

Research Department  
Federal Reserve  
Bank of  
San Francisco

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## The Aldrich Plan

Prior to 1908, the United States' financial system had been subject to a series of financial panics that led the Congress to establish a National Monetary Commission to recommend specific reforms. The Commission ascribed the panics to an "inelastic currency"—the inability of banks to issue enough currency to meet depositors' additional demands for cash during periods of financial stress—and to the prevailing system of "pyramiding" reserves which allowed a dollar of reserves to be counted as reserves more than once.

Under the National Banking System established in 1863, the nation's supply of currency consisted of a fixed amount of government currency (greenbacks) and notes issued by national banks. In principle, the amount of national banknotes in circulation could increase when the public's demand for currency rose, but it was felt that in practice the response was inadequate—that the supply of currency was too inelastic to respond to the demand for currency. In the eyes of many critics at the time, the problem of an inelastic currency was compounded by the practice of "pyramiding," in which country banks would place their reserves with city banks, who in turn would loan them out in the market. A shortage of currency at the country banks, sometimes just because of higher seasonal needs, would lead to calls for their funds from city banks, which if the extra demand was great enough, would find themselves with insufficient cash to meet these calls. In such situations, country banks might have to close their doors, precipitating depositor panics that spread to other banks.

The Commission submitted its report early in 1911 and the following year its Chairman, Senator Nelson Aldrich (R-RI), framed his recommendations in a bill to establish a "National Reserve Association of the United States."

Over the years, certain critics of the Federal Reserve System have charged that the Federal Reserve Act, passed by the Congress in December 1913, was almost identical with the Aldrich Plan. They have claimed the Act was conceived and drafted by private bankers with foreign ("Rothschild and Warburg") and "Wall Street" connections who first used the Republican and then the Democratic party as their sponsor. In fact, there were some significant differences between the Aldrich proposal and the Federal Reserve Act: in the people who supported them, of the type of central bank which they proposed, in the organizational structures, and in their arrangements for holding and mobilizing bank reserves, discounting, and issuing currency. This *Letter* will discuss the Aldrich Plan for banking and currency reform and why it was rejected by the incoming administration of President-elect Woodrow Wilson.

### The Aldrich Plan

Although the Aldrich Plan had the virtually unanimous endorsement of the American Bankers Association and that of a considerable majority of Congressional Republicans, it was specifically repudiated (along with any unitary, European-type central bank) by Presidential candidate Woodrow Wilson and the Democrats in their 1912 party platform. "Progressive Party" candidate, Teddy Roosevelt, also denounced the plan as a scheme "to place the currency and credit system of the United States in private hands not subject to effective public control." After his election, Wilson stated that the fundamental issue surrounding a financial reform bill was whether it would be written by the administration and embrace a regionally structured central bank (the term "central bank" was not used at this time because of its connotations of centralized control) with a proper mix of private and public interests, or be written by "a controlling group of bankers" determined to achieve a highly

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centralized structure under private control. This position was reflected in a House currency committee investigation early in 1913 that found a "vast and growing control over money and credit" in the hands of a private Wall St. "money trust."

### **Private, centralized control**

Criticisms of the Aldrich Plan centered on the highly centralized and privately controlled structure of the National Reserve Association, including the procedures by which its directors (and those of its proposed 15 branches and local associations) would be elected. Those procedures tended to place voting control in the hands of the larger banks because votes were based, in part, on the number of shares of stocks that banks held in the Association.

Moreover, among the National Association's proposed 46-member Board of Directors, only four would represent the public as *ex officio* members (the Secretaries of the Treasury, Agriculture, Commerce and Labor, and the Comptroller of the Currency), while a fifth *ex officio* member, the "Governor," would be selected by the President from a list submitted by the other directors, who also would select two deputy governors and could remove all three. Similarly, only two of the Board's nine-member governing Executive Committee (the Governor and the Comptroller) could be said to represent the government.

### **A "Breeder of Panics"**

Several other aspects of the proposed National Reserve Association also were considered by the incoming Democratic Administration to be fatally flawed. These included its key provisions regarding how banks could hold their reserves, the terms on which they could borrow from the Association, and how currency would be issued.

In the view of its critics the Aldrich Plan was flawed by allowing membership in the Reserve Association to be voluntary. Also, the plan was criticized for allowing banks to

continue to pyramid reserves if they wished, thus perpetuating the fundamental weakness of the existing National Banking System... a "breeder of panics" in the words of House Banking Committee Chairman Carter Glass.

Another criticism of the Aldrich Plan centered on the provision that required the approval of the Governor of the National Reserve Association and the concurrence of the Treasury Secretary when a bank used its own promissory note as collateral to acquire currency and borrow reserves from the Association. Critics argued that the geographical enormity of the U.S. and the highly diversified structure of its regional economies rendered such highly centralized control and decisionmaking inappropriate. Similar objections were made to the proposal for a uniform nationwide discount rate.

Finally, under the influence of the populists in the Democratic Party (including William Jennings Bryan, who became President Wilson's Secretary of State), the incoming administration strongly opposed the Aldrich Plan's proposal that the privately owned National Reserve Association "at its discretion," issue new banknotes as its own obligation rather than as that of the government, even though such notes would be redeemed in gold or other "lawful money" upon demand. The proposal reflected the prevailing banking orthodoxy that, as the National Monetary Commission put it, the direct exercise by the government of authority to issue money "of any kind... has, as shown by the experience of the world, inevitably led to disastrous results."

### **The Federal Reserve Act**

HR7873, the banking and currency reform bill developed by Congressman Glass under the guiding hand of President Wilson, was designed to rectify the perceived defects of the Aldrich Plan's proposed National Reserve Association. President Wilson made clear his desire for a decentralized

central bank (again, the term "central bank" was not used) composed of a system of regional Reserve Banks in which national banks and voluntarily participating state banks would be required to hold stock and maintain their reserves (other than vault cash). He was equally adamant on the matter of the dispersion of power and control, stipulating that while six of a regional reserve bank's proposed nine directors would be chosen by banks, only three of these could themselves be bankers, while three, including the chairman, would be chosen by a separate Federal Reserve Board located in Washington and designed to be the capstone of the System.

Wilson also stipulated that the members of the proposed Board other than its ex officio members (the Secretary of the Treasury and the Comptroller of the Currency) should be chosen by the President and confirmed by the Senate and should not include any members chosen by banks. This view, strongly urged by Senate Banking Committee Chairman Robert Owen (D-Okla.) and William Jennings Bryan, initially was opposed by Congressman Glass and was strongly criticized by Aldrich Plan supporters who argued that such a Board would be "hopelessly political." To these banker criticisms, Wilson replied, "which of you gentlemen think the railroads should select members of the ICC?"

The specific elements of the Federal Reserve Act, which were presented to the House Banking Committee for its consideration in June of 1913, did not fall easily in place. At one juncture, Treasury Secretary McAdoo ("one of the few men in the world who could swear interestingly," according to Congressman Glass) proposed to solve the currency and banking problem by simply establishing in the Treasury, a bureau "with all the elements of a central bank." Also, prior to its submission for consideration by the House Banking Committee, the bill had to survive a stormy party caucus ("no such scenes were ever witnessed before") in which die-hard

populists and agrarian soft-money advocates of "corn tassle currency" demanded that a bona fide member of a labor union, a farmer, and former U.S. Presidents be made members of the proposed Federal Reserve Board. They also demanded that the Reserve Banks be required to lend \$200 million directly to farmers with guaranteed prices for their corn, cotton and wheat crops, and that additional hundreds of millions of dollars be loaned to finance public works in the various states. However, even William Jennings Bryan balked at the "soft money" proposals and finally endorsed the Administration's hard money proposal to issue Federal Reserve notes that were backed by gold and which were legal obligations of the Reserve Banks and the U.S. government.

The new central bank created by the Federal Reserve Act of 1913 was very different in several key respects than that proposed in the Aldrich Plan, whose supporters, including significant elements of the banking community, bitterly opposed the bill in Congress. Despite this, revisionist critics of the Fed to this day paint it as a creature of the banking industry that embodies the highly centralized, private control features of the Aldrich Plan. A future *Weekly Letter* will discuss the key provisions of the Federal Reserve bill, and the hostility which they encountered from many bankers and supporters of the Aldrich Plan.

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**BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT**  
 (Dollar amounts in millions)

Selected Assets and Liabilities	Amount Outstanding	Change from	Change from			
			12/21/83	12/14/83	Dollar	Percent
<b>Large Commercial Banks</b>						
Loans (gross, adjusted) and investments*	165,335	474	1,726	1.1		
Loans (gross, adjusted) — total#	145,161	468	2,594	1.8		
Commercial and industrial	43,967	17	1,486	3.3		
Real estate	57,743	114	644	1.1		
Loans to individuals	25,716	148	1,878	7.9		
Securities loans	3,355	82	616	22.5		
U.S. Treasury securities*	7,847	15	849	12.1		
Other securities*	12,326	21	1,717	12.2		
Demand deposits — total#	43,419	218	1,355	3.2		
Demand deposits — adjusted	30,054	462	1,217	4.2		
Savings deposits — total†	66,028	338	24,409	58.6		
Time deposits — total#	70,481	298	20,130	22.2		
Individuals, part. & corp.	64,440	184	16,254	20.1		
(Large negotiable CD's)	17,489	204	13,832	44.2		
<b>Weekly Averages of Daily Figures</b>	<b>Week ended</b>	<b>Week ended</b>	<b>Comparable</b>			
	<b>12/21/83</b>	<b>12/14/83</b>	<b>year-ago period</b>			
<b>Member Bank Reserve Position</b>						
Excess Reserves (+)/Deficiency (-)	129	55	134			
Borrowings	35	5	25			
Net free reserves (+)/Net borrowed(-)	94	49	109			

\* Excludes trading account securities.

# Includes items not shown separately.

† Includes Money Market Deposit Accounts, Super-NOW accounts, and NOW accounts.

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