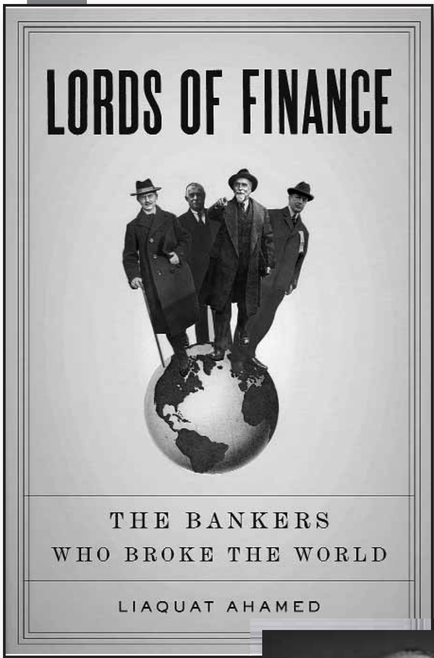

Does the World Need a Financial *Manhattan Project?*

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Excerpt from **The Lords of Finance: The Bankers Who Broke the World,** *by Liaquat Ahamed (Penguin Press, 2009).*

In the early 1940s, the world's best scientific minds took on the challenge of preempting Adolf Hitler's plans for a nuclear weapon. In a parallel sense, do the world's best financial minds need collectively to assemble to find some global independent means of unraveling today's securitized asset markets and related derivatives products which have paralyzed world credit markets?

In his new book, **Liaquat Ahamed** *describes a similar exercise in 1912—a coming together of premier experts—which led to the formation of the Federal Reserve.*

—D. Smick

"The 1907 panic exposed how fragile and vulnerable was the country's banking system. Though the panic had finally been contained by decisive action on [J. Pierpont] Morgan's part, the panic became clear that the United States could not afford to keep relying on one man to guarantee its stability, especially since that man was now seventy years old, semiretired, and focused primarily on amassing an unsurpassed art collection and yachting to more congenial climes with his bevy of middle-aged mistresses.

Shaken by the crisis, the U.S. Congress decided to act. In 1908, it created the National Monetary Commission, consisting of nine senators and nine representatives, and chaired by Senator Nelson Aldrich, to undertake a comprehensive study of the banking system and to make recommendations for its reform. Over the next few years, the commission produced a voluminous set of studies on central banking in Europe but not much else. Memories of how close the system had come to imploding progressively dimmed and the momentum for reform stalled.

In 1912, [Henry] Davison, now a Morgan partner, frustrated by the lack of progress and fearing that without changes the next panic would be even more catastrophic, set out to convene a meeting of experts to develop a formal plan to establish an American central bank—the third in the nation's history. Only five men were invited. Besides Davison himself, there was Senator Aldrich; Frank Vanderlip, the forty-eight-year-old president of the National City Bank, the largest in the country; Paul Warburg, of the well-known Hamburg banking family, a forty-two-year-old partner at Kuhn Loeb who, although he had only just moved to New York, was probably the greatest expert on central banking in the United States; A. Piatt Andrew Jr., the thirty-nine-year-old assistant secretary of the treasury, who had been a professor at Harvard and accompanied the original commission on its European study tour; and Benjamin Strong, then thirty-nine years old.

Davison was worried, and for good reason, that any plan put together by a group from Wall Street would immediately be suspect as the misbegotten product of a bankers' cabal. He therefore chose to hold the meeting in secret on a small private island off the coast of Georgia—in effect creating the very bankers' cabal that would have aroused so much public suspicion. The preparations were elaborate. Each guest was told to go to Hoboken Station in New Jersey on November 22 and board Senator Aldrich's private railroad car, which they would find hitched with its blinds drawn to the Florida train. They were not to dine together, nor to meet up beforehand, but to come aboard singly and as unobtrusively as possible, all under cover of going duck hunting. As an added precaution, they were to use only their first names. Strong was to be Mr. Benjamin, Warburg Mr. Paul. Davison and Vanderlip went a step further and adopted the ringingly obvious pseudonyms Wilbur and Orville. Later in life, the group used to refer to themselves as the "First Name Club."

Disembarking at Brunswick, Georgia, they were taken by boat to Jekyll Island, one of the small barrier islands off the Georgia coast, owned by the private Jekyll Island Club, which had opened in 1888 as a hunting and winter retreat for wealthy northerners. Described by one magazine as "the richest, the most exclusive and most inaccessible club in the world," it numbered only some fifty members, including J. P. Morgan, William Vanderbilt, William Rockefeller, Joseph Pulitzer, and various Astors and Goulds. Membership was now closed and had become hereditary.

For the next ten days, the little party had the club with its skeleton staff to themselves—it had been closed for the summer and would not be open to other members for several weeks. They worked every day from early morning to midnight, convening in the luxurious rambling clubhouse with its turret, fifteen-foot ceilings, and numerous verandas and bay windows overlooking the Atlantic Ocean. Davison and Strong rose at daybreak to go riding or swimming, before settling down to work after breakfast. They ate copiously—pans of fresh oysters, country hams, wild turkey—and celebrated Thanksgiving together. Vanderlip would later write that it had been "the highest pitch of intellectual awareness that I have ever experienced." The group dispersed under an oath of secrecy, a pledge that all faithfully kept. Although the fact of the meeting came to light in a magazine some four years later, none of the participants would publicly admit to having been there for another twenty years.

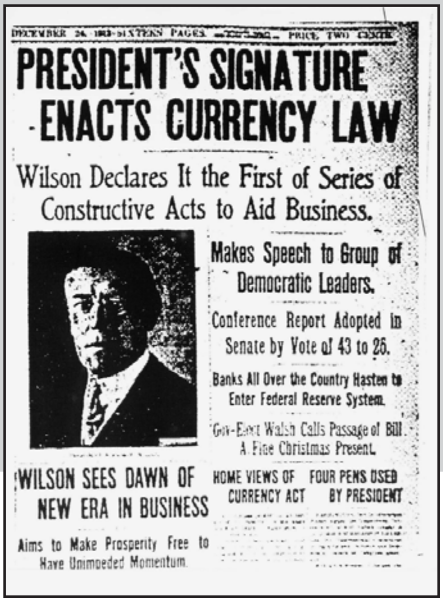
The plan they developed over those ten days, the final details of which were drafted by Vanderlip and Strong, was

Davison chose to hold the meeting in secret on a small private island off the coast of Georgia.

Rather than creating a single central bank, which would involve too great a concentration of power, the Glass Plan called for a number of autonomous regional institutions: Federal Reserve Banks, as they were to be named. While these individual entities were to be controlled and run by local bankers, a capstone—the Federal Reserve Board, a public agency whose members were to be appointed by the president—was placed in an oversight role over the whole structure.

Eventually New York bankers—pragmatic as ever and recognizing that the Glass Plan at least offered something better than the status quo—came around and it was signed into law as the Federal Reserve Act by Woodrow Wilson on December 23, 1913.

—L. Ahamed



PRESIDENT'S SIGNATURE ENACTS CURRENCY LAW

Wilson Declares It the First of Series of Constructive Acts to Aid Business.

Makes Speech to Group of Democratic Leaders.

Conference Report Adopted in Senate by Vote of 43 to 25.

Banks All Over the Country Hasten to Enter Federal Reserve System.

WILSON SEES DAWN OF NEW ERA IN BUSINESS

Aims to Make Prosperity Free to Have Unimpeded Momentum.

HOME VIEWS OF CURRENCY ACT

FOUR PENS USED BY PRESIDENT

unveiled to the public on January 16, 1911. Known as the Aldrich Plan, it had at its center a single institution—the National Reserve Association—a central bank in everything but name that would have branches all over the country, with authority to issue currency and to lend to commercial banks. While the government was to be represented on the association's board, the association itself was to be owned and controlled by banks, a sort of bankers' cooperative.

Nelson Aldrich may have been the most knowledgeable member of the Senate about finance, but the cause of central banking in the United States could not have found a worse champion. In a Senate full of very rich men—it was becoming known as the "millionaires' club"—he was one of the richest, having supposedly sold his stake in the United Traction and Electric Company of Rhode Island for $10 million; he boasted a grand estate in Newport, Rhode Island, and his daughter Abby had married John D. Rockefeller Jr. He was a fervent supporter of big business, a bitter enemy of regulation, an advocate of high tariffs; rumors abounded, furthermore, that he traded political favors for financial contributions. In short, he was the living embodiment of everything that opponents of a central bank most feared.

Frank Vanderlip, the forty-eight-year-old president of the National City Bank, would later write that it had been "the highest pitch of intellectual awareness that I have ever experienced."

Over the next few months, much to Strong's dismay, Progressives and midwestern Republicans joined forces to kill the plan; but in early 1913, the Democrats in Congress, led by Senator Carter Glass, salvaged the idea by modifying it. Rather than creating a single central bank, which would involve too great a concentration of power, the Glass Plan called for a number of autonomous regional institutions: Federal Reserve Banks, as they were to be named. While these individual entities were to be controlled and run by local bankers, a capstone—the Federal Reserve Board, a public agency whose members were to be appointed by the president—was placed in an oversight role over the whole structure.

Although Glass's bill copied many of the essentials of the Aldrich Plan, Strong actively campaigned against it, predicting that its decentralized structure would simply perpetuate the fragmentation and diffusion of authority that had so bedeviled American banking and would only lead to conflict and confusion. Eventually New York bankers—pragmatic as ever and recognizing that the Glass Plan at least offered something better than the status quo—came around and it was signed into law as the Federal Reserve Act by Woodrow Wilson on December 23, 1913. ◆