a talk in 2016 on the governance of the Federal Reserve, in West Virginia, stating that it was an “appropriate place to discuss this issue, because a representation of broad geographic interests – rural areas as well as money centers – was central to the design of the Fed System a century ago.” And, he concluded, “a century ago is where my remarks tonight will begin, because understanding the Fed’s fundamental purpose is essential to understanding why we are governed the way we are.”266 Roger Lowenstein, an acclaimed financial journalist, has also recently written a paean to the Fed’s founding and traced from it the indelible lessons for the present.267 And in March 2017, Jerome Powell, a member of the Fed’s Board of Governors, made essentially the same claims.268

266 Lacker (2016)
268 Powell (2017)
As a historiographic tool, this vision of “founders’ history” doesn’t work. It largely skates by the tumult that follows of the events that followed, including especially the Wilsonian/federalist system’s abrogation in 1935. But this dissertation is arguing something more. This kind of self-conscious, sometimes subconscious, invocation of a revised history is a familiar kind of collective memory that we see in a variety of other contexts, from Civil War memorializing to imperial historicizing. It is a process of historical legitimizing, a kind of historicity: it is an effort to assert truth claims in the service of broader goals.

This chapter tells the story of this legislative redesign during the Second New Deal. Unlike the Federal Reserve Act, the Banking Act of 1935 was not the major legislative discussion during its congressional session. It wasn’t even in the top three. The Banking Act was marketed by its sponsors as a minor course correction for the New Deal banking reforms that had already passed Congress, as indeed two-thirds of the Act was designed to do. But Title II of the Act was not minor. It was the effort largely of one man, Marriner S. Eccles, to turn the Federal Reserve System into an engine of governmental authority that would allow Eccles to pursue his vision of governmental intervention into a failing market system.

In this effort, Eccles faced marginal, but intellectually important, opposition from his right and his left. On the right stood Carter Glass, the former legislative sponsor of the Federal Reserve Act of 1913, later the Secretary of the Treasury (and ex officio chair of the Federal Reserve System), and now a senior Senator and Chairman of the Senate.

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269 For the first, see Blight (2001); for the second, see Tharoor (2017).
Banking Committee. Glass did not want the radical reformation of the Fed that Eccles sought, and nearly prevented him from achieving that goal.

On the left stood Father Charles Coughlin, whose ideas of abolishing the Fed outright and replacing it with a “government bank” didn’t gain much traction in Congress but fired the imagination of his tens of millions of radio listeners. Eccles stood astride these two movements and sought to create a kind of intermediate institution. The Federal Reserve System that emerged from that debate, including a new Board of Governors and the demoted Federal Reserve Banks, looked very little like the “federalist” system that Wilson and Glass had envisioned a generation before. If the Fed is a “quintessentially American” institution after 1935, it is because Americans prefer governmental agencies to private power in the regulation of the economy.

*The Campaign of 1932 and the Banking Crises*

To understand the changes Eccles wrought to the Federal Reserve System, we need to understand more about how banking fit within the context of New Deal reforms and the campaign of 1932. To say that the Depression—from the banking panics to the collapse in the stock market to the catastrophic rise of unemployment and the protesting veterans of World War I—dominated the 1932 campaign is an understatement. In most ways, the Depression *was* the campaign.

Roosevelt displayed some of his renown as a politician par excellence during the campaign, pledging immediate action but without giving much by way of specifics. During one stump speech, for example, he argued that “[t]he country needs and, unless I mistake its temper, the country demands, bold persistent experimentation. It is common
sense to take a method and try it: if it fails, admit it frankly and try another. But above all, try something.” Roosevelt lacked a consistent theory of regulatory response; the pride of place following his 1932 election was for fast reaction, not necessarily legal or institutional coherence. As historian Richard Hofstadter put it, the New Deal was characterized as a “chaos of experimentation.”270 To a question about his philosophy, Roosevelt responded somewhat contemptuously: “Philosophy? Philosophy? I am a Christian and a Democrat—that’s all.”271

Even so, part of Roosevelt’s political genius was also knowing his audience and the limits for that very experimentation. During the campaign, for example, he lambasted Hoover for the profligacy of his spending, not Hoover’s willingness to experiment:

High-sounding, newly invented phrases cannot sugarcoat the pill. Let us have the courage to stop borrowing to meet our continuing deficits. … Revenues must cover expenditures by one means or another. Any government, like any family, can for a year spend a little more than it earns. But you and I know that a continuation of that habit means the poorhouse.272

The idea of fiscal conservatism was rooted deeply into the American psyche, and even the early days of the Depression wouldn’t uproot it.

President Hoover was not, at least initially, on board with the idea of balanced budgets in the midst of the Depression. According to his Secretary of War, Henry Stinson, Hoover “likened it to war times,” when “no one would dream of balancing budget.”273 Ironically, the issue that pushed Hoover—and, in reaction, the 1932

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270 The presidential address is Address at Oglethorpe University in Atlanta, GA, May 22, 1932. Hofstadter (1960, 304). For more on New Deal experimentation, see Katznelson (2013), Brinkley (1995)
271 As quoted in Perkins (1946/2011, 315)
272 Radio Address on the National Democratic Platform, Albany, New York, July 30, 1932
273 As quoted in Schwarz (1970, 112-13)
campaign—back to balanced budgets as the prime tool for combating the Depression wasn’t the fear of overspending for its own sake, but the consequences of institutionalized money in Great Britain and the knock-on effects in the United States. In 1931, Great Britain abandoned the gold standard, devastating British and American banks alike that had depended on the Old World order made new again. In reaction to the badly shaken banking system, Hoover—facing the largest peacetime deficits in U.S. history—sought to shore up the American position by passing a tax increase. Although Eccles would come to savage these fiscally conservative policies as worse than useless, the idea of balanced budgets and fiscal austerity had broad political appeal: FDR’s attacks on the Hoover Administration’s fiscal profligacy had already begun.

As Herbert Stein explains it, though, the Revenue Act of 1932 wasn’t only about filling a hole in the annual budget: it was an effort, too, to stanch the bleeding in the banking system. A tax increase “was a kind of bond support program [for banks], to be carried out with tax receipts rather than with newly created money.” The tax hike didn’t make sense without understanding “the unwillingness, or inability, of the Federal Reserve to support bonds by creating more new money in the fall of 1931.”274 Hoover’s earlier preference for ignoring the deficit gave way to austerity, but Roosevelt punished him for his uncertainty—not from his left, but from his right.

_The Rise of the Radical Banker_

Most bankers broadly supported these kinds of policies and were staunchly in favor of this kind of fiscal rectitude and sound money. Marriner S. Eccles, one of the

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274 Stein (1996, 32)
most fascinating figures in Federal Reserve history, was initially no exception. Eccles’s father was a Scottish immigrant, a Mormon convert, a bigamist (Marriner’s mother was his father’s second wife), and, in time, one of the wealthiest men in the state of Utah. Eccles thrived in his father’s business and expanded it into mining, timber, and especially banking. He was a millionaire by the age of 22 and considered himself a devotee of laissez-faire principles of business and banking. At the most, he would permit acknowledgment that whatever excesses of private market ordering had come before, the Federal Reserve System had fixed it: “Since the organization of the Federal Reserve System in 1913 the growth and development of banking in this country has been phenomenal,” with no broad financial panics and a robust apparatus for funding the Great War.

The Depression changed everything. In a passage that evokes Virginia Woolf, Eccles would write in his memoirs that “on a morning toward the first of 1931, the scales suddenly dropped from my eyes.” In perhaps the most eloquent and personal passage in his memoirs, Eccles describes his visceral, psychological hopelessness at confronting the Depression as someone who should have had answers but, in fact, had no idea what to do.

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275 Eccles’s biographical details can be found in his memoir, Eccles (1951) and biography, Hyman (1976).
276 Eccles Papers, “Speech by MS Eccles, Ogden Utah, 1928”, Box 74, Folder 1, Item 2.
I saw for the first time that though I’d been active in the world of finance and production for seventeen years and knew its techniques, I knew less than nothing about its economic and social effects. The discovery of my ignorance, however, did not by itself lead anywhere. Friends whose estates I managed, my family, whose interests I represented, and the community at large, in whose economic life I played a sensitive role, all expected me to find a way out of the economic trap we were all in. Yet all I could find within myself was despair. Having been reared by my father to accept the responsibilities of wealth and having been placed by circumstances at the helm of many enterprises, there were times when I felt the whole depression was a personal affront. Wherein had I been at fault? Night after night following my head-splitting awakening, I would return home exhausted by the pretensions of knowledge I was forced to wear in a daytime masquerade. I would slump forward on a table and pray that the answers I was groping for would somehow be revealed. As an individual I felt myself helpless to do anything.277

The rest of Eccles’s public and private life would be devoted to trying to resolve this helplessness.

The “scales” that fell came as a result of the bank runs seizing the country, northern Utah included. The president of one of northern Utah’s oldest banks had alerted him that it wouldn’t be able to open the next Monday, making very real the possibility that Eccles’s banks would face similar pressures. He decided to move in front of the run, rather than react to it, and sent a telegram to his large depositors that divulged the information he had received. “We have anticipated this for some time and are fully prepared to meet any and all demands which are made upon us,” the telegram boldly declared, with a bit of false brio.278

The telegram had a calming effect, but wasn’t enough to stop the panic. Eccles next instructed his tellers and other employees how to respond to a panic.

277 Eccles (1951, 54)
278 As quoted in Hyman (1976, 79).
If you want to keep this bank open, you must do your part. Go about your business as though nothing unusual was happening. Smile, talk about the weather, be pleasant, show no signs of panic. The main burden is going to fall on you boys in the savings department. Instead of the three windows we normally use, we are going to use all four of them today. They must be manned at all times. If any teller’s or clerk’s window in this bank closes even for a short time, that will stir up more panic. We’ll have sandwiches brought in; no one can go out to lunch. We can’t break this run today. The best we can do is to slow it down. You are going to pay them. But you are going to pay them very slowly. It’s the only chance we have to deal with the panic. You know a lot of depositors by sight, and in the past you did not have to look up their signatures. But today when they come here with their deposit books to close out their accounts, you are going to look up every signature card. And take your time about it. Another thing. When you pay out, don’t use any big bills. Pay out in fives and tens, and count slowly. Our object is to pay out a minimum today.279

The strategies worked; none of Eccles’s banks ever went under during any of the banking panics of the Depression.

The experience, though, did seem to radicalize Eccles. At the 1932 Utah State Bankers Convention, he laid out his theory of the Depression and its cure in plain language. “Our depression was not brought about as a result of extravagance,” he said. “It was not brought about as a result of high taxation.” It came, instead, because “[w]e did not consume as a nation more than we produced. We consumed far less than we produced. The difficulty is that we were not sufficiently extravagant as a nation.” There was a simple reason for this, as he put it to his listeners. “The theory of hard work and thrift as a means of pulling us out of the depression is unsound economically. True hard work means more production, but thrift and economy mean less consumption. Now reconcile those two forces, will you?”

279 Eccles (1951, 58-59)
Eccles had diagnosed the problem, and Eccles was also ready with the solution:

“There is only one agency in my opinion that can turn the cycle upward and that is the government.”\(^{280}\) In modern parlance, we’d call arguments like these Keynesian. But 1932 was four years before John Maynard Keynes had published his *General Theory of Employment, Interest, and Money*, the book that expounded the notion that government should be responsible for slackening consumer demand. Even though they had never met, the millionaire Mormon from Utah had anticipated the Cambridge don’s worldview.\(^ {281}\)

Eccles didn’t make much more headway with the bankers and businessmen who heard him articulate these heretical views in Utah in 1932 than he did with Keynes in 1944. “Poor Eccles,” a president of a Western railroad is said to have remarked. “He must have had so terrible a time with his banks that he is losing his mind.”\(^ {282}\) But the opinions of Utah bankers mattered much less than that of Rex Tugwell, already part of FDR’s original Brains Trust. The two met through a mutual acquaintance, and through Tugwell, Eccles launched from his role as a successful if iconoclastic Utah banker into a national, even global force.

\(^{280}\) Eccles (1951, 83-84)

\(^{281}\) Keynes had circulated these ideas before the General Theory, as early as 1929, but that Eccles claims never to have heard them. And regardless, Keynes was not the first to espouse these views. See Laidler (1999). The point is that Eccles was something of an original article. In an amusing historical aside, the two did eventually meet during the Bretton Woods negotiations about the future of the world’s post-war economic order. Despite their common diagnosis of depression and consumption, they didn’t take well to each other. Eccles thought the British needed to make better assurances of repayment to the U.S. for pre-war loans, a source of great consternation to the British. “No wonder that man is a Mormon,” Keynes retorted to a colleague outside of Eccles’s hearing. “No single woman could stand him.” As recounted in Skidelsky (2003, 813).

\(^{282}\) Eccles (1951, 84)
Eccles Steps into the Spotlight

Through his newly established contacts with the FDR Brains Trust, Eccles made his way to Washington and, eventually, to testify before the U.S. Senate during the presidential transition. His testimony was bold and controversial. In it, he relied on his bona fides as a millionaire banker, even though he disclaimed any representation of “any one class or section.” The measures he would propose were not “designed to help my section of the country at the expense of any other section.”283 Indeed, his vision of what the country should do was far-reaching and required a clean break with the past:

The Nineteenth century economics will no longer serve our purpose—an economic age 150 years old has come to an end. The orthodox capitalistic system of uncontrolled individualism, with its free competition, will no longer serve our purpose. We must think in terms of the scientific technological interdependent machine age, which can only survive and function under a modified capitalistic system controlled and regulated from the top by government.284

From Eccles’s perspective, the old had to give way to the new.

The new regime Eccles had in mind was what he called a “five-point program.”

He could barely introduce the points without spurring a chorus of dismissal from the Senators. His first point, to provide $500 million “as a gift” from the federal government to the states “to adequately take care of the destitute and unemployed,” prompted immediate resistance. His remaining points were along similar lines—to allocate funds for public works, aggressively regulate agriculture prices, refinance farm mortgages throughout the country, and settle permanently—by which he meant forgive—allied war debt.285 In sum, Eccles wanted to take some of the thorniest political problems of the

284 Ibid at 706.
285 Ibid at 712-713.
Hoover Administration and launch radical solutions that even the Roosevelt Administration would not touch.\footnote{Indeed, the Roosevelt Administration’s enthusiasms for fiscal conservatism were a bone in Eccles’s throat for much of that period, perhaps the only place where he disagreed with the President. For more on that dynamic, see Brinkley (1995) and Zelizer (2000).} Hence, the pickled reaction from even his local paper, quoted in the chapter’s epigraph. Eccles was a radical visionary, critics complained. The only way to pull off this program was to “bring back Midas reincarnate to become secretary of the treasury.”\footnote{Salt Lake Telegram, February 28, 1933}

The New Deal’s Suite of Banking and Monetary Reforms

Roosevelt was inaugurated shortly after Eccles’s start turn in front of Congress, in the midst of one of the most catastrophic banking crises in U.S. history. On February 18, 1933, the governor of Michigan declared a banking “holiday,” a transparent euphemism for the reality that the government was shutting people out of their life savings because the banks simply could not meet depositor demands. Thirty-two governors followed, and those that didn’t severely limited withdrawals. As David Kennedy writes, “[h]istory's wealthiest nation, the haughty citadel of capitalist efficiency, only four years earlier a model of apparently everlasting prosperity, land of the pilgrims’ pride, of immigrant dreams and beckoning frontiers, America lay tense and still, a wasteland of economic devastation.”\footnote{Kennedy (1999, 132-33)}

This was the hour of Roosevelt’s inauguration. At the height of that interregnum crisis, Roosevelt would do nothing: Hoover begged for some kind of joint message, even
drafting statements for the president-elect’s signature. Roosevelt refused. He would do nothing until he could do everything.289

Roosevelt wasted little time in acting. In his first fireside chat, the new President announced a national banking holiday and the steps taken to ensure the continuation of a good, sound currency.

This bank holiday, while resulting in many cases in great inconvenience, is affording us the opportunity to supply the currency necessary to meet the situation. Remember that no sound bank is a dollar worse off than it was when it closed its doors last week. Neither is any bank which may turn out not to be in a position for immediate opening. The new law allows the twelve Federal Reserve Banks to issue additional currency on good assets and thus the banks that reopen will be able to meet every legitimate call. The new currency is being sent out by the Bureau of Engraving and Printing in large volume to every part of the country. It is sound currency because it is backed by actual, good assets.290

The public’s understanding of the banking system was, as FDR said in this address, limited due to the “many proclamations from State capitols and from Washington, the legislation, the Treasury regulations, etc., couched for the most part in banking and legal terms,” but the sense of fear and outrage was not new to the banking holiday. Senate investigations into the malfeasance of bankers during the Great Crash and before—the Pecora hearings, after the name of the investigating committee’s pugnacious chief counsel, Ferdinand Pecora—had been going on for weeks, dominating the front pages for months.291 But the “fear” that seized the country and provided Roosevelt with the key theme of his inauguration, if not his entire first administration, was a fear of the failure of the capitalist system.

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290 Fireside Chat on Banking, March 12, 1933.
291 Perino (2010)
The New Deal response to the banking and securities crises sprung forth from this context. Congress passed sweeping banking and securities reforms. The Banking Act of 1933, known for its congressional co-sponsors Carter Glass and Henry Steagall, created a Federal Deposit Insurance Corporation to provide a governmental guarantee to consumer deposits. The Act, perhaps more famously although less enduringly, required financial institutions to choose: either they could be an investment bank or they could be a commercial bank, but they couldn’t be both. The Securities Act of 1933 also initiated an overhaul of the entire capital markets system, to be followed by the Securities Exchange Act of 1934. Perhaps most importantly, Roosevelt also abandoned the gold standard, in place in the United States in one form or another since 1879.

This last action took the world by surprise: although the banking holiday and other subsequent measures reduced the redeemability of the U.S. dollar in gold in the spring of 1933, the president had sought as late as April to reassure the world that the Administration hoped “to get the world as a whole back on some form of gold standard.” (The president began the jocular conference by asking the press “How do you define inflation?” and saying he didn’t know the answer to this deceptively complex question. “I have gotten to the point where even a cigarette tastes bad.”)²⁹²

And yet, by July, Roosevelt had issued a “bombshell” statement to an international conference that awaited his leadership on that very issue. In a message widely published and intended for domestic political consumption, Roosevelt dropped his earlier commitment to the “sound money” that had dominated his earlier public speeches.

²⁹² Excerpts from the Press Conference, April 19, 1933.
“Old fetishes of so-called international bankers are being replaced by efforts to plan national currencies.” With a stroke, the gold standard had ended.

Missing, remarkably, from these extraordinary actions in Roosevelt’s first hundred days was the Federal Reserve. There were some minor changes to its structure. Glass-Steagall had created the “Federal Open Market Committee,” a body consisting of the governors of the twelve Federal Reserve Banks and given open market authority. The FDIC, created by the same legislation, was funded through a tax on the Reserve Banks. And the practice of central banking changed in some limited ways. But for an entity that Hoover had so fully blamed for the Depression, the Fed emerged from the morass remarkably unscathed.

Eccles and the Beginning of the 1935 Banking Act

Soon this insulation from legislative reform would change, and Eccles would be the change agent. Eventually, Eccles was considered for the position of Governor of the Federal Reserve Board, not then a particularly prestigious position. To give a sense of how the Board Governor position was then perceived, the post became vacant when Eugene Black resigned—to take the position of Governor of the Federal Reserve Bank of Atlanta. Eccles initially refused the offer, despite broad support for it within the Administration and in the press. In response to inquiries of his availability, he responded that he “would not touch the position of governor [of the Federal Reserve

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293 Wireless to the London Conference, July 3, 1933
294 Eccles (1951, 84)
295 For example, Washington Post, August 22, 1934.
Roosevelt invited him to propose his view of what those changes should be, and he and an assistant prepared a three-page blueprint of what amounted to a refounding of the Federal Reserve that eliminated the federalist Wilsonian compromise. He narrowed his sights on the tangle of the Fed’s governance, a theme to which he would return again and again:

There is no reason to suppose that this administrative organization which functioned so badly in the past, will function any better in the future. The diffusion of power and responsibility, the root cause of the trouble, remains. Over one hundred individuals are responsible, in various degrees, for the formulation of policy. Obviously the more people there are who share the responsibility, the less keenly any one of them will feel any personal responsibility for the policies adopted. It is therefore almost inevitable that such a loosely knit and cumbersome body as the Federal Reserve Administration should be characterized by inertia and indecisive action generally. Moreover, a complete stalemate resulting from a disagreement of the reserve banks and the Board is always possible. To correct this condition reform must be in the direction of concentrating authority and responsibility for control into the hands of a small policy formulating body.  

The memorandum struck at the very heart of the structure of money, less extreme than an outright abolition of the previous system perhaps because it would retain the name “Federal Reserve System” and some of its structural components. But only some. What Eccles proposed was to create a system that would differ more dramatically from the first Federal Reserve System than the Second Bank of the United States would differ from the First.

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296 As quoted in Hyman (1976, 155)
297 Ibid.
Eccles returned to this theme of governance confusion again and again. It motivated his entire conception of Fed reform that so few others were discussing during this contentious legislative season. Currie, a Canadian-born economist Eccles met when they both served at the Treasury, followed Eccles to the Federal Reserve Board. Currie was an economist whose academic work in had been critical of the economic theory that supported Fed policy from its inception, and, fortunately, was an active memo writer. The problem, as Currie saw it, was not just about eliminating private control as a formal matter: the original Federal Reserve Act had plainly stated that the Federal Reserve Board would “supervise” the Reserve Banks. The question was whether that supervision could be plausible.298

Currie described the problem in a 1934 memo to Eccles: “Decentralized control is almost a contradiction in terms. The more decentralization the less possibility there is of control.” The problem was that “[e]ven though the Federal Reserve Act provided for a very limited degree of centralized control, the system itself by virtue of necessity was forced to develop a more centralized control of open market operations.” The ad hoc institutional development consisted of “fourteen bodies composed of 128 men who either initiate policy or share in varying degrees in the responsibility for policy.” (The fourteen were the twelve Federal Reserve Banks, the Federal Reserve Board, and the once powerful Federal Advisory Council, a group of bankers that was to advise the Federal

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298 There is reason to suspect that Eccles shared Currie’s views on these issues: Currie and Eccles were, in fact, the authors of the memorandum that first proposed the Fed’s overhaul, and they engaged in a flurry of correspondence during the months before the bill’s enactment. These memos are included in the Eccles Papers, housed in hard copy at the University of Utah, but almost fully digitized by the Federal Reserve Bank of St. Louis, through their Federal Reserve Archival System for Economic Research (FRASER). This extraordinary and comprehensive collection of documents is a national treasure and essential resource for monetary and financial historians.
Reserve Board.) These various bodies, their governors and boards, created made governance and public accountability virtually an impossibility. Currie glumly concluded that “[s]uch a system of checks and balances is calculated to encourage irresponsibility, conflict, friction, and political maneuvering” such that “anybody who secures a predominating influence must concentrate on handling men rather than thinking about policies.”

Roosevelt was sold on the proposal. He committed the Presidency to the passage of Eccles’s bill, and Eccles accepted the Governorship so that he could more effectively lead the legislation through Congress from inside the Fed. The *New York Evening Post* summarized the point perfectly: “Marriner S. Eccles is a unique figure in American Finance—a banker whose views on monetary policy are even more liberal than those already embraced by the New Deal.”

Their timing was also propitious: the New Deal experimenters were embarking on a legislative frenzy known as the Second New Deal. In a single legislative session, Congress passed five major pieces of legislation, including the Social Security Act, the Wagner Act (which reshaped American labor law), the Public Utilities Act, the Banking Act, and the Revenue Act (a controversial tax bill known by critics and defenders alike as the “Soak the Rich” bill). As with the McFadden Act in 1927, the Fed would be able to skate below the surface of much greater public attention on the more controversial bills.

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299 Currie Memo to Eccles, April 1, 1935.
300 Hyman (1975, 161)
301 For more on the Second New Deal, see Kennedy (2001).
that would radically change, for example, labor relations in the United States or the retirement system. Banking mattered, but much less than it had in 1913 or even in 1933.

**Father Coughlin and Banking Reform**

That isn’t to say that banking was ignored in the rest of the country. In fact, an often forgotten counterpoint to Fed histories of the Banking Act of 1935 is Charles Coughlin, the “radio priest” and one of the most successful political dissidents in American history. Coughlin would later be known as “one of the nation’s most notorious extremists: an outspoken anti-Semite, a rabid anti-communist, a strident isolationist, and, increasingly, a cautious admirer of Benito Mussolini and Adolf Hitler.”\(^{302}\) But while Eccles was finding his way in the Roosevelt Administration and plotting the overhaul of the Federal Reserve System, Coughlin commanded a radio audience of over 40 million people and made a very different kind of overhaul central to that message.\(^{303}\)

Coughlin began his career as a Catholic priest who took to radio almost by accident. His parish was in dire financial straits; the radio was a way to raise the funds necessary to save it from ruin. But he quickly saw that he had a singular ability to connect with people, through his voice, on a visceral, even spiritual level. Novelist Wallace Stegner, a regular listener, described Coughlin’s as “a voice of such mellow richness, such manly, heart-warming, confidential intimacy, such emotional and ingratiating charm, that anyone tuning past it on the radio dial almost automatically returned to hear it

\(^{302}\) Brinkley (1982, x)

\(^{303}\) Marx (1962, 119).
again.” It was “without doubt one of the great speaking voices of the twentieth century, . . . a voice made for promises.”

Coughlin’s success also depended on its timing: his was a voice of dissidence during a time of depression and despair. And though his prescriptions to right the wrongs of the Depression varied, his diagnosis had a consistent core. Unlike banker Eccles, who saw the problem as a collapse in consumption and wanted to reform the Fed only as an afterthought to that broader fiscal ambition, Coughlin saw the cause of the Depression from a different perspective. It wasn’t about demand, but about the flaws in the institutional basis of money: “only by reforming the currency and restructuring the nation’s financial institutions could the government hope to restore prosperity.”

Coughlin’s diagnosis wasn’t about aggregate behavior or central bank governance. It was a morality play with scheming villainy that attached to both features of institutionalized money that are perennial themes in U.S. history. First, in early 1933, Coughlin wanted to see abandonment of gold and the remonetization of silver. When FDR pursued the first but the second failed to gain traction, Coughlin switched tacks and focused on the structure of money. “I believe in the abolition of the privately owned Federal Reserve Banking system . . . and in the establishment of a Government-owned central bank,” he said on radio (and later published as a kind of manifesto). It was banker control that he resented. “I believe in rescuing from the hands of private owners the right

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304 Stegner (1949, 234)
305 Brinkley (1982, 110)
to coin and regulate the value of money, which right must be restored to Congress where it belongs."

By 1935, as Eccles was beginning to lay his assault on the Federal Reserve System, Coughlin’s proposals were more specific and far more sweeping than his earlier complaints had permitted. Coughlin sought a “Bank of the United States of America” that, unlike either the previous two Banks and the Federal Reserve System, would not have any private participation. Indeed, the public participation would not be through the bureaucracy, but through the franchise: it would be a “financial democracy,” with each state entitled to elect a representative of the people. It would be, in a sense, an alternative government to the constitutional order established in 1789.

Coughlin’s views were not persuasive to most of official Washington, but no one could argue with his audience, or with his popularity. In the minds of his listeners, the Catholic priest and former teacher was a leading authority on monetary and financial matters. Eccles, then, could and did exploit that difference. Eccles considered Coughlin a “money crank” and saw himself—in the banking if not the fiscal context—as a moderate.

Coughlin’s name is not prominent in the coverage of the 1935 Act, but that may well be a function of how thin the coverage of the Act was compared to the more contentious items in the news that legislative session. Whether Coughlin’s extremism on one side helped balance Eccles’s assault on Carter Glass’s Federal Reserve System is difficult to prove, but it bears emphasis that the three men situated themselves on a

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306 Coughlin (2013/1935, 16-19)
307 Ibid. page 171-172. See also Brinkley (1982, 112).
spectrum. Eccles’s proposals to jettison the Wilsonian compromise seemed less extreme in 1935 in part because there was more extremism gaining a wide public audience. Eccles was a moderate by comparison.

_The Moderate Banking Act of 1935_

With Coughlin on his left flank, Eccles set out to redefine the Fed with the tacit support of a popular president against what would be clear opposition. His memorandum to the president reflected much of the earlier thinking between him and Currie, but contains the clearest statement of Eccles’s conceptions of what a central bank should be, presented as an eight-point memorandum that reads at times like an eight-point manifesto.308 After discussing in preliminary points the basic connections between the banking and monetary systems and the overall problems facing the country, Eccles set his sights on the administrative chaos that Wilson, Glass, and the process of institutionalization—though he did not use the term—had wrought on the Federal Reserve System.

The problem was the Federal Reserve Banks and the vaunted status of their Governors. The Federal Reserve Act never mentioned them, but they had “attained positions of major importance in influencing policy” despite being entirely severed from any kind of political accountability. It was this problem—on a bureaucratic level, on a democratic level—that Eccles wanted to change. “Although the Board is nominally the supreme monetary authority in this country,” Currie wrote Eccles, in a memo debating strategy, “it is generally conceded that in the past it has not played an effective role, and

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that the system has been generally dominated by the Governors of the Federal Reserve Banks.” As an “unfortunate result,” he continued, “banker interest, as represented by the individual Reserve Bank Governors, has prevailed over the public interest, as represented by the Board.” Eccles’s position was notable: Eccles was himself a banker whose views were represented by the Federal Reserve Bank of San Francisco, and yet he sought the Banks’ exclusion from national policy. The problem wasn’t only one of inappropriate banker influence on the System; it was also one of governance. “With such an organization” wrote Currie, “it is almost impossible to place definite responsibility anywhere. The layman is completely bewildered by all the officers, banks and boards. Even the outside experts know only the legal forms.” This was the problem that Eccles wanted to solve.309

This old debate, then, had come again. It was nearly the same as had occupied Jefferson and Hamilton, and, as Glass never tired of reminding those gathered, it was the problem the framers of the Federal Reserve System in 1913 had thought they had solved with the great Wilsonian compromise. But those who opposed the “Eccles bill” as it was (rightly) coming to be called didn’t count on the two extremes that were otherwise dominating the discussion: something like the public control that Father Coughlin was then advocating and what was regarded as the failure of laissez-faire that the First Federal Reserve System seemed to represent.

Eccles knew that keeping the strategy within that context was an advantage over

309 On Reserve Bank dominance, Eccles & Currie (1934/2004). Hoffman (2001, 139-145) sees Eccles in a classic Benthamite utilitarian position of justifying “state action” to insert itself “where nature ends, to ensure optimal outcomes.” I see Eccles as more of an interest-group theorist, skeptical of banker-domination of the financial system and eager to apply a proto-Keynesian worldview to the special case of a deflationary spiral. He would have seen himself as a practical businessman.
those who would have dropped the entire system. “The adoption of these suggestions would introduce certain attributes of a real central bank capable of energetic and positive action without calling for a drastic revision of the whole Federal Reserve Act,” Eccles wrote to the President. “Private ownership and local autonomy are preserved, but on really important questions of policy authority and responsibility are concentrated in the Board. Thus, effective control is obtained, while the intense opposition and criticism that greets every central bank proposal is largely avoided.” Whether or not he was being disingenuous is an open question, but the overhaul he had in mind was already being marketed—to the President, as it would to the public—not as an overhaul, but as a clarification.

As Eccles records it, Roosevelt cautioned that the proposals would be controversial, but that they were desirable. He had the president’s blessing.\textsuperscript{310}

\textit{Eccles, the Banking Act, and the Governor Appointment}

A week after he submitted his final memorandum to the president, he had not only Roosevelt’s blessing on the suite of reforms, but also his appointment as Governor of the Federal Reserve Board. Within weeks, Eccles’s proposal would formally arrive at Congress. The Chairman of the Federal Reserve Board and Governor—previously, two separate positions, with the Secretary of the Treasury in the first and Eccles’s predecessors in the second—would be merged. Salaries would be raised to attract top talent, avoiding the embarrassing situation where the Governor of the Federal Reserve Board would resign in favor of becoming the Governor of a Federal Reserve Bank (as

\textsuperscript{310} Eccles (1951, 175).
had happened with Eugene Black). The Board would control reserve requirements over
member banks, and the FOMC would be reconstituted to have Board control.311

The House was much more sympathetic to the proposal than the Senate. There
were questions at the heart of what Eccles was trying to accomplish: “What is the
difference between this measure and an outright central bank?” To this question, Eccles
equivocated. “Well, I do not know just what you mean by ‘central bank’,” he began,
before explaining that “the Federal Reserve System has always been expected to perform
certain functions of a central bank. It was set up on the basis of certain regional
autonomy, due, I suppose, in part, to the opposition to centralization in this country at the
time the Federal Reserve System was set up.” Eccles knew he had to avoid the damning
label, and so made clear: “The proposed bill in no way changes the physical structure.”312

This explanation was enough for the Democrats, but not the Republicans. They
were struck especially by how the bill was prepared, so much in secret given the
redesign. Representative John Hollister, Republican of Ohio, thought the bill represented
an abolition of that private structure.

You have today a Federal Reserve Board that is charged with responsibility,
and no one would deny that the Federal Reserve Board today has enormous
power, enormous authority, and enormous responsibility; and also that, to
all intents and purposes, there are 12 banks which have considerable—not
considerable, but some—Independence, not as much as they used to have. I
am not asking that they have more, but I just dread taking away what they
have left.313

312 Hearings before the Committee on Banking and Currency, House of Representatives, 74th Congress,
on HOUR 5357, February, March, and April 1935, pages 209
313 Ibid at 358.
To this, Eccles stuck to his legislative and rhetorical strategy. “I do not believe that we are taking it away,” Eccles responded. The changes were only for clarity, not redesign.

Some Democrats, channeling Father Coughlin, pushed Eccles in the other direction. Clyde Williams, a Democrat from Missouri, noted the “considerable agitation, a good deal of comment in the country, about the Government owning these institutions.” Why not just go all the way toward that model? Why the intermediate step? Here, Eccles sought to have it both ways. “I see no reason why a management selected with the Government owning the stock would insure the System being operated in the public interest anymore than would be the case with members of the Federal Reserve Board being appointed by the President of the United States.” He concluded, “it is not so much who owns the bank as it is the way the bank is set up and the responsibility with which it is charged.”

Eventually, the House approved the controversial Title II, with only a few changes to the Eccles proposal. The Federal Reserve Board would expand to eight, with one Governor; the two except officio members would remain. And the FOMC would consist of all eight Board members, and five Reserve Bank representatives. This level of participation was not enough to win the Republican minority, but Democrats commanded such a majority that it didn’t matter.

The Senate was a different story. Here, Eccles overplayed his hand. He had wanted not to eliminate the Reserve Banks completely—it was on this basis that he tried

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314 Ibid at 226.
315 Ibid at 229
to thread the needle. He wanted to gut their influence over policy and turn them into advisers, not policy-makers. But, as he later admitted, he played the political game poorly. Eccles’s proposals offended Glass’s sense of policy and his sense of pride, and the aging Senator did more than bring in hostile witnesses: he also retaliated by holding up Eccles’s confirmation hearings as the old Federal Reserve Board’s Governor (and in fact was the only Democrat to vote against Senate confirmation when the vote finally did go through).317

As the debate around the Eccles bill continued, there may also have been a sense of longing for what might have been for Glass. The aging Senator was very nearly Roosevelt’s first Secretary of the Treasury and was in fact offered the position first. Had he accepted it, he would have been Eccles’s boss when Eccles first floated the prospect of a demolition derby of Glass’s beloved System and the Reserve Banks. But Glass would have been a bad fit for FDR’s Administration, and not just because his health was fading. Glass was, in his core, deeply conservative and hated almost everything about the New Deal, despite lending his name to one its signature achievements, the Glass-Steagall bill. In fact, “[h]is record of opposition to the New Deal, based on a study of thirty-one bills on which he voted, 1933-1939, was 81 percent opposed—easily the highest of all Democratic senators of the period.”318

Glass’s opposition meant that he was able to salvage a continuing policy role for the Reserve Banks: they would keep their private status (through member banks’ ownership

317 Eccles discusses his political blunders in Eccles (1951, cite this PAGE NUMBER cite this).
318 For more on the near-miss, see Brand (2008, 292). For Glass’s conservatism, see Patterson (1967, 20).
of the Reserve Banks), they would keep their private boards of directors, and the Federal Open Market Committee—created under Glass-Steagall just two years before—would include five seats for the Reserve Banks, to be filled on a rotating basis.319

Even so, while Glass won some concessions, Eccles got most of what he sought. The final version of Title II created a system that represented a dramatic departure from every other experiment in central bank design in U.S. and indeed world history. It abolished the Federal Reserve Board created in 1913 and replaced it with the Board of Governors of the Federal Reserve System. (The term “Federal Reserve Board” remains in wide if anachronistic use to refer to the Board of Governors.) It also demoted the heads of the Federal Reserve Banks, who would no longer carry the name “governor.” That title would be reserved for the members of the Board of Governors. At the Reserve Banks, the head would be the “president.” This was an intentional demotion: unlike in politics, in banking lingo, a “Governor” was an august title reserved to the central bank; a mere “president” could be any joe from the corner savings and loan.

The Reserve Banks weren’t the only ones shown the door by the Banking Act of 1935. The Treasury Secretary was also out. For Treasury Secretaries like Andrew Mellon—the second longest-serving Secretary, second only to the early 19th century Secretary Albert Gallatin—the chairmanship of the Federal Reserve System was largely a ceremonial post. But others were different: Glass, Mellon’s immediate predecessor as Secretary of the Treasury had, perhaps like the jealous father he was, essentially treated it “a bureau of the Treasury instead of as a board independent of the Government.” The

319 The Federal Reserve Bank of New York didn’t become a permanent member until 1942.
removal of the Secretary was Glass’s idea, in fact. Apparently, if he couldn’t control it, he wanted to make sure others in government couldn’t either.320

As historian David Kennedy has written, after the 1935 Act, “the Fed now had more of the trappings of a true central bank than any American institutions had wielded since the demise of the Bank of the United States in Andrew Jackson’s day,” precisely the result Eccles had both sought and denied seeking. But the Federal Reserve System after 1935 was more than that: The new Federal Reserve System had the trappings not only of a “true central bank,” but was the beginning of what economic historian Charles Goodhart has called central banking’s “evolution” from private banks running a private banking policy with public benefits to a public central bank in the modern sense of the word. The Fed didn’t join the fold of central banks at last in 1935; Eccles and FDR had created a new institution altogether.321

Ironically, just as the Secretary of the Treasury was removed from the Fed’s

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320 For Mellon’s role at the Fed, see Cannadine (2006, 321-22). Glass is quoted in Hackley (1971, 71-72). An explanatory note is appropriate on the provenance of Hackley’s extraordinary book. Hackley, then General Counsel for the Board of Governors, prepared this 200-page manuscript for internal purposes. It is an invaluable scholarly source that contains both references to other useful primary documents (such as early opinion letters from the Comptroller General) and is a useful reflection of the Board’s view of several important legal issues at the time. Upon learning of the document’s existence from William Greider’s journalistic history of the Fed, see Greider (1989, 49, 736), I asked the reference librarians at Stanford Law School if they could secure it. For more details on Erika Wayne’s impressive success, see Conti-Brown (2011).

Besides the Secretary of the Treasury, another internal institution within the Federal Reserve System was demoted to the point of irrelevance: The Federal Advisory Council. Prior to 1935, the FAC (which consisted exclusively of bankers and their representatives) had presented itself as an authoritative voice on monetary and financial policy, often failing to identify itself as something other than the “Fed.” This particularly earned Eccles’s ire; the FAC never recovered. It still exists today, but is a largely ceremonial committee far from the contributing role it enjoyed during the first Federal Reserve. For more on the FAC in the early Fed, see Warburg (1930, 376) and Eccles (1951, 188).

Board of Governors, Eccles sought to coordinate fiscal and monetary policy in the joint mission of lifting the economy out of Depression. “Coordinate” may even suggest more separation between the Fed and the Roosevelt Administration than Eccles intended: he meant for monetary policy to be administration policy. In fact, Eccles’s clear policy—expressed before Utah bankers or to FDR’s Treasury—was to use all policy instruments at the government’s disposal to do for the economy what the broken consumers could not do: spend.

It is no surprise, then, that the Eccles Fed in the 1930s saw less of a need to declare formal independence from government, as the Banking Act of 1935 had done in a declaration of independence from private bankers. Even during a brief and painful interlude of further recession in 1937-38, the Fed’s policy during the 1930s was congenial to the Administration’s.322

*The Fed, the War, and the International Order*

World War II and its aftermath only cemented Eccles’s proximity to the administration. Eccles’s views on fiscal-monetary coordination during economic depression were born of the fear of deflation: that is, he believed government was the only force capable of stopping the economic freefall. His views on fiscal-monetary coordination during war came to the same conclusion, via a different path: war on the nation’s mortal enemies was no time for anything but full-throated support of all within the democracy.

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322 Friedman & Schwartz (196, 446-450); Meltzer (2003, 415-420)
The day after the Japanese attack on Pearl Harbor, Eccles sprang into action to reassure the nation that the Fed would stand by the war effort. In its annual report in 1941, the Fed declared that it was “prepared to use its powers to assure that an ample supply of funds is available at all times for financing the war effort and to exert its influence toward maintaining conditions in the United States Government security market that are satisfactory from the standpoint of the Government’s requirements.” In practice, this meant that interest rates for government debt were “pegged”: 90-day bills at less than ½%, one-year bonds at less than 1%, and long-term debt at 2.5%. Despite the Fed’s refounding in 1935 as an agency unto itself, the War brought it squarely under presidential control.323 This became known as the “pattern of rates” and recommended a commitment to ensure that the government would have little trouble raising money from the public, even at the expense of debauching the currency.

This kind of accommodation, though, was not new. Eccles may have sprinted to assure markets and the rest of government that the Fed stood at the ready to support the government’s debt, but this had been going on for a long time, with transparency. Beginning in 1917, at the beginning of World War I, the Secretary of the Treasury (still William McAdoo) pushed the Fed to accommodate the Treasury’s debt functions and allow the Treasury to float a debt issuance well below market. As H. Parker Willis wrote soon after the fact, the Treasury tried “not to unload anything further on the Federal Reserve Banks, certainly not without notice, and in consideration of his attitude in the matter it was agreed that every effort should be made to bring about a satisfactory

323 Chandler (1958, 408) provides an excellent overview of the Fed’s war-time policies. See also Meltzer (2003, chapter 7). For the 1942 announcement, see Federal Reserve System Annual Report (1941, 1)
organization for shifting Treasury requirements to member banks and, through them, to
the public.” Thereafter, the Treasury sought a policy of what New York Fed president
Allan Sproul called the “bank-borrow-and-buy,” that would use the Federal Reserve
Banks as a source of debt management for the government, a function that caused some
to howl in protest.324

Even the Federal Reserve Bank of New York’s annual report in 1939 had made
this clear: “the open market operations in which this bank participated during the past
year were not undertaken primarily with a view to affecting the reserve position of
member banks,” as one would expect for a light-touch central bank seeking to
accommodate market demands for bank credit, “but rather with a view of exercising an
influence toward the maintenance of orderly conditions in the market for Government
securities.”325 There was a history of this kind of accommodation that long preceded the
peg. It wasn’t new to the world in 1942.

Conclusion

Eccles encountered some sticky institutions and replaced them with others. He
took the singular achievement of the Wilson Administration with respect to the Federal
Reserve Act and subtly, almost easily, undid it. The idea that monetary policy would be
in the hands of the Reserve Banks alone died in the Second New Deal; it is not an
exaggeration to say that Eccles wielded the dagger that killed them.

324 Sproul (1964, 52)
325 Annual Report of the Federal Reserve Bank of New York, 1939 (page 26)
The reception history of the Banking Act of 1935 suggests, though, that some institutions prove stickier even than the law allows. The original Wilsonian Compromise, though it was undone by the events described in this chapter, has proved more durable in the historicity of the Federal Reserve System, as the mug mentioned in the introduction suggests. The same is true for the removal of the Secretary of the Treasury from the Fed’s governing board, a change that might have brought greater distance between the Fed and the Treasury when subsequent events would only bring the two more closely together. The next chapter explores dynamics along both dimensions.

“The accord was a major achievement for the country.”

Allan Meltzer, 2003

“The Federal Reserve does not have, never has had, and never has claimed to have an independence in monetary affairs which divorces it from the general economic policies of the Government.”

Allan Sproul, 1964

Introduction

Few events in Fed history have the mythological status for the modern conception of the Federal Reserve as the Fed-Treasury Accord, the March 1951 agreement between the Fed and the Treasury that is commonly perceived to have set the Fed on an independent course in determining monetary policy free of political interference. It is at the very heart of what it means to be an “independent” central bank, an obsession of central bankers for much of its history that received a boost after the Accord. It has become almost an academic discipline to discuss central bank independence, and many accounts of the Federal Reserve point to the Fed-Treasury Accord as the moment of departure. In 2004, Alan Blinder, an academic and former central banker, called the study of central bank independence a “growth industry,” and the growth has accelerated in the years since.

326 Meltzer (2003, 711)
327 Sproul (1964, 73)
328 See Grove (1952)
329 Meltzer (2003), Bernanke (2015), Blinder (2013)
Although there are nearly as many specific definitions of “central bank independence” as there are authors who document it, in reference to the Federal Reserve, there is a rough consensus of the term. That consensus goes something like this: Fed independence is the separation, by statute, of the central bankers (specifically the Fed chair) and the politicians (specifically the president) for purposes of maintaining low inflation using a purely technical skill set, not a political or ideological one.331

As we have seen in previous debates about the structure and functions of the Federal Reserve, this idea of legal separation from politics is an old one. And the policy justification behind it is also old. That monetary phenomenon that an independent central bank is meant to avoid is in the temptation politicians will have to interfere with the smooth operation of money as a store of value. Citizens in a democracy naturally prefer a prosperous economy. Politicians please these citizens by giving them that prosperity (or at least by trying to take credit for it). But when there is no prosperity to be had, politicians will resort to goosing the economy artificially by running the printing presses to provide enough monetary lubrication to keep the economy humming. The short-term result is reelection for the politicians or their preferred successors by an accommodating public. The long-term result is worthless money that wreaks havoc on our economic, social, and political institutions.

The Fed-Treasury Accord has reached a level of something of an unwritten constitution in the history of Fed independence, a moment whereby the organization of

331 I discuss this conception of independence in more detail in Conti-Brown (2016)
the Federal Reserve and the norm of political insulation met in a process of collaboration—a true “institutionalizing” moment, as we have been using the term.

This chapter seeks to separate the history from the historicity of the Fed-Treasury Accord. It was a conflict wrapped in presidential politics and national security. Perhaps it was a “major achievement” for the country, as Allan Meltzer, a leading historian of the Federal Reserve, has said in the quote in the chapter’s epigraph. There is also good evidence that it was about a personal conflict between a central banker and a president, each looking askance at the other. And regardless, there is almost no evidence that the historical actors who forged this quasi-legal “accord” had anything like a declaration of Fed independence in mind when it was reached. This would come later. Like the Fed’s later use of the Great Depression as a motivating factor in reshaping itself, the Fed-Treasury Accord came to be an institutional moment only after the fact.

This chapter must therefore look beyond the tumultuous events of the spring of 1951 to examine the Accord’s institutionalization through the person and leadership of William McChesney Martin, Jr., the Treasury official made Fed Chair in the aftermath of—and potentially, as part of—the Accord. Martin didn’t accomplish the task of creating a central banker persona by persuasion only, although there was plenty that was persuasive about Bill Martin. It was also through the elimination of rivals. This chapter, then, must tell the story not only of the rise of Bill Martin but also the fall of Allan Sproul, the long-term president of the Federal Reserve Bank of New York. Although the Banking Act of 1935 had already severely limited the Reserve Banks’ policy roles within the Federal Reserve System, the informal authority of personality and leadership had
meant that Sproul—including in the Accord deliberations themselves—had been able to maintain his role in Fed leadership, even expanding it (with Marriner Eccles’s sometimes enthusiastic concurrence).

What Martin did was to cut the New York Fed even further from the discussions, eventually abrogating the very policy apparatus that New York had built over decades. In a debate that became known as the “bills only” debate, and one that would be a harbinger of discussions about quantitative easing in the early 21st century, Martin displaced Sproul’s more discretionary monetary policy maneuvering by limiting the Fed to the short-end of the government maturities market: “bills only,” or only those Treasury bills with three month maturities. While that policy would not be followed permanently after its advent in the mid-1950s, it would eventually become the primary tool for monetary policy for decades until the financial crisis of 2008 brought back a vision of market support that Sproul would have applauded.

This chapter tells the story, then, of the power of ideas but also the power of relationships in constructing institutional moments and the norms, organizations, and processes that define them. It is not the story of a single iconic moment that redefines an institution forever. It is the story of institutional moments that gain currency only over time.

Truman and Eccles and the Beginning of the End of Fed Subordination

Like so many Americans, Marriner Eccles grieved the death of Franklin Roosevelt. After the war had ended with the new Truman Administration in place—an Administration in which Eccles felt at sea—the glory days of Fed-Treasury coordination
against the common enemies of economic depression and Nazi fascism came to an end.
The close relationship between the Fed Chair and the President came to an end, too.
Eccles was Roosevelt’s man, not Truman’s. Whether because of differences in
personality, policy perspectives, or a lack of shared history, Eccles did not remember his
time as Truman’s Fed Chair with warm regard. They were “years of frustration and
failure, as I tried, in my limited capacity, to influence public thought and governmental
policy.”

Given these frustrations, what happened in early 1948 should not have been
terribly surprising: nine days before Eccles’s four-year appointment as Fed Chairman
came to an end, Truman instructed an assistant and mutual friend to tell him that the
president would no longer back Eccles in that capacity. Eccles was “decapitated,” to
quote the colorful phrase of one Senator.

In a letter from the president, dated January 27, 1948—already a week and a half
after Truman had made the decision to appoint Eccles’s successor—Truman wrote to
Eccles that it was the President’s “preference to appoint a new member of the Board . . .
and, when confirmed by the Senate, to designate him as Chairman.”

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332 Eccles (1951, 397).
333 Confirmation of Thomas McCabe, Hearings before the Committee on Banking and Currency, United
States Senate, 80th Congress, March 3, 10, 11, 24, and 30, 1948, page 154 (hereinafter “McCabe Hearings”)
334 McCabe’s journals discuss his meeting with the President and Treasury Secretary on January 18,
1948, a fact and date McCabe subsequently disclosed in his Senate hearings. McCabe diaries, January 18,
1948; McCabe hearings, page 154
335 Eccles Papers, Letter from Truman to Eccles, January 27, 1948, File 14, Folder 7, Item 11. The
Truman became president because Eccles thought the Fed Chairman should serve at the pleasure of the president. Perhaps writing for a public audience, Truman explained that the decision “reflects no lack of complete confidence in you, or dissatisfaction in any respect with your public service, or disagreement on monetary or debt-management policies, or with official actions taken by the Board under your chairmanship.” To that end, Truman “urged [Eccles] to remain as a member of the Board and to accept the Vice Chairmanship,” a clear demotion.336

It’s unclear what Truman hoped to accomplish with this offer, whether it was given in sincerity or whether it was a face-saving gesture against the inevitable complaint that Truman was trying to rid himself of a monetary thorn in his policy side. Or perhaps he was sincere, and hoped that the appeal to Eccles’s patriotism and public service would appeal to Eccles’s sense of duty.

Whatever the case, Eccles’s answer, written and sent the same day, was direct: “I have carefully considered your request [to take the Vice Chairmanship]. After consultation with close friends and associates on the Board . . . I have decided to remain with the Board in the capacity you suggest.”337 Whatever the original intention, Eccles was all in.338 Indeed, newspaper accounts reporting on the arrangement presented the Vice Chairmanship as complete.

Soon it became obvious that Truman had either changed his mind about the personnel shift, or was not expecting the proud banker to accept the demotion. After the

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336 Eccles Papers, Letter from Truman to Eccles, January 27, 1948, File 14, Folder 7, Item 11
337 Eccles Papers, Letter from Eccles to Truman, January 27, 1948, Box 2, Folder 24, Item 2
338 For more on the Vice Chair battle, see Eccles (1951, 437-42); Meltzer (2003, 655-56), Clifford (1965,208-211), and Kettl (1986, 63-64).
President repeatedly stalled, Eccles eventually withdrew his candidacy in a public, dispirited letter. “Four months have now passed,” Eccles wrote to the President in a letter he later leaked to the press, “since you first requested me to accept the vice chairmanship, and nearly a month and a half since you reiterated that request.” Eccles had grown weary of waiting: “Under these circumstances, and in view of other developments, I wish to withdraw from any further consideration for designation as vice chairman.” Eccles didn’t name the “other developments,” but he insisted that he would “continue to serve as a member of the board,” a luxury he enjoyed given that his term would not expire until 1958. Truman’s inexplicable refusal to engage wasn’t a mere oversight; the press asked Truman for explanations during the four-month delay, but the President never provided them, something well covered by newspapers at the time.

What accounts for this “decapitation”? It was a question that “never was explained by Mr. Truman and remained a mystery even to White House intimates.” It may have been a simple failure to connect. Eccles’s prominence as a thorn in the Administration’s side was not secret. As the Wall Street Journal reported, “Eccles’ record on the Reserve Board has been that of a stormy petrel who has many times differed publicly with other administration leaders as well as with Federal Reserve officials and private bankers.” In particular, there were two key regulatory disputes between Eccles and Truman at the beginning of Truman’s presidency. First, Eccles wanted much more severe banking regulation than the rest of the administration preferred. In particular,

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Eccles sought a much more stringent reserves policy that made banks less reliant on fractional reserve banking. He asked Congress for legislation that would have granted the Board, but not the Federal Reserve Banks, the authority to set bank reserves at 25% of demand deposits, up from 10%, as a kind of secondary reserve fund. It was a plan that the once powerful Eccles could not get through, even to his colleagues on the FOMC: Allan Sproul, New York Fed president, said publicly that the plan was “futile.”

More contentiously, Eccles had launched a lawsuit against AP Giannini, a banker in California and pioneer of multi-branch banking whose empire would eventually include a holding company with 46 banks in the group. The Board had initiated an antitrust suit against Transamerica, a bank holding company that was growing in California and represented, in Eccles’s view, a threat to the system of unit banking in the United States. The rest of the Administration didn’t share this view, and Eccles’s efforts to bring this action in coordination with the Justice Department, but not in its shadow, may have had something to do with these frustrations.

Eccles believed the second theory. After a courteous exchange of pleasantries between him and the president over Christmas 1947, he was blindsided that Truman would fail to reappoint him so soon before his term expired. The presidential assistant who delivered the news was also dumbfounded, Eccles wrote. “Marriner, believe me. I don’t know what this is all about,” the assistant, John Steelman, reportedly said. “I know

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344 Neal (1953, 191)
of few people who have a higher standing over here than you do. This is as much a
surprise to me as it is to you and I have told you all I know.”345

Eccles freely filled in the gaps in his memoir, although he noted that he was
speculating “based on circumstantial evidence and the bits and pieces of revelations that
have appeared in stories written by trustworthy reporters.”346 Eccles noted that his
reappointment was opposed by the Democratic Senator from California, Sheridan
Downey, he presumed on the basis of his opposition to the Giannini family bank holding
company. Eccles, by his own lights, was the product of pure politics: Truman needed
California in 1948, and that meant the wealthy Gianninis. And given Eccles’s antitrust
case, the Gianninis had little use for Eccles.347

As the relationship between the Fed and the Truman Administration took shape,
though, the particulars of bank regulation or examination weren’t the only issue and
certainly wouldn’t be the way that either Eccles or Truman would remember the
relationship after the fact. The bigger problem is, as the theoretical account of central
bank independence would suggest, the one that many politicians face when confronting
bureaucrats whose views on inflation vary from their own. And on that score, Eccles
stood as a constant thorn in Truman’s side. That he would may have been a surprise.
Eccles had changed from his early days as a proto-Keynesian in 1933. By the end of
World War II, Eccles became what we would call today an inflation hawk. He saw risks
of runaway inflation in continuing the “peg” he had established in 1942. Here, with

345 Eccles (1951, 436)
346 Eccles (1951, 443).
347 Felix Belair, Jr., “Eccles Blames Giannini Pressure for Ouster as U.S. Reserve Head”, New York
Times, June 16, 1951, page 1.
others inside the Federal Reserve System (especially New York Fed president Allan Sproul), Eccles began an effort to subvert the subordination of monetary policy that Eccles’s own policies had created.

This anti-inflationary enthusiasm was coming at a critical point in U.S. history. Over the course of 1947 and early 1948, Truman Administration officials had been drafting what would come to be called the Marshall Plan, after George Marshall, the former Army chief of staff and celebrated general who was then serving as Truman’s Secretary of State. In an address to Congress in November 1947, President Truman outlined the urgency for supporting what was then referred to as the European Recovery Plan. “The future of the free nations of Europe hangs in the balance,” Truman intoned. “Austria needs $42 million, Italy needs $227 million, and France needs $328 million to buy food, fuel, and other essential goods during the next 4½ months.” Truman recognized that there would be no easy fixes: “Emergency aid is no substitute for a long-range recovery program,” he acknowledged. “But it is a vital prerequisite to such a program.”

The Marshall Plan was not uncontroversial, with critics worrying that it would destabilize an already unsteady U.S. dollar. To them, and in the very same address, Truman had the other answer: he accepted the critique. “The future of our economy is in jeopardy” because of inflation, an evil that he regarded as the second critical challenge facing the Congress, after the need to give assistance to the Europeans. “Today, inflation stands as an ominous threat to the prosperity we have achieved. We can no longer treat

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inflation--with spiraling prices and living costs--as some vague condition we may
encounter in the future. We already have an alarming degree of inflation. And even more
alarming, it is getting worse.”

There will be reason to doubt Truman’s anti-inflationary bona fides. For now, though, it is important to note that he never modified his public support of the idea of inflation as an evil that his Administration, including the Fed, would seek to fight.

*Thomas McCabe: Philadelphia Industrialist Turned Central Banker*

As Eccles’s successor, Truman appointed Philadelphia industrialist and chairman of the board of the Federal Reserve Bank of Philadelphia Thomas McCabe, perhaps the most forgotten of Fed chairs in the modern era—that is, since the creation of the Fed Chair in 1935. To the extent that history has taken notice of him, McCabe has been presumed to be a central banker during a period of little importance. This is unfortunate. McCabe would play an essential role in shaping the identity of the Fed in the immediate postwar period, and may have been a decisive voice in paving the path for his successor, William McChesney Martin, a central banker who remade the Fed in his own image (as we shall shortly see).

McCabe came to office not as part of the Missouri network of local politicians, or from the many close associates that Truman knew from his days in Washington. McCabe had spent his life in the paper industry, besides some government service in the Army, Navy, and State Department during World War II. His banking experience consisted

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349 Truman address to Congress, November 17, 1947.
350 Romer and Romer (2003, 130-31) analyzes each of the modern Fed chairs—except McCabe, because “the Federal Reserve was committed to supporting Treasury bond prices” and not exercising the role of independent Fed Chair.
exclusively of serving as a director of the Philadelphia Fed and of a commercial bank. His lack of experience was a sticking point at his confirmation hearings, but eventually these were resolved.\footnote{McCabe Hearings, 152.}

As McCabe assumed the helm of the Fed’s Board of Governors, he was entering a world where the Fed and Treasury had worked so closely together that members of Congress had begun to look at the relationship with jaundiced eyes. Some members of Congress had long viewed the Fed as its responsibility. For instance, Wright Patman, a Democratic member of the House from Texas, had called the Fed “quasi-legislative,” and intended to “carry out the constitutional mandate on Congress to regulate the value of money.”\footnote{Hearings before House Banking and Currency Committee on H.R. 7230, 75th Cong., 3d Sess. (Mar-Apr 1938), page 170.} We have already seen in the previous chapter Carter Glass’s jealousies of the congressional relationship to the Fed. And McCabe was subject to the same grilling. Senator Charles Tobey, Republican from New Hampshire and Chairman of the Senate Banking Committee, asked McCabe if, “[i]n the case of a disagreement with the Treasury, for instance, do you think the Board should yield to Treasury’s viewpoint?” McCabe hemmed a bit, wanting “to be sure of [his] statutory authority,” but that he had a record of “working with the various departments of government rather harmoniously, and yet never giving up what I felt was the primary interest of the job.”\footnote{McCabe Hearings at 153.}

It was this kind of accommodation that Truman and his Treasury Secretary John Snyder may have hoped they would get, perhaps the kind of appointment that Truman had felt he had already made in Snyder himself. For others, Snyder’s appointment had
marred Truman’s early reputation as a national politician. The Treasury Secretary was not one of the Roosevelt holdovers, nor did he have any kind of national experience that preceded Truman’s ascent. In fact, his first federal appointment was as a federal loan officer after Truman became president in 1945; shortly thereafter he spent a year as director of the Office of War Mobilization and Reconversion. After Fred Vinson resigned as Treasury Secretary in June 1946, Truman appointed Snyder as his replacement.354 David McCullough, Truman’s biographer, deemed the appointment “hardly adequate for the second highest ranking position in the Cabinet. . . .an uninspiring choice, one that seemed to be made too hurriedly by Truman.”355

Whatever his qualifications (or lack thereof), Snyder made clear that he expected the same treatment that his predecessors had received in terms of the Fed’s maintenance of the “pattern of rates” that had supported government debt at various maturities had started to build. As documented in the previous chapter, the pegged pattern of rates was not new in 1942, and the Fed’s desire to get out from under them was not new either. In 1949, after only months on the job, McCabe sought an agreement with Treasury that would allow the Fed to start weaning Treasury from the market support to which it had grown accustomed.

Due in part to the pressure from the still-present Marriner Eccles, now as a demoted Governor on the Fed’s Board of Governors, and Allan Sproul, the president of the Federal Reserve Bank of New York, McCabe began squaring off against Snyder in an effort to wean the Treasury from Fed support. In 1949, a would-be Fed-Treasury Accord

354 McCullough (1993, 357)
355 Ibid. at 505-506
was ostensibly struck. In language strikingly similar to the eventual 1951 Accord, the FOMC released a statement, “after consultation with the Treasury,” that it would now be “the policy of the Committee to direct purchases, sales, and exchanges of Government securities by the Federal Reserve Banks with primary regard to the general business and credit situation.” This was a strong announcement: this kind of break from the peg was exactly what Eccles, Sproul, and others had been seeking since the end of the war. The statement was also explicit about the risks of failure to pursue this new policy: “Under present conditions the maintenance of a relatively fixed pattern of rates has the undesirable effect of absorbing reserves from the market at a time when the availability of credit should be increased.”

McCabe viewed this “announcement as a significant milestone because it reflected the joint judgment of the Treasury and of the Federal Open Market Committee that the postwar economic and financial situation had evolved to a point where open market operations could safely be permitted to play a more orthodox role in our policies.”

Once again, Truman seemed, in public comment, to be broadly sympathetic with these anti-inflationary goals, just as he had done in his November 1947 speech to Congress. In a July 1950 address to a joint session of Congress that postwar inflation, given the quantity of debt the government incurred to fund its military, the United States “should rely in major degree upon fiscal and credit measures,” suggesting that both the Fed and the President should work together as inflation fighters. “The more prompt and vigorous we are with these general measures, the less need there will be for all of the

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357 Ibid
comprehensive direct controls which involve the consideration of thousands of individual situations and thus involve infinitely greater administrative difficulties and much greater interference with individual choice and initiative.\textsuperscript{358}

Whatever his preference for anti-inflation, Truman and Snyder were not ready to concede control over managing the nation’s currency to the Fed, the 1949 “announcement” to the contrary notwithstanding. By now, members of the Federal Open Market Committee were getting frustrated, especially Eccles and Sproul, and especially with Secretary Snyder. As often as the Fed tried to nudge Treasury away from the assurance that the central bank would always be on hand to provide whatever demanded the Treasury needed for a successful debt issuance, Treasury refused to listen. “We have marched up the hill several times and then marched down again,” a contemptuous Allan Sproul said in an August 1950 FOMC meeting. “This time I think we should act on the basis of our unwillingness to continue to supply reserves to the market by supporting the existing rate structure and should advise the Treasury that this is what we intend to do—not seek instructions.”\textsuperscript{359}

Truman was also growing increasingly distressed by statements coming from members of the FOMC, including McCabe. As the FOMC members like Eccles and Sproul continued to speak about the risks of inflation, Truman fought back and called McCabe at his home and gave his subordinate the President’s instructions. As McCabe presented to the Board at their next meeting, “the Federal Reserve Board \textit{[sic]} should make it perfectly plain. . . to the New York Bankers [meaning, presumably, Allan Sproul]  

\textsuperscript{358} Special Message to the Congress: The President’s Midyear Economic Report, July 26, 1950  
\textsuperscript{359} FOMC Minutes, August 18, 1950, p. 137.
that the peg is stabilized.” The alternative, the President warned, would be for the
Committee to “allow the bottom to drop from under our securities.” Truman concluded with an ominous warning: “If that happens that is exactly what Mr. Stalin wants.”

Truman’s strategy of reminding the Fed of its patriotic duty in the beginning of what might have become World War III didn’t work, and the dispute continued to spill out into the public. Treasury Secretary Snyder publicly warned that the Fed was indulging in a “delusion” for the position that “fractional changes in interest rates can be effective in fighting inflation.” Sproul reiterated his earlier contempt for the process. The FOMC “had been discussing these problems [of the pattern of rates] with [Snyder] for more than a year,” and yet Snyder “had discussed them with us little or not at all.” Sproul continued:

[Snyder] had usually turned to an associate and usually asked if they had any comment to make and then said that he would let us know what he was going to do... [T]hat had usually been followed by an announcement by him, often anticipating far in advance his needs, of the financing program which had differed almost completely from our recommendations and which had had the effect of freezing our position.

Sproul was ready for something bolder than they had previously sought.

Truman was ready for that fight, and sought to stage it on his own turf. For the first and last time in history, the Federal Open Market Committee met in the Oval Office for a presidential lecture. Truman did most of the talking, but members of the Committee repeated their concerns and made no commitments. But immediately after the meeting’s

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361 Snyder Papers, Truman Presidential Library, Speech before the New York Board of Trade, January 18, 1951.
362 FOMC minutes, February 6, 1951, page 69.
conclusion, Truman issued a press release that presented the (false) view that the “Federal Reserve Board [sic] has pledged its support to President Truman,” and “the market for government securities will be stabilized at present levels and . . . these levels will be maintained during the present emergency.” (It is testament to the Federal Reserve System’s confusing governance system that even the president referred to the Federal Reserve Board instead of the FOMC.)

It is difficult to know what to make of the President’s press release. It certainly didn’t match the understanding of the members of the FOMC who had attended the Oval Office meeting, to put it mildly. And given how much the members of the Committee had made their discomfort with the continuing relationship clear, Truman and Snyder must have anticipated some tension. Perhaps Truman and Snyder were trying to play the Fed for fools—that the letter was “bullshit,” in the Frankfurtian sense of the term as a disregard for the truth proposition it made. It is also possible that Truman and Snyder simply regarded any contest between the Fed and Treasury, especially during a time of escalating hostilities in Korea, as a contest that the Treasury must necessarily win.

Whatever the view, this letter (and its public release) burned Marriner Eccles, who attempted to steer the public—and Congress—to toward the conclusion that it was the President, not the Fed, that was violating the public trust. In a tradition of government bureaucrats seeking to delegitimize politicians, Eccles leaked the internal memorandum the Board had prepared, on behalf of the FOMC, to summarize what had occurred at the Oval Office meeting to two major newspapers, directly and publicly disputing the

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363 Kirshner (2007, 144).
364 Frankfurt (2005)
Truman Administration’s account of the meeting. What became known as the “Treasury-Fed dispute” was now litigated in the public eye. As Eccles put it in his memoir, “the fat was in the fire.”

The early public reactions were mostly in favor of the Fed. In an editorial titled “A Victory for Inflation,” the New York Times wrote that the Eccles disclosure meant that Truman “has ordered the Federal Reserve Board to take its orders in the future from the Secretary of the Treasury. We can recall no instance where the independent central banking system in a democracy has been subjected to similar public degradation.” Members of Congress, in both parties, were also more sympathetic to the Fed than to the Treasury.

The Path to Peace

Cooler heads on the staffs of both the Treasury and the Fed intervened to come to grips with this internal dispute. Eccles had offended even some of his greatest collaborators with the release of his letter, and Chairman McCabe quickly followed up with a public letter to the President:

You as President of the United States and we as members of the Federal Open Market Committee have unintentionally been drawn into a false position before the American public—you as if you were committing us to a policy which we believe to be contrary to what we all truly desire, and we as if we were questioning you and defying your wishes as the chief executive of the country in this critical period.

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365 Eccles (1951, 496).
367 New York Times, March 2, 1951
368 McCabe to Truman, February 7, 1951, File 15, Folder 11, Item 14
McCabe was ready to make peace, something Truman and Snyder also desperately wanted.

They decided to resolve the issue once and for all by hammering out a durable compromise that would honor the Fed’s desire to respond to inflationary pressures as they arose and the White House’s fear that uncertainty in interest rates would make it impossible to fight Communism in Asia. From the Fed staff, Winfield Riefler led the way; from the Treasury, the Assistant Secretary of the Treasury William McChesney Martin. Part of the delegation to staff was logistically important: McCabe had previously suggested they follow this procedure, but Snyder had preferred the course they followed, of hashing out details between principals. Snyder was now persuaded, perhaps in part because he was hospitalized for a scheduled eye surgery. He had to delegate to his “close adviser,” William McChesney Martin, the Assistant Secretary of the Treasury for Monetary Affairs.369

The substance of the Fed-Treasury Accord—the actual deal reached—is not at all clear from the historical record. Allan Sproul, years after his retirement from the Federal Reserve Bank of New York, wrote that the Accord consisted of seven points, including that the Treasury would no longer issue any debt at a pegged rate, and that it would swap what debt was still outstanding at 2 ½ percent, the discontinuation of Fed interventions in the short end of the Government market, prior consultation on any changes in debt management, and the publication of an announcement of agreement “to be brief, financial, and nonpolitical.”370 As we shall see, there are reasons to doubt Sproul’s

370 Sproul (1964, 66).
memory here, especially with respect to Fed commitments for prior consultation and no more intervention in short-term markets, but the point is that Sproul understood the Accord in very specific terms.

What we do know is what the “brief, financial, and nonpolitical” statement itself disclosed. It looked like a more tightly written version of the 1949 announcement. The published Accord consisted of a single sentence that would allow both sides to declare victory, but committed no one to anything. After agreeing to the terms, both sides announced that they had accepted the compromise, which came to be known as the Fed-Treasury Accord. The problem is that announced result is nothing more than an announcement. Here it is, in full:

The Treasury and the Federal Reserve System have reached full accord with respect to debt management and monetary policies to be pursued in furthering their common purpose to assure the successful financing of the Government’s requirements and, at the same time, to minimize monetization of the public debt. Even a reasonably well informed citizen or lawyer of the day could not have recognized the extraordinary import of this dense sentence. In fact, some in Congress thought very little of so informal an arrangement.

John Snyder didn’t view the Accord that way at all, and saw it as nothing more than a temporary truce that would frame future discussions. In hearings after the announcement of the Accord, Senator Paul Douglas (D.—Ill., 1949-1967)—long critical of Treasury control of the Board of Governors—made clear that he thought the Accord and Secretary Snyder’s subsequent attempts to clarify its meaning were bogus. In Senator Douglas’s words: “Talleyrand said that words were used to conceal thought. I have
always thought that words should be used to express thought, and it is the lack of this quality which I find unsatisfactory in your testimony throughout.” 371

Senator Douglas was right. From the perspective of the moment, there is no sense that the “accord” that had been reached was, in fact, the Fed-Treasury Accord. But the point to note now is not only that the words didn’t have much content; the form didn’t either. The Fed-Treasury Accord is purely informal. It is not a statute or regulation, nor binding law enforceable in any court. In fact, some within Congress in favor of separating monetary from fiscal policy thought the informality of the Accord was extremely dangerous. Nonetheless, the Accord stuck and has endured. In some ways, it performed even better than a statute might have done. Recall that in the Banking Act of 1935, the Secretary of the Treasury was struck from the Board of Governors. That statutory removal was essentially irrelevant to the question of the fiscal domination of monetary policy. The meaningless sentence published in the Federal Reserve Bulletin was not.372

*The National Security Context of the Accord*

Looming over every aspect of these discussions, from both directions, was the overwhelming sense of national security. Truman, whose wartime experience consisted of service in France in World War I and then Senate investigations during World War II, was new to the world that Roosevelt had created. But Roosevelt died before the full impact of the postwar world could be understood. The Accord cannot be understood without a better appreciation for how this world had changed, especially given two key,

related factors: the rise of the threats of an atomic Soviet Union and the fear of Communist infiltration of the government and the reality that a fallen China had led to war in Korea, a war that was fast-breaking during the very weeks and months of this negotiation.

The rise of an atomic Soviet Union is a remarkable story in its own right.373 Truman had mentioned to Stalin in the spring of 1945 at Tehran in July 1945 that the U.S. “had a new weapon of unusual destructive force. All he said was that he was glad to hear it and hoped we would make ‘good use of it against the Japanese.’”374 In fact, the Soviets had been developing their own nuclear program since 1942 and had depended, successfully, on espionage from British and American sources. So it was that the Soviets were able to detonate their first atomic bomb in August 1949, which Truman made public the next month. It was expected, he noted, this development would occur. Quoting himself from four years before, he said that “scientific opinion appears to be practically unanimous that the essential theoretical knowledge upon which the discovery is based is already widely known. There is also substantial agreement that foreign research can come abreast of our present theoretical knowledge in time.”375 As William Laurence wrote in the New York Times the next day, the announcement “ranks only next to his original announcement of the explosion of the first atomic bomb over Hiroshima.” The announced marked “the end of the first period of the atomic age and the beginning of the second.” It also came three years ahead of schedule.376

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373 See Halloway (1994) for an overview, and Balogh (1991) for the U.S. side of that debate
374 Truman (1956, 416)
375 Truman Statement on Detection of Soviet Atomic Test, September 23, 1949
It was during this time that the Fed was seeking liberation from subsidizing the public debt, during the beginning of the era of two atomic powers. But this was not merely a threat of hot conflict; hostilities in China and Korea made the threat of warfare a reality. China fell to Communism just six months before the announcement of an atomic Soviet Union. And within a year of the atomic announcement, U.S. troops were engaged with Chinese Communists, supported in part by the Soviet Union, on the Korean peninsula. While the FOMC was champing under Treasury’s bridle, war in Korea had already broken out.

The Korean War is one of the most puzzling, often neglected events in U.S. history. William Manchester, in his biography of General Douglas MacArthur, summarizes the peculiarities of the conflict well:

The situation in Korea was Orwellian. A former ally of the United States, the Soviet Union, was championing a captive state, North Korea, in a conflict in which the South Korean foe was being supported by the United Nations, to which the Russians belonged, while the Soviets, meanwhile, were demanding the right to participate in treaty negotiations with a former enemy of the Americans and the Russians—Japan—which would bring peace between Japan, which was becoming the base for anti-Pyongyang forces, and the United States, now the Soviets’ archenemy. To crown it all, the grand alliance fighting the puny North Koreans seemed to face imminent defeat.377

As David Halberstram, a historian of the War put it, “To calling it an unwanted war on the part of the United States would be a vast understatement,” a war “orphaned by history.”378

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377 Manchester (1978, 552)
378 Halberstram (2007, 2)
But at the time, the question of China’s fall, a newly atomic Soviet Union, and real hostilities on the Korean Peninsula were front and center in the American imagination, often to Truman’s detriment. The Red Scare was well underway when the Accord was being negotiated. Joseph McCarthy’s Wheeling, Virginia speech was in February 1950; the fever around McCarthyism would not break until several years later. Not only, then, were the domestic politics of the situation highly volatile, but the sense of impending disaster was, too. As Snyder explained, “When war broke out in Korea, the Treasury visualized the possibility of a third world war.”

Indeed, at precisely the time that the Fed and Treasury reached their Accord, affairs in Korea were taking a truly bizarre turn. General Douglas MacArthur, regarded as the hero of the Pacific front during World War II, had conducted a war strategy that, from the Administration’s perspective, recklessly risked turning a small war into a large one, the very thing the Administration feared and hoped to avoid. As Truman sought to manage the war and take advantage of recent strategic victories under General Matthew Ridgway, he instructed MacArthur to prepare for peace talks with the Chinese. MacArthur balked and, instead, issued his own “pronunciamento,” taunting the Chinese in his typically florid style, essentially threatening the Chinese with total annihilation:

The enemy, therefore, must by now be painfully aware that a decision of the United States to depart from its tolerant effort to contain the war to the areas of Korea, through an expansion of our military operations to his coastal areas and interior bases, would doom Red China to the risk of imminent military collapse.

380 As quoted in President’s News Conference, May 17, 1951
The tensions between MacArthur and Truman, already strained, burst on this news (made only worse by the public disclosure of MacArthur’s criticisms of Truman’s war policies, disclosed through Republicans in Congress). On April 5, 1951, Truman removed MacArthur from his post.

The Fed officials promoting the Accord knew that Korea loomed large over these deliberations, they just interpreted them differently. Rather than supporting the Administration’s war policies with easy credit, as had been the order of the day during World War II, the Fed viewed the conflict as “transform[ing] the tone and tempo of American life,” to quote the New York Fed’s 1950 Annual Report.381 This was the conflict. As Truman (very briefly) described the conflict in his memoirs, it was his view “that until we could determine the extent of the defense requirements that might result we should maintain a stable position in reference to money rates that affected the management of the public debt.” His strong view was “that interest he moment of impending crisis we should not take deliberate steps that could possibly disturb public confidence in the nation’s financing.”382 Those who argued in favor of the Accord saw things differently.

The argument is not that the anti-inflationists who defended the Fed in this dispute were indifferent to the rise of Communism. Indeed, some saw the two as going hand in hand. Senator Douglas, perhaps the biggest defender of the Fed’s prerogatives during the dispute, put it this way:

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382 Truman (1956, 44).
By wiping out the middle classes and separating society into two classes of the propertyless on the one hand and the rich speculators on the other, inflation paved the way for fascism and communism on the continent of Europe. It is a destroyer almost as evil as war itself. In the eyes of those who want to destroy democracy and capitalistic institutions it is a cheap way of achieving their collapse. It costs the enemy nothing in lives and treasure. It is really a supreme folly for a nation which is arming against the threat of invasion from without to let this invader, inflation, bring ruin from within.\textsuperscript{383}

It’s hard to argue that Douglas, at least (and by implication Marriner Eccles, who quoted the paragraph in full in his memoir), viewed inflation as a purely fiscal phenomenon. They were concerned about the national security implications, as well. They just disagreed with the Commander in Chief about what those national security implications were.

The point of this recitation of history is that the Fed-Treasury Accord, when viewed within the context of the Fed’s relationship with Treasury and Treasury alone, can be—indeed, has been—cast as a battle between good and evil, a brave Federal Reserve versus a venal Treasury. Or perhaps more accurately, the contest is about the long-term wisdom of anti-inflationary policies against all of its alternatives. Those alternatives included cutting off a war effort that seemed headed to a possible nuclear confrontation with the Soviet Union. That the Fed, with its congressional sponsors, viewed its role as standing up to the President on this issue is an extraordinary thing.

\textit{Eccles and the Accord}

Eccles’s pugnacious attitude was a sea change from just a few years before, when he carried the mantle of Fed Chair. In a Board letter, ironically sent to Thomas McCabe when McCabe was chairman of the Philadelphia Fed’s board of directors and the Philly

\textsuperscript{383} As quoted in Eccles (1951, 480-481).
Fed had requested a rise in the discount rate, Eccles and the Board were very clear of the political risks of rattling the Secretary’s cage too heavily:

if the Secretary of the Treasury were confronted with any such consequences as would be produced by the System’s abandonment of support of the Government bond market, he would no doubt take the issue directly to the President who, in turn, would take it to the Congress if the Open Market Committee remained adamant. There can hardly be any doubt as to what the result would be.384

Why the change? Eccles concluded in his memoir that he changed because he feared the inflationary pressures that were building up throughout the system. But those pressures had been building up for years; there was nothing new about them.

It is difficult to dismiss the idea that Eccles went to war against Truman for personal reasons: the two simply didn’t care for one another, especially after the “awkward” way in which Truman had dismissed Eccles from his post. Eccles himself rejected this idea: The difficulties that arose between the Treasury and the Federal Reserve was not due to a clash of personalities. They were due to a conflict of responsibilities.”385 Perhaps. But there is also ample evidence that the conflict was about both personalities and responsibilities alike.

Institutionalizing an Independent Federal Reserve

As a result of Martin’s appointment, the Accord became seen as “the start of the modern Federal Reserve System,”386 and a “major achievement for the country.”387 It has become a founding moment for the Federal Reserve, on par with the Federal Reserve Act of 1913 and the Banking Act of 1935, invoked often to justify the idea that politicians

384 Eccles to McCabe, Board Minutes, May 28, 1947
385 Eccles (1951, 421).
386 Hetzel and Leach (2001, 53)
387 Meltzer (2003, 712)
should steer clear of the Fed. Unclear though it may be, written with an intent to conceal though it may have been, this sentence forms the basis in perception and in fact of the idea that the Fed’s monetary policy is institutionally separate from the economic policies of the President and the Secretary of the Treasury. The idea that is held sacred by most central bankers. And it comes from sentence almost completely devoid of content.

To reach its mythic status required a process of institutionalization that began soon after the Accord was reached. And that process also reflected the power and importance of William McChesney Martin. There is a good reason why the two main Federal Reserve buildings are named for Marriner Eccles and William McChesney Martin Jr. Eccles we already know. But Martin’s role in this history has, so far, been as the inadvertent negotiator for the U.S. Treasury in trying to withdraw Fed-Treasury relations from the spotlight.

Martin, however, represents the process of institutionalization as historical process, not a moment in time. After his ascension to the Fed Chairmanship, Martin worked to change fundamentally the way that central banking is practiced, both structurally (by wrenching central banking control from the Federal Reserve Bank of New York) and functionally (by imposing a “bills only” policy that radically shifted the nature of money in the economy). Martin also became one of the first figureheads of the

388 Examples are legion, but consider Perry (2015)
389 “A star” is “a major achievement
Federal Reserve System through his use of colorful metaphors and by placing himself constantly in the public eye.

In discussing the influence of an individual, the rest of the chapter discusses a significant source of deinstitutionalization: namely, the way that norms, organizations, and processes become less sticky in the way that institutions evolve. During this era, there is no larger figure than Allan Sproul, a central figure in the effort to displace Treasury domination of the Federal Reserve during the Fed-Treasury fight but now driven from his post as president of the Federal Reserve Bank of New York, sick with the ulcers that his battles with Martin had created. The story of Martin’s consolidation of Fed power in the hands of Washington central bankers is also the story of the displacement of Sproul and his cadre of New Yorkers.

*William McChesney Martin, Jr and the Making of the Fed Chair*

Martin was himself a child of the Federal Reserve System: his father was the first chair of the Federal Reserve Bank of St. Louis and in 1929 became its governor (and later, after the 1935 act, its president)—just in time for the Depression. Martin grew up in the company of his father’s dinner guests, including Benjamin Strong and Carter Glass. In that presence, he was “provid[ed] a continuing seminar in central banking and public service.” Although there is no record of exactly what Benjamin Strong and Carter Glass said in Martin’s presence during those formative years, the elder Martin viewed the

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390 Bremner (2004, 13)
separation of central bankers “from the politician and the plutocrat” as central to his worldview.391

Martin’s rise through the public and private sector may have been influenced by this early formation, but the combination defined his early life. After working out of Yale College in a small Wall Street brokerage, he grew increasingly involved in the management of the New York Stock Exchange, including as the new Roosevelt Administration sought to upend the way that securities were issued and traded on Wall Street. Martin always took moderate positions between those he regarded as extremists: the old guard that viewed any interference with Wall Street as tantamount to socialism, and the New Dealers who had thinly veiled disdain for all that they beheld at the Exchange and beyond.392

The battle between the new SEC and the old guard at the Exchange continued to rise with the ascent of William Douglas as the third Chairman of the SEC. A securities lawyer and Yale professor, Douglas was a reformer with little patience for the denizens of Wall Street. In 1937, Douglas wrote a scathing report about the failings of the New York Stock Exchange and, among other proposals, called on the Exchange to dispense with the notion that it could be run by people occupied full time with their own jobs and their own interests. “The tasks of conducting the affairs of the large exchanges are too engrossing for those who must also run their own businesses,” Douglas wrote.393

391 See Bremner (2004, 9).
392 Seligman (2003, 167-175)
393 The full text of Douglas’s report was published in the New York Times, November 24, 1937, page 39
The exchange vacillated between two factions, one that wanted to work with the new Chairman and take his recommendations seriously, and the other that wanted to dig in and prevent any meaningful reform, regarding the problems with Douglas as “primarily a public relations problem.”

The impasse exploded after revelations that the former Exchange president, Richard Whitney, had embezzled over $1 million from the Exchange’s Gratuity Fund, a fund set up to care for the often destitute survivors of deceased Exchange employees. After an investigation, it was clear that Richard Whitney had defrauded not only the exchange, but clients, family, and friends. He was convicted and served over three years in prison. Douglas marked his confrontation with the Exchange over the initial investigation as the moment when “the Exchange was delivered to my hands.”

Martin was in the right place at the right time. Despite his tender years—he was only thirty-one years old at the time—he was inoffensive to the warring factions within the exchange. As Martin’s biographer put it, his “candidacy was neither widely supported nor vehemently opposed, which made him a suitable compromise, but one that few members actively supported.” This was enough: the Exchange presidency, now a full-time, compensated position, was his.

Martin performed well in this function, despite the enormous challenges of overseeing capital market activities especially as war loomed over the exchange. After three years in the position, he resigned, was drafted as a private in the U.S. Army during

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394 As quoted in Bremner (2004, 29)
395 Douglas (1974, 289)
396 Bremner (2004, 33)
World War II (which he did not resist, unlike many others serving in high semi-official positions such as his), and eventually became returned as President of the Export-Import Bank under President Truman. It was from that post that he eventually acceded to his position in Treasury, from which he would be nominated to chair the Federal Reserve System.

Martin, then, was no stranger to the Truman Administration, as we’ve seen. What is intriguing, though, is that he was not only the favorite of John Snyder, but also of Thomas McCabe, the outgoing Fed Chair who had lost the confidence of Truman and John Snyder. Both Snyder and Truman regarded the entire Fed-Treasury affair as an effort by New York bankers to try to win back the financial power that had been lost during the New Deal. Snyder said, in his oral history, that the New York bankers had “decided that it was time to recapture control of government financing and bring it to New York where the decisions would be made.”397 In his memoir, Truman dismissed the affair as unlikely to “make the headlines (except, of course, in the financial publications),” but that the effort to remove influence over finance from Washington was the real issue: My approach to all these financial questions always was that it was my duty to keep the financial capital of the United States in Washington. This is where it belongs—but to keep it there is no always an easy task.”398

Both Truman and Snyder had regarded McCabe as captured by that banker mentality exemplified by Sproul and Eccles, and Snyder convinced Truman to tell

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397 Snyder oral history, Post-Presidential Files, Truman Library, page 31.
398 Truman (1956, 45)
McCabe that “his services were no longer satisfactory.”\textsuperscript{399} Truman regarded the appointment of McCabe to be “just as bad as Eccles,” and he wanted to get it right.\textsuperscript{400} Here, McCabe gave his unqualified recommendation of Martin, an appointment McCabe regarded “of critical importance at this juncture is the intimate part he has played in reaching the fine and full accord that now exists between the Treasury and the Federal Reserve System.” McCabe concluded, giving the Truman Administration fair warning: “It is vitally important that this accord be maintained.”\textsuperscript{401}

All went as planned. McCabe resigned from the Board; Marriner Eccles followed in July. Martin was joined on the Board by another Truman Administration insider, James Robertson, former First Deputy of the Comptroller of the Currency. Senator Douglas also saw the almost immediate resignation of the two senior members of the Board of Governors, and their replacement by two Treasury insiders, as something of an unofficial deal that the “truce” declared in the Accord just meant Treasury domination, as usual. Truman certainly hoped so: To enforce the uncertain terms, Truman was sending what he hoped would be his Trojan Horse.\textsuperscript{402}

To the chagrin of his patrons in the Truman Administration, this former Truman insider quickly established that the Fed-Treasury Accord did not mean what Truman thought it meant. After the Accord, the Treasury continued to issue long-term debt at roughly the pegged rate, and Martin expressed willingness to support and coordinate those efforts. But he also pushed against the perception and reality of the peg, and

\textsuperscript{399} Snyder oral history, Post-Presidential Files, Truman Library, page 31. 
\textsuperscript{400} Truman’s interjection in a joint interview with Snyder. \textit{Ibid}, page 33. 
\textsuperscript{401} McCabe Papers, Letter from McCabe to Truman, March 9, 1951, File 14, Folder 8, Item 5. 
\textsuperscript{402} Kettl (1986, 74). Clifford (1965, 267-68)
eventually made clear that he, too, would abandon it completely. None of this sat well
with President Truman: on Martin’s report, at their next meeting at an event at a New
York City hotel, Truman had but one word to say to the affable Martin: “Traitor!” 403

Martin’s role in negotiating the Accord mattered, but his status in implementing it
mattered much more. Truman did not know his man. Here, as in so many other aspects of
Fed and institutional history generally, personnel is policy.

Martin, Allan Sproul, and the Federal Reserve Bank of New York: The Rise of the
Federal Open Market Committee

Martin was not satisfied to declare his independence from Treasury alone. He also
wanted to forge a new kind of central banking that also limited the participation of
another power center within the system, the Federal Reserve Bank of New York. This
approach required major changes to the operations of the Fed as they existed at the time.
The consequence of Carter Glass’s partial victory over Marriner Eccles in preserving the
Reserve Banks in Fed policy making was that some bank presidents still sought to
exercise more power than their statutory authority allowed. Because they had a seat at the
table, exaggerating their stature was easy to do.

Allan Sproul, the president of the New York Fed, was one such president. He
played a singular role in the Fed-Treasury dispute, and had been a Fed lifer. Sproul
relished his role as a central banker. In one congressional hearing in 1945, for example,
Senator Charles Tobey, the Republican from New Hampshire, praised Sproul’s approach
to a the Bretton Woods discussions by saying that Sproul was “approaching this thing as

403 Bremner (2004, 91)
a banker, as you should, backed by all the conservatism and good judgment that you have acquired by years of experience." But Sproul retorted in irritation: "I appear here not as a banker, but as a central banker. There is quite a distinction. I have no years of conservatism behind me. I have years of trying to improve and develop and liberalize the functioning of the domestic and international banking machinery." 

His voice dominated three levels of monetary policy decision making. When the full FOMC met just four times a year, the New York Fed’s president was the traditional vice chair and held a permanent seat on the FOMC (whereas the other eleven Reserve Banks had to rotate in the remaining four seats). When the full FOMC was often not in session, the Fed met by Executive Committee consisting of the Fed chair, the New York Fed president, two other governors and one other Reserve Bank president (a model that looked a lot like that favored by Eccles in the House version of the Banking Act of 1935). This Executive Committee had roughly the same policy-making authority as the full FOMC. Finally, the New York Fed implemented decisions of the Executive Committee or FOMC on its own, from its trading desk in New York City. This included making decisions about which assets to purchase on what kinds of time horizons: that is, whether to buy short-term government bonds or long-term corporate bonds.

Martin sought, slowly and cautiously, to change all of this. To do so required confronting Sproul subtly, but unmistakably. Sproul was regarded as one of the preeminent central bankers of his era. Almost from the beginning, Sproul and Martin

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404 United States Senate Committee on Banking and Currency, Hearings on Bretton Woods Agreements Act, June 21, 1945, p. 310.
405 Ibid.
sparred for supremacy within the system. Their disputes were over the meaning of the Federal Reserve Act, and Sproul’s contention that, even after the Banking Act of 1935, the Reserve Banks—and especially the New York Reserve Bank—maintained some autonomy from the Board of Governors, especially in open market operations.406

Sproul understood what he was up against. He saw that the changes Martin wanted to make were about not only questions about how the Government securities markets were structured, but also about “the performance of the management of the System Open Market Account” itself, formerly the exclusive purview of the New York Fed. This also meant that the Washington types wanted to reevaluate the “power distribution involved in the linkage between policymaking by the Federal Open Market Committee at Washington and the execution of policy by the New York Bank.”407

Sproul stood up to this fight, and wanted to preserve his stature and that of the New York Fed. In his capacity as vice chair of the FOMC and as member of the Executive Committee, Sproul confronted Martin relentlessly, conducting parallel statistical analysis to rebut the conclusions and recommendations that Martin would advance to the entire FOMC. And in the implementation of the decisions of either body, Sproul exercised autonomy by simply refusing to report: implementation was his part of the playground, not Martin’s.408

406 Sproul had long sought to undo some of the damage to the Reserve Banks wrought by the Banking Act of 1935. For example, he thought any credit policy—including the discount function—should be given fully to the FOMC, not to the board. Clifford (1965, 216–22).
407 Sproul (1964, 72-73).
408 Bremner (2004, 111).
Over the course of his first five years, Martin used suasion with his other colleagues on both the board and the FOMC to chip away at Sproul’s—and New York’s—authority. The FOMC voted to double their meetings from four to eight per year to get more participation from the other governors and Reserve Bank presidents. The committee then changed the rules to require, rather than allow, each member to speak his views, rather than letting a few voices—that is, Sproul’s—dominate. The committee then disbanded the Executive Committee entirely. 409 Except for his status as the Vice Chairman of the FOMC, the New York Fed president had lost all of his structural advantages within the system.

_Central Banker Discretion: The “Bills Only” Debate_

Another frontier of the Sproul vs Martin debate returned the Fed again not only to the question of who should predominate within the institutional money system—Martin had already brought the question front and center—but also into the debate about what money itself should be. In particular, Martin pioneered a fight over the conduct of monetary policy that would limit the Fed’s market activities much further than the Accord had envisioned. Indeed, if Sproul’s account of what the Accord actually meant can be trusted, Martin’s new frontier meant that he was abrogated the Accord itself.

He made his first speech on this topic in 1953 to the Economic Club of Detroit, giving the speech the provocative title, “for want of better of better words,” “The Transition to Free Markets.” 410

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409 For more on this, see Bremner (2004) and Anderson (1965).
410 Remarks of Wm McC. Martin, Jr, Chairman, Board of Governors of the Federal Reserve System at luncheon meeting of the Economic Club of Detroit, Detroit Michigan, April 13, 1953.
What Martin announced in this speech, and in the FOMC discussions that had preceded it, was a dramatic departure from the way that monetary policy had been conducted until that point. Arguing that there would always necessarily be some “minimum of monetary management,” Martin insisted that the “aspiration remains to have has much freedom of choice and action as is compatible with the common good.” This extended to the way the Fed must conduct its monetary affairs as well. After apologizing for what the Fed had become, he read the Accord in full and hailed it as a “landmark” in monetary history. He then set about to subtly reinterpret that landmark.

The Fed wasn’t only going to be the partner of the Treasury, it was going to “regain[] its influence over the volume of money,” by which he actually meant that markets would regain that influence: “In a free market, rates can go down as well as up, and thus perform their proper function in the price mechanism. Dictate money rates breed dictated prices all across the board. This is characteristic of dictatorships.”

Moving beyond the rhetoric, Martin moved to specifics. He was worried that ten years of the peg had made the markets for government securities inert. They lacked “the depth, breadth, and resiliency needed for the execution of effective ad responsive market operations and for flexible debt management purposes.” As a result, Martin announced a subtle but important change to the Accord, such as it was. Rather than striving to “maintain an orderly market,” the Fed would thereafter direct efforts “more toward correcting disorderly conditions,” an important shift in emphasis that would pull the Fed back from the role it had taken as an active intervenor in those markets.

411 Ibid.
412 Ibid.
This change in orientation had a very specific upshot: the Fed would no longer intervene at various maturities of government or other debt, and would instead focus only on “Treasury bills,” or the short-term governmental debt of three-month maturities. This policy became known as the “Bills Only” debate.

Opposite Martin in this discussion was, as during the Truman Administration, Allan Sproul. Sproul viewed the economy as “a mixed Government-private economy” in which the central bank—by which he often meant the Federal Reserve Bank of New York—should play a decisive role in shaping credit conditions, not leave these questions to markets. The U.S. hadn’t had “a free market in government securities since . . . open market operations of the Federal Reserve system came to be used as a principal weapon of credit policy.”413 He thought that limiting the FOMC and New York Fed to short-term government securities was a harmful development. The central bank should “not tie one arm behind our back by restricting transactions” to short-term Treasury bills. Instead, he and his colleagues “should be free to influence the supply, availability, and cost of credit in all areas in the market . . . to promote economic stability and progress.”414

Sproul saw something more dangerous in the “bills only” debate, and sought to sabotage it from within. As Lawrence Ritter put it, the debate carried “an emotional undertow that perhaps dragged the leading participants further than they had originally intended,” and that “was the traditional suspicion between Washington and New York, a tug-of-war that had considerable precedent in Federal Reserve history.”415

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413 Bancroft MSS, Sproul Papers, Allan Sproul to Henry Alexander of J. P. Morgan & Co., 12 March 1954, Sproul Papers, FOMC correspondence, 1954, folder 1,
414 Ibid.
415 Ritter (1980, 14)
suspected, rightly, that the “bills only” policy was an effort to consolidate the practice of central banking away from New York, just as Martin had accomplished through the other mechanisms of eliminated the Executive Committee and removing New York’s ability to engage in open market operations without the rest of the Committee’s approval.

There is no denying how the members of the FOMC viewed the issue. In June 1953, the committee took a vote to rescind the “Bills Only” directive that Martin had described in Detroit. The discussion as gleaned from the minutes suggests something of an ambush by Sproul: Martin repeatedly questioned “whether Mr. Sproul felt that the matter was of sufficient urgency to put it to a vote interest he absence of some members of the Committee when it involved, as it did, a change in policy of importance.”416 Sproul was serious and proposed dropping the entire experiment. The matter was put to a vote, and Sproul won. The vote was five in favor (all representing Reserve Banks) and four against (all from the Board of Governors).

By September, though, three of the Reserve Bank presidents changed their votes and with better attendance from the Board, the final vote was nine to two, with Sproul again in dissent.417

This wasn’t just an emotional debate for Sproul. He also viewed the restriction of open market operations to the “short end” of the government market as an attempt at finding the all-important “rule” that would allow central banks to accomplish their goals of supporting money markets without human discretion.

416 FOMC Minutes, June 11, 1953.
417 Minutes of
From the earliest days of central banking in its primitive forms to the present era in which central banks, as the national monetary authorities, are charged with promoting the general economic interests of the nations they serve, domestically and internationally, there has been a continuous pursuit of a will-o’-the-wisp—a policy norm which would guide the operations of such banks with a minimum intrusion of fallible human judgment. The theory has been that a central bank, or any monetary control, must have a supreme norm of reference; that it cannot use more than one norm of reference.418

“Bills only” was just another attempt at finding precisely this kind of monetary policy rule, that “will-o-the-wisp” that was simply a mirage, in Sproul’s view.

Despite losing—again, for good—the vote at the Federal Open Market Committee, Sproul was not yet done with his fight. This intramural battle became the subject of Congressional hearings, with Sproul and Martin testifying on opposite sides of the issue.419 Perhaps befitting his status in the public imagination, members of Congress referred to him erroneously as “Chairman of the Federal Open Market Committee,” an error that Sproul corrected. Sproul repeatedly called it a “minor problem” and sought to emphasize the substantial agreement that he and Martin shared, not least with respect to the need to eliminate the peg: “As one of the principals in the fight to free the Federal Reserve System from the pegging of prices of Government securities, throughout a difficult period of controversy on this point, . . . I think I have the right to make it clear.”420 Nevertheless, Sproul pushed his case:

Suggestions for publishing a set of rules of the game, references to a constitution for open-market operations, and the repeated argument that Government security dealers could not create a broad, continuous market if we did not forego operation in long-term securities . . . gave me the disturbing impression that we were in danger of placing ourselves in a straitjacket which

420 Ibid at 224.
would not permit us to accomplish what the Congress and the public might expect us to accomplish in terms of monetary management.\footnote{Ibid at 225.}

Sproul made the case, and made it as strong as he could.

It wasn’t enough, and it was taking a toll on his health. Ritter, the editor of some of his papers and author of a biographical note, wrote that more than the Fed-Treasury Accord, the “bills only” fight took everything out of him. “His ulcers had become so bad that it would take a week of milk and bland foods following the tension of every Open Market Committee meeting before he began to feel well again.”\footnote{Ritter (1980, 16).} After a few more months, and with nearly five years left in his latest appointment as New York Fed president, Sproul announced his resignation.

The news landed in newspapers throughout the country, again, often mistaking his status: “Sproul Resigns as Reserve Head,” said the Washington Post.\footnote{Washington Post, Sproul Resigns as Reserve Head, May 1, 1956, page 34.} The telegrams poured into Sproul. “Allan Sproul and the Federal Reserve were synonymous to me and always will be.”\footnote{Clarence Francis to Sproul, May 24, 1956, BANC MSS79/26 C, Box 3:23} Wrote the President of the New York Stock Exchange, “[t]he news that you are going to retire from the federal Reserve Bank of New York has the same effect on me as would the sudden disappearance of the protective railing around the top of an observation tower.”\footnote{Letter from Keith Funston, President of the New York Stock Exchange, May 4, 1956, Box 3:29} Sproul was replaced by Alfred Hayes, a banker who had had no previous Federal Reserve experience. Despite the New York Times’ insistence that “[i]t would occur to no one to question Mr. Sproul’s simple explanation of his retirement when he says he wants to return to California while he is young enough to enjoy
others viewed the early departure as a victory for Martin, who wanted “more power centralized in Washington” and, with the moves away from New York, succeeded “in cutting the wings and humbling the pride of the New York Bank.”

The legacy of the Martin-Sproul fight was the unmistakable subordination of the New York Fed to the rest of the FOMC on issues of monetary policy, including the key issue of the institutionalized nature of money. The Banking Act of 1935 had already accomplished as much as a matter of law, but the New York Fed’s continued presence on the FOMC and its place of prominence in the heart of the U.S. financial system meant that the legislative change was only partial. Personalities matter, and Martin wrested from Sproul the control of monetary policy, and with it a significant measure of the power of the Federal Reserve System.

*The Poetry of Central Banking*

Another key aspect of Martin’s influence was in his willingness not only to face the public with his ideas—we’ve seen this kind of public-facing attitude in Eccles, during the Treasury-Federal Reserve dispute—but in his ability to speak about the technical aspects of central banking policies in ways that would appeal to, and be quoted by, others in the general public. This kind of approach was a marked departure from the standard for central bankers set by Montagu Norman, the long-time Governor of the Bank of England from 1920 to 1944, whose ethos was purportedly to “never explain, never defend,” a

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427 *The Economist*, June 2, 1956
private man who frequently traveled in disguise, under false names, and who viewed any kind of public accountability with profound skepticism.428

Martin, though he grew up at the feet of central bankers, did not share this ethos. Instead, he wanted to explain the Fed to a world not familiar with its operations. It is hard to overstate Martin’s love for metaphors: his public speeches are full of them. Most famously, perhaps, is a 1955 speech before the New York Group of Investment Bankers of America. He was explaining to this group of bankers a point with which they were already familiar: what the Fed does. “In the field of monetary and credit policy, precautionary action to prevent inflationary excesses is bound to have some onerous effects—if it did not it would be ineffective and futile. Those who have the task of making such policy don’t expect you to applaud. The Federal Reserve, as one writer put it, after the recent increase in the discount rate, is in the position of the chaperone who has ordered the punch bowl removed just when the party was really warming up.”429 This image of a central banker willing, if not altogether eager, to resolve the problem of what economists call a “time-consistency problem” whereby our short-term interests conflict with our long-term interests has had an enduring effect. Had he formalized the argument mathematically, he may well have won a Nobel Prize.430

But that wasn’t his only enduring image. The Fed must also, he explained, “lean against the winds of deflation or inflation, whichever way they are blowing.” Another he

428 For more on Norman’s traveling habits, see Ahamed (2009)
430 See Kydland & Prescott (1977) for a formalized version of how central banks can be changed to resolve this problem.
preferred, and used frequently, was that of the economy as a river: the Fed’s aspiration was for money and credit to “flow . . . like a stream. This stream or river is flowing through the fields of business and commerce. We don’t want the water to overflow the banks of the stream, flooding and drowning what is in the fields. Neither do we want the stream to dry up, and leave the fields parched.”\footnote{Interview in U.S. News and World Report, Feb 11, 1955, 56} Indeed, Martin frequently used this kind of language to thwart efforts to trim the Fed’s sails or be bullied by politicians. After he had accepted one of Lyndon Johnson’s infamous invitations to tour the President’s Texas ranch at blistering speeds with Johnson driving recklessly, Martin took the opportunity to point out a large boulder interfering with the flow of the river on the property. Martin explained to Johnson that raising the discount rate was like removing that boulder: it would let credit, like water, run more smoothly. When Martin recounted the exchange to Fed staffers, they quickly corrected the Fed Chairman: that’s not how discount rates work. Martin responded: “Well, it did this time.”\footnote{As recounted in Bremner (2004, 211)}

Martin changed the language and style of central banking. He was a marked departure from Eccles, of whom even close friends described as problematic from the perspective of leadership. As one friends remembered in an oral history, Eccles “had little hesitation in telling anyone—his staff, senators, even presidents—what ought to be done, and even his friends called him abrasive with both superiors and subordinates.”\footnote{As recorded in Kettl (1986, 52).} That was not Martin’s style. In word and deed, he sought to change the public’s perception of what the Fed did. This changed conception of Fed practice matched his view of “flexible
monetary policy,” or the ability to use words and actions to nudge markets in desirable directions, not bulldoze them. By changing the practice and language of monetary policy alike, Martin offered a new theoretical justification for the central bank itself, away from the idea that we must strike a bargain between bankers and politicians and instead toward the idea of central bankers as technocrats tinkering with the economy. If the Fed operates in “an economy of words,” as Douglas Holmes has put it, Martin’s metaphors are the tools to explain and legitimize itself.434

Martin, Eisenhower, and Managing the Politicians

Martin’s successes in the early 1950s at consolidating the idea of a Federal Reserve System independent of both New York and Washington was not due to his skills alone. In Dwight Eisenhower, the country—and its central bank—had a strong hawk on inflation, a president with hostility for deficit spending, and one whose understanding, such as it was, of the functions of central banking strongly counseled in favor of repudiating the earlier tensions in the Truman Administration. In his first State of the Union speech, President Eisenhower concluded that “[p]ast differences in policy between the Treasury and the Federal Reserve Board have helped to encourage inflation.” His policy would be different: “Henceforth, I expect that their single purpose shall be to serve the whole Nation by policies designed to stabilize the economy and encourage the free play of our people’s genius for individual initiative.”435

Eisenhower would make his position even clearer later. In 1956, the Board of Governors had just raised the discount rate. When Eisenhower was asked at a press

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434 Holmes (2013)
435 Annual Message to the Congress on the State of the Union, February 2, 1953.
conference about his administration’s opposition to Martin’s move, the President explained that “the only comment I can logically make is this: the Federal Reserve Board is set up as a separate agency of Government. It is not under the authority of the President, and I really personally believe it would be a mistake to make it definitely and directly responsible to the political head of the state.”\textsuperscript{436} This is a fascinating endorsement not of the Accord as it was understood by Sproul, Eccles, or the Truman Administration. But it is the view of Fed independence that Martin preferred. If Martin was the poet of Fed independence in the early 1950s, Eisenhower was the patron who let it be so.

This is a pride that Eisenhower retained for Martin. Later, when Martin was facing flak from the Johnson Administration for the Fed’s interest rate policies, he received a letter from the former president. Eisenhower wrote of “the intense pride I have in seeing you stand 4-square for what you know to be right” and predicted that “history will evaluate your career in the Federal Reserve Board something like it does for John Marshall on the Supreme Court.”\textsuperscript{437} Martin’s name on the Fed’s building suggests that Eisenhower was at least partially correct.

\textit{Conclusion: The Fed-Treasury Accord and the Legacy of William McChesney Martin}

That a relatively obscure skirmish between the Fed and Treasury would reach iconic status many decades later is perhaps the best illustration of the historical and historicist processes of institutionalization that this dissertation seeks to understand. From the perspective of the bankers, central bankers, and politicians involved in the debate in the spring of 1951, it is not at all clear that a program for combating inflation—if this is

\textsuperscript{436} The President’s News Conference, April 25, 1996.\textsuperscript{437} As quoted in Bremner (2004, 211).
how we should interpret the Accord’s aftermath—should take precedence over a newly atomic Soviet Union and the Chinese and Korean Communists they supported on the Korean peninsula. While bankers and the public generally may have had a strong preference for the return to normalcy that they hoped would occur after the end of World War II, putting these sometimes conflict policy goals in conversation with each other is a highly political process. That the Fed’s insiders, especially Sproul and Eccles, were able to maneuver around the President and his Secretary of the Treasury is a remarkable thing.

But even if one believes that combating inflation should take precedence over waging war, or that fighting inflation was part of the national security effort, it bears emphasis that the Accord itself was not universally regarded as establishing that precedent at the time it was reached. The most we can say of the Accord in the spring of 1951—as the nation’s attention was focused on the dramatic confrontation between Truman and MacArthur and the growing menace of Stalinist Communism—is that it announced the end not of collaboration between the Fed and Treasury, but of completely domination of the Fed by the Treasury. The Accord became a kind of critical juncture, in the language of path dependence in political science, that only became more critical after the fact. William McChesney Martin, Jr. is responsible for much of that effort.

Martin’s legacy from the 1950s is two-fold. First, he implemented the Accord to his liking, giving his Treasury sponsors a surprise by the idea that Fed subservience would yield to Fed-Treasury coordination which would in turn yield to Fed independence. At the same time, he changed the operations of the Fed to create what we now call conventional monetary policy: the purchase of short-term government securities
to influence interest rates in a reaction to inflationary or disinflationary pressures, one
nudge at a time, with New York deemphasized, Washington kept at bay, and the Fed
Chairman a position of extraordinary prestige.

Second, he simultaneously created the language—especially the metaphors—of
central bank “independence.” It is a tribute to Martin that he was able to convey his
technical approach of flexible monetary policy in words that are cited by journalists today.
Generally, central bankers are not known for their felicitous phrasings. Martin was an
exception.

Martin would go on to lead the longest tenure as a Fed chair in its history, serving
for just under twenty years. But the rest of his career only underscored how fluid the
institutional context of central banking would become. As he stepped away from the
Fed’s helm, even he acknowledged that he was doing so at a time when the Fed had
failed to manage inflation.438 That the Fed stood at the beginning of the Great Inflation
was not yet clear. Martin’s influence was exceptional, and in many ways long-lasting.
But the institutionalizing of the norms, and the character of his office, would not stand
still. Martin’s role in rendering the institution of central banking and the institution of the
Federal Reserve durable would matter, but not permanently.

Conclusion: Institutionalizing the Federal Reserve

This dissertation has sought to make two kinds of contributions. First, it is an attempt to revisit old assumptions about how the Fed functioned and changed during the Progressive Era, the Great Depression, the Second New Deal, and the beginning of the Cold War. What we have assumed to be true about the Federal Reserve—that it was the progressive response to the panic of 1907, that it survived failures of the Great Depression with relatively minor tweaks, that it stood for technocratic expertise against the overreach of a Cold Warrior president—is incomplete, and sometimes wrong. The historiographic contribution, then, will be to engage scholars of central banking to revisit these key events with new eyes.

These contributions are important not only for the historical debates they enter, but also to reinforce the idea that the Fed has changed so much at so many different junctures that the analysis of its Progressive Era founding isn’t a useful end point for understanding what the institution has become. Doing so is like looking at the Articles of Confederation for insights into whether there exists in 2017 a constitutional right to gay marriage. It’s not a useless exercise, but it’s pretty close.

The second contribution is theoretical and disciplinary. Institutional history is weakly theorized, with an insufficient attention to the definitional and historiographic questions. Institutional history can be, I argue, a viable subdiscipline within history, but only if we do the hard work of defining what institutions are and describing the process of telling their history. This dissertation is an attempt to take institutional history

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439 See Hilt (2017, forthcoming), who notes that historians of capitalism, for example, ignore institutions almost entirely.
seriously, to trace how an organization becomes an institution and to make sense of how to tell an institution’s history.

This kind of methodological-historiographic ambition must necessarily be the more modest of the two goals. My aim is not to settle a question about what institutional history is, but to participate at the beginning of that conversation.\textsuperscript{440} Historians have much to add to other scholars of institutionalism, whether in economics, sociology, political science, or organizational theory. My hope is that this work will invite other efforts—some sympathetic, some critical, some perhaps orthogonal—to take up that charge.

Institutions are different from other historicized concepts, like culture, economy, society, or law. Historians have long heralded their importance. The time has come to give them content, and to tell their histories.

While I invite other scholars to take up the theoretical and methodological task of defining institutions and telling those histories, this dissertation describes my view of what institutions are and how they change (or stay the same). Charting their “path” on some predetermined teleology is foolhardy. As the history of the Federal Reserve shows, there are various junctures at which we might have declared the “end of history” on any one of the themes: private versus public control, the definition of money, the separation from central banking from other forms of government, or even the professional identity of the central banker herself. Indeed, that conclusory narrative—especially, for example,\textsuperscript{440} The two edited volumes I cite throughout the dissertation, Mahoney and Thelen (2010) and Bucheli and Wadhwani (2014) are valuable first steps in this conversation, though they are with their limits.
about the Fed-Treasury Accord as the beginning of “Fed independence,” whatever that means—is precisely the narrative I argue against.

Instead, institutions are constantly changing, their future undetermined. And so, in fact, is their past. As we have seen again and again in this dissertation—from the invocation of Walter Bagehot to the reinterpretation of the Bank Wars during the Fed’s founding to the Fed’s responsibility for the Great Depression and perhaps especially the reinterpretation of the Fed-Treasury Accord—interested parties will seek to reinterpret the past so that moments that moved through history one way are repurposed for other uses later on. All of this change is at the core of the process of institutionalization: Interest groups’ preferences may be slippery, frameworks for resolving debates may change, and the fundamental character of finance and society may shift so dramatically that we are using old vocabulary to address new concerns.

This sense of shiftlessness and impermanence is an institutional reality, but my argument about institutional change is not that there can be no history to tell, nor is it that there is only a chaotic tale to tell. My theory of institutions is a more moderate one. If institutions are not foreordained to meet some goal with greater and greater efficiency, they are also sticky in many respects. Indeed, the stickiness is what makes a norm and an organization an institution at all. Institutional change is always against the backdrop of what has come before; there are no do-overs in institutional history.

What this means for historians of central banking or other institutions is to recognize that present institutional arrangements and organizations owe a significant debt to the past. But it also means that those debts are not dispositive. Each generation,
unevenly and with various successes and failures, takes a hand at institutional design and
institutional change. But each generation deals with the institutions they have inherited,
resulting in a kind of “institutional layering,” most recently expressed by Kathleen
Thelen.441 The key to doing good institutional history, then, is not to lose sight of either
reality: the contingencies of the past studied matter no less than the contingencies of the
past that came well before.

The Federal Reserve System illustrates the potential for this kind of narrative
institutional history. The first forty years of the Federal Reserve System were, in a word,
tumultuous. They were tumultuous because the world around the Fed had caught fire in a
thirty years’ global war interrupted only for a global depression. They were tumultuous
because the very conception of what it meant to be a central bank was constantly up for
grabs. And it was tumultuous because the Progressive coalition that sponsored the
Federal Reserve Act gave way to other forces and pressures that served to change in
fundamental ways what the Fed was and how it would operate.

My argument in this dissertation has not been that this forty year period was
particularly tumultuous. Indeed, my conception of institutional history would blanch at
these kinds of comparative assertions. A similar dissertation could be written about
another slice of Fed history, with other “founding” events that served as institutional flash
points that reoriented one or more basic conceptions of what the Fed is or should become.
A full, comprehensive history of the Federal Reserve would be, by this conception, an
account of these strings of founding events.

441 Thelen (2004)
A snapshot of the Fed’s balance sheet over the period covered in this dissertation illustrates this argument about multiple foundings.

Figure 1: Federal Reserve Balance Sheet, 1915 - 1955


What we learn from this view is the essential nature of the “foundings” argument. The balance sheet represents the functional ideas about institutionalized money. And even before the beginning of World War II, we see a radical expansion of that balance sheet (largely due to gold inflows), and we see a dramatic resurgence in the Fed’s consumption of governmental debt. The idea that what the Fed did during this period stayed the same is not a serious one; linking the Fed’s present to its origins, without much reflection, should not be taken seriously either.
The events that followed Martin’s consolidation of Fed functions in the person of the charismatic Chair would justify this conception of institutional history. Martin’s grip on the economy as the national chaperone was strong in the 1950s, but would grow weaker. His relationship with Richard Nixon reached a nadir of presidential relations with the Fed, and the failure to check inflation led in part to the Great Inflation under his successor, Arthur Burns. Just because we see the Fed as an inflation fighter in 1950s doesn’t mean that that institutional role had been cast in amber: as in so many other cases, the Fed’s institutional history was still unfolding.

The financial crisis of 2008 further illustrates how much is up for grabs for institutional evolution of even permanent institutions. The Fed was, in 2006, one of the most respected agencies of the government, according to one Gallup poll.\textsuperscript{442} Its Chair, Alan Greenspan, was the “Maestro,” the man who knew how to control the economy, the one for whom the rest of the political system vied for approbation. It is no coincidence that Bill Clinton, in his first address before a joint session of Congress, placed Chair Greenspan in the First Lady’s box, rich for the photo op that would put the prestige of the Federal Reserve, not the presidency, in the front seat.\textsuperscript{443}

Everything changed in 2008. The financial crisis led the Fed to invoke authorities that had long lay dormant in law and in practice. The very act of this invocation, followed by radical changes in the statutory framework governing Fed authority and the practical

\textsuperscript{442} Carroll (2006)  
\textsuperscript{443} Conti-Brown (2016, 196)
use of tools of unconventional monetary policy, represented defining, founding moments of the Fed’s history that have defined the Fed for the public in profound ways. Gone is the Fed’s prestige and popularity. When Gallup conducted a similar survey in 2013, only the IRS was less popular.\textsuperscript{444}

As I complete this dissertation in the spring of 2017, we are in the midst of another defining season for the Fed. The election of Donald Trump to the presidency will mean many things to many different constituencies. For the Fed, President Trump’s anti-technocratic positions will present an unusual challenge. There are, at this writing, three vacancies at the Fed’s Board of Governors. As President Trump fills them, he will have the chance to leave his mark on the Fed, as all presidents do. But we should also expect to see an extra-legal process by which the President uses the significant resources of the Administration to provoke the Fed. The President should expect to see an institutional fight from the Fed; he will see there will be real difficulties in launching a significant reform effort by sheer dint of presidential will power. But he will also see that the Fed’s responses to his policies may lead to another founding moment. What kind of Federal Reserve survives this process is anyone’s guess. That the Fed will emerge a different institution should not, however, be a surprise.

\textsuperscript{444} Jones and Saad (2013)
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