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The Origins of the Federal Reserve

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The Federal Reserve Act of December 23, 1913, was part and parcel of the wave of Progressive legislation, on local, state, and federal levels of government, that began about 1900. Progressivism was a bipartisan movement which, in the course of the first two decades of the twentieth century, transformed the American economy and society from one of roughly laissez-faire to one of centralized statism. Until the 1960s, historians had established the myth that Progressivism was a virtual uprising of workers and farmers who, guided by a new generation of altruistic experts and intellectuals, surmounted fierce big business opposition in order to curb, regulate, and control what had been a system of accelerating monopoly in the late nineteenth century. A generation of research and scholarship, however, has now exploded that myth for all parts of the American polity, and it has become all too clear that the truth is the reverse of this well-worn fable. In contrast, what actually happened was that business became increasingly competitive during the late nineteenth century, and that various big-business interests, led by the powerful financial house of J.P. Morgan and Company, had tried desperately to establish successful cartels on the free market. The first wave of such cartels was in the first large-scale business, railroads, and in every case, the attempt to increase profits, by cutting sales with a quota system and thereby to raise prices or rates, collapsed quickly from internal competition within the cartel and from external competition by new competitors eager to undercut the cartel. During the 1890s, in the new field of large-scale industrial corporations, big-business interests tried to establish high prices and reduced production via mergers, and again, in every case, the mergers collapsed from the winds of new competition. In both sets of cartel attempts, J.P. Morgan and Company had taken the lead, and in both sets of cases, the market, hampered though it was by high protective tariff walls, managed to nullify these attempts at voluntary cartelization.

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It then became clear to these big-business interests that the only way to establish a cartelized economy, an economy that would ensure their continued economic dominance and high profits, would be to use the powers of government to establish and maintain cartels by coercion. In other words, to transform the economy from roughly laissez-faire to centralized and coordinated statism. But how could the American people, steeped in a long tradition of fierce opposition to government-imposed monopoly, go along with this program? How could the public's consent to the New Order be engineered?

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Fortunately for the cartelists, a solution to this vexing problem lay at hand. Monopoly could be put over in the name of opposition to monopoly! In that way, using the rhetoric beloved by Americans, the form of the political economy could be maintained, while the content could be totally reversed. Monopoly had always been defined, in the popular parlance and among economists, as “grants of exclusive privilege” by the government. It was now simply redefined as “big business” or business competitive practices, such as price-cutting, so that regulatory commissions, from the Interstate Commerce Commission to the Federal Trade Commission to state insurance commissions, were lobbied for and staffed by big-business men from the regulated industry, all done in the name of curbing “big business monopoly” on the free market. In that way, the regulatory commissions could subsidize, restrict, and cartelize in the name of “opposing monopoly,” as well as promoting the general welfare and national security. Once again, it was railroad monopoly that paved the way. For this intellectual shell game, the cartelists needed the support of the nation’s intellectuals, the class of professional opinion molders in society.

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The Morgans needed a smoke screen of ideology, setting forth the rationale and the apologetics for the New Order. Again, fortunately for them, the intellectuals were ready and eager for the new alliance. The enormous growth of intellectuals, academics, social scientists, technocrats, engineers, social workers, physicians, and occupational “guilds” of all types in the late nineteenth century led most of these groups to organize for a far greater share of the pie than they could possibly achieve on the free market.

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These intellectuals needed the State to license, restrict, and cartelize their occupations, so as to raise the incomes for the fortunate people already in these fields. In return for their serving as apologists for the new statism, the State was prepared to offer not only cartelized occupations, but also ever increasing and cushier jobs in the bureaucracy to plan and propagandize for the newly statized society. And the intellectuals were ready for it, having learned in graduate schools in Germany the glories of statism and organicist socialism, of a harmonious “middle way” between dog-eat-dog laissez-faire on the one hand and proletarian Marxism on the other. Instead, big government, staffed by intellectuals and technocrats, steered by big business and aided by unions organizing a subservient labor force, would impose a cooperative commonwealth for the alleged benefit of all.

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By the late 1890s, groups of theoreticians in the United States were working on what would later be called the “Leninist” theory of capitalist imperialism.

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The theory was originated, not by Lenin but by advocates of imperialism, centering around such Morgan-oriented friends and brain trusters of Theodore Roosevelt as Henry Adams, Brooks Adams, Admiral Alfred T. Mahan, and Massachusetts Senator Henry Cabot Lodge. The idea was that capitalism in the developed countries was “overproducing,” not simply in the sense that more purchasing power was needed in recessions, but more

deeply in that the rate of profit was therefore inevitably falling. The ever lower rate of profit from the “surplus capital” was in danger of crippling capitalism, except that salvation loomed in the form of foreign markets and especially foreign investments. New and expanded foreign markets would increase profits, at least temporarily, while investments in undeveloped countries would be bound to bring a high rate of profit. Hence, to save advanced capitalism, it was necessary for Western governments to engage in outright imperialist or neo-imperialist ventures, which would force other countries to open their markets for American products and would force open investment opportunities abroad.

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Congress, however, pressured by the silver lobby, balked at the BIA’s plan. And so the BIA again turned to the seasoned public relations and lobbying skills of Charles A. Conant. Conant swung into action. Meeting with editors of the top financial journals, he secured their promises to write editorials pushing for the Conant plan, many of which he obligingly wrote himself. He was already backed by the American banks of Manila. Recalcitrant U.S. bankers were warned by Conant that they could no longer expect large government deposits from the War Department if they continued to oppose the plan. Furthermore, Conant won the support of the major enemies of his plan, the American silver companies and pro-silver bankers, promising them that if the Philippine currency reform went through, the federal government would buy silver for the new U.S. coinage in the Philippines from these same companies. Finally, the tireless lobbying, and the mixture of bribery and threats by Conant, paid off: Congress passed the Philippine Currency Bill in March 1903.

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Emboldened by United States success in the Philippines, Panama, and Mexico, Secretary of War Root sent Jeremiah W. Jenks on a mission to China in early 1904 to try to transform China from a silver to a gold-exchange standard. Jenks also wrote to President Roosevelt from China urging that the Chinese indemnity to the United States from the Boxer Rebellion be used to fund exchange professorships for 30 years. Jenks’s mission, however, was a total failure. The Chinese understood the CIE currency scheme all too well. They saw and denounced the seigniorage of the gold-exchange standard as an irresponsible and immoral debasement of Chinese currency, an act that would impoverish China while adding to the profits of U.S. banks where seigniorage reserve funds would be deposited. Moreover, the Chinese officials saw that shifting the indemnity from silver to gold would enrich the European governments at the expense of the Chinese economy. They also noted that the CIE scheme would establish a foreign controller of the Chinese currency to impose banking regulations and economic reforms on the Chinese economy. We need not wonder at the Chinese outrage. China’s reaction was its own nationalistic currency reform in 1905, to replace the Mexican silver coin with a new Chinese silver coin, the tael.⁴⁸

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By the time he died in Cuba in 1915, Charles Conant had made himself the chief theoretician and practitioner of the gold-exchange and the economic imperialist movements. Aside from his successes in the Philippines, Panama, and Mexico, and his failures in Cuba and China, Conant led in pushing for gold-exchange reform and gold-dollar imperialism in Liberia, Bolivia, Guatemala, and Honduras. His magnum opus in favor of the gold-exchange standard, the two-volume *The Principles of Money and Banking* (1905), as well as his pathbreaking

success in the Philippines, was followed by a myriad of books, articles, pamphlets, and editorials, always backed up by his personal propaganda efforts.

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It is interesting that for Conant, paper was the most “advanced” form of money. It is clear that the devotion to the gold standard of Conant and his colleagues, was only to a debased and inflationary standard, controlled and manipulated by the U.S. government, with gold really serving as a façade of allegedly hard money.

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At the same time, in the spring of 1910, the numerous research volumes published by the NMC poured onto the market. The object was to swamp public opinion with a parade of impressive analytic and historical scholarship, all allegedly “scientific” and “value-free,” but all designed to aid in furthering the common agenda of a central bank. Typical was E.W. Kemmerer’s mammoth statistical study of seasonal variations in the demand for money. Stress was laid on the problem of the “inelasticity” of the supply of cash, in particular the difficulty of expanding that supply when needed. While Kemmerer felt precluded from spelling out the policy implications—establishing a central bank—in the book, his acknowledgments in the preface to Fred Kent and the inevitable Charles Conant were a tip-off to the cognoscenti, and Kemmerer himself disclosed them in his address to the Academy of Political Science the following November.

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After this meeting, Chicago banker James B. Forgan, president of the Rockefeller-dominated First National Bank of Chicago, emerged as the most effective banker spokesman for the central bank movement. Not only was his presentation of the Aldrich Plan before the executive council of the ABA in May considered particularly impressive, it was especially effective coming from someone who had been a leading critic (if on relatively minor grounds) of the plan. As a result, the top bankers managed to get the ABA to violate its own bylaws and make Forgan chairman of its executive council.
