THE FEDERAL RESERVE ACT OF 1913: HISTORY AND DIGEST

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PHILADELPHIA

History

ON MONDAY, October 21, 1907, the National Bank of Commerce of New York City announced its refusal to clear for the Knickerbocker Trust Company of the same city. The trust company had deposits amounting to $62,000,000. The next day, following a run of three hours, the Knickerbocker Trust Company paid out $8,000,000 and then suspended.

One immediate result was that banks, acting independently, held on tight to the cash they had in their vaults, and money went to a premium. According to the experts who investigated the situation, this panic was purely a bankers' panic and due entirely to our system of banking, which bases the protection of the financial solidity of the country upon the individual reserves of banks. In the case of a stress, such as in 1907, the banks fail to act as a whole, their first consideration being the protection of their own reserves.

The conditions surrounding previous panics were entirely different. In 1873 the currency was inconvertible and depreciated, and the banks could not increase their available cash reserve by the acquisition of gold. About twenty years later silver purchases weakened the monetary structure and caused distrust of American securities at home and abroad. The panic of 1907 was not preceded by any legislative disturbances or monetary unsoundness.

This panic was preceded by a season of greatest prosperity. It was followed by a widespread demand for currency reform. What economic students had been urging for a long time at last, as a result of this panic, culminated in the appointment of a National Monetary Commission by Congress and ultimately in the Federal Reserve Act of 1913. A study of monetary conditions was authorized by a Republican administration, and remedial legislation was enacted by a Democratic administration.

The immediate result of this panic was the enactment of a temporary measure known as the Aldrich-Vreeland emergency currency act, which was to expire by limitation on June 30, 1914. This act permitted the incorporation of national banks into associations similar to clearing houses and the issuance of "emergency" currency in times of stress upon certain securities approved by the authority of these associations and the government, which securities could be other than government bonds.

It was some time before the banks would organize under the authority of this act, the claim being made that the law would not work. Finally the Secretary of the Treasury during the Taft administration persuaded the banks in a number of the cities to organize. This, it was believed, was merely for the purpose of a pretense, as no one ever contemplated that the terms of the temporary act would be put into practice, and experience since has proven the truth of this prediction.

The National Monetary Commission was composed of Nelson W. Aldrich, of Rhode Island, chairman; Edward B. Vreeland, of New York, vice chairman; Julius C. Burrows, of Michigan; Eugene Hale, of Maine; H. M. Teller, of Colorado; H. D. Money, of Mississippi; Theodore E. Burton, of Ohio; Jas. P. Taliaferro, of Florida; Boise Penrose, of Pennsylvania; John W. Weeks, of Massachusetts; Robert W. Bonynge, of Colorado; L. P. Padgett, of Tennessee; Geo. F. Burgess, of Texas; A. P. Pujo, of Louisiana; Geo. W. Prince, of Illinois, and Jas. McLachlan, of California. A. Piatt Andrew, of Massachusetts, later Assistant Secretary of the Treasury during the Taft administration, was employed as an assistant to the commission and did most of the formulative work of that body.

The commission conducted investigations and held hearings in this country and abroad. The greater part of the energies of the commission, however, were expended in collecting an adequate working library. Volumes on the various banking systems of the world were prepared by the leading economic students of the countries in question, and all were published by the commission. Because of the large monetary outlay made in this direction the Democrats criticized the commission very severely.

The National Monetary Commission, upon investigation, discovered the principal defects in our banking system to be in that:

"1: We have no provision for the concentration of the cash reserves of the banks and for their mobilization and use wherever needed in times of trouble. Experience has shown that the scattered cash reserves of our banks are inadequate for purposes of assistance or defense at such times.

"2. Antiquated Federal and State laws restrict the use of bank reserves and prohibit the lending power of banks at times when, in the presence of unusual demands, reserves should be freely used and credit liberally extended to all deserving customers.