

DURING THE FIVE-YEAR period from 1921 through 1925, Montana lost nearly half its banks through closure, merger or voluntary liquidation. Of the 428 banks operating at the end of 1920, only 220 at best count were still in existence at the end of 1925.¹ It was a staggering blow to the economy of Montana and, in the minds of many of the people who lived through the period, set up shock waves of bitterness that still roll whenever old-timers gather.

Who caused it? Why did it happen? For many, the young Federal Reserve System, and particularly the Federal Reserve Bank of Minneapolis, were convenient scapegoats upon which to shower abuse for this unhappy situation. Their spokesman was Joseph Kinsey Howard.

In his book, *Montana—High, Wide and Handsome*, Howard delivered a savage attack on the Federal Reserve System and the Federal Reserve Bank of Minneapolis for being directly responsible for the merciless liquidation forced upon banks, farmers and ranchers in the State.

¹ This figure was determined from records made available by the offices of the Comptroller of Currency and the Secretary of State for the State of Montana.

He charged:

*The Federal Reserve System, a quasi-public agency, set out coldly and deliberately to smash prices, including the inflated agricultural values its wartime credit policy had helped to establish; and, despite its protestations to the contrary, it did this with brutal haste. After agricultural values had collapsed, the System swung back to a policy of liberal "accommodation" of business and industry—but not of agriculture.*²

Howard, a first-rate newspaperman but no economist, was not the first (and, alas, far from the last) to attack the Federal Reserve System and charge it with many wrongs, most of them deliberate. His charges bear a striking likeness to those made by other critics in the 1920s. His description of the plight of Montana which, within the short period of five years, lost almost half its banks, is vivid. He obviously believed strongly what he wrote, and he wrote well. It is marvelously well calculated to arouse the reader's sympathy for the hapless people caught up in the collapse, and the reader's ire against a specific institution for causing it.

² Joseph Kinsey Howard, *Montana—High, Wide and Handsome*, Yale University Press, New Haven, 1943, pp. 211-212.

SOWING AND REAPING:

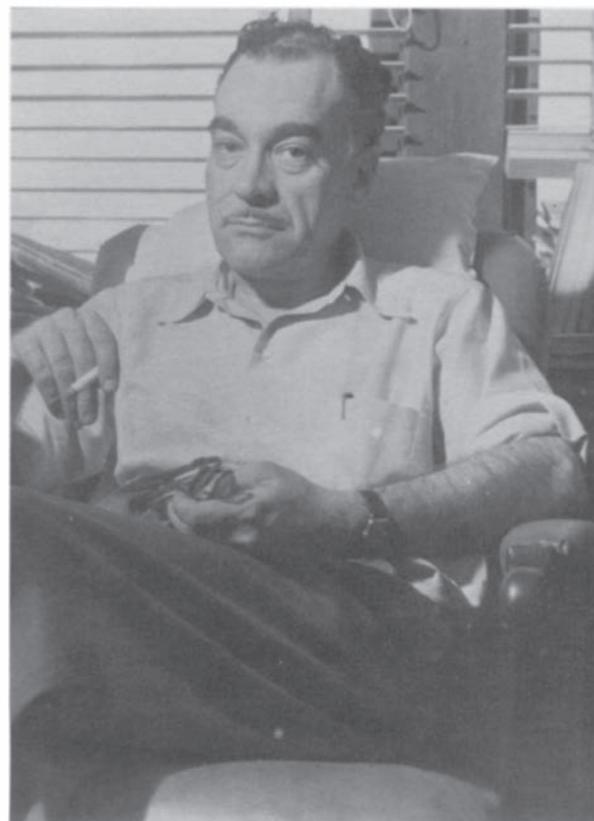
BY CLARENCE W. GROTH



Howard's is a serious book, but was his denunciation of the Federal Reserve Bank warranted? To adequately deal with his charges, to pass upon them and assess them for their worth, it is necessary to delve into the past and find out, if possible, what gave rise to them. Oddly, it is a task to which few historians have thus far addressed themselves.

ONE OF THE EVENTS that affected, at least indirectly, the banking situation in Montana was the spectacular increase in the State's population between 1900 and 1920. At the turn of the century, Montana's population was 243,000; in 1910 it had risen to 376,000; and in 1920 it was 549,000—an increase of 126 percent in 20 years.³

Most of the impetus for this massive migration of people from the midwestern states to Montana was provided by James J. Hill, president of the Great Northern Railroad. Great North-



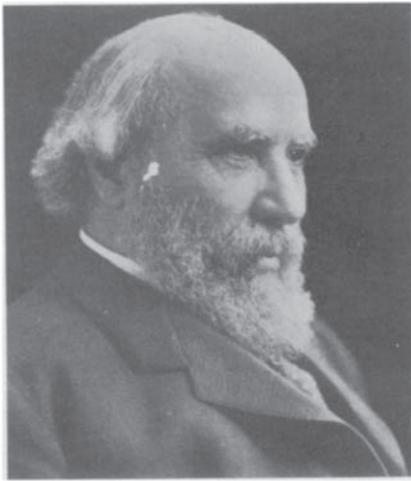
COURTESY ROSALEA FOX, GREAT FALLS, MONT.

JOSEPH KINSEY HOWARD

³ *Thirteenth Census of the United States 1910*, Vol. II, Government Printing Office, Wash., 1913, p. 1132; *Fourteenth Census of the United States 1920*, Vol. III, Government Printing Office, Wash., 1923, p. 574.

Montana Banking--1910-25

EDITOR'S NOTE: This analysis of the role of financial institutions during the terrible decades of the early 1900s in Montana is unabashedly told from the standpoint of the Federal Reserve System. Yet, thanks to a recent reorganization of that institution's archives at its headquarters in Minneapolis, it is the first by-product of those holdings and deserves, in our opinion, a hearing, now that historians are at last beginning to interpret and appraise these political and financial upheavals in some depth. Hugh D. Galusha, Jr., a native Montanan and now president of the Federal Reserve Bank of Minneapolis, has been largely responsible for the reorganization of his institution's archives; it was through his interest in The Montana Historical Society that Mr. Groth's article reached our hands. "As far as I know," Mr. Galusha recently wrote, "Dutch Groth and Joe Howard are the only two who so far have attempted to analyze the role of financial institutions during that desperate time in Montana. They are really companion pieces. Joe's two chapters were written with more passion than accuracy, I suspect, and reflect the spirit of the Non-partisan League and Populist tradition. However quaint it may seem in 1970, though, the beliefs of the League were widely shared and had broad justification. . . . Time has advanced me to the age of the group I once heard inveigh with great bitterness against eastern bankers (and the Twin Cities were way East then!) for the contraction of Montana bank credit and, therefore, the collapse of Montana agriculture. That post-war agricultural needs had changed drastically, with no national policy to cushion the blow, plus grasshoppers and weather cycle changes, to mention only a few of the other factors that accelerated the collapse, were seldom mentioned. Most of those people are now dead, and the interest of their descendants in those agonies may well be marginal, but I think not. It is time now for a new look."



JAMES J.
HILL

ern's line, running across the northern part of the State, had been completed a few years before 1900; it obviously was to Hill's advantage to get settlers into the area served by the railroad. Hill and other prominent men in the eastern and midwestern parts of the United States stated for publication that they believed eastern and middle western farmlands were threatened with exhaustion and, because the northern plains of Montana produced luxuriant grasses, production of crops there would be good.⁴ The implication was that the only requisite to acquire a fortune in Montana was to dig up the virgin soil, plant crops and harvest them.

Travel folders issued by the Great Northern Railroad in 1913 assured crops of 60 to 85 bushels of oats per acre, 20 to 30 bushels of rye, 20 to 25 bushels of wheat, and 18 to 36 bushels of flax. Round-trip homeseekers' fares were listed as \$30 between Minneapolis and Glasgow and \$32.50 between Minneapolis and Havre.

In 1909 and 1912, Homestead Acts passed by Congress provided that 320 acres of land could be acquired by paying a nominal filing fee, erecting a one-room shack and living on the property only seven months of each of the next three years. The full cost of 320 acres was less than \$50 if occupancy requirements were met. In 1912, there were 12,597 homestead entries in Montana; by 1914 the total had jumped to 20,662, nearly seven times the annual average of the first decade of the century.⁵

The mass movement of settlers to the new land brought with it the need for financial institutions.

⁴ Howard, *op. cit.*, p. 176.

⁵ *Ibid.*, p. 177.

IT WAS NOT DIFFICULT for new banks to get a charter. The minimum capital requirement for a Montana state bank in 1910 was \$20,000, paid into the treasury of the bank itself. The State Auditor had the authority to approve these applications, even though he had no other connection with banking. In 1915, the law was amended so that the \$20,000 capital requirement had to be deposited in cash in another bank. In addition, the authority to examine applications and rule on their validity was given to the State Examiner, who was responsible for examining state banks, rather than to the Auditor. The minimum capital requirement for a national bank was \$25,000 in places where the population was less than 3,000.

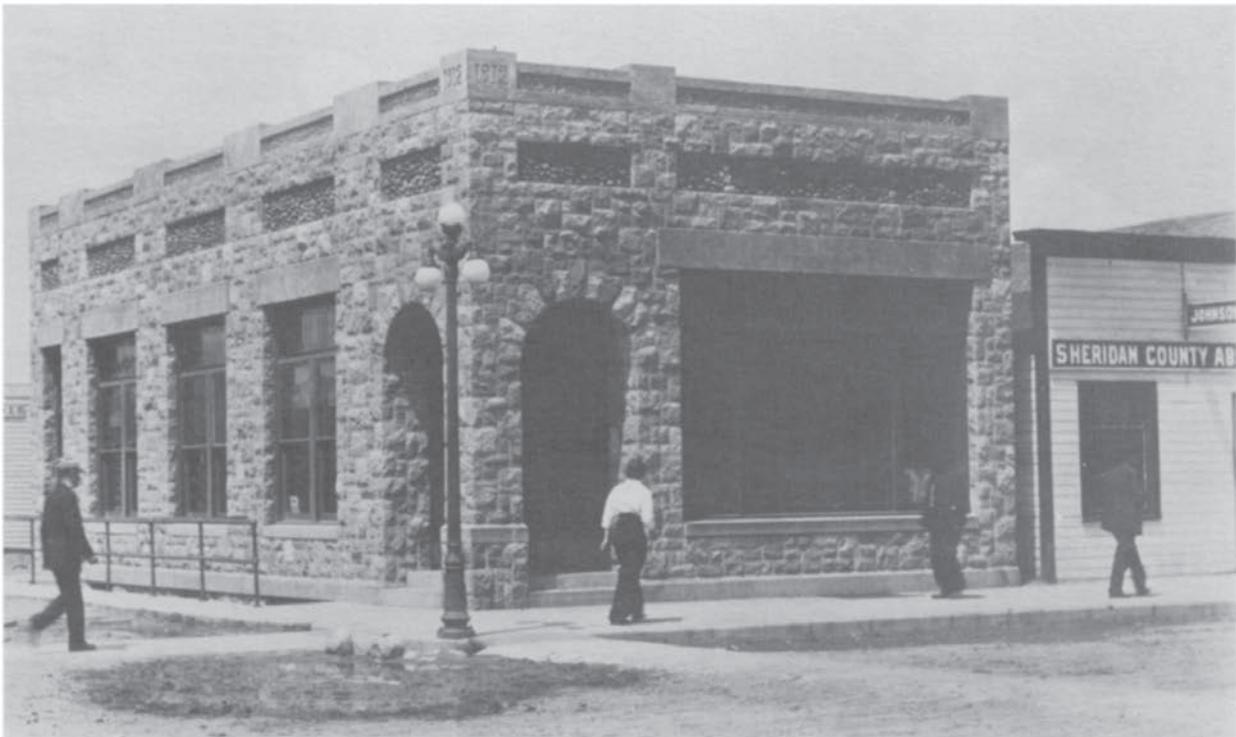
The number of bank charters issued in Montana from 1910 through 1919 was a staggering 397, with about three-fourths of them going to state banks. The high point was reached in 1917 when 82 charters were granted—39 state and 43 national.

Twenty-three of the charters granted during those 10 years were not used. At Bridger, two state banks were granted charters within three days in March of 1915; these charters were not activated. Another was granted in May, and in August a charter was granted for a national bank; neither bank survived. Even now, Bridger has a population of less than 900. At the little settlement of Agawam, which had less than 50 people, a charter was obtained in anticipation of the railroad going through town. The railroad came, but the line stopped at that point, so the bank charter was not activated.

There were a number of instances when two or more charters were granted almost simultaneously in a settlement where there was not enough activity to support even one bank. In Roy, Montana, which had a population of less than 300, two banks were chartered in 1917—both of them subsequently closed. At Opheim, with a population of less than 350, one bank was chartered in 1914, two more in 1917. None of them survived.⁶

To serve a total population of about 37,500 in Fergus, Hill, Sheridan and Valley counties in 1920, there were 85 banks (about one for each 440 persons—against a 1920 national average of one to 3,500). The fact that so many re-

⁶ Statistics relating to bank charters were abstracted from records made available by the offices of the Comptroller of Currency and the Secretary of State for the State of Montana.



A. RIBA'S BANK IN PLENTYWOOD,
BUILT OF NATIVE STONE IN 1912

HOMESTEADERS ARRIVING IN
FLATHEAD VALLEY



COURTESY ROBT. J. MARSHALL, RAVALLI, MONT.

ceived charters and only eight survived is a strong indication that promiscuous chartering of banks during the ten years prior to 1920 contributed in a major way to the financial collapse in Montana during the next few years.

WITH SO MANY BANKS being opened in such a short time, there was a great demand for people to operate them. Since there were not enough experienced bankers to go around, ranchers and businessmen who had little knowledge of the hazards of loaning money, especially under the circumstances existing at that time, were recruited. Outsiders who came to Montana to enter the banking business were wholly ignorant of the economy in which they had to operate.

The prospect of large and quick profits made these inexperienced bankers eager to lend their resources. For a few years prior to 1920 almost anyone could get a bank charter, and almost anyone could get a bank loan. Most of the borrowers were homesteaders who had brought little with them to the new country. In addition to their lack of knowledge of operating conditions in their new environment, they had almost no equipment or livestock for farming. The familiar pattern for obtaining operating money, repeated many times by the new settlers, was to apply for a bank loan to buy horses and machinery and to plant crops. Collateral for the loan consisted of the purchased equipment, the expected crop and mortgage on the 320 acres which had cost the homesteader less than \$50 in filing fees. The bankers knew little about their borrowers except that they owned land (subject to fulfilling the requirements of the Homestead Act) and were willing to try to raise a crop.

The managers of newly created banks charged the borrowers interest at the rate of 12 percent. According to a veteran Montana banker, the 12 percent rate was adopted because it was easy to compute at the rate of 1 percent a month. When a banker at Rudyard reduced his rate to 10 percent in 1917, his action caused consternation in the ranks of his competitors, not only because of the anticipated reduction in earnings, but also because bankers now had to obtain a book containing interest tables.⁷

During the good years prior to 1917, bank borrowers were not asked for payments on their

⁷ John Swanson, vice president and director, Citizens State Bank, Choteau, Montana, to the author, 1969.

loans. If they had anything left to apply on their bank loan after selling their crop, paying living expenses, buying additional equipment, including quite often a new car, the banker accepted the money. Usually the loan was renewed, and frequently the accrued interest was added to their debt; in fact, by that time most bankers had been carrying the loans so long that they had to try to keep their borrowers solvent or go down with them.

Beginning in 1917, Montana experienced four successive years of crop failures caused by drought, hailstorms, grasshopper and cutworm infestations or a combination of these. Then, after two years of fair crops (which brought little money), came two more years of drought and grasshoppers. The homesteaders who came to Montana before 1920 had been carpenters, painters, ministers, teachers, musicians, merchants, butchers, and others who had little or no farming experience. The combination of their inexperience and the adverse conditions made their ultimate fate almost a foregone conclusion.

A number of Hill County settlers recently recorded impressions of their homesteading days. One of them said:

In 1916, I went to Kremlin and bought another team of horses, harnesses and an old wagon for \$400. Got it on time from the First State Bank of Kremlin. . . . From 1917 to 1921 there was nothing but hardships, we just barely got by. In 1921, we had two awful bad hailstorms. In the fall I only got 30 bushels of grain . . . 1923 was a Hopper year . . . 1924 was a dry year.⁸

Another homesteader recounted experiences of a friend:

In the summer of 1916, they all proved up their claims. In the spring of 1917, Ben bought 4 horses and some machinery. He didn't have money to pay for them but it was easy to borrow from the bank, but it was much harder to pay it back.⁹

And finally, "When we left in 1927 about 90 percent of the homesteaders were gone."¹⁰

Banks could not be expected to survive inexperience, ignorance and mismanagement, plus four successive years of crop failures.

⁸ *In the Years Gone By*, compiled as a Centennial project by the Cottonwood Home Demonstration Club, Simpson and Cottonwood, Montana, 1964, pp. 9-10.

⁹ *Ibid.*, p. 2.

¹⁰ *Ibid.*, p. 17.

THE EXAMINATION REPORTS of a number of banks that closed in the early 1920s disclosed that strikingly similar situations existed in many of these banks prior to their closing. The reports reveal that the volume of criticized loans had increased each year, deposits had decreased steadily indicating depositors' loss of confidence in the bank, borrowed money in the form of bills payable and rediscounts had increased from year to year, the management had usually been described as inexperienced and incompetent and, eventually, losses had wiped out the bank's capital. In almost every case, the amount of loans outstanding exceeded deposits, in some instances by a substantial amount. Even by standards in those days, this was bad banking. This pattern in one form or another was repeated over and over in most of the banks forced to close in Montana in the early 1920s.

Painfully, Montanans learned that banking, unlike the other sins with which it was lumped, required something more than opportunity and desire. Managerial skill, capital, and an inherently sound economic base in the community, were basic necessities. They did not have to be present in equal proportions, but no bank could survive for long with none of them.

Moreover, the American search for the devil figure was not turned off by this obvious fact. While it might be acknowledged that Sam X was not the best banker in the world, or even that the combination of weather, grasshoppers, and inexperience gave a push to the slide of many farmer customers, yet the desire to find a scapegoat outside Montana was irresistible. Joseph Kinsey Howard found one in the Federal Reserve. To answer Howard's charge that the System and Federal Reserve Banks savagely and ruthlessly embarked on a course to smash agricultural prices, requires a closer look at the state of the economy and at the position of the Federal Reserve System during that time.

THE TERRITORY SERVED BY the Minneapolis Reserve Bank and its Helena Branch was prosperous during the early 1900s. Good weather produced good crops, and the rapid expansion of the country produced good markets. And then, of course, came World War I and the exhortations to expand production to feed the Allied nations. It seemed almost the millenium; even the most optimistic prophecies of James J.

Hill seemed now to be conservative expressions. Nor was the prosperity limited to the West. The whole country seemed almost to explode with energy and success.

The Federal Reserve System came into existence in 1914. Very quickly, concern developed within the System that this prosperity might degenerate into a speculative boom. The Board, however, could take no positive action—other than issue warnings—because during World War I, the discount policy became to all intents and purposes part of the Treasury's loan policy; the System had temporarily yielded its normal function of regulating credit. The System's discount policy, the interest rate charged on loans to member banks, was regulated, not by the condition of the money market, but by the absolute necessity of aiding the Treasury Department float great issues of long-term bonds and short-term certificates. Obviously, such a policy was dictated by expediency; discount rates were held artificially low, which encouraged bankers to borrow from the Fed and thus expand the money supply. Given this discount policy, the inevitable result was currency and credit inflation.

The armistice in 1918 might very naturally have been expected to put an end to this situation, but it did not. From a financial point of view, the war was not over until late in 1919 and, as long as it continued, the hands of the Federal Reserve Board were shackled.

Toward the end of 1919, the Treasury's war financing was completed and the Federal Reserve System was at last free. Early in November, member banks advanced their discount rates by one-half of one percent. Another increase in discount rates was approved in January of 1920. The Federal Reserve Board also urged all banks to discriminate between speculative and productive loans, and between loans for essential commercial purposes and those for other uses.

The 1919 Annual Report of the Minneapolis office stated, "In endeavoring to curb the drift toward extravagance and to exercise such reasonable corrective influences as it is plainly obligated to do under the law and the regulations of the Federal Reserve Board, the Federal Reserve Bank, through fractional advances in its discount rates, sought to further these purposes and stood prepared to make further advances should occasion demand."

Fears that a speculative boom was developing, with a recession in its wake, were well-founded. The postwar boom continued into 1920, when it reached a peak in the spring, and then prices—especially farm prices—fell drastically.

Not long after the end of World War I, the export of American agricultural products declined as the productivity of European farms was restored to prewar levels. The foreign demand for our agricultural products vanished; prosperity changed to adversity for the farmer. Wheat, which had sold at the Minneapolis Grain Exchange at a price as high as \$3.30 a bushel in early 1920, dropped to \$1.46 later that year.¹¹ Potatoes dropped even more—from over \$4.00 to about \$.70. Prices for meat animals also declined greatly.

Faith in banks and the price of wheat went down together. Runs on banks took place and panicky conditions prevailed in many places. The farmers became vocal about their grievances and their cause was taken up by the politicians and the press. The outcries consisted almost completely of denunciations of the Federal Reserve Board. The charge that the System had deliberately set out to smash agricultural prices was repeated again and again.

During the latter part of 1920, a rumor was widely circulated that the Federal Reserve Bank of Minneapolis had sent letters to member banks instructing them to press for payment of agricultural loans. This rumor was publicly denied, which the following news item from the October 28, 1920, issue of the *Glenwood, Minnesota, Herald* illustrates:

The statement has been made that local banks have received orders from the Federal Reserve Bank to call agricultural loans. A letter issued by the Reserve Bank, signed by C. L. Mosher, Assistant Federal Reserve Agent, says "The Statement that farmer's loans are being called now and that country banks have orders to call loans and deny use of credit facilities to farmers is, insofar as the Federal Reserve Bank of this district is concerned, wholly false. Loans to agriculture and to stockgrowers are 75% of the total credit extensions to commerce and industry (\$80,900,000 agricultural and livestock; \$26,900,000 commercial paper). No circular has ever gone out from this bank instructing member banks to call loans made to farmers or to deny farmers the use of credit facilities."

The amount of aid given by the Federal Reserve to agriculture through the commercial

¹¹ *Eighty-Seventh Annual Report of the Minneapolis Grain Exchange for the year ending December 31, 1969*, p. 85.

banks during this critical period was very substantial. (Federal Reserve Banks loan money to member banks and not the non-bank public, except under rare circumstances. As security for the loans, the borrowing bank has to deposit collateral. If they don't have government securities, they pledge, or "discount," their customer loans.) At the Federal Reserve Bank of Minneapolis, the holdings of agricultural and livestock paper as collateral for loans to member banks were \$1,870,000 in January, 1919. In November, 1920, after farm prices had collapsed, they had increased to \$63,794,000; and in December, 1921, they were \$27,711,000.¹² Federal Reserve Banks in other agricultural districts showed comparable situations.

The average end-of-the-month credit outstanding to Montana member banks at the Federal Reserve Bank of Minneapolis for the four years beginning with 1920 was as follows: 1920—\$7,500,000; 1921—\$10,600,000; 1922—\$7,400,000; and, 1923—\$4,800,000.¹³

It is obvious that the period of falling agricultural prices is precisely when the Federal Reserve Bank of Minneapolis gave its greatest aid to agriculture. It was not, as Howard charges, a case of "half of the farmers and ranchers of Montana going bankrupt for lack of a little credit."¹⁴

John Rich, Minneapolis Federal Reserve Agent, said in a speech in October, 1922:

Upon the floor of the United States Senate the policy of the Federal Reserve System since the beginning of 1920 has been characterized as a "murderous policy of discrimination against agriculture" and "a drastic and cruel policy of deflation." That price deflation has occurred and that it has been of a very drastic character and that it has caused serious losses and hardships is admitted by every authority, both inside the Federal Reserve System and out.

That there has been no material credit deflation is so obviously and conclusively proven from so many official sources that to contend even at this date that credit deflation has been coincident with or has followed price deflation is a deliberate and willful perversion of the facts.

MOST OF THE CRITICISM directed at Federal Reserve during this time came from those outside banking and agriculture. There

¹² *Federal Reserve Bulletin*, issues of March 1919, January 1921, February 1922.

¹³ Taken from the records of the Discount Department, Federal Reserve Bank, Minneapolis.

¹⁴ Howard, *op. cit.*, p. 222.

are no records of homesteader complaints about the treatment received from banks in their areas or from the Federal Reserve Bank of Minneapolis. Neither were complaints voiced by the managing officers of five member banks who, in 1924, expressed in letters their sentiments regarding the Federal Reserve Bank of Minneapolis and the service it performed in the early 1920s. In one of those letters, the bank officer said:

The credit which we have been able to extend to the farmers has proven to be most profitable and of immense benefit to the farmers, and it is only by reason of our ability to re-discount with you that these credit facilities have been made possible for the farmer, and it does get on my nerves when I read some of the criticism heaped upon the Federal Reserve System by would-be politicians. It seems to be a popular place to place the burden of blame for the deflation period which we have passed through.

Another banker expressed his sentiments with the following statement:

In behalf of our bank, I wish to thank you for the courtesies accorded and the financial help so freely given during the last three years, enabling us in turn to stand by our farmers during the years when crops were poor and prices low. But for the help extended by the Federal Reserve Bank of the Ninth District, half of our farms would have been abandoned and many more banks closed.

So, from the professionals, there was little or no criticism leveled at the Federal Reserve System or the Federal Reserve Bank of Minneapolis insofar as their actions in the early 1920s were concerned.

However, the less knowledgeable were never reluctant to attack a favorite target. Federal Reserve Agent John Rich described the situation

well in a 1923 letter to The Honorable C. A. Lindbergh, a former Minnesota Congressman:

I presume mistakes occasioning just criticism are made in every kind of business, but I am continually astonished by the fact that criticisms of the Federal Reserve Bank of Minneapolis, and for that matter, of the System as a whole, are so infrequently of that character, but trace back so invariably to the vagaries, misconceptions and unfounded theories of political and economic adventurers.

A year earlier at the annual conference of Federal Reserve Agents at Washington, D. C., he had ended a speech as follows:

Propagandists will still cry out about the "cruel and drastic deflation" engineered by the Federal Reserve System, but no intelligent or thoughtful businessman or farmer needs more than a few simple facts to convince him that such a charge has not and never has had the slightest foundation of fact or even the faintest shadow of substance.

Although it would be unjust to classify Joseph Kinsey Howard as a propagandist, he certainly was in the populist tradition. Perhaps it would be unfair to include him in the group referred to by John Rich as "political and economic adventurers afflicted with vagaries, misconceptions and unfounded theories." Certain it is, though, that his scholarship in this instance was at fault. Rather than the Federal Reserve Bank of Minneapolis causing the agonizing mortality of Montana banks and farmers in the early 1920s, it came as a result of the State's overbanked condition at the start of the period, inexperienced and incompetent management in many banks, inexperienced and marginal homesteaders, a succession of drought years and poor crops, and, finally, a loss of confidence in banks.

CLARENCE W. (DUTCH) GROTH, a native of Brownton, Minnesota, retired at the end of 1969 after a long and distinguished career with the Federal Reserve System. A graduate of the University of Minnesota in 1927 (B.S., finance major), he began working as a part-time check department employee while still a student in 1923. Subsequent to working in the collection and Federal Reserve agent's departments, he was with the bank's examination department for ten years prior to going to the Helena Federal Reserve Branch in 1948 as its managing officer. He returned to the Federal Reserve Bank of Minneapolis as a vice president in 1955 and at the time of his retirement was a senior vice president. An enthusiastic sportsman, Dutch Groth still lives in Minneapolis, although he and his wife, Ethyl, spent their first winter of retirement at Palm Desert, Calif., where they have been wintering for several years. His seven years of residence in Montana gave rise to his interest in the state's banking history, particularly the difficult years of the 1920s and 1930s as recounted in this article.

