

The Art of Invisible Governance in Progressive Banking Reform:

Paul Warburg and the Origins of the Federal Reserve

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In 1927, Harvard professor of government William Bennett Munro penned an article for *The Atlantic Monthly* on “the money power” in politics. Speaking of “our invisible government,” he described the consistent and pervasive influence of interest groups on the process of lawmaking in America. The legislature, he contended, only puts the finishing touches on laws, just as a proofreader only puts the finishing touches on a book manuscript. The greater part of legislation is conceived, written, and lobbied for by powers outside of the official government. And since average citizens are too occupied by work and family to follow the machinations of political powerbrokers battling over technical details of arcane legislation, the vast majority of the population remains wholly ignorant of how their government actually operates.¹ This state of affairs, however, did not trouble Munro. Except for a few “hectic interludes,” the United States had since the drafting of the Declaration and the ratification of the Constitution been dominated by wealthy elites with big business connections—in other words, the “money power.”

Munro’s *Atlantic Monthly* article struck a chord with the German-born banker Paul Warburg; the man historian Robert Craig West has called “the single most powerful force in shaping the direction of American banking reform.”² On the first page of his autobiographical tome on the origins of the Federal Reserve System, Warburg reproduces a lengthy quote from Munro’s piece on the money power’s role as an invisible government. “No one conversant with the history of the Federal Reserve Act,” Warburg writes, “is likely to read this passage without noticing how closely it applies to the origin of that measure.”³

The concept of an invisible government guiding state formation raises important questions about the relationship between democratic institutions and the machinery of reform. Historians of the Progressive Era, however, have paid surprisingly little attention to the establishment of central banking in the United States, an event that fundamentally transformed

the federal government's role in the economy. Discussion faded after most of the participants' memoirs were released in the 1920's, and would not revive again until the advent of the New Left sparked an interest in critical reappraisals of Progressive Era reforms. Two historians working in this tradition, Robert Wiebe and Gabriel Kolko, contended that the establishment of the Federal Reserve was the result of the largest Wall Street and Midwestern banks competing for political influence and seeking to protect themselves from competition. Wiebe argued the Midwest won this battle; Kolko argued that New York did. But both saw the formation of central banking as part of the larger process of centralization and corporate rent-seeking that characterized the business world during the Progressive Era.⁴ Debate fell dormant again until 1986, when James Livingston became the first historian to author a dedicated monograph on the origins of the Federal Reserve. Criticizing what he characterized as the "structural-functional" approach of Wiebe and Kolko, Livingston argued that the banking reform movement transcended the social and cultural-intellectual limits of any single interest group. For him, the origins of central banking lay with "the awakening and articulation of capitalist class consciousness." That is, the Federal Reserve's purpose was to stabilize and centralize the financial system and to protect the capitalist class against the political-economic designs of leveling populists and organizing workers.⁵

Economists have authored much of the literature on the early development of the Federal Reserve, and have generally approached the subject with a narrower focus. Robert Craig West, Richard Timberlake, and Nelson White have focused on the discussions and debates between contemporary economists and banking experts. According to this approach, widespread acceptance of the "real bills doctrine"—the idea that bank credit would not lead to inflation if confined to short-term loans to business—determined the form that America's monetary system

would take.⁶ Political scientist J. Lawrence Broz has criticized this view, however, for leaving a crucial puzzle unexplained. According to him, central banking is a public good, and the domestic benefits that the Federal Reserve conferred do not sufficiently explain why rationally motivated bankers undertook the costs of supporting reform. This collective action problem, he concludes, was only overcome because bankers realized that the internationalization of the dollar that American central banking made possible would compensate for the costs of reform.⁷ Most recently, economist Elmus Wicker has argued that all previous interpretations have neglected the role of practical politics. According to Wicker, Nelson Aldrich and Carter Glass provided the previously lacking Congressional leadership in banking reform, successfully removing the political obstacles that had prevented the formation of a central bank in the past.⁸

While the current literature has illuminated the role of banker self-interest, contemporary economic theory, and congressional debate in the formation of the Fed, it has largely ignored the evolving historiography on Progressivism concerned with the Era's implications for democratic government. The reformers themselves were engaged with these issues—none more than Paul Warburg, a recent immigrant intent on importing the German model of central banking to the United States. In both his advocacy and in his professional role as a partner in a leading Wall Street firm, Warburg was an unapologetic defender of what Munro called “our invisible government,” and like many of the reformers of his day, he believed that society's most crucial and most complex institutions should be ruled by experts insulated from public opinion and political control.⁹ The nation's financial sector fit into this category both because of its importance to the economy and because few people outside of the banking industry possessed the specialized knowledge necessary to develop fully informed and nuanced opinions on monetary policy. Warburg would take advantage of his extensive knowledge of European

financial systems and his reputation as an international authority on the principles of sound banking to push his ideas to the forefront of elite discussions on monetary reform in the aftermath of the Panic of 1907. Though his ideology was no doubt self-serving, it would be overly simplistic to dismiss his arguments against political control of the financial system solely on this account. His ideas and his attempts to translate his ideas into reality reveal the tension between democratic government and the establishment of central banking during the Progressive Era.

Warburg was part of a distinguished family of Jewish bankers who had been involved in finance since the eighteenth century. Originally a member of the family firm M.M. Warburg and Company based in Hamburg, he moved to New York in 1902 to become a partner of the influential Wall Street firm of Kuhn, Loeb, and Company, after marrying the founder's daughter. Warburg was thoroughly unimpressed with the American banking system, which he thought was unsuited to the needs of a modern industrialized economy. The system was characterized, he would later write, by the gospel of "extreme individualism." It left everyone "free to have his own individual fling, while the subsequent disaster was the common property of all."¹⁰ Thousands of small banks dotted the countryside. Each state enforced different regulations, and even among the banks of a single state, there was no centralized system to prevent banking panics. The few large national banks based in New York, Chicago, and St. Louis did maintain larger reserves that could be lent to smaller banks desperately short of money, but according to Warburg this was not enough. The currency was "inelastic"; that is, because there was no centralized system to coordinate money flows, banks could not expand the money and credit supply as much as they wanted, especially during recessions. This left them more susceptible to bank runs, which could precipitate a larger bank panic. Such a system was bewildering to a

banker trained in Europe, where reserves were centralized, note issues were “elastic,” and acceptance markets were well developed.¹¹

Shortly after arriving in New York, Warburg drafted a short memorandum outlining his critiques of the American banking system, which he then showed to the senior partner at his firm, his boss and brother-in-law, Jacob Schiff. According to Warburg, Schiff agreed with most of the ideas in the document, but told him that the American people would never accept any system that even appeared to resemble a central bank. Schiff welcomed Warburg’s initiative, however, and circulated the paper among several of his closest associates. At the same time, Schiff warned the recent immigrant to keep his views muted; the American banking community would not appreciate being lectured by a German on the superior virtues of European banking systems. Sure enough, one of Schiff’s select friends who had read the memorandum visited Warburg and challenged his interpretation. The critic, James Stillman, President of the National City Bank of New York, told Warburg that the American system of banking was, in fact, superior to the European. America, he explained, had already discarded its central bank during Andrew Jackson’s administration. Progress would be made not by copying the European model, but by improving upon the American one.¹²

Warburg had yet to learn how to package his ideas in a way that appealed to nationalistic sentiments like these. Stung by the chilly reception and self-conscious of his imperfect English, he remained largely silent about banking reform until 1906, when, on the eve of that year’s financial crisis, he attended a small gathering of bankers and economists at the home of Professor Edwin Seligman of Columbia University. When talk turned to the ominous signs of a failing banking sector, Warburg spoke up and gave his explanation for the nation’s monetary problems. Seligman in particular was impressed and urged Warburg to publish his views. Despite his initial

reluctance, Warburg eventually agreed to write an article for the *New York Times*' annual review of the country's financial conditions.¹³ He found the memorandum he wrote in 1902, brought it up to date, enlisted the help of a friend to assist with his English, and published it as "Defects and Needs of Our Banking System."

Any reticence that Warburg may have held earlier was gone by the time his article was published on January 6, 1907. In the area of banking, he argued, "The United States is 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 Hammurabi." The main reason for this state of affairs, Warburg contended, was the immobility of reserves held by any American bank. There was no central bank to rediscount their borrowers' promissory notes, which meant that promises of future payment could not easily be exchanged for cash to meet depositors' demands. To increase money on hand in the American system, a bank would have to take out a loan itself, an arrangement Warburg deemed "costly and most unscientific." The creation of a central bank, he argued, would eliminate this problem of inelasticity just as it had done in every other civilized country in the world.¹⁴

In seeking to assuage the prevalent distrust of central banking in the United States, Warburg seems to have hoped that Americans disliked politicians more than they disliked bankers. He took the German Reichsbanks as his example, an institution he characterized as "the most perfect organization of its kind." There, the president of the Bank was a salaried professional banker who held his position irrespective of changes in government. It held little political power, he contended; its only duty was to keep the market running smoothly by managing the money supply and acting as a lender of last resort. At the same time, Warburg was not wholly blind to the negative public perception of Wall Street. He tried to portray the idea of a

banker-controlled central bank as the perfect middle road between reform plans that would have given bankers' associations powers traditionally held by the Treasury Department and plans that would have established a central bank under inexpert political control.¹⁵

Warburg's stinging criticisms of the American banking system fell on deaf ears, but later in the year his cause received a major boost. The bankruptcy of the United Copper Company triggered a bank run that soon engulfed the entire country's financial system. As the public sensed the insolvency of their banks, they began demanding gold in exchange for their bank notes and deposits. Most banks did not have enough reserves to meet this demand for hard currency and were only saved from bankruptcy by a federal order that suspended specie payments. That is, the banks were allowed to continue operations without redeeming their customers' deposits in gold. The flood of reform plans that followed the panic can roughly be divided into three categories: those that favored following the populist program and vesting the government with the sole authority to regulate the currency; those that favored following the Canadian model of larger reserve requirements, an asset-based currency, and nationwide branching; and those that favored following the European model of central banking. The populist agenda, which aimed to provide farmers and small businessmen with cheap credit, found most of its support among the Democratic Party. The Canadian model, which aimed to reform the current financial system within a decentralized framework, was mostly supported by Republicans. After the panic, however, the majority of the financial community became convinced of the need for a European-style central bank that could bail out ailing financial institutions.¹⁶

At the height of the panic, Warburg published a second paper, "A Plan for a Modified Central Bank," that criticized rival proposals and aimed to offer a more concrete version of his plan. The idea of establishing an asset-based currency (which would tie the amount of currency a

bank could issue to its real assets) was wholly inadequate to the scale of the problem, he argued. Under such a system, reserves would still be inelastic; the excess reserves of one bank could not be used to supplement the insufficient reserves of another. Only a central bank run by a board of independent experts could provide the elasticity necessary to ensure a stable financial system. As a starting point, Warburg suggested that this board be composed of delegates from the largest banks, delegates from the chambers of commerce of the largest cities, and include the Secretary of the Treasury and the Comptroller of the Currency. This rough outline was intended to give an example of a board “which would be independent of politics, which would comprise men of business knowledge and experience, and which, by its composition, would afford a reasonable guarantee that it would not be swayed by selfish motives in its actions.”¹⁷ Taking into account the reception of his previous paper, Warburg realized that his opponents would attack this plan as un-American and attempted to preempt these charges. Rival reform plans, he contended, gave vast and vaguely defined powers to one or two political officers in the Treasury Department, who may or may not have business or banking experience. The proper route for “a democratic, a conservative, and a modern” government was to vest clearly defined and limited powers in a central bank run by a committee of the country’s best-trained businessmen.¹⁸

Late in December, Senator Nelson Aldrich visited the offices of Kuhn, Loeb, and Company to inquire about some of the internal workings of the German Reichsbank. Aldrich, who was busy working out the details of a stopgap reform bill (which was later to become the Aldrich-Vreeland Act), was referred to Warburg. The resulting conversation strayed beyond the Reichsbank, and Aldrich invited Warburg to send him any further suggestions he had for currency reform.¹⁹ Warburg availed himself of the opportunity, and sent the Senator two letters over the course of the next week. Aldrich did not yet support the establishment of a European-

style central bank, so Warburg made two suggestions meant to make his idea more politically palatable. It would be feasible, he wrote, to withhold from the proposed institution the power to discount commercial paper and the right to receive government deposits. The stripped down central clearing house thereby created would not be a full fledged central bank, but it would still serve the key function of centralizing reserves in its role as a “banker’s bank.”²⁰ Warburg offered these suggestions with the knowledge that significant segments of Congress and the general public would promptly reject his ideal centralized European-style bank. Over the next six years, as Warburg “continued hammering my doctrines into such victims as came my way,” he would persist in his attempts to couch his plan in democratic language and show his willingness to compromise with the American decentralist tradition, as long as such measures were “a step in the right direction.”²¹

Warburg did not think the Aldrich-Vreeland Act, passed on May 30, 1908, was a step in the right direction because it kept bank reserves decentralized. He was pleased, however, that the bill provided for the creation of a monetary commission under the chairmanship of Senator Aldrich that was charged with investigating the banking systems of other countries and submitting recommendations to Congress. While members of the commission toured Europe, Warburg refined his presentation and widened his circle of associates. In the fall of 1909, he attended a dinner arranged by MIT Professor Davis Dewey along with several top economists from Harvard, Columbia, and Johns Hopkins. His debates with these scholars, which continued by mail for months afterwards, helped him tweak his plan to meet the “criticism of a deeply prejudiced public.”²²

Warburg’s growing sophistication was on display in what was to become his most influential article, “A United Reserve Bank of the United States,” published in March, 1910. In a

substantial shift from the language in his earlier articles that characterized American banking as semi-barbaric compared to the superior European systems, he reassured his American audience that his proposed bank was unlike the central banks in Europe. “It is a scheme,” he wrote, “based upon conditions peculiar to our country and our form of government. It recognizes the vast territorial area of the United States, the diversity and dissimilarity of interests, and even the traditional, sectional, and partisan prejudices of the people.”²³ Also significant, if subtle, was his name for the planned bank. In his “Plan for a Modified Central Bank,” he bluntly called his proposed institution the “Government Bank.” But he had now changed its appellation to “The United Reserve Bank of the United States,” a title that suggested a more federal character.

Directly addressing concerns that a central bank was an un-American institution, Warburg challenged the “ghost of Andrew Jackson” by appealing to the memory of Abraham Lincoln. He quoted Lincoln’s first political speech in which the future president declared his support for a United States Bank, a protective tariff, a system of internal improvements, and a stop to the expansion of slavery. In the seventy-seven years since that speech, Warburg wrote, the only plank of the platform unfulfilled was Lincoln’s call for a U.S. Bank. “Let us hope that it will be the pride of our generation,” he continued, “to have achieved this step in the onward march of the United States.”²⁴

Despite the new packaging, however, the essential functions of the United Reserve Bank were the same as the Government Bank’s. The difference lay in the composition of the board of directors, which was designed to be “non-political, non-partisan, and non-sectional.”²⁵ Warburg suggested dividing the country into about twenty zones of operation, each of which would be in charge of appointing delegates to the central board in Washington. That way, no one section (New York) would dominate the operations of the bank, and each part of the country would be

represented. Of course, the board was to be composed of “experts”—three-fifths would be bankers, one fifth would be businessmen, and one fifth would be *ex officio* members from the Treasury Department.²⁶

Once the National Monetary Commission returned from Europe, Warburg was invited to appear before it at a hearing held at the Metropolitan Club of New York. After he testified on the opinions of a list of European authorities consulted on the recent trip, Senator Aldrich pulled him aside. Warburg, still under the impression that Aldrich opposed the establishment of a central bank, was astonished to hear the Senator praise his ideas and chastise him for not pushing for their full implementation. Warburg explained his concern about the “deep-seated prejudices and suspicion” which a central bank constructed along unabashedly European lines would encounter. Further, he feared that if such a bank were established, it would become the target of bitter partisan attacks that would lead to its ultimate dismantling. Aldrich remained unmoved, a fact Warburg would later attribute to an honest desire to leave a central bank as his political legacy.²⁷

These conversations, along with his tireless advocacy, would earn Warburg an invitation to accompany Aldrich and three other banking elites—J.P. Morgan partner Henry P. Davison, National City Bank of New York vice president Frank A. Vanderlip, and Assistant Secretary of the Treasury A. Piatt Andrew—to a secret conference at an exclusive resort on Jekyll Island off the coast of Georgia. The purpose of the gathering was to write the central banking bill that Aldrich would introduce in the Senate and strategize over how to secure its passage. Because the group feared drawing attention to what might be construed as a Wall Street conspiracy, the Senator’s staff told the press that he was leaving on a simple duck hunting expedition. Outfitted in hunting gear and calling each other only by their first names, the cabal traveled south in the Senator’s private train car.²⁸ According to Vanderlip, such measures were necessary because “if

it were to be exposed publicly that our particular group had gotten together and written a banking bill, that bill would have no chance whatever of passage by Congress.”²⁹

Over the course of a week in November 1910, the group composed a bill that provided for a “National Reserve Association” with all the crucial powers that Warburg had previously outlined in his publications—the power to centralize reserves, issue elastic notes, and rediscount commercial paper. To provide the appearance of decentralization, reserves would not actually be centralized all in Washington, but in eight to twelve regional reserve banks. This technical change did not worry Warburg, who still thought that concessions to political control and the tradition of decentralization were necessary to secure the bill’s passage. Overall, Warburg was elated that the Aldrich bill “was closely akin to the plan proposed in ‘United Reserve Bank of the United States.’”³⁰ Three years after the publication of his first article pushing for the establishment of an American central bank, a plan heavily influenced by his ideas was about to be introduced in Congress by one of the country’s most powerful Senators.

Unfortunately for Aldrich and his coterie of banking elites, the Democrats swept the Congressional elections of 1910. This inconvenience barely fazed Warburg, who, on his return to New York, immediately began plotting to secure the plan’s success. During the Monetary Conference of the National Board of Trade on January 18, 1911, Warburg chaired a commission that proposed the creation of a “Business Men’s Monetary Reform League” with the purpose of launching “an active campaign of education and propaganda for monetary reform, on the principles...outlined in Senator Aldrich’s plan.”³¹ The League was to be headquartered in Chicago with branches throughout the country. Its members would be charged with influencing the businesses, chambers of commerce, and any other commercial organizations they were involved with.³² After A. Piatt Andrew gave a speech in favor of the proposal, the conference

unanimously approved the resolution and elected Warburg to head a committee charged with creating what would become the “National Citizens’ League for the Creation of a Sound Banking System.”

Over the course of his reform efforts, Warburg had grown ever more cautious about the public’s perception of Wall Street. Several years before, he had written to an acquaintance in Nebraska that it was “unfortunate that the general attitude of the country towards New York and Wall Street is such that any measure proposed from here would be doomed from the start. For this reason it looks to me as if the situation would have to come from the West.”³³ The impetus for this reform effort, of course, was coming almost exclusively from New York. But by locating the Citizens’ League in Chicago and recruiting supporters there to run its operations, Warburg and his allies hoped to make the movement for banking reform look like a national phenomenon, emanating from the heartland.³⁴ On April 26, 1911, Warburg’s committee met in Chicago and convinced five of the city’s leading businessmen and economists to take leadership of the new League. Among these, the president of the U.S. Chamber of Commerce Harry A. Wheeler and University of Chicago economist J. Laurence Laughlin would be particularly invaluable in using their influence to rally support for reform.³⁵

Throughout the summer of 1911, Warburg worked to establish League branches in New York, New Jersey, Massachusetts, Pennsylvania, and Missouri. In a flurry of correspondence, Warburg and his Jekyll Island associates schemed over the recruitment of allies with non-New York roots. Since they already had the support of powerful bankers and a technical plan (the Aldrich bill), the emphasis was on finding people who could serve as the face of the movement. For Missouri, Warburg and his allies sought to enlist Thornton Cooke, the treasurer of a large bank in Kansas City. A. Piatt Andrew touted him as “well informed on matters of theoretical

banking” and concluded that since he was “a native of the Middle West,” he would be a great help in “organizing the League, and in propagating an interest in his region.”³⁶ For Massachusetts, they recruited Major Henry L. Higginson, a veteran of the First Battle of Bull Run who had written positively about the Aldrich plan. His endorsement, Andrew wrote, “would carry weight in New England.”³⁷ For New Jersey, Warburg targeted another aging Civil War veteran, ex-governor Franklin Murphy. When Murphy demurred, Warburg wrote to Aldrich, explaining that his contacts in New Jersey “say they need [Murphy’s] support, and even if he would serve only in a nominal way, leaving others to do the actual work, they say they cannot afford to lose the use of his name.”³⁸ Noting that Murphy was then in Washington, Warburg implored Aldrich, “Won’t you make it a point to urge him as much as you can, to serve?” Cooke, Higginson, and Murphy would all eventually agree, and by the time pamphlets adumbrating the League’s ideals were first distributed that summer, the organization could boast of subsidiary chapters in thirty-one states, each with a well-known president and a staff well-educated in the principles of banking reform.³⁹

As leaders of the League constructed a nationwide, non-sectional organization, they also set about establishing themselves as non-partisan; they were convinced that monetary reform could only succeed with the support of both parties. If the current Republican bill passed as it was currently packaged, they feared, the newly established central bank would be endangered anytime the Democrats came to power. The League’s leadership believed it was necessary, therefore, to gain the support of more Democrats. The first step in achieving this goal was to distance the organization’s efforts from Aldrich’s name, if not the principles he espoused. In their first press release, they declared that the object of the National Citizens’ League was to “carry on an active campaign for monetary reform *on the general principles of the Aldrich Plan*

*without endorsing every detail of the National Reserve Association.*⁴⁰ In its first statement of principles, the League attempted to ease the Democratic-populist fear of a despotic Wall Street plot. The League called for the “cooperation” rather than “dominant centralization” of the country’s banks. Such a system would be achieved by an “evolution” of the nation’s current institutions.

In July, J. Laurence Laughlin gave a speech to the New York chapter of the League that neatly summed up the organization’s talking points. He explained to the members present and to the press that the demand for change came from average businessmen, not the big Wall Street interests. The League represented the borrowers of capital, not the lenders. Its organization, he argued, was wholly independent of Aldrich’s National Monetary Commission and its recommendations, although it did recognize that “many valuable suggestions have come from the commission and its Chairman.”⁴¹ Laughlin stressed that this movement was a spontaneous, grassroots response to a broken monetary system. “Business troubles of the past,” he explained, “are what inspired Western business men to form the national organization whose headquarters have been established in Chicago.” Laughlin further argued that wage earners also had an interest in supporting the sound currency that banking reform would ensure. Contending that a man who worked for his wages was just as much interested in “a fixed standard of value in money” as wealthy capitalists, he expressed confidence that the middle and working classes would eventually tip the scales in favor of banking reform, just as they had secured the defeat of the 1896 populist campaign for an inflationary monetary policy through the free coinage of silver.⁴²

All the premises Laughlin constructed this speech on were false, and he admitted as much in his book on the origins of the Federal Reserve published two decades later. After explaining

how the League was Paul Warburg's idea and how Aldrich's circle foresaw the difficulties of overcoming the public prejudice against Wall Street, Laughlin explained that "They decided to create an organization, and promised it financial support, provided the Chicago organization would take upon itself the task of organizing the country for the purpose of educating public opinion on good banking principles."⁴³ The purpose of these measures was "to have the movement seem to come spontaneously from the business men of the country."⁴⁴ Warburg, in his account, adds that the most liberal contributors to the League were banks.⁴⁵ In other words, contra Laughlin's 1911 speech, the League represented the lenders of capital, not the borrowers.

For the rest of 1911, the League circulated its weekly periodical, *Banking Reform*, to newspaper editors all over the country. It commissioned well-known and respected businessmen to write pamphlets in favor of reform, published a handbook to educate its members, and held conferences throughout the country. Later in the year, the League experienced its first tastes of success. The editor of the *Kansas City Star* was converted to the cause and secured a speaking arrangement for Laughlin at the Trans-Mississippi Commercial Congress.⁴⁶ And in November, the League's members succeeding in getting the American Bankers' Association to endorse the Aldrich Bill.⁴⁷ Despite the League's growing influence, however, in early 1912 it became clear that the Aldrich Bill would not pass. If the banking reform movement were to succeed, it would need to do so with another politician at the helm.

After the election of Woodrow Wilson in 1912, Henry Morgenthau, a key advisor to the future president during his campaign, visited Warburg and asked him to prepare a new banking reform plan that would be more compatible with the tenets of the Democratic Party. Warburg did so, coming up with a scheme that provided for a central reserve bank in Washington and twenty regional reserve banks spread throughout the country. This institution would have all the key

powers he outlined in his earlier plans, but would be subject to government supervision. That way, Warburg would later explain, “The Democratic doctrine would thus have been respected without a surrender to extreme [populist] demands.”⁴⁸ Warburg thought that this system of federal reserve banks could work as long as the regional banks were closely tied together, and he did not think that official government control would be a problem as long as the institution was designed and staffed by expert bankers.

William Jennings Bryan and Rep. Carter Glass had by this time expressed their support for a system of regional reserve banks, but Warburg was afraid that the “cooperation” that these plans provided for was far too loose. In an address to the Republican Club of the City of New York, he argued that if the regional banks were too independent of each other, then the country’s reserves would not truly be centralized, and a key plank of banking reform would be left undone.⁴⁹ Warburg also feared the reemergence of plans that entirely diverged from the principles he has pushed for so vigorously over the past several years. In a letter to Laughlin, he expressed apprehension that some of his colleagues were considering older Canadian-inspired asset-based currency reforms along the lines originally proposed by Republican Congressman Charles Fowler. Warburg denounced Fowler in the hopes of “killing the prestige” he enjoyed among the National Citizens’ League’s leadership committee. “Fowler has never been a banker, and never been successful,” Warburg ranted, “and I am astounded by his courage to advocate a new and untried scheme approved by no practical banker, against a plan which has been carefully developed on the well established European principles by the combined banking and business-brains of the country.”⁵⁰ As Warburg became more involved in practical politics, this antipathy towards politicians would become more apparent. He recoiled at the thought of

someone with less banking experience than him—a category that included nearly the entire population—designing a banking reform program.

Early in January 1913, the new Chairman of the House Committee on Money and Banking, Carter Glass, held hearings on banking reform, and Warburg was invited to testify. In his opening statement, Warburg outlined his familiar arguments in favor of an elastic currency and reserve centralization. Expressing optimism that there was a growing consensus on the substance that needed to be included in any banking reform measure, Warburg tried to convince the Democrats on the committee that his reform plan could be adapted into a form that would be acceptable to a country that abhorred centralized power. He argued that the centralized reserve institutions Congress was considering creating were not analogous to European central banks because they would have no power to interfere with the independence of the country's existing banks. He conceded that the businessmen he was in favor of placing in charge of the proposed reserve banks would be susceptible to "selfish motives and boundless ambition," but argued that political appointees would be subject to the same temptations. The only solution was to create an institution with well-defined and limited powers and to staff it partly with political appointees and partly with banking experts.⁵¹ Warburg tried to argue that such a system could not properly be called a central bank at all. While it is true that the system of central and regional reserve banks under discussion would not directly compete with private banks in the economy as did European models, in all other essential elements Warburg's plan was clearly modeled after the Reichsbank and had changed little since he presented his "Plan for a Modified Central Bank." His denial is best seen as part of a larger shift towards a more egalitarian and republican language meant to allay the fears of the newly empowered Democrats.

By this time, Warburg's assertion that "the difference of opinion concerning the proper methods to be applied in our country exists more regarding the shell than the kernel" was largely correct.⁵² The plan Glass was working on aimed to centralize reserves and provide for an elastic currency through the use of the same instruments that Warburg had advocated. During questioning, however, Glass emphasized his differences with Warburg, the Aldrich ally. After Warburg outlined his fear that a system of regional reserve banks insufficiently tied together would produce an inefficient and dangerous system, Glass combatively asked, "Would you say that we should do nothing if we cannot [adopt the Aldrich plan]?"⁵³ Warburg replied that he was confident that, given certain minimum requirements, a sufficiently centralized institution would evolve out of a regional organization. Glass was unsatisfied, and persisted in his attempt to pigeonhole his witness. "You do not agree [then]," he asked, "that the cooperation of banks throughout the country in the region reserve associations would be infinitely better than the existing system?"⁵⁴ Warburg again tried to explain that the question was not so black and white, that his plan could work and be consistent with the Democratic platform. Unconvinced, Glass began questioning Warburg about his support for the Aldrich bill. Glass's campaign to distance himself from the German-born Wall Street banker continued after the hearing adjourned. Despite Warburg's attempts to portray his scheme as a non-central bank subject to partial government control, Glass characterized it a system of "central banks of the banks, by the banks and for the banks."⁵⁵ Later in the month, Glass told Wilson that Warburg's purpose was "battering the committee into a repudiation of the Democratic platform."⁵⁶

Even as Warburg became the target of partisan attacks, his plan was coming closer to its realization. The National Citizens' League which he had helped create sent two witnesses to the Glass Committee hearings, the president, John Farwell and the chief executive, J. Laurence

Laughlin. Under much less suspicion, both offered plans that preserved the essential elements of the Aldrich bill within the framework of a regional system.⁵⁷ At the same time, Warburg kept up his efforts. After the hearings, he tweaked the plan he had originally outlined for Henry Morgenthau. Elaborating how his regional reserve system would work, he proposed a system that provided for reciprocal reserve exchanges between the member reserve banks. “This will not be as easy as under the previous United Reserve Plan,” he wrote, “but it can be done, if that is the price for securing otherwise perfectly adequate legislation.”⁵⁸ According to Warburg, he received Morgenthau’s assurances that he sent his copy of the plan to Wilson.⁵⁹ This seems likely enough, as the administration maintained backchannel communications with him; in April 1913, Colonel House sent Warburg a first draft of what was to become the Glass bill and asked him for an analysis of it.⁶⁰ Warburg was basically sympathetic to the draft bill, which provided for a system of regional (federal) reserve banks to carry out the functions of a central bank. He did advise that the number of reserve banks—which was as yet unspecified—be limited as much as possible to prevent them from becoming bastions of localist resistance to Washington.⁶¹ House circulated the memorandum among the administration’s top officials, which infuriated Glass when he found out. Warburg included in his letter to House copious commentary on the technical provisions of the bill, which Glass interpreted as outright opposition to the plan. He would later write that Warburg “was simply unalterably hostile to certain fundamental provisions of the federal reserve bill and in plain terms persistently said so. This he had said at the committee hearings in January, which made it quite futile to have him repeat it in April...”⁶² Glass’s motivation appears to be wholly partisan. Even though he ended up endorsing Warburg’s main suggestion—that the number of regional banks be as limited as possible—he never changed his assessment of the Wall Street banker.

Warburg would find a more principled critic in Democrat Senator Robert Owen, the chairman of the Committee on Banking and Currency. The two met in May, and Owen told Warburg about his idea to create a government agency that would be in charge of issuing currency. Owen criticized the Glass bill for giving the directors of the national reserve banks too much power. He was strongly opposed to this provision because “it would not give the United States control of the system.”⁶³ Warburg, of course, was unconvinced. He saw such populist-inspired programs as anathema to all principles of sound banking, and was distressed by the provision in the subsequent Owen-Glass bill that provided for a Federal Reserve Board with seven members, all political appointees. In one letter to Colonel House, he expressed hope that President Wilson and Secretary of the Treasury McAdoo would not be swayed by these changes. “They cannot possibly believe,” he wrote, “that these Owen-Bryan heresies can be forced upon our poor country without the worst consequences politically and economically.”⁶⁴ In another he both complained about the changes Congress was making to his plans and worried that he would never get credit for his role in the reform movement. “I have been in the international banking business for 27 years,” he told House. “I have preached the gospel of reform on the lines now adopted at a time when Mr. Owens and Glass had not begun to study the alphabet of banking.”⁶⁵

Warburg’s mood improved as the bill took shape. At every stage of its development, he would later write, it “represented a great triumph of the fundamental principles for which banking reformers had striven.”⁶⁶ He thought that the progress of the measure had shown that both parties had come together to endorse sound banking. The Republicans had outgrown their attachment to the old decentralized system, and the Democrats had outgrown their attachment to complete political control and the inflationary silver standard. In other words, they both had given up politics and accepted nonpolitical expertise.⁶⁷ The final version of the Federal Reserve

Act, which Wilson signed into law on December 23, 1913, provided for eight regional reserve banks presided over by a seven-member Federal Reserve Board. The Board would include the Secretary of the Treasury and the Comptroller of the Currency as *ex officio* members. The remaining five would be appointed by the president, but at least two would need banking experience.

In a congratulatory letter to Glass, Warburg shared his feelings on the act. While he feared that the Federal Reserve Board would become “hopelessly political,” he rejoiced that “The fundamental thoughts, for the victory of which some of us have worked for so many years, have won out.”⁶⁸ The battle, however, was hardly over for Warburg. Having grown accustomed to advocacy over the previous six years, he did not regard the Federal Reserve Act as a finality. When Wilson offered him a nomination to serve on the first Federal Reserve Board, he could not resist accepting it. From this post, he could set precedents, fight for new powers, and help determine the course of the new institution.⁶⁹

Despite Glass’s attempts to distance himself from Warburg and Aldrich, most scholars today believe that the Aldrich and Owen-Glass bills are so similar that there is little doubt the Democratic plan was heavily influenced by its Republican predecessor. Warburg himself was so confident that the similarities between the two were self-evident, he devoted over two hundred pages of his memoirs to a side-by-side juxtaposition of the two pieces of legislation.⁷⁰ Elmus Wicker is only the most recent scholar to vindicate Warburg in this regard. In his 2005 book, he argues that “The New York bankers got all they wanted, with the single exception of banker control”; and “The Federal Reserve Act owes as much, if not more, to Senator Aldrich as it does to Representative Glass.”⁷¹

Warburg was impelled to write his memoirs after Carter Glass's account of the origins of the Federal Reserve was published in the mid 1920's. He was incensed at Glass's attempts to claim credit for banking reform and for his portrayal of Warburg as an obstructionist. Although Warburg claimed to regret allowing himself to be drawn into a political controversy, he finally decided to publish his account when he became convinced that the Federal Reserve System was entering a period of transition and that it was important for the public discussion that the truth about its origins to be known.⁷² His role was important, he argued, because "the way a law looks when it is 'half made, and more than half made'" deserves special study. It is in this stage that the law, if it is constructed by selfless men, "represents, as nearly as may be possible, the law in its ideal form. It is the neutral mode of a non-partisan proposal untainted by political considerations."⁷³ Parliamentary procedure, for Warburg, is a necessary evil, because it distorts the law from its neutral, ideal form. In the case of American banking reform, the Aldrich bill was the Republican version of the neutral model, while the subsequent Owen-Glass bill was the Democratic version. The third stage of the evolution of legislation reveals the law in operation. It shows, Warburg explains, where practical experience leads the legislature to remove some of the ineffective and undesirable features that were forced into law by political considerations or honest miscalculations. A democracy, then, is successful to the extent its political process can return the law to its ideal form, originally conceived by experts in the field.⁷⁴

Warburg contended that it was essential for the public to know the importance of the Aldrich plan because otherwise they might miss the fact that the Federal Reserve System was the child of both parties. For, "If Congress is to place the Reserve System in a position of unassailable authority and to safeguard it from political interference, the Reserve System must have the undivided friendship of both parties."⁷⁵ Warburg hoped that the Federal Reserve would

soon be likened to a national monument, like the medieval cathedrals of Europe, which were the collective work of many masters over many generations. He explained that, “Because Bramante conceived, Rafael Sanzio elaborated, and Michael Angelo carried out, the Cathedral of St. Peter’s at Rome, this monument of their combined genius, is all the more cherished by the people of Italy as one of their most sacred possessions.”⁷⁶ In this thought experiment, as in the creation of the Federal Reserve, non-elites play only a passive role.

Before the creation of the Federal Reserve, the subjects of money and banking were controversial political issues. From Hamilton and Jefferson’s battle over the establishment of the First Bank of the United States, to Jackson’s successful campaign to destroy the second, to the battle over the silver standard in the latter half of the 19th century, debate over the country’s financial system was as common as debate over any other economic issue. Positions on these subjects were expressed in newspaper columns, political meetings, and party platforms. After the establishment of the expert run, bi-partisan Federal Reserve, however, the discussion of monetary policy has largely disappeared from the public sphere. For decades, most debates about the subject have been left to academic economics journals, which require a degree in mathematics to read.

Harold Kellock of *The Century Magazine* was perhaps exaggerating when he described Paul Warburg as “a shy, sensitive man [who] imposed his idea on a nation of a hundred million people.”⁷⁷ Warburg, while a powerful force in banking reform, hardly accomplished his task alone. His wide, thorough, and specialized knowledge, however, secured him an extremely privileged place in what can accurately be called an “invisible government.” Few in America ever knew his name, but he nonetheless influenced the substance of the Federal Reserve System

more than any elected official. This institution has survived almost one hundred years without substantial alteration and its “independence from political control” is still trumpeted as a virtue.⁷⁸

Historians who seek to “re-democratize” the Progressive Era by emphasizing events like the triumph of the women’s suffrage movement, the passage of the 17th Amendment, and the spread of institutions like the initiative and the recall should keep in mind the existence of such “invisible” reformers like Paul Warburg.⁷⁹ The centralization of decision-making power in fewer hands and the removal of important issues from the public sphere lessen the public’s ability to determine the course of their government. Requiring specialized knowledge and elite credentials as a prerequisite for participation in certain political debates can be as formidable a barrier to widespread public participation in politics as more formal and visible methods of exclusion.

¹ William B. Munro, “The Money Power in Politics,” *The Atlantic Monthly*, April 1927, 447-454.

² Robert Craig West, *Banking Reform and the Federal Reserve 1863-1923*, (Ithaca, NY: Cornell University Press, 1977), 54.

³ Paul Warburg, *The Federal Reserve System: Its Origins and Growth—Reflections and Recollections*, vol.1. (New York: Macmillan, 1930), 3.

⁴ Gabriel Kolko, *The Triumph of Conservatism: A Reinterpretation of American History, 1900-1916*. (New York: The Free Press, 1963), 217-255; Robert Wiebe, *Businessmen and Reform: A Study of the Progressive Movement* (Cambridge: Harvard University Press, 1962), 62-63, 215.

⁵ James Livingston, *Origins of the Federal Reserve System: Money, Class, and Corporate Capitalism, 1890-1913* (Ithaca and London: Cornell University Press, 1986).

⁶ West, *Banking Reform and the Federal Reserve*; Richard Timberlake, *The Origins of Central Banking in the United States* (Cambridge: Harvard University Press, 1978); Eugene Nelson White, *The Regulation and Reform of the American Banking System, 1900-1929* (Princeton: Princeton University Press, 1983).

⁷ J. Lawrence Broz, *The International Origins of the Federal Reserve System* (Ithaca and London: Cornell University Press, 1997).

⁸ Elmus Wicker, *The Great Debate on Banking Reform: Nelson Aldrich and the Origins of the Fed* (Columbus: The Ohio State University Press, 2005).

⁹ On this common Progressive Era belief, see Martin Schiesl, *The Politics of Efficiency: Municipal Administration and Reform in America*, (Berkeley and Los Angeles: University of California Press, 1980), 1-24; Samuel Haber, *Efficiency and Uplift: Scientific Management in the Progressive Era, 1890-1920* (Chicago: University of Chicago Press, 1973), 101-107; Samuel P. Hays, *Conservation and the Gospel of Efficiency: The Progressive Conservation Movement, 1890-1920* (Cambridge: Harvard University Press, 1959), 1-4; James Weinstein, *The Corporate Ideal in the Liberal State, 1900-1918* (Boston: Beacon Press, 1968).

¹⁰ Warburg, *The Federal Reserve System*, vol. 1, 14-16.

¹¹ *Ibid.* A banker's acceptance is a promised future payment, similar to a post-dated check. Any holder of an acceptance can wait and cash it on the date of maturity, or they can sell it at a discount to someone else who will wait for the date of maturity. In a country with a well-developed acceptance market, banks short on money can sell any acceptances they are holding in reserve to meet their financial obligations. See Pricilla Roberts, "Quis Custodiet Ipsos Custodes?" The Federal Reserve System's Founding Fathers and Allied Finances in the First World War," *The Business History Review* 72, no.4 (Winter, 1998), 585-620.

¹² Warburg, *The Federal Reserve System*, vol. 1, 18-19.

¹³ Harold Kellock, "Warburg, the Revolutionist," *The Century* 90, (May 1915), 81-82.

¹⁴ Paul Warburg, "Defects and Needs of Our Banking System," *New York Times*, January 6, 1907.

¹⁵ *Ibid.*

¹⁶ Robert F. Bruner and Sean D. Carr, *The Panic of 1907: Lessons Learned from the Market's Perfect Storm* (Hoboken, NJ: John Wiley & Sons, 2007), 40-49; Murray N. Rothbard, *A History of Money and Banking in the United States: The Colonial Era to World War II* (Auburn, AL: Ludwig von Mises Institute, 2002), 240; West, 46-51; Warburg, *The Federal Reserve System*, vol. 1, 20-21.

¹⁷ Paul Warburg, "A Plan for a Modified Central Bank," *Proceedings of the Academy of Political Science in the City of New York* 4, No. 4, Essays on Banking Reform in the United States (Jul., 1914), 24-25.

¹⁸ *Ibid.*, 29.

¹⁹ Warburg, *The Federal Reserve System*, vol. 1, 31-32.

²⁰ Warburg to Aldrich, December 31, 1907. Paul Moritz Warburg Papers MS 535, Series I, Box 1, Folder I, Yale University Library, New Haven, CT. The power to discount paper was an essential feature of Warburg's ideal central bank. The purpose of this function was to encourage the development of an acceptance and bill-of-exchange market (see note 12) by offering to buy promissory notes held in banks' reserves at lower rates than would be offered on the free market.

The purpose of allowing the proposed bank to accept government deposits was to secure it a regular source of income.

²¹ Warburg, *The Federal Reserve System*, vol. 1, 33, 557.

²² *Ibid*, 35.

²³ Paul Warburg, “A United Reserve Bank of the United States,” *Proceedings of the Academy of Political Science in the City of New York* 4, No. 4, Essays on Banking Reform in the United States (Jul., 1914), 75-76.

²⁴ *Ibid*, 115.

²⁵ *Ibid*, 77.

²⁶ *Ibid*.

²⁷ Warburg, *The Federal Reserve System*, vol. 1, 57-59.

²⁸ Ron Chernow, *The Warburgs: The Twentieth-Century Odyssey of a Remarkable Jewish Family* (New York: Random House, 1993), 133-134; Rothbard, 252-254; Warburg, *The Federal Reserve System*, vol. 1, 60. Writing in 1928, Warburg still felt uncomfortable discussing the meeting: “Though eighteen years have since gone by, I do not feel free to give a description of this most interesting conference concerning which Senator Aldrich pledged all participants to secrecy.”

²⁹ Frank A. Vanderlip and Boyden Sparkes, *From Farm Boy to Financier* (New York: Appleton-Century Company, 1935), 214.

³⁰ Warburg, *The Federal Reserve System*, vol. 1, 59-60; Rothbard, 253.

³¹ “Report of Delegates from the New York State Chamber of Commerce to the Monetary Conference in Washington, January 18, 1911,” in *The Federal Reserve System*, Vol. 1, 569.

³² *Ibid*.

³³ Paul Warburg to James B. Forgan, February 28, 1908, Warburg Papers, Series I, Box 1 Folder I.

³⁴ Warburg frankly admits this in his work on the Federal Reserve. Closely echoing his 1908 letter to Forgan, he writes of the Citizens’ League, “For obvious reasons, it would have been fatal to launch such an enterprise from New York; in order to succeed, it would have to originate in the West.” See Warburg, *The Federal Reserve System*, vol. 1, 68.

³⁵ Warburg, *The Federal Reserve System*, vol. 1, 69.

³⁶ Piatt Andrew to Warburg, April 19, 1911, Warburg Papers, Series I, Box 1, Folder II; see also, Piatt Andrew to Warburg, January 19, 1911, Warburg Papers, Series I, Box 1, Folder II.

³⁷ Piatt Andrew to Warburg, January 24, 1911, Warburg Papers, Series I, Box 1, Folder II.

³⁸ Warburg to Aldrich, December 7, 1911, Warburg Papers, Series I, Box 1. Folder II; see also, Warburg to Aldrich, June 15, 1911, Warburg Papers, Series I, Box 1, Folder II.

³⁹ J. Laurence Laughlin, *The Federal Reserve Act: Its Origins and Problems* (New York: MacMillan, 1933), 56-57.

⁴⁰ “Chicago to Lead Money Reform,” *Chicago Herald*, April 27, 1911. Emphasis in original.

⁴¹ “Currency Reform: Its Popular Side,” *New York Times*, July 26, 1911.

⁴² Ibid.

⁴³ Laughlin, 59.

⁴⁴ Ibid.

⁴⁵ Warburg, *The Federal Reserve System*, vol. 1, 70.

⁴⁶ Laughlin, 79-80.

⁴⁷ Ibid, 74.

⁴⁸ Warburg, *The Federal Reserve System*, vol. 1, 84.

⁴⁹ Warburg, “Review of the ‘Report of the National Monetary Commission’ by the Committee on National Affairs of the Republican Club of the City of New York,” in *The Federal Reserve System*, vol. 1, 610-611.

⁵⁰ Warburg to Laughlin, April 22, 1912, Warburg Papers, Series I, Box 1. Folder III.

⁵¹ Warburg, “Statement Before the Subcommittee of the Committee on Banking and Currency of the House of Representatives, January 7, 1913,” *The Federal Reserve System*, vol. 1, 558-564.

⁵² Ibid, 562.

⁵³ Ibid, 564.

⁵⁴ Ibid, 565.

⁵⁵ Warburg, *The Federal Reserve System*, vol. 1, 410.

⁵⁶ Qtd in Ray Stannard Baker, *Woodrow Wilson: Life and Letters*. Vol. 4 (Garden City, NY: Doubleday, 1931), 147.

⁵⁷ Warburg, *The Federal Reserve System*, vol. 1, 89.

⁵⁸ Ibid, 90.

⁵⁹ Ibid.

⁶⁰ Ibid, 91-92.

⁶¹ Warburg, “Letter to Colonel House Analyzing Dr. H. Parker Willis’s Synopsis of the First Draft of the Glass Bill, April 22, 1913,” in *The Federal Reserve System*, vol. 1, 613-625.

⁶² Carter Glass, *An Adventure in Constructive Finance* (Garden City, NY: Doubleday, 1931), 49.

⁶³ Robert Latham Owen, *The Federal Reserve Act* (New York: The Century Company, 1919), 72-79; see also, Untermeyer to Warburg, May 20, 1913, Warburg Papers, Series I, Box 1. Folder V. Untermeyer’s letter to Warburg is indicative of the aura surrounding the banker. “I consider it almost presumptuous,” Untermeyer wrote, “to differ—however slightly—from you on a subject to which you have given a life study and on which I regard you as the most eminent authority in our country, and of which I am a very recent and doubtless a superficial student.”

⁶⁴ Warburg to House, July 30, 1913, in *The Federal Reserve System*, vol. 1, 102.

⁶⁵ Qtd in Chernow, 136.

⁶⁶ Warburg, *The Federal Reserve System*, vol. 1, 90.

⁶⁷ Warburg, “The Owen-Glass Bill as Submitted to the Democratic Caucus: Some Criticisms and Suggestions,” *Proceedings of the Academy of Political Science in the City of New York*, 4, No. 4, Essays on Banking Reform in the United States (Jul., 1914), 173-203.

⁶⁸ Ibid.

⁶⁹ Warburg, *The Federal Reserve System*, vol. 1, 141.

⁷⁰ Warburg, *The Federal Reserve System*, vol. 1, 178-407.

⁷¹ Wicker, 94, 109. See also, Rothbard, 257-258; William Greider, *Secrets of the Temple: How the Federal Reserve Runs the Country* (New York: Simon & Schuster, 1987), 277. Greider writes, “The Bill drafted by Willis and his boss, Representative Carter Glass of Virginia, differed in detail but not in fundamentals from the Aldrich plan: a privately controlled network of regional reserve banks that would be given government powers.”

⁷² Warburg, *The Federal Reserve System*, vol. 1, vii-viii.

⁷³ Ibid, 4.

⁷⁴ Ibid, 6.

⁷⁵ Ibid, 7.

⁷⁶ Ibid, 9-10.

⁷⁷ Kellock, 79.

⁷⁸ Ben S. Bernanke, “Central Bank Independence, Transparency, and Accountability,” Board of Governors of the Federal Reserve System, <http://www.federalreserve.gov/newsevents/speech/bernanke20100525a.htm>

⁷⁹ See for example, Robert D. Johnston, “Re-Democratizing the Progressive Era: The Politics of Progressive Era Political Historiography,” *Journal of the Gilded Age and Progressive Era* 1, No. 1 (Jan., 2002), 68-92.