Reflections from History:

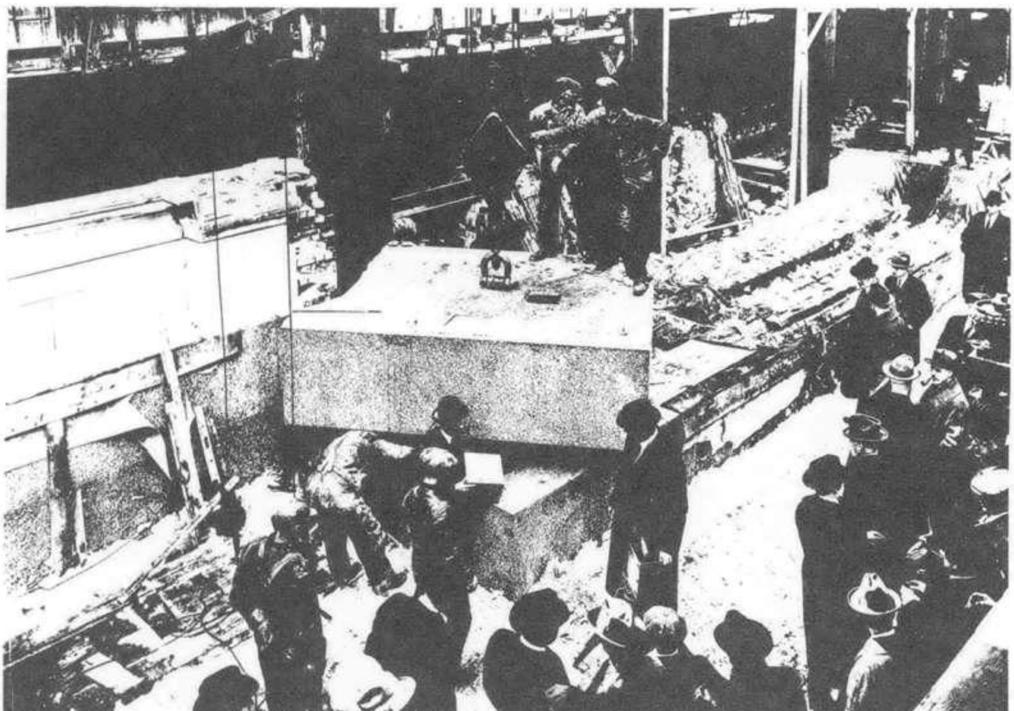
the Minneapolis Federal Reserve Bank

Cover photograph:

Early in 1915, the eighteen employees of the Minneapolis Federal Reserve Bank moved into leased quarters in the New York Life building (on left in cover photo, looking up Fifth Street from Second Avenue South).

Excerpts from

Reflections from History: the Minneapolis Federal Reserve Bank



Clarence W. Nelson

Federal Reserve Bank of Minneapolis
February 1973

Foreword

These excerpts are drawn from a publication prepared as a commemorative piece during the Bank's fiftieth year, 1964. Authored by Clarence Nelson, who is now director of research, Reflections still provides a thoughtful perspective on the Federal Reserve System and the Minneapolis Reserve Bank as they have evolved during this century.

Bruce K. MacLaury
President

"I wish to place great emphasis upon the public service which the (Federal Reserve) banks are destined to perform . . . not alone to make banking a safe business but to provide and guarantee safe conditions under which the business man and farmer may continue their activities . . ."

John H. Rich — Federal Reserve Agent — 1914

Blueprint for reform: how to draft it?

Was it fear? Fear was a part of it.

There was stubborn independence, too, and apprehension over control of their destinies — control, as they saw it, by "The East," by "Big Money" interests. Strong currents of feeling from the people of the Northwest region contributed to the ideas and the politics of national monetary reform that eventually became word of law in the Federal Reserve Act of 1913.

To be sure, there were other, weightier voices. Throughout America's South and West, men shared the fear of "Wall Street domination." But nowhere did feelings run more strongly than in the northern great plains — a land opened by homesteading, rooted in the soil, yet dependent on a seemingly indifferent "East" for its financing and its markets. Here was sired a distinctive "prairie politics" that found voice in the Populist movement with its own sprung-from-the-soil remedies for money ills.

Reform there would be. And the Northwest would lend its own special flavor to the national consensus. The time was early 1908. Ahead lay a six-year period of debate — a debate, you might say, over "architecture." If either doubt or lethargy existed earlier over the need for reform of the monetary system, they were shaken loose by the Panic of 1907. From that point through 1913, study, debate, and a growing popular insistence ruled that a new financial superstructure would soon be built. Farmer, banker, businessman, and politician — all agreed. The only question now — and for the next six years — was what *design* for reform should Congress adopt.

The need for a change

Many defects marred the nation's monetary system as the 20th century began; some of them were obvious to almost everyone, others were understood only by a relatively few financial experts. One of the obvious flaws was that currency — that is, hand-to-hand, pocket money — was incapable of expanding in volume to meet the fluctuating needs of agriculture and commerce. "Inelastic," they called it. This was obvious to people of the Northwest, because periodically they found that banks could not convert their deposits into cash, forcing them to resort to scrip or to barter. Harvest-season shortages of cash continually vexed farmers, and at times they had to pay "premium" to get currency.

"Pyramided reserves" was another flaw that even the lay observer could appreciate. A small, farm-community bank in North Dakota, for example, ordinarily kept only a part of its reserve funds as cash in its vaults, the remainder being deposited, say, in larger Twin Cities banks. Twin Cities banks, in turn, kept reserves in Chicago banks; and the Chicago banks, New York. Sudden, unusual demands for cash could quickly shift pressures for cash from the outlying countryside through the financial centers and focus them on New York where the reserve funds of the nation tended to concentrate. This reserve arrangement worked well enough in good times, but it was a ready-made system for transmitting financial panic in times of low confidence — and it had so operated at least once a decade since the time of the Civil War.

Then, too, in New York the excess funds usually ended up in the stock market in the form of "call loans," which meant technically they could be gotten back by the banks on a moment's notice. The trouble was that often the borrower was speculating and in the process had all his own money, plus the borrowed money, in stock. When "calls" had to be made in large volume and the borrowers tried to get cash by selling stock, then prices dipped — or plunged — in a cumulative wave of forced selling. In this way, "runs" on banks in the hinterland were sometimes translated into stock market crashes in New York.

There was another problem. More often than not, a bank that had been closed by a "run" of withdrawals was basically in sound shape; at least it held a portfolio of perfectly good assets, even though it had no place to turn to get temporary cash for them. Or, if the assets were "callable" loans or "marketable" securities, any attempt by the bank to turn them into cash under crisis conditions only abetted chaos in the banking system.

These were but a few of the recognized ills of the extant system. Congressional study during this period distinguished seventeen such defects, many of which played a part in the

Minnesota Historical Society

A run on a Minneapolis bank during the Panic of 1893

Panic of 1907. This crisis started, somewhat differently from most of its predecessors, by rumors of insolvency followed by panicky withdrawals from a few big banks in the New York money market. But the jitteriness spread quickly, and runs were soon made on banks in distant farming areas. The effects of these runs, in turn, converged back on New York. The result: complete collapse of the nation's banking system and the forced bankruptcy of many businesses. Although major panics had occurred before (1873, 1884, 1893), the Panic of 1907 turned out to be the one that catalyzed reform efforts.

Efforts in Congress

An aroused Congress passed the Aldrich-Vreeland Act on May 30, 1908. This Act accomplished some minor patchwork by providing emergency sources of currency. Much more important, it established a bipartisan Congressional committee, the National Monetary Commission, under the chairmanship of Republican Senator Nelson Aldrich of Rhode Island, which was instructed to:

. . . inquire into and report to Congress at the earliest date practicable, what changes are necessary or desirable in the monetary system of the United States or in the laws relating to banking and currency . . .

The Commission's study was broad, thorough, and lengthy; a final report was not issued until January 1912. Its many findings and recommendations formed the main fabric of two Congressional proposals for remedial action.* Senator Aldrich himself introduced the first proposal in January 1911 carefully based on the committee's work. His bill — the Aldrich plan for a "National Reserve Association" — nevertheless had two fatal flaws: its "architecture" and its "politics."

The Aldrich plan provided for voluntary, regional associations of banks, and also a national supervisory body to be elected largely by bankers. The associations were granted various powers, among them to mobilize reserves of the banking system, and to issue currency based on commercial need. The plan was built upon expert advice and was well-geared to remedy essentially all the ills diagnosed by the Commission. The plan's regional emphasis appealed to the deep sectional feelings, such as those existing in the Northwest. On the whole the plan had the support of bankers, since their membership was voluntary and since they were given elected representation in the associations.

But the whole arrangement was too "banker-oriented" to gain grass roots acceptance. For example, Republican Congressman Charles A. Lindbergh of Minnesota, member of the House Committee on Banking and Currency (and father of the famous aviator), spoke critically of the Aldrich plan, charging that the reserve associations would fall into the hands of the so-called "Money Trust." Others objected outright to the lack of direct government control over the proposed financial superstructure.

As though these substantive features weren't obstacle enough, the fact that the bill bore the name of Republican Senator Aldrich further doomed it to defeat. The Democratic party had gained control of the House of Representatives in the 62nd Congress (1911-1913), and partly as a result the Aldrich proposal was never brought to a vote. Then, with the elections

*These were the Aldrich Plan of 1911 and the Owen-Glass Bill of 1913.

of November 1912, when Woodrow Wilson and a Democratic Senate were swept into power, it became clear that in order to pass in the 63rd Congress any reform measure would have to be authored by Democrats. The Democratic platform of 1912 had declared: "We oppose the so-called Aldrich Bill or the establishment of a central bank . . ."

In this context, then, the key figure became Carter Glass, Democratic Representative from Virginia's 6th district and newly-appointed chairman of the House Banking and Currency Committee. By the time election results were posted, Glass had outlined a preliminary draft of a reform bill, which he then discussed with President-elect Wilson in December. In the next half year successive revisions incorporated the results of (1) hearings by the Committee during January-February 1913, (2) detailed review by Glass, Secretary of Treasury McAdoo, and Committee expert H. Parker Willis, and (3) compromise with the insistence on government control demanded by William Jennings Bryan, then Secretary of State in the Wilson cabinet. The end-product of all this jostling was a monetary reform bill introduced into the House on June 26, 1913, as H.R. 6454, popularly called the Owen-Glass Bill in deference to the fact that an identical companion bill was introduced in the Senate by Democratic Senator Robert L. Owen of Oklahoma.

The Owen-Glass proposal to establish a Federal Reserve System of regional reserve banks differed in some important respects from the Aldrich plan, although there were many basic similarities. Some of the differences — notably the introduction of a fully government-appointed board to supervise the system from Washington,* and the provision for compulsory membership for banks with national charters — aroused strong opposition from bankers. But these measures gathered broader support from some of the factions that had opposed the Aldrich plan.

As first introduced the plan had a great many technical defects. So its various provisions were debated at length in Congress and in Committee on technical as well as political grounds through summer and fall of 1913. Glass rewrote the bill and introduced it into the House (as H.R. 7837) on August

*This was a direct result of Glass's compromise with the "Bryan wing" of the Democratic party; the earlier Glass-Willis draft, discussed with and approved by Wilson in December 1912, provided for banker-elected representation on the central board.

29. Though never fully purged of technical flaws, the much revised Owen-Glass proposal, with some last minute compromises between Senate (Owen) and House (Glass) versions, became the blueprint for reform that Congress finally and officially approved.

Role of the National Citizens' League

In January 1911, against the background of three years of the National Monetary Commission study, and publication of the Aldrich proposal, a group of businessmen meeting at a Conference of the National Board of Trade in Washington resolved to promote monetary reform in an organized way and on a national scale. That businessmen should have taken direct initiative in the matter of monetary reform is not at all strange. Panics typically exacted great toll from businesses. The Board of Trade appointed a seven-man committee under the chairmanship of Paul M. Warburg of New York, and the work of setting up an organization began immediately.

The committee knew it could not locate the headquarters for such an organization in New York, or any eastern city for that matter, because suspicion of eastern influence was so strong that the West and the South would give a New York based operation no support. So the committee chose Chicago where, after a series of discussions, its members persuaded a group of Chicago businessmen to organize the National Citizens' League for Promotion of a Sound Banking System. The League was promptly organized with John V. Farwell as president and was fully ready for work by June 1911.

The League's objectives were to arouse interest in banking reform and to carry on a nationwide campaign to inform people about the issues. And while League members favored the principles of the Aldrich plan, they declined officially to endorse its details. As it turned out, the League helped pave the way for the plan of reform that finally emerged from Congress in December 1913.

The League's work was accomplished through state committees that were quickly set up in most states. Many businessmen from the Northwest stepped into voluntary posts on the committees and devoted themselves for two or more years to establishing their state organizations, arranging for meetings, seminars and speakers, and distributing educational material throughout the entire Northwest.

The Minnesota state committee, headed by John H. Rich, a businessman from Red Wing, had its headquarters in the Goodhue County National Bank of Red Wing. Mr. Rich, with his assistant, Curtis L. Mosher ("on loan" from the Northern Pacific railroad), proceeded to organize one of the most active and effective chapters of the League in the country. Norman B. Holter, operator of the Holter Hardware company at Helena, was Mr. Rich's counterpart in Montana; L. B. Hanna, Fargo, banker and Congressman at large from North Dakota, headed the North Dakota chapter; and T. Henry Foster of John Morrell & Company, Sioux Falls, led the South Dakota organization. As we shall see, many of these dedicated and determined leaders in the League's campaign for monetary reform ultimately became directors or officers in the Federal Reserve Bank of Minneapolis.

Perhaps the most telling episode of the League's work occurred in early 1913. At that point it appeared to the League that growing momentum for reform might falter under the incoming Wilson administration. True, President-elect Wilson had conferred with Carter Glass on the matter in December 1912. Yet, revision of the tariff was the main objective set for the special session of Congress which the President-elect had announced for April 1, and he had not committed himself publicly on the question of whether monetary reform would also be pushed.

During the pre-inaugural period the League continually exhorted its members to make their desires for monetary reform known in Washington. For example, in the February 1, 1913, issue of the League's monthly newsletter, *Banking Reform,* a bold-print, front-page editorial charged all members:

> Congress is wavering over the question of banking reform. The Democratic leaders are undecided whether to bring in a currency bill at the special session in the Spring or defer action until the regular session next December . . .
>
> President-elect Wilson has been quoted as holding the view that public sentiment as to banking reform has not yet crystallized.
>
> Write to Mr. Wilson if you know him. If you don't know him, it is a good way to get acquainted.
>
> The National Citizens' League has 10,000 members and a million friends. If every member of the League and every friend of banking reform does his duty, Congress will have substantive evidence that

> the business world is not indifferent. . . .
>
> Now is the time to act.

Shortly after the inauguration, John Farwell and a delegation from the National Citizens' League met with the President and inferred from their discussion that Wilson was in no hurry to introduce monetary reform measures in the spring program. Wilson reportedly was not aware of sufficiently widespread popular demand for reform to justify him in taking personal interest at that time. The League's delegation promptly wired the Chicago headquarters to call its state organizations into action. Response from members quickly followed. Telegrams poured into the White House by the bushel basket — reportedly some 27,000 messages within about three days. The President was impressed. "Call off your members," wired Presidential Secretary Tumulty to the Chicago headquarters of the League, "The President has all the evidence he needs." Assured of the great public demand for monetary reform, President Wilson became "a firm and unwavering friend of banking reform legislation" and gave strongest backing to efforts to speed complete legislation.

Thus the League was able to proclaim in the final issue of *Banking Reform,* October 1, 1913:

> With the introduction of the Glass bill the work of the National Citizens' League practically ended. It was deemed wise by the Executive Committee to continue until there was more definite assurance of the intentions of the Wilson administration to push the cause of banking reform to an early conclusion. These assurances have been made both definite and emphatic. The time when an adequate bill will be passed cannot be set, but there is no doubt that it is near. . . .

The Owen-Glass Bill, as finally revised, passed Congress on December 23, 1913 and that same day was signed into law by President Wilson.

Blueprint for a monetary "superstructure"

The question of what changes were necessary or desirable in the monetary system began the era of debate in 1908. The answer that closed the era (but certainly not the debate) was given by Congress in 1913 when the revised Owen-Glass Bill became Public Act No. 43 of the 63rd Congress — the Federal Reserve Act:

> An act to provide for the establishment of Federal reserve banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes.

The Act was a blueprint for a great many important changes. In fact, no other modern nation had ever undertaken through democratic processes such complete and broad reform of its financial system. Many defects in the plans still would have to be worked out, but, on the whole, the Act was widely heralded as a remarkable achievement.

We shall single out three basic elements of design of the new system, first, because they were so fundamental to the architecture as it was drawn in 1913, and second, because in the reasons for their ultimate abandonment we shall see unfolding the evolution of a new architecture — and that is the theme of our story.

(1) With respect to *structure:* the Act called for several regional reserve banks, empowered to operate more or less autonomously within their own areas.

(2) With respect to *control:* the Act compromised between private and government control by providing: (a) at the regional level, a board of directors of each Federal Reserve Bank, a majority of whom would be elected by (and presumably responsive to) the member banks of the region, and (b) at the national level, a government-appointed supervisory body. The national supervisory body would, in turn, have a directly-appointed representative on the board of directors of each of the regional banks. Policy-making was to be in large measure at the initiative of the regional boards of directors.

(3) With respect to *function:* the amount of reserve bank credit extended to member commercial banks would rise and fall almost *automatically,* its volume correctly attuned to the needs of the economy because only legitimate "productive" borrowing at commercial banks by their farm and business customers would serve as the basis for extending reserve credit. Furthermore, the mechanism for providing reserve bank credit — the *rediscounting* process — was to operate in a thoroughly decentralized manner in response to actions taken by the

individual commercial bank.*

The blueprint still had technical gaps and defects, but many of these could only be filled in or remedied with time and experience. Whatever the flaws, by the final week of 1913 the nation had drawn its plans — "a uniquely American solution to an American problem" — and was ready to grapple with the job of organizing the regional reserve system. The country's regional reserve banks, including the Federal Reserve Bank of Minneapolis, were about to enter the scene.

*This method of functioning was as prescribed by the then widely-held "Real Bills Doctrine": Whenever commercial banks found themselves faced by heavy pressures on their reserve funds, they were to rediscount some "real bills" at a Reserve Bank. (Real bills are loan paper created by "productive" borrowing, i.e., borrowing to finance the production or marketing of goods.) The rediscounting process (i.e., member bank borrowing at the Reserve Bank using real bills as security) would provide the "pressured" banks with extra reserves, and, in turn, would permit the total reserves of the banking system to expand in just the right amount to accommodate the economy's legitimate needs for credit and money.

When, later on, the needs for the added reserves had diminished (i.e., after the commercial transactions had been completed and customer loans paid off), commercial bank pay-off of their rediscounts at the Reserve Bank would automatically reduce the reserve lending power of the banking system in line with the economy's reduced needs.

Defining the districts: where to draw the lines?

> As soon as practicable the Secretary of the Treasury, the Secretary of Agriculture, and the Comptroller of the Currency, acting as "The Reserve Bank Organization Committee," shall designate not less than eight nor more than twelve cities to be known as Federal reserve cities, and shall divide the continental United States, excluding Alaska, into districts, each district to contain only one of such Federal reserve cities . . .

With these words of Section 2 of the Federal Reserve Act, a committee-of-three was designated to choose cities and draw lines. "Not less than eight," the law read, "nor more than twelve." Actually most of those versed in the technical problems of central banking operations preferred fewer regions — four or six — on the basis of efficiency of operations or balance of banking strength among the districts.* It was said that William Jennings Bryan wanted fifty banks — with "a branch at every major crossroad" if necessary. Out of the variety of ideas and opinions came the compromise in the 1913 law with its eight-to-twelve option.

Certainly New York, Chicago, and San Francisco would each house one of the Reserve Banks. And the large cities of Boston, Philadelphia, and St. Louis each had a strong edge in the competition. But the choosing of other cities and the drawing of boundaries required hard deliberation. The Organization Committee launched into an intensive study through the first three months of 1914. Enjoined to apportion the districts "with due regard to the convenience and customary course of business," the Committee held public hearings in eighteen cities throughout the country, and received evidence from more than two hundred cities through their clearinghouse associations, chambers of

*New York state alone held nearly one-fourth of the nation's commercial bank resources.

commerce or other representatives. Thirty-seven cities — among them St. Paul and Minneapolis — asked to be designated as the site of a Federal Reserve Bank. In addition, a ballot of preferences was taken among the country's 7,471 national banks that had formally assented to the provisions of the Federal Reserve Act. So the contestants for Federal Reserve sites were also judged by popularity poll.

St. Paul and Minneapolis each made strong pleas for a separate Northwest district. Perhaps the leading alternative to a separate Northwest district was the reasonable possibility that it simply be made part of a larger Chicago district served locally by branches where needed.

One of the requirements of the law was a specification of minimum bank resources for the districts. Capital stock for each Federal Reserve Bank had to be subscribed by its member banks in the amount of 6 per cent of each member's respective capital and surplus. The Act required each Federal Reserve Bank to have a minimum of $4,000,000 in subscribed stock — a requirement that proved an important practical constraint in determining district boundaries.*

Messrs. McAdoo, Houston, and Williams, the Reserve Bank Organization Committee, rendered their final decision on districting on April 2, 1914. The case for a separate Northwest district with a bank in the Twin Cities was evidently well enough argued, for the Committee defined the Ninth Federal Reserve District, with Minneapolis designated as Federal Reserve city.** The district lines were drawn so as to exclude those parts of the Pacific Northwest the Minneapolis and St. Paul commercial interests separately had asked for; and, on the other hand, it included some parts of Wisconsin and Michigan around which the Twin Cities interests had not really built their case. The additional area had been included at the initiative of the Organization Committee to ensure that the new Minneapolis district,

*The Organization Committee, for example, looked with considerable favor upon a proposal to form a Federal Reserve district composed of Idaho, Washington, and Oregon, but it could not muster sufficient capital from the banks within the area to set it out separately as a district. As a result, the Pacific Northwest was combined into the very large western district served out of San Francisco.

**The prospectus compiled by the Minneapolis Civic & Commerce Association detailing its case for Minneapolis was perhaps one of the most complete, fully illustrated, and statistically documented brief presented on behalf of any city to the Reserve Bank Organization Committee.

one of the two leanest in financial resources, would garner the necessary $4,000,000 in subscribed stock as required by law. However, many of the banks in Wisconsin and Upper Michigan felt that the lines had not been drawn with "due regard to the convenience and customary course of business."

The Federal Reserve Board was given the authority to review the determinations made by the Organization Committee if appeals should arise. By November 16 — the date on which all twelve Federal Reserve Banks opened for business — no less than seven separate petitions for review had been filed with the Board. Hearings on these petitions took place from the middle of January to the middle of February 1915, and even as the Board was deliberating on this group of hearings an eighth petition arrived — this one from the banks in a group of Wisconsin counties requesting that their area be reassigned from the Minneapolis to the Chicago district.

In its January-February deliberations the Federal Reserve Board ruled on some of the petitions, postponed others for further study, and decided that the whole matter of districting ought to be studied more broadly. The press of other matters forced the Board to delay work on district consolidation until late 1915. But finally on October 19 the Board voted to refer the question of redistricting to a special committee consisting of Mr. Delano, Mr. Harding, and Mr. Warburg, all members of the Federal Reserve Board.

The appeal of the Wisconsin banks to transfer out of the Minneapolis district and into the Chicago district was, of course, still pending before the Board. In December the Committee asked the Attorney General for two further opinions to guide it in making recommendations on the remaining unresolved petitions:

> (1) Can the Federal Reserve Board legally change the present location of any Federal Reserve Bank? . . .
>
> (2) Must the Federal Reserve Board, in exercising its admitted power to readjust preserve the $4,000,000 minimum capitalization required of each Federal Reserve Bank as a condition precedent to the commencement of business?

The Attorney General, in his opinion to the President on April 14, 1916 answered "No" to both questions. The response to the first question put an end by denial to two pending petitions, those of the cities of Pittsburgh and Baltimore asking to be named Federal Reserve cities. With this ruling the only legitimate changes the Federal Reserve Board could make in reviewing appeals were redistricting changes, that is, shifting the district lines to accord more closely with "the convenience and customary course of business."

Part 2 of the opinion had direct relevance for the Wisconsin petition since a large block of counties with substantial bank resources was involved in the requested shift out of the Minneapolis district. The ruling indicated, of course, that it was no longer necessary to preserve the original minimum capitalization, the $4,000,000 minimum pertaining only to the time at which operations initially commenced. Thus in principle a transfer of banks could be made even if it resulted in reducing the Minneapolis Federal Reserve Bank capital below $4,000,000.

By the spring of 1916 the Wisconsin petition was the only unresolved appeal before the Board. On October 13 the Board finally cleared it up with the following order:

> . . . it appears to such Board that the convenience and customary course of business and the best interests of the Federal Reserve system will be served by a readjustment of the geographical limits of districts Nos. 7 and 9 . . .

Of the petitioning Wisconsin counties, twenty-five were granted transfer while the nine northernmost counties and the petitioning Michigan banks were denied transfer (see Figure 1). This decision of October 13, 1916 is pertinent because it established the geographical outline of the Minneapolis district as it stands today.

Interesting, and perhaps a bit ironic, were some of the arguments presented in the final brief of the petitioning Wisconsin banks. These arguments were obviously aimed at quelling fears over the proposed removal from the Minneapolis district of a part of that district's already near-minimal bank capital. Senator Paul O. Husting of Wisconsin testified at the rehearing on behalf of the petitioning banks:

> . . . We all know that the Northwest has just started to grow. There is not any doubt in my mind, and I do not think there is any doubt in the mind of this Board, that in the next twenty or twenty-five years, — well in fact, there is no use in setting any time limit on it, — from now on, that great Northwest Empire is going to become one of the most populous and richest regions of the United States,

Figure 1 — Redistricting decision of October 1916

> and consequently that this particular bank, this regional bank that is just starting out now, under favorable auspices, will become one of the strongest and most influential banks in the United States. Right on the Mississippi Valley, this great empire, as I say, to the northwest, is hardly touched. There is every reason to suppose that in a very short time, continually for scores of years, and centuries, we hope, this great section will continue to grow more populous and richer all the time.

Senator Robert M. LaFollette, one of the Badger State's most famous Senators, said at the same hearing:

> Now, then, they [the remainder of the Minneapolis district] do not need us. Business all up in this great wonderful region off to the north and west of St. Paul and Minneapolis goes right that way. You can not send it in any other direction. Montana, the two Dakotas, northern Iowa, and Minnesota all gather right in here. You know the vastness of that country, and the richness of it, and it is simply on the edge of its production at this time.

Such optimism about the future of the Minneapolis district might well have reflected the opinions of many residents of the Northwest as well. However, this promise of greater parity of financial resources still eludes the Ninth District. Growth has occurred, of course, but the Minneapolis district still remains among the smallest of the twelve districts in financial resources.

The question of district size, and even the question of district boundaries, had special importance early in the System's history.

Integral to the initial "decentralization architecture" was the idea that Federal Reserve Banks were to act with substantial regional independence. Stress on the policy-making importance of individual Reserve Banks led one faction of the Federal Reserve Board to favor consolidation of small districts, if only on the grounds that small banks might not be able to attract qualified leaders or otherwise achieve high operating efficiency. With the same architecture in view, a second faction opposed consolidation on the grounds that the greater in number the autonomous banks, the harder it would be for any single sectional group or special interest to gain control of the System. Because this second faction felt that maximum decentralization was so important, the Minneapolis district — small though it might be — won a "guaranteed" existence.

But with the gradual abandonment of the earlier design of regional independence, the matter of district size became progressively less important. Even district boundaries are less significant than they once were. Yet despite these changes, proposals for redrawing district lines have continued to be made over the years.

Building the bank: people and plant

With lines drawn and cities picked, the Reserve Bank Organization Committee turned in the spring of 1914 to its other statutory tasks under the Federal Reserve Act; among them, seeing that each Federal Reserve Bank got established as a franchised corporation, complete with stockholders, a board of directors, and a nucleus of operating personnel. From then on it would be up to the twelve banks, their directors, and the Federal Reserve Board in Washington to build the System and develop its operations according to the Congressional blueprint.

Since Congress had chosen to design the Federal Reserve Banks along the organizational lines of a private corporation, the early organizational work involved legal steps by stockholders-to-be, namely the member banks. The Organization Committee simply supervised these procedures, starting, as directed in Section 4 of the Act, with the mailing of application forms for membership to eligible banks. The Committee then proceeded to oversee that the member banks in each district (1) carried out incorporation proceedings for the district's Federal Reserve Bank; and (2) elected a board of directors to the Bank.

A word about the directors: the Act provided for nine of them for each Bank, six to be elected by the member banks of the district, and three (including the chairman) to be appointed by the Federal Reserve Board. Compromise of federal interest and regional control is evident in this arrangement. Other provisions were written into the law to insure that the bank-elected directors represented no single interest in the district: three directors (Class A) could be bankers and were to represent the banking community; three directors (Class B) had to be "actively engaged in commerce, agriculture, or some other industrial pursuit" and were to represent the commercial community. Furthermore, the voting banks were grouped according to size — small banks, electing two directors (one from each class); medium-sized banks selecting another two; and large banks, another two. Three other directors (Class C) were to be appointed by the Federal Reserve Board to represent the public at large.

Within this framework the Reserve Bank Organization Committee took steps during April 1914 to incorporate the Minneapolis Bank and elect six directors. The election was set up with the aid of an informal committee of thirty-six bankers representing the six district states. Meeting in St. Paul on April 24, the committee agreed upon a pattern of geographic representation *within* the district that has been observed ever since.* The Bank was incorporated on May 18, 1914, and election of directors, held during the summer, resulted in the following initial slate:

	Director	*Affiliation*	*Town*
Class A: (elected by member banks to represent bankers)	J. C. Bassett	Bank president	Aberdeen, S. Dak.
	E. W. Decker	Bank president	Minneapolis, Minn.
	L. B. Hanna	Bank president	Fargo, N. Dak.
Class B: (elected by member banks to represent credit users)	F. R. Bigelow	Insurance company executive	St. Paul, Minn.
	F. P. Hixon	Lumberman	LaCrosse, Wis.
	N. B. Holter	Hardware merchant	Helena, Mont.

By October 1, 1914 selection of the board of directors of the Minneapolis Bank was finally completed with the naming of the following Class C directors by the Federal Reserve Board:

	Director	*Affiliation*	*Town*
Class C: (appointed by the Federal Reserve Board to represent the public)	J. W. Black	Wholesale coal merchant	Houghton, Mich.
	P. M. Kerst	Clearing house examiner	St. Paul, Minn.
	J. H. Rich*	Manufacturing executive	Minneapolis, Minn.

*Chairman and Federal Reserve Agent

We have already met three of the nine directors in our survey of the monetary reform movement of the National Citizens' League. John H. Rich had been president of the

*Two directors from Minnesota; one from each of the states of North Dakota, South Dakota and Montana; and one from the combined portions of Wisconsin and Michigan included in the Ninth District.

Minnesota chapter, Norman B. Holter had been president of the Montana chapter, and North Dakota Governor L. B. Hanna had been president of that state's chapter.

Meeting in Minneapolis for the first time on October 14 and 15, 1914, the board of directors adopted by-laws, set up an executive committee, appointed Theodore Wold chief administrative officer of the bank (with the title, "Governor"), and made other organizational decisions, largely in accord with the organizational procedures suggested by the Federal Reserve Board.

Shortly after their first meeting, the directors and officers of the Minneapolis Federal Reserve Bank joined with their counterparts in the other Federal Reserve Banks and with the Federal Reserve Board in an historic conference on October 20-22 in Washington, D.C. As a result of these meetings the decision was made that the banks would open for business in approximately five months. But, within five days, on October 26, Secretary of the Treasury McAdoo informed the banks that the opening date would have to be hastened because of the war in Europe. He instructed all banks to begin receiving payments from member banks for stock subscriptions on November 2, and to open their doors to receive and discount commercial paper on November 16. Since at that point the Minneapolis Bank had neither doors nor staff, a staggering job confronted its organizers.

In order that the Bank could begin receiving stock subscription payments, temporary offices were opened on October 28 in the directors' room of the Minnesota Loan & Trust Company at Fifth and Hennepin where Wold had held a directorship. On November 14 the Bank was notified that its organization certificate had been executed that day in Washington by John Skelton Williams, Comptroller of Currency. Now legally qualified to commence operations under the provisions of the Act, the Bank duly opened for business on November 16, 1914, in temporary quarters in the Lumber Exchange building at Fifth and Hennepin, using rented vault space in nearby commercial banks. With a tiny nucleus of personnel the Federal Reserve Bank of Minneapolis now stood ready to rediscount commercial paper for member banks of the district. Initially, the demand was light and operations were limited to a few "courtesy" borrowings by banks wishing to familiarize themselves with the new institution and to acquaint the public with the new Federal

Reserve currency. But by year's end the Minneapolis Federal Reserve Bank had made a modest beginning on the great variety of functions envisioned for it in the Owen-Glass blueprint.*

In mid-January of 1915 the Bank's eighteen employees and officers moved into more permanent quarters that had been leased in the New York Life building at Sixth Street and Second Avenue South. During the next two years staff and facilities of the Bank gradually increased to perform a growing number of reserve banking functions. The entry of the United States into World War I caused rapid expansion — with a peak of more than 500 employees in 1918 — to meet the needs of the Treasury for war financing.

By 1919 the initial, formative era of the Minneapolis Bank's history was drawing to a close. The Minneapolis "Fed" was now a going institution with a wide array of reserve bank functions — though much was yet to be learned about central banking and many legislative changes were still to be made. The Bank had organized a full complement of departments to carry out its work, assembled a capable staff, and secured (even outgrown) workable quarters in the Minneapolis financial district.

Administrative leadership in the early years

An intriguing and sometimes puzzling aspect of the organizational blueprint for the twelve Federal Reserve Banks was an unusual "duality" of leadership. In the Minneapolis Bank, for example, authority was vested jointly in John H. Rich as federal reserve agent and in Theodore Wold as governor.

The major responsibilities of the two posts were fairly clear: the governor was placed in charge of the internal administration of the Bank as well as the conduct of its day-to-day relations with its members. The federal reserve agent was given a broader, though less well defined, "public" responsibility and was to serve as liaison between the Federal Reserve Board and the Reserve Bank.

Yet there remained undrawn (or undrawable) lines in these first organization charts. By law the federal reserve agent had an office in the Bank, and was the Board's representative at the

*Among these functions: operation of a check clearing system, issuance and redemption of Federal Reserve currency, bank examination and supervision, fiscal agency activity for the Treasury, open market operations, and rediscounting of commercial paper for member banks.

Bank. But the Act did not make it clear just what the "supervisory" powers of the Federal Reserve Board over the banks amounted to. This ambiguity had been present in the System's architecture from the very beginning and it resulted from the need to reconcile the conflicting desires for central control and for regional autonomy. This arrangement gave rise in a few of the Reserve Banks during these early years to frictions between the federal reserve agent (interpreted by some as the more important officer in the Bank), and the governor (assumed by others to be fully in charge).

In the Minneapolis Bank a relatively smooth working relationship between the agent and the governor was established from the outset, and both of these early leaders, Theodore Wold and John H. Rich, devoted their respective talents fully to the Bank's early efforts at organization and development.

The Governor

In Governor Wold the board of directors had chosen an able administrator well versed in banking. While the Federal Reserve Bank was to have different objectives from those of the commercial banks with which Wold had been associated, its technical operations would resemble those already well developed in commercial banks. Wold, who was 46 years old when he joined the Minneapolis Federal Reserve Bank, had had twenty years banking experience in several Minnesota communities (including Elbow Lake, Little Falls, and Winona), and had been president of the Scandinavian National Bank of Minneapolis since 1910. His principal responsibility was to assemble and organize the Bank's staff, build the several departments into smoothly-working operations, coordinate the work of this Bank with that of the other Federal Reserve Banks, and to gear into the over-all operations each of the statutory reserve bank functions as they were developed or expanded. Needless to say, the great demands for Treasury financing brought on by the war severely complicated his job.

It was natural for the leaders of the Federal Reserve Banks in the early years to be drawn from management ranks of the commercial banking system, and a number of them after serving the "Fed" for a time returned to the more lucrative field of commercial banking.

Federal reserve agent: the man and the job

John H. Rich had been president of the Goodhue County National Bank of Red Wing, Minnesota, for fifteen years. On more fundamental matters, he had already demonstrated his ability to bring to the job not only a broad understanding of the problems of finance and commerce but a more compelling quality of dedication to civic duty and principle. His broad business background gave him clear and direct grasp of the businessman's side of the financial problem. He had founded the clay pipe industry that flourished at Red Wing, Minnesota, and had been its president for twenty years and mayor of Red Wing.

Late in the summer of 1911 he was persuaded by a group of Twin Cities bankers and businessmen to take over the formation and direction of the Minnesota chapter-to-be of the "National Citizens' League for the Promotion of a Sound Banking System." Thus, at the age of 54, he turned from his business interests to embark on a new venture, dedicating himself energetically and wholeheartedly to the cause of monetary reform. By the time the Federal Reserve Act was passed, John Rich's public leadership abilities were widely recognized because of the success and support attained by the Minnesota Citizens' League.

These qualifications made John H. Rich a natural candidate for federal reserve agent. He was appointed to that post (thus also the chairmanship of the board of directors of the Federal Reserve Bank of Minneapolis) on October 1, 1914. His subsequent record in the Federal Reserve made it clear that Rich not only had dedication and vision but also that he was practical and discerning.

From the outset he understood the fundamentals of monetary reform well enough to realize that the Owen-Glass blueprint was far from perfect and that amendments to the law would be necessary before the System could be made truly effective:

> After more than 60 years of debate, experimentation and discussion, there at last has been created in the United States a banking system which I do not hesitate to say places this country on a parity with the principal nations of the old world. So far as any single measure can, it satisfies the best opinion of banking experts, economists and financiers. I would not assert that it is perfect at all points or that it is not susceptible of beneficial amendment. So great a piece of constructive legislation was necessarily the product

John H. Rich   Theodore Wold

of argument and compromise. It is my sincere conviction that the Federal reserve act, while not yet perfect at all points, embodies all of the important principles and provides the facilities which have so long been demanded by our best financial and economic opinion in the United States. . . .

His convictions that the Federal Reserve Bank of Minneapolis had to be guided by principle running above sectional view or special interest were summarized in the same 1915 speech:

> The practical functions of the Ninth Federal Reserve bank in relation to its member banks, must be performed at all times in consideration of the nation-wide purposes which lie back of the founding of the new banking system, and cannot yield wholly to the influence of district, state or local conditions. . . .
>
> I wish to place great emphasis upon the public service which these banks are destined to perform. Merely to satisfy the technical requirements as indicated in the act will not entitle them to the full confidence of the public. Their purpose was not alone to make banking a safe business but to provide and guarantee safe conditions under which the business man and farmer may continue their activities. . . .

In his role as federal reserve agent during the formative years of the Bank's initial era, John Rich carried out fully the organization consultants' earlier injunction to "be a Government representative and spend his time in furthering the interests of the public at large . . ." And he did this by programs designed to (1) acquaint member banks with their opportunities and responsibilities under the System, (2) persuade nonmember state-chartered banks to join the System, and (3) inform the public about the nature of the System and what it would mean to them.

In his role as "public representative," Rich had another important job — answering the inevitable criticisms of the newly established System and of the Federal Reserve Bank of Minneapolis. Direct criticisms of the Bank and its functions up to the end of the formative era in 1919 were relatively few and mild; public acceptance of the Federal Reserve, due at least in part to the efforts of John Rich, himself, was generally very good.

But in 1919 a new era of challenges and problems was beginning. Roy Young had just assumed administrative direction of the Bank after the resignation of Governor Wold. John Rich was continuing as federal reserve agent, destined to face perhaps the most rewarding and certainly the most trying portion of his Federal Reserve career.

Through the year 1919 and a part of 1920, a postwar inflation continued to rage. But by summer of 1920, prices — especially farm prices — had suddenly and drastically collapsed. The ensuing depression, which hit agriculture even harder than it hit industry, brought a nationwide clamor against the Federal Reserve. Main theme of the criticism was that the Federal Reserve Banks had pursued a deflationary policy which had in turn caused price collapse and brought on farm depression. While the facts of the case did not support the criticisms, hostility was so great that a strong and convincing defense of the System was crucial to its very survival. Most of the defense, of course, had to be made at the national level.*

Yet, the Minneapolis Bank with its heavily agricultural district faced more than its share of criticism in its own back yard. Rich accepted the challenge and proceeded with eloquence and determination to explain the position and the accomplishments of the Federal Reserve Bank. To bring the case for the "Fed" to the local level, he and his staff prepared hundreds of speeches and articles, and organized a series of Farmer-Banker Confer-

*The historic speech to the Senate by Carter Glass in mid-January 1922 was a landmark in the campaign.

ences throughout the district.

Providing for a permanent home

During the "Second Era," the Federal Reserve Bank of Minneapolis undertook to construct a distinctive and well designed bank building. If it seemed to be a logical, indeed even routine, next step when the process was started in 1919, this notion was to be shattered in the episodes soon to follow.

All twelve Reserve Banks were experiencing the overcrowding that resulted from wartime expansion, and, after the Armistice of 1918, the Federal Reserve Board recommended that each bank investigate construction of permanent quarters and obtain land for future construction. Congress in early 1919 provided for the financing of such construction by amending the Federal Reserve Act so as to permit the banks to increase their surpluses by 100 per cent "for buildings and other purposes."

Shortly thereafter the board of directors of the Minneapolis Bank appointed a special building committee. John Rich was named chairman, and to the project he applied his characteristic singleness of purpose. Indeed, apart from efforts to defend the public image of the "Fed," the design and construction of the new building became John Rich's major preoccupation during his remaining years with the Bank. From the very first he was determined that the building would embody all the Bank stood for: it would have strength; it would have dignity; it would be a public monument to the people of the Ninth District. And it would be second to none in its physical serviceability.

During the closing months of 1919, the building committee purchased a tract of land at Fifth Street and Marquette Avenue, one block from its rented quarters. It selected as architect Cass Gilbert of New York, a distinguished architect who designed the Minnesota state capitol in St. Paul.

A branch at Helena

Meanwhile, the Minneapolis Bank was expanding in another direction by establishing a branch in Helena, Montana. The idea had been proposed in 1919 by the Bank's director from Montana, Norman B. Holter. Holter was prompted to make the suggestion to Chairman Rich and the other directors of the Minneapolis Bank after he learned that a number of branch banks had been set up in other districts. Formal presentation was made subsequently by a group of Montana bankers, and the plan for a Helena Branch was approved, first by the directors at their November 1919 meeting, and then by the Federal Reserve Board. O. A. Carlson, manager of the Bank Examination Department, was named manager of the Helena Branch.

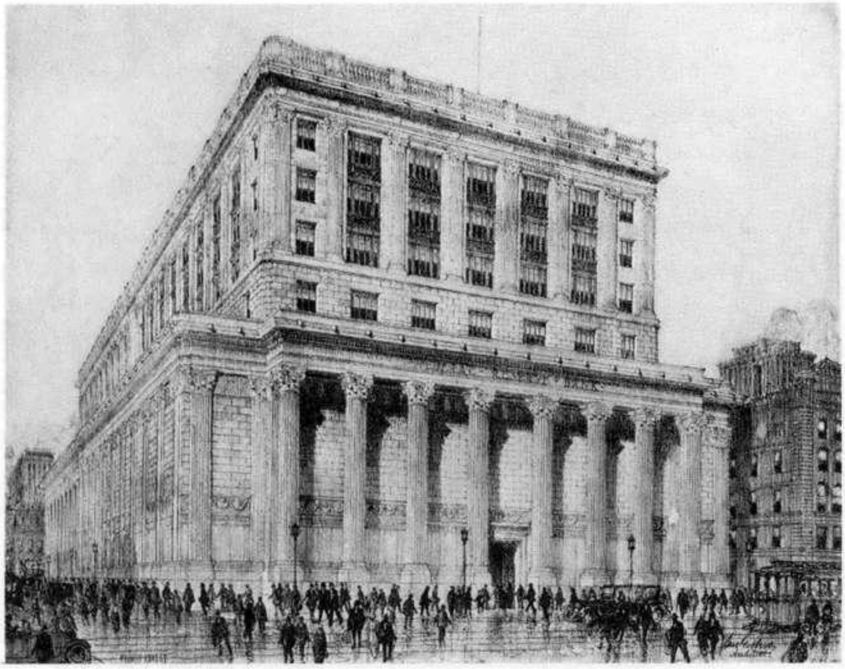
Of plans and protests

With the Helena Branch now inaugurated, the management of the Minneapolis Bank faced 1921 with high hopes: construction work on the head office building should soon get under way. But, while the Branch project had proceeded fairly smoothly, no such course lay ahead for the Minneapolis building. By 1921 prices had collapsed and sharp depression had begun. Their ardor cooled, both Congress and the public were ready to be far more critical of anything the Federal Reserve Banks did. Prime targets for criticism became the banks' building programs, many of which were by that time already committed. Responding to the mood of the times, the Federal Reserve Board, too, grew more sensitive to expenditure proposals such as that by the Minneapolis Bank.

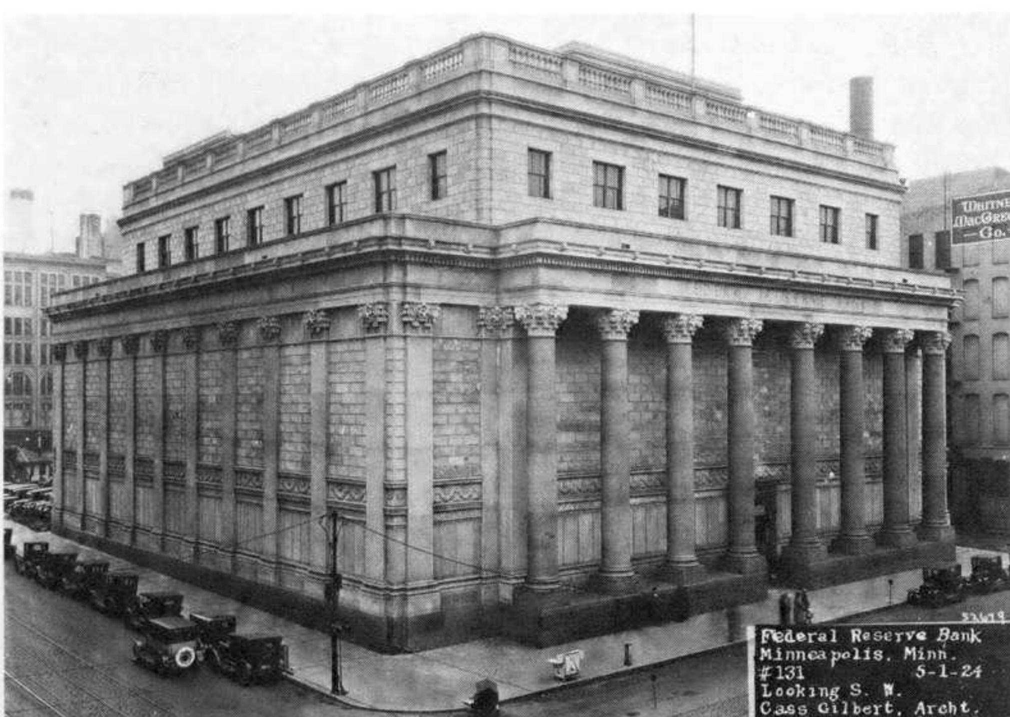
Early in 1921, Rich and Gilbert called at the Federal Reserve Board and outlined the plans for the Minneapolis building. At that time the Federal Reserve Board raised no special objection. Full details were outlined to the Minneapolis board of directors, who, with minor questions and directives for changes, approved the general plan at their May 9 meeting. Initial contracts were negotiated to cover construction work up to street level, building permits were secured, and public announcement of the building plans was made.

The board of directors intended to let contracts for construction above street level by the end of 1921. But in late summer opposition arose from the Federal Reserve Board. Final go-ahead on the Minneapolis building was delayed nearly a year because of objections on two grounds: design and cost. This came, of course, as a hard blow to John Rich, who had conceived the structure, and to Cass Gilbert, who had spent two years in developing the design.

But they pressed their argument with the Board and with the Board's architectural consultant, Mr. Trowbridge. Gilbert presented drawings, diagrams, and a plaster scale model to illustrate the building's concept and its structural and architec-



Cass Gilbert's original conception of the Minneapolis Reserve Bank, 1921



With some modifications, the Minneapolis Reserve Bank as completed, 1925 tural details. The Board feared that cost per cubic foot for the seemingly elaborate Minneapolis plan would be too high compared with cubic footage costs of other Federal Reserve Banks.

By January 1922, strong attacks were being made on the Federal Reserve both in and out of Congress. Some of the criticism was specifically directed at the current building programs — especially that of the New York Federal Reserve Bank. Among proposals introduced into Congress was the Harris Bill, which would have required express Congressional consent for any building construction in excess of $250,000 by a Federal Reserve Bank.

When January 17 came around, Senator Glass made his historic defense of the Federal Reserve before the Senate. He defended the System in general, and specifically justified the Federal Reserve building programs as necessary and economical.

The Harris amendment passed,* and although its provisions did not apply to any building actually under construction, it did nonetheless represent a kind of mandate to the Board to scrutinize minutely any proposed expenditures. Little else could be done in the Minneapolis case but scale down the proposed structure.

Thus, with some modifications, John Rich's dream of a Federal Reserve Bank building embodying the essentially fortress-like character and neoclassical design that he had admired in the Bank of England, now stood approved in Washington. New bids were obtained on the revised plans, and the Minneapolis board of directors finally approved the revised building program on May 22, 1922, with only minor reservations. Estimated cost including land was slightly more than $3 million. With no major obstacles remaining construction began in September 1922.

On April 9, 1923 the cornerstone was laid. Exterior structural work was almost completed by the end of 1923, another year being required to complete the interior.

These few episodes about men and matériel have spanned only the initial decade of the Federal Reserve Bank of Minneapolis. Yet within that decade, the Bank — expanded to offer a full range of departmental services at its two geographic sites

*The same amendment, approved June 3, also added to the Act the specification that "agriculture" be represented on the Federal Reserve Board, and increased the number of appointive members from five to six.

— had "come of age." From then on it was a process of building upon that which had already been established.

Learning the job: a central bank evolves

The most vital aspect of the Minneapolis Bank's story is, to some, the attrition of early notions about the nature of a Reserve Bank, its functions and its control. Through a series of changes in practice and in law the Minneapolis Federal Reserve Bank was transformed from a presumably "autonomous regional reserve bank" into an integral part of the larger central bank of the United States.

It was a "quick" evolution. The three main elements of the System's initial architecture described earlier had been all but abandoned by the time the Minneapolis Bank moved into its new building in 1925. (These three original principles, you will recall, were (1) the autonomy of the Reserve Bank, (2) the private control of Reserve Bank policy through banker-elected directors, and (3) the automatic regulation of Reserve credit through the discounting of commercial paper by member banks.*)

The decline of these concepts began very soon after the launching of the System. The first step, probably, was a 1916 Congressional amendment that drove an opening wedge between Reserve Bank credit on the one hand and self-liquidating commercial transactions (real bills) on the other; the amendment permitted Reserve Banks to make advances to member banks secured by U.S. government securities. Needless to say, the drama of abandonment of Original Doctrine was in large measure enacted upon a national stage. A few incidents from the history of the Minneapolis Bank, however, will help illustrate some of the change that occurred.

*In addition to operating under the so-called "Real Bills Doctrine" indicated here, the nation's money and credit system was also supposed to have been subject to the impersonal, credit-governing effects of movements of gold into and out of the country under an "International Gold Standard" as a second facet of the over-all *automatic* mechanism.

The reign of not-quite-autonomy (1914-1923)

The idea of autonomy was logically the first to go. For one thing, regional independence was compromised in the Act itself by the provision for a central supervisory body. For another, the Banks' managements recognized early that some form of "coordination" of policy was necessitated by the essentially national rather than regional character of money and credit markets.

Since centralized policy control would inevitably emphasize the position of the government-appointed Federal Reserve Board, while regional policy control would emphasize the position of the privately-elected majority of directors at the Reserve Banks, the matter of *autonomy* was closely linked to the matter of *control*. Prevailing opinion at the time of the Act, of course, tended to stress the private character of the individual Federal Reserve Banks. On this issue John Rich's views were somewhat unorthodox:

> I personally prefer the wiping out of all of the paid-in capital. This is objected to on the theory that reserve banks would then be government banks. I had supposed that they are now, and have always been, government banks. . . .

Direct coordination of System policy was attempted several times by the governors themselves. From the outset efforts to "organize" the statutory pluralism were made under the leadership of Governor Benjamin Strong of the Federal Reserve Bank of New York via the periodic Governors' Conferences. Such arrangements were consistently opposed by the Federal Reserve Board, partly because any combination of governors might seem a threat to the Board's supervisory authority, but also because any organization for unity of action conflicted with the still-official viewpoint disavowing all taint of centralization of policy-making.

The official position was clear: with the exception of setting up eligibility rules for commercial paper (which is reserved to the Board), *policy initiative lay with the Federal Reserve Bank of Minneapolis and its sister banks, each operating within its own region.* Emphasis on private control, obviously interwoven with the principle of regional autonomy, was also stressed.

A movement away from this early view of credit policy was to arise unexpectedly out of the exercise of powers granted to the individual Reserve Banks. From the beginning monetary policy prerogatives granted the Minneapolis Federal Reserve Bank were delegated to the executive committee, under the supervision and control of the board of directors. Four powers pertaining to credit control were tersely summarized in the Minneapolis Bank's by-laws as follows:

(a) To pass upon all commercial paper submitted for rediscount.

(b) To initiate and conduct open-market transactions.

(c) To fix the discount rate from time to time with the approval of a majority of the Board of Directors.

(d) To buy and sell securities. . . .

The full significance of the above powers was not known to the banks at the time they were written, and indeed remained undiscovered until as late as 1922. During the first several years, the banks proceeded under these powers to apply the then limited concepts of monetary policy within the framework of regional independence. Powers (a) and (c) were considered the heart of the Bank's policy-making endeavors under the automatic regulatory mechanism of the Real Bills Doctrine.

Each Bank was empowered to conduct independent purchases and sales of trade acceptances and U.S. government securities in the open market for its own account as indicated by (b) and (d), but these powers were initially rather unimportant. The Minneapolis "Fed" (like some of the other Reserve Banks) was especially concerned in the early years with the problem of earnings, and particularly with the problem of earning enough to cover dividends on the member banks' stockholdings. Holdings of government securities or other assets purchased at the Bank's initiative for its own portfolio were considered mainly a way to bolster earnings if and when rediscounts — the Bank's major source of earnings — were too low.

As John Rich explained the Minneapolis Bank's viewpoint to the Third Conference of Federal Reserve Agents in 1916, ". . . We do not want bonds for a permanent investment. The only incentive was to get some revenue. . . ."

But out of these presumably minor provisions, (b) and (d), was to come the Federal Reserve's major policy instrument.

The Open Market episode and the era of vestigial autonomy (1923-1935)

In consequence of war finance programs, the Minneapolis Bank held some government securities during the period 1919-1921, and from these it secured some earnings. Rediscounts for member banks, however, formed the bulk of the Bank's earning assets. During the year 1920, for instance, the Minneapolis "Fed" averaged better than $80,000,000 in discounts outstanding, while its holdings of government securities averaged only about $8,000,000. From this portfolio the Minneapolis "Fed" derived earnings of $5,300,000, which was substantially more than its expenses of $1,000,000.

By late 1920, however, the postwar depression had begun to change the earnings picture greatly. Decline of agriculture and commerce coupled with continued gold inflow from Europe, caused a substantial reduction in credit pressures on commercial banks. This drop, in turn, was reflected in a rapid decline in rediscounts at the "Feds" from late 1920 through early 1922.

Discounts at the Minneapolis Bank had dropped by early 1922 to a mere third of their peak figure of late 1920. By the end of January 1922, it appeared that the Minneapolis Bank's monthly gross earnings soon might not cover current expenses. So, like some of the other "Feds," the Minneapolis Bank decided to act on its own, specifically by adding to its holdings of U.S. government securities in order to protect its earnings position. During the last week in February and the first week in March 1922, the Bank made its first large purchases — about $5,000,000 worth (thereby doubling its portfolio of government securities). Purchases continued through March and April, until the Minneapolis holdings rose to about $14,000,000. Other banks bought, too, and for the same reason. In all, between January and May 1922, hundreds of millions of dollars worth of securities were purchased. During this splurge of buying, in the competition for securities in the New York money market, individual Federal Reserve Banks even occasionally outbid the New York Federal Reserve Bank (which handled purchases for some of them) and the U.S. Treasury Department.

The disruptive effects on the securities markets of these uncoordinated purchases by independently operating Federal Reserve Banks rang a warning bell. Moreover, it soon became apparent that *efforts to bolster earnings via purchase of* *government securities tended to be self defeating.*

This fact-of-life, all very logical in retrospect, was seemingly unforeseen in the early years. As the Federal Reserve Banks bought securities from private holders, the money paid for them was lodged by the sellers in commercial banks, which in turn took advantage of their improved reserve positions to pay off their debts to the "Feds." So, as the Reserve Banks piled up securities in their collective portfolios, member banks paid down their rediscounts. This being so, Federal Reserve earnings were on a treadmill.

The earnings revelation was not nearly so important, however, as an unexpected finding that accompanied it — the discovery that such "open market operations" were a powerful force for easing or tightening of general credit conditions, a force that could be deliberately introduced into the central money markets, and would spread very quickly to all corners of the country.

At the Governors' Conference on May 6, 1922 the problem of coordinating purchases was discussed, and a special committee under the chairmanship of Governor Strong of New York was appointed, the "Committee on Centralized Execution of Purchases and Sales of Government Securities by Federal Reserve Banks." While it did no more at that point than coordinate and channel purchases and sales of the separate Federal Reserve Banks through the single agency of the New York Federal Reserve Bank, it set the stage for an era of more centralized policy-making.

In October 1922 the special committee, after stressing to the Governors' Conference the power of Federal Reserve Bank investment policy on the money market, suggested that the committee ought to take on an "advisory" function. But the governors' initiative in moving to meet the now-recognized need for coordinated investment policy was soon brought under supervision by the Federal Reserve Board.

In March 1923 the Board dissolved the "committee-with-the-long-name" (much to the consternation of the governors) and set up, under the general supervision of the Federal Reserve Board, a new committee, the "Open Market Investment Committee for the Federal Reserve System." The OMIC was designed to recommend plans for the purchase, sale, and distribution of securities for the System.

Note that these decisions, accomplished within roughly a year, effectively put an end to the idea of regional policy autonomy. In short, powers (b) and (d) referred to earlier were simply removed from the province of regional boards of directors.

Rediscount policy remained, of course, in the hands of the directors of the Reserve Banks. But its stature as an instrument of Federal Reserve credit policy was greatly reduced because the Real Bills Doctrine, on which its credibility rested, was also vitiated by the 1922-1923 revelations. It had become obvious from experience that extension of Reserve Bank credit based on rediscounting of commercial paper did not automatically produce the correct amount of commercial bank credit, guarantee its use in productive channels, or automatically cause its extinction as soon as legitimate commercial needs subsided. The realization that neither real bills nor the gold standard could function properly as a basis for Reserve credit was recorded in the Federal Reserve Board's Annual Report for 1923:

> There are no automatic devices or detectors for determining, when credit is granted by a Federal reserve bank in response to a rediscount demand, whether the occasion of the rediscount was an extension of credit by the member bank for nonproductive use. . . . A farmers' note may be offered for rediscount by a member bank when in fact the need for rediscounting has arisen because of extensions of credit by the member bank for speculative use. . . .

In reference to the international gold standard, the Report stated:

> . . . Under the present conditions, with gold embargoes in force in most foreign countries and the United States practically the only free gold market of the world, the movement of gold to this country does not reflect the relative position of the money markets nor does the movement give rise to corrective influences. . . .

With this realization, "automaticity" was dead — to all practical effects — and the System entered a new policy era in which the key word was "judgment":

> . . . In its ultimate analysis credit administration is not a matter of mechanical rules, but is and must be a matter of judgment — of judgment concerning each specific credit situation at the particular moment of time when it has arisen or is developing.

Henceforth, if the "correct" amount of credit was to be supplied, the monetary authorities would have to (1) use judgment to determine credit conditions appropriate to each economic situation, and (2) actively employ their available policy implements to achieve the chosen degree of credit tightness or ease. Of the available policy implements, investment policy was easily the most direct and manageable. System investment policy became the primary instrument of credit control, while the setting of discount rates by the banks became, for the most part, a secondary technical adjustment dictated by Federal Reserve investment policy.

Thus, by April 9, 1923, when the Federal Reserve Bank of Minneapolis was laying the cornerstone for its permanent home, the Federal Reserve System almost simultaneously was laying the cornerstone for a modern monetary policy.

In the course of its first decade the Federal Reserve had (1) substantially replaced the original doctrine of regional autonomy; (2) correspondingly strengthened "public" control (represented by the Federal Reserve Board) over "private" control (represented by boards of directors of the banks); and (3) essentially scrapped the notion of automatic or passive credit regulation.

The broad pattern of the first decade, in a nutshell, was this: Out of the considered efforts to correct flaws of original design revealed through early experience, a central bank — in fact though not yet in form — was forced to evolve. The evolution would continue in the ensuing decades, yet the System would retain the stamp of its lineage. *The central bank developed to serve the United States is unlike any other central bank and has drawn from the period of its founding a distinctive character that has perhaps supplied one of its greatest elements of strength: decision-making is centralized, but it is strongly and specifically tempered by regional representation.*

Depression, crisis, depression, reform

The second ten years of the Federal Reserve Bank of Minneapolis were as fraught with economic difficulties as one could imagine. Most of the nation recovered from the collapse of the early twenties, and rode it out till 1929 in a faltering prosperity. But in the agriculture-dominated Ninth District the farm depression lingered on and on. In consequence, financial problems became especially intense in the Northwest. Bank failures mounted. During the period 1923-1927 more than 1,160 Ninth District banks failed, representing nearly a third of all bank suspensions in the entire United States during that period.

The district had never really climbed out of the trough of the twenties by the time the stock market crash of 1929 signaled the beginning of the most severe and prolonged depression of modern times, complete with financial panic and a "Bank Holiday." Something had gone wrong, terribly wrong, and even the Federal Reserve System had been unable to prevent money panic under the conditions of 1933. Following the panic economic reform became the nation's number one item of business, including reform of the defects in the Federal Reserve. As a result, several important reform bills affecting the Federal Reserve were passed by Congress, beginning with emergency measures in the Glass-Steagall Act of 1932, continuing through a series of banking acts in 1933 and 1934, and culminating in the Banking Act of 1935.

The Banking Act of 1935: Congress redraws the blueprint
With the Banking Act of 1935, Congress formally cast aside the three elements of the original design. To summarize the accomplishments in brief, Congress

(1) centralized policy-making under the substantial control of a single System body,

(2) clearly established public or governmental sponsorship of the central decision-making body, and

(3) broke finally and completely with the Real Bills Doctrine by providing that Federal Reserve Banks could make advances to member banks secured by government securities, or, under emergency conditions, *any* paper — including stocks — "acceptable" to the Federal Reserve Bank.

Further, the International Gold Standard, which had been defunct as an arrangement between nations since World War I, was officially discarded by Congress for the domestic economy in 1934. Thus both features of the earlier notion of an automatic credit mechanism were formally scrapped.

Along with its redefined role, the Federal Reserve Board got a new name: it became the Board of Governors of the Federal Reserve System. Symbolic of this shift of statutory control, the title "governor" was no longer used to designate the operating executive at the individual Reserve Bank. The number of appointive governors on the Board was increased to seven from the previous six, all appointed by the President with Senate approval, while the two ex officio members (Secretary of the

Treasury and Comptroller of Currency) were removed from the Board.

In addition, the Open Market Investment Committee, established in 1923 as a necessary outgrowth of Federal Reserve efforts to administer the original Act, but not mentioned in the Act, was given a statutory recognition through express creation of a Federal Open Market Committee. The FOMC was to be made up of twelve members: five heads of Federal Reserve Banks as before, plus the seven members of the Board of Governors, who thus formed a voting majority. Further, the Board of Governors was given additional power over discount rates by a provision requiring each bank to establish rates every fourteen days or oftener if deemed necessary by the Board (the original act left the timing of changes up to individual banks). The Board also received power to approve (or disapprove) appointment and salaries of executive heads of the individual Federal Reserve Banks. These and other policy powers placed in the hands of the Federal Reserve Board by Congress make it clear that the System had been officially redesigned before it was even twenty-five years old.

Reflections on a theme

We have seen that the Minneapolis Federal Reserve Bank, along with other Federal Reserve Banks, seemed very different at the outset from what it turned out to be. And most of the changes in the new direction took place during its first twenty-five years.

Now we can well ask: what is the Federal Reserve Bank of Minneapolis today? Obviously it is not an autonomous regional reserve bank, for if we have learned anything, it is that regional autonomy is a thing of the past. But to say that the Bank is simply a "branch" of the central bank would also be wrong, for it is something more than this. Perhaps the Federal Reserve Bank of Minneapolis is best viewed as one integral part of the nation's central bank. The Bank's president, in fact, participates in the System's highest monetary policy deliberations. In contributing a "regional voice" to the decision-making process, he draws upon information and views provided by the Bank's professional staff and its directors representing, in turn, member banks and the borrowing public.

Certainly the Minneapolis Bank's ability to serve the Ninth District has been strengthened by the centralization that has occurred. Yet it is probably also true that the Federal Reserve System's ability to serve the national economy has been strengthened by the traces of regionalism retained within its structure.

For additional copies contact:
Office of Public Information
Federal Reserve Bank of Minneapolis,
Minneapolis, Minnesota 55480