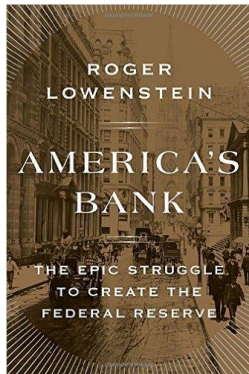


The Central Bank of Barbados Book Review Series seek to highlight publications which offer useful insights and analysis on topics related to finance, economic development, and other issues relevant to small island developing economies. The views expressed are those of the author(s) and do not necessarily represent those of the Central Bank of Barbados.



AMERICA'S BANK – THE EPIC STRUGGLE TO CREATE THE FEDERAL RESERVE

Author: Roger Lowenstein

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*Book Review contributed by Winston Moore**

The role of a central bank is something that has again come to the forefront of policy discussions, particularly in the wake of the US Financial Crisis. Roger Lowenstein provides an innovative approach to the topic. Using a historical analysis of the formation of the US Federal Reserve, he provides insights into the potential role of a central bank that we sometimes take for granted. Throughout the book, *America's Bank*, the author draws interesting parallels between the current era and the early 1900s when the Federal Reserve was established.

The text is separated into two main sections: (1) The Road to Jekyll Island (Chapters 1-7) and (2) the Legislative Arena (Chapters 8-14). Section I (The Road to Jekyll Island) provides a discussion of the context for the formation of the Federal Reserve. Unlike their European counterparts, the United States experimented with the concept of a central bank in its early history (in the immediate post War of Independence period) but it was abandoned in 1811.

In 1858, the starting point for the text, America had thousands of currencies, with these notes backed by gold or state bonds. This obviously created problems when individuals wanted to travel from state to state, as bankers and businesspersons might not necessarily accept currency notes from another state. In addition, given that there was no central bank, this meant that each bank had to keep enough funds (capital) in its vaults to meet customer demands. Therefore, any unexpected increase in demand for cash could easily result in a run on the bank.

Without a central bank to pool the reserves of banks and other financial institutions, the country suffered numerous financial crises and periods of inflation. In addition to their poor track record, there existed the belief that banks were the financiers of the consolidation and monopolisation taking place in other industries (e.g. oil and railway) resulting in most ordinary Americans

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distrusting banks. Any attempt to consolidate banking through a so-called central bank was therefore seen as another channel of exploitation by Americans for a number of years.

In addition to reserve pooling, the lack of a central bank also implied that there was very little that could be done in the face of a recession. One of the responses to the most recent global recession by central banks around the world was to increase the supply of money. Without a central bank, the US economy during this era was characterised by many ups-and-downs, as there was no one to issue more currency during an economic downturn.

The parallels between current financial issues crises and those that occurred so early in American history were quite interesting. In Chapter 4, Lowenstein tells the story of the 1907 panic. During this year, a Montana copper magnate, who had used his control of New York bank to finance an attempt to manipulate a copper-mining stock, experienced a collapse in the price of the stock. With the depositors' funds in jeopardy, depositors began withdrawing their funds. The bank sought assistance from the New York Clearing House. However, most of the funds that could be used to lend support were tied-up in Trusts who had used the funds to speculate in real estate. It was only through the leadership and deal making of J.P. Morgan that a greater crisis was averted.

While the Panic of 1907 spurred many leaders on Wall Street and Congress to consider the idea of a central bank, the idea was still very controversial. Americans were distrustful of centralisation in any form. A central bank, with shares held by private banks was considered a dangerous consolidation, while a government controlled central bank encroached on state rights. The idea of a central bank was so controversial that the first major attempt to discuss the idea was held in secret on Jekyll Island (chapter 7), an exclusive private club. The bankers and legislators that attended the meeting were so concerned about their discussions and stirring-up public hostility that the document drafted at this meeting was not widely circulated until it was time to bring the legislation to Congress.

The second half of the book largely focussed on the quite difficult task of getting the legislation for a United States Central Bank passed through Congress. While the plan for a central bank was formulated in 1910 at the Jekyll Island meeting, it was not until 1913 when legislation for the Federal Reserve was actually passed (chapter 13). In order to address distrust over centralisation, eight reserve banks were established around the country, with a Federal Reserve Board coordinating the activities of these eight reserve banks. In addition, to allay the public's concern about the formation of another monopoly, this time in banking, the Government largely controlled the entity. Unlike a single central bank therefore, the US adopted a more decentralised approach to central banking.

The book *America's Bank* provides an engaging recount of the events and players involved in the US Federal Reserve. While the text is a tremendous accomplishment in relation to economic history, it is written in a very engaging fashion and should easily be consumed by persons with little or no training in finance or economics. For economists and policymakers, however, familiar themes such interlocking directorships and bank capital adequacy requirements are brought to life and the reader can see the implications of these characteristics on the banking industry in particular, and the corporate world in general. Overall, the book is a nice contribution to the field of monetary policy studies and could be used in most monetary economics courses.