FEDERAL RESERVE BANK OF PHILADELPHIA

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Dimes, Dollars, and Drive-in Windows

Banking: An Industry of Ideas and Innovation

Farmers Had Good Crops—But Low Prices

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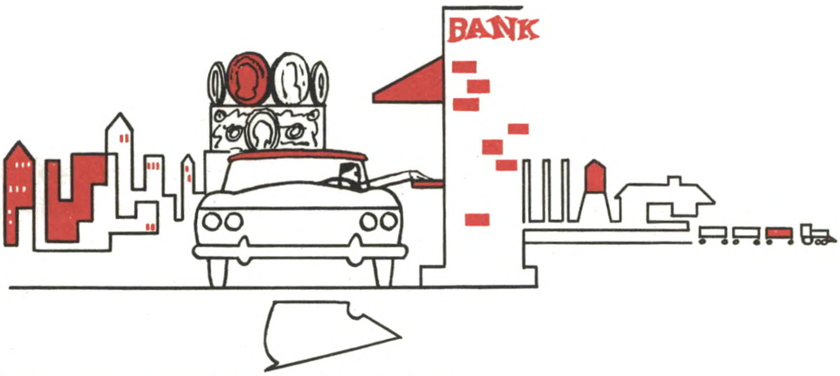
DIMES, DOLLARS, AND 

DRIVE-IN WINDOWS

The Story of Financial Institutions in a Competitive Economy

This is the first of two articles describing our financial institutions. This month we discuss the nature and evolution of financial institutions. In next month's Business Review *we look at financial institutions in the Third Federal Reserve District.*

Stop ten passersby at random. Ask each what thought first enters his mind when someone mentions the term "financial institution." Chances are you will get ten different answers.

The busy housewife, hurrying about the countless chores involved in managing a modern household, might say, "Financial institutions are banks. Like the First National where we keep our checking account. We find it a real convenience in paying bills. And those marvelous new drive-in windows. . . ."

The rising young executive might stress different institutions and different services. He might answer, "Financial institutions are our chief source of capital funds. Why, just the other day we negotiated the biggest loan deal in our history from the Granite Life Insurance Company. . . ."

And so the comments would go. Some people would emphasize particular institutions, some would stress particular financial services. By the time you had finished your tenth interview you would probably have a pretty good idea of the variety of financial institutions and the diversity of services offered.

But you would still need to organize your answers to get an over-all perspective. Only then could you gain an insight into the economic reason for the existence of financial institutions.

FINANCIAL INSTITUTIONS IN PERSPECTIVE

Just suppose that our tenth passerby had been an economist. How would he react when we mentioned the term "financial institution"?

He might say that financial institutions are so varied that we can best understand them by mentioning some of the characteristics and functions which most of them have in common.

First of all, he would probably tell us that most financial institutions collect the funds of individuals and others who don't spend all of their income and lend them to individuals, governments, and businesses which spend more than they currently take in.[1] Thus they are our principal purveyors of credit, helping to determine the direction of economic activity in the United States.

Second, he might mention that financial institutions hold what are called "intangible financial assets." These are written promises to repay, resulting from the lending-investing process mentioned above. They include mortgages, loan notes, and corporate and government securities.

Finally, our economist would probably tell us that the diversity of financial institutions is in itself a sort of common characteristic. Their activities may differ markedly, yet under one or the other of the above criteria a wide variety of businesses still qualify as financial institutions. Some, for example, are principally engaged in making short-term business loans. Some make only consumer loans. Some buy stocks, some buy bonds. Some accept savings deposits, others collect premiums.

From the enclosed chart we get an idea of the wide variety of services provided by our financial institutions. In 1958 there were 54 million checking accounts in the United States, a little over one account for each of our 50.4 million households. In addition, there were about 96 million savings accounts, almost two for each household.

On the lending side, the financial institutions covered in the chart held $236 in consumer loans for each man, woman, and child in the United States, $990 in business loans and securities, and $702 in mortgage loans.

Thus, financial institutions are quite important to our everyday lives—so important that it is difficult to see how we ever did without them. But we did—for thousands and thousands of years.

THE EMERGENCE OF FINANCIAL INSTITUTIONS

Before we could have financial institutions, it was necessary to have money. Before we had money, it was necessary to have something to exchange. Before we had something to exchange, it was necessary to have a surplus over our minimum subsistence needs. Thus, the historical development of financial institutions is inextricably entwined in man's quest through the centuries to satisfy his material wants. By following this quest we can find out why financial institutions emerged and why such varied forms exist today.

Man in a self-subsistent economy

Far back in the misty eons of time—about 1,000,000 to 20,000 years B.C.—man lived in caves and stalked his food deep in the danger-filled primeval forest. His name was Java, Peking, Heidelberg, and Neanderthal. He seemed as much ape as human. His was the stone age.

This early man had no financial institutions.

[1] He might also mention the peculiar case of commercial bank lending and investing which creates money within limits determined by the Federal Reserve System. But this is a story which our limited space precludes us from telling.

Indeed, he had only the rudest of tools—sharp pebbles and fractured flints—to assist him in extracting from a grudging nature the minimum necessary to clothe his hairy form and fill his growling stomach. With little enough to live on, he certainly had nothing left over to save or exchange. With nothing to save or exchange, there was no place for financial institutions.

But man did have certain assets which set him off uniquely from the rest of the animal world. He had a complex brain, a tool-grasping hand, and the capacity for social cooperation. His progress was to come largely through improvements in these basic assets—innovations in the tools and techniques he used to battle nature for his survival—and improvements in societal organization.

As the centuries moved along, man's unique assets proved their worth. From chipped flint and sharp pebbles, he went on to develop spears, bows, and arrows. He learned to domesticate animals. And his crowning achievement, he discovered agriculture.

The change wrought by agriculture in man's way of life was nothing short of revolutionary. With his new techniques he found it possible to produce enough for his own needs and *more.* Although he had not the foggiest notion of it at the time, he had established the first requisite in the inexorable train of events that was to lead to the development of financial institutions—a surplus above that necessary to satisfy his creature wants. But he still had far to go. He had to develop an exchange economy, money, and a need for financial institutions.

Man in an early exchange economy

As the ages passed, important economic changes took place. Man noticed that some of his fellows had become particularly adept at performing some tasks, while others were more skillful at different chores. One could grow more grain per acre, another could turn out more and better plows in a day's work, and still another could make better cooking pots in less time.

Man recognized these facts. Since it now took less than the entire community to produce sufficient food for all, he decided that it was to his advantage to specialize along those lines in which he was most talented and exchange the products of his labor. In this way he could produce more with the same amount of effort, thereby raising his standard of living. Man began to work not only for himself but also for a market. He had developed an exchange economy.

Thus the first two requisites of the financial institution were established. Man had an economic surplus and had begun to specialize and exchange. But still the recipe was incomplete. Man had to develop money and an economic need before financial institutions would appear as we know them today.

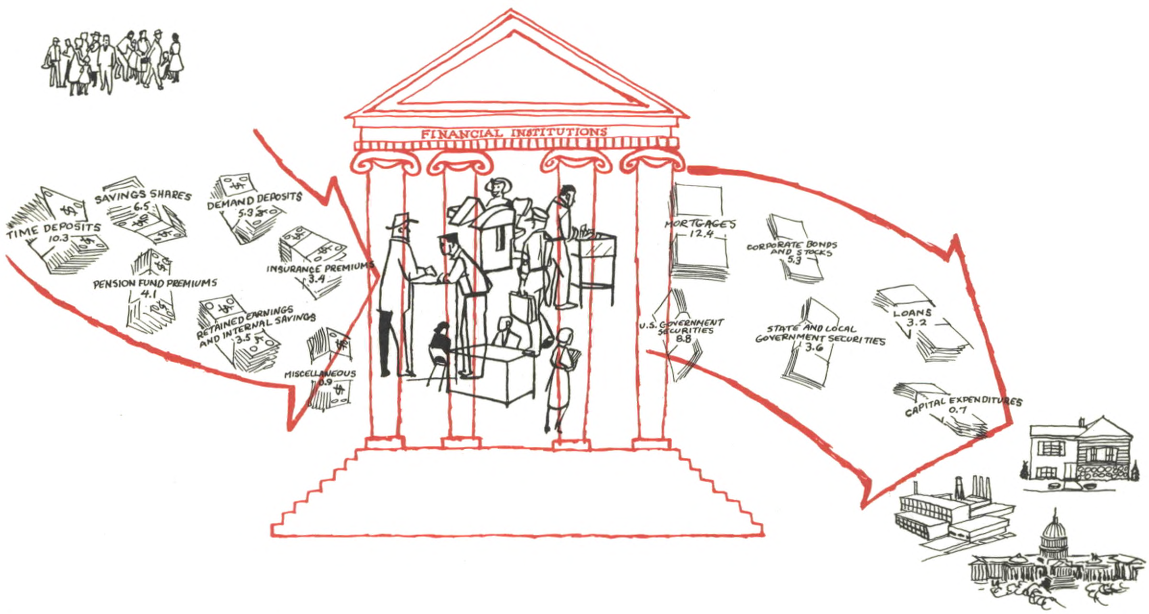
Man in a money economy

In the early exchange economy, trade was burdened by the difficulties of exchange. These difficulties arose because goods were most often bartered.

Barter had several defects. In the first place, problems arose from a multiplicity of values. Whereas the worth of a few oft-traded goods might be well-known and easily remembered—one cow for ten bushels of grain, ten goats for one wife—problems of valuation multiplied as the goods offered for trade increased. It was necessary to quote goats in terms of bananas; bananas in terms of grain and goats; grain in terms of hunting knives, bananas, and goats; hunting knives in terms of goats, bananas, grain,

NET FLOW OF FUNDS THROUGH FINANCIAL INSTITUTIONS DURING 1958*
(IN BILLIONS OF DOLLARS)

SOURCES OF FUNDS



* Excludes flows of funds through Federal Reserve System

Source: Federal Reserve Board

USES OF FUNDS

and so on. Pity the poor housewife at the supermarket if such conditions existed today!

A second difficulty lay in bringing the two parties to a transaction together. For example, if Eklieb, the farmer, should come to town desiring a few tankards of ale, he might bring a suckling pig to offer in exchange. Garth, the brewer, however, might be well supplied with pork, desiring only ox hides. Oogmo, the potter, might need pork but have no ale or ox hides to exchange. Poor Eklieb might die of thirst before he could find someone who (a) wanted pork, and (b) had ale or ox hides.

To overcome these inconveniences, man invented money. Money served him first as a standard of value. Now, cows, hunting knives, grain, bananas, and wives could all be quoted in terms of one commodity—money—thereby relieving the confusion of multiple valuation. Second, money served as a convenient medium of exchange. Eklieb, the farmer, could sell his grain for money which Garth, the brewer, would be more than willing to accept, knowing that some possessor of ox hides would in turn accept it from him.

At first, many seemingly odd things were used as money (and still are by some groups). These included commodities such as salt, corn, or wheat; animals like cows, oxen, or goats; many kinds of teeth—porpoise, whale, shark, dog; woodpecker scalps, feathers, hatchets, fish hooks, and shells. Soon, however, man developed a preference for the more durable and convenient metals to serve as his medium of exchange.

Surplus, exchange, money—all that remained for the development of financial institutions was a need. And that need was soon to be felt.

Man in a credit economy

As population and incomes rose, and as markets widened, a corresponding expansion of industrial and commercial activity took place. To support this expansion, the early merchant or manufacturer needed additional productive capacity. Often, however, his needs were so great as to exceed his available funds. In such cases he was forced to turn to others to borrow the gold and silver which society had begun to accept in exchange for its goods and its labor.

The early entrepreneur probably first approached his family and friends to meet his capital requirements. Or he may have taken in a partner of means. As both domestic and foreign markets continued to widen, however, more new businesses were established and existing ones sought further to enlarge their productive capacity. Supplementary financing was required, sometimes in large amounts. While the early Neolithic potter needed only a small investment in clay and wheel, the pottery manufacturer of Babylon, Alexandria, Phoenicia, or Athens—often serving an international market—required buildings, inventory, and an expanding labor force.

Thus, along with the development of an economic surplus and a money economy, a need for credit became apparent. Herein were all the fundamentals necessary for the emergence of financial institutions. And emerge they did, one by one—first in one city or kingdom, then in another, whenever all of the prerequisites had been met.

In ancient Babylonia, Greece, Rome, England, and on the Continent, financial institutions sprouted like daisies in a summer meadow. But nowhere were the variations and refinements to be of such scope as in the New World, in the United States of America.

THE DEVELOPMENT OF FINANCIAL INSTITUTIONS IN THE UNITED STATES

It is not difficult to see why financial institutions appeared in the United States, a nation with great industrial potential, bountiful natural resources, and an expanding population. But rather than just one or two, today we have more different types of financial institutions than we have fingers to count them on. Why?

The diversity of financial institutions stems basically from the variety of financial *needs* which emerged in this country. As our nation grew we needed funds to finance business and agriculture. We needed mortgage money and depositories for our savings.

To meet our growing financial requirements, the following alternatives were possible:

1. Existing financial institutions could expand their operations to encompass new needs, or
2. Additional institutions could be established as financial demands evolved.

In fact, existing institutions were either reluctant to meet or unable to satisfy fully our dynamic demand for financial services. As a result, new institutions were established as new needs became evident. But let us turn back the pages of time and see for ourselves.

Short-term commercial lending

Our first financial institutions were commercial banks. The first chartered bank in our young country appeared in 1781. By 1834, we had 500 banks. By 1861, we had 1,600.

Banks developed in response to: (a) increasing demand for hand-to-hand currency, and (b) a need for commercial and agricultural credit. They met both of these needs by lending their own personal bank notes to merchants and others. The loan transaction provided credit. The borrower put the notes into circulation in payment of his own obligations, thereby increasing the supply of currency.

But the early banks did not provide nearly the range of services that banks do today. Bankers felt, first of all, that the nature of their liabilities prohibited them from making either long-term business loans or housing loans. Since their deposits and bank notes were payable in gold on demand, and since only a fractional gold reserve was held against these liabilities, they reasoned that their credit activities should be limited to short-term loans of 30- to 60-day maturity. Such loans, they believed, would insure a continuous inflow of funds and thus easily enable them to meet their demand liabilities.

Nor did bankers concern themselves with consumer lending. To lend for consumption purposes, they felt, was to violate the very principle on which banking was built—thrift. Finally, and in spite of their emphasis on thrift, bankers made no provision for interest-paying time deposits.

We can see, then, that a number of voids were evident in our growing economy—voids that had to be filled, if not by bankers, then by someone else.

Savings deposits and mortgage lending

Rising incomes in the United States and the expansion of urban population helped emphasize one of our first and most pressing financial voids. Early in the nineteenth century more people began to accumulate savings. Most individual savings, however, were not large enough to justify the purchase of stocks or bonds. Some alternative outlet was needed, one which would be safe, liquid, and yield some interest.

At the same time an acute housing shortage was developing on our Eastern Seaboard. Immigration from abroad had begun to swell Philadelphia, Boston, New York, and other cities. Expanded housing facilities were urgently needed.

Public-spirited men began to ponder these problems. They concluded that institutions should be set up to encourage thrift by accepting interest-paying deposits. And what, they asked, would be more reasonable than to invest these funds in mortgages?

The result was the mutual savings bank. The nation's first mutual was opened in Philadelphia in 1816. In the same year, a second was chartered in Boston. But the demand for mortgage credit grew faster than the mutual savings bank. In 1831, another type of institution was established, the savings and loan association. Though it had different organizational characteristics, the savings and loan association served the same function as the mutual, accumulating savings and making mortgage loans.

Capital funds and economic security

Along with the growing demand for mortgage funds, an increasing flow of long-term business capital was required as we built new factories, expanded our railroads, and as we pressed westward toward the Pacific.

Fortunately, the rising demand for capital funds coincided with a second developing economic need. People in the United States were becoming security-conscious. With our rising incomes, we had begun to think not only of the present but also of the future. We became willing to part with a portion of our present income to assure our future economic well-being. In short, we became interested in insurance.

The need for security thus gave rise to a new and important source of funds. And this particular source was peculiarly suited to long-term uses. Unlike bank deposits, insurance-type payments were more regularly received and less likely to be withdrawn. Moreover, it was found that current claims could generally be met from current receipts. Thus *liquidity* was less of a problem. Funds channeled into insurance-type institutions could be committed for the long term, to finance our burgeoning industrial expansion and to meet further housing needs.

Given the needs, the insurance-type institutions began to appear. Fire, casualty, marine, and then life insurance companies were first on the scene, followed by trust companies, private pension funds, and much later, investment companies. Some, including the insurance companies, had prototypes in operation even before the signing of the Declaration of Independence. But the real period of development and expansion came after 1850, with the unprecedented expansion in industrial activity and real incomes.

Consumer lending

But not all of our rising incomes were paid into trust funds, savings deposits, or insurance premiums. Between 1850 and 1900, the United States economy gradually assumed the high-consumption personality that so well characterizes it today. Who could resist the gaily painted bicycles pouring off our production lines? What young housewife could forego that wonderful invention, the sewing machine? Consumer sales soared.

And rising sales of consumer goods were accompanied by an expanding demand for consumer credit. Characteristically, however, existing institutions were reluctant to enter this new and unexplored field. They looked at the consumer down the length of their collective noses. Where credit was extended, it was usually the seller of goods who obliged.

But this situation was to be short-lived. As robins are the harbingers of spring so financial needs are the precursors of financial institutions.

Some of the first institutions specializing in consumer credit were the prototype personal finance companies which began to appear in the 1870's. They were followed by credit unions in the early 1900's. At first, these institutions lent not to facilitate the purchase of specific consumer goods but to tide the borrower over some temporary emergency that had arisen in his life. But indirectly they facilitated durable goods consumption, for they provided liquidity during times of stress which otherwise would have had to come from saving—and saving, of course, is abstaining from consumption.

Later, in the twentieth century, personal finance companies and credit unions finally became important sources of credit for specific durable consumption. Then, along with their new competitors, the sales finance companies, they were quick to respond to the wails of the infant which was to become the giant of American industry, the automobile.

In 1900 there were about 8,000 automobiles in the United States. Fifty years later there were almost 50 million. And with the automobile came radios, washing machines, refrigerators, toasters, etc., etc. The modern period of consumer credit had begun. Where consumption loans had been calculated in millions of dollars, they were now expressed in *billions!* Consumers had become the backbone of big business.

The banker breaks his bonds

All of these developments did not escape the penetrating gaze of the banker. He saw the growing demand for housing, for business capital, and for consumer credit. And he was not unaware of the profits which accrued to the specialized financing institutions. But throughout the nineteenth century and part of the twentieth, the demands for his traditional ware—short-term commercial credit—were generally adequate to absorb most of his funds and thus keep him in an orthodox frame of mind.

Let his traditional demands become *inadequate* though, and the banker might prove less orthodox than many suspected. Indeed, he might reverse the entire trend of the development of financial institutions in the United States. Rather than specialization, he might usher in a new era of diversification in financial services.

In the 1930's, after the first financial shocks of the great depression were spent, we had the first real test of the banker's orthodox preference for short-term lending, for his excess reserves skyrocketed while commercial loans began to go begging.

With surplus funds, the banker began to cast about for additional borrowers. In his quest, he noticed certain structural changes that had developed in our economy—changes which might help him bridge the yawning gap between short- and long-term lending. The Federal Reserve System (established in 1913) gave him a source of credit on which he could draw in case a liquidity crisis should arise. The growth of commercial bank time deposits provided funds less subject to sporadic and sudden withdrawal. The introduction of Government-insured mortgages and of a secondary mortgage market added to the safety and liquidity of mortgage lending.

The structural changes plus the existence of surplus funds turned the trick. Mortgage loans, long a staple of the rural banker, became a much more significant portion of the urban banker's loan portfolio. The banker became ever more willing to make long-term loans to business. And, noticing that the sales finance companies didn't "go under" during the depression as he had expected, the banker began lending on a larger scale to consumers. The age of specialization had indeed given way to the age of diversification. The structure of our financial institutions had reached its present-day form.

In conclusion

This is the story of our financial development—from one to many institutions, from specialization to diversification. And running thread-like through the story is one paramount idea—change.

Change is inherent in the very nature of financial institutions. They are designed to provide financial services. Demands for financial services change as our economic wants and objectives change. To meet these shifting demands, it is necessary for us to adjust our traditional ideas of the nature and functions of financial institutions.

In short, financial institutions have been and still are an *evolving concept*. They have changed in the past. They will continue to change in the future.

BANKING:

AN INDUSTRY OF IDEAS AND INNOVATION

Ever notice how many things you can buy today which were not even known a few years ago? Hi-fi, wash-and-wear clothes, wonder drugs, push-button sprays, instant this, automatic that—the list seems endless. Manufacturers, realizing the importance of innovation in modern markets, constantly strive to improve their products.

And so do bankers. Banks, too, are offering more new services than ever before. Banks now have charge account and revolving check credit plans, postal lock box arrangements, and accounting services. You can get a bank loan to buy a boat, a helicopter, or swimming pool. We read about a bank that even provides small certified checks for merchants to give away instead of trading stamps.

Banking's bumper crop of innovations is the latest stage in a long-run trend toward broader services. Early in this century, the commercial banking system specialized in short-term commercial loans. In the 1920's, the system added to its repertoire mortgages and loans secured by stocks and bonds. Consumer credit was adopted widely in the 1930's. Then came the term loan with maturity over a year, the amortized loan, and the equipment loan. Another significant development that began in the 1930's and 1940's was the branch movement which took banking services to the suburbs.

Individual banks, as well as the system as a whole, have been broadening their operations. As late as the 1930's, many banks concentrated on a particular phase of the business. One bank might emphasize its trust department while another would serve large corporations almost exclusively. In the past decade or two, however, most large banks and many smaller ones have been rounding out their activities. They have built up departments that were relatively dormant and added others to extend a more complete line of service.

Now with the standard services offered widely, banks have been thinking up new ones at an accelerated rate. But why the freshet of new features at this time? Before the answers, let's examine some of banking's new product line more closely.

SERVICES NEW AND OFTEN USED

There is nothing new under the sun, the old adage tells us. Perhaps not. Perhaps many of banking's new services are adaptations of old ideas. But it makes little difference here. The things of which we shall speak, if not all recently created, have achieved new importance in the past several years. While all may not be new to banking, they are new to many banks.

We have assembled the following album of innovations from talks with local bankers, current publications, and other sources. It is by no means complete. A lot we had to leave out due to space limitations and, to be sure, a lot we didn't find out. But we hope that it will give the reader an idea of what is going on in banking. The fact that we mention a service does not mean that we endorse it.

What's new for individuals

Revolving check credit is one of the most talked about trends in retail banking. Less than a year ago only a handful of banks offered the service; today hundreds do and every week brings another batch.

Revolving check credit is an application of the line-of-credit principle to consumers. Once approved, the customer may borrow automatically and continuously within certain limits. For a discussion of the subject in some detail, see the September 1959 issue of the *Business Review.*

Charge account plans are banking's entry in the credit-card field. The service has gained considerable acceptance in the past several years, with about 125 banks now offering it. This is the way a typical plan works.

The bank signs up an assortment of retail stores and issues charge cards to selected individuals. Card holders may charge purchases at any participating store; they simply present their card and sign the sales slip. The retailer turns the slips over to the bank and receives credit for the face amount less a discount of 5 to 7 per cent. The bank handles all collection matters. At the end of each month, it bills the customer for his purchases. He has the option of paying the entire sum right away or extending payments over a number of months. Most banks have put a limit on the amount that any one customer may owe.

This plan is designed for the small retailer, giving him, at reasonable cost, a credit plan with which to compete with large merchants and department stores. The service relieves the shopkeeper of credit worries and permits him to concentrate on merchandising. The bank gets a profit from the discount and a foot in the door for new loan and deposit business. Mr. and Mrs. Consumer get a lot of new opportunities to say "charge it."

Tuition payment plans finance college and private school educations. This service differs from other consumer loans in that it makes provision for deferring and extending repayments. Some local banks will permit repayments to run a year or more after graduation, while in other areas where the state guarantees college tuition loans, repayments do not even start until the learner has become an earner.

In most cases the application forms are kept on campus where they are filled out and sent to the bank. Loans are made to parents, guardians, and sometimes to the scholars themselves.

Dental bills may be discounted and financed at certain banks. After drilling and filling, the dentist sells his bill to the bank at a discount. The bank then undertakes to collect from the patient, often in a series of installments. The transaction in many ways resembles the one where an automobile or appliance dealer discounts sales paper at a bank.

In the medical field, one West Coast bank operates a plan which combines health insurance and a credit card to be used for doctors' fees.

In-plant banking brings certain banking services to employees on the job. There are several variations. When the business warrants, banks may set up permanent branches on company property. In other instances, the banks may furnish a company's personnel office with a supply of loan and deposit forms which, when prepared, are forwarded to the bank. Some firms will deduct loan repayments and saving and checking account deposits from an employee's pay check.

Executive transfer departments have been set up by several banks. The idea is to help executives of multi-office companies get settled when they move into town. The bank will make loans to cover moving expenses and will help the new arrival find a home and place a mortgage. It recommends doctors, lawyers, brokers, and advises on schools, taxes, transportation, etc.

The service builds good will with both the company and the executive. The bank, of course, hopes that the new resident will do all his future banking business there.

Insurance premium loans help people spread the cost of insurance. The bank pays the insurance company once a year, taking advantage of the lower annual premium rate. The insured then repays the bank in 12 equal installments. Several policies may be included so that a family's total insurance bill can be handled in one monthly payment to the bank.

Estate planning is a popular service in these days of high incomes and high taxes. Experts well-versed in inheritance laws call on prospective customers to explain how the bank's trust department can save money and trouble. True, this is a business-development device but it can be of distinct benefit to those with estate problems.

Retirement plans for self-employed business and professional people are another relatively new trust service. These plans, already going strong, will receive a big boost if Congress grants a retirement tax concession to the self-employed. Such a bill has been introduced in several sessions but has not yet passed.

Banking has other new ideas up its sleeve for individuals. To name a few: group life insurance for mortgagors, financial plans for bowling leagues, personal money orders, and, a light touch, one bank buys a favorite tobacco and regularly mails it to a client who is overseas in the Government service.

What's new for businessmen?

Lock box collection plans are a fast-spreading feature in commercial banking. Their purpose is to reduce the time it takes to turn accounts receivable into collected cash.

A company directs its customers to address their remittances to a certain post office box. The participating bank has a key to the box and makes frequent pickups—often hourly. The bank opens the envelopes, takes out the invoices and checks, matches the two, and credits the checks to the company's deposit account. Thus the checks wind up as spendable cash a day or more sooner than they would if mailed directly to the company. The bank then forwards the invoices to the company for bookkeeping purposes. National concerns often establish a network of lock-box plans using banks in areas where their customers are concentrated.

While lock-box service may help a bank get and hold good commercial accounts, it may prove quite costly. Sometimes a large number of small items such as utility bills or gasoline bills must be handled. Also, there are concerns that put pressure on banks to do a lot of extra work on the invoices—preparing cash journals, making double photostats, and so on. Because of the time and labor involved, some banks charge a fee for the service, while others offer it only to large depositors.

Account reconciliation plans are designed for companies who use punch-card checks. The bank sorts the checks it receives into numerical order, lists them on a journal sheet, and indicates each outstanding check. Also shown are opening and closing balances for the period. This information helps companies that write checks in volume reconcile their accounts.

Salary deposit arrangements virtually eliminate payroll checks. A firm sends its bank a list of each employee and his net pay along with one check for the total pay roll. The bank sets up a free checking account for each employee and credits his pay to it. The employee may write checks on his account immediately. The company benefits by not having to draw a number of checks, and the employee is saved a trip to the bank. Salesmen and others who are frequently on the road find this service especially convenient.

Freight payment plans are operated by more than a dozen major banks. The clearing house principle is used. Both shipper and carrier—generally truckers but sometimes railroads—maintain accounts with the bank. Validated freight bills are paid by debiting the shipper's account and crediting the carrier's account. The system also is used to settle inter-line freight bills where several carriers are involved in the same shipment.

These plans simplify bookkeeping procedures and cut collection time for the participating companies. Although reputedly not big money makers for the bank, the plans provide a valuable entree to other business.

Accounting service is being offered by a number of banks. The bank is appointed treasurer or fiscal agent for an organization and in that capacity pays all bills, computes and pays salaries, pays taxes and insurance, maintains records, and prepares statements. This frees the customer from routine accounting duties and enables him to devote his time to other things. The bank is reimbursed on a fee basis. It should be mentioned, however, that a bank's legal power to act as treasurer for certain types of organizations has not been fully established in all jurisdictions.

Bookkeeping service is available to the customers of certain banks. It is offered under the copyrighted plan of a Princeton, New Jersey, corporation. Bank customers using the service mark each check and each deposit ticket with a descriptive code number. The bank processes the items in the usual way and, as a final step, key punches a card for each. At the end of the accounting period, the bank sends the cards to the nearest machine accounting service bureau where they are sorted, listed, and totaled. The information thus obtained can be used by a customer to prepare balance sheets, tax returns, and many other statements. The bank charges a fee based on the volume of business the client does.

Research and advisory services for bank customers have been around for a long time but recently the number of banks offering such services has grown considerably. More and more banks now are offering economic forecasts, industry analyses, and marketing surveys to their customers. Also spreading is the bank "letter" (often a small magazine) containing commentary on economic subjects of national and local interest. Hundreds of banks now issue letters on a regular basis. Some banks employ their own writing staffs while others purchase the letter already prepared and send it out under their own name. As a general rule, anyone interested can subscribe free of charge.

A relatively new idea is the bank-sponsored seminar for local businessmen and other groups. A guest expert invited by the bank leads discussions of pertinent problems in business management, personal finance, etc.

Other popular services extended to businessmen are expanded facilities for the purchasing and safekeeping of securities, administration of pension and profit-sharing plans, and draft-collection plans.

WHAT SPARKS INNOVATION

Which comes first, a new banking service or the demand for it? Like the old poultry puzzler, there is no pat answer. In many instances new services are introduced to meet a definite need. Thus, in our dynamic economy, the changing demands of banks' customers are an important spur to innovation. But in other cases the service may come first. Banks may hit upon a new idea and, using Madison Avenue techniques, make their customers want it.

Many other factors have contributed to banking's accelerating rate of innovation. Competition is a major one. According to reports from bankers, competition among banks, especially in the larger cities, is keener now than ever before. In addition, the rivalry between bank and non-bank lenders such as sales finance companies, small loan companies, insurance companies, and many more is said to have intensified.

Economists tell us there are two general ways for business firms to compete: in prices and in products. Price, or interest-rate competition, is not so important in banking because of legal restrictions, tradition, and other reasons. Banks are more likely to compete by differentiating and improving their products. They try to win new customers by giving more, better, and newer kinds of service than their competitor down the street.

The general level of interest rates has edged up in recent years. Corporations, large and small, have not missed the fact. They have acquired the habit of figuring their cash requirements closely and investing temporarily idle funds, usually in short-term U. S. Government securities. This has pinched the banks who previously held these invested funds as deposits.[1] Because banks cannot pay interest on demand deposits, they have tried other ways to compete with attractive market yields. Giving new services is one method they have chosen.

Cyclical changes in the money supply have played a two-way part in the search for new banking services. In recessions, the supply of lendable funds rises relative to demand and banks grow hungry for borrowers. Slack times, therefore, usually finds banks thinking up new ideas to stimulate loan business. On the other hand, in boom periods the supply of lendable funds does not keep pace with demand. Money becomes "tight" and many banks seek to attract and hold deposits—without which the individual

[1] The process of investing does not decrease deposits for the banking system as a whole but it does redistribute deposits among banks.

bank cannot make loans—by extending new services.

Over the years, bank management has changed in at least two ways that may have stimulated innovation. Many banks, largely as a result of mergers and natural growth, are better able to attract well-trained, aggressive executives, men and women who recognize the need for improved services and have the ability and knowledge to implement and operate such services.

The youth movement is another basic management change. Banking's postwar expansion has enabled competent young executives to move up quickly. Many now hold positions of considerable influence. Because they are young, these bankers are likely to be less set in their ways and a little more willing to try out a new idea.

The increased use of machine accounting is another spur to innovation. Many large banks now have punch card installations and some have electronic computers. Machinery has made it possible for banks to offer many new services which would not be feasible with manual methods. In addition to enabling innovation, machines have, in some cases, impelled it. A bank finding it doesn't have enough internal work to utilize new equipment fully may offer new services to customers in order to get capacity operation and thereby cut unit costs.

People pack up and move more than they ever did. One person in five, it is said, changes his residence every year. Thus more people are breaking established banking ties and are shopping around for new ones. This plus the fact that people are more knowing about banks and banking services make it necessary for banks to be up to date in everything.

The factors we have mentioned apply to banks as a whole, but many of them seem to be more pertinent to large city banks. For example, the use of complex machinery, the hiring of younger, better-trained executives, and the struggle to retain corporate balances are more characteristic of big, metropolitan banks. Possibly this is the reason that the mainstream of innovation appears to run from cities to smaller towns to the rural areas. Revolving check service was Boston-born and lock boxes were pioneered in Detroit. Charge account plans, while conceived in a medium-sized Long Island bank, did not achieve wide national acceptance until several "giants" adopted them.

CHANGE WILL CONTINUE

The rate of innovation in banking is not likely to slow in the near future. In fact, it might well accelerate. Banking is now only on the threshold of automation. As banks use more machines—many yet to be invented—there is no telling what new services will develop.

One interesting possibility advocated by Leonard Andrews, a banker and advertising man, is Controlled Credit Communication. This idea, Mr. Andrews claims, could eliminate as much as 75 per cent of all checks written annually. You, as a customer, authorize your bank to pay bills for you by deduction from your checking account. Utilities, insurance, mortgage, rent—anything that comes due regularly—would be covered. The bank combines all payments to each creditor and settles the total with one check. Thus, multitudes of individual checks would never need to be written. So far as we know, no bank has yet adopted this scheme and maybe none ever will. We mention it only as a possibility for the future.

These are exciting days in banking. New ideas are popping all the time. But, as one might expect, rapid evolution also brings some problems and confusion. Many of the new services may prove inappropriate but many others will find a permanent place in banking. Since it's difficult to tell in advance which will be which, a certain amount of risk is involved with innovation. It should also be pointed out that some of the services we have mentioned could be of doubtful legality in certain jurisdictions.

Experts further caution banks that are thinking about adopting a new service. In order to justify it fully, the business gained or retained must offset the cost of the service; the bank otherwise would be giving away slices of profit. It is said, therefore, that banks should make sure their cost accounting techniques are sharp enough to find out exactly what each new service costs and how much benefit it brings.

FARMERS HAD GOOD CROPS—

BUT LOW PRICES

How are crops in the tri-state area of Pennsylvania, New Jersey, and Delaware? Pretty good say county farm agents, but prices are too low. Most of the complaints about prices concerned poultrymen and vegetable farmers. Dairymen with excellent field crops and our tobacco growers appeared to be in the strongest position. However, living expenses and production costs have increased for all farmers. They are in the middle of a two-way squeeze. The outcome: a strong possibility that farm income may decline this year, in spite of good crop yields.

Farmers had a good growing season

Weather conditions over most of the 1959 growing season favored substantial yields of generally high-quality crops. There were some exceptions, like the rains that from time to time plagued vegetable growers in New Jersey and short periods of dryness which temporarily retarded other crops in Pennsylvania. Actually, about the only widespread damage that could be blamed on the weather was the freezing of grain planted last fall. These losses occurred over the winter in the absence of adequate snow cover. A large part of this acreage was replanted to spring crops which matured nicely. Pastures provided plenty of feed for livestock over the entire season to mid-September, when a cold spell ended the growth of most grasses.

Field crops ran to high yields

Corn for both silage and grain seems to be the most promising of all field crops. Some county agents say it is the best they have seen in a long time. This crop matured rapidly in the hot, humid weather of late August, thus minimizing the danger of frost damage. Hay was another large crop this past season, with farmers in some areas making third and fourth cuttings. Above-average yields are reported for early-and late-summer potatoes, but production may be somewhat less than a year ago because of a smaller planted acreage. Quality is said to be high in the leading growing areas. Soybeans, an increasingly important crop in Delaware, may at least equal the high yields reported last year.

Pennsylvania tobacco is an excellent crop

Lancaster County farmers, who grow nearly all of this tobacco, are looking for record or near-record yields this year. The September 1 estimate indicated a harvest of about 55 million pounds. This would be an increase of 8 per cent over a year ago and 14 per cent above the 1948–1957 average. Because of a high moisture content, some difficulty was experienced in curing the early crop. Later tobacco has been harvested under more favorable weather conditions. Last season's crop was sold early at good prices and it is expected that this situation will be repeated. The tobacco growers seem to have been fortunate this season, as little or no damage from hail or frost was reported to this highly vulnerable crop.

New Jersey cranberry growers are optimistic

An estimated 110,000 barrels of cranberries, mostly in Burlington and Ocean Counties, may be produced this year. This would be a crop nearly one-fourth larger than the one harvested in 1958 and would exceed the ten-year average by about 28 per cent. Current reports indicate that quality is high, the berries are large, and they have colored nicely. Although production in competing states also is much larger than a year ago, the carry-over from last season is said to be small, so the marketing prospects should be bright. Blueberries, another small fruit of consequence in this area, did not fare so well. It was too wet at harvest time and considerable trouble was experienced with mold after the berries were boxed and crated.

Vegetable growers had their problems

Early season vegetables grown chiefly for the fresh market are said to have been high on both yield and quality. Sweet corn, particularly, seems to have been a good crop. But some of the later vegetables, including tomatoes for processing, were a disappointment to many farmers. Frequent rains in July, followed by high temperatures and excessive humidity combined to reduce the yield and quality in some areas. Harvesting operations were interrupted and we heard many reports of increasing difficulty in controlling insect pests and plant diseases. Conditions seemed to vary widely among vegetable growers in this District, but those in New Jersey and Delaware appear to have experienced the greatest problems, not the least of which were low prices.

Fruit prospects look promising

Peaches were labeled a good crop almost everywhere this year. The fruit was well-sized, had good color, and market prices were not too bad. In the case of summer apples, however, supplies seemed to run well ahead of the demand. Reports from the commercial growing areas of fall and winter apples continue encouraging. All three states in this District are looking for much larger crops this year than last and production is expected to be considerably above the ten-year average. Most growers say they expect a better price on packaged fruit; moreover, processors' prices in southern Pennsylvania are reported somewhat higher than a year ago.

Dairymen are well off for feed

Two successive seasons of excellent feed and forage crops have strengthened the position of virtually all our dairymen. Milk production has continued high all year. Markets have shown considerable stability and price-wise we have heard few complaints. Production costs, always high on a dairy farm, have been held down as a result of abundant pasturage. Most of our county agents tell us their dairymen will have to buy very little feed this year. They also say, that with the good returns from this season's operations, most dairymen can continue their spending to increase the size and quality of herds, modernize or enlarge dairy barns, and install additional labor-saving equipment.

Poultrymen had another bad year

Over-production that plagued the poultrymen in 1958 appears to have stayed with them this year. The situation has been especially bad for those who raise broilers. Most farmers with laying flocks are said to have fared little better until late in the season, when egg prices rose a little. Some are inclined to blame integration in the broiler industry for too heavy production and continued troubles marketwise. Under this plan, the poultryman builds the houses and cares for the birds, but does not own them. They belong to the companies who supply the feed. Usually, the farmer receives a flat fee for raising the chicks to marketable weights. When this operation shows a profit, the grower receives a share—but this year profit margins are said to have about reached the vanishing point on persistent low prices.

Production costs are creeping up

The living expenses of farmers are still rising—just as are those of everyone else. But, more importantly, it costs the farmer more to produce the things he sells. This was an especially good year for virtually all feed crops, so in this respect the drain on his pocketbook has eased a bit. Not so with the wages he must pay for help. The farmer must compete with the rising wages paid by industry. Machinery, an increasingly important item in the struggle to improve efficiency, also costs more this year. Rising land values are a fine thing in themselves, if a farmer decides to part with some of his acreage. But many times they also imply higher taxes, particularly for those who live near growing urban developments. Thus, from the cost standpoint, 1959 is just another year in which expenses weighed a little more heavily against income.

Farm cash income is off from a year ago

Receipts from the sale of farm products in the three states included in the Philadelphia Federal Reserve District have been running below 1958 levels since early spring. The decline has not been very great, but it must be remembered that 1958 was not a spectacular year from an income standpoint. Over much of the current season, cash income from crops has continued well above year-ago levels, offsetting in large part sharp declines in receipts from livestock and livestock products. Lower prices received this year for poultry, eggs, and hogs were chiefly responsible for the relatively poor showing made by the livestock component of cash income.

As shown by the accompanying table, Pennsylvania farmers are making out somewhat better this year than their neighbors in Delaware and New Jersey, where the agricultural economy is less diversified. Broilers and eggs, respectively, are big cash crops in these two states. And, as previously indicated, there has been too much poultry around this past season.

Farm Cash Income — 8 months 1959 vs. 1958	Crops	Livestock and products	Total
Pennsylvania	+ 13%	— 5%	— 1%
New Jersey	+ 1	— 10	— 6
Delaware	+ 4	— 19	— 14
Three States	+ 7	— 7	— 3
United States	+ 2	— 3	— 1

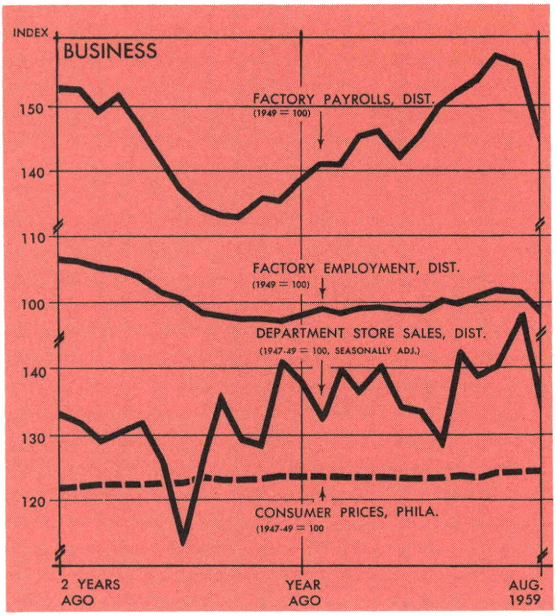
Source: U.S. Department of Agriculture

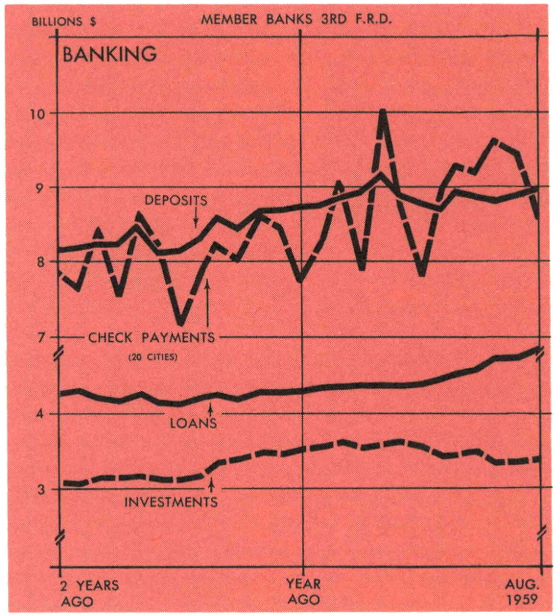
Looking ahead to what remains of the 1959 crop season, it seems quite likely that the dairyman will label this one of his better years. Tobacco farmers and fruit growers will have to wait until their crops have been sold before they know for sure what kind of a season they have had. Right now, prospects look bright for both of them. Those who raised vegetables for the fresh market and for processing no doubt feel they worked mighty hard for their returns. For the poultryman, whose broilers and eggs brought such low prices, this was the second discouraging year in a row.

NEW PUBLICATION

45 Years of the Federal Reserve Act is a revision of the article (40 Years of the Federal Reserve Act) which appeared originally in the Annual Report of the Federal Reserve Bank of Philadelphia for 1953. It gives a brief description of the Act, the historical development of the Act since its beginning, and a synopsis of the major changes over the four and a half decades it has been in effect. This publication is available on request from the Department of Research, Federal Reserve Bank of Philadelphia.

FOR THE RECORD...





SUMMARY	Third Federal Reserve District — Per cent change — Aug. 1959 from mo. ago	Third Federal Reserve District — Aug. 1959 from year ago	Third Federal Reserve District — 8 mos. 1959 from year ago	United States — Per cent change — Aug. 1959 from mo. ago	United States — Aug. 1959 from year ago	United States — 8 mos. 1959 from year ago
OUTPUT						
Manufacturing production.	− 5	+ 1	+ 5	+ 3	+ 9	+15
Construction contracts ...	− 3	−13	+ 7	−16	−11	+ 7
Coal mining	+17	−25	+ 3	+37	−10	+ 3
EMPLOYMENT AND INCOME						
Factory employment (Total)	− 3	+ 1	+ 2	− 1	+ 5	+ 5
Factory wage income.....	− 7	+ 5	+10	....	....	....
TRADE*						
Department store sales ...	− 9	− 2	+ 6	+ 1	+ 2	+ 7
Department store stocks ..	− 1	+ 8	....	+ 1	+ 8	....
BANKING (All member banks)						
Deposits	+ 1	+ 3	+ 5	0	+ 2	+ 4
Loans	+ 2	+12	+ 8	+ 1	+14	+ 9
Investments	0	− 5	+ 3	− 2	− 9	+ 2
U.S. Govt. securities.....	+ 1	− 6	+ 4	− 2	−11	+ 1
Other	− 1	− 4	+ 3	− 1	+ 1	+ 7
Check payments	− 9†	+11†	+12†	−12	+12	+ 9
PRICES						
Wholesale	....	....	....	0	0	0
Consumer	0‡	+ 1‡	+ 1‡	0	+ 1	+ 1

*Adjusted for seasonal variation. †20 Cities ‡Philadelphia

LOCAL CHANGES	Factory* Employment — Per cent change Aug. 1959 from mo. ago	Factory* Employment — year ago	Factory* Payrolls — Per cent change Aug. 1959 from mo. ago	Factory* Payrolls — year ago	Department Store† Sales — Per cent change Aug. 1959 from mo. ago	Department Store† Sales — year ago	Department Store† Stocks — Per cent change Aug. 1959 from mo. ago	Department Store† Stocks — year ago	Check Payments — Per cent change Aug. 1959 from mo. ago	Check Payments — year ago
Lehigh Valley .	−13	−10	−23	− 8	....	....	....	....	−11	−15
Harrisburg ...	− 9	− 2	−19	− 3	....	....	....	....	−10	+ 1
Lancaster	0	+ 6	0	+13	−11	+ 1	− 1	+10	− 8	+ 8
Philadelphia .	− 2	+ 1	− 3	+ 9	− 8	− 2	− 3	+10	− 8	+14
Reading	+ 2	+ 7	+ 1	+16	− 6	0	− 4	+ 5	− 7	+11
Scranton	+ 2	− 1	+ 1	0	− 8	− 6	0	+ 9	− 5	+ 4
Trenton	− 2	+ 3	− 4	+10	− 1	− 3	+ 5	+ 5	−13	−10
Wilkes-Barre .	+ 4	+ 9	+ 3	+13	− 9	− 6	+ 3	+10	− 6	+ 7
Wilmington ..	− 5	0	− 5	+ 6	− 4	− 2	− 1	+ 6	−16	+17
York	+ 4	0	+ 5	+ 7	−10	− 5	− 3	+ 8	−10	+11

*Not restricted to corporate limits of cities but covers areas of one or more counties.
†Adjusted for seasonal variation.