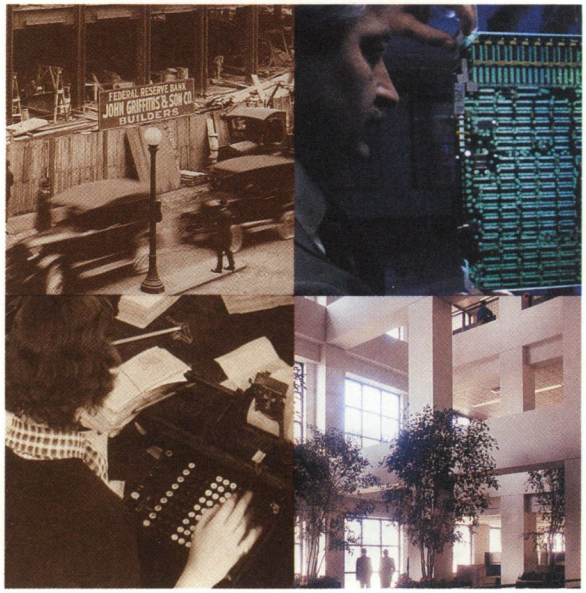
ANNUAL REPORT

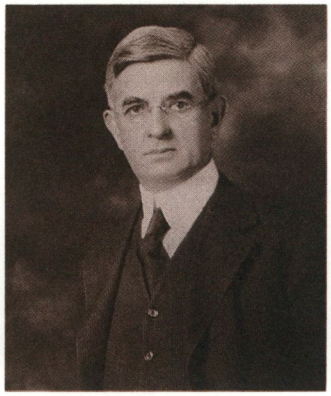
1988



FEDERAL RESERVE BANK OF CHICAGO

CONTENTS

The Federal Reserve Bank of Chicago, as part of the nation's central banking system, serves the Seventh District which includes major portions of Illinois, Indiana, Michigan, and Wisconsin plus all of Iowa. Its role is to foster a healthy financial system and economy by participating in the formulation and conduct of the nation's monetary policy, supervising banks and bank holding companies, and providing banking services to depository institutions and the U.S. government.



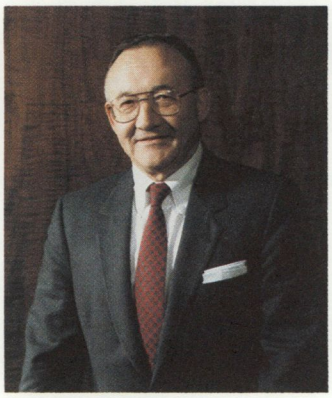
". . . The Federal Reserve Act is the bulwark and safeguard of our banking resources, just as our Federal Constitution was framed to protect the rights, liberties and opportunities of the people of the Nation as a whole."

GOVERNOR JAMES B. MCDOUGAL,
First Chief Executive Officer,
Federal Reserve Bank of Chicago,
May 1919

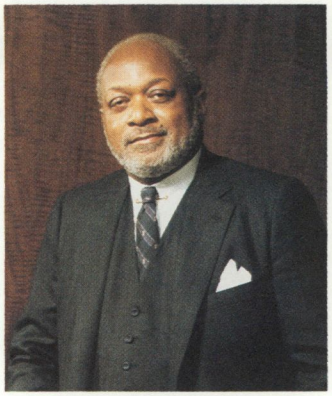
MESSAGE FROM MANAGEMENT

Seventy-five years have passed since President Woodrow Wilson signed the Federal Reserve Act, launching the nation's third, and certainly most successful, experiment in central banking. Such a milestone provides a natural temptation to look back, so in this spirit, our 1988 Annual Report includes a retrospective that we hope you will find of interest.

The story it tells is actually rather exciting—an excitement stirred not so much by the drama of past events as by what it suggests about the future. Reviewing the three quarters of a century of the Bank's history reveals certain very distinct and



CHAIRMAN ROBERT J. DAY



DEPUTY CHAIRMAN MARCUS ALEXIS

very positive themes. The ups and downs of our nation's economy are clear during that period, but through them, the steady progress in our economic and financial system is evident. Just as clearly, an unmistakable theme of commitment emerges from the Bank's story—a dedication to public service and a desire to play a vital role in the economic life of the region and nation. Most of all, our look back suggests that these themes of the last 75 years, so clearly echoed by the developments of 1988, will continue to set a very positive tone for the period ahead.

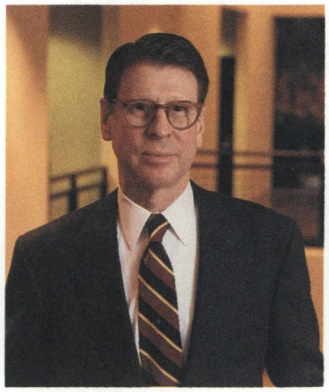
The state of the economy certainly provides cause for confidence in the future. Overall, 1988 was a very good year, adding to the achievements of what was already the longest peacetime expansion in our nation's history. With the Gross National Product approaching the $5 trillion level, industrial production continued to advance at a healthy pace—a particularly good sign for those of us in the Midwest. Most rewarding of all was the employment story—over 16 million new jobs created during this expansion—and all indications point toward further growth.

With continued, albeit more moderate, expansion anticipated for 1989, the most significant risk relates to inflation. While we can be pleased about our recent price experience compared to a decade ago, a worrisome pattern of successively higher inflation rates is evident over the last few years. However, the lessons of the late 1970s and early 1980s are not forgotten within the Federal Reserve. And motivated by the particularly harsh consequences of those experiences for the Midwest, the Chicago Reserve Bank has, through our recent economic research initiatives, gained an even better understanding of the processes that shape our region and affect our monetary policy actions. So while the monetary policy challenge looms large, we can be reassured by the Federal Reserve's continuing commitment to price stability and our own Bank's ability to participate in the development of policy in pursuit of that end.

Similarly, the outlook for the financial system and the Chicago Reserve Bank's role within it is very positive. Despite continued turbulence, particularly in the thrift industry, the financial system remains resilient, and banking conditions in 1988 followed the positive trends of the past few years. And important accomplishments by this Bank during 1988 should help foster the safety and soundness of the financial system into the future.

Like its counterparts within the Federal Reserve System, the Bank in 1988 further upgraded its monitoring techniques and abilities in line with a rapidly changing and increasingly complex financial environment. And taking a broader view of the responses required by a changing environment, the Bank in 1988 developed a comprehensive proposal, discussed further in the next section of this report, for the restructuring of the regulatory system.

The Bank also contributed to the smooth operation of the financial system as a provider of services to depository institutions, the government, and the public. The Bank successfully met the enormous challenges of implementing the Expedited Funds Act during 1988. At the same time, we further improved the quality of our service offerings and the efficiency, reliability, and security of our operations, again exceeding our expense containment, cost recovery, and other financial goals.



PRESIDENT SILAS KEEHN

". . . an unmistakable theme of commitment emerges from the Bank's story—a dedication to public service and a desire to play a vital role in the economic life of the region and nation."

The accomplishments of the past year are a tribute to the tireless efforts of our employees, the leadership of our officers, and the wise counsel of our directors. In the tradition of all their predecessors of the past 75 years, the dedication and commitment put forth by these individuals today sets the standard for the Federal Reserve Bank of Chicago tomorrow.

ROBERT J. DAY
CHAIRMAN

MARCUS ALEXIS
DEPUTY CHAIRMAN

SILAS KEEHN
PRESIDENT

Shaping the future with a new regulatory plan

While banking conditions improved in the District during 1988, it remained clear that fundamental changes in the nation's system of financial regulation are called for. To this end, staff from various areas of the Bank, including Economic Research, Supervision and Regulation, and Legal, joined forces to develop a comprehensive proposal for financial restructuring.

The shortcomings of a structure designed in the 1930s were reflected in the current problems of the financial services industry—excessive risk-taking, high rates of failure among both thrifts and banks, and the declining profitability of traditional banking services which encouraged banks to seek entry to new activities. Within this environment, bankers have been pushing to eliminate the barriers between banking and the rest of the financial services industry while regulators have become increasingly concerned that adequate protections be put in place to assure the stability of the banking system.

The challenge taken on by the Chicago Reserve Bank was to develop a plan that would accomplish both goals—that would permit banking organizations to take full advantage of broader powers without threatening the solvency of the deposit insurance funds or the stability of the banking system. The plan that emerged contained three essential elements:

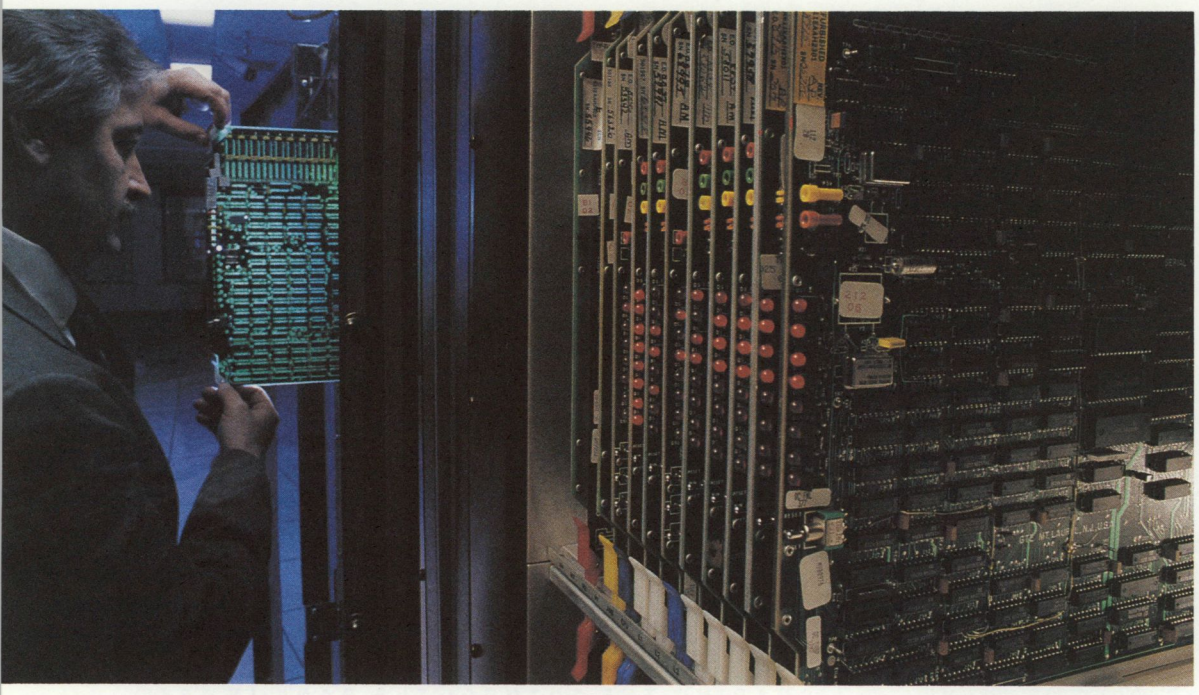
- Creating a corporate structure that would protect the banking subsidiaries of diversified bank holding companies;
- Limiting the protections of the bank safety net to depository institutions; and
- Establishing a buffer between bank equity and deposits in the form of subordinated debt, so as to foster market discipline and facilitate timely closure of insolvent institutions.

The first element of the plan focuses on insulating banks from the risks associated with broader powers. Bank holding companies would be free to pursue a broad array of financial activities, but only through nonbank subsidiaries, while banks would be limited to traditional lending and deposit functions.

Effective "firewalls," with meaningful penalties for violating them, are essential elements of the proposed corporate

SHAPING THE FUTURE: THE BANK IN 1988

In this the 75th anniversary year of the Federal Reserve, the Chicago Reserve Bank is pausing only momentarily to examine its origins and development, not dwelling on past accomplishments. In fact, 1988 has been a forward-looking year, a time for innovation and change designed to shape the future of the financial system. We highlight a few of those innovations here.



The Seventh District Network, designed to meet the communications needs of the Bank and its customers well into the future, was completed in 1988.

structure. These firewalls would take the form of requiring separate directors and officers for the bank and nonbanking subsidiaries, limiting inter-affiliate transactions, and providing assurances that the bank can operate on a stand-alone basis without support from other subsidiaries.

The separation of the banking and nonbanking functions of the holding company is important to the operation of the regulatory safety net. This net includes access to the discount window, the payment system—particularly electronic transfers of large dollar payments through FedWire—and deposit insurance. With firewalls around the bank, regulators could ensure that the availability of the discount window and the FedWire network does not spread to the nonbanking, unsupervised subsidiaries of the holding company.

The plan calls for deposit insurance, an important element of the safety net, to be substantially modified to provide market discipline and proper incentives for banks. Rather than charging banks a flat-rate premium while extending protection to uninsured depositors, the plan calls for risk-based insurance premiums.

Even with this change, the Chicago Reserve Bank proposal calls for further market discipline to be provided by requiring banks to issue a special form of subordinated debt. In the case of a failing institution, equity capital would be extinguished as the bank's losses increased, but the subordinated debt, acting as a buffer between stockholders and depositors, would provide continued protection for depositors and the publicly underwritten insurance fund while bank reorganization and recapitalization plans were being developed.

While not fail-safe, the Chicago plan seeks to avoid the types of deposit runs and traumatic closings or regulatory rescues that the financial industry has been experiencing. At the same time, it puts more of the cost of insolvency in the private sector, where it belongs. Hopefully, the plan will serve as a springboard for meaningful debate and action on regulatory reform.

Shaping the future through Expedited Funds Availability

Among changes in the Bank's operations areas during 1988, the one receiving the most widespread public attention was the implementation of the Expedited Funds Availability Act (EFA). Passed by Congress in 1987, the Act was designed to ensure the prompt availability of funds to bank customers and to expedite the return of checks.

To fully implement EFA by September 1988 required enormous efforts on the part of the Federal Reserve Banks and depository institutions alike. To assist institutions to prepare for the impending changes, the Chicago Reserve Bank mounted an extensive educational campaign. Two series of seminars were conducted across the District, reaching more than 8,000 individuals at 85 different sessions. And as the Bank reached out, it also

focused on the internal operational changes necessary to handle the anticipated return item volume increases while meeting much earlier processing deadlines.

As expected, the increase in return item volumes was dramatic for the Chicago Reserve Bank as well as for the Federal Reserve System. In the Seventh District, return volume in the fourth quarter of 1988 increased by 36 percent compared to the fourth quarter of 1987. With the initial challenge met, the Bank turned toward the refinements that will be needed to meet additional EFA requirements taking effect in 1990.

Shaping the future through new electronic networks

Another important innovation in 1988 was the completion of the Seventh District Network, following more than four years of planning and development. The network is a general purpose data communications facility for transmitting information between Federal Reserve offices within the Seventh District and the customers of each office. Rather than an addition to previously existing systems, it is a completely new network tailored to meet the business needs of the various offices of the Chicago Reserve Bank and their customers well into the next decade in a cost-effective manner.

Another state-of-the-art innovation of 1988 was the completion of the Dial-PC connection. In 1988 nearly 600 institutions in the Seventh District converted their existing computer terminal connections to the Federal Reserve's network. These new connections are designed to carry Federal Reserve services in support of the payments system, and to disseminate information between District financial institutions and their local Federal Reserve Bank offices.

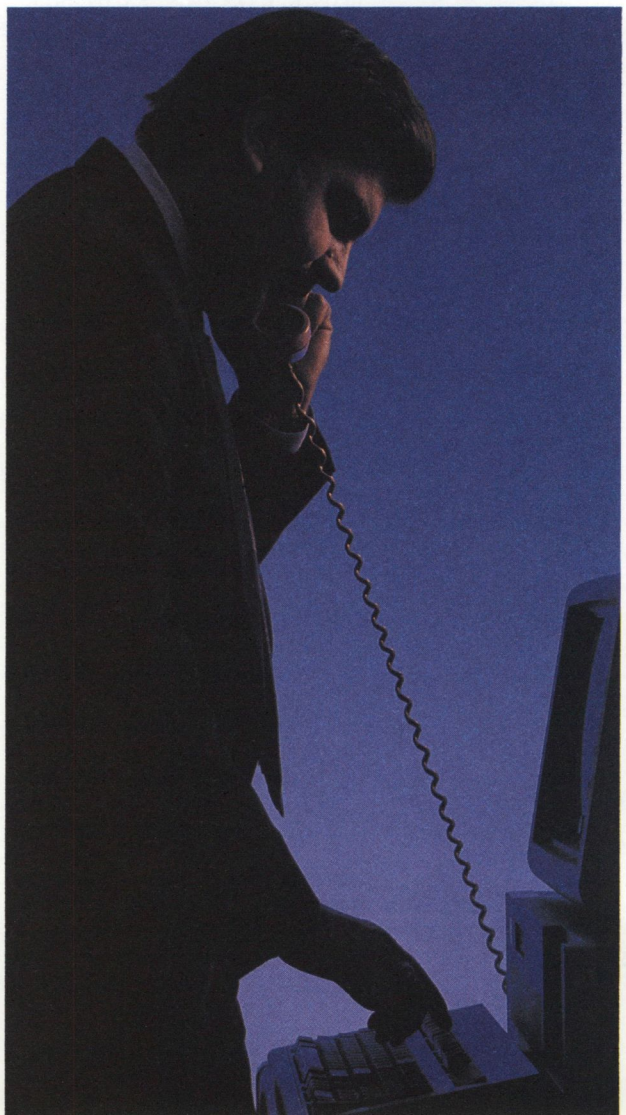
Employing personal computers and software developed by the Federal Reserve, the new system is more flexible and more efficient than its predecessors and has greater capacity. Dial-PC connections are already providing institutions with funds transfers, check return notifications, Enhanced Money Position, ACH database returns, and Treasury tax and loan call notices, with other services to be added in 1989.

Shaping the future with a "new" building

Certainly the most visible changes at the Bank during 1988 related to the complete renovation of its headquarters, meant to create a facility that will serve the Bank's needs well into the next century.

The renovation project, now in its final stages, has essentially given the Bank a new building. A 1922 structure has been totally transformed into a modern, efficient, and pleasant work environment complete with new computer-controlled heating, ventilating, and air-conditioning facilities. The redesign of the building provides for more efficient work flows and movement of people—improvements that are most obvious in the operations areas such as check processing.

Moved to its new facilities in March 1988, the check department has been redesigned to accommodate the increased check volumes handled by the Bank. Check receiving, the reader/sorter



Dial-PCs that now connect customers to the Bank provide the vital link for expanding service in the future.

machines, and return items have all been located to accommodate the work flow for fast, efficient handling of all items.

Other innovative aspects of the building's redesign include bright, open work spaces surrounding internal atriums, and floor layouts designed to bring the outside light into the Bank. Work stations have been designed to accommodate computers and other equipment that help people be more efficient.

While these building changes enhance efficiency and enable the Bank's employees to better serve customers, other innovations reflect the Bank's commitment to public access. Most notable is the first floor Visitors Center that will serve to enhance the Bank's interaction with the community. The Center consists of a 65-seat auditorium and an exhibit that highlights the role of the Bank and its importance in the economic life of the Seventh District.

As a result of all its efforts in 1988, the Bank should be poised to effectively play that role well into the future.

VOLUME OF OPERATIONS

	DOLLAR AMOUNT		VOLUME	
	1988	1987	1988	1987
CHECK AND ELECTRONIC PAYMENTS				
Checks, NOWs, and share drafts processed	1.1 trillion	1.1 trillion	2.0 billion	2.0 billion
Fine sort and packaged checks handled	198.7 billion	150.6 billion	406.4 million	327.9 million
U.S. government checks processed	52.1 billion	52.4 billion	59.3 million	59.8 million
Automated clearinghouse (ACH) items processed	969.6 billion	750.9 billion	211.1 million	146.1 million
Transfers of funds	25.7 trillion	23.0 trillion	10.4 million	9.7 million
CASH OPERATIONS				
Currency received and counted	21.8 billion	21.0 billion	1.9 billion	1.9 billion
Unfit currency withdrawn	4.4 billion	3.2 billion	513.8 million	476.6 million
Coin received and processed	589.0 million	540.1 million	4.3 billion	4.0 billion
SECURITIES SERVICES FOR DEPOSITORY INSTITUTIONS				
Safekeeping balance December 31:				
Definitive securities	14.1 billion	13.6 billion	—	—
Book entry securities	215.6 billion	192.7 billion	—	—
Purchase and sale	3.6 billion	3.9 billion	22.2 thousand	19.8 thousand
Collection of securities and other noncash items	1.2 billion	1.4 billion	251.1 thousand	276.5 thousand
LOANS TO DEPOSITORY INSTITUTIONS				
Total loans made	4.6 billion	4.7 billion	2,195	2,353
SERVICES TO U.S. TREASURY AND GOVERNMENT AGENCIES				
Issues, redemptions and exchanges:				
U.S. savings bonds	4.2 billion	3.6 billion	26.5 million	30.3 million
Definitive government securities	1.2 billion	1.7 billion	100.5 thousand	144.1 thousand
Book entry government securities	2.7 trillion	2.4 trillion	1.2 million	1.2 million
Government coupons paid	140.8 million	172.1 million	137.0 thousand	195.0 thousand
Federal tax deposits processed	107.4 billion	98.3 billion	863.5 thousand	877.7 thousand
Food stamps received and processed	1.4 billion	1.4 billion	312.4 million	295.0 million


RESERVE BANK
FFITHS & SON CO.
LDERS

"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."

–Federal Reserve Act, December 23, 1913

Taking its cue from its always-confident president, Theodore Roosevelt, the United States anticipated another prosperous year in 1907. In the past decade, the country had begun to build the Panama Canal, defeated former world-power Spain in a war, and was on its way to becoming the leading industrial nation in the world. The future looked bright.

Optimism was also strong in the Midwest. The *Chicago Tribune* noted that 1906 had been the most prosperous year ever for the city, and confidently predicted that the volume of business would be even greater in 1907. [18]*

For most of 1907, these predictions generally held true. By March, however, bankers were already concerned about their inability to meet the financial demands of the booming economy. James B. Forgan, president of First National Bank of Chicago and later a director of the Chicago Reserve Bank, wrote: "Money is scarce all over...the pressure on us has been so extraordinary...I am in daily terror of something giving way under the strain." [18]

Eventually, something did give way. In October, the scarcity of money led to a panic in New York that spread through the rest of the country. Chicago's banks followed the lead of New York and suspended currency payments. As might be expected, depositors were angry. One irate letter to Forgan, signed only "A Small Depositor," stated that "unless the banks shall resume currency payments... so as to restore some feeling of confidence among the masses, there are apt to be such scenes of riot and bloodshed in this city as Chicago has not seen..." [18] Throughout the country the banking system ground to a halt. In five states, banks were closed by order of the governor. Every state in the country was forced to issue some form of emergency currency. [18] Eventually, the panic was halted through the efforts of J.P. Morgan and other leading bankers, but the damage had been done.

The panic, which occurred in the midst of general prosperity, illustrated one indisputable fact—the U.S. banking system was not meeting the financial needs of the country. The system's shortcomings included two basic problems—an inelastic currency and immobile reserves. The supply of national bank note currency, which was tied to government bonds, changed in response to the bond market rather than the needs of American business. In addition, bank reserves were scattered throughout the country—a total of 50 different cities served as reserve depositories. Thus, even when reserves were sufficient, it was difficult to move the money where it was most needed.

It was generally agreed that some form of central bank was needed. The controversy centered on how to structure the central bank. On one side the Progressive movement, which generally represented small businesses and the small town and farm population, was suspicious of concentrating too much power in the hands of bankers. Conservatives, representing the most powerful business and banking groups of the large Eastern cities, insisted on the need to avoid political interference in central banking.

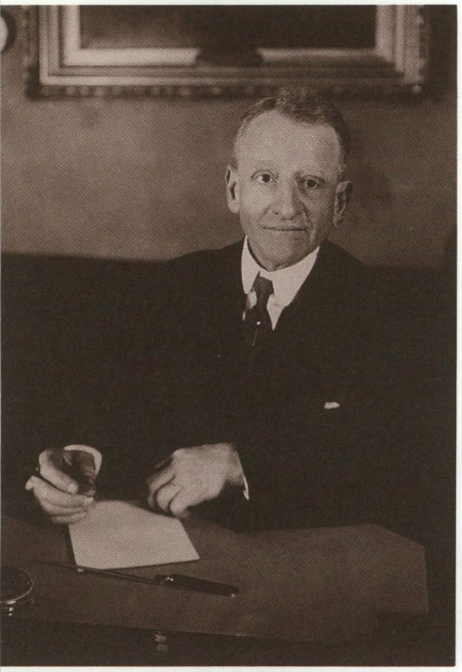
The first attempt to solve the problem, the Aldrich Plan, was rejected as too conservative. In 1912, Representative Carter Glass of Virginia initiated a second attempt. Working with Glass was H. Parker Willis, a former professor of economics who served as advisor to the House Committee on Banking and Finance. Glass and Willis worked through most of the year and finished a draft just prior to Woodrow Wilson's election as president in November 1912.

A 1906 run on the Milwaukee Avenue State Bank in Chicago occurred when the bank's president fled to Tangiers after losing depositors' money in risky real estate ventures.
Chicago Historical Society (DN 3927)

In the view of progressives, bankers refused to submit to the "bridle" of government control.
"Some Horses Just Fear a Bridle," by J. Darling, Des Moines Register

*Numbers in brackets refer to sources listed in the bibliography that appears on the inside back cover.

To their plan for a system of regional Reserve Banks, Wilson added an important balancing feature—a central board to coordinate the work of the regional banks. The central board, a public agency, would be appointed by the President and approved by the Senate. To supply the elastic currency required by the economy, the central bank would rediscount bank notes and issue a new national currency, Federal Reserve notes. National banks would be required to become members of the Federal Reserve System, while banks chartered by the state would have the option of not joining.



After months of effort and compromising, the bill was passed by Congress on December 23, 1913. The U.S. had a central bank.

"The future is clear and bright with promise of the best things...We now know the port for which we are bound."

–Woodrow Wilson, on the opening of the Federal Reserve Banks

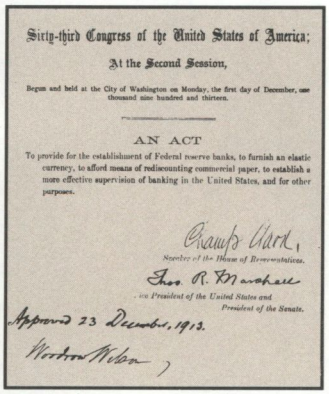
Although many bankers had opposed the Federal Reserve Act, especially those in Chicago, the majority were resigned if not enthused about the new legislation. One prominent merchant in Chicago wrote, "During the past week, I have heard a number of bankers and business men discuss [the Act], and there seemed to be a unanimity of opinion that, while the act is not an ideal one, it is a great improvement upon the plan under which we are now working...it should be accepted in the hope...that the wrinkles, as they manifest themselves, will be ironed out by future legislation." [18]

Perhaps one of the reasons the Act was palatable for many was its vagueness on certain key issues. Regarding the number of Reserve Banks, the Act called for no fewer than eight and no more than twelve. The question of each Bank's territory was left unanswered. An Organization Committee consisting of the comptroller of the currency, the secretary of agriculture, and the secretary of the treasury was given the unenviable task of resolving these issues.

When the Committee visited Chicago as part of a nationwide tour, there was little doubt that the city would have a Reserve Bank. Instead the debate centered on the territory to be included in the Chicago Bank's district. Typically the Committee had encountered fairly partisan testimony; Chicago was no exception. Presenting the case for Chicago bankers, J.B. Forgan advocated putting all of Illinois, Indiana, Iowa, Michigan, and Wisconsin and even parts of Nebraska, Minnesota, and Ohio in the Chicago Reserve district. Secretary of the Treasury William G. McAdoo, who earlier had listened to New York lay claim to nearly half of the country's banking resources, noted that there would be very little left for the other Fed Banks if New York and Chicago were accommodated. Forgan, never shy in presenting his view, responded, "That is the difficult problem that you gentlemen have got to solve...From one point of view, you know, if we are just going to look upon it territorially we are really the center and New York is on the circumference of the circle." [18]

After the Organization Committee left Chicago, interest in the new central banking system quickly waned. There was little excitement in the Midwest when it was announced that there would be twelve districts and that the Chicago Bank's territory would consist of northern Illinois and Indiana, southern Wisconsin, all of Iowa

Carter Glass
Historical Pictures Service, Chicago



Sixty-third Congress of the United States of America;

At the Second Session,

Begun and held at the City of Washington on Monday, the first day of December, one thousand nine hundred and thirteen.

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.

Champ Clark,
Speaker of the House of Representatives.

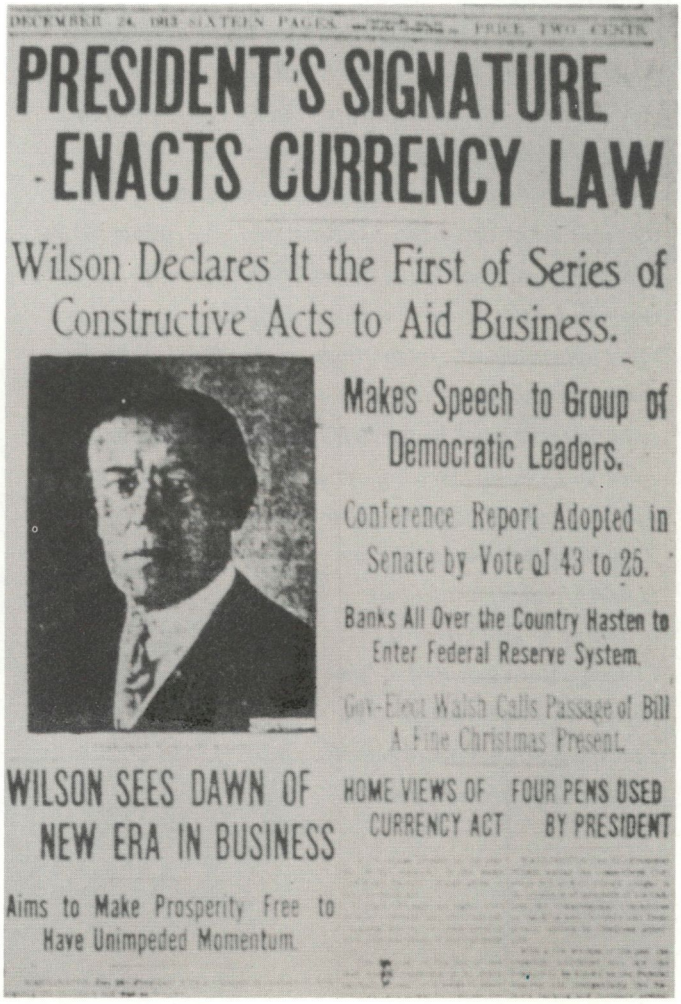
Thos. R. Marshall
Vice President of the United States and President of the Senate.

Approved 23 December, 1913.

Woodrow Wilson

President Woodrow Wilson's strong support of the Federal Reserve Act helped to overcome objections from both progressives and conservatives.

H. Parker Willis
Historical Pictures Service, Chicago



DECEMBER 24, 1913 SIXTEEN PAGES PRICE TWO CENTS

PRESIDENT'S SIGNATURE ENACTS CURRENCY LAW

Wilson Declares It the First of Series of Constructive Acts to Aid Business.

Makes Speech to Group of Democratic Leaders.

Conference Report Adopted in Senate by Vote of 43 to 25.

Banks All Over the Country Hasten to Enter Federal Reserve System.

Gov-Elect Walsh Calls Passage of Bill A Fine Christmas Present.

WILSON SEES DAWN OF NEW ERA IN BUSINESS

Aims to Make Prosperity Free to Have Unimpeded Momentum.

HOME VIEWS OF CURRENCY ACT

FOUR PENS USED BY PRESIDENT

President Woodrow Wilson signed the Federal Reserve Act on December 23, 1913, just a few hours after it was approved by the Senate.

and the lower peninsula of Michigan. This decision was supported by a poll in which 714 of the 861 banks in that area chose Chicago as its preferred Reserve Bank location. [16] (The only change in the Bank's district since then occurred when northern Wisconsin banks assigned to the Minneapolis Reserve Bank's territory petitioned to be moved to the Chicago district. The Federal Reserve Board allowed banks in 25 Wisconsin counties to shift to the Seventh District in October 1916.)

The organization of the Chicago Reserve Bank proceeded quickly. Soon after the Organization Committee announced its decision, representatives from five Seventh District banks gathered on May 18, 1914 for the formal signing of the Chicago Fed's organization certificate. As specified in the Federal Reserve Act, six of the Bank's nine directors were elected by member banks. The Federal Reserve Board appointed the other three directors, including C.H. Bosworth who served as chairman of the board and federal reserve agent. The appointment was in keeping with the Federal Reserve Act, which specified two positions—governor, and chairman of the board and federal reserve agent. The framers of the Act seem to have intended that the federal reserve agent serve as the Bank's chief executive officer. A majority of the Bank's directors, however, decided that the governor, who would be their own appointee, should assume that role. The federal reserve agent, in the words of one of the directors, was to "have a minor position." [18]

Having decided on this matter, the directors selected James B. McDougal as the Bank's first governor. (In 1935, the title of governor was changed to president.) The choice "was greeted with universal approval" according to a local news report. [18] Having served as head examiner for the Chicago Clearing House for the past eight years, McDougal was well-acquainted with Chicago bankers. He had also spent fourteen years with a commercial bank in Peoria and worked as an examiner with the Comptroller of the Currency.

The Federal Reserve Bank of Chicago, along with the other eleven Fed Banks, opened for business on Monday, November 16, 1914. One of the Bank's original employees later described the scene: "After less then three weeks of preparation...some place to hang your hat and coat—a few desks and stools...the message from Washington [arrived], 'All ready—get set' and Governor McDougal's happy smile and hearty handshake and then, 'We're off'—the roar of flashlights to the click of the newspaper cameras...." [7] While the Bank and its 41 employees were ready to carry out their appointed duties, exactly what these duties would be was to some extent unclear. The Bank's first annual report noted optimistically, if somewhat uncertainly, that the "various departments are now fully organized and equipped and in readiness for increased activities, whatever they may be."■

Among the many hopefuls who applied to work at the Chicago Fed in 1914 was a man with a recommendation from William Jennings Bryan, the Democratic Secretary of State and leader of the Progressive Movement. The Bank declined to hire the man, a decision that moved the Democratic senator from Illinois, J. Hamilton Frank, to complain to newspaper reporters that the Chicago Reserve Bank's 41 employees were all Republicans. Bank officials replied that while they doubted that all employees were Republicans, they could not give a definite response because no one had been questioned about political affiliation.

The allegation touched off a minor political firestorm that resulted in newspaper headlines and even debates in the U.S. Congress. Eventually interest in the matter waned as the involved parties agreed that political affiliations should not affect appointments. Interestingly, in an effort to settle the controversy, the Bank's chairman conducted a poll of the 26 employees who voted in the 1912 presidential election: 12 voted for Democrat Woodrow Wilson, 12 supported "Bull Moose" candidate Theodore Roosevelt, and 2 voted for Republican William Howard Taft. The incident, according to The Growth of Chicago Banks, *helped to "emphasize the determination of the Chicago Reserve Bank to keep its skirts entirely free from politics."*


No. 7

Treasury Department
Office of Comptroller of the Currency
Washington, D.C.

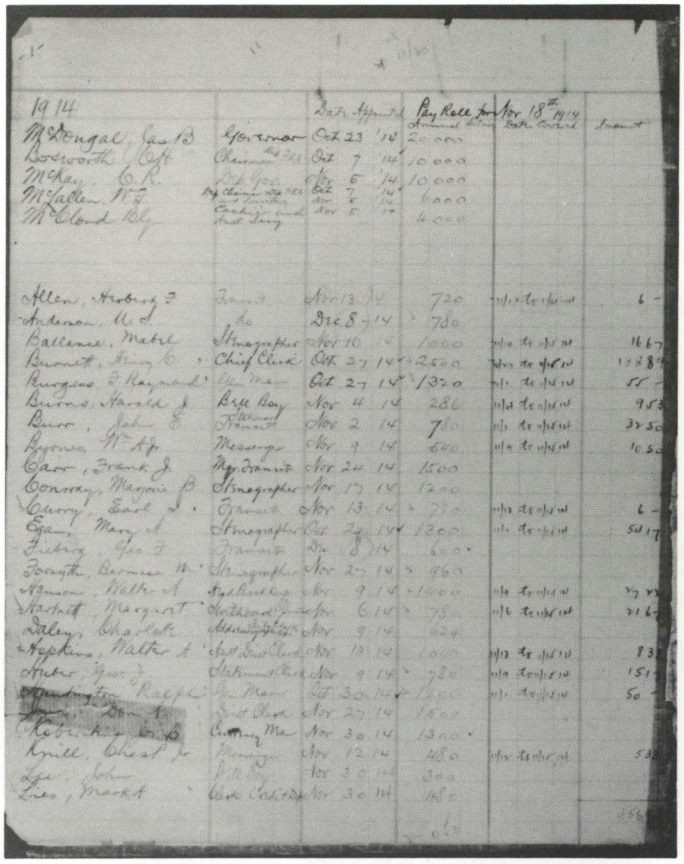
By virtue of the power vested in me by Section 4 of the Act of Congress approved December 23, 1913 and known as the
Federal Reserve Act,
I, John Skelton Williams, Comptroller of the Currency,
certify that the necessary provisions of law having been complied with, the
Federal Reserve Bank of Chicago,
located in the City of Chicago, State of Illinois, and in District No. 7,
as defined by the Reserve Bank Organization Committee,
is authorized to commence business and to exercise all powers granted to it by law.

In testimony whereof, witness my hand and seal of office this 7th day of November, 1914.

John Skelton Williams
Comptroller of the Currency

Federal Reserve Board, 1914. Seated left to right: C.S. Hamlin, governor; W.G. McAdoo, secretary of the treasury and chairman; F.A. Delano, vice governor. Standing left to right: P.M. Warburg; J.S. Williams, comptroller of the currency; W.P. Harding; and A.C. Miller.

The Bank's first deputy governor, Charles R. McKay, played a key role in developing the Federal Reserve System's nationwide clearing system. The system, he wrote in 1920, is "a modern piece of banking machinery made in America...especially designed to redeem expeditiously the tremendous volume of checks...."



The annual salaries of the Bank's 41 original employees ranged from $20,000 for Governor James McDougal to $300 for bell boy John Lee.

1915-1939

"The development of the check-collection function has proved the most difficult problem confronting the management of the bank."

–1916 Annual Report, Federal Reserve Bank of Chicago

Following the relative excitement of the opening, the Chicago Fed spent its first few months feeling its way in its new role as a Reserve Bank. As specified in the Federal Reserve Act, the Bank issued Federal Reserve currency and rediscounted some bank notes. In general, however, the Bank was calm. Years later, the Bank's only switchboard operator reminisced of bringing sewing to work because there were only six calls a day. [7] A more formal indication of the Bank's relatively calm operations is contained in the 1915 annual report, which notes that "Notwithstanding the relatively small demands...for either credit or currency...the system fully demonstrated its worth, inspiring confidence and banishing fear, and forestalling panic from the mere fact of its existence."

With its currency and rediscounting functions at a low ebb, the Bank focused on developing a check collection system--one of the responsibilities that fell under the vague category of "other purposes" in the preamble of the Federal Reserve Act. Throughout its history the U.S. banking system had been hampered by an inefficient collection process. Although local clearinghouses operated efficiently in some large cities, much of the country was saddled with exchange fees and indirect routing designed to avoid these charges. Recognizing these flaws, the Federal Reserve Act gave the Fed authority to provide check clearing services. A check collection plan faced one basic problem: many bankers had come to depend on exchange fees as a regular source of income and were reluctant to make changes.

While the Chicago Fed offered limited clearing services on the first day it opened, it concentrated on developing an intra-district collection system in which checks would be accepted without an exchange fee, also known as accepting at par. In April 1915, member banks were notified that a voluntary collection system would go into effect on June 10th. Banks were free to join the system or ignore it as they chose. In general, they chose to ignore it. During the one and only year of the voluntary operation, only 114 of the District's 980 member banks participated. The voluntary system had, in the words of the Bank's 1916 annual report, "proved unsatisfactory."

Having tried a voluntary approach, the Federal Reserve instituted a compulsory system for member banks in July 1916. All member banks were required to accept at par a check drawn upon themselves and presented for payment by a Fed Bank. To discourage exchange fees, the Fed Banks distributed a list of banks that accepted at par.

The effect of the new system was immediate. The Bank's check volumes rose from 8,900 items a month under the old system to 18,000 checks a day through the rest of 1916. [16] The trend toward par collection received a boost in 1918 when the Fed Banks began offering collection services free of charge to all banks on the "par list." By 1920, the Bank's original seven-man Check Department had 350 employees processing 60 million checks annually. The number of District banks collecting at par grew quickly. Over 3,300 banks appeared on the par list in January 1918. Four years later, every bank in the District accepted at par. Nationwide, all but 1,755 of the country's 30,523 banks accepted at par in 1921. [17]

Through the rest of the 1920s opposition began to build as opposing bankers fought par collection through the courts or state legislatures. In some cases, banks took more direct methods such as stamping on blank checks, "Not valid if presented through Federal Reserve." [25] This resistance was mainly centered

One of the first tasks facing the Chicago Reserve Bank was coordinating World War I bond drives. The Bank organized the District's Liberty Loan sales organization which included approximately 300,000 volunteer workers. The Illinois Division of the Liberty Loan Volunteers in 1917 is pictured above.

in the Southern and Western sections of the country. In the Seventh District, bankers generally accepted the plan, with some misgivings, as being good for business. [16] In spite of some lingering resistance, par collection was established and eventually became standard practice.

"Winning the war is the thing uppermost in our minds...the Seventh District will be found ready, as it has been, to sacrifice to the utmost of its abundance and of its best blood."

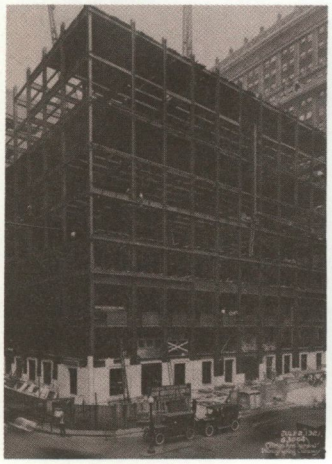
–1917 Annual Report, Federal Reserve Bank of Chicago

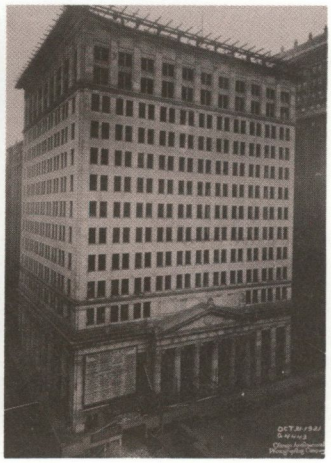
Having opened just three months after the outbreak of the war in Europe, the Chicago Fed did not have to wait long to assume its second major responsibility. When the U.S. declared war on Germany in April 1917, the Reserve Banks were authorized to handle the financial operations associated with the war, including the sale of Liberty bonds. The nationwide goal of the first Liberty Loan campaign was to sell $2 billion in bonds—a staggering amount of money at the time. According to *Financing an Empire—Banking in Illinois,* even the largest bankers were "stunned" and at first thought that "such a stupendous amount could never be raised."

Nevertheless, the campaign began in earnest in the Seventh District. Additional quarters were rented by the Bank, committees of leading citizens were appointed, and publicity efforts began. The initial response, however, was not promising. To the people in the District the war must have seemed a distant and not very real event. Noting the lack of interest, the *Chicago Tribune* fretted that the American people must be made to realize "that they are not in normal conditions, but are going into the ordeal by fire." The newspaper added that Americans "must meet the test with their money and with their bodies. The nation wants, now, the people's money. It is a test of patriotism." Efforts intensified: a great parade of bond salesmen marched through the city and the "Four Minute Men"—a small army of speakers who gave short talks on bonds—were dispatched wherever an audience could be gathered.

On June 10th, with only five days left in the campaign, the District had subscribed for slightly more than half of its $298 million quota. In response, the city of Chicago ordered that churches and schools ring their bells every day to remind citizens of the cause. Finally, in the last few days of the campaign, enthusiasm began to build and subscriptions rapidly increased. By June 15th, the aggregate sales were $357 million and the District had easily exceeded its quota. Four more Liberty Loan campaigns were undertaken in the next two years. Bond sales for the District totalled $3.29 billion—the largest subscription per person in any of the Federal Reserve Districts. The Illinois portion of the District alone accounted for $1.45 billion, more than the country's total bonded debt in 1916. [17]

As its responsibilities increased, the Chicago Reserve Bank rapidly outgrew its original rented quarters in the Rector Building. The Bank began to construct a new building in 1918, a project that was completed four years later at a cost of $7 million. The Detroit Branch underwent a similar process after it opened in 1918. Branch employees moved from rented quarters to a new three-story building in 1927.





For the Chicago Fed, which was responsible for organizing the bond effort as well as processing the securities, the immediate impact of the Liberty Loan campaigns was tremendous. The war effort had a more important long-term effect, however. In the spring of 1915, the Fed Banks were, in the blunt opinion of J.B. Forgan, "not of much benefit anywhere." [18] The Liberty Loan campaign accelerated the Fed's integration into the banking system, and by October 1917 Forgan wrote, "You must get in the habit of believing and acting on the fact that your bank is part and parcel of the Federal Reserve System...The stronger the Federal Reserve banks are, the stronger will the [banking] system be." [18]

"The building is simple in outline and severely plain in its general effect, the aim of the design being to produce an impression of dignity and strength."

–1920 Annual Report,
Federal Reserve Bank of Chicago

Due to the sudden growth of its burgeoning check and fiscal agent duties, the Bank quickly found itself outgrowing its quarters. Initially the Bank opened for business with 41 employees on two floors of the Rector Building at Clark and Monroe. By 1919, the Bank's 1,200 employees were scattered throughout the Loop. In some cases stenographers had to cross the street from one building to another and climb three flights of stairs to take dictation. Other problems cropped up: one building was overrun with rats, another had heating deficiencies. Years later, two of the Bank's original employees wrote of trying to keep warm by resorting to the Dickensian solution of wrapping currency sacks around their feet. [7]

It was clear that new quarters were needed. Accordingly, the Chicago Fed purchased a 165 x 160-foot lot on LaSalle Street extending from Quincy Street to Jackson Boulevard. The 1918 annual report noted that the property was not only "the most desirable site" in the city for the Bank's purposes, but was "acquired at an exceedingly low cost, the purchase price being $2,936,149."

Having purchased property, the Bank's directors hired the architectural firm of Graham, Anderson, Probst, and White to design the building. The firm, which later designed the Continental Bank Building across the street from the Chicago Fed, also built such Chicago landmarks as the Wrigley Building, the Civic Opera, and the Merchandise Mart.

Beset by labor and material shortages, the project was delayed for several years. Construction was eventually completed in 1922 at a cost of $7 million. The 1920 annual report depicted the building as "classic in style, fully interpreted to harmonize with modern conditions." The report added that in "line with modern ideas very comprehensive arrangements have been included for the general welfare of the entire working staff. An assembly room, dining rooms, rest rooms...are some of the more important features."

As the Bank began planning a new building in Chicago, there was increasing interest in establishing a Branch in Detroit. Fed member banks in

The Federal Reserve's modern wire transfer system can be traced to 1918 to the leased wire system headquartered at the Chicago Fed. The evolution of the system began in 1915 when the Federal Reserve established the Gold Settlement Fund as part of its nationwide check collection system. Fed Banks made payments to each other through credits and debits on the fund's books as opposed to shipping large amounts of currency or gold. To transfer funds, the Reserve Banks telegraphed the Federal Reserve Board.

With the Gold Settlement Fund in place, the Chicago Fed began to encourage the use of telegraph transfers among bankers through price incentives. At first, the Chicago Fed cut the cost of telegraphic transfers and increased the price of mail transfers. Eventually, the Bank began offering telegraphs at no cost.

As volumes began to rise, the Federal Reserve decided to install a leased wire system rather than send wires over the normal commercial system. The Chicago Fed was given charge of the new system, which connected the Board and all the Federal Reserve Banks. The leased wire system began operations in June 1918 and quickly averaged 20,000 messages a month. Within 30 years, more than 1 million messages annually were sent via the leased wire system.

An early ill-fated venture in show business by the Bank was a 1919 production entitled "A Trip to Jazzland." Described as a "musical mixture of maids, mirth, and melody," the show was staged by the Bank's employee organization, the Federal Reserve Club. Unfortunately, in the view of Governor James McDougal, the musical featured too many maids and not enough melody. The Chicago Evening American *described the scene when a short-skirted chorus line danced on the stage singing "Who Wants a Baby": "Out danced the shapely limbs. Up rose Mr. McDougal. 'Stop!' cried Mr. McDougal. 'Stop that! I won't stand for this sort of costume.' " The number was halted and the chorus line later reappeared in more decorous gingham gowns and sun bonnets. McDougal, concluded the* Evening American, *might be described as the "man who put the reserve into the Federal Reserve Club chorus."*

the lower peninsula of Michigan had to clear checks and obtain rediscounts through the Chicago Bank, a fairly inefficient process given the geography involved. Frustrated by these time delays, Michigan bankers met in Lansing in 1917 in an effort to build enthusiasm for locating a Branch in Detroit. As the second largest industrial area in the Seventh District, Detroit was a logical candidate and the Chicago Fed board of directors voted in November 1917 to establish a Branch.

The Branch opened for business on March 18, 1918. The following year, the Bank's annual report stated that the Branch "justified in every way its creation." As expected, the Branch eliminated a delay of one or two days in check clearing, rediscounting, and other operations. By 1920, the Branch began to exercise all of the functions of a Reserve Bank except for note issuance and a few minor tasks.

"The problem of differentiating between necessary expansion on the one hand and dangerous inflation on the other is yet to be solved."

–1917 Annual Report,
Federal Reserve Bank of Chicago

Having proved its worth in its World War I financing efforts, and with the check collection system well in hand, the Fed began to delve gingerly into the relatively unexplored terrain of monetary policy. Throughout the 1920s, the Federal Reserve moved toward increased centralization and coordination in monetary policy. The concept of 12 regional credit policies based on the needs of each district was slowly replaced by a coordinated policy that balanced the needs of each district.

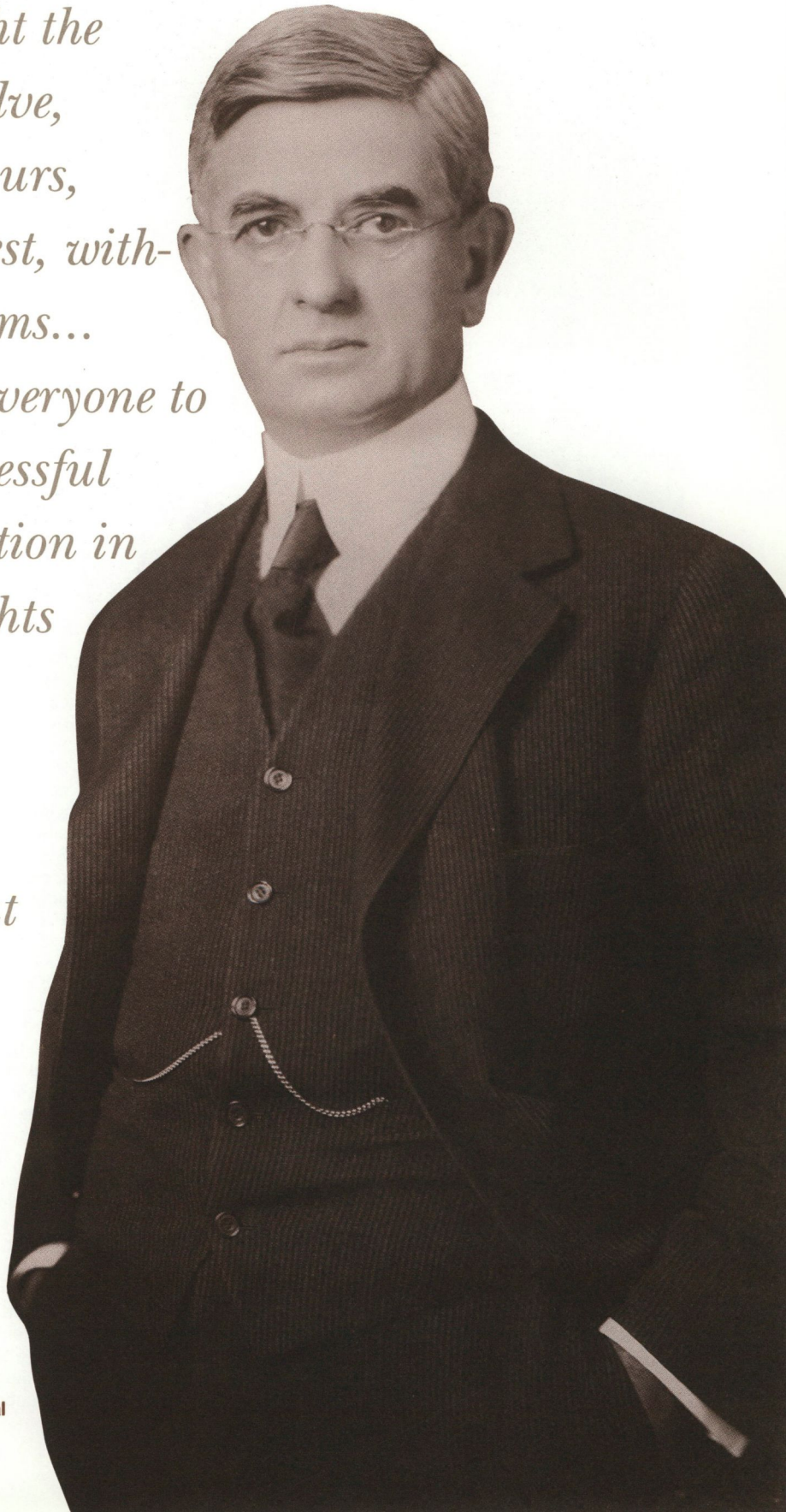
An important first step was in the area of research and statistical analysis. In the early 1900s, due in part to the advent of the federal corporate income tax, statistical information on business trends was becoming increasingly available. The Federal Reserve Board in Washington, D.C. and the Fed Banks began to sort and analyze the data, an effort pioneered by the Chicago Fed. In 1918, the Chicago Reserve Bank established the Statistical and Analytical Department to compile statistical information for the Federal Reserve Board and member banks. The Bank had already begun publishing *Business Conditions,* a monthly review of the Seventh District economy, in October 1917. Over the next few years, the Chicago Fed began collecting a condensed statement of condition from selected member banks and started a "Business Reporting Service" that gathered data from producers and merchants. As the Reserve Banks refined their research capabilities, the Federal Reserve had a prerequisite for a centralized policy—a flow of information from each section of the U.S. to incorporate into an overall policy.

As the Fed Banks increased their research efforts, they became increasingly aware of a potentially powerful new monetary policy tool—open market operations. When the System was created, rediscounting, or making loans to member banks, was the chief means of affecting credit. It was not until 1921, when the Reserve Banks began to buy and sell government securities to build their earnings, that the potential effect of open market operations was fully realized.

In 1923, the Federal Reserve Board established the Federal Open Market Investment Committee comprised of the governors of the Chicago Fed and four other Reserve Banks. Operating under the supervision of the Board, the Committee was instructed to conduct operations "with the primary regard for the accommodation of commerce and business and to the effect of these purchases and sales on the general credit situation."

Even as open market operations became increasingly centralized, the role of the Reserve Banks in setting the discount rate was still unclear. Under the Federal Reserve Act, the Reserve Banks set the regional discount rate subject to the "review and determination" of the Federal Reserve Board. An early controversy

"The boys in the trenches trained and fought for results and got them and covered themselves with glory... But these boys and girls before me—do they know that we know that they fought the good fight too...ten, twelve, fifteen, even eighteen hours, day after day without rest, without bands, without drums... I want them each and everyone to know this, that the successful operation of this institution in the trying days and nights through which we have passed is due entirely to those hearts and heads and hands, that without their wholehearted individual efforts and their teamwork, it would not have been possible to accomplish anything."



James McDougal

Bank Currency Department picnic, 1920

involving the Chicago Reserve Bank highlighted the issue. The incident initially involved Chicago Reserve Bank Governor McDougal and Benjamin Strong, the charismatic head of the New York Reserve Bank, and provided an interesting contrast in styles as well as philosophy. Known as the "Quiet Man of LaSalle Street," McDougal had a reputation for listening a lot and talking very little. Well respected in the financial community, his "integrity and financial sagacity was a byword among Chicago bankers," according to the *Chicago Tribune.* Strong, one of the leading figures in the Federal Reserve System, was described by contemporaries as an outgoing personality who was a charming conversationalist and a man of unusually strong intellect. [2]

In 1927, Strong was leading an effort to reduce the discount rate. Strong's outlook was a global one—he favored an easy money policy to aid the European financial position. McDougal, traditionally a conservative in credit policies, opposed the move as did several other Reserve Banks. Strong wrote to McDougal in August 1927 exhorting the Chicago Bank to join a Systemwide effort to ease credit. McDougal was not persuaded. In a letter to Strong, he wrote "It is understood that the governing factor...is the international situation, and it seems to me that the desired result has already been attained through the reduction in your rate." As far as uniformity among the Reserve Banks was concerned, McDougal wrote "up to the present time we are not convinced as to the necessity of having a uniform rate in all districts."

Strong replied, "My dear Mac: I have read that austere letter of yours...and after finishing it felt as though I were sitting in an unheated church in midwinter, somewhere in Alaska." According to Strong, lowering the discount rate "is neither a New York question nor a Chicago question nor a district question but a national question bearing upon our markets in Europe, consequently an international question."

Still, McDougal and the Bank's board held firm. The discussion erupted into a controversy when the Federal Reserve Board ordered the Bank to reduce its rate on September 6th. The Board's action aroused bitter controversy within the System and a fair amount of publicity outside the System. Two of the strongest dissenters against the Board's action were Carter Glass and H. Parker Willis. Strong himself opposed the move and tried to prevent it. [5] According to the *New York Herald Tribune,* the controversy centered on "the long smouldering question of whether in matters of fundamental policy the several regional reserve banks of the system are to be granted self determination...."

The Chicago Bank complied with the rate reduction, but also announced that it would seek an opinion from the U.S. Attorney General as to the legality of the Board's action. Later, however, the Bank had second thoughts, and the convenient resignation of one of the Board members supporting the forced discount rate reduction helped to ease the controversy. The issue was not resolved, but the trend toward centralization had received additional impetus.

"The year immediately preceding was characterized by an unprecedented orgy of extravagance, a mania for speculation..."

–1920 Annual Report, Federal Reserve Board

As the Federal Reserve refined its monetary policy efforts, the U.S. experienced a giddy period of industrial growth and high employment through most of the 1920s. In keeping with the confidence of the times, many felt that financial panics had become a thing of the past. As late as 1931, the *Encyclopedia of Banking and Finance* stated "this country is now thought to be panic proof." [20] At the same time, many worried about the extremely high levels of speculative spending. In February 1929 the Federal Reserve Board, as part of its unsuccessful campaign to curtail

speculation, decried the "excessive amounts of the country's credit absorbed in speculative security loans." [24]

Soon after that statement the stock market began to sour. The plummeting market shook the confidence of the United States. In Chicago, the glum attitude was reflected on October 22nd as a band marched up LaSalle Street to celebrate the laying of the cornerstone of the new Board of Trade Building. Many listeners, according to the *Chicago Tribune,* thought the band should have played a funeral dirge. [18] On October 29th, the stock market crashed. The Fed responded by easing credit through open market operations and reductions in the discount rate, a policy it continued through the first half of 1931.

Nevertheless, the economic decline continued. By mid-1931, a financial crisis abroad added momentum to the Depression. England abandoned the gold standard in September 1931, a move that shook the international financial community. Fears of a dollar devaluation triggered a flow of gold out of the U.S. The Federal Reserve reacted in traditional central bank fashion by tightening credit, the classic method of slowing the flight of gold.

Contributing to the Fed's decision was a requirement of the Federal Reserve Act that gold or eligible paper provide backing for Federal Reserve currency. With eligible paper scarce, the need for gold as collateral increased. In addition, many simply thought that tighter credit was needed. Many commercial banks, understandably skittish after the events of the past two years, kept excess reserves as a cushion, a move that helped convince the Fed that some tightening was needed. [14] In Chicago, the *Commercial and Financial Chronicle* reported that funds were so plentiful that bankers reversed their earlier pleas for liquidity and were in open revolt against the easy money policies of the Fed. [18]

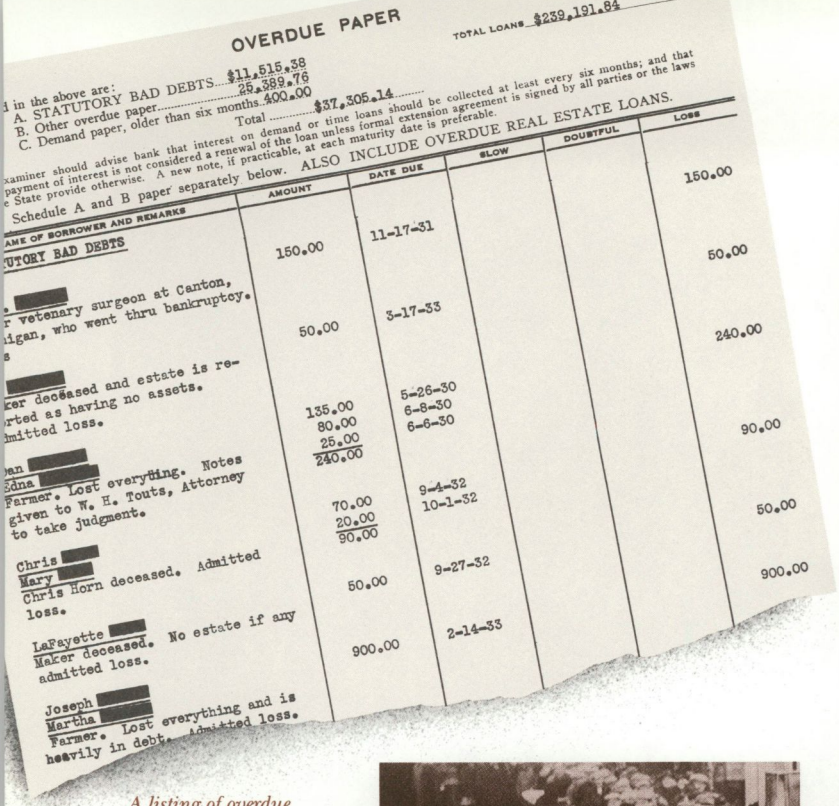
The tightening of credit, however, put increased pressure on the economy. The Depression deepened and unemployment rose to 11 million. The Seventh District reflected the nationwide trend. The Bank's annual report noted that "in 1931, as in the preceding year, the Seventh District shared in the world-wide decline in industrial and business activity." The dropping agricultural prices and "unusual number" of bank suspensions fueled the District's sharp decline.

Spurred by the economic problems, Congress passed the Glass/Steagall Act of 1932, which enabled the Fed to use government securities as backing for its notes. During the first nine months of 1932, the Reserve Banks bought an unprecedented $1 billion of securities, but this additional liquidity was quickly absorbed by the parched banking system. [24]

The economy continued to decline and industrial activity reached a low point in July 1932. Banks began to feel extreme pressure. In addition to growing loan defaults, the country experienced a wave of currency hoarding. State and local governments began to announce bank holidays. In the Seventh District, a number of local holidays were announced in cities such as Rock Island, Illinois, Muscatine, Iowa, and Huntington, Indiana. [18] The piecemeal approach to bank closings accelerated the deposit withdrawals.

As pressures increased, the two dominant banks in Detroit were facing collapse by February 1933. Chicago Fed Governor McDougal, leading commercial bankers, U.S. Treasury officials, representatives of the Reconstruction Finance Corporation (RFC), and others met to try to resolve the crisis. After studying the banks' books, the RFC declined to provide the large loan necessary to keep the banks open. Private corporations also refused. With no solution in hand, the governor of Michigan declared a statewide bank holiday on Tuesday, February 14th. The closing was a severe shock. During the rest of the week, the currency drain on the Chicago Fed was three times greater than for the same period in 1932. [18]

During the first three days of March panic reached a peak throughout the U.S. as bank customers withdrew huge amounts of deposits. On March 3rd, the evening before



OVERDUE PAPER

TOTAL LOANS $239,191.84

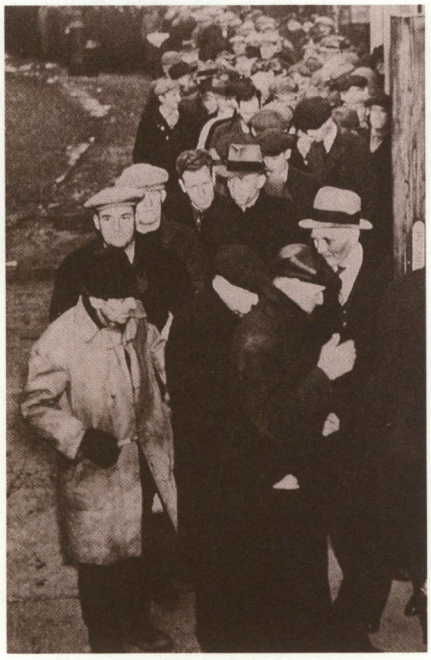
d in the above are:
A. STATUTORY BAD DEBTS $11,515.38
B. Other overdue paper 25,389.76
C. Demand paper, older than six months 400.00
Total $37,305.14

xaminer should advise bank that interest on demand or time loans should be collected at least every six months; and that payment of interest is not considered a renewal of the loan unless formal extension agreement is signed by all parties or the laws e State provide otherwise. A new note, if practicable, at each maturity date is preferable.

Schedule A and B paper separately below. ALSO INCLUDE OVERDUE REAL ESTATE LOANS.

AME OF BORROWER AND REMARKS	AMOUNT	DATE DUE	SLOW	DOUBTFUL	LOSS
UTORY BAD DEBTS					
r vetenary surgeon at Canton, igan, who went thru bankruptcy. s	150.00	11-17-31			150.00
ker deceased and estate is re- rted as having no assets. dmitted loss.	50.00	3-17-33			50.00
en Edna Farmer. Lost everything. Notes given to W. H. Touts, Attorney to take judgment.	135.00 80.00 25.00 240.00	5-26-30 6-8-30 6-6-30			240.00
Chris Mary Chris Horn deceased. Admitted loss.	70.00 20.00 90.00	9-4-32 10-1-32			90.00
LaFayette Maker deceased. No estate if any admitted loss.	50.00	9-27-32			50.00
Joseph Martha Farmer. Lost everything and is heavily in debt. Admitted loss.	900.00	2-14-33			900.00

A listing of overdue loans contained in a 1931 Chicago Fed examination of a state bank. During 1931, 631 Seventh District banks suspended operations. Only 102 of these banks were members of the Federal Reserve System.



National unemployment was estimated to be as high as 25 percent during the depths of the Great Depression.

the inauguration of Franklin Roosevelt, the governors of Illinois and New York declared a bank holiday. The executive committee of the Chicago Fed's board of directors met at 10:30 p.m. that night and passed the resolution that the "Federal Reserve Board should urge upon the President of the United States that he immediately declare a bank holiday... in order to give the banks and the governmental authorities sufficient time and an opportunity to provide the necessary measures for the protection of the public interest..." The nation's banking system was effectively shut down.

Although a host of factors caused the banking collapse, many beyond the reach of the Federal Reserve, the fact remained that the Fed was unable to head off the very catastrophe it had been established to prevent. In addition to being hindered by out-of-date legislation, the Fed did not yet have a full understanding of the capabilities and responsibilities of a central bank. Throughout the crisis, the Federal Reserve's progress on the monetary policy learning curve was a step behind the sequence of events.

Despite the depressed conditions in the early 1930s, many were still concerned about the dangers of inflation.

"I can assure you it is safer to keep your money in a reopened bank than under a mattress."

–Franklin D. Roosevelt, March 12, 1933

Roosevelt took quick action once he assumed office. Under the Emergency Banking Act of 1933, banks were reviewed by regulators and licensed to reopen if they were solvent. Confidence was restored and the crisis passed. The cost was high—bank suspensions soared in the early 1930s, reaching 4,000 in 1933. Approximately 30 percent of the suspensions were in the hard-hit Seventh District. [9]

With the banking crisis in hand, Congress took on the task of reforming the financial system. Banks were restricted from engaging in securities activities and prohibited from offering interest on demand deposits. The Federal Deposit Insurance Corporation was created to protect small depositors against loss. The Federal Reserve was given a powerful new monetary policy tool—the authority to change member banks' reserve requirements. The Fed also received permanent authority to lend to member banks on the basis of "satisfactory" assets. Previously, the Fed was prevented from lending to institutions that did not have eligible paper to collateralize the loan. The legislation also capped the Federal Reserve's trend toward centralization by creating the Federal Open Market Committee (FOMC) to conduct the System's open market operations. This committee, consisting of the Board and five Reserve Bank presidents, came to be the System's chief monetary policymaking body.

Despite the legislation and the New Deal efforts to stimulate spending, the downswing continued through the 1930s. It was not until preparations for World War II began that the country completely shook off the Depression. Although the Federal Reserve now had its monetary policy tools in hand, and a better understanding of how to use them, fiscal policy dominated the scene for the next ten years. As in 1917, a world war was to absorb the Fed's attention for the next several years. ■

1940 - 1964

"Our armed forces now are fighting on all the seas and on many battlefields...the amount of money to be raised has reached tremendous proportions."

–Henry Morgenthau Jr., Secretary of the Treasury, April 1942

Suddenly thrust into the second World War on December 7, 1941, the U.S. girded itself for a major financing effort. One day after the attack on Pearl Harbor, the Board of Governors announced that it was "prepared to use its powers to assure that an ample supply of funds is available at all times for financing the war effort...." [9] Once again, the Chicago Fed found itself responsible for coordinating the Seventh District's bond drives. The Bank's recently appointed president Clifford "Hap" Young was designated chairman of the regional War Finance Committee. Volunteers were recruited, additional quarters rented and new employees hired. Unlike the first World War, the Bank did not encounter any initial lethargy. The "aroused American public," according to the Bank's monthly business review, flocked to buy savings bonds after Pearl Harbor. The first bond drive was a huge success raising $13 billion nationwide—$4 billion more than originally targeted.

It was only a beginning. "Millions more must take part in payroll savings plans and must invest hundreds of millions if we are to do our job," Secretary of the Treasury Henry Morgenthau declared in 1941. "Our plans at the Treasury for financing war are based upon the belief that the American people will want to assume a big share of the cost of the war of their own free will." [9]

As it turned out, the American people were more than willing to assume a big share of the cost. The U.S. Treasury held eight war loan drives that raised a total of $157 billion. In each drive, the District and the nation as a whole oversubscribed, and the World War I total of $21 billion in Liberty bonds was dwarfed.

Once again, the war effort had a tremendous effect on the Chicago Fed's operations. About 1,500 Chicago Fed employees—one-third of the Bank's staff—were involved in war financing activities. The Chicago office alone handled 50 million securities worth $24 billion or $3 billion more than the entire amount raised nationwide in the first World War.

But as the Fed concentrated on the war effort, it assumed a passive role in monetary policy. At the onset of the war, the Board of Governors announced that it would "exert its influence toward maintaining conditions in the United States Government security market that are satisfactory from the standpoint of the Government's requirements." Essentially, this meant that the Federal Reserve pegged interest rates on Treasury securities. The *Federal Reserve Bulletin* noted in February 1943 that the "policy of the Treasury and of the Federal Reserve System has been directed toward the stabilization of prices and yields of marketable securities. Investors... know that prices and yields are stabilized and that they will obtain no higher yields by deferring purchases...."

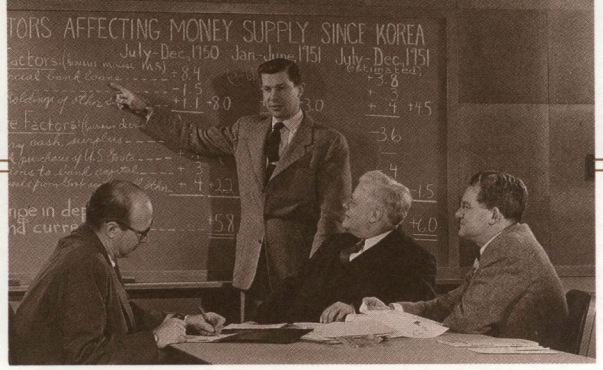
To maintain this stability, the Fed pledged to buy Treasury securities at a predetermined rate. Member banks that wished to acquire reserves usually sold Treasury bills to Reserve Banks. In effect, the initiative of member banks determined the amount of reserves in the banking system.

By the end of the war, the Fed had grown restive under these restrictions. In 1946 the Federal Reserve discontinued pegging interest rates for short-term securities. In March 1951, after numerous conferences, the Federal Reserve and the Treasury announced a "Full Accord" on future policy. Bond prices and yields were gradually allowed to seek their own level as dictated by overall credit requirements.

"The Midwest...has shared fully in the nation's vast growth and in the almost unbelievably high standard of living the American economy produces."

–1955 Annual Report, Federal Reserve Bank of Chicago

Chicago Reserve Bank President Clifford "Hap" Young coordinated the Seventh District's World War II bond drives. Young (second from the right) is pictured here with the Bank's "Liberty Fleet."



From left to right: Economists George Cloos and Robert Holland, President "Hap" Young, and Vice President and Director of Research George Mitchell discuss the economic outlook for 1952. Holland and Mitchell were later appointed as members of the Federal Reserve System's Board of Governors, while Cloos went on to serve as vice president in the Bank's Economic Research Department.

Clifford "Hap" Young, the Chicago Reserve Bank's president from 1941 to 1956, was the antithesis of the stereotypical stuffy central banker. Nicknamed "Hap"–a derivative of happy–Young was described as "having a genius for making people in all walks of life feel welcome and thoroughly at ease." [10] After working in small commercial banks and as a bank examiner with the state of Illinois, Young joined the Chicago Fed in 1921. He was named manager of the Bank Examination Department in 1932 where he established his reputation by playing a leading role in licensing District banks during the moratorium. Young was elected president in 1941, a position he held for 15 years. Like James McDougal, the Bank's predominate personality in the years prior to World War II, Young set the tone of the Chicago Fed during his long tenure in office.

At the time of the Treasury Accord, the Federal Reserve had its three monetary policy tools in hand—open market operations, reserve requirements, and the discount rate. Through the 1950s, the Fed generally followed a policy aimed at moderating the severity and duration of cyclical readjustments, a strategy described by Federal Reserve Chairman William McChesney Martin as "leaning against the wind."

Although much of the responsibility for monetary policy was now centralized with the Board of Governors, the Reserve Banks were responsible for measuring and evaluating the economic trends in their district--acting as observation posts scattered throughout the nation. In the 1940s, Chicago Fed President Young began the practice of holding meetings of the Bank's board of directors outside of Chicago to help obtain a grass-roots "feel" for the Seventh District economy. As part of the same effort, he frequently traveled throughout the District to meet with farmers, bankers, and business leaders. "The day is past when a banker can sit at his desk and read reports," Young stated. "We have to get out and know what is happening." [10]

Buoyed by a general policy of monetary and fiscal stimulus, the U.S. economy grew at a steady clip through most of the 1950s and early 1960s. The Seventh District prospered with the rest of the nation. The economy's vigor is reflected in the Bank's publications, which seemed to overflow with good news:

> "In the year 1950, the Seventh Federal Reserve District as well as the nation reached new peak levels of economic activity...A listing of the accomplishments of the American economy in 1953 becomes almost a monotonous recitation of new record highs...1959 ended on a resounding note of strength...Activity in the Seventh Federal Reserve District advanced along with the nation during 1963...."

The District's economic growth was fueled by a healthy farm sector and heavy industry such as steel and autos. In its 1955 annual report—entitled "Growth and Prosperity in Five Midwest Cities"—the Bank

A post-war housing boom added impetus to the growing economy.
Historical Pictures Service, Chicago

noted that the District states accounted for 19 percent of the nation's personal income, one-fourth of factory output, and nearly one-fourth of farm income.

"Like the stream from a hydrant with a broken valve the checks pour in—an endless, unstoppable flow. Each day's paper mountain must be attacked to clear the way for the avalanche that's sure to come tomorrow."

–1952 Annual Report, Federal Reserve Bank of Chicago

In step with the growing economy, the Bank's service volumes soared in the 1940s and 1950s, particularly in the check collection area. Nationwide, the number of checks written by consumers rose from 4 billion in 1940 to 13 billion by 1960. [13] As the largest check processor in the Federal Reserve System, the Bank began to feel increasing pressure. In 1941, the Chicago and Detroit offices together processed 271 million checks. By 1956, the Bank was operating 24 hours a day to clear more than half a billion items annually. Approximately 40 percent of the Bank's employees were engaged in clearing checks. The operation was, according to the Bank's annual report, the "world's largest check clearing installation."

Complicating the Bank's task was the labor-intensive, time-consuming nature of check clearing. Although proof machines were introduced in the 1940s to help automate the process, each item had to be individually checked by an operator. The Federal Reserve System and commercial bankers began to explore the possibility of automating the process in the mid-1950s. The Federal Reserve and the American Bankers Association worked with bankers, check printers, and business machine manufacturers to find an answer. The eventual solution was MICR—magnetic ink character recognition that would enable machines to "read" and automatically process checks.

In 1961, the Chicago Fed and four other Reserve Banks began to test automated check-sorting equipment from different

By the mid-1950s, the Bank required hundreds of semi-automated "proof machines" to sort half a billion checks annually.

Patricia Dempski operates the first automated check processing machine at the Bank. The Chicago Fed was one of five Reserve Banks that tested automated equipment in 1961.

had to have checks that were magnetically encoded," Bierbauer said. "It was quite a job to sell to bankers the idea that we were going to have a brand new system and that they should start a program with their local check printers to encode checks." The new system also required check printers and business machine manufacturers to make substantial investments. "We went to them and asked them to believe that we've got something here and it will succeed if you cooperate."

manufacturers. Heading the project at the Chicago Fed were Vice President Harry Schultz and Assistant Vice President Carl Bierbauer. The goal was to automatically process 1,500 checks a minute on each machine, but there were a variety of initial problems. Bierbauer, who went on to become a senior vice president at the Bank, recalls, "There were days and weeks when things didn't go right. It wasn't a case where we just brought in a machine and it worked."

Despite setbacks, the Federal Reserve decided to introduce automated processing at all twelve Reserve Banks. "We had the new system, but in order to do anything about it we

Over a number of years, the MICR system replaced the proof machines. By 1964, 60 percent of the Bank's check volume was sorted on high-speed equipment. "It was hard work," Bierbauer said. "Progress was slow. But if we hadn't developed the system, I don't know how we would have handled all the checks. By the late 1960s we would have been in serious trouble. I'm sure that there were skeptics that thought it couldn't be done, but it's still running today."

"Mr. Stevens has very definite and strong ideas on the matter of payment of interest on savings. He says he is not concerned with what the other banks do. The bank pays 1% on regular savings and intends to continue on that basis....This has been in use for some time and Mr. Stevens says there will be no change."

–Bank Relations Department interview with District banker, February 1956

Cushioned by the strong economy, banks prospered in the 1950s. The era was a pleasant change from the harrowing events of 1933. At that time, bankers' reputations had hit a low point and much of the Depression-era legislation was designed to prevent banks from engaging in "risky" activities. Surveying the scene in late 1933, H. Parker Willis described banking as "a discredited, hampered, and governmentally henpecked...occupation." [20] *American Banker* correspondent U.V. Wilcox wrote in his 1940 book—aptly entitled *The Bankers Be Damned*—that the "bankers of America are—collectively speaking—in the national doghouse...Bankers are now being trained in the rules of rigid supervision, wearing their stripes with only occasional murmurs of protest." [2]

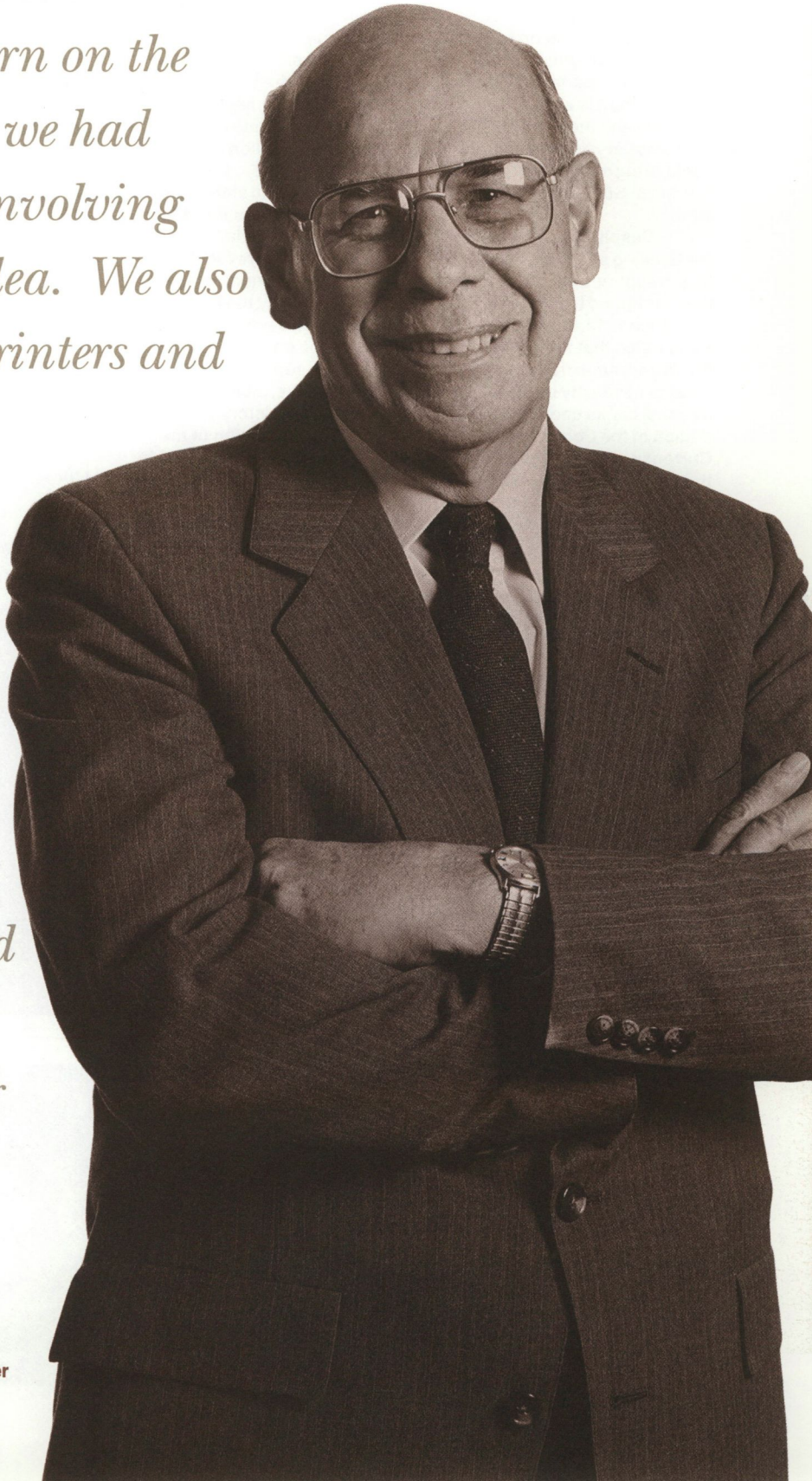
While the stripes of rigid supervision were sometimes confining, they also proved to be fairly comfortable. With low-cost deposits and strong demand for loans, the task of making money with money was relatively simple. It was later characterized as the "3-6-3 era" of banking: pay 3 percent on deposits, charge 6 percent on loans, and get to the golf course by 3 p.m. [2]

The attitudes of the time are reflected in the interviews of District bankers conducted by the Chicago Fed's Bank Relations Department. A 1953 report, for example, noted that the cashier at a bank in a small town in Michigan "could not understand why the other bank in town decided to raise its

One of the Bank's original responsibilities was to issue Federal Reserve notes.

"Along with the other things that had to be done, we had to go out to the member banks and convince them to use magnetic ink on their checks. It was a hard sell; here was a brand new approach.

There was a lot of concern on the part of bankers whether we had something real or were involving them in a fly-by-night idea. We also had to convince check printers and business machine manufacturers to invest in new equipment. We convinced them that this was not a half-hearted effort...we were committed...we could make it work. And it worked. As the years went by it just ran better and better and it's still running today."



Carl Bierbauer

interest rate from 1 percent to 2 percent on savings deposits...." The cashier added that he had "plenty" of loan applications and that he had to foreclose on only one loan in the past nine years.

"The economic times were such that things were relatively calm," according to James R. Morrison, who served as a banker and a Federal Reserve examiner in the 1950s and 1960s and went on to head the Bank's Supervision and Regulation Department. "Competition is what drives all business and the competition then was very limited. People could bring money to banks or maybe an S&L and that was about it."

Despite the tranquility of the banking system, the Bank's role in supervision and regulation continued to evolve as it had since 1914. In 1919, the Bank noted that the "growth of the Department of Examinations must of necessity be slow" with national banks under the jurisdiction of the Comptroller of the Currency and state banks under the purview of state banking departments. Field work was largely confined to cooperative examinations with state banking departments and inspections of state banks applying for membership in the Federal Reserve System.

During the bank holiday of 1933 the Bank's Examination Department came to the forefront, playing a crucial role in reviewing and licensing District banks. Working with other regulators and the Reconstruction Finance Corporation, the Chicago Fed helped to reorganize or recapitalize hundreds of District banks.

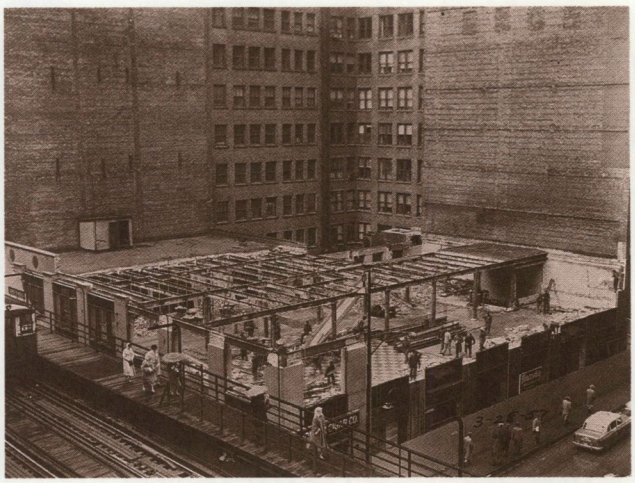
During the 1940s and the 1950s, the Department continued to examine state member banks in cooperation with state banking authorities. During this period, virtually all state banks were gathered under the federal supervisory umbrella. State member banks were regulated by the Fed, while nonmembers were overseen by the FDIC if they obtained deposit insurance. By the end of the 1950s, banks were supervised by a comprehensive, albeit confusing, federal regulatory structure.

The legislation of the 1930s, combined with favorable economic conditions and the cautious attitudes of bankers and regulators, made bank failures a virtual anachronism. From 1941 to 1964, only one member bank in the Seventh District failed. Throughout the nation, the number of failures was negligible.

As the Bank celebrated its 50th anniversary in 1964, it could look back on 20 years of general economic prosperity and stable banking conditions. There were, however, stirrings of change as interest rates creeped upward and bankers grew restive in the face of increasing competition. One development portending the heightened activity within the banking environment was the emergence of bank holding companies in the early 1950s. In 1956, Congress gave the Federal Reserve authority to oversee bank holding companies, a move that led to a major increase in the Fed's supervisory responsibilities. The pace of change would rapidly accelerate in the coming decades. ■

An undesirable by-product of the Bank's expanding operations was the cramped quarters at both Chicago and Detroit. In a move that was "typical of economic growth in Michigan," according to the Bank's annual report, the Detroit Branch in 1953 completed an addition to its original 1927 building. The eight-story annex tripled the Branch's working space.

The Chicago office embarked on a similar project in 1957. The original bank building, which occupied approximately one-half of a city block, had grown increasingly inadequate through the 1950s. To provide more space, the Bank purchased the remaining land on the block and built a 16-story addition on the southern one-half of the lot. At the same time, a three-story basement and a first floor were constructed throughout the half-block area. The new addition was completed in time for the Bank's 50th anniversary celebration in 1964.



Chicago Reserve Bank examiners in 1955. President "Hap" Young is seated in the front row, fourth from the left. Seated at his left is Charles J. Scanlon, who served as the Bank's president from 1962 to 1970.

Soft drinks were the beverage of choice at an employee party in 1952.

By the late 1960s, inflation and interest rates had begun to creep upward.

1965 - 1988

"In July 1965, the President announced a step-up in military operations...it became clear that a greatly expanded military effort was being superimposed on a booming private economy."

–1967 Annual Report, Federal Reserve Bank of Chicago

For approximately two decades, the Federal Reserve Bank of Chicago had enjoyed a period of general stability. By the mid-1960s, however, there were indications of change. In 1966, the Bank's annual report warned that economic developments in 1967 were "not likely to follow a classic pattern" because a "war effort involving the expenditure of many billions of dollars is taking a growing share of the nation's resources of men and materials." By the end of 1968, the Bank reported that "most interest rates were at a new high in the experience of today's generation."

Constrained by ceilings imposed under Regulation Q, bankers watched helplessly as deposits flowed to competitors that provided higher yields. Seventh District bankers tried to respond to the increased competition. At the end of the decade, approximately 74 percent of District banks were paying the 4 percent maximum rate for savings deposits, according to a 1969 Chicago Fed survey. Many banks changed from quarterly computation of interest to daily or constant compounding, and offered noninterest extras such as "instant" loan privileges.

As interest rates increased, banks stepped up their efforts to avoid restrictions on their activities. While the Federal Reserve was responsible for overseeing multibank holding companies, enterprising bankers discovered that Congress neglected to include one-bank holding companies in the Fed's purview. By 1970 1,352 one-bank holding companies held more than one-third of the commercial bank assets in the U.S. Many of these companies engaged in nonfinancial activities ranging from agriculture to mining operations. In the five Seventh District states, 361 one-bank holding companies controlled 27 percent of the states' deposits. In 1970, Congress closed the loophole in the Bank Holding Company Act and the Chicago Fed became responsible for overseeing all District banking companies and ensuring that they engaged in activities "closely related to banking."

The end of the 1960s also saw the beginning of the Federal Reserve's responsibility for consumer credit regulation. In 1969, Congress passed the Truth-in-Lending Act and gave the Federal Reserve responsibility for implementing the legislation. From this relatively simple beginning, there was a stampede of consumer credit legislation—13 separate acts were passed by Congress by the mid-1970s.

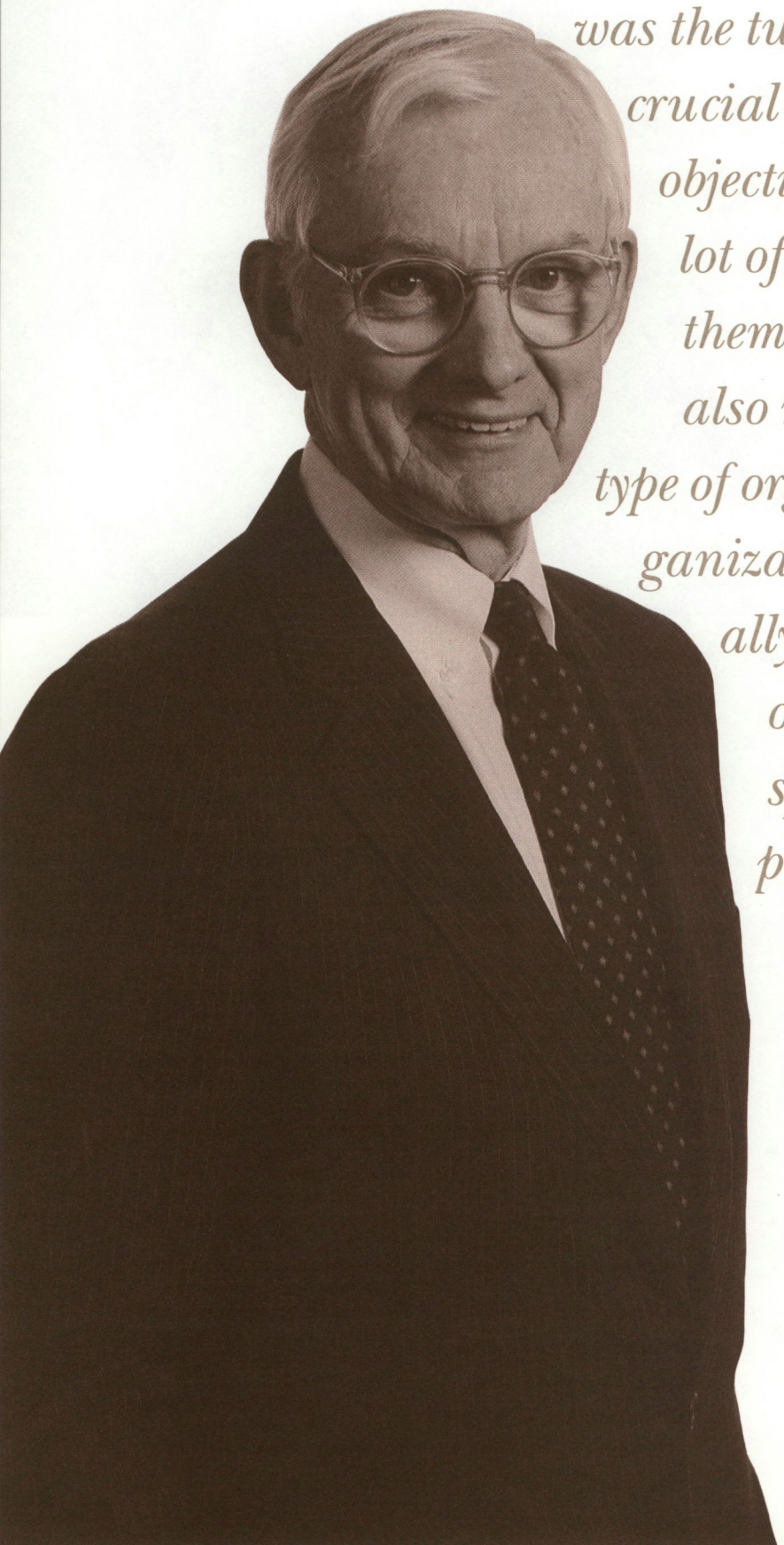
"...the most significant banking legislation before the Congress since the passage of the Federal Reserve Act in 1913."

–Senator William A. Proxmire, 1980

As the U.S. entered the 1980s, the financial system faced a host of problems triggered by the higher and more volatile interest rates of the 1960s and 1970s. As interest rates increased, banks squirmed under the constraints of Depression-era legislation while new competitors invaded their traditional turf. At the same time, the Federal Reserve found its ability to conduct monetary policy threatened as member banks fled the System to avoid the burden of holding noninterest-bearing reserves.

In 1980, Congress passed the Depository Institutions Deregulation and Monetary Control Act (MCA) in an attempt to resolve some of the dilemmas facing the financial services industry. To enable financial institutions to compete more effectively, the Act phased out deposit ceilings and authorized NOW accounts. The Act also addressed the Fed's membership problem by imposing reserve requirements on all depository institutions. At the same time, the MCA required the Fed Banks to price many of their services and offer them to all depository

"The Monetary Control Act had an extraordinary impact on operations. It energized the organization and gave it a private-sector, bottom-line orientation. 1984 was the turning point. It was a crucial year. We set some volume objectives for 1983 and for a lot of reasons we didn't meet them. We had to cut costs. We also needed a very different type of organization. The old organization was very functionally oriented. Under the new organization, there was responsibility for an entire product—for all the services, all the inputs, and for delivery to the customer. We turned it around that year. Since '84, we haven't had a loss in priced services."



Daniel M. Doyle

While many of the financial industry's predictions failed to materialize in the 1960s and 1970s, the expectation of rising check volumes was right on target. By 1970, the Chicago and the Detroit offices were clearing 1.24 billion checks annually–double the volume in 1960. While automated machinery enabled the Bank to quickly sort checks, transporting an item to a central processing location was often time-consuming. The Bank began to explore the idea of establishing regional offices to eliminate the need for banks in Indiana, Iowa, and Wisconsin to send their checks all the way to Chicago. A regional office was set up in Des Moines in 1973; in the next two years, the Bank established Indianapolis and Milwaukee offices. In addition, ACH facilities were set up in each office to encourage the use of "paperless" electronic transfers. In 1988, the Chicago Fed's five regional offices cleared nearly 2.5 billion checks.

In the early 1970s, the Chicago Reserve Bank coordinated the newly-established Interdistrict Transportation System (ITS), an air transport service that provides overnight delivery of checks.

institutions. As one of a number of competitors in the marketplace, the Federal Reserve was to recover "in the long run" the costs of providing priced services.

The MCA had an immediate effect on the Bank—the number of potential customers and institutions required to submit statistical data jumped from 904 member banks to approximately 7,000 banks, savings and loans, and credit unions. To help in the transition, the Bank turned to the private sector when it became time to select a new president in 1981. Silas Keehn, who had previously served as vice chairman of Mellon National Corporation and Mellon Bank, N.A. in Pittsburgh, and as chairman of Pullman Incorporated in Chicago, brought to the Chicago Fed the valuable perspective gained in the competitive marketplace.

"It was a time of tremendous challenge and opportunity," Keehn recalls. "The Bank, and the financial services industry as a whole, were experiencing dramatic changes on virtually every front. It's hard to imagine a more exciting time to have started at the Bank."

The pricing of Fed services received scant public attention initially compared with interest rate deregulation and uniform reserve requirements. The transition to priced services, however, posed a major challenge to the Reserve Banks and eventually had a ripple effect on institutions and their customers.

The Chicago Fed's first step was to research its new customers and to revise its services strategy, an effort headed by First Vice President Daniel Doyle. Previously, the Fed Banks provided a fairly basic, operationally prudent, array of services. With the advent of pricing, the Chicago Fed worked to offer a wider variety of services at a relatively low price. "As a general rule," Doyle notes, "we gave them more options to choose from, more services. There was much more responsiveness to customer needs."

The Bank's electronic services volumes were not expected to drop markedly, because of the lack of close substitutes on the market. The Bank's check clearing services, however, were expected to face significant competition. Fed-processed check volume did drop with the advent of pricing—approximately 20 percent for the System in the last quarter of 1981, although the Bank's decrease was about half that amount. Some expected the Fed to scale back its operations as a result of lower volumes. Instead, however, the Fed decided to intensify its efforts and let the marketplace determine its role in financial services.

Doyle notes that 1984 was a "crucial year" for priced services. The Bank had failed to meet its volume objectives in the previous year and faced the need to make changes. The Bank cut costs, continued to refine its services, and reorganized departments to centralize responsibility for all aspects of a major product. That year the Chicago Fed recovered some of its lost check business; the trend shifted toward growth rather than loss.

The MCA affected the Fed's services, and eventually the financial services industry, in several ways. Check clearing schedules were shortened, new check services were introduced, and relatively low prices were maintained. As required by the MCA, Fed float was recovered through a combination of pricing and more efficient operations.

In electronic services, Automated Clearinghouse (ACH) usage, aided initially by price subsidies, increased substantially. The MCA also enabled the Fed Banks to encourage more efficient on-line wire transfers through price incentives and the availability of inexpensive computer equipment.

The MCA also had a dramatic effect on the Bank itself. "It produced a much leaner, more efficient, and, I think, more satisfying organization," Doyle observes. "It's one thing to respond to internal standards, it's quite another thing to meet the standards of the marketplace. I think we were very successful."

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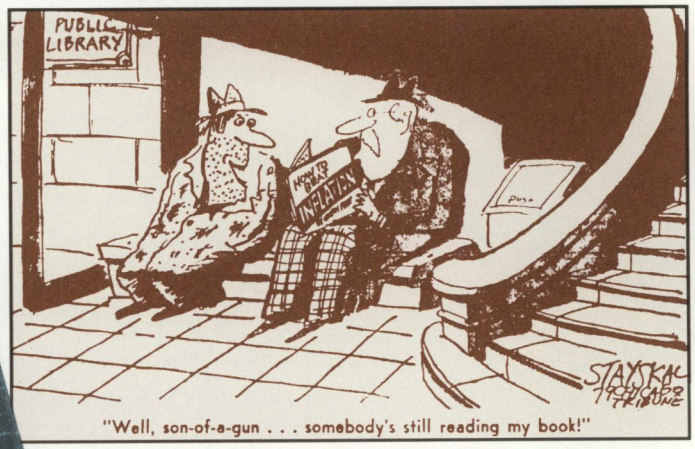

"Well, son-of-a-gun . . . somebody's still reading my book!"

As prices increased through the 1970s, there was growing public attention on inflation.

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"Given the performance of the American economy...can we be optimistic? During the closing year of the decade, we experienced the worst inflation of the post-war period...can we break away and avoid still higher inflation a few years down the road?"

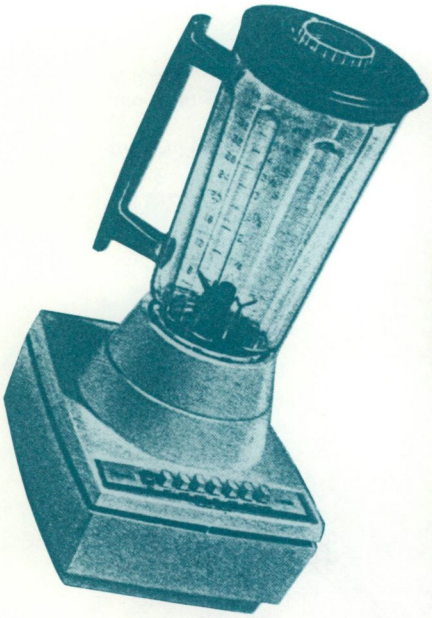
–President's Letter,
1979 Annual Report,
Federal Reserve Bank of Chicago

As events unfolded that would eventually lead to the Monetary Control Act, the Seventh District economy underwent a painful readjustment process. The 1970s had provided little respite from the inflation problems that had built up in the late 1960s. Wage and price controls instituted in 1970 were, in the words of the Bank's monthly review, "judged unsatisfactory by virtually everyone." 1974 was labeled a "year of calamity" by the Bank's review, which noted that the U.S. economy was hit by an "unprecedented array of adverse developments" ranging from record price inflation to shortages to the nation's first presidential resignation.

The Federal Reserve tried to curtail the inflationary trend. In 1975, the Fed announced a policy to reduce money growth rates to eliminate inflation, an attempt that generally failed. Four years later, the U.S. was jolted by the second oil price shock of the decade, and experienced its worst inflation in the post-war period. A dramatic gesture was needed. On Saturday, October 6, 1979, the FOMC gathered for an emergency meeting in Washington, D.C. to discuss the deteriorating economic situation. To avoid publicity, FOMC members were located in different hotels around the city. [22] That evening recently appointed Chairman Paul Volcker announced that the Federal Reserve's monetary policy efforts would focus on reaching target levels of bank reserves through open market operations. The announcement was a signal of the Fed's determination to wring inflation from the economy once and

FRCS 80

In 1917, the Chicago Reserve Bank's annual report noted somewhat mournfully that only one District bank opted to take advantage of its fledgling transfer service. Seventy years later, the Bank's FedWire service was transferring approximately $23 trillion annually. Much of this tremendous growth occurred after 1964 as the wire transfer operation evolved from utilizing telegraphs and adding machines to personal computers and high-volume communication networks. Prior to 1965, institutions generally called or wrote the Chicago Fed with a request to transfer funds via telegraph. In 1966, the Chicago Fed introduced an on-line wire transfer service that utilized electronic typewriters. In the next five years, the annual dollar value of wire transfers at the Chicago and Detroit offices jumped from $889 billion to $2.39 trillion. By 1972, institutions could send wire transfer requests directly to computers in Chicago or Detroit. The Federal Reserve Bank of Chicago also took a leading role in designing and implementing a nationwide communications network in the early 1980s to handle the System's growing volumes. Today, the Federal Reserve's current communications network (FRCS-80) is based at Chicago and operated by the Bank.



As inflation and market interest rates rose in the 1970s, banks found themselves constrained by interest rate ceilings. Many banks tried to compensate by offering customers a variety of "premiums" for opening accounts.

The oil embargo of 1973 led to gas shortages and soaring energy prices. AP/World Wide Photos

for all. The immediate market response was dramatic—a sharp increase in the entire spectrum of interest rates.

The economy began to slow. By the fourth quarter of 1981, GNP was declining at an annual rate of 4.9 percent. [22] The recession was particularly tough on the Midwest. The Bank's economic review noted in 1981 that "for almost two years the economy has stumbled on a rocky path marked by soaring inflation, record-high interest rates, and a constant specter of fuel shortages...the Seventh Federal Reserve District has shouldered a disproportionate share of the trouble."

As the Midwest economy faltered, the Bank became involved in cooperative efforts directed at improving the long-run economic performance of the Seventh District. Working with various public and private groups, the Bank participated in a number of economic development projects including studies of the Great Lakes region, the states of Iowa and Wisconsin, and the cities of Chicago and Detroit.

Eventually the national economy began to improve. In his Congressional testimony in July 1982, Volcker reported that "evidence now seems strong that the inflation tide has turned in a fundamental way." [22] At year-end 1982, Chicago Fed President Keehn wrote in the Bank's annual report that "there is mounting evidence that long-term economic growth could and would be renewed without igniting inflation."

By 1985, the U.S. economic expansion had reached its fourth year without reigniting inflation. Still the Midwest lagged behind. "It is particularly—and painfully—clear to all of us in the Midwest that the expansion has been uneven in different regions of the country...," Keehn wrote in 1985. "Despite strong gains in employment nationally, manufacturing jobs continue to decline and the agricultural sector remains extremely depressed."

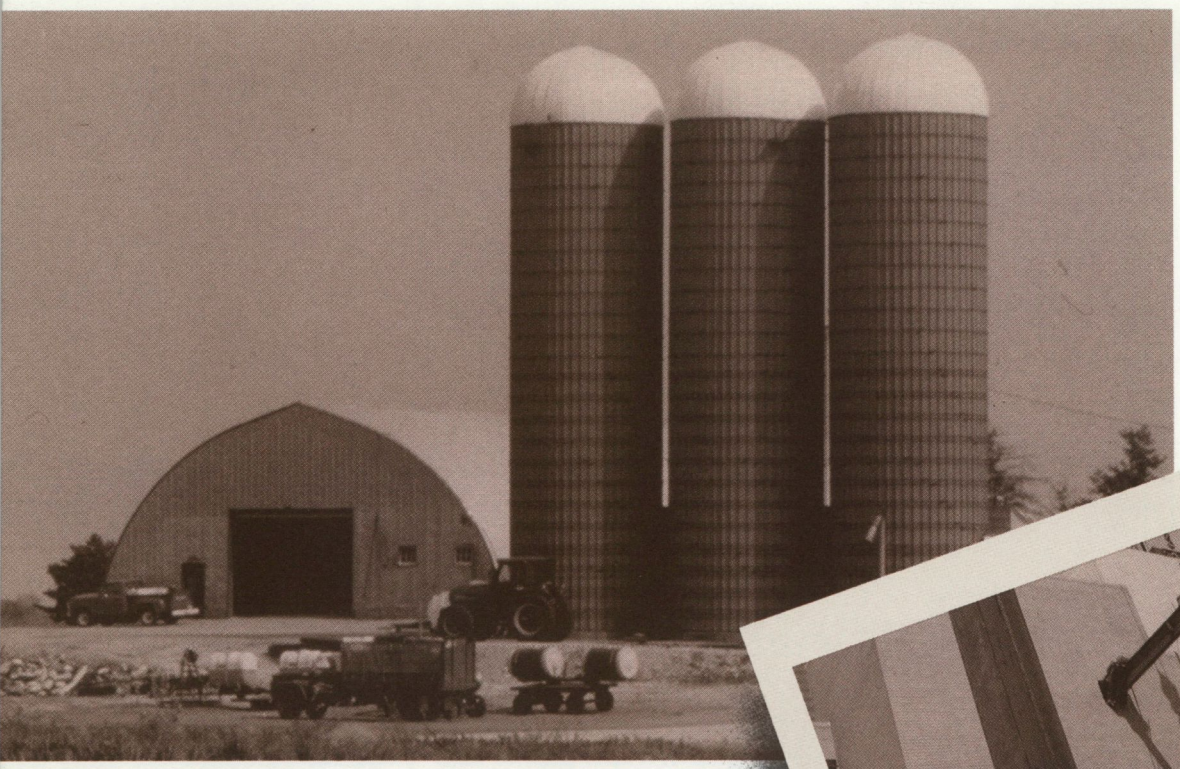
The outlook for the Midwest finally brightened in 1987. The U.S. entered its sixth year of uninterrupted growth—the longest peacetime expansion in the nation's history. And the Midwest finally shared in the good news—its performance was the best of the decade. For the first time since 1980, overall economic activity in the Midwest outpaced the rest of the nation. "While one year does not make a trend," the 1987 annual report concluded, "there is reason to be optimistic about the prospects for the District's economy as it approaches the 1990s."

"Mr. [Smith] said that profits will be much lower...it is tough to make much profit when deposits are 7 1/4% or more and the usury limit is 9%."

–Bank Relations Department interview with District banker, November 1973

Economic troubles, combined with increased competition, began to take a toll on banks in the early 1980s. The number of bank failures increased dramatically compared with previous decades. Agricultural banks, feeling the effects of a severe slump in the farm sector, were especially hard-hit. By 1984, ag bank failures accounted for 32 percent of all bank failures nationally. The large percentage of ag banks in the Seventh District posed "a tremendous challenge for us," said James Morrison, who headed the Bank's Supervision and Regulation Department from 1968 to 1988. With only a few exceptions, however, ag banks' strong capital and stable deposits enabled them to withstand the crisis. By 1986, the decline in ag bank performance began to moderate.

At the other end of the spectrum from the predominately small ag banks, some large money center banks began to experience difficulties in the early 1980s. The uncertainty surrounding the repayment of foreign loans, and the severe slump in certain sectors such as energy, contributed to their problems. The money-center bank problems emphasized the growing complexity of the financial system. A bank run was no longer necessarily a local phenomenon, but could originate in one part of the world with the break of dawn



Problems in the farm sector began to affect agricultural banks in the early 1980s.
Illinois Department of Agriculture

In the mid-1980s, the Bank began a massive renovation of its headquarters building.

and follow the sun across the globe. The potential for a worldwide electronic run presented new challenges for the Chicago Reserve Bank. Unlike 1933, however, when regulators were unable to prevent the collapse of two Detroit banks that helped trigger the banking holiday, the Federal Reserve and other regulators had the resources to help prevent, if necessary, a bank from closing.

The rapid plunge in the stock market in October 1987 provided another indication of the financial system's growing complexity. Following the crash, the Fed responded by injecting liquidity into the financial system, by emphasizing its willingness to lend to banks through the discount window, and by extending the hours on FedWire, the Federal Reserve's large dollar transfer system. At the same time, each of the Reserve Banks intensified its monitoring activities to detect signs of further stress. At the Chicago Fed, Bank officials paid particular attention to developments at local exchanges. While the stock market crash in 1987 was perhaps the most notable financial disturbance in 50 years, it also provided a strong indication of the fundamental resilience of the financial markets.

As the financial system evolved, so did the Chicago Fed's supervision of banks and bank holding companies. "Our view of banks became dramatically broader in the 70s and 80s," Morrison noted. "Previously, we would check the accuracy of the bank's books and review the loan accounts. Today, there is a broader scope. The interest rate position—what the bank is paying for money and what it is receiving—is much more carefully reviewed. The organization and structure of a bank is looked at more closely. And there is much more emphasis on policy on the assumption that a bank's policy will influence future decisions. Institutions—especially the bigger ones—are monitored on a 'flow basis' throughout the year through statistical reports and examinations. It's a much more complicated process, but we're also dealing with a much more complicated financial system."

"We shall deal with our economic system as it is and as it may be modified, not as it might be if we had a clean sheet of paper to write upon, and step by step we shall make it what it should be."

–Woodrow Wilson, 1913

Woodrow Wilson's observation on the passage of the Federal Reserve Act is surprisingly apt in 1988. The Chicago Reserve Bank has never had "a clean sheet of paper to write upon." Instead it continues to respond to the challenges of the evolving financial and economic system. This continuing process is symbolically captured by the recently completed renovation of the Bank's headquarters building, a project undertaken to satisfy the Bank's needs well into the next century. As it did throughout its first 75 years, the Bank is preparing to meet, "step by step," the challenges of the coming decades. ■

STATEMENT OF CONDITION

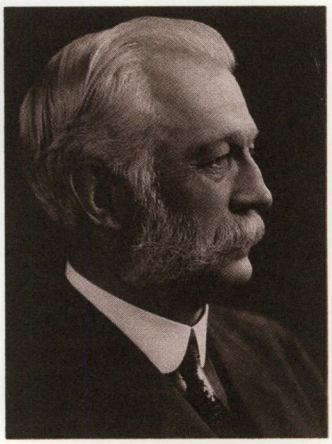
	DECEMBER 31, 1988	DECEMBER 31, 1987
ASSETS		
Gold certificate account	$ 1,394,000,000	$ 1,383,000,000
Interdistrict settlement account	(1,715,509,834)	2,605,492,303
Special drawing rights certificate account	656,000,000	656,000,000
Coin	44,379,423	30,996,628
Loans and securities:		
Loans	44,415,000	19,275,000
Federal agency securities	845,754,016	875,886,823
U.S. government securities	28,367,341,607	25,385,206,512
Total loans and securities	29,257,510,623	26,280,368,335
Cash items in process of collection	773,969,167	619,910,166
Bank premises	99,839,960	70,486,933
Other assets:		
FDIC assumed indebtedness	2,316,178,167	2,623,471,867
Other	1,868,157,282	1,617,504,999
Total other assets	4,184,335,449	4,240,976,866
TOTAL ASSETS	$ 34,694,524,788	$ 35,887,231,231
LIABILITIES		
Federal Reserve notes	$ 29,657,842,254	$ 30,029,272,890
Deposits:		
Depository institutions	3,413,112,943	4,324,615,741
U.S. Treasury–general account	0	0
Foreign	19,200,000	20,400,000
Other	106,580,985	145,421,015
Total deposits	3,538,893,928	4,490,436,756
Deferred availability cash items	564,978,798	522,129,789
Other liabilities	386,797,008	322,785,696
Total liabilities	$ 34,148,511,988	$ 35,364,625,131
CAPITAL ACCOUNTS		
Capital paid in	$ 273,006,400	$ 261,303,050
Surplus	273,006,400	261,303,050
Total capital	546,012,800	522,606,100
TOTAL LIABILITIES AND CAPITAL	$ 34,694,524,788	$ 35,887,231,231

STATEMENT OF INCOME

	1988	1987
CURRENT INCOME		
Interest on loans	$ 169,974,426	$ 179,483,497
Interest on government securities	2,168,845,209	1,858,905,221
Interest on investments of foreign currencies	38,564,698	46,776,722
Service fees	89,093,953	85,444,353
All other	2,405,836	2,439,365
Total current income	$ 2,468,884,122	$ 2,173,049,158
CURRENT EXPENSES		
Operating expenses	$ 147,164,235	$ 142,027,683
Other current expenses	24,497,231	22,891,037
Total current expenses	171,661,466	164,918,720
Less reimbursement for certain fiscal agency and other expenses	12,412,611	12,305,001
Current net expenses	159,248,855	152,613,719
CURRENT NET INCOME	$ 2,309,635,267	$ 2,020,435,439
ADDITIONS TO (OR DEDUCTIONS FROM) CURRENT NET EARNINGS		
Net profit (or loss) on sales of securities	$ 2,623,055	$ 4,853,276
Net profit (or loss) on foreign exchange transactions	(65,392,051)	245,381,666
Board of Governors assessment	(33,779,083)	(34,556,202)
All other–net	(3,968,837)	(5,212,203)
Net additions (or deductions)	$ (100,516,916)	$ 210,466,537
NET EARNINGS AVAILABLE FOR DISTRIBUTION	$ 2,209,118,351	$ 2,230,901,976
DISTRIBUTION OF NET EARNINGS		
Dividends paid	$ 16,088,003	$ 15,356,719
Payments to U.S. Treasury (as interest on Federal Reserve notes)	2,181,326,998	2,205,614,207
Transferred to surplus	11,703,350	9,931,050
TOTAL	$ 2,209,118,351	$ 2,230,901,976

1988 Board of Directors, Federal Reserve Bank of Chicago, from left to right: seated, J. Gabbert, R. Day, M. Alexis, B. Sullivan; standing, P. Schierl, C. McNeer, E. Powers, B. Backlund, M. Naylor.

Charles H. Bosworth, first Federal Reserve Bank of Chicago Chairman and Federal Reserve Agent, 1914–1916.



James B. Forgan (First National Bank of Chicago), first Seventh District representative to the Federal Advisory Council and Council President, 1914–1919

DIRECTORS

Federal Reserve Bank
of Chicago

CHAIRMAN
Robert J. Day
Chairman and
Chief Executive Officer
USG Corporation
Chicago, Illinois

DEPUTY CHAIRMAN
Marcus Alexis
Dean, College of Business Administration
University of Illinois
at Chicago
Chicago, Illinois

B. F. Backlund
Chairman and
Chief Executive Officer
Bartonville Bank
Bartonville, Illinois

John W. Gabbert
President
First of America Bank-
La Porte, N.A.
La Porte, Indiana

Charles S. McNeer
Chairman of the Board and
Chief Executive Officer
Wisconsin Energy
Corporation
Milwaukee, Wisconsin

Max J. Naylor
President
Naylor Farms, Inc.
Jefferson, Iowa

Edward D. Powers
President
Fire Brick Engineers
Company
Milwaukee, Wisconsin

Paul J. Schierl
Chairman and
Chief Executive Officer
Fort Howard Paper Company
Green Bay, Wisconsin

Barry F. Sullivan
Chairman of the Board
First Chicago Corporation
The First National Bank
of Chicago
Chicago, Illinois

1988 Board of Directors, Detroit Branch, from left to right: seated, P. Peters, R. Lindgren, B. Beltaire; standing, R. Story, D. Mandich, F. Meijer, J. Aliber.

DIRECTORS

Detroit Branch

CHAIRMAN
Richard T. Lindgren
Former President and Chief Executive Officer
Cross & Trecker Corporation
Bloomfield Hills, Michigan

James A. Aliber
Chairman of the Board and Chief Executive Officer
First Federal of Michigan
Detroit, Michigan

Beverly Beltaire
President
P.R. Associates, Inc.
Detroit, Michigan

Donald R. Mandich
Chairman and Chief Executive Officer
Comerica Bank-Detroit
Detroit, Michigan

Frederik G. H. Meijer
Chairman of the Board
Meijer, Incorporated
Grand Rapids, Michigan

Phyllis E. Peters
Director, Professional Standards Review
Touche Ross and Company
Detroit, Michigan

Ronald D. Story
Chairman and President
The Ionia County National Bank of Ionia
Ionia, Michigan

FEDERAL ADVISORY COUNCIL

Seventh District Representative

Charles T. Fisher III
Chairman and President
NBD Bancorp and National Bank of Detroit
Detroit, Michigan

ADVISORY COUNCILS

■ Advisory Council on Agriculture

Ben Bement
Dowagiac, Michigan
Michigan Pork Producers Association

Russell J. Clark
Frankfort, Indiana
Indiana Pork Producers Association

David Conklin
Corunna, Michigan
Michigan Farm Bureau

Kenneth Dalenberg
Mansfield, Illinois
Land of Lincoln Soybean Association

Thomas Dorr
Marcus, Iowa
Iowa Corn Growers Association

Gerald Elenbaum
Owendale, Michigan
Michigan Bean Commission

James A. Grenlund
Capron, Illinois
Illinois Beef Association

Robert R. Joslin
Clarence, Iowa
Iowa Farm Bureau Federation

Jerry King
Victoria, Illinois
Illinois Pork Producers Association

Anita Klein
Plymouth, Wisconsin
Women Involved in Farm Economics

Wendel E. Shireman
Columbus, Indiana
Indiana Grange

Gale Tigert
Oshkosh, Wisconsin
Wisconsin Soybean Association

■ Advisory Council on Small Business

Frank A. Buethe
Green Bay, Wisconsin
Independent Business Association of Wisconsin

James N. Farley
Des Plaines, Illinois
Independent Business Association of Illinois

Enrique Loza
Chicago, Illinois
U.S. Hispanic Chamber of Commerce

Cyril Ann Mandelbaum
Des Moines, Iowa
National Association of Women Business Owners/ Iowa Chapter

Marilu B. Meyer
Chicago, Illinois
Illinois State Chamber of Commerce

Michael J. Morton
Southfield, Michigan
The Small Business Association of Michigan

Clifford A. Nederveld
Lansing, Michigan
National Federation of Independent Business

Jeanne G. Paluzzi
Livonia, Michigan
National Association of Women Business Owners/ Michigan Chapter

James L. Siegmann
Goshen, Indiana
Indiana Chamber of Commerce

John A. Travlos
Ottumwa, Iowa
Iowa Association of Business and Industry

OFFICERS

Silas Keehn
President

Daniel M. Doyle
First Vice President

CENTRAL BANK ACTIVITIES

■ Economic Research and Information Services

Karl A. Scheld
Senior Vice President and Director of Research

Economic Research

David R. Allardice
Vice President and Assistant Director of Research

Gary L. Benjamin
Economic Adviser and Vice President

Larry R. Mote
Economic Adviser and Vice President

Anne Marie L. Gonczy
Senior Economist and Assistant Vice President

Steven H. Strongin
Senior Economist and Assistant Vice President

Herbert L. Baer, Jr.
Research Officer

Information Services

Nancy M. Goodman
Vice President

Statistics

Jean L. Valerius
Vice President

Officers and staff, Federal Reserve Bank of Chicago, November 16, 1915—the first anniversary of the Bank's opening.

■ Supervision and Regulation and Loans

Franklin D. Dreyer
Senior Vice President

Supervision and Regulation

David S. Epstein
Vice President

Roderick L. Housenga
Vice President

Geoffrey C. Rosean
Vice President

Nicholas P. Alban
Assistant Vice President

Barbara D. Benson
Assistant Vice President

John L. Bergstrom
Assistant Vice President

Douglas J. Kasl
Assistant Vice President

William H. Lossie, Jr.
Assistant Vice President

Patrick J. Tracy
Assistant Vice President

Alicia Williams
Assistant Vice President

A. Raymond Bacon
Examining Officer

Robert A. Bechaz
Examining Officer

Kathleen E. Benson
Examining Officer

George M. Gregorash
Banking Analysis Officer

John M. Montgomery
Examining Officer

N. Dean Rowland
Examining Officer

John A. Valenti
Information Support Officer

Barbara A. Van Den Bossche
Examining Officer

Gay W. Whiting
Applications Officer

Loans and Reserves

Gerard J. Nick
Vice President

William J. O'Connor
Loans Officer

Federal Reserve Bank of Chicago Management Committee, from left to right: seated, S. Keehn, W. Gram, D. Doyle; standing, C. Furbee, F. Dreyer, R. Sloan, C. Vander Wilt, R. Bush, R. Anstee, W. Conrad, K. Scheld.

SERVICES TO DEPOSITORY INSTITUTIONS

■ Automation and Electronic Services

William C. Conrad
Senior Vice President

Automation Support

Stephen M. Pill
Vice President and Data Security Officer

Kenneth R. Berg
Assistant Vice President

Frank S. McKenna
Assistant Vice President

Karen L. Rosenberg
Automation Officer

James L. Strieber
Automation Officer

Computer Operations

James A. Suprinski
Vice President

Charles L. Schultz
Assistant Vice President

Brenda D. Ladipo
Automation Officer

Electronic Services

Glen Brooks
Vice President

James M. Rudny
Assistant Vice President

Linda B. Grimmer
Assistant Vice President

System Communications Center

George E. Coe
Vice President

Bonnie Bates
Assistant Vice President

R. Steve Crain
Assistant Vice President

■ Operations and Check Services

Charles W. Furbee
Senior Vice President

Cash, Fiscal Agency, and Securities Services

David R. Starin
Vice President

Jerome D. Nicolas
Assistant Vice President

Lawrence J. Powaga
Assistant Vice President

Check Services

Wayne R. Baxter
Vice President

Paul J. Bettini
Vice President

William A. Bonifield, Jr.
Vice President

Allen R. Jensen
Vice President

Theodore E. Downing, Jr.
Assistant Vice President

Charles M. Lund
Assistant Vice President

Diane S. Noble
Assistant Vice President

Colleen M. Walsh
Assistant Vice President

SUPPORT FUNCTIONS

■ Financial and Management Services

Carl E. Vander Wilt
Senior Vice President and Chief Financial Officer

Accounting Services

Jerome F. John
Vice President

Jeffrey L. Miller
Operations Officer

Management Services

Glenn C. Hansen
Vice President

Margaret K. Koenigs
Assistant Vice President

■ Office of the General Auditor

Richard P. Bush
General Auditor

Angelina S. Chin
Assistant General Auditor

■ Office of the General Counsel

William H. Gram
Senior Vice President, General Counsel, and Secretary

Legal Services

Teri J. Kurasch
Vice President and Associate General Counsel

Office of the Bank Secretariat

Joan M. DeRycke
Assistant Vice President and Assistant Secretary

■ Support Services

Richard P. Anstee
Senior Vice President

Administrative and General Services

Robert A. Ludwig
Vice President

Adolph J. Stojetz
Vice President

Susan H. Riis
Assistant Vice President

Facilities Improvement

Robert D. Lauson
Vice President

Human Resource Services

Thomas G. Ciesielski
Vice President

Brian W. Hausmann
Assistant Vice President

Gerald I. Silber
Assistant Vice President

Sheryn E. Bormann
Personnel Officer

FEDERAL RESERVE SYSTEM SECURITIES PRODUCT OFFICE
(effective January 1, 1989)

James A. Bluemle
Vice President and Securities Product Manager

DISTRICT OFFICES

■ Detroit Branch

Roby L. Sloan
Senior Vice President and Branch Manager

Frederick S. Dominick
Vice President and Assistant Branch Manager

Yvonne H. Montgomery
Assistant Vice President

Joseph R. O'Connor
Assistant Vice President

Richard L. Simms, Jr.
Assistant Vice President

F. Alan Wells
Assistant Vice President

Patrick A. Garrean
Operations Officer

■ Regional Offices

Des Moines

Edward L. Ketchmark
Assistant Vice President

Indianapolis

Donna M. Yates
Assistant Vice President

DIRECTORS

■ The selection process for a Reserve Bank's nine-member board of directors ensures broad representation from banks of varying sizes, as well as from diverse sectors of the District economy, including consumers, industry, agriculture, commerce, services, and labor. Three bankers and three nonbankers are elected by member banks. Three additional nonbank directors are appointed by the Board of Governors in Washington, D.C.

■ The directors have a general governance responsibility for the management of the Bank's operations, act on the Bank's discount rate, and contribute to the formulation of U.S. monetary policy.

■ For 1988, Robert J. Day was redesignated chairman of the board and Marcus Alexis was redesignated deputy chairman. In addition, Dr. Alexis was appointed to a second three-year term as a director, and Edward D. Powers and Barry F. Sullivan were elected to serve second terms beginning in 1988.

■ At year-end 1988, John W. Gabbert and Max J. Naylor were reelected as directors and Charles S. McNeer was reappointed, all to begin second three-year terms in 1989. In addition, Mr. Day and Dr. Alexis were again named to one-year terms as Reserve Bank chairman and deputy chairman, respectively.

■ Seven members serve on the board of the Bank's Detroit Branch. Of these, three nonbankers are appointed by the Board of Governors and four additional directors are selected by the Chicago Reserve Bank board.

■ At year-end 1987, the Board of Governors appointed Beverly Beltaire to a three-year term as a Branch director. At the same time, the Chicago Reserve Bank board named James A. Aliber and Frederik G. H. Meijer to serve three-year terms on the Branch board. They replaced three directors who completed their terms of service: Thomas R. Ricketts, chairman of the board and president, Standard Federal Bank, Troy, Michigan; Richard M. Gillett, chairman of the board, Old Kent Financial Corporation, Grand Rapids, Michigan; and Robert E. Brewer, senior vice president (retired), K mart Corporation, Troy, Michigan.

■ At year-end 1988, director Richard T. Lindgren, who served as the Branch chairman for 1988, was again named chairman. Also effective for 1989 was the appointment of Robert J. Mylod, chairman, president, and chief executive officer of Michigan National Corporation, Farmington Hills, to a three-year term, replacing Donald R. Mandich who completed his term. Additionally, Phyllis E. Peters was appointed to a second three-year term as director.

ADVISORY COUNCILS

■ The Federal Advisory Council is comprised of one member from each of the 12 Federal Reserve Districts. Each year the Chicago Reserve Bank's board of directors selects a representative to this group. The council meets quarterly with the Board of Governors in Washington, D.C., to discuss current business and financial conditions. Charles T. Fisher III served a second term as the Chicago Bank's representative in 1988 and also was selected to serve as the council's president..

■ The members of the Bank's two advisory councils served the second year of their two-year terms in 1988. Members are selected from nominations by Seventh District small business and agricultural organizations and provide a vital communication link between the Bank and these important economic sectors.

OFFICERS

■ Appointments to a Federal Reserve Bank's official staff are made by the Bank's board of directors. In 1988 the board promoted Franklin D. Dreyer to senior vice president in charge of the Supervision and Regulation and Loans Department. Dreyer was named to the position upon the retirement of James R. Morrison, senior vice president, who had served the Chicago Reserve Bank for 35 years.

■ Officers promoted to vice president during 1988 included Nancy M. Goodman, Information Services; Allen R. Jensen, Check Services; Jerome F. John, Accounting Services; and James A. Suprinski, Computer Operations.

■ Promoted to assistant vice president were Barbara D. Benson, Supervision and Regulation; Angelina S. Chin, Office of the General Auditor; Linda B. Grimmer, Electronic Services; Brian W. Hausmann, Human Resources; Margaret K. Koenigs, Financial and Management Services; Yvonne H. Montgomery, Detroit Branch; Diane S. Noble, Operations and Check Services; and Steven H. Strongin, Economic Research. In addition, Donna M. Yates was named assistant vice president in charge of the Bank's Indianapolis Office.

■ Other officers appointed during 1988 were George M. Gregorash, banking analysis officer, John A. Valenti, information support officer, and Kathleen E. Benson, John M. Montgomery, N. Dean Rowland, and Barbara A. Van Den Bossche, examining officers, in Supervision and Regulation; Brenda D. Ladipo, Karen L. Rosenberg, and James L. Strieber, automation officers in Automation and Eletronic Services; Jeffrey L. Miller, operations officer in Accounting Services; and Patrick A. Garrean, operations officer at the Detroit Branch.

■ The past year also saw the retirements of Daniel P. Kinsella, Robert W. Wellhausen, and Allen G. Wolkey, all vice presidents in Operations and Check Services, who had each served the Bank for over 40 years, and also Joseph G. Kvasnicka, economic adviser and vice president in Economic Research, following 23 years of service.

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