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"Progress in Country Banking Over Three Decades."

It would be of little purpose to spend time in retrospect without attempting to gain some lesson for the future. It is quite often difficult reliably to anticipate future events on the basis of history, because the circumstances of the present so frequently have no parallel with the past. However, a study of what has gone before may help to detect the guise under which old fundamental difficulties may reappear.

The past several decades have experienced two of the three most outstanding pieces of bank legislation in our history. These were the creation of the Federal Reserve System in 1913 and the Banking Act of 1933.

The first banking legislation of national consequence was the National Bank Act, passed in 1863. This attempted to select and combine the best parts of the legislation which had previously been passed by various states. In turn, it subsequently served to act as a guide for further state legislation.

The year 1863 ended with only 66 national banks and 1,466 state banks operating. The total had risen to about 10,000 at the turn of the century, and reached its peak in 1921 when there were more than 30,000 commercial banks, of which about 8,000 were national banks. Available statistics indicate that about 3,400 banks closed between 1863 and 1921, including about 540 national banks. The year 1921 saw the beginning of a series of heavy bank failures that culminated with the Banking Holiday of 1933. From over 30,000 in 1921, the number of commercial banks in this country dropped to about 17,800 by the end of 1932. However, the indicated drop of over 12,000 does not tell the full story, for during that period there were about 3,500 new banks chartered. Only 800 of the banks that went out of business were voluntary liquidations. The drop in the total number of active commercial banks in the three years ending in 1923 appeared to indicate the closing of about 1,000. Actually, about 2,500 banks were suspended, as over 1,200 new ones were chartered and almost 300 suspended ones were reopened. It seems incongruous that the year 1932 saw the organization of 93 new banks, 83 of them state institutions. The operation that started our ailing banking system on its way to convalescence in 1933 involved 4,000 bank suspensions some of which subsequently ended in reopenings. From January 1921 to January 1934, the number of active national banks dropped 37% while total operating state commercial banks declined 56%.

In the 15½ years following 1933, only 410 insured commercial banks have been forced to close. At the end of last year there were 14,109 operating commercial banks, of which 696 were noninsured banks.

The Federal Reserve System did not attract much state bank membership until 1917, when the authority to examine state members was transferred from the Comptroller of the Currency to the respective Federal Reserve banks. Membership then rose to 1,648 in 1922 and declined to 805 by the end of 1932. State member banks at the end of 1948 totaled 1,924.

Probably most people are accustomed to referring to the Banking Holiday of 1933 as the collapse of the banking system, or the worst banking crash in history. However, it was really only the culmination of slow death deterioration that had plagued the banking business for a number of years, as can readily be seen from the foregoing facts.

In 1920 the west north central and the east north central states, made up of 12 states predominantly devoted to agriculture, had exactly 50% of the total number of the nation's banks. By the end of 1933, while the banking system was shrinking to just half its 1920 size, this group of states lost 60% of its banks. Several of the states in these two sections fared better than the others and a few other states in other sections had even worse experience, but in nearly all the worst cases the states were entirely or largely devoted to agricultural activities.

Old records show that in June 1915 some 26,000 banks had loans of $13,588,000,000 and capital totaling $4,175,000,000. In June 1933 slightly over 14,000 banks had $16,447,000,000 of loans and $6,175,000,000 of capital. At the close of last year commercial bank loans totaled $42,000,000,000 and capital funds aggregated $10,160,000,000. Since 1934, nongovernment securities have risen to $8,932,000,000, an increase of nearly $3,000,000,000, with most of the rise represented by municipal investments.

Before complete conclusions can be drawn from the foregoing record of the banking business, it is necessary to know something of the economy which attended it. While the banking business seemed to be breaking up, other commercial and industrial enterprises apparently were enjoying steady growth. For a period of 33 years from 1897, with the exception of 1918, the number of recorded active business enterprises in this country increased. The 2,213,000 of 1929 recorded an all-time high up to that point. Even 1933 produced only a little more than 10% drop in active businesses, which fell to 1,961,000. By the beginning of World War II the number of active businesses had almost regained its 1929 level but by 1944 the various restrictions and other circumstances which attended the war had reduced these businesses to 1,855,000. At that time more than three-fourths of these businesses were in the retail trade and about five-sixths of the number were small businesses with net worth of $10,000 or less. Recent figures indicate that active businesses have increased more than 800,000 in number since 1944.

This record of business events leading up to 1933 tends to suggest bank management very much inferior to that operating other types of business, but there is something more to be taken into consideration. The adverse record of the farmer after World War I undoubtedly had much to do with our past banking difficulties. From 1910 to 1914, prices received by farmers and the prices paid by farmers ran about even, and that fact now is the basis for determining our present parity ratio base of 100. The first World War caused a sharp rise in farm prices which was attended by a rise in production costs that allowed a moderate, favorable differential. However, beginning with 1920, farm prices dipped very fast while production costs came down much more slowly. An even sharper decline began in 1929, reaching bottom in about 1932. This was intensified by a contraction of farm markets. The situation with respect to farm land prices had a similar experience. The 100 price index on farm real estate was established on the basis of 1912-14 figures. However, in this instance farm mortgage debt rose almost parallel with the increase in farm land prices that started about 1915, but came down very gradually in contrast to the sharp decline in farm land prices which reached its bottom about 1934. This adversity in the agricultural world undoubtedly has to be identified with the bank disasters that had their nucleus in the country banks.

At this point perhaps it would be well to look for implications in the course of our country banks over the past three decades. The epidemic of bank failures that ended in 1933 indicates three major weaknesses that existed during the preceding period. The first was indiscriminate and competitive chartering of banking institutions without a control in the form of some approach to their economic necessity and prospects for success. The second was that our banking structure was so closely wedded to the fortunes of the other major segments of our economy. The third was management weakness, particularly in its failure to regulate its affairs against adversity in other business situations likely to affect it; in other words, to localized conditions.

The consequences of competition in the chartering of banks between Federal and state authorities were clear to the Congress when they began reviewing the emergency banking legislation enacted in 1933, looking toward further amendments which were finally enacted in the Banking Act of 1935. One of the important features was that which specifies several factors which must be considered by the Comptroller of the Currency and the Board of Governors of the Federal Reserve System before chartering a national bank or accepting a state bank into membership, as the case may be. While the Federal Deposit Insurance Corporation has no chartering authority, it also is required to consider these same factors before granting insurance to an applying nonmember state bank. These factors are: financial history and condition of the bank, the bank, the adequacy of its capital structure, its future earnings prospects, the general character of its management, the convenience and needs of the community to be served, and the consistency of corporate powers. This uniform requirement acts to prevent any proposed bank from finding acceptance in one of our banking systems when barred from another because of some considered deficiency in basic factors. It is undoubtedly significant to note that only 966 new banks have been admitted to deposit insurance, either as a national, state member or nonmember state bank, since the institution of the Federal Deposit Insurance Corporation.

The relationship of the misfortunes of agriculture with those of the banking system in the past on such a wide scale emphasizes the effect one important phase of our economy can have upon another. The picture as it relates to the decline in the number of active businesses probably is somewhat misleading, as it fails to show the thousands of instances where businesses remained in operation although operating in a state of severe distress, many of which we know were enabled to carry on by the help of banks. Banks had to close when they could not meet the demands of their depositors, whereas, the overall business situation was in such dire straits that creditors, many of whom were also involved financially, would have had little to gain by throwing their debtors into bankruptcy. On the other hand the farmer had no alternative but to work his farm to feed himself and his family, at the same time hoping to produce a little income with which to keep going.

When the people of this country indulged in a natural and national tendency, to find a goat for our banking misfortunes, bank management may have come in for some harsh treatment. Today there are more than a few banks which were reorganized and are now being successfully run by the management that was in them when they closed 16 or more years ago. On the other hand unqualified and incompetent management helped to cause and aggravate the troubles that beset banking after the first World War. The indiscriminate and competitive chartering of banks which allowed almost anyone to open a bank if he could put up the small amount of capital required, permitted too many incompetents to stray into the banking business. Naturally the mortality rate was high among these novices, and that certainly had much to do with the contagion that was so generally fatal. But do not be beguiled into thinking that bank management generally was blameless, or that what emerged in 1933 was entitled to a clean bill of health. Some of the problems now to be found in our banks can be laid at the door of management that failed to profit by the experiences of the past.

What, then, has been the progress of our banking system, particularly our country banks? I emphasize country banking because of the predominance of institutions in the rural and small communities. According to information compiled by our statisticians last year, almost 90% of the insured banks of the nation had assets of $10,000,000 or less.

Our banks entered the 1929-33 breakdown somewhat in the same condition one would expect to find in an anemic person who had been exposed to serious contagious disease for a long time. As you well know, the patient was saved and restored to health by hypodermic means. The creation of the Reconstruction Finance Corporation in 1932 was not sufficient to stem the tide, but it served as a crutch for many institutions until more help came. The Home Owners Loan Corporation which undoubtedly was aimed primarily at relieving individuals, also gave a much needed transfusion to our banking system. However, it was the Banking Act of 1933 which produced the Federal Deposit Insurance Corporation that rallied the patient quickly and surrounded it with a healthy atmosphere in which to recover fully and permanently.

In comparing the size of our present banking system with that of thirty years ago, one can readily see that the thinning out process which is a fundamental necessity in horticulture, has acted just as constructively in connection with our banks.

But to become more concrete, let us examine the accomplishments of banking over the past three decades. After struggling for nearly half of that period in an unsuccessful atmosphere, banking underwent a major operation and in 1933, cleaned house and restored its reputation. However, when World War II struck, many banks had not yet succeeded in ridding themselves of all of the unsatisfactory assets which they had been forced to carry over from depression days. The recovery in values, particularly real estate values, which accompanied the war economy, enabled our banks to complete their house cleaning chores, so that by the end of the war, banks generally were in a highly liquid condition, and holdings of stagnant assets were negligible.

Our banks also rose to the occasion by acting as the right-hand of our treasury in carrying out the most essential job of financing the war. It is true that the banks benefited by the exercise of our government bond subscription privileges, but bankers gave unstintingly of their services in campaigning to place millions of dollars worth of government bonds in the hands of individuals and other investors. So successfully did banks handle the sale of savings bonds that it has become one of their permanent functions. Our government also called upon many of our leading bankers to study various financial problems and act as advisors, both at home and abroad. The value of the services of banking in assisting with the rationing program was immeasurable. Despite the fact that the banking business was so essential to the war effort, most banks had to operate shorthanded because bank employees did not receive exemption from the draft.

Since depression days our banks have been aiding in reconstruction, both independently and as a partner of the government. With the war won, they have turned to the task of financing the economy through the periods of reconversion and post-war adjustment. Along those lines both the banks and business generally have been helped by the explorations, conclusions, and recommendations of the American Bankers Association.

All these accomplishments have been constructive. Some of them are now creditable things of the past, while others no doubt will be perpetuated to advantage. Undoubtedly the greatest physical accomplishment of our country banking in the past 30 years has been the handling of an increased volume of business by half as many banks as existed shortly after the first world war. In 1920 the assets of our commercial banks totaled a little over $46,000,000,000. By June 1933 this had shrunk to approximately $40,000,000,00 At the close of last year, the assets being handled by our insured commercial banks, which constitute all but about 700 of the nation's commercial banks, totaled $154,000,000,000. While it is true that a large percentage of this increased total is constituted of an increased investment in United States Bonds, the most significant point is in the fact that loans constitute

$42,000,000,000. Of even more significance is the fact that these loans now represent $4.00 for every $1.00 of capital, whereas in 1915 loans were about $3\frac{1}{2}$ times capital and in 1933 were approximately $2\frac{1}{2}$ times total capital.

All this brings us to the question, "Of what future significance is the progress of our country banking over the past three decades?" To begin with, banking faces whatever period of possible post-war adjustment may be ahead with the support and protection of federal deposit insurance. It is true that federal deposit insurance has not yet been tested by the impact of a major business depression. Nevertheless, the record of federal deposit insurance in action is believed evidence of its ability to cope with any situation that may arise, if given reasonable support by its insured members. While the banking business was given a strong shot in the arm in 1933, many of its members were wobbly on their pins and there were some further fatalities. The existence of federal deposit insurance permitted the elimination during the period from 1934 to 1941 of these weak situations, on the heels of bank failures that panicked the nation, without even a ripple of uneasiness, because of the facility with which depositors were taken care of. Of the 410 banks it has been necessary for the Federal Deposit Insurance Corporation to assist, the majority went out of business within the first five years of federal deposit insurance. It is remarkable that the 410 bank closings of the past $15\frac{1}{2}$ years were less in number than those which closed in any single year from 1921 through 1933, except for 1922, in which 366 banks closed.

Federal deposit insurance and life insurance are alike in this respect, the decendent never collects on the policy. Federal deposit insurance has succeeded where other deposit insurance systems have failed, because its national scope gives protection against concentrated or localized adversity. To anyone who might say that the billion dollars of Federal Deposit Insurance Corporation assets plus its $3,000,000,000 borrowing capacity are puny in contrast to the $140,000,000,000 of insured banks' deposits, the reply is that the pay-off of the nation's entire insured deposit structure at one time never was or is contemplated by those who originated it or those who have administered it. The Federal Deposit Insurance Corporation is strictly based on the insurance principle.

The strength of the Federal Deposit Insurance Corporation and its task obviously will depend upon the caliber of its bank membership. It is not sufficient for the individual banker to be complacent about his own situation on the presumption that the banking system is safe, because even though failures can be successfully eliminated from time to time, they are of serious consequence to stockholders, bank personnel, and up until the last $5\frac{1}{2}$ years have caused some loss to depositors with funds of more than $5,000.

Therefore, bankers collectively and singly should be concerned about economic conditions which may have an adverse bearing upon their banks, as a system or as units, and should regard well their policies. At the present time the credit situation appears to deserve foremost consideration. It has been demonstrated by recent banking history that banks are directly and irresistibly affected by changes in our economy, of which agriculture is an important factor.

The part played by agriculture in events leading up to 1933 has been outlined. Today, however, the farmer is generally regarded as being highly prosperous. He is receiving widespread federal aid. Price supports, implemented by the functions of the Commodity Credit Corporation, and various other methods of aiding farmers, exist today. Most of our modern facilities and mechanization are available to agriculture and utilized by many farmers. The price index on farm land on July 1st was 172, reflecting an increase of 140% above the 72 point index of 1933. Present farm mortgage debt of $5,100,000,000 is down 35% from the $8,000,000,000 of 1933, but it represents a 10% increase since 1947. However, it is significant to note that the price index on farm land has begun to drop since the high of 177 in November 1948. This situation seems to be much more favorable than in 1920, when both farm land prices and farm mortgage debt were near their highest points since 1910.

However, there is great significance in recent reports on the short term debts of farmers. On January 1, 1949, the short term debts of farmers, exclusive of CCC loans, totaled $5 billion. This is considerably higher than the $4,100,000,000 of 1948 and the $2,800,000,000 of 1946. The United States Department of Agriculture reports that the heavy use of short term credit has been necessary to keep the farm industry operating at a high level. It further reports that relatively high incomes have prevented extensive debt distress. However, it cautions that many individual farmers may have borrowed too much. Already there are signs that short term debts may have to be carried over or refinanced. It is indicated that some lenders have not fully considered the income outlook of agricultural borrowers. In view of the heavy credit being carried by many a farmer it is concluded that a general decline in farm income would create the widespread need for refinancing.

In an article in BANKING in May 1948 the Agricultural Commission of the American Bankers Association cautioned its members to keep in mind that the sound value of farm land depends upon the capacity of farms to produce a profitable income over a period of years. This is surely sound advice. Accordingly, the recent records of prices paid and prices received by farmers should be of significance. The all-time high for prices received by farmers since 1910 was recorded in January 1948 when the index reached 307. At that time the index of prices paid was 251, allowing the highest differential in favor of the farmer in almost 40 years. However, prices received dropped within 9 months from 307 to 277, or a dip of 30 points. Even so, there remained a differential of 28 points between prices received and prices paid. However, the gap has begun to close steadily, and the July 1949 index figures show 249 for prices received and 244 for prices paid. Consequently, the parity ratio has receded in 18 months from an all-time of 133 to the current 102, the latter being only 2 points above the base figure.

Now, it would appear that the farmer is immeasurably better off today than he was in the comparable period after the first world war, from the standpoint of land debt. It also would seem that, despite the fact that he is apparently little better price-wise than 35 years ago, he is protected and assisted by supports and controls. However, no one should lose sight of the fact that the earnings advantages produced by controls must inevitably be reflected in the price of farm land. Obviously, the affairs of the farmer must be constantly watched and carefully studied to prevent a new variety of old troubles from again developing to hurt our banks.

Any attempt to peer into the future calls for a careful examination of the implications of the changes in the active businesses in this country, on which data previously has been discussed. The fact that active businesses have shot up the better part of a million in number in less than five years should be very sobering. This change has taken place during a period of rising economy and prices. Our daily observations reveal that many of these new business enterprises are new ventures entered into by returned veterans many of whom are inexperienced, others have had only limited business experience, and undoubtedly hundreds have been induced to go into business because of the assistance afforded by the GI Bill. Obviously thousands of new business enterprises have sprung up as a result of the demand for all kinds of goods, which created a sellers' market. Recently the pinch of competition, the saturation of consumer demand, and the fact that operating costs as well as sales prices are high, have resulted in rising business fatalities. Authoritative reports have begun to show a substantial and rising number of business failures. During the first six months of 1949, 4,644 business failures were reported, which is in significant contrast to the 595 failures reported for the last 7 months of 1944, and the 810 failures reported for the entire year 1945.

Now, neither the sad chronicle of the experiences of banking during the forepart of the period we are considering, nor the adverse implications pointed up in the latter paragraphs are intended to be doleful. Our country banking system again is respected and has steadily gained in stature since the days of its disrepute. It is incomparable, in that there is nothing else where in the world to match its independence and its tremendous facilities. The old adage, "Experience is the best teacher," has never been refuted. This account of the experiences and progress of our banking, tied in with necessarily brief reference to contributing factors and those which undoubtedly will have much to do in the future, is aimed at emphasizing the need for aligning the past, present, and possible future together in carefully determining the course to be pursued by our banks today, in the best interests of the banks and the country as a whole tomorrow. Let us not forget that "on the looms of today, from the materials of yesterday, we are weaving a better tomorrow."

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