Written by **Charles Scaliger** on February 25, 2019
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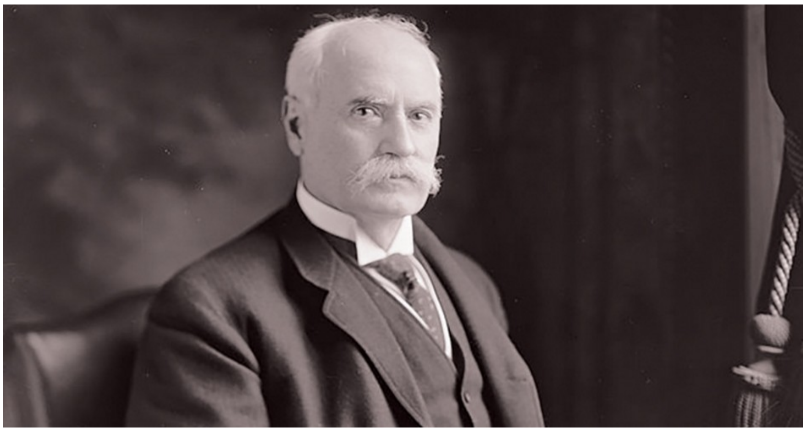
Trump and the Federal Reserve



In December 1965, Federal Reserve Chairman William McChesney Martin was summoned to the ranch of President Lyndon Johnson for a dressing-down. President Johnson, a believer in the fiscal stimulus programs enacted by his predecessor, John F. Kennedy, wanted to cut taxes further, and expected the Fed to do its part by keeping interest rates low. Martin, however, was of the opinion that interest rates should be raised, arousing the ire of the volatile president.

Ushered into what he expected would be a calm meeting with the president, Martin was shocked to find himself being physically shoved around the living room and against the wall by a furious Lyndon Johnson, who kept screaming at him, “Boys are dying in Vietnam, and Bill Martin doesn’t care!” President Johnson had apparently never gotten the memo on the supposed independence of the Federal Reserve from political influences. Cowed by the president’s belligerence, the Fed chairman maintained interest rates very low that year and the next, putting the lie to the Fed’s alleged detachment from tawdry politics.

In our time, we again have, in Donald Trump, a president openly hostile to the Fed and its policies. Trump, be it noted, has shown no inclination to physically assault Fed chairmen. But his withering anti-Fed rhetoric on Twitter has shocked the sensibilities of the East Coast establishment because, in the years since Johnson’s outburst, criticism of the Fed simply hasn’t been acceptable to the Powers That Be. Throughout its history, the Federal Reserve has maintained a public posture of independent decision making and immunity to criticism. But the reality behind the scenes is a central bank beholden to special interests both public and private, determined to maintain the traditional veil of secrecy and special privileges that have always concealed its true nature from the general public.

Of, by, and for the Rich

In the beginning, the Federal Reserve was created to serve the interests of financial and political elites, both inside and outside the U.S. government, and both in the United States and abroad. It is purely a creation of the internationalist financial and political establishment, and has no accountability whatsoever to the American public. The fact that one of its original sponsors, Rhode Island Senator Nelson Aldrich (shown), was a prominent politician, does nothing to diminish this fact. Aldrich, related by marriage to the Rockefeller dynasty, was wholly beholden to the secretive cabal of international bankers who planned the Federal Reserve at the infamous top-secret meeting at the Rockefellers’ Jekyll Island estate in 1910. Aldrich loaned his personal train car to enable the bankers to ride in secret down to Jekyll Island, on the southern Georgia coast, without being detected by the press or the general public. To this secret meeting Aldrich went in person, along with at least five other notables: Paul Warburg, A. Piatt Andrew, Henry Davison, Arthur Shelton, and Frank Vanderlip.

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The backgrounds of these men were telling. Paul Warburg, a partner at Kuhn, Loeb, and Company and a European banking agent connected with various London and Paris banking interests for whom he had worked, was the leader of the group, by all accounts. A native of Hamburg, Warburg in 1910 was not yet a U.S. citizen, although he would become one the following year. He would go on to be a director of the Council on Foreign Relations, a key organization within the American political and financial establishment, from 1921 until his death in 1932. Warburg was determined to foist on America a central bank modeled after the great European central banks such as the Bank of England, which had been around since the end of the 17th century. Abraham Piatt Andrew, a financial wunderkind who was the son of a banker and an Ivy Leaguer, was director of the U.S. Mint and assistant secretary to the Treasury Department during the Taft administration. Henry Davison had been a founder of the Bankers Trust Company and was a partner at J. P. Morgan. Arthur Shelton was secretary to Nelson Aldrich and to his National Monetary Commission, an organization created by Congress at the behest of Aldrich in the wake of the Panic of 1907, whose ostensible purpose was to study the American financial system and propose remedies that would prevent such panics from happening again. Frank Vanderlip was president of National City Bank (the lineal ancestor of Citibank), and had long been an open advocate for an American central bank. An additional possible seventh member of the Jekyll Island group, Benjamin Strong, was the energetic vice president of Bankers Trust and would later become the founding chief executive officer of the Federal Reserve Bank of New York and the true architect of American central banking. Frank Vanderlip recalled Strong being present at Jekyll Island in his autobiography, but other researchers have doubted that he was there. Given his later influence, it would be surprising if Strong — the first governor of the Federal Reserve's New York branch — was not involved.

The small group assembled at Jekyll Island represented all of the major American banking and financial concerns, elite American political interests, and (via Warburg in particular) wealthy European banking houses. Because many of the attendees were public figures, Aldrich concocted the cover story of a duck hunting trip and insisted that the men address one another only by their first names during the train trip — lest any of the train workers recognize them and report their activities to the media. Aldrich also pledged all of those in attendance to secrecy. The fact of the meeting having occurred was brought to light in 1916 in an article by B. C. Forbes in a publication called *Leslie's Weekly*, but all of those in attendance claimed the article was pure fiction. It was not until 20 years after the meeting that some of those in attendance, including Senator Aldrich, finally admitted that they had conspired to draw up plans for the Federal Reserve at the top-secret Jekyll Island meeting. Public admissions of complicity by the likes of Aldrich and Vanderlip notwithstanding, the most important figure at Jekyll Island, Paul Warburg, always refused to talk about the event, believing himself "pledged … to secrecy."

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Banking per se has been around for thousands of years, but the modern money-manufacturing machines known as central banks — hybrid public-private institutions designed to manipulate the money supply to the advantage of wealthy elites under the protection of the state — date from the Bank of Sweden and the Bank of England, both of which were set up in the late 17th century. By the turn of the 20th century, most modern countries had central banks, and the entire European economy was based on the ability of these institutions to manipulate the money supply by issuing debt not necessarily backed by any real assets. Although the United States during the 18th and 19th centuries had periodically experimented with central banking, the last such institution, the Second Bank of the United States, had been terminated by President Andrew Jackson, reflecting Jackson's (and many of the Founders') view that central banks were dangerous to liberty and independence. Now, Aldrich, Warburg, and their co-conspirators were determined to bring the European system of central banking to the United States, to better serve the interests of America's moneyed classes and their colleagues overseas.

Banking Becoming Like Europe

According to standard accounts, the American and European financial systems at the time were in stark contrast. The American system, goes the official version, was plagued by instability because American banks typically loaned out their reserves to stock speculators in large cities during boom times, making those reserves difficult to access during times of crisis. Moreover, American banks did not operate overseas and also had great difficulty clearing checks and other forms of money transfer between cities or regions. Finally, the American monetary system was strictly tied to gold, making it difficult to meet market demand for looser credit (i.e., more money) during certain times of the year, like harvest time. All of these alleged deficiencies of the American system had been solved by the Europeans, whose banks tended to loan money directly to merchants and manufacturers, thereby guaranteeing ready access to collateral in the case of default or crisis. With greater power to create money not backed by assets, European powers fancied themselves more flexible in responding to financial crises. That Paul Warburg believed all of this is borne out by an article he published in the *New York Times* in 1907, in which he averred that the United States' financial system at the time was "at about the same point that had been reached by Europe at the time of the Medicis, and by Asia, in all likelihood, at the time of Hammurabi."

Warburg's snide appraisal seemed to be vindicated in the great Panic of 1907 that erupted scant months after its publication. The drama of those few tumultuous weeks saw a number of powerful American financial institutions ruined and the city of New York itself teetering on the brink of bankruptcy. The situation was saved when J. P. Morgan and John D. Rockefeller, along with a number of America's wealthiest citizens, came together and used parts of their vast fortunes to shore up America's teetering finances. As is nearly always the case in a free market economy, they were acting primarily out of self-interest; they knew that the financial hurricane that had brought down the likes of Knickerbocker Trust might eventually engulf their own concerns if they failed to act. But after so doing, they resolved never to do so again; in the future, they expected some government entity, funded ultimately by American taxpayers, to be the guarantor of financial stability.

The result was the creation of the Federal Reserve in 1913, America's first modern central bank, which has lasted up to the present day.

When the Federal Reserve was first set up, its structure was slightly different from what it is today. For one thing, the dominant figure in the early Federal Reserve was not its chairman but the governor of the New York branch of the Federal Reserve. The organization was structured at its inception to create the illusion of decentralized power; unlike European central banks, the Fed had a number of branches — 12 in all — in major cities across the country, which represented 12 districts, each of which theoretically wielded the same amount of power as any of the others. Also, the Fed was presided over by a board of governors, which supposedly made decisions deliberatively and independent of all political or private financial interests that might be brought to bear.

In reality, the early Federal Reserve was completely dominated by the New York branch and by its energetic governor, Benjamin Strong, who enjoyed many ties to the New York financial and banking community and generally acted in their interest — not the interest of bankers in San Francisco, Chicago, or other parts of the United States. Strong, as we have seen, was tied to Bankers Trust, one of the largest players in New York finance. It was he who in effect dictated Fed policy, which the board of governors was expected to rubber-stamp. Strong enjoyed ascendancy over the other Federal Reserve branches because, in addition to his and the New York Fed's close ties to the New York banking and financial establishment (and their colleagues in Europe), the New York Fed became the chosen repository for a lion's share of the Fed's gold reserves, a state of affairs that persists to this day. It was also chosen, as we shall see, as the center of the Fed's open market operations. Thus from its inception, the Fed was wholly a creation of New York financial insiders, their political myrmidons, and their European colleagues. While the passage of generations has diluted to some extent the near-monopoly that the New York financial sector once enjoyed over the finances of the entire United States, the existence of the New York Fed, with the unique role created for it by Benjamin Strong, has done much to ensure that most of America's finances are still concentrated in the Big Apple. Consider, for example, that even though cities such as Charlotte and San Francisco have developed into significant international banking centers, most of the major stock and financial markets are still located in New York City.

A major reason for this is the methods developed by Benjamin Strong to enable the Fed to manipulate the money supply efficiently. Strong is credited with the invention of so-called open market operations, the most important tool used by the Fed to expand or contract the money supply, and now a standard practice with central bankers all over the world. Open market operations are the purchase or sale of government securities ("Treasuries") at regular auctions. Strong and some of his colleagues appear to have discovered by trial and error how open market operations affected interest rates and the money supply, and in 1923, the Fed's Open Market Committee was created, with Strong as its leader, to plan the purchase and sale of government securities. Ordinarily, such securities, issued as debt instruments by the U.S. Treasury, are bills and bonds that have already been purchased from the government by some private party; the Fed does not normally purchase newly issued securities directly from the Treasury Department, as such a practice would be too egregiously inflationary. But by buying and selling securities on the secondary market, the Fed can influence market demand for the issuance of more new Treasury debt and thereby incentivize expansion or contraction of the money supply indirectly. In other words, the Fed is not so indelicate as to print new money outright, or even (except under extreme circumstances) work directly with Treasury officials to issue new money in direct exchange for new debt. But the subtle minds that operate the machinery of America's central bank understand well the power of financial incentive; they know that by buying Treasuries from third parties with newly created money, they also incentivize further issuance of debt by the Treasury Department — debt that will ultimately be paid for in yet more new money.

In similar fashion, Fed officials understand that by lowering interest rates — specifically, the interest rate at which the Fed loans money to member banks, the "discount window" — it incentivizes member banks to lower interest rates in turn, which drives up the demand for credit and, again, leads to an expansion in the money supply.

Over the years, the Fed has developed additional techniques for manipulating the money supply, including raising or lowering reserve requirements for member banks, buying and selling foreign currency, and other, more arcane methods invented by Fed Chairman Benjamin Bernanke in response to the Great Recession of 2007-2009.

Open market operations are significant not only because they constitute the Fed's most often-used tool for manipulating the money supply (a practice otherwise known as inflation), but also because they are carried out only between the Fed and certain authorized banks and financial concerns (so-called primary dealers). These 23 ostensibly private institutions are nearly all headquartered in New York City, Canada, Europe, or Japan, and all enjoy a special privilege that no other bank or financial institution enjoys: first dibs on new money being pumped into America's financial bloodstream. Open market operations are carried out by the New York Fed, which is how the Fed has helped New York City preserve its ascendancy in American and international finance. These gigantic financial institutions authorized to participate in open market operations thus enjoy a privileged position over American and global finance: They are the first to benefit from the Fed's inflationary largess, and use their access to new money to drive up stock prices and carry out many other advantageous activities, both in the United States and abroad. This state of affairs alone puts the lie to the Fed's claims of empyrean impartiality; the very existence of open market operations guarantees a financial oligarchy whose interests will always be served first and foremost by Fed decision making.

When the Federal Reserve was set up, America remained on the gold standard, and many early proponents of the Federal Reserve, including Benjamin Strong, believed in the need for an international gold standard to maintain financial stability. As a result, the Fed's early inflationary activities, including both open market operations and the use of the "discount window" to manipulate interest rates, were carried out in the context of a currency standard that required currency to be redeemable in gold. In reality, of course, the Fed, thanks to its new "flexible" credit powers, was able to pyramid fiat monetary assets on top of a fraction of its reserves kept in gold.

Financing Wars

The Fed has consistently used those credit powers to serve the interests of the power elite. One of the most important powers of a modern central bank, with its essentially unlimited inflationary potential, is to finance wars desired by political and financial elites, but which are unpopular with the taxpaying public. One of the Fed's first big roles was the financing of America's involvement in World War I, a deeply unpopular and (as events turned out) feckless enterprise that accomplished little more than set the stage for an even bigger war later in the century. Nevertheless, American involvement in the war was ardently desired by American bankers and industrialists who stood to make a fortune manufacturing weapons and financing the combatants — and to lose a fortune if, as appeared likely would happen, the losing side (most notably the French) ended up having to default on huge debts owed to the likes of J. P. Morgan. The problem with war is the immense cost. The Revolutionary War bankrupted the fledgling United States, and every war since has left a trail of debt for succeeding generations to pay. Wars financed by up-front taxation are seldom politically viable. But wars financed by inflationary means, using the legerdemain of modern central banking, are a boon to politicians and moneymen alike. Inflation is a form of taxation, too; eventually, the piper has to be paid for the debasement of currency occasioned by printing money. But the process is so subtle that few people understand what is happening, or who is to blame.

The Benjamin Strong-led Fed jumped enthusiastically into the World War I effort, acting as an agent of sale for war bonds and offering preferential interest rates for member banks that wanted to purchase Treasury debt. The New York Fed, not surprisingly, was named the Treasury Department's agent for selling Treasury bonds, and the Fed, in concert with the demands of politicians, kept interest rates artificially low to incentivize more public purchases of government debt. Ironically, all of this was taking place as America was flush in, of all things, new gold. Since the outbreak of the war, European gold had been pouring into America to finance the war. Yet in the view of many financiers and scholars then and now, this created inflationary instability and required robust action on the part of the Fed to counteract.

World War I, the first great test of the new Federal Reserve, showed beyond any doubt that the Fed had no intention of being independent of political and other special interests. As Allan Meltzer noted in his monumental history of the Federal Reserve, "Independence was sacrificed to maintain interest rates that lowered the Treasury's cost of debt finance" during the war years.

Much of the European gold that flowed into the United States during the war ended up in the Fed's vaults, giving it vast new assets to use in its activities. During the 1920s, as open market operations came into their own, the Fed used some of its gold to amass government securities that it then learned to use to micromanage the money supply. The Fed also opened the money spigots substantially by keeping interest rates low, especially later in the decade. Those low interest rates prompted banks and investors to borrow money to purchase stocks in the infamous speculative frenzy that led up to the stock market crash of 1929 and the Great Depression that followed.

In a 2002 speech honoring the 90th birthday of economist Milton Friedman, then-Fed Chairman Ben Bernanke admitted, in a rare moment of candor, that the Federal Reserve had been largely responsible for the Great Depression. "Regarding the Great Depression … we [at the Fed] did it. We're very sorry.… We won't do it again," Bernanke confessed. What Bernanke was referring to were alleged errors in judgment, whereby the Fed raised interest rates drastically in the months before the crash of '29, and continued on the same course until well into the 1930s — at a time when, according to the dubious wisdom of Keynesian economists, the Fed should have been keeping interest rates low to continue expanding the supply of money and credit.

The Fed has also been criticized for failing to live up to its promise to act as a lender of last resort and prevent a systemic banking collapse — precisely what occurred in 1930 through 1933. But these criticisms miss the mark. To be sure, the Fed was largely responsible for the Great Depression, but its responsibility has less to do with errors in judgment than with the fact that the entire premise of modern central banking — that prosperity can be produced by expanding the money supply — is completely false. In the midst of the turmoil of the global Great Depression, the United States and many other Western countries went off the gold standard completely, yet the alleged flexibility that this act should have conferred on central bankers to rectify the crisis only made things worse.

From that time to the present day, the saga of the Federal Reserve and of central banking in general has been one of banks amassing more and more power, operating more and more in concert with political interests, in order to solve increasingly daunting problems that they have created themselves. The early 1930s saw a flurry of new bills that effectively transformed the banking system into an arm of the federal government — the Banking Act of 1932, the Banking Act of 1933, the Glass-Steagall Act of 1933, the Gold Reserve Act of 1934, and the Banking Act of 1935. And numerous other pieces of legislation in the decades since have further consolidated the Fed monolith and its ties to political interests. But none of that prevented the great inflationary crisis of the 1970s, and numerous recessions large and small, especially the Great Recession of 2007-2009 and its worldwide aftermath, a crisis that Ben Bernanke, glib promises to the contrary, was powerless to prevent or palliate.

Throughout its checkered history, the Fed has been mostly immune to criticism in the halls of power in Washington. Aside from Lyndon Johnson's thuggish tactics, few presidents have ventured to criticize the central bank, and even in Congress, criticism of the Fed has been rare and usually muted (a notable exception being the career of former congressman Ron Paul, who was Bernanke's most vocal and unflinching adversary before, during, and after the Great Recession). For this reason, it is refreshing that, in President Trump, we have for the first time in generations a president unafraid to criticize the Fed, and in Congress, a statesman in Thomas Massie who, in introducing a bill to audit the Fed, has effectively taken up Ron Paul's mantle (see Extended Inside Track). But it is unclear whether President Trump's criticisms of the Fed are grounded in principled opposition to the moral outrage that is modern central banking, with its money spigots and special interest allegiances, or whether, like many economists who support central banking in principle while deploring this or that Fed policy decision in hindsight, Trump is more interested in reforming the organization.

Since it is probably the latter, it bears clarification that, commendable as any criticisms of the Fed may be (and to the extent that they raise public awareness of the organization's deficiencies, they certainly are), no amount of reform will rectify the Fed's fundamental flaws. No matter how ingenious central bankers become, they will remain powerless to stop recessions and depressions, and in fact will generally be the cause of them. The financial sector — like the rest of the economy — is simply too complex to be planned. What's more, the perverse incentives associated with central banking and fiat money production will always ensure that central bankers will amass more and more power and wealth, along with their political and financial cronies, while impoverishing the rest of us. The inflation that has eroded the value of the dollar — and people's savings and asset valuations into the bargain — over several generations is wholly the fault of the Federal Reserve System.

The only possible solution is the abolition of the Fed and the entire modern fiat money system along with it. Such an act will of course be a shock to the moneyed interests, but will bring great relief for those lower on the economic ladder who have been unable to save money for decades — in other words, most of the rest of the American public, for whom lifelong debt has become a dreary reality. The Fed never has and never will be the benign, impartial arbiter of financial well-being it is portrayed as being, and it is long past time to dispose of it.

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