

STATE BANKS
AND THE
FEDERAL RESERVE SYSTEM

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AND THE
FEDERAL RESERVE SYSTEM

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DEDICATED
TO
DEAN CHESTER A. PHILLIPS

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PREFACE

The federal reserve system is now almost fifteen years old. And yet, in many ways, it is still in its infancy. We have learned much from its experiences during the past decade. But that we have much more to learn is quite obvious. For example, there is at present widespread disagreement over what constitutes the proper functions of the federal reserve system. At the same time that its policies are drawing commendation from certain quarters, they are being vigorously criticised in others. This difference of opinion cannot be avoided; in fact it should be welcomed. Nothing reveals a public institution in its true light more than free and open discussion of its merits. But is it too much to ask of critics of the federal reserve system that they base their criticisms on facts rather than on imagination or prejudice, as they have frequently done in the past?

The advantages and disadvantages of membership in the federal reserve system have furnished a fertile field for controversy. There is still much ignorance or misunderstanding of the operations of the system on the part of bank directors and executives, to say nothing of the general public. Nowhere is this more clearly evident than in discussions on the value of membership in the system. The great majority of American banks will probably not join the federal reserve system, at least during this generation. While their membership is not essential to the success of the system, yet many of them would find it to their advantage to join. And the irony of the situation is that the very benefits for which the federal reserve system is responsible render any perceptible increase in membership in the near future highly improbable. For nonmembers

enjoy many of the advantages of membership indirectly, through their city correspondents.

In a study of this phase of the federal reserve system we are confronted with certain unpleasant facts. There are now one thousand fewer members of all kinds than in 1922. Over two hundred state banks and trust companies have withdrawn from membership. Nearly one thousand national and state bank members have closed their doors because of financial difficulties since 1920. Surely, there has been something wrong somewhere. Would not more stringent supervision have prevented the insolvency of a large part of the seven hundred national banks that failed during this period? It would seem so. But that is not the complete answer.

No answer could be satisfactory that did not recognize the dual character of our banking system. A severe tightening of banking standards in the federal reserve system would probably drive out a large number of present members, because they could, in many cases, operate under state laws much more profitably. Until the various states take appropriate measures to secure higher standards of banking ability and practices it is difficult for the federal reserve system to accomplish much more than it has already done in this respect.

In view of the fact that members of the system deserve special consideration, I believe it would be advisable to amend the Federal Reserve Act to permit special dividends on federal reserve bank stock from time to time as the earnings of the reserve banks make this possible. There is now no particular reason why all of the surplus earnings should be paid to the government. I believe this can be done without committing the federal reserve banks to a profit making policy. A plan such as that proposed by the New England bankers in 1923 seems highly feasible.

Even if membership in the federal reserve system does not increase during the next few years there is little ground

for discouragement. A larger proportion of all banks in the country belong to the system than ever before, and the members control over three-fourths of the country's commercial banking resources.

The writer of a book of this nature is constantly faced by the problem of keeping his material and facts up to date. I have wished many times that I could have written about an episode concerning which nothing more could be discovered. A chapter is no sooner finished than it stands in need of revision. I have completely revised various portions of this volume several times because of succeeding developments, and even now as it goes to press I find some of it already out of date. Take the chapter on branch banking, for example. Events have moved so swiftly in this field that by June 30, 1928 the total number of branches had grown to 3230. On that date, 169 national banks operated 941 branches; 186 state members operated 1220 branches; and 480 non-members controlled 1069 branches. Unfortunately, for the writer of contemporary economic history, economic changes occur so rapidly that the written record lags always far behind.

I have tried in this study to present an accurate description and discussion of the problems arising from state bank and trust company membership in the federal reserve system. Those to whom I am indebted for information and assistance are too numerous all to be mentioned here individually. May I take this opportunity of expressing my lasting gratitude to the officers of the federal reserve banks and the national and state bankers who gave me so unsparingly of their time and knowledge. I am especially grateful to Mr. Walter L. Eddy, Secretary of the Federal Reserve Board; Mr. C. A. Peple, Deputy Governor of the Federal Reserve Bank of Richmond; Mr. M. B. Wellborn, former governor of the Federal Reserve Bank of Atlanta; Mr. Wm. A. Heath, Federal Reserve Agent and Chairman of the Board of the Federal Reserve Bank of Chicago; Mr.

Wm. McC. Martin, now governor of the Federal Reserve Bank of St. Louis; and Mr. F. R. Jones of the County Bankers' Association of Georgia. They all showed the utmost courtesy and patience in replying to my requests for information.

To the Editors of the *American Economic Review* and the *Journal of Political Economy* I am indebted for permission to use material from articles which I have written and which have from time to time appeared in those journals.

My greatest debt of gratitude is to the Department of Economics of Princeton University. Mr. Edwin Walter Kemmerer, who first suggested the subject, was a constant source of inspiration and encouragement. Mr. Frank H. Dixon and Mr. George B. McClellan were at all times friendly and loyal counsellors. Mr. Frank A. Fetter, Mr. David A. McCabe, and Mr. Frank D. Graham all were kind enough to read the manuscript in its original form and made numerous suggestions. Mr. Frank H. Knight, formerly of the University of Iowa, but now of the University of Chicago, read the manuscript as it approached its final form and offered many criticisms and suggestions for improvement. In Dean Chester A. Phillips of the University of Iowa I found an advisor and friend of inestimable worth. To these, at times severe but kindly critics, all that is really worthwhile in this book is due. With much that is in it I know they may not agree, but I have tried to describe the situation as it appeared to me. Miss Mary Elizabeth Dearborn was of great assistance in preparing the manuscript for the press. But without the constant patience, sympathy, and encouragement of my wife it could never have been written at all.

Seattle, March 6, 1929.

C. S. T.

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