Fiftieth Anniversary of the Federal Reserve System—Early Response of the Commercial Banks*

During 1914, as the Federal Reserve System was about to be launched, one of the major questions was how well the System would be accepted by prospective member banks. There existed considerable evidence that not all important commercial banking interests were in accord with the principles of the Federal Reserve Act. While the measure was being discussed in Congress in 1913, an apparent consensus among bankers had favored the earlier Aldrich proposal, which had pointed toward a more centralized institution with greater representation for banking interests. Even Benjamin Strong, then president of Bankers Trust Company, New York, and shortly to become the first Governor of the Federal Reserve Bank of New York, had expressed serious misgivings about the Federal Reserve System as it had emerged from Congressional debate.

In addition to disagreements on principles, there were also practical questions of potential disadvantages of membership, such as the absence of interest payments on reserves deposited with a Federal Reserve Bank and the expected adoption of a par check collection mechanism among member banks by the Federal Reserve System. Under the earlier National Banking Act and existing state banking laws, a considerable portion of required reserves could be—and usually were—deposited in earning accounts. Furthermore, the smaller banks in particular looked with disfavor at the possibility of par check collection, since many obtained a sizable portion of their earnings from exchange fees deducted from the face value of the checks sent to them by other banks for payment. These banks were also apprehensive over the additional supervision of the Federal Reserve authorities, while both large and small state-chartered banks felt further uncertainty as to whether or not they could legally withdraw from the System once they had accepted membership.

There were, of course, powerful factors working toward broad bank membership. These included the service facilities that the new System was about to develop, and the knowledge that membership contributed to an over-all strengthening of the commercial banking structure. Of even greater importance was potential access to the Federal Reserve "discount window". The previous absence of a "lender of last resort" had often led to embarrassment for individual banks and had contributed to damaging money panics affecting the entire financial system.

The first evidence of the response of the banking community proved highly encouraging. By April 2, 1914, no less than 7,471 national banks had applied for stock in the Federal Reserve Banks, leaving only 15 who chose to relinquish their charters rather than join the System. Since national banks held about half of the banking system's deposits, acceptance of membership by this overwhelming majority was of critical importance.

The pace of entry proved considerably slower among the estimated 9,000 state banks and trust companies who met the Reserve Act's capital requirements for membership. By the end of 1916, 37 state-chartered institutions had joined the System and 119 more had become members by converting or reorganizing as national banks. Meanwhile, however, evidence was accumulating that membership did provide tangible benefits to offset some of the apparent disadvantages. Moreover, the passage of an amendment to the Reserve Act on June 21, 1917—when the number of state-chartered members had risen to 53—assured state members that they could withdraw if they desired. Between that date and the year end 197 banks entered the System, and in 1918 an additional 686 became members.

By the fall of 1919, five years after the inauguration of the Federal Reserve System, it was clear that commercial banks generally supported the System. Its membership included almost one third of all commercial banks, and these members held over 70 per cent of all deposits in such banks. Today, a half century later, 45 per cent of all commercial banks, accounting for over 83 per cent of commercial bank deposits, are Federal Reserve members.

* The sixth in a series of historical vignettes appearing during the System's anniversary year.