

A Division of Power

BY CHARLES GERENA

During an intense four months in 1914, America's central bank took shape. How Richmond won a Reserve bank

April 2 had a special meaning for Richmonders in the years following the Civil War. It was that date in 1865 when Southern soldiers fled the Confederate capital as Union troops approached, setting fire to tobacco warehouses and bridges during their retreat. The ensuing conflagration and looting that followed the next morning left smoldering piles of rubble where newspaper offices, banks, and hotels once stood.

Almost a half century later, the date would bring a feeling of vindication to a city that spent decades recovering from that devastating fire and the economic upheavals of the Reconstruction era. On April 2, 1914, it was announced that Richmond would become one of 12 cities to serve as a base of operations for the Federal Reserve System.

The Fed's formation culminated years of debate over what kind of central bank the United States needed to avert liquidity problems and bank failures in the future. Should the Fed be governed by the private sector in association with government officials or by political appointees? Should the Reserve banks have a high level of autonomy or be mere branches

of a powerful central authority? For various economic and political reasons, Congress decided on a regional approach with the Federal Reserve Act of Dec. 23, 1913.

That was only half the battle. For the next three months, the Reserve Bank Organization Committee made some tough choices on the number of Reserve banks, the boundaries of the districts that the banks would serve, and the headquarters city for each district. The latter task attracted formal petitions from 37 cities, including Baltimore; Washington, D.C.; Charlotte; Columbia, S.C.; and Richmond.

Every contender had its merits, its fierce supporters, its political levers. While Richmond was smaller in population compared with Baltimore or Washington, the city loomed large in the eyes of Southern businessmen. This was reflected in the flow of capital at the time. Richmond's national banks loaned \$33.5 million to borrowers in 13 Southern states as of January 1914, more than any other community in the country — except New York — and four times greater than Baltimore and Washington combined. This historical connection likely gave the River City an edge in gaining a Reserve bank.

The Conflict

The Reserve Act designated who would serve on the organization committee: Treasury Secretary William McAdoo, Agriculture Secretary David Houston, and Comptroller of the Currency John Williams. (Williams wasn't confirmed by the U.S. Senate until mid-January so he missed the early stages of the committee's work.) While all eyes focused on these men, the initial preparation of a districting plan fell to a group of experts led by Henry Parker Willis, an economist

The Richmond Fed opened the doors to its first headquarters at 1109 East Main Street in November 1914, less than a year after the city's business leaders began their bid for a Reserve bank.



who helped Congress craft the Reserve Act and would later serve as secretary for the first Federal Reserve Board.

The committee's mandate was clear but the path to meeting that mandate was not. The only criteria were a few paragraphs in the enabling legislation.

For example, each Reserve bank district had to open with at least \$4 million in paid-in capital from its member banks. That may not sound like much by today's standards, but the average resources of state and national banks in 1915 amounted to just \$916,000 per institution. The Reserve Act required member banks to pay 6 percent of their resources into the new central bank, or \$54,960 per institution based on the average capitalization at that time. So, it would take about 73 banks of average size to put a Reserve bank over the \$4 million threshold.

That made drawing district lines tricky. Banking resources were concentrated in the Northeast, necessitating the division of the region into several smaller districts to prevent any one Reserve bank from commanding too much capital at the expense of other banks. The reverse was true on the West Coast — economic activity was spread out so the district boundaries had to be drawn as broadly as possible to ensure that each bank was large enough to serve its constituents.

In addition, there had to be at least eight Reserve bank districts, but no more than a dozen. Here, the tension between a centralized and a regional system of central banking reasserted itself.

Prominent bankers in large cities wanted the minimum number of districts, with New Yorkers advocating a Reserve bank in their city that controlled most of the Northeast and seven other banks with less power and geographic scope. They felt a dominant New York Fed was necessary in order to win the respect of the financial community abroad.

Businessmen in smaller and more rural communities who wanted their interests served by the nation's new central bank had the opposite view.

They wanted as many Reserve banks as possible, evenly distributed throughout the country and roughly the same size. Advocates of this approach also included populists like William Jennings Bryan; Treasury Secretary McAdoo, who feared a dominant New York Fed would overshadow the other Reserve banks; and Henry Willis, who felt each Reserve bank needed to be strong and self-supporting.

Also, a regionally balanced central bank would be better positioned to address seasonal imbalances between supply and demand in regional capital markets. According to University of Idaho economists Jon Miller and Ismail Genc, rediscounting commercial paper was the primary tool of monetary policy, given the rigidities of using the gold standard to regulate the money supply. "At times of high loan demand, regional Reserve banks could accept commercial paper owned by member banks as collateral for loans to them to expand the reserve base," they wrote in a 2002 article.

Ultimately, neither side of the debate got everything they wanted. Twelve districts were drawn and the capital paid into the Federal Reserve System was divided as evenly as possible, but the New York Fed still ended up with more capital than the four smallest Reserve banks combined. The New York Fed wasn't as large as its supporters wanted — that would have resulted in one bank commanding about half of the system's total capitalization — but it still ended up being the largest and the most influential. Its vaults have held gold reserves for foreign countries since 1924, its president assumed a permanent spot on the Federal Open Market Committee in 1943, and its domestic trading desk has conducted the Fed's open market operations since the 1920s.

Finally, the Reserve Act required that "districts shall be apportioned with due regard to the convenience and customary course of business." Railroad and telegraph lines had to connect each Reserve bank city with the communities it served so that checks could be delivered for clearing,

member banks could present their collateral in person for loans of reserves, and bank employees could keep abreast of credit conditions.

At the Reserve Bank Organization Committee's first official meeting on Dec. 26, 1913, McAdoo and Agriculture Secretary Houston decided to focus on three factors when choosing a Reserve bank location: geographical convenience to member banks, the industrial and commercial development needs of communities within a district, and the established custom and trend of business.

"In laying out the districts and establishing the headquarters for Reserve banks, every effort will be made to disturb as little as possible existing conditions, and to promote business convenience and normal movements of trade and commerce," noted McAdoo and Houston in a statement released the next day. "While the committee appreciates the local pride and sentiment which are prompting many cities to urge their claims, [it must arrive] at sound conclusions through consideration of fundamental and vital factors."

The Prize

Even before the organization committee officially began its work, cities began petitioning for a Reserve bank. "Reserve cities are springing up all over the United States," Houston lamented to President Woodrow Wilson in a letter sent three days after the committee's initial meeting. "Certainly nobody could have imagined that so many [cities] had strategic locations."

Winning a Reserve bank was seen as good for business, though its precise economic impact was unclear. According to David Hammes, an economist at the University of Hawaii at Hilo, the responsibilities of the Federal Reserve System weren't fully known. "Nobody knew what was being created, not even the people on the committee," Hammes says. Some businessmen confused the role of the Reserve banks with commercial lenders.

Hammes adds, Uncle Sam didn't have the local presence and economic

impact that it has today. Therefore, the creation of a regionally oriented central bank represented one of the first federal projects of national scope, promising to bring some form of government employment to communities, though the magnitude was still to be determined.

Finally, having a Reserve bank nearby would provide a convenient source of coin and currency, check handling, and other services to commercial banks. Among other things, this was expected to benefit firms involved in correspondent banking, which encompasses a variety of services that one bank provides to another bank, such as payments processing and foreign currency settlement.

During the selection process, McAdoo pointed out that the location of a Reserve bank in a city wouldn't be as important to their economic development as many assumed. In retrospect, it is possible that access to the Fed's efficient check clearing and discount window services indirectly helped businesses in the immediate vicinity of a Reserve bank. However, it is equally possible that the Reserve bank cities were already progressing more than other locales, which is why they were chosen.

In Richmond's case, its selection as a Reserve bank site was credited for elevating its status as a regional financial center. The city also had a lot going for it economically in the early 20th century.

Despite the turmoil of the Civil War and Reconstruction, Richmond remained a center of trade and finance in the "Old South." James Dooley, a wealthy railroad executive, described the city in this manner in a letter to Comptroller Williams. "Richmond is still to all intents and purposes the capital of that great division of the United States which lies between the Atlantic Ocean and the Mississippi, south of the Mason and Dixon's line," Dooley wrote. "She is the capital city of their business, the capital city of their banking, the capital city of their affections." Washington and Baltimore both had commercial ties to the South and

retained many of its cultural traditions. But Richmond was more closely identified with the region.

Also, goods and capital in the South Atlantic tended to flow from south to north. Therefore, a Reserve bank in Richmond would be able to accommodate those regional flows and still be within reach of the Northeast's economic centers.

The Campaign

Even with these advantages, Richmond initially wasn't a contender for a Reserve bank, according to a book by Henry Willis in 1923 on the central bank's history. "In none of the preliminary surveys of the situation was the establishment of a bank at Richmond, Va., ever seriously considered," he wrote.

Willis himself considered a Richmond Fed "unnecessary" since Reserve banks in Atlanta and Philadelphia would be accessible to most of the Southeast and Mid-Atlantic. "He thought he had the Eastern Seaboard covered," Hammes notes, so having a Reserve bank in Richmond "didn't solve an economic problem."

Others believed that if the East was to be divided into multiple Reserve bank districts, Baltimore or Washington were better suited for a bank headquarters.

The Maryland Bankers Association and other trade groups supported Baltimore for several reasons. The port town handled a large volume of foreign trade, plus it was a center of domestic trade in the South Atlantic region. Supporters argued that the extent of Baltimore's trade within the region wasn't fully reflected in clearinghouse data since a "tremendous volume" of transactions was handled by jobbing houses and manufacturing plants.

Bankers and businessmen in nearby states said they had close financial ties to Baltimore and wanted to expand them. John Mayo, a Kentuckian who helped develop the state's coal and timber resources, was one of them. "Baltimore has lent us money for the development of our resources when we

could not get it anywhere else and when New York turned us down," he said in a *Baltimore Sun* article. "If our paper is to be rediscounted, we want it held in a city in which we feel at home..."

The Washington Clearing House Association and other organizations believed their hometown deserved a Reserve bank because of the city's prominence as the seat of the federal government. Also, the bank would be near the Treasury Department and the Federal Reserve Board that was designated to manage the new central bank.

"If one of such banks be located in Washington directly under the vision of the Federal Reserve Board, that supervisory authority can watch ... the work that is being carried on, note how the bank serves the purpose for which it is intended, and decide from personal contact and observation what rules and regulations are needed to bring all such banks to a high state of efficiency," noted Henry McKee of the Clearing House Association in his testimony to the Reserve Bank Organization Committee.

Oliver Sands, a prominent Richmond banker, initiated that city's lobbying efforts on Dec. 29, 1913, less than a week after the Reserve Act was enacted. He called a meeting of local banks eligible for Federal Reserve membership to discuss the idea of having a district headquarters in Richmond. Later that day, the Business Men's Club met to discuss the matter.

Both groups agreed to pursue a Reserve bank, calling on representatives from the private and public sector to form a joint "Committee on Locating a Federal Reserve in Richmond." The committee coalesced two days later, with Sands serving as the chairman.

A corps of stenographers and administrative assistants worked from a conference room at the Business Men's Club to gather information and send promotional literature to communities throughout the South Atlantic. Teams of volunteers also toured the region to convince local bankers. George Seay, who worked for the joint committee as a consultant and would

later serve as the first leader of the Richmond Fed, gave several talks during an 11-day tour of the Carolinas.

Richmond managed to win over many Carolinians, including the president of the North Carolina Bankers Association and the former mayor of Charleston, S.C. The support wasn't unanimous, however. Some Tar Heels wanted a Reserve bank in Charlotte, while others in the Palmetto State preferred Columbia. Eventually, both cities mounted their own campaigns.

West Virginians were torn. Many bankers in the Mountain State felt more closely aligned with their neighbors in Ohio and Pennsylvania than with Virginia and other South Atlantic states. Wheeling, W.Va., bankers wanted to be included in a Reserve bank district along with Pittsburgh, a city that it had economic ties with. In January 1914, a poll of state and national banks in West Virginia revealed a preference for a Reserve bank in Pittsburgh or Cincinnati; Baltimore was also a popular option, while Richmond was the first choice of only 17 bankers.

Meanwhile, McAdoo and Houston had to act quickly. The Reserve banks were to be open for business by Nov. 16, 1914, less than a year after the Reserve Act was enacted. So, during six weeks in January and February, the gentlemen and a small entourage visited 18 cities on a highly publicized fact-finding mission, starting in New York City and ending in Cleveland. During their cross-country travels, a stenographer recorded more than 5,000 pages of testimony from more than 300 witnesses.

Representatives from Virginia and the Carolinas traveled to the nation's capital on Jan. 15 to present Richmond's case. Several hundred strong, the group greatly outnumbered other delegations from Baltimore, Charlotte, and Columbia which crowded into Williams' office at the Treasury Department during three days of hearings in Washington. (Williams, who was the assistant Treasury secretary at the time, did not stay for the hearings since he wasn't

yet confirmed as Comptroller of the Currency.)

Seay presented his brief, prepared in just 18 days, outlining why Richmond should have a Reserve bank. The thoroughness of the stat-heavy brief, as well as of follow-up documents submitted about a month later, reportedly impressed McAdoo and Houston. Backers of a Reserve bank in Charlotte and Columbia were also apparently swayed by Seay's arguments, which were published in a bound volume and

widely circulated. Those cities' campaigns fizzled in the face of growing support for Richmond.

The Fallout

Comptroller Williams joined McAdoo and Houston to work on the committee's plans for the rest of February and all of March. On April 2, 1914, they announced the fruits of their labor.

At the close of business that day, a crowd gathered at the Richmond offices of John L. Williams, a prominent

Popularity Contest

When the Reserve Bank Organization Committee wanted to take the pulse of the banking industry in 1914, there were no toll-free numbers that bankers could call or Web-based surveys they could answer. Instead, the Treasury Department mailed card ballots to each of the 7,471 national banks that had formally accepted the terms of membership in the new central bank system. The ballot asked for a first, second, and third choice for the location of a Reserve bank that bankers preferred to be associated with. "The ballots were gathered prior to designation of any district boundaries, so banks were unconstrained in their choice of cities," noted University of Hawaii at Hilo economist David Hammes in a September 2001 article in *The Region*, published by the Minneapolis Fed. "Comments by committee members in the various cities indicate that they had access to the results of the balloting prior to both the completion of their tour and their deliberations," which ended on April 2, 1914, with their announcement of the Reserve bank district boundaries and headquarters cities.

In a statement released eight days later in defense of its decisions, the committee members noted that bankers in North Carolina and South Carolina didn't want to be aligned with a Reserve bank located to their south or west. Instead, Carolinians preferred Richmond, which was the obvious favorite of Virginian bankers.

Not surprisingly, bankers polled in the District of Columbia and Maryland wanted a Reserve bank in Washington and Baltimore, respectively. But the committee members chose not to locate a bank in one of those cities, in part, because either would have been too close to the Philadelphia headquarters of the Third District. In addition, "the industrial and banking relations of the greater part of the district were more intimate with Richmond than with either Washington or Baltimore," they wrote in their statement.

South Carolina's capital city, Columbia, was the first choice of 28 national banks in the Palmetto State versus 11 for Richmond. But when the votes were added up, the latter city came out on top by garnering more second-choice votes: 27 for Richmond versus five for Columbia. Richmond also received far more first- and second-choice votes than Baltimore, Washington, or Charlotte from banks in North Carolina and Virginia. Baltimore did garner the most second-choice votes in West Virginia, placing it behind Pittsburgh in the final tally.

The views of West Virginia's bankers were especially divided, according to the committee's statement. So, the Northern Panhandle counties of Marshall, Ohio, Brooke, and Hancock were placed in the Fourth District, where they had business ties to the cities of Cincinnati and Pittsburgh. Those who had wanted to be associated with a Reserve bank in either of those cities, however, were still disappointed because the district's headquarters was located in Cleveland. (Pittsburgh and Cincinnati were later chosen as branch locations for the Fourth District.) The rest of West Virginia ended up in the Fifth District.

— CHARLES GERENA

banker, to await news from his son, the comptroller. Richmond's mayor and Virginia's governor anxiously waited with local bankers and businessmen to hear the announcement.

E.L. Bemiss, comptroller Williams' brother-in-law, kept his ear to the phone "and conversation fell to a whisper," according to a news report in the *Richmond Times-Dispatch*. Three men stood by a map of the United States to trace the boundaries of the Reserve bank districts as they were announced.

Finally, the call came from Comptroller Williams at 6:30 p.m. Bemiss relayed every word as Williams announced the 12 Reserve bank districts and boundaries one by one. "There was a dramatic and intense moment as the list of Reserve Bank cities and their regions came over the wire," the *Times-Dispatch* described. "When Richmond's name was called, bank presidents grasped hands and held them while they cheered together. Soon messenger boys were struggling into the crowded rooms with telegrams of congratulations from all sections of the country."

Richmonders celebrated as if they had gained a major league baseball team or the Summer Olympics. The next evening, the upscale Jefferson Hotel hosted a mass meeting and

buffet dinner sponsored by the local chamber of commerce.

Elsewhere, though, the selection of Richmond and other Reserve bank cities wasn't as well received. New York, Chicago, St. Louis, and San Francisco were obvious choices for Reserve banks. They were centers of business and finance, had large populations, and were designated under the National Bank Act of 1864 as cities where national banks had to maintain reserves equal to a percentage of their deposits. Other choices were less obvious and subject to question. Baltimore and Washington, D.C., were clearly disappointed. So, too, were New Orleans and Denver. City leaders in both towns thought that they were deserving of a Reserve bank. Denver, in particular, questioned the wisdom of placing a Reserve bank in Kansas City, giving Missouri two banks.

The Reserve Bank Organization Committee offered a general explanation of how it drew district lines and selected headquarters cities, from the ability of a Reserve bank to assist businesses in its district to the district's economic track record and future prospects. Still, accusations flew of committee members playing politics.

Several Reserve bank cities had ties to high-level members of the

Democratic Party, which was reinvigorated after taking control of Congress in 1910 and the White House in 1912. For example, Rep. Carter Glass, chairman of the House banking and finance committee, President Wilson, and Williams had strong Virginia connections and played pivotal roles in the formation of the Federal Reserve System. Glass, in particular, played a major role in crafting the Reserve Act and ushering it through Congress.

For several days, lawmakers on Capitol Hill debated the validity of the organization committee's choices. Glass gave an impassioned speech on April 8, 1914, defending Richmond's selection and the committee's motives.

"The business of the national banks in Virginia, including Richmond, is far ahead of the business of the national banks of Maryland, including Baltimore, or any other of the five states embraced in [the Fifth District]," he argued. As of Jan. 13, the capital and surplus of Virginia's national banks amounted to \$32.9 million, compared with \$31.3 million in Maryland, \$18 million in West Virginia, \$13.3 million in North Carolina, \$12.6 million in the District of Columbia, and \$10 million in South Carolina.

The organization committee eventually answered its critics by issuing another statement on April 10. Committee members argued that they wanted to choose cities which were growing in importance. Richmond's national banks were the largest source of loans, outside of New York, for businesses in the South. Also, they held more deposits from the region's banks than Baltimore or Washington, even though the latter were among the cities where banks had to park their reserves.

To provide further justification for its decisions, the committee released the results of a nationwide poll of 7,471 national banks. The poll was likely taken because many bankers had opposed the creation of the Fed, so the committee members wanted to be sure they felt included in the process.

The organization committee closely followed the preferences

Poll of National Banks, Top-Five Preferences for Reserve Bank Cities by State

| MD | 1st & 2nd Choice Votes | NC | 1st & 2nd Choice Votes | SC | 1st & 2nd Choice Votes |
|--------------|---------------------------|--------------|---------------------------|--------------|---------------------------|
| Baltimore | 97 | Richmond | 57 | Richmond | 38 |
| Philadelphia | 25 | Charlotte | 26 | Columbia | 33 |
| Washington | 25 | Baltimore | 23 | Baltimore | 6 |
| New York | 15 | Washington | 7 | Washington | 3 |
| Pittsburgh | 6 | Philadelphia | 3 | Charlotte | 3 |
| VA | 1st & 2nd Choice Votes | WV | 1st & 2nd Choice Votes | D.C.* | 1st & 2nd Choice Votes |
| Richmond | 104 | Pittsburgh | 54 | Washington | 12 |
| Baltimore | 58 | Baltimore | 53 | Baltimore | 10 |
| Washington | 45 | Cincinnati | 39 | New York | 1 |
| New York | 7 | Richmond | 28 | Philadelphia | 1 |
| Philadelphia | 7 | Washington | 13 | | |

*Only four cities in total received votes from national banks in the District of Columbia.

SOURCE: Reserve Bank Organization Committee, 1914

expressed by those surveyed — 11 out of the 12 cities that garnered the most support were selected as Reserve bank cities. Cleveland got the nod instead of Cincinnati or Pittsburgh, both of which were the preference of banks in the Fourth District.

Unmoved by the organization committee's assertions of objectivity, protests continued over Richmond's selection. The mayor of Baltimore and Maryland's governor led a massive demonstration at a downtown theater on the evening of April 15. More than 3,000 people attended, lining up in the pouring rain from the time the doors were opened until well after the meeting's start.

While other rivals eventually accepted the Reserve bank plan, Baltimore didn't back down. On April 29, the Regional Reserve Bank Committee of Baltimore asked the organization committee to reconsider and delay the formation of the Richmond Fed pending an appeal to the Federal Reserve Board. When the organization committee refused to do either, Baltimoreans crafted a detailed brief and sent it directly to the newly appointed Reserve Board on Sept. 11, 1914.

The brief argued, among other things, that Baltimore was a natural point of trade and its total banking resources far exceeded Richmond when taking into account the capital of the city's trust companies and mutual savings banks. In a formal rebuttal, George Seay pointed out that trusts were unlikely to join the Federal Reserve while mutual savings banks couldn't join, so their resources shouldn't have been counted. (This

might have skewed the results of the poll as well since only Federal Reserve member banks were sent ballots.)

Despite these efforts, Baltimore lost its bid for a Reserve bank when the U.S. attorney general ruled in April 1916 that the Federal Reserve Board didn't have the authority to tinker with the locations of Reserve banks. Less than two years later the city did get a branch office that has grown into the eighth-largest check processor for the Federal Reserve System, handling 620 million checks in 2005.

The Legacy

Were the organization committee's decisions politically motivated? "The key role played by Virginians in devising, legislating, and ... implementing the new system no doubt provided encouragement" to Richmond's boosters, wrote James Parthemos, former director of research at the Richmond Fed, in a 1991 article for the bank's *Economic Review*.

However, Parthemos didn't think politics played a decisive role. "That the Richmond leaders were not prepared to count on political favoritism is indicated by their retention at some early stage of two of the nation's highly regarded professional banking consultants to evaluate the case for locating a Reserve bank in Richmond," he noted.

If the organization committee was politically motivated, then the choices for Reserve bank cities initially suggested by Henry Willis in a confidential report to the committee would have differed significantly from the committee's final plan, assuming that Willis wasn't merely telling the

committee what it wanted to hear. In fact, there were only two differences — Willis selected Portland and Cincinnati, while the committee chose Richmond and Dallas.

Several researchers have found that the organization committee's decisions were likely based on economics, not just politics. For example, economist Michael McAvoy at the State University of New York at Oneonta compared a decisionmaking model based on economic factors with a model based on political preferences. He determined that the former was a better predictor of what the committee members agreed upon.

"The [organization committee] selected the proper 12 FRB locations based upon bankers' preferences, city population, [banking system] capital growth, and population growth," McAvoy described in a July 2006 article. "Given these objective criteria, the [committee] likely maximized social welfare rather than its own."

People have continued to push for some changes — a branch of the Richmond Fed opened in Charlotte in December 1927 after years of lobbying led by a local banker, while bankers and local government officials in Washington tried and failed to get a branch for their city in the 1970s. And, economists Miller and Genc, among others, have proposed reevaluating the district boundaries to better reflect regional economic relationships.

Still, as the saying goes, the proof of the pudding is in the eating. The operational structure of the Federal Reserve System has persisted through two World Wars, 17 recessions, and 16 U.S. presidents. **RF**

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