The Great Debate on Banking Reform

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The revival of interest in the origins of the Federal Reserve System has been an exciting scholarly development. With the exception of West’s (1977) study, the topic had lain dormant since the 1920s. Part of the revival has been purely accidental; it coincided with the works of two historians, James Livingston (1986) and Richard McCulley (1992), and a political scientist Lawrence Broz (1997). Previously, neither historians nor political scientists had paid any attention to the origins of the Fed question. Economists’ interest was also reawakened; they were attracted to explanations of the origins of the Fed with the underpinnings in the private clearinghouse association within a self-regulating framework. The initial sparks have ignited a whole new research agenda.

The U.S. problem had been to get bankers to take action, especially during banking panics, that would benefit all as members of a group but might not be thought to be consistent with their individual self-interest. A solution to the collective action problem seemed to reside in the clearinghouse, a voluntary association of banks originally created to expedite the clearing and collection of checks, but which subsequently provided the only opportunity for organized cooperation among the participating banks. Collective action by the New York Clearing House was responsible for forestalling banking panics in 1860 and 1861 (and less successfully in 1873) by agreeing to the equalization or pooling of reserves among the NYCH banks. Thereafter, reserve pooling in a crisis was abandoned for lack of support and was never revived. Banks with surplus funds were reluctant to aid banks with a deficit of funds. Self-interest crowded out collective action.

In the absence of effective collective action, solutions were sought to the
inelastic currency and banking panic problems that focused on the individual bank motivated solely by self-interest. This class of banking reform proposals was asset-based. Currency issued by individual banks chartered by the comptroller of the currency (national banks) had been bond-secured; that is, a national bank could issue paper currency upon the purchase of eligible government securities. Advocates of banking reform from 1894 to 1908 were dissatisfied with a bond-secured currency for reasons that will become clearer later and substituted an asset-based currency on commercial paper. The amount of currency each participating bank could issue was constrained to a proportion of its capital stock. Moreover, a guaranty fund protected noteholders of failed banks. The safeguards against overissue did not satisfy everyone. There remained the threat that small local banks would overissue and thus generate inflation. Asset-based currency proposals were the immediate forerunners of a U.S. style central bank. Any inquiry into the origins of the Fed necessarily entails a detailed account of the various proposals and their legislative success or failure.

We begin by summarizing the work of the two historians: James Livingston (1986) and Richard McCulley (1992), and then we take up the contribution of J. Lawrence Broz (1997), a political scientist. We then turn to the contributions of the economists: Mark Toma (1997), Gary Gorton and Donald Mullineaux (1987), Richard Timberlake (1984), and Ellis Tallman and Jon Moen (2001). We begin with a short summary of their contributions and then turn to a more extended discussion.

Our knowledge of the movement for banking reform has been considerably enhanced during the past fifteen years by the three major studies of Livingston (1986), McCulley (1992), and Broz (1997). Both Livingston and Broz have advanced original interpretations of the Fed’s origins. Livingston, a neoprogressive (Marxist), attributed the Fed’s origins to the concentration of ownership and control of the modern corporation which, he thought, required a centralization of financial responsibility in the guise of a central bank. Broz also called attention to the structural changes taking place in the American economy after 1870. The growth of the U.S. share of world trade required the “internationalization of the dollar.” Before 1913 the dollar was not an international currency, and the financing of exports and imports was in the hands of foreign bankers. To gain an increased share of world trade, New York bankers needed to spearhead a movement for banking reform which necessitated also a reform of the payments mechanism.

Although less original than Livingston or Broz, McCulley (1992) set his historical narrative in a broader political context, illustrating how sectional and economic interests together with political and partisan clashes shaped the course of banking reform. He did not think the origins of the
Fed were to be found in purely economic considerations; that is, in structural weaknesses of the national banking system. Banking reform may have originated in frequent banking panics and seasonal money market stringency, but something more was required if banking reform was to succeed.

Namely, bankers and businessmen had to be aroused, to be followed later by a well-mobilized public opinion to ensure a favorable legislative response by the politicians. The task was formidable and required patience, self-discipline, and, more importantly, experienced leadership. McCulley’s study is the best organized of the three. Although there are no original hypotheses or startling revisions of interpretation, his scholarship is sound and his judgment mature, which gives the narrative a tone of authority missing in Broz and Livingston.

What distinguished each of the three from earlier treatments of the origins of the Fed is the extensive use of manuscript collections including those of Glass, Willis, Aldrich, Warburg, Vanderlip, and Laughlin, as well as others. McCulley and Livingston are the first historians, to my knowledge, to have attempted a serious and extended treatment of the origins of the Fed. Neither economists nor economic historians of money and banking had taken the pains to explore the archival sources. West (1977) was the exception; he acknowledged the use of the papers of Willis, Strong, and Laughlin, but no others.

McCulley and Livingston fill an important gap in the literature on the origins of the Fed by describing the progress of banking reform from the mid-1880s until the passage of the Federal Reserve Act in 1913. For example, we have full descriptions of what happened at the Indianapolis Monetary Convention in 1896, the proposals presented to the American Bankers Association at various intervals, the evolution of the Aldrich-Vreeland Act (1908), and the Aldrich bill (1912). Proposals for banking reform such as branch banking, deposit insurance, asset-based currency, and a central bank are described fully. By the time of the appointment of the National Monetary Commission in 1908 various banking reform proposals with the exception of a central bank had been thoroughly canvassed, at least between bankers and business leaders. What was absent was any progress toward reconciling the various remedies. A catalyst was missing. And no group was able to exert strong leadership to eliminate these differences.

Various remedies for the elimination of banking panics were on the table: branch banking, deposit insurance, and the like, but they were regarded as politically infeasible. An asset-based currency issued by the national banks had been rejected by the New York bankers. The reserve pooling remedy of the NYCH had been forgotten.
JAMES LIVINGSTON

Livingston’s interpretation of the origins of the Fed is Marxist inasmuch as the prime mover was a so-called business elite, a ruling class who were committed to remaking capitalism in the United States. The concepts of class and class-consciousness explain the emergence of a ruling class. Although the phrasing is recognizably Marxian, the language turns out to be extraneous to the events being described. It is the facts being described rather than the interpretation imparted to them that lend merit to Livingston’s study.

He is the first historian to have systematically utilized the papers of the leading participants in the post-1870 movement for banking reform. Moreover, he has provided a detailed description of the main issues and events associated with the banking reform movement from 1870 to 1913. His account of the movement for banking reform in the United States begins well before the Aldrich-Vreeland Act and the creation of the National Monetary Commission in 1908. By that date considerable progress had been made in identifying the alleged weaknesses of the national banking system, in suggesting remedies, and in educating the general public about the necessity for banking reform. But there was still a long way to go. No consensus had been reached about what ought to be done. Both the corporate and banking sectors exercised initiative in mobilizing opinion within each sector and provoking discussion about the various remedies. In these endeavors the American Bankers’ Association (ABA) and the New York Chamber of Commerce, as well as the Indianapolis Monetary Convention, deserve special recognition.

Among the issues drawing the most attention were an asset-based currency, branch banking, deposit insurance, and a central bank. The ABA had recommended the Baltimore Plan in 1894 for the issue of currency on the basis of general assets of the banks. The report of the Indianapolis Monetary Commission in 1896 also recommended an asset currency coupled with a proposal for branch banking. Livingston maintained that until 1902 the movement for banking reform centered on the recommendations of the Indianapolis Monetary Commission. The Fowler bill of the same year added a branch banking provision.

The Livingston narrative established how far the debate had progressed by 1907 on the necessity of an asset-based currency, the establishment of some form of central bank, and the mobilization of corporate and business opinion on the merits of banking reform. He identified the leaders who were in the forefront of pre-1907 banking reform, Frank Vanderlip, A. Hepburn, J. Laughlin, J. Forgan, Lyman Gage, and many others, and evaluated their contributions.
Livingston attempted to show how a corporate business elite organized the movement for banking reform and constituted its social basis. This sentence could stand equally well if the word “elite” were removed; he documented how business leaders mobilized public opinion and orchestrated the movement for banking reform. The novelty of Livingston’s interpretation does not reside in its Marxian underpinnings but in two controversial hypotheses he advanced to explain the movement for banking reform and the creation of a central bank: (1) the controlling assumption of the reform agenda after 1893 was that the banking sector had countercyclical responsibilities; and (2) concentration and control of the new corporate business sector required a corresponding centralization of responsibility in a central bank. He proposed the first hypothesis to explain the movement for banking reform which began in the early 1890s. It coincided with a serious economic depression and shaped the outlook of businessmen and bankers who were seeking remedies for the economic malaise. Currency reform, he thought, was a countercyclical solution. Without a central bank, the banking sector had the responsibility for maintaining effective demand; specifically, he meant the expansion of bank lending. The recognition of these responsibilities would be enhanced if legislation were enacted removing the tax on the issue of state bank notes, legalizing clearinghouse certificates, and allowing banks to issue an asset-based currency.

The Livingston hypothesis placed banking reform in the broader context of the business cycle, in sharp contrast to a narrower framework of seasonal movement of interest rates and banking panics. The implicit assumption never stated was that currency reform would provide a device for moderating cyclical changes in economic activity, and that was the motivating objective of the reformers. The weak link in the chain, however, is the relationship between smoothing interest rates, eliminating banking panics, and moderating economic contraction. Livingston attempted to demonstrate that the movement for banking reform must be viewed in the broader setting of general economic activity, and the bankers were supposed to recognize their countercyclical responsibilities.

Livingston’s second hypothesis can be put in its strongest form, as follows: the existence of a growing corporate business sector implies the existence of a central bank. But he failed to provide any evidence to support that proposition. Was the existing institutional framework effective in providing for the financial requirements of an expanding corporate sector? Were the capital and money markets up to the task? The answer to the first question is far broader than the creation of a central bank. The key issue is the efficiency with which saving was channeled into investment—the intermediation process. Banks obviously play an important role in this process, but it is not at all clear why a central bank is a necessary condi-
tion for the efficiency of the intermediation process or the efficient functioning of the capital market. Livingston has not identified specific defects in the capital markets that required the intervention of a central bank.

Contrary to Livingston’s assertion, heads of corporate business and bankers did not labor long and hard for a central bank, but as we shall show, for a particular form of central bank that was banker controlled. When President Woodrow Wilson rejected their plea for banker control, their enthusiasm turned to anger and frustration. They opposed the passage of the Glass-Owen bill. The so-called business elite and ruling class received a rude awakening. All, however, was not lost. Glass-Owen allowed New York banks to engage in the financing of the export trade. The opposition of the New York banks was noted by Willis (1923, pp. 306–7):

‘The New York group or element in the National Citizens League which had been previously hostile to anything except the Aldrich bill, from the very beginning practically declared open war; its members employing all of the usual legislative stratagems and methods for the purpose of defeating the Federal Reserve Act in the Senate, or at all events amending it back into conformity with the terms of the Aldrich measure.’

Livingston’s exposition of the views of the leading participants in the Great Debate on banking reform is frequently marred by his literal transcription of an archaic and obsolete economic language usage in which their views were embedded. Consequently, often the reader is not able to make heads or tails of the validity of the issue being contested. And Livingston refrains from either translating the language into current jargon or attempting to evaluate the validity of the archaic argument.

J. LAWRENCE BROZ

Broz, who is a political scientist, has succeeded in producing an original interpretation of the origins of the Fed—no mean feat considering that the Federal Reserve Act is over eighty-five years old. He assigned a key role to international considerations, downplaying the conventional view that domestic factors were paramount, most notably the prevention of banking panics. Without a new international goal, he maintained, there was no plausible explanation of how the barriers to collective action were surmounted. It was the rapid advance of the American economy after 1870 that generated the requisite incentive to undertake a drastic reform of the banking system.
The dollar had no international stature, and American exporters and importers had to rely on foreign banks to finance external trade. With the rise of America's global position, these arrangements became increasingly irksome and created a demand for institutional change. The opportunity cost of the existing financial machinery in the form of lost potential revenue to American banks increased. The handful of New York banks that could take advantage of an internationalized dollar had a strong financial incentive to initiate a plan for banking reform that would enable the dollar to acquire the status of an international currency. But that entailed the overhaul of the payments machinery as well. The one could not be accomplished without the other.

To explain how the appropriate incentive structure to innovate was generated, Broz (1997, p. xi) resorted to Mancur Olson's joint products model, which he thought was the key to understanding the voluntary collective action behind the Federal Reserve Act; Broz maintained that "a public good produced jointly with a private good can yield collective action in a large group setting, because the addition of the private good creates the necessary convergence between the individual and the social costs of collective action." To put it another way: if an agent wants to produce a private good whose production is contingent on the production of the public good, it will act as the incentive to produce both goods. Internationally the dollar was the private good desired by a small group of large New York banks, and the redesign of the payments mechanism was the public good.

It was not the benefits of the elimination of banking panics that provided the motivation, but the potential gains to a few banks of revamped international monetary arrangements. That explains the key entrepreneurial role played by a small coterie of influential New York bankers selected by Aldrich that constituted the vanguard of the banking reform movement. The Federal Reserve Act was a response to the new role of the United States in the world economy, not as previously thought the answer to the domestic financial instability produced by banking panics. International considerations were the catalyst for banking reform.

Improving the role of the U.S. dollar in world trade was a well-recognized goal of both the Aldrich and the Glass-Owen bills. Broz simply elevated its priority as a motivation for creating the Federal Reserve System. But he underestimated what other powerful incentives might have motivated the New York bankers besides anticipated gains of internationalizing the dollar. Foremost among these other incentives was the desire to shape whatever changes were to be made so as to conform to the preferences of the New York banks, namely a new banking structure that would minimize outside governmental interference and prevent the creation of
an asset-based currency. The New York bankers had a relatively low opinion of the knowledge available in the rest of the country on matters pertaining to banking reform; they would be loathe to surrender the initiative to the midwestern bankers or to politicians in Washington.

Why, we may ask, if international considerations were paramount, did the New York banks so strenuously oppose the Glass-Owen bill? The framework for internationalizing the dollar was not a matter of dispute. If they had achieved their primary objective, why wrangle over the control issue? After all, according to Broz, it was the benefits from dollarization that explains the incentive for change. Broz states that their public opposition to the bill was contradicted by their privately held views; that is, they thought that they could live with the bill though it left much to be desired. Nevertheless, they were prepared to sabotage the Glass-Owen bill even if they had gained their international objective. That hardly makes sense.

RICHARD McCULLEY

The third study on the origins of the Fed to be considered was also the work of a historian. He tells the story of the banking reform movement from the time of the Indianapolis Monetary Convention in 1897 to the creation of the Federal Reserve System in 1913. Unlike Livingston and Broz, there are no grand new interpretations or surprising hypotheses to reveal. The distinctiveness of his contribution resides solely in his imaginative organization of the narrative. He constructed a three-part scheme purely for narrative purposes as a device for classifying the various proposals for banking reform: Wall Street, LaSalle Street, and Main Street. Proposals emanating from New York were labeled Wall Street; those originating from the ABA, largely dominated by Chicago bankers, LaSalle Street; and from the many small town banks and local businesses, Main Street. There is much to be said for McCulley’s schema, which tended to remove political and partisan differences from the spotlight and shifted the focus to regional and sectional differences instead.

In the approximately two decades before the Federal Reserve Act was passed, the weaknesses of the national banking system were fully aired and specific remedies proposed. No agreement, however, could be reached about what the preferred remedy should be. The debate had focused on the merits of a bond-secured and asset-based currency. Should all greenbacks be retired? LaSalle Street favored the retirement of U.S. notes and their replacement by an asset-based currency. The ABA authorized a currency report in 1906 which called for minimum government interference in banking and an asset-based currency. Wall Street, on the other hand, was
unalterably opposed to giving individual banks the power to expand the note issue. Main Street preferred provision for the issue of emergency currency without any drastic changes in the note issue function.

McCulley identified the leading issue following the 1907 panic as the role government would play in a reformed banking system. LaSalle Street preferred self-regulation and a minimum of government control. Both LaSalle Street and Wall Street agreed that the government's role should be small, the smaller the better. But when the initiative for initiating legislation shifted to Aldrich, he assembled a group of like-minded young New York bankers to meet at Jekyll Island to draft a banking bill. McCulley's portraits of the participants revealed a group of self-confident, intelligent, and well-informed New York bankers who never doubted their credentials for the task before them. Central to the Jekyll Island concept of a central bank was autonomous banker control, that is, independent of government: “the essence of the Jekyll Island Plan was a centralized banking system that was independent of government, beyond political reach and that was banker administered in the interests of the financial community as a whole” (1992, p. 233). To McCulley this was the crucial issue. Apparently no consideration was given to a government controlled structure, although minority representation by government was debated. The priorities of the Jekyll Island group matched those of LaSalle Street and Main Street. Self-regulation was not only favored by the bankers; it was highly regarded by Carter Glass, the author of the Glass bill. It was based, however, on his commitment to the real bills doctrine. There was no need for outside regulation; credit would expand and contract with the needs of business. Glass thought that at least there should be some banker representation on the Federal Reserve Board but abandoned his position out of deference to the wishes of President Wilson, to whom banker control was anathema.

Neither Livingston nor McCulley regarded the progress of banking reform legislation through the various committees of the House and the Senate to be deserving of careful and detailed consideration. Livingston thought that it added nothing to his account of the origins of the Fed. McCulley skipped over it quickly, even though he regarded banker control the key issue; but it was the subject of extensive discussion during the debates in Congress.

McCulley's distinctive contribution resides in his description and analysis of the politics of banking reform, that is, the process of consensus formation by which a specific banking reform goal is achieved. This task is quite different from assessing the economic viability of various banking reform proposals. What was economically viable was not necessarily politically feasible. The main participants in the Great Debate included...
bankers, businessmen, economists, and legislators, as well as the president. A successful policy outcome turned on either reconciling or muting diverse and conflicting interests. There were marked differences between bankers and legislators. McCulley’s telling metaphors—Wall Street, LaSalle Street, and Main Street—were meant to capture some of those conflicting interests. Banker opinion dominated the first stage of the debate, which was controlled by LaSalle Street and the proposal for an asset-based currency. At the beginning of the second stage Wall Street bankers seized the initiative when they recommended a central bank.

Once reform measures reached the legislative stage, purely partisan political considerations surfaced. Legislation originating with bankers and business trade associations while the debate process was in gestation was presumably nonpartisan, but legislation required a congressional sponsor, and the debate thereafter assumed a partisan tone. The partisan character of the debate became sharper when the president saw fit to exercise leadership. In 1912 the Democratic platform contained a plank expressing opposition to the Aldrich bill and a central bank. The emergence of a party agenda for banking reform came rather late in the debate. It was preceded by attempts to reach consensus among the interested parties, mainly bankers and businessmen. Congress was not reluctant to initiate legislation, but in the absence of strong support from bankers and businessmen, it could go nowhere.

ORIGINS OF THE FED: ECONOMISTS’ CONTRIBUTIONS

Reawakened interest in the origins of the Fed was reflected not only in the Livingston, McCulley, and Broz studies, but also by a series of papers by Gorton (1985), Gorton and Mullineaux (1987) and Timberlake (1984), as well as a monograph by Toma (1997). Toma (1997) and Gorton (1985) advanced a novel hypothesis: that the founders of the Fed intended to create a national clearinghouse rather than a modern central bank. The national clearinghouse was supposed to compete with the private clearinghouse system. In Toma’s model, public finance considerations, namely government revenue requirements, were important in predicting fundamental changes in monetary institutions. Seigniorage requirements presumably dictated the kind of banking reform. If the seigniorage requirements were large, a central bank would be preferred to the national clearinghouse arrangement, but seigniorage requirements were not significant. Toma and Gorton concluded the founders of the Fed created a competitive reserve banking system of limited national scope that was supposed to be self-
regulating in accordance with the real bills doctrine. Toma acknowledged (1997, p. 30) that public finance considerations “played a relatively minor role in this political and economic debate leading up to the founding of the Fed.” They were absent. It is indeed anomalous to attribute a critical role to public finance considerations even when the founders were ignorant of their own motivation! The significance of real bills influence will be addressed in a later chapter.

Timberlake (1984) believed that the creation of the Fed was partly a reaction to the discretionary policies of the secretary of the treasury, who had assumed some responsibility during banking panics by injecting govern- ment funds, especially in select New York banks. His actions had been condemned by bankers in the interior as arbitrary, having the undesired effect of holding down interest rates. Proposals had been made to turn the U.S. Treasury into a central bank, but the debate focused on other remedies, notably an asset-based currency.

Ellis Tallman and Jon R. Moen (2001) find the origins of the Federal Reserve System in the panic of 1907. Not only did the panic accelerate the banking reform movement, but it was the distinctive characteristic of that panic that converted the New York bankers to the idea of a central bank. In a series of papers (1990; 2001, p. 148) the authors have focused on the trust companies in New York as the source of the 1907 crisis. Deposits of New York City trust companies fell nearly 37 percent compared with a decline of more than 11 percent for state banks in the city, whereas the deposits of New York City national banks actually increased by over 8 percent. The banking panic in the city was a trust company panic, where the suspensions were the highest. Since the trust companies were not members of the NYCH, they were refused financial support. But there was more to it than nonmembership in the NYCH. Jealousy and rivalry among the commercial banks and the trust companies was also a factor. Although aid came eventually from a consortium of banks initiated by J. P. Morgan, the runs on the trust companies continued. Nevertheless, some of the younger generation of New York bankers—Strong, Vanderlip, and Davidson—became convinced of the necessity for a central bank. But we may very well ask why Tallman and Moen did not conclude that allowing trust company membership in the NYCH was the solution. Since the trust companies were allegedly the source of the 1907 panic, making provision for their support during banking disturbances through the clearinghouse should have solved the problem. Why the necessity for a central bank?

Earlier attempts to find a solution to the banking panic problem through the NYCH were overlooked by Gorton (1985) and Toma (1997). Although Timberlake (1984) was aware of these efforts, he objected to the equalization of reserves (reserve pooling) for two reasons: (1) due to moral
hazard, the individual bank would feel no constraint in making demands on the pool; and (2) pooling was unnecessary, for banks with surplus reserves would lend to banks with deficit reserves, thereby redistributing the pool of reserves. Surplus banks, however, were not disposed to decrease their stock of legal tender to deficit banks so that they could continue to pay out currency to interior banks. Timberlake (1984) asked: “Why did we establish a central bank under government auspices when the clearinghouse system, with some modification, could have refined and continued as an effective lender of last resort?” The modification he had in mind, however, was not reserve pooling. Rather, the clearinghouse should be permitted to issue currency with a security collateral requirement. Unlike clearinghouse loan certificates, these notes would be paid out and thereby enter the general circulation. The loan certificate was a device that allowed the clearinghouse in effect to discount paper of the participating banks, the proceeds of which could be used to discharge clearinghouse indebtedness, thereby serving in a limited sense a central bank function. The issue of loan certificates did not, however, prevent interior banks from reducing their banker balances and demanding legal tender currency. These demands when unmet could lead to the suspension of cash payment by the clearinghouse banks. The clearinghouse could not issue currency, although on occasion certificates of small denomination did circulate. Suspension of cash payment was not a matter of insufficient reserves. The problem lay in the unequal distribution of these reserves among the twelve or fifteen largest New York City banks holding the majority of bankers’ balances. Some of these banks had a surplus of reserves, some had a deficit. In 1860 the NYCH called for a pooling of reserves whereby specie belonging to the associated banks would be treated as a common fund for mutual aid and protection. This pooling arrangement was used successfully in 1860 and 1861 and less so in 1873.

The reserve pooling arrangement as a viable remedy for banking panics was retrieved recently by Wicker (1996) to illustrate how far the New York Clearing House and its leaders had gone in recognizing its responsibility for banking stability and creating the instrument for its implementation. Walter Bagehot was doing the same for the Bank of England at precisely the same time! The London Economist (Dec. 8, 1860, pp. 5–6) called the reserve pooling device “as remarkable as any which the remarkable annals of commercial panics can show, and one which removed the difficulty in a ‘strange way.’” A month later (Jan. 26, 1860) it stated that reserve pooling was “an expedient view, we believe, in banking and showing their bankers great confidence in each other, the result has been entirely satisfactory.” The New York Times (Nov. 22, 1960, p. 8) reported that the NYCH had voted to meet the crisis “primarily and boldly by unlimited expansion” by
making “common their whole stock of specie now about 20 million.” Currency could be paid out as long as it lasts, and if not adequate “they will go down together . . .” The *Times* acknowledged that the strategy was new, but it was the “approved and successful policy under such circumstances, of the national banks of England and France.” The NYCH had recognized as early as 1858 that the associated banks in New York City were the holders of the ultimate banking reserve.

In a report (NYCH, No. 5, 1858, p. 50) prepared by George S. Coe, president of the American Exchange Bank in 1858, it was clearly acknowledged that the New York City banks were the ultimate holders of the specie reserve and “bear the same relation to this country as the Bank of England does in the United Kingdom.” Moreover:

It must always be remembered that the absence of any important central institution, such as exists in other commercial nations, the associated banks (NYCH) are the last resort in this country, in times of financial extremity, and upon their stability and sound conduct the national prosperity greatly depends.

No statement of the responsibilities of the NYCH was ever stated more clearly. Reserve pooling and the loan certificate were the instruments forged specifically for panic prevention.

After the 1873 panic no more is heard about reserve pooling. Opposition had arisen because some banks attempted, a few successfully, to evade the pooling arrangements by treating newly received greenbacks as “special deposits” which were excluded from the pool. The greenbacks were then replaced with national bank notes and paid over the counter. A policy of collective action was suppressed by the stronger rent-seeking motivation of some of the NYCH banks.

Charles F. Dunbar (1907, p. 146) and Oliver Sprague (1910), both professors of economics at Harvard University, did their utmost to keep the idea of reserve pooling alive, but they were unsuccessful. Sprague’s study of banking panics of the National Banking Era for the National Monetary Commission set out very clearly and persuasively the reserve pooling policies of the NYCH in 1860 and 1861. However, there are no references in the congressional hearings and debates on the Glass-Owen bill to such an arrangement. It evaporated from the literature, which probably accounts for Gorton and Toma’s omission of any discussion of this remedy.
RECAP

The brief survey of recent contributions to the origins of the Fed literature reveals the extent to which scholarly interest has been aroused. What is indeed surprising is that it includes the work of two historians and a political scientist, as well as economists. Economists might have been expected to maintain a lively interest, but why the recent burgeoning attention? We may conjecture that they were responding to the persistent and sometime strident criticism of central bank behavior by reopening the question: Are central banks really necessary? Was there a free market solution? That is no more than a step away from a rephrased question: What were the alternatives to the creation of a U.S. style central bank?

I have not been able to find an equally plausible explanation for the newly awakened interest of the historians and a political scientist. They have been Johnny-come-latelies to the operation of the Federal Reserve System. Undoubtedly they are better qualified than economists to unravel the process involved in mobilizing the relevant interest groups in banking and business to support a change to a central bank and the internal politics within the halls of Congress to develop a majority consensus for banking reform. They are less helpful on the purely technical questions of central banking. It could be said that they were merely responding to an acknowledged gap in our knowledge. The timing, however, still remains a mystery.

The Livingston-McCulley contributions leave some crucial questions unanswered. Why were asset-based currency proposals rejected in favor of a central bank? If internationalization of the dollar was the key objective of the New York bankers, why did they reject the Glass-Owen bill? What role, if any, did Senator Aldrich play in the establishment of the Federal Reserve System? Answers to these questions should be found in the chapters to follow.