Causes and Effects of Bank Failures in the 1930s and 1980s

An Honors Thesis (ID 499)

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Causes and Effects of Bank Failures
in the 1930s and 1980s

I. Introduction

Hundreds of businesses fail each year. These failures occur when the market value of the businesses' assets becomes less than that of their liabilities. In most business failures, the impact is limited to a few people, mainly the immediate investors. After all, failures are an important part in maintaining a competitive and efficient economy.

A failure is economy's effective way of "saying that the firm's products no longer pass the market test and that its resources should be transferred to other firms." Failures in banking are more important because history has shown that sometimes bank failures cause larger losses than nonfinancial business failures (Kaufman 2). "A family's lifetime savings can be wiped out; corporations can lose millions since the largest deposits are not adequately covered by most insurance plans." Also, bank failures jeopardize a community's continued economic vitality (Rose, "Failing Banks and Bad Publicity" 59). Bank failures can be more disastrous than just a regular business failures, since bank failures, if numerous enough, can wreck the economy. This was best shown by the bank failures that occurred in the 1930s.
There were three waves of bank failures in the early Thirties. These waves seemed to have an almost domino effect. By 1933, 9,000 banks, which had deposits totaling $7,000 million, failed. The situation had deteriorated so rapidly that by March 5, 1933, every state had declared a bank holiday. When President Franklin D. Roosevelt's Inauguration Day was over, he closed all the banks for a week.

During this week, the financial machinery in the United States was completely shut down. "The wheels of trade and industry slowed down immediately and ... the economic life of the nation was threatened" (Nadler and Bogen 1). Though the United States recovered, the early Thirties' bank failures will always be remembered.

When banks started failing by the hundreds in the 1980s, some people started to worry. Was history about to repeat itself? Did all these failures mean that the United States banking system was about to fail again? With a casual look, one may say history was repeating itself.

However, if one looked closely at the bank failures in the United States in the Thirties and the Eighties, one would notice that the causes are different. Also, the effects of the bank failures are not the same. A close examination at the causes and effects of the bank failures in the Thirties and Eighties would prove that history is not repeating itself. This paper will first compare the causes
and effects of the bank failures in the Thirties and the Eighties. We begin with the early seeds of the bank failures in the United States in the Thirties.

II. Early Seeds of the Bank Failures in the Thirties

The early seeds of the bank failures in the United States in the early Thirties were planted during World War I. Many studies of the banking crisis placed a great deal of emphasis on World War I, since the war destroyed the international economic system and altered the financial balance of the world, mainly by encouraging inflation.

In the United States, the Federal Reserve System was the main source of inflation. When it was organized, the men who created it wanted rational control by an efficient management, which would make it an "effective stabilizing agent" in the economic structure. Those who set it up thought of reserves and ratios rather than of leadership. For in practice, the Federal Reserve System worked with efficiency when it came to "credit expansion and prosperity creation," but it had rarely been utilized to "deflate credit and check speculative booms" (Nadler and Bogen 9). Thus, the newly organized Federal Reserve banks paved the way for a great inflation of bank credit.

Bank credit grew nationally, but more importantly, international indebtedness increased enormously. This overseas lending along with the "liquidation of foreign-owned stock enabled the United States to emerge from
the war as the leading creditor nation of the world" (Fearon 16). This later would prove to be disastrous.

President Herbert Hoover tied to blame the disaster of the Thirties upon the war, but the seeds planted during the war were only a small part of the later financial problems. Hoover would have been more correct if he had placed the blame on the peace that followed World War I. The end of the war was the beginning of a "generation of political leaders who were veritable economic and financial madmen" (Nadler and Bogen 4). Even the resulting peace treaty was said to show this.

Because of World War I and the resulting peace treaty, there should have followed an economic depression. Instead, the financial and political leaders of the Twenties decided "that this cataclysm, the day of reckoning, inevitable though it seemed, should not occur." So, they counteracted by creating debt, which resulted in the "inevitable corrective depression" that occurred in the Thirties (Nadler and Bogen 6). But the leaders then were only concerned with the present, and inflation seemed to be the answer.

The Twenties brought about an unprecedented recourse to inflation as a remedy for the unbalanced economic conditions of the time. Both nationally and internationally, inflation continued. "The old reliance upon automatic economic adjustments, upon laissez-faire doctrines preached by the British economists, gave way to a general recourse to
currency and credit management as a means of escaping the penalties of economic maladjustments" (Nadler and Bogen 7).

The world tried to escape from the economic maladjustments of its actions. So, money began to get manufactured greatly in order to have purchasing power to overcome the threatened depressions. The first post-war bank failure epidemic started on a large scale in 1921. The land prices in the Midwest and the Northwest fell, which caused a lot of banks in those areas to close down, because land had been used as collateral at the banks. The year of 1926 was the worst for bank failures before the depression began. Over nine hundred institutions closed. A lot of these were closed because of the collapse of the Florida land prices. Most of these institutions were small, local banks, which caused the communities in which they were located to suffer, but not the whole nation (Nadler and Bogen 23). Therefore, the rest of the nation paid little heed.

Most of the nation in the Twenties was experiencing a huge boom. The principal characteristics of this boom were "a flow of consumer goods, high company profits, low unemployment, a stable price level, great advances in productivity, a building boom and mounting speculation in property and on the stock exchange" (Fearon 29). Because of this huge boom, the nation did not worry about the economy.
Throughout the Twenties, economics was dominated by politics. Oddly enough, economists lent their talent and name to rebuilding the world in a totally disorganized fashion by the politicians. Only J. Maynard Keynes protested. The world did not listen to his "gloomy but unerringly true prophecies." Keynes pointed out in two separate books the "imbecility of new economic arrangements" (Nadler and Bogen 5). But no one would listen to Keynes.

The great slump that Keynes had predicted began in 1929. Its origins in the United States were caused by reducing its capital imports and exports of goods. This placed an unreasonable strain on the economy. The financial and economic structure in the United States in the 1920's was fragile, and the economy was moving into a recession; therefore, when the United States boom started to collapse, the "general collapse was inevitable" (Fearon 58). The United States boom collapsed because of the fragility of its financial and economic systems.

It would be hard to explain why the turning point came when it did. As Goronwy Rees explained:

Despite the sophistication which economics has achieved in recent years, economics is not yet so exact a science that it can assign precise causes to precise effects. Sometimes indeed it is unable to distinguish between what is cause and what is effect; it is even more incapable of telling us what precise weight and influence we should give to economic factors in a total situation in which political and psychological factors are at least equal if not greater importance. (Rees 254)
Many feel that the death of the gold standard in Europe hurt the banks in the United States. Although the gold standard has been adopted to further financial stability, it was too inadequate. Britain's going off the gold standard in 1931 "not only broke up the international monetary system but also triggered off a further round of deflation in those countries that chose to maintain the gold value of their currencies" (Fearon 48).

The gold standard failed partly because of the way that it had been restored in the Twenties. Before the war, the gold standard operated under "conditions of equilibrium," but in the Twenties, the economies were fundamentally imbalanced. There were several weaknesses in the system. These included the position of London, which was in a vulnerable position, as reserves fell short of sterling liabilities, and the loss of gold from the primary producing countries as agricultural prices fell. The post-war gold standard did not provide stability, but rather was a source of instability (Fearon 24-5). Some disastrous events, which will be described later, were the result of the failure of the gold standard.

In fact, the failure of the gold standard may have led to one of the three major causes of the bank failures in the Thirties in the United States, business depression and price deflation. The other two major causes were managerial defects and structural defects in the American banking system (Nadler and Bogen 25). A large portion of the banks
failed because of price deflation and business depressions, which will now be examined.

III. Business Depression and Price Deflation in the Thirties

For thousands of American banks, the effects of the European monetary crisis were the last straws. These banks were holding mortgages that they could not foreclose at even close to their face values. Also, the banks were loaded with frozen assets. The real estate value in New York fell to about sixty percent of its value in 1929. Equities were destroyed, so any kind of mortgages became uncertain investments. Banks that had mortgages as collateral for bad loans were getting even more desperate. Hoover called a secret meeting of the big bankers and begged them to pool in and help the weaker banks. They refused and said that there was nothing that they could do that would help (Bird 18).

After Britain abandoned the gold standard, American banks started to liquidate in terror. They called in loans. They sold bonds and stocks that they had been holding as collateral for several years. In fact, they sold off so many bonds that the prices of the bonds fell by twenty percent. When the banks were taking these losses, the real condition would begin showing up in their books, which triggered even more desperate moves. "More than half of the $5 billion shrinkage of bank deposits between 1929 and 1932 took place in the last three months of 1931" (Bird 18-19).
Price deflation became more evident.

As will be shown, the United States suffered severely from the deflation which accompanied the devaluation of the pound. This was emphasized by the fall of sterling which took place at the end of 1932. "From 3.39 to the dollar in October, sterling fell to 3.27 in December and did not rise above 3.43" for a while (Rees 256). In fact, it was not until the banking crisis was over that sterling started to rise.

The fall of sterling resulted in fluctuations and uncertainties for the stock exchanges. The value of the sterling, and the currencies which copied its example, did not fall and remain at a fixed point but fluctuated over a wide range. These fluctuations created an uncertainty which resulted in disaster for the traders as they were not permitted to take out any insurance through forward currency transactions. "And beyond all the damage done to normal trading, exchange fluctuations increased the risks of long-term capital investment to such an extent that for a time it almost totally ceased" (Rees 257). The fall of sterling had still other effects.

The discontinuance of gold payments in London and the devaluation of sterling in London caused the central banks, which kept part of their reserves in sterling, to have a reduced value in their reserves at a time when large withdrawals where taking place. Smaller central banks and
financial institutions were suffering also because of the value that they had placed on sterling (Rees 256-7). The losses from the devaluation of sterling were great.

A desperate struggle for liquidity followed as banks tried to cut their losses from the devaluation of sterling. As gold prices also fell, the United States and other countries tried to protect their markets by "erecting a formidable wall of tariffs, quotas, exchange restrictions, import prohibitions, barter agreements, and central trade-clearing agreements" (Rees 257). But these actions were not enough.

Depreciation in values of securities and collateral was said to be the cause of 489 bank failures in the United States in the Thirties. Over 1,500 banks were said to have failed because of local financial depression (O'Connor 82). Besides the European crisis, the business depression in the United States, which started with the stock market crash in 1929, was a major cause of the bank failures, because stocks were used as collateral at the banks.

After the crash in 1929, the confidence of the business people in the financial world was badly shaken. That resulted in few new industries, and trading activities were at a low point. Few businessmen dared to venture into new business attempts. The bankers were not willing to make loans as they were said to have already made loans that were ludicrous.
But the fact was that these loans were made ludicrous only because of the depression. As John Sperling wrote:

Loans which would have been perfectly good were perfectly foolish by the collapse of the borrower's prices or the markets for his goods or the the value of the collateral he had posted. The most responsible bankers - those who saw that their debtors were victims of circumstances far beyond their control and sought to help - were often made to look the worst. The bankers yielded, as did the others, to the blithe, optimistic and immoral mood of the times but probably not more so. (Sperling 154)

Price deflation and business depression proved to be systematic causes of bank failures, not random causes.

The price deflation and business depression caused some of the bank failures but can not be said to be the reason for the banking crisis in the United States in the Thirties. The Canadian and English banks withstood the attack of the depression very well. It was a lack of a strong banking structure and a good management in the banks that caused the crisis to be worse in the United States. Managerial defects will be examined first, and then the banking structure.

IV. Managerial Defects in the Thirties

Over 1,400 banks failures were attributed to incompetent management. Of these, 271 were caused by the defalcations of officers and employees. Excessive loans to officers or the directors for their benefit caused 128 bank failures (O' Connor 82). Inexpert management, unwise management, and dishonest management all caused the United
States' banking system to suffer.

One problem with the bankers was that they were almost always on the side of inflation, and they "generally agreed that aggressive open market operations and lower discount rates were in order." One famous meeting of the bankers in New York in the summer of 1927 brought about large purchases of government bonds by the Reserve banks and a reduction of the rediscount rates, events which are generally agreed upon as those which caused the stock market boom and crash in 1929 (Nadler and Bogen 5). The bankers were just not wise.

Embezzlements were another main reason that a lot of the banks were going under. Even the most upright banker was discredited by the embezzlements uncovered. Columnist Marquis Childs wrote about a fictional bank president who was "so pious that the very sight of him reassured depositors. Yet when the pinch came, he was caught looting $300,000 from the personal accounts of leading citizens who had left their money with him for safekeeping" (Bird 97).

Though Childs wrote about a fictional bank president, the man he described could have been real. Charles E. Mitchell, president of the National City Bank, borrowed money from the bank to cover his losses from the stock market (Bird 95). The bankers in Texas offered a reward for anyone that brought in a dead bank robber, but the bankers themselves were said to embezzle more than the robbers ever did (Bird 97). All over the nation, bankers were known to
loot money.

In one disturbing case in Columbus, New Mexico, the Mexican government had paid a local widow $10,000 indemnity because her husband had been murdered when Pancho Villa raided the town. A bank president heard of it and personally persuaded her to deposit the check in his bank. The next day the bank was closed forever (Bird 13). Embezzlements became a growing problem.

One reason for the embezzlements was that it was too simple to be a banker. It was comparatively easy to receive charters. Banking was still thought of to be strictly the "private affair of the banking proprietor with an absolute right to own and operate his bank without any supervision or control whatsoever by governmental authorities" (O'Connor 6-7). Since it was so easy to become a banker, a lot of the bankers were far from experts at banking.

Inexpert management of the banks also led to failures. The best example of this was the failure of the Bank of the United States in New York, which failed in December of 1930. Investigation brought out some startling irregularities to which the state bank examiners had consented because they thought it would help maintain confidence (Bird 17). However, the lack of expertise of these examiners caused the bank to fail.
Not only were the managements far from being experts, but they were also unwise. Many of the banks' loans in the United States became more questionable in the Twenties. After 1925, the judgment of both the underwriters and investors worsened. Banks were using the aggressive approach of searching for potential borrowers. This led to fierce competition, and many agents urged their clients to borrow to the hilt. The bankers used more enthusiasm than common sense.

However, the bankers were not really that much more foolish in the Twenties. The banking structure was too weak, which caused a lot of the banks to fail. As John Sperling described it:

The weakness was implicit in the large numbers of independent units. When one bank failed, the assets of others were frozen while depositors elsewhere had a ... warning to go and ask for their money. Thus, one failure led to other failures, and these spread with a domino effect. When income, employment, and values fell as the result of a depression, bank failures could quickly become epidemic.

(Sperling 154-5)

The weakness in unit banking and other structural defects will now be discussed.

V. Structural Defects in the Thirties

The major structural defect in the United States banking system in the Twenties and Thirties was unit banking. Branch banking was not permitted in most states. Of the few states that allowed it, most restricted it to
city limits (Nadler and Bogen 25-6). So, branch banking was rare.

Branch banking had several dominant foes. The first opponents were the officials of the unit banks. These officials feared that they would lose their position and livelihood if branch banking was allowed. The stockholders of unit banks also opposed branch banking. The stockholders felt that their equities would decrease in value if the strong city banks were allowed to enter the community and take away deposits because of their reputation and strength. Large business corporations did not want branch banking as they wanted to keep the local bankers in servitude by their deposits. The large city banks did not want branch banking either. Large profits were made by the large city banks when they acted as correspondents for the smaller banks. One large bank that took a big stand against branch banking was a correspondent to 3,000 out-of-town banks (Nadler and Bogen 27-8). With so many foes, branch banking did not have a chance of surviving.

The United States system of the small unit banks was one of the weakest and most obsolete links in the economic structure. One major defect in unit banking was that there was not enough talented management to supply the thousands of institutions with skilled management. Effective supervision and regulation of the thousands of banks were impossible tasks for the authorities. Some argued that the unit banking system allowed the existence of too many
independent banks, which resulted in cutthroat and excessive competition (Nadler and Bogen 32). But more importantly, there were two basic weaknesses that affected unit banking.

The first defect was that "unit banking may be likened to a long chain made up of innumerable links, large and small, strong and weak" (Nadler and Bogen 29). When the chain is subject to strain, some of the weak links break. In a country with unit banking, the weaker banks fail. These bank failures have a contagious effect, and the strong banks start to feel the strain.

The second defect in unit banking was that it did not permit many of the banks to have sufficient degree of diversification in their business. Farming communities had banks that depended entirely on farming, and other banks in small communities depended on one industry (Nadler and Bogen 30-1). When the economy caused a particular industry to slow down, the banks felt the strain.

Another structural weakness of the banking system in the Thirties was the existence of national and state banks side by side, "subject to 49 different laws and regulated by different authorities." The organization of the Federal Reserve System in 1913 further confused the system. As a result of the confusion, less than ten percent of all state banks were members of the Federal Reserve System. The dual system of banking allowed national banks to free themselves from the control of the Federal Reserve System by changing
to a state charter (Nadler and Bogen 32-35).

All these structural defects led to bank failures. When added to the failures caused by managerial defects, plus failures caused by business depression and price deflation, a banking crisis developed quickly as there was no insurance on deposits, and bank runs became numerous.

The banking crisis in the Thirties had numerous consequences in the United States. The epidemic was a strain on businesses and individuals. The bank failures produced economic, legal, international, and social effects. The after effects continued for several years after the crisis climax ed on Franklin Roosevelt's inauguration. These effects will be examined next, starting with the economic effects.

VI. Economic Effects in the Thirties

The bank failures resulted in wrecking the economic system. The bank failures hurt the business world in various ways. When a bank failed, the value of commodities and real estate dropped even lower. Businesses that used to depend upon the banks for their loans were suddenly without this customary accommodation, which forced them to the wall (Nadler and Bogen 21). The worst economic effect though was that the failures of the banks tied up the bank deposits, which reduced the supply of money.
The effect on the supply of money was induced by the result of the increased probability of bank runs. The banks tried to increase their ratios of reserves, and individuals attempted to enlarge the ratio of currency in their cash balances. These changes in choices resulted in a reduced money supply. When the individuals withdrew the currency from banks to increase the proportion of currency in their cash balances, the currency stopped being available for bank reserves. Also, each dollar of bank reserves resulted in fewer dollars of deposits as the banks increased their reserve ratios (Temin 53-4). So, money became scarce.

When individuals started saving more and hoarding the money, money became even scarcer. A dependable bank president said that savings could wreck the economic system. He went on to state that savings would tear down the economic system if the savings took the form of hoarding (Chase 12). The banks paid out a lot of cash to the hoarders.

Banks paid out so much cash in the early Thirties that the sum of the money in circulation raised every week. Usually, the majority of money changed hands by check, and only "one dollar out of every ten is spent in cash. As Roosevelt's inaugural approached, the overworked mint was providing one out of every seven dollars in cash" (Bird 103). This was still not enough. People still lined up at the banks, took cash, and hoarded it. The bank failures restricted funds and increased the financial difficulties of
educational institutions. At one time in a single state, $15,000,000 in school funds were frozen by the bank suspensions (Enzler 109). The economic plight of all private educational and charitable institutions was devastated by frozen funds, through local mortgages and securities or in closed banks (Hansel 145). Most of the closed banks were the weak country banks.

When the weak country banks began to slip, the sound banks were hurt in the aftereffect. As Nadler and Bogen described the economic aftermath that followed the failure of the weak banks:

Like a deadly and contagious epidemic, which strikes down healthy men and women in their prime as well as the sick and the halt, the wave of bank failures which spread over this country with unexampled and unbridled force after 1929 struck down institutions that had withstood successive panics and depressions in the past. Vast areas were left almost without banking facilities when the holocaust was over. (Nadler and Bogen 22-23)

The failures of the country banks weakened the city banks, which generated runs on them. Everywhere banks liquidated their assets at a sacrifice price so they could meet the demand for cash. The bankers could not afford the risk of lending their money out, which delayed the expansion of normal and legitimate business, as well as crop financing and inventory (Bird 98). Because of President Franklin Roosevelt's swift legislative acts, the economy began to pick up and become less bleak in his presidential years.
Hoover's and Roosevelt's legislative acts that resulted from the bank failures will now be examined.

VII. Legal Consequences in the Thirties

Herbert Hoover had tried to end the financial disaster that was taking place when he urged the bankers to form the National Credit Corporation (NCC). (In spite of its name, this was not a government body.) The bankers provided the NCC with $500 million that it was to lend to shaky banks. President Hoover was proud of the fact that he had dealt with the problem in what he called the "American way." But the solution that he devised came too late and provided very little relief. Another problem with the NCC was the bankers who were in control of it. They were in Hoover's own words, "ultraconservative, then fearful," and the corporation died because the bankers were too hesitant to lend the money to the banks that were in need the most (Garraty 35).

After the demise of the NCC, Hoover stressed the maintenance of the safe fiscal position of the federal government. While he claimed this in 1931, nearly 2,300 banks failed. Finally in 1932, though Hoover was reluctant to approve it, Congress created the Reconstruction Finance Corporation (RFC). The RFC was a model of the War Finance Corporation, which lent money for expansion of plants for companies engaged in production of war materials in 1917-18. The RFC was a "federal agency empowered to lend money to troubled banks, insurance companies, railroads, and state
and local governments" (Garraty 35).

The RFC had a twin policy of providing relief to the commercial banks by capital investment and loans. In 1932, the RFC started to lend out what was to become a total of $1.5 billion in an attempt to save the banks and businesses (Bird 79-80). One controversial issue of the RFC was that by investing money in the banks by buying capital stock, the government became part owners and managers of the banks (Romasco 56-7). The RFC was one of the major acts passed by Congress while Hoover was President.

Congress also passed the Federal Home Loan Act in July of 1932, while Hoover was still President. This established twelve district banks that were ruled by a Federal Home Loan Bank Board like the Federal Reserve System. The new Home Loan Bank System was slow in getting started. At the beginning of 1933, only $838,000 of total loans were outstanding. By the end of 1933, the total loans outstanding had climbed to $94 million (Rothbard 279). The success of this may be due to the fact that Franklin Roosevelt became President.

When Roosevelt became President, the nation was at its bleakest point in history. Almost every state had declared bank holidays. The day after his inauguration, President Roosevelt called for a special session of Congress for March 9, 1933. Meanwhile, he executed orders under World War I legislation that declared a four-day bank holiday and
forbade dealings in gold and silver without the permission of the Treasury (Frisch and Diamond 89-90).

Roosevelt turned to the RFC to carry out the task of permitting banks to go back to their primary task of lending. Roosevelt informed the head of the RFC that:

The government needs the willing and confident cooperation of its banks and is willing to go into partnership with them on a limited basis, permitting the banks to end the partnership at will, but in the meantime making it easy for them to furnish the credit necessary for the recovery program. (Romasco 55-6)

By March 9, 1933, most of the banks had reopened; a restoration of flow of funds to the Treasury and Reserve Banks set in, and within two weeks stock prices rose about fifteen percent. On March 9, Roosevelt's orders were confirmed by the Emergency Banking Relief Act. This Act gave Roosevelt immense powers in banking, precious metal, and currency. The RFC was authorized to buy the preferred stock of trust companies and national banks (Frisch and Diamond 89-90). The panic was checked. Roosevelt's Administration reversed itself from Hoover's Administration and rapidly went toward monetary inflation, credit expansion, price and wage rises, public works, and relief payments. The most important decision was forced on Roosevelt by an "inflation-minded Congress." This decision was to go off the gold standard, and Roosevelt, on April 20, 1933, did this by placing an embargo on gold (Sperling 145).
On June 16, 1933, which was the last day of the session that was called the Hundred Days, a major legislative act was passed, the Glass-Steagall Banking Act, or the 1933 Banking Act. This act established the Federal Deposit Insurance Corporation (FDIC) and increased the roles of the Federal Reserve Banks, enlarged membership of the system, and separated commercial and investment banking. Deposit insurance was thought to prevent harsh panics, if the "Federal Reserve notes count as cash, or as government credit is maintained" (Frisch and Diamond 90-91).

The primary purpose of the FDIC was to "provide a supplementary stabilizing device for the banks, preventing the reoccurrence of bank runs by guaranteeing the deposits of some sixty million Americans" (Romasco 57). The Glass-Steagall Act also gave the Federal Reserve Banks the authority to create loans on assets that previously had not been permitted. This measure helped prevent many businesses from going bankrupt and kept a lot of banks from having to shut their doors (Garraty 21).

Most bankers were extremely delighted to give their approval for the separation of investment and commercial banking. Small bankers had seldom been involved in securities, and several of the big city banks had such unpleasant experiences that they were glad for an excuse to get out and stay out (Krooss 167). Opinions were more divided on the issue of deposit guarantee. The big bankers fiercely opposed the idea, since most of the costs would be
paid by them, yet they would get the least benefit. The bankers argued that deposit guarantees already had been tried in several states and failed and that deposit guarantees encouraged irrational bankers who would no longer be responsible for their mistakes (Romasco 58). Deposit insurance was not liked by the state banking associations.

Before the passage of the Glass-Steagall Act, almost every state banking association had adopted resolutions against deposit insurance. One professor, H. Parker Willis said, "To allow it to go on the statue books is practically suicide for independent banking and business." Francis Sisson, president of the American Bankers Association, said that it was "unsound, unscientific, unjust, and dangerous" (Krooss 192). A few bankers were glad though to see the passage of the deposit insurance. Samuel W. Keyes, president of the Virginia Association, said: (the Act) "marks the greatest revolution in banking since the Federal Reserve Act and possibly the greatest revolution for all the time.... It is the answer to the public demand for a new deal in banking" (Krooss 167). Though some did not like the 1933 Banking Act, it was one of the major legislative consequences of the bank failures of the Thirties.

The 1935 Banking Act was another major legislative initiative that resulted from the banking crisis. This act enlarged the powers of the Board of Governors to change the reserve requirements, regulate banks, and limit interest rates (Saint-Etienne 36). The first increase in reserve
requirements of fifty percent was on August 16, 1936; a second similar increase was phased in the spring of 1937, which raised the reserve requirement to its legal limit (Romasco 224).

The RFC also was a legislative consequence of the bank failures. Congress had continued to enlarge the powers of the RFC by amending the related legislation around thirty times by the end of 1937. This continual process made the RFC the world's largest and most powerful bank (Romasco 54-5). By the end of 1937, this was the last legislation dealing with the bank failures. We will now discuss the international effects of the bank failures in the United States in the Thirties.

VIII. International Effects of Bank Failures in the Thirties

For some time in the early Thirties, the international banking situation was in trouble. For the United States bankers, the predicament of all the bank failures was a huge embarrassment. A former president of National City Bank of New York, Frank A. Vanderlip, exclaimed:

This is shameful and humiliating exhibition. It is uniquely bad. Across the border in Canada, there was not a single bank failure during our period of depression, and one must go back to 1923 to find even a small one. Nowhere else in the world at any time, were it a time of war, or of famine, or of disaster, has any other people recorded so many bank failures in a similar period as we did. We were not experiencing a war, a famine or any natural disaster....
Human stupidity and cupidity were the taproots of this great financial disaster. (Sperling 127-8)

Not only did the bank failures cause intense humiliation, but the failures caused problems for Americans in foreign countries. In many instances, people became stranded away from home. In Europe, "expatriates who had weathered the currency crisis of 1931 could not draw on funds in closed banks at home. They milled around the American Express office in Paris demanding that someone, maybe the American consul, advance passage money to get them home" (Bird 99).

The banking crisis did not really destroy many foreign relations. The other countries were not so disastrously troubled, but the majority were hurting, also. In the Thirties, the international relationships were not that strong, plus several of the countries were too involved in their own affairs. For example, Germany had its infatuation with Hitler. But the impact on society was huge, and this impact will now be examined.

IX. Social Impact of Bank Failures in the Thirties in the United States

The bank failures in the Thirties had an enormous impact on society in the United States. The confidence in the banking system became an important issue. Confidence in the system was essential to paper money and banking. The banks could not keep all their assets in cash as they would
not be able to lend out the money and make a profit. If the banks kept the cash so that they could pay every depositor at any moment in full, they would only function as a vault. Paper money and the banking system were only possible as long as most people had confidence in them (Bird 96).

But by December 1932, the depositors' confidence in banks was slipping fast. People began to gossip and wonder. Newspapers were hesitant to print the alarming situation concerning the banks. Some newspapers did report rather gleefully the failures of banks that had refused credit and made enemies. The Wall Street banks felt that publishing the number of bank failures was a threat to business. The bank examiners thought that they were maintaining confidence by taking it easy on the weak banks (Bird 96-97). But not printing the alarming news did not help build confidence.

Cash started getting scarce, so individuals began to hoard it. When the bad news and scandals spread, people started to wonder if their money would be good. At Christmas in 1932, a popular gift was ten-dollar gold piece as there was something reassuring about gold (Bird 98). Gold and money became more scarce.

As more banks failed and money became scarce, swapping became common. Advertisements appeared in newspapers like "man's overcoat, in good condition, for slide trombone, piccolo, or French horn." At Ohio State University, the students used cigarettes for money. Bills were paid in
various ways. Colleges took sacks of coal, eggs, etc. in exchange for tuition. Doctors and dentists were paid food by farmers, or sometimes, a member of the patient's family would work around the house of the doctor or dentist (Bird 100). Swapping was only one result of the scarcity of money as a medium of exchange.

Money became so scarce that whole towns were not able to make change in the stores. Employers began paying off their employees in IOUs of small denomination, which local stores honored. Blaine, Washington, tried to put humor in the situation and issued wooden nickels. Tenino, Washington, went even farther, and sold wooden nickels as souvenirs. They sold enough that they were able to buy the building of a bank that had failed. Over 300 communities were getting along without cash substitutes when Roosevelt was inaugurated (Bird 99-100).

At this point, schemes for living without money were widely discussed. Intellectuals told people that it was time to go back to independent, self-contained living on the land. People who grew their own food, made their own clothes, and gathered their own fuel wrote magazine articles and books advocating life in the country over the "artificial life in the corrupt cities" (Bird 100). Living without paper money was thought a possibility.
In February of 1933, the outlook for paper money was horrible. Paper money started to appear as if it would be worth less than the gold of its face value. People demanded gold from the banks which they suspected would fail. Then the people would hide these gold pieces "in baking-powder tins, under floorboards, between walls." One lady in Boston "glued five-dollar gold pieces into walnut shells." Some people put their gold in cans and then went to the country and buried it with a shotgun nearby (Bird 101-2). Hoarding gold was common.

People were not only hoarding their gold, but they began to hold on to what cash they could get. People tried to think of various places to hide their cash. Some people hid their money so well that they could never find it again. Bills were put between pages of books, and the pages were pasted together. Money was put in handlebars of bicycles, behind the lining of pictures, and one person went as far as taping bills under the feathers of his pet parrot. One boy was discovered at school with $1000 taped to his chest. He explained that his parents were scared of banks. (Bird 102-3). All this hoarding hurt the banks even more.

A few people, instead of hurting the banks by hoarding their gold and paper money, helped the threatened banks. Leaders of small cities helped to get public support. Some of these leading citizens pledged the majority of their wealth so that the banks could withstand the runs on them. Volunteer workers telephoned or drove all night to get the
necessary emergency funds. Women helped out by contributing their jewelry (Bird 103). But these people were not numerous.

When Roosevelt dramatically closed and quickly reopened the banks in March 1933, a lot of confidence in the banking system was restored. This move by Roosevelt was a psychological achievement (Romasco 55-6). Though the banks were still troubled, the society's confidence began to come back. One aftereffect of the bank failures on society was the feelings of the public toward the bankers themselves. As one person declared several years later:

I often wondered if the hatred the farmers had for the bankers would ever die down. But it did. Oh, some old men remember, but good times wash away a lot of the bitterness of bad times, and in a way it wasn't the banker's fault. It was the old story though. In good times, 'Borrow, fellows, and pay off when the crop comes in.' In bad times, 'Not a nickel for you guys and I've got orders to start proceedings against you for the land.' That was the way it went. (Broadfoot 335)

The bankers had to deal with other problems besides bitterness. They were in trouble with their bosses if they had made bad loans. The bank inspectors were the tough ones. "They'd order the bank managers to grab that piece of land or that one, or this one" (Broadfoot 335-6). The bank managers were hated even more than the loan officers.
The hatred for the bankers in Maine was fierce. The businessmen had suffered terribly because of the bank failures, and then the bankers in Maine would not lend out money as they were too scared. They felt that the policy of the Government was inconsistent. The Government had closed the banks up as the assets were not liquid enough, and the bankers felt that they would get in trouble again. As a result, many of the reopened banks in Maine had nothing but money which they would not lend out. This cautious attitude of the bankers made it very difficult for the businessmen to borrow money. One merchant offered a bank "$8,000 worth of bonds as collateral and was able to borrow only $3,000" (Lowitt and Beasley 43).

One of the bankers' problems was that the banking crisis had left them timid and fearful. The bankers also faced a thin demand for loans by equally fearful businessmen. But Jesse Jones, director of the RFC, felt that the main problem of the bankers was that "bankers take themselves very seriously. They try to make their job as hard as possible, while lending is really simple" (Romasco 61).

The failure of the banks and the ill feelings directed at the bankers in the Thirties led to the founding of the National Union for Social Justice by the American "radio priest," Charles E. Couglin. This organization had over a million members and went from religious to political. Couglin called the New Deal "a government of the bankers, by
the bankers, and for the bankers." His followers found "his
denunciations of bankers emotionally satisfying" (Garraty
151-2). After several years passed and the United States
entered World War II, Couglin and his followers were no
longer of any significance.

Though World War II and other events made the bank
failures of the Thirties become less significant to society,
the failures and the panic in the Thirties were never
forgotten. Therefore, when banks started to fail by the
hundreds in the 1980s, comparisons started being made. How
closely related were the failures of the Thirties and the
failures of the Eighties? To compare effectively, the same
causes and effects will be examined for the Eighties as the
Thirties, starting with the early seeds of the bank failures
in the Eighties.

X. Early Seeds of the Bank Failures in the Eighties

It has been argued that the early seeds of the bank
failures in the 1980's were planted by the European trade
unions in the late 1960's and early 1970's. During this
time, the European trade unions came together and gained
enough power to destroy the social compact that had earlier
united capital and labor. As a result of this grab of
power, the "share of labor income in gross domestic product
began to rise in the major European countries."
Though it was logical to expect the real wages in Europe to decline as oil prices rose, this did not happen. Because European nominal wages were mostly indexed, real wages remained high. Since European capital spending was "less than buoyant," foreign lenders began sending their funds to the American market. Foreign-owned bank assets in the United States rose from $24 billion in November 1972 to $98 billion in May 1978. In about the same time period, foreign banks nearly doubled their share of the market for the United States commercial and industrial loans - from 7 percent to 13.5 percent.

This invasion of foreign banks, along with the decline in profitable lending opportunities in the United States banks, increased competition. This increased competition led to sharper practices including:

- Substantial price cutting and an erosion of credit standards. Spreads on quality business began to slide, emboldening aggressive and over-confident banks like Continental to move "downstream" in a effort to book additional loans from once-likely sources. (Rose "Peering into Banking's Future" 1-4)

Unlike the Thirties, in the Eighties, there were not very many early seeds that the decade before had planted. Some of the bank failures of the 1980's were attributed to the deregulation that occurred in the 1980s. The common thread that was said to be responsible for the failures was that deregulation was making banking more difficult (Bush 12). The high interest rates caused by deregulation,
recession, and the poor economic environment in the early Eighties prompted failures in several industries. These hard times caught many people, and especially the bankers, by surprise (Much 67-8).

Many of the problems in the Eighties in the banking system were related to the rough path of these industries. Obviously, the business depression of the energy, farm, and real estate sectors had an impact on the financial industries located in those states dependent on these industries (Jacobe, "Economic Dislocations Spawn Losses for Commercial Banks and Savings Institutions" 44). This business depression, along with price deflation that occurred in those industries, caused these industries not to be able to pay off the principal of their loan, and sometimes the interest accrued, so the bankers were left with bad loans in their hands. These bad loans caused the banks to fail. So, it is useful to take an indepth look at the business depression and price deflation of the agricultural, energy, and real estate sectors that caused banks to fail.

XI. Business Depression and Price Deflation in the Eighties

One of the theories about bank failures in the Eighties was that the root cause of the failures were the "fluctuations in economic conditions coupled with the willingness of many bankers today to accept greater risks."
At least in the United States, demographic and local economics seemed to have a close relationship with the number of bank failures. Banks in small towns and rural banks were definitely the most likely to fail (Rose, "Failing Banks and Bad Publicity" 60-1).

A distinction should be made between risky activities of one specific bank that lead to that specific bank's failure (random) and activities that are typical of many failing banks in the industry (systematic). Business depression and price deflation were systematic causes of failures in the Eighties, at least in Idaho, Colorado, Nebraska, Iowa, Oklahoma, Texas, and Louisiana. These states had about 25 percent or more of both the commercial banks and savings institutions in their states lose money for the year 1985. These states were the ones most seriously damaged by the energy, farming, and real estate problems.

In situations where about 25 percent of the financial institutions in a state lose money, it can be presumed that the problem was business depression and price deflation (Jacobe, "Economic Dislocations Spawn Losses for Commercial Banks and Savings Institutions" 44). There was other evidence that suggested that local economic conditions were related to the incidence of bank failures. For example, the number of bank failures was highest during the period of recession, according to the National Bureau of Economic Research (Scott and Rose 5). This was especially true for
the farm banks.

The number of farm banks that was in serious trouble began to grow in the recession of the early Eighties. "Poor commodity prices, heavy debt loads, and plunging land value" forced a lot of farmers to their knees. Not only did the value of their land deteriorate rapidly, but the value of their machinery fell so quickly that millionaires became debtors. Then interest rates rose sharply, which left the farmers under very heavy debt loads. The destruction of the export market and the lower commodity prices left the farmers unable to pay off their debts (Bennett, "Farmers and Bankers Withering on Same Vine as Crisis Deepens" 1-10). So, agricultural banks started to stagger.

Agricultural banks are defined as banks with 25 percent or more of their loan portfolio in agricultural loans. Agricultural banks made up about 28 percent of all banks in the United States in the early Eighties (Bennett, "Number of Troubled Farm Banks Doubled in 1984" 6). In the Eighties, the agricultural banks that deteriorated the most were in a twelve state area, which was comprised of the western Corn Belt, the Great Plains, and the northern Rocky Mountain region. The agricultural banks in other states, such as those in California, had wide diversification in their loan portfolio, which enabled them to weather their severe loan losses from the farm sector (Melichar 439). But for the rural agricultural banks that were not diversified, the problems were very serious.
Small agricultural banks with assets under $500 million were reporting more numbers of delinquent loans in 1982. Banks with "farm loans making up over 80 percent of all loans charged off 1.92 percent in 1982; in 1979, that same category of banks only charged off .06 percent of their loans (Bennett, "Number of Troubled Farm Banks Doubled in 1984" 6). These heavy losses cut into the net income of farm banks, causing financial problems.

These financial problems were caused by price deflation. Land in 1982 was valued at only half what it had been valued at in 1977. Commodity prices fell also. For example, the price of a pound of rice fell from fourteen cents to eight cents. Equipment prices fell too. Equipment bought at $1.4 million by Prairie Rice was only worth a fourth of that (Magnuson 33). These financial problems in the farm sector adversely affected many rural banks. The greatest impact was felt by banks with the "greatest relative involvement in farm lending." Before 1982, agricultural banks as a group still enjoyed the "favorable loan experience -low delinquency rates and losses - and relatively high profits." After 1982, the loan problems at these rural banks began to mount, in some cases posing a serious threat to the banks. During 1984, failures of rural agricultural banks became common, and by 1985, more than one rural bank per week failed on the average. These stresses at the rural banks resulted mainly from the business depression and price deflation of the farm sector, not in
changes made from the deregulation of 1980 (Melichar 437).

The only way that deregulation could be said to have an effect on the failures of the farm banks was that the higher interest rates caused the farmers not to be able to make their payments. After deregulation, interest rates rose until the rates peaked in 1981 at around twenty percent. But the decline at small banks lagged behind that at larger banks. "Some observers have assumed that small banks have maintained higher rates on farm loans recently in order to cover some of the higher loan delinquencies and losses they have experienced on these loans" (Melichar 447). The problems mainly consisted of the farm prices falling, which causes the collateral against which most farmers borrowed to fall. Therefore, the banks started to fail (Muck-spreading Across America’s Midwestern Banks” 81). Thus, price deflation and business depression in the farm sector caused the rural agricultural banks to fail.

Price deflation and business depression in the energy sector also caused some bank failures in the Eighties. In the early 1980s, there was a drilling boom for oil. "Sharply higher oil prices and partial decontrol of domestic natural gas prices opened up vast new vistas for the oil industry." Independents, who account for about 85 percent of the United States drilling activity, borrowed heavily. Oilmen thought there was a "no-lose" future (Niering 58). The bankers felt the same way.
"The energy outlook from earlier periods had been pretty good," noted a top bank executive. So, bankers assumed that they were dealing with "impunity" in the energy-lending area, since you couldn't miss with oil" (Much 67). But bankers were not dealing with impunity, and when the price deflation and business depression for the energy sector did occur the banks were hurt because of the numerous loans that the banks had made to the energy sector.

Lending to the oil industry grew by as much as 20 percent annually in the early Eighties. From 1978 through 1985, "drilling completions (nationwide) more than doubled to an annual average of 72,572, with a peak of 89,234 in 1981." No one expected oil prices to fall below $20 a barrel. But the world oil prices fell to $10 a barrel. This collapse in the world oil prices brought the boom to a sudden halt and sent the industry, and its bankers, into a sharp financial depression. A downgrading in the volume of petroleum reserves produced "consolidations and bankruptcies that rendered many outstanding loans unserviceable." The estimate of the amount of bad loans to the energy sector was in the billions of dollars (Niering 58). Penn Square was one of the largest banks to lose from the deflation of prices in the oil sector.

When Penn Square Bank failed on July 5, 1982, the bank had over $400 million in assets, mostly energy loans to independent oil producers operating in Oklahoma. About 80 percent of its portfolio was energy related. When the oil
prices started to decline at the end of 1981, the bank was in a precarious position. Loan chargeoffs rose considerably. In 1980, loan chargeoffs were $405,000 and rose to $4,500,000 in 1981 (Weiner, LaCresse and Bennett 8). Penn Square had channeled most of its loans to small oil and gas producers, and when price deflations brought the energy sector to its knees, Penn Square failed.

When Penn Square failed, several other banks that were heavily involved in energy loans failed, too. Seafirst (Seattle-First National Bank) in Washington was one that also failed. Seafirst bought over 200 individual loan participations and some $400 million of its $7.4 billion loan portfolio was related to Penn Square’s energy loans. Besides buying Penn Square’s energy loan participations, Seafirst made its own oil and gas lending ("Cross-border Rescue" 7). Thus when prices fell in the energy sector, the collateral of Seafirst fell considerably, and Seafirst failed.

Seafirst was one of the few banks that failed because of business depression and price deflation from the energy sector that was not located in Texas or Oklahoma. Most banks which failed because of the deflation of prices in the energy sector were located in one of these two states. In July 1986, Oklahoma's 'Rock of Gibraltar,' the First National Bank and Trust Company of Oklahoma City, was declared insolvent by the United States Comptroller of the Currency. The bank had become so lumbered with worthless