Fiftieth Anniversary of the Federal Reserve System— The Banking System in 1914

In early 1914, the nation's commercial banking system was very different from the system we know today. For one thing, there were almost twice as many commercial banks—25,500, compared with 13,400 today. About 7,500 had national charters; the remaining 18,000 were chartered by states.

Demand deposits and currency totaled $11.6 billion in 1914, compared with the current money supply of about $155 billion. Currency then included national bank notes, gold coin, and gold certificates—all of which have now disappeared—as well as the still-familiar United States notes, silver certificates, and silver and minor coins. Federal Reserve notes, the bulk of today's currency, were of course unknown.

Banking services were neither as flexible nor as diversified as they are today. Bankers' acceptances, which were widely utilized in Europe to finance domestic and foreign trade, could not be created by national banks until passage of the Federal Reserve Act, nor by New York State banks until shortly afterward. The earlier restriction had weighed particularly on banks in New York City, because one third of the nation's exports and more than one half of its imports passed through this port.

Markets in which banks could readily obtain and dispose of short-term earning assets were poorly developed by today's standards. Most of the relatively small amount of United States Government securities held by commercial banks was unavailable for trading, because these securities were required as legal backing for the outstanding notes of national banks.

Even in 1914, payments by check were estimated to account for about 90 per cent of all business payments. Local clearing-house arrangements were efficient, but the collection of out-of-town checks often proved slow and costly. Many banks, particularly those outside financial centers, deducted exchange fees from the face value of checks drawn on their deposits. To avoid these charges, banks sought to route checks only to correspondent banks, and some of the travels of individual checks through these correspondent links proved absurdly time consuming.

Lending consisted primarily of short-term commercial financing based on promissory notes or secured by marketable staples. These notes were generally not very liquid; correspondent relationships—under which smaller banks could rediscount this paper with larger banks when pressed for funds—were of extreme importance in providing what liquidity there was. Correspondent deposits and discounting concentrated in money centers—especially New York City—where the banks did not themselves have ready access to a source of liquidity in times of stress. One of the purposes of the new Reserve System was to fill this void. As the Reserve Bank Organization Committee, established under the Federal Reserve Act, began to deliberate on how many Reserve Districts to create (the law specified a maximum of twelve and a minimum of eight) and where to locate the Federal Reserve Banks, it was certain that New York City would have one of the Federal Reserve Banks.