# Jekyll Island: Where the Fed Began

BY JESSIE ROMERO

A secret meeting at a secluded resort led to a new central banking system

On Nov. 24, 1910, a select group of men enjoyed a Thanksgiving dinner of wild turkey with oyster stuffing at the luxurious Jekyll Island Club, off the coast of Georgia. The resort offered a host of leisurely pursuits, but the men weren't there to golf or ride horses. Instead, the group was there to devise a plan to remake the nation's banking system. The meeting was a closely guarded secret and would not become widely known until the 1930s. But the plan developed on Jekyll Island laid the foundation for what would eventually be the Federal Reserve System.

### "Defects and Needs of Our Banking System"

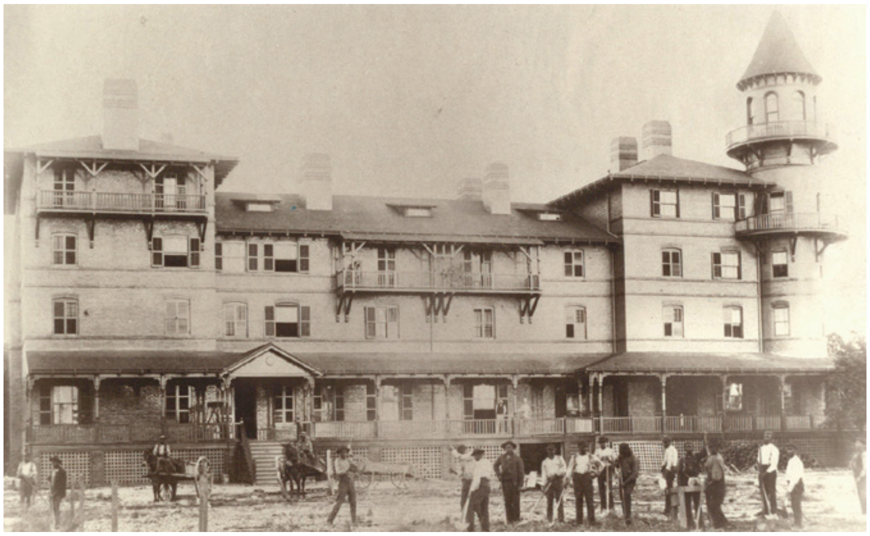
Between 1863 and 1910, there had been three major banking panics and eight more localized panics in the United States. (Some modern scholars count as many as six major panics.) These panics stemmed in part from the country's "inelastic" currency: The supply of bank notes didn't expand and contract with the needs of the economy. This was an unintended consequence of the National Banking Acts of 1863 and 1864, which required all currency to be backed by holdings of U.S. government bonds. Because the aggregate supply of bonds was fixed for long periods, the aggregate supply of notes was also limited. In addition, for a bank to issue new notes, it had to purchase bonds, deposit those bonds with the U.S. Treasury, wait for Treasury to authorize printing the notes, and then wait for the notes to be printed and shipped. The entire process could take as long as three weeks. As a result, it was difficult for banks to provide enough currency during seasonal increases in demand, such as the fall harvest and the holiday shopping season. Banks also struggled to provide enough currency during the banking panics that accompanied many economic downturns, when many people would rush to withdraw their deposits at the same time.

The banking system at the turn of the century was also highly fragmented. The laws in most states barred banks from opening branches, so essentially every small town had its own bank, to the tune of more than 27,000 banks in the country in the early 1900s. These many small banks were connected to larger banks in the cities through a complex system of interbank deposits and clearinghouses that allowed strains to spread quickly throughout the entire financial system.

In many European countries, the currency was backed by commercial paper, the volume of which naturally expanded and contracted along with the economy. These countries also had central banks that rediscounted the commercial paper; by setting the discount rate, the central bank could help regulate the flow of currency. The central bank could also, in certain circumstances, act as a "lender of last resort" and provide loans to banks during times of crisis.

Bankers, businessmen, and policymakers were aware of the problems, and a number of groups were working on different proposals for currency reform. On Wall Street, however, a few young financiers were becoming interested in establishing a central bank.

***The main clubhouse on Jekyll Island was a social hub for the island's wealthy visitors.***



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One of these bankers was Henry Davison, a partner at J.P. Morgan and Co. Davison started his career as an office boy at a small bank in Connecticut and rose quickly through the banking world, becoming vice president of the First National Bank of New York by age 35. In 1903, while at First National, Davison founded the Bankers Trust Company, which became the second-largest trust company in the country. Five years later, J. Pierpont Morgan asked Davison to join his firm.

Frank Vanderlip had followed a circuitous path to Wall Street. He grew up on a farm outside Aurora, Ill., and as a teenager took a job in a machine shop to support his family after his father died. He later worked as an editor at a small-town newspaper and then made his way to Chicago, where he joined the *Tribune* and eventually became the financial editor. When the Chicago banker Lyman Gage was appointed Treasury secretary, he asked Vanderlip to accompany him to Washington as his private secretary. Within months, Vanderlip had been promoted to assistant secretary, and his successful handling of the sale of $1.4 billion in Spanish-American War bonds drew the attention of Wall Street. He left Treasury for National City Bank, the forerunner of Citibank, in 1901 and became president of the bank eight years later.

Paul Warburg, a partner at the investment bank Kuhn, Loeb and Co., was one of the most vocal critics of the U.S. banking system. (Kuhn, Loeb merged with Lehman Brothers in 1977.) Warburg was born in Germany to a wealthy banking family, and he worked in Hamburg, London, and Paris before moving to the United States in 1902. He gave numerous speeches and wrote articles about the virtues of a central bank, including "The Defects and Needs of Our Banking System," which ran in the *New York Times* on Jan. 6, 1907. In it, he noted that the United States' banking system was at "about the same point as was reached by Europe at the time of the Medicis and by Asia, in all likelihood, at the time of Hammurabi." He advocated a system like that used by European countries, in which a central bank issued currency backed by short-term commercial loans. "We have reached a point in our financial development," he wrote, "where it is absolutely necessary that something be done to remedy the evils from which we are suffering."

## The Panic of 1907

Those evils surfaced once again during the Panic of 1907, when a run on the Knickerbocker Trust Company spread to other New York City trusts and banks. J.P. Morgan returned to New York from a trip to Richmond, Va., to figure out how to stop the panic. The first step was to determine which trust companies were worth saving, a task he assigned to Davison, then still at First National, and to Benjamin Strong, whom Davison had hired as secretary of Bankers Trust. Davison and Strong could not assure Morgan that the Knickerbocker was sound, and Morgan did not intervene. The Knickerbocker failed on Oct. 22. But they judged the Trust Company of America (TCA) worthy of support, and over the next several days Morgan assembled a group of bankers to make a $10 million loan to TCA and two loans of $25 million and $10 million to the New York Stock Exchange, quelling the panic. (John D. Rockefeller provided an additional $10 million to the trust companies.)

The Panic of 1907 wasn't the worst financial crisis of the National Banking era, but it got the attention of the older generation of New York bankers, who began to come around to their young colleagues' point of view. That's because it was fundamentally different from previous panics, according to research by Jon Moen of the University of Mississippi and Ellis Tallman, now at the Cleveland Fed. "The Panic of 1907 happened in trusts, in a group of intermediaries outside the New York Clearinghouse and outside the purview of the national banks," says Moen. "The New York bankers realized that if the next panic were any bigger, their banks wouldn't collectively have enough assets to stop it. A lot of the older bankers hadn't thought a central bank was necessary, but they changed their tune very quickly."

The Panic of 1907 also got the attention of Republican Sen. Nelson Aldrich, the chair of the Senate Finance Committee. Aldrich was one of the most powerful politicians of his time: President Theodore Roosevelt dubbed him the "kingpin" of the Republicans, and journalists called him (not fondly) the "boss of the United States." Aldrich was a key political ally of Morgan, and many of his fellow legislators were suspicious of his wealth and his ties to business and finance, including his daughter's marriage to John D. Rockefeller Jr.

In response to the panic, Aldrich pushed through a bill in 1908 that, among other things, created the National Monetary Commission to study reforms to the financial system. (The bill was co-sponsored by Republican Rep. Edward Vreeland.) The Commission included eight senators and eight representatives, with Aldrich as chair. But in Aldrich's opinion, "The drafting of a bill was a matter for experts, not members of Congress inexperienced in banking and financial matters," as economic historian Elmus Wicker wrote in *The Great Debate on Banking Reform*. So Aldrich hired several advisers, including Davison and A. Piatt Andrew, an economics professor at Harvard University, and set off to meet with bankers and central bankers in Europe. "He had been very shrewd in making up the commission," wrote Nathaniel Wright Stephenson in a 1930 biography of Aldrich. "It had three parts: those whose names were valuable but who would not want to go to Europe and so would not hamper the work; those who would like to go to Europe but would be willing enough to be excused from real work; those who meant business."

When Aldrich left for Europe, he supported the existing bond-backed currency and was skeptical about the necessity of a central bank. But his meetings persuaded him that the European system was worth emulating, and after returning home he asked Paul Warburg to give a presentation at the Metropolitan Club of New York. Warburg had written Aldrich several letters about his views on financial reform and was surprised by the senator's change of heart. But

Warburg was also doubtful the American public would accept a central bank, no matter the benefits. Aldrich was more optimistic. "I like your ideas — I have only one fault to find with them," he told Warburg. "You say that we cannot have a central bank, and I say we can."

### The Duck Hunt

By the fall of 1910, Aldrich had learned a great deal, but he didn't actually have a plan for a central bank. Nor did he have a bill to present to Congress, which would begin meeting in just a few weeks. So Aldrich — most likely at Davison's suggestion — decided to convene a small group to hash out the details. The group included Aldrich, his private secretary Arthur Shelton, Davison, Andrew (who by 1910 had been appointed assistant Treasury secretary), Vanderlip, and Warburg.

A member of the exclusive Jekyll Island Club, probably J.P. Morgan, arranged for the group to use the club's facilities. Founded in 1886, the club's membership boasted elites such as Morgan, Marshall Field, and William Kissam Vanderbilt I, whose mansion-sized "cottages" dotted the island. *Munsey's Magazine* described it in 1904 as "the richest, the most exclusive, the most inaccessible" club in the world.

Aldrich and Davison chose the attendees for their banking expertise, but Aldrich knew their ties to Wall Street would arouse suspicion about their motives. "Knowledge of who wrote the plan could have influenced people's perception of the value of the ideas and the likelihood of its political passage," says Gary Richardson, the Federal Reserve System historian and an economics professor at the University of California, Irvine. So Aldrich went to great lengths to keep the meeting secret, adopting the ruse of a duck hunting trip. He instructed the men to come one at a time to a train terminal in New Jersey, where they could board his private train car. Warburg went so far as to bring all the trappings of a duck hunter, when in fact he had never shot a duck in his life. Andrew didn't even tell his boss, the Treasury secretary, where he was going.

So secretive was the meeting that even the exact list of participants is lost to history. In his autobiography, Vanderlip says Benjamin Strong attended and recalls him horseback riding before breakfast. But Strong is absent from other historical accounts, including Warburg's first-person recollections. Strong was named the first president (then called governor) of the New York Fed, and "during the 1920s he was heralded as being the only person who really knew what a central bank was supposed to do," says Moen. "So it was assumed later he was there, but there really isn't any evidence he took part in the meeting."

Once aboard the train, the men used only their first names with each other. Vanderlip and Davison went even further, as Vanderlip wrote in his autobiography: "Davison and I adopted even deeper disguises, abandoning our own first names. On the theory that we were always right, he became Wilbur and I became Orville." Vanderlip and Davison would continue to call each other Wilbur and Orville for years, and the men referred to themselves as the "First Name Club" for decades.

### The Plan Takes Shape

Aldrich and his colleagues quickly realized that while they agreed on broad principles — establishing an elastic currency supplied by a bank that held the reserves of all banks — they disagreed on the details. Figuring out those details was a "desperately trying undertaking," Warburg told Davison's biographer, Thomas Lamont; completely secluded, the men woke up early and worked late into the night for more than a week. "We had disappeared from the world onto a deserted island," Vanderlip recalled in his autobiography. "We put in the most intense period of work that I have ever had." But it was also, Vanderlip wrote, "entirely thrilling."

By the end of their time on Jekyll Island, Aldrich and his colleagues had developed a plan for a Reserve Association of America, a single central bank with 15 branches across the country. Each branch would be governed by boards of directors elected by the member banks in each district, with larger banks getting more votes. The branches would be responsible for holding the reserves of their member banks, issuing currency, discounting commercial paper, transferring balances between branches, and check clearing and collection. The national body would set discount rates for the system as a whole and buy and sell securities.

Shortly after returning home, Aldrich became ill and was unable to write the group's final report. So Vanderlip and Strong — who was a member of the "First Name Club" even if he hadn't been on Jekyll Island — traveled to Washington to get the plan ready for Congress. Aldrich presented it to the National Monetary Commission in January 1911, without telling the commission members how the plan had been developed. A final report, along with a bill, went to Congress a year later with a few minor changes, including naming the new institution the National Reserve Association.

In a letter accompanying the report, the Commission (that is, the Jekyll Island attendees) said they had created an institution "scientific in its methods, and democratic in its control." But many people, especially Democrats, "hated the version of democracy it presented," says Richardson. "The Aldrich plan presented a reform of the financial system that was the kind of plan many Americans feared. It looked like the biggest banks would have an outsized influence on the leadership, like bankers in New York would through their control of finance and credit be able to control the country and rig the system."

With a presidential election coming up, the Democrats made it part of their platform to repudiate the Aldrich plan and the idea of a central bank more generally. When Woodrow Wilson won the presidency and the Democrats took control of both houses, Aldrich's National Reserve Association was officially shelved.

But some Democrats also were interested in financial reform, in particular Carter Glass, a congressman from Virginia. Glass had developed a plan for a system of separate regional reserve banks, as opposed to a central bank with regional branches, as in the Aldrich bill. At President Wilson's insistence, Glass also included a Federal Reserve Board composed of presidential appointees to provide federal oversight. But in its technical details, the Democrats' final bill closely resembled the Aldrich bill. "What people were really upset about was the political structure of Aldrich's plan. So the Democratic reply was a proposal that used the same technical infrastructure and policy tools. A lot of it is word for word. They just put a different political structure in place," says Richardson. The combination of regional independence and federal oversight was more to the public's liking, and the Federal Reserve Act, a combination of Glass's bill and a bill introduced by Sen. Robert Owen, became law in 1913.

## Postscript

In 1917, the journalist B.C. Forbes, the founder of *Forbes* magazine, somehow learned about the Jekyll Island trip and wrote about it in *Men Who Are Making America*, a collection of short biographies of prominent financiers, including Davison, Vanderlip, and Warburg. But not many people noticed the revelation, and those who did dismissed it as "a mere yarn," according to Aldrich's biographer.

The participants themselves denied the meeting had occurred for 20 years, until Andrew, Vanderlip, and Warburg shared the story with Aldrich's biographer in 1930. (Aldrich died in 1915 and Davison in 1922.) The impetus for coming clean was probably the publication in 1927 of Carter Glass' memoir, *An Adventure in Constructive Finance*. In it, Glass, by now a senator, had claimed all the credit for the ideas in the Federal Reserve Act. After that, Richardson says, "The other people who contributed, particularly the Jekyll Island guys, came out with books and articles to talk about their role in creating the Aldrich plan."

Warburg was especially critical of Glass' description of events. In 1930, he published a two-volume book describing the origins of the Fed, including a line-by-line comparison of the Aldrich bill and the Glass-Owen bill to prove their similarity. In the introduction, he wrote, "I had gone to California for a three months' rest when the appearance of a series of articles written by Senator Glass ... impelled me to lay down in black and white my recollections of certain events in the history of banking reform." (Warburg's book does not mention Jekyll Island specifically, although he alludes to a secret meeting with Aldrich.)

The Jekyll Island Club never bounced back from the Great Depression, when many of its members resigned, and it closed in 1942. Today, its former clubhouse and cottages are National Historic Landmarks, and the secret meeting that launched the Federal Reserve is a historical curiosity for the many tourists who visit the island. But the issues Aldrich and his colleagues wrestled with over Thanksgiving more than 100 years ago remain relevant today, as policymakers and the public continue to debate the structure and powers of the Fed. **EF**


### Readings

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