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5 The Origins of Federal Deposit Insurance

Charles W. Calomiris and Eugene N. White

5.1 Introduction

The insurance of bank deposits has become a common feature of banking regulation in many countries, but until recently it was strictly an American phenomenon. Many countries adopted deposit insurance in imitation of the United States, where—with the exception of many economists—it is regarded as an institution necessary for the stability of the banking system and the protection of depositors. In the current debate about how to reform the U.S. banking system, most argue on economic or political grounds that deposit insurance must be retained in some form, despite the enormous costs it has imposed. Federal deposit insurance may thus be the only enduring legacy of the New Deal's banking legislation.

The widespread support for deposit insurance in the United State represented a remarkable change of public opinion. Until the early 1930s, there was no general interest in deposit insurance. Even after the 1933 banking crisis, a bitter struggle was waged over deposit insurance legislation. As Carter Golembe (1960, 181–82) pointed out over thirty years ago, "Deposit insurance was not a novel idea; it was not untried; protection of the small depositor, while important, was not its primary purpose; and finally it was the only important piece of legislation during the New Deal's famous 'one hundred days' which was neither requested nor supported by the new administration."

On the one hand, the answer to the question why the United States passed

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long-dormant deposit insurance legislation is simple. In 1933, the United States had just suffered the worst economic contraction in its history, and proponents of deposit insurance offered it as a prophylactic against a repetition of the disruption and depositor loss that plagued America in the early 1930s. Had there been no Great Depression, it seems unlikely that the United States would have adopted deposit insurance. On the other hand, although the Great Depression may have constituted a necessary condition for deposit insurance's success, it is not clear why it was sufficient. There were many formidable obstacles to its passage, and there were alternative means to stabilize the banking system.

The obstacles included the Roosevelt administration and the bank regulatory agencies, all of which opposed deposit insurance. Bankers were divided on the issue, but the banks who traditionally favored deposit insurance—small, rural, single-office (unit) banks in states that prohibited bank branching—had been in retreat economically since 1921 and had lost ground politically. Agricultural distress in the post–World War I years hastened the movement toward larger, more diversified banks, which had less need of protection. Experiences with deposit insurance at the state level had proved disastrous. Eight state-level deposit insurance systems had been created since 1908 at the behest of small unit banks in those states. In the 1920s, all collapsed under the weight of excessive risk taking and fraud, encouraged by the protection of deposit insurance. The experiences of these states were widely discussed at the time (American Bankers Association 1933; White 1983; Calomiris 1992a).

Deposit insurance cannot be explained as an emergency measure conceived in haste to resolve an ongoing crisis. The legislation had been debated for years, the banking crisis of 1933 had been over for months prior to the implementation of the new insurance plan, and prior losses of banks and depositors were unaffected by the plan. Finally, there was an alternative long-run solution to the instability of the American banking system—nationwide branch banking—and it had been gaining ground politically in the 1920s, partly in response to widespread failures of agricultural unit banks and the failures of state deposit insurance schemes.

The purpose of our paper is to explain how and why federal deposit insurance—special-interest legislation that had failed in Congress for nearly fifty years—was adopted with near unanimity in 1933. We consider the forces in favor of, and against, federal deposit insurance from the nineteenth century to 1933. We argue that, even though the traditional supporters of federal deposit insurance had suffered repeated defeats and their power was at the nadir in 1933, the nature of the political struggle over deposit insurance changed in the 1930s from a battle waged in Congress among special interests to one that engaged the general public. The banking collapse focused the attention of the public on the otherwise esoteric political issue of banking reform and offered the supporters of deposit insurance the opportunity to wage a campaign to

convince the public that federal deposit insurance was the best solution to banking instability.

Throughout the history of the debate over federal deposit insurance, advocates and opponents agreed that an alternative solution to bank instability would be to reduce the number of banks and increase their geographic scope by repealing limits on bank branching and consolidation.[1] Advocates of insurance—including small banks—opposed allowing greater bank concentration, while opponents of deposit insurance saw concentration as the best means to promote stability. A key factor in the passage of federal deposit insurance was the discrediting of large-scale banking by the advocates of deposit insurance.

5.2 The Historical Context of the Struggle over Federal Deposit Insurance

5.2.1 Unit Banking, Bank Instability, and Deposit Insurance in the United States

The debate over federal insurance of deposits was conducted with reference to earlier efforts to insure bank liabilities. Insurance schemes were enacted by six states prior to the Civil War, and by eight states between 1907 and 1917. In all of these cases, insurance of banknotes or deposits was the mutual responsibility of banks, not the state governments.[2] The instability of small, unit banks and the desire to insulate the economy from recurrent disruptions of bank failures and suspensions of convertibility motivated all of the deposit insurance systems created by the various states (Golembe 1960). Thus the evolution of the structure of the banking system is closely tied to the history of deposit insurance.

The fragmentation and consequent instability of the American banking system are without parallel in the international history of banking. Experiments with large-scale banking—including the antebellum South and the federally chartered Banks of the United States—were early exceptions to reliance on

1. It was widely understood that fractional-reserve banking, in and of itself, was not the source of the peculiar instability of banking in the United States. Other countries with fractional-reserve banking, but which lacked the fragmented banking system of the United States, avoided the episodes of widespread bank failure and suspension of convertibility that characterized the U.S. experience (Bordo 1985; Calomiris and Gorton 1991; Calomiris 1992b).

2. The National Banking Acts of the 1860s provided federal government insurance of national banknotes. But this insurance was redundant protection because notes always were secured by 100 percent (or more) of their value in the form of deposits of U.S. government bonds held at the Treasury. Unlike the antebellum free-banking systems on which it was modelled, bond backing under the national banking system eliminated default risk on notes. The National Banking Acts were motivated by the financial exigencies of the Civil War, as well as long-standing Jacksonian policy proposals to create a uniform national currency backed by government bonds (Duncombe 1841). Of course, government bonds and national banknotes did suffer numeraire risk, notably during the period of greenback suspension and silver agitation (Calomiris 1993).

local, unit banks. Despite increasing interest by banks in consolidating and expanding branching networks, by the late nineteenth century restrictive state and federal regulations combined to make unit banking the norm. The U.S. banking system expanded until 1920 primarily by adding banks rather than by increasing the size of banks. By 1920, there were more than thirty thousand banks operating in the United States, or one bank for every 3,444 people. Thirteen years later less than half that number remained, as banks disappeared in the wake of the severe agricultural distress of the 1920s and the Great Depression. The structure of the American banking industry—thousands of mostly small banks operating in geographical isolation of one another—produced its propensity for panics and bank failures by reducing opportunities for diversification of portfolios and by making it difficult for banks to coordinate their joint response to financial crises.

The origins of unit banking and its persistence have been widely debated by historians. One of the most important preconditions for bank fragmentation was federalism and the early judicial and legislative precedents giving individual states authority to design their own banking systems and limit competition from institutions outside their state. In particular, the Supreme Court's decision not to apply the commerce clause to banks and the Congress's deference to state chartering powers set the stage for a banking system in which individual states could determine the industrial organization of banking within their borders. Why states would choose unit banking is less clear. Here attention has focused on the role of populist propaganda by rent-seeking unit bankers (White 1984) and on the benefits to some farmers from tying banks to particular locations as a form of loan insurance (Calomiris 1992b).

The inherent fragility of a unit-banking system set the stage for further regulations to stabilize the system, notably deposit insurance. Every one of the fourteen states that enacted deposit insurance legislation from 1829 to 1917 was a unit-banking state seeking to find a means of stabilizing its banking system. States that chose to imitate wholly or even partly the standard international practice of allowing branch banking eschewed insurance.

Of the six antebellum state mutual-guarantee schemes, three had short lives and suffered large losses, while the other three suffered virtually no losses and survived for long periods (Golembe and Warburton 1958; Golembe 1960; Calomiris 1990). The varying degrees of success of these two groups of systems can be traced to the incentives created under their different regulatory regimes. The successful systems of Indiana, Ohio, and Iowa included limited numbers of banks (typically about thirty) with strong incentives to police one another and with broad powers of self-regulation and enforcement. Banks provided substantial mutual protection to one another without encouraging excessive risk taking. These systems were eliminated by federal legislation that imposed a 10 percent annual tax on state banknote issues (their primary liabilities) to foster the newly created national banking system.

The other antebellum insurance experiments (of New York, Vermont, and

Michigan) all had become insolvent by the 1840s as the result of common problems of design that induced adverse selection and moral hazard, encouraging risk taking within the insured system. The large numbers of members and limited mutual liability encouraged free riding, and the government provided little effective supervision and regulation. Protection to noteholders and depositors under these three mutual-guarantee systems was limited; protection rested on the ability and willingness of surviving banks to remain in the systems to fund the losses of failed banks. Bank failures resulted in substantial losses to noteholders and depositors.

Stimulated by the disruptions from the Panic of 1907, states began a second round of experimentation with mutual-guarantee systems (White 1983; Calomiris 1990, 1992a).[3] Like the antebellum systems, all the post-1907 state insurance systems arose in unit-banking states dominated by large numbers of small, rural banks. White (1983, 200) found that the probability of passage of deposit insurance at the state level was positively affected by the presence of unit-banking laws, small bank size, and a high bank-failure rate.

Unfortunately, the postbellum systems all adopted the design features of the failed antebellum systems, including limited mutual liability and government rather than private regulation. In a sense, this imitation is not surprising. A successful system of self-regulating banks with unlimited mutual liability—like those of Indiana, Ohio, and Iowa—would not have been feasible for state unit-banking systems of hundreds of unit banks like those of the postbellum deposit insurance states. In systems of hundreds of banks, banks would have little incentive to expend resources policing one another, since the benefits one bank would receive from monitoring another would be shared with too many others banks, while the costs of monitoring would be borne privately. Thus the decision to imitate the design of the failed antebellum systems was consistent with the industrial structure of banking in these large, agricultural states dominated by large numbers of unit banks.

These systems suffered large losses and went bankrupt in the 1920s. Calomiris (1990, 1992a) and Wheelock (1992) trace these large losses to the exces-

3. At the federal level, protection was offered to depositors via the postal savings system, which was also established in the wake of the Panic of 1907 (Kemmerer 1917). Postal savings was the limited remedy to banking instability offered by the victorious Republicans after the election of 1908. The Democratic platform had contained a proposal for federal deposit insurance (O'Hara and Easley 1979, 742–43). To limit competition between postal savings and bank deposits, postal savings paid low interest, was restricted to small deposits, and was largely reinvested in the banking system. While the government stood behind postal savings deposits (many of which were deposited in commercial banks), this did not expose the government to significant risk because banks were required to secure postal savings account deposits with municipal, state, and federal bonds specified by Congress (Zaun 1953, 27–28). Thus government backing for postal savings was redundant in the same way as the backing for national banknotes. Banks profited from the spread they earned on postal savings deposits (equal to the yield on collateral bonds, less the 2 percent interest paid to the post office on the accounts). This profit turned negative during the Great Depression, as bond yields fell. The result was a switch from the investment of postal savings deposits in banks (who refused them) to direct investment of postal savings in government bonds.

sive risk taking of banks in insured states during the World War I agricultural boom. Insured banking systems grew at an unusually high rate in the form of small banks with relatively low capital. In the face of the post-1920 agricultural bust, insured banks failed at a high rate and with the lowest asset values relative to deposit claims of any banks in the 1920s. State banks in agricultural states all suffered from the large price and land-value declines of the 1920s, but the risk taking encouraged by deposit insurance added greatly to the costs state banks suffered in the face of the decline.

At the same time that the post-1907 state insurance systems collapsed, conditions in the banking industry began to change in a direction that threatened the future of unit banking. Up to 1914, the banking system had been expanding rapidly, which, under the prohibition of branch banking in most states, resulted in the proliferation of small unit banks. Beginning with the postwar recession, many banks failed in agricultural areas. They continued to fail at historically high rates, even as the rest of the economy thrived in the mid-1920s. Surviving banks faced tougher competition as legal barriers to branching were weakened under pressure from larger urban banks and by efforts to allow surviving banks a means to fill the gaps created by the many rural bank failures. The proven survivability of branching banks during the 1920s in contrast to the failures of the insured unit-banking systems also favored expanded branching and consolidation (White 1983; Calomiris 1992a, 1992b). Table 5.1 provides data on bank industry trends during the 1920s. As the number of banks declined, the number of branches began to rise and mergers became more common. Banks began to diversify their activities, moving into a variety of financial services, including trust services, brokerage, and investment banking. A larger, more diversified, and safer portfolio (White 1986) and the availability of a variety of new services attracted customers (Calomiris 1994). Smaller unit banks found it hard to compete in this environment and turned to the political arena to secure economic protection.

5.2.2 Constituent Interests and Federal Deposit Insurance

From an early date, advocates of deposit insurance pushed for federal legislation. From 1886 through 1933, 150 bills were introduced into either the House or the Senate, proposing to establish federal deposit insurance. These proposals differed in their particulars regarding the range of membership (i.e., whether to restrict members to national banks, all Federal Reserve member banks, or all national and qualifying state banks), the form of protection for deposits (mutual bank guarantee or government guarantee), and the charges to participating banks, but they shared common fundamental features. All the proposed systems would have established a national system of insurance in which all banks would pay identical premiums and receive identical protection. Such a national system would have extended to the national level the model of deposit insurance adopted at the state level by the eight postbellum insurance systems.

Table 5.1 Bank Mergers, Branching, and Securities Affiliates, 1900–1931

Year	Bank Mergers	Total Assets Acquired ($mil)	Banks Operating Branches	Number of Branches	Branch Banks Loans and Investments ($mil)	Securities Affiliates of Banks	Number of Banks
1900	20		87	119			
1901	41						
1902	50						
1903	37						
1904	63						
1905	69		196	350			
1906	56						
1907	54						
1908	97						
1909	80						
1910	127		292	548	1,272		
1911	119						
1912	128						
1913	118						
1914	142						25,510
1915	154		397	785	2,187		25,875
1916	134						26,217
1917	123						26,831
1918	119						27,457
1919	178	650					27,859
1920	181	874	530	1,281	6,897		29,087
1921	281	710	547	1,455	8,354		29,788
1922	337	750	610	1,801	9,110	277	29,458
1923	325	1,052	671	2,054	10,922	314	29,201
1924	350	662	706	2,297	12,480	372	28,372
1925	352	702	720	2,525	14,763	413	27,858
1926	429	1,595	744	2,703	16,511	464	27,235
1927	543	1,555	740	2,914	17,591	493	26,149
1928	501	2,093	775	3,138	20,068	561	25,330
1929	571	5,614	764	3,353	21,420	591	24,504
1930	699	2,903	751	3,522	22,491	566	23,251
1931	706	2,757	723	3,467	20,681	525	21,309

Sources: Data on the number of bank mergers from Chapman 1934, 56; the assets of banks absorbed by merger from White 1985, 286; the number of banks operating branches, the number of branches in operation, and the loans and investments of branching banks from Board of Governors 1976, 297; the securities affiliates of banks from Peach 1941, 83; and the number of state and national commercial banks from Board of Governors 1976, 19.

In economic terms, regardless of whether insurance was funded by banks or backed by a government guarantee, such a scheme necessarily involves cross-subsidization of risk across states. States with banks that suffered higher risks of failure would gain at the expense of other states' banks, and in the case of government guarantees, at the expense of the rest of the nation's taxpayers. From this standpoint, one would expect that the states most likely to favor

national insurance would be those with the most vulnerable banking systems. For these states, the common costs of insurance would be more than reimbursed by the expected bailouts of failed banks by relatively stable banks (and taxpayers) from other states. Compared to state-level deposit insurance, federal deposit insurance was particularly attractive to unit bankers located in the high-risk rural states because it offered greater protection at lower cost. But this same fact made federal insurance legislation less likely to succeed. Rural unit banks wielded more power in their states than they wielded in Congress, where banks from states with relatively stable banking systems would oppose cross-subsidization of risky banks.

One way to test this special-interest, rent-seeking view of support and opposition for federal deposit insurance would be to compare each state's banking system's vulnerability with its support for federal legislation creating deposit insurance.

5.2.3 Inferring Constituent Interest from Congressional Behavior

Difficult conceptual issues and empirical pitfalls arise in inferring constituents' interests from politicians' support for particular legislation. Conceptually, it is not always clear how to map from congressional behavior to the probable interests of constituents. There is a large and growing literature on the difficulty of measuring constituent interest from voting records (e.g., Poole and Rosenthal, chap. 3 in this volume). Elected representatives often trade votes on issues, so that a negative vote on one bill does not necessarily indicate that constituents would be opposed to that bill. Political parties often play an important role in enforcing intertemporal trade-offs in voting across different bills. Party discipline can encourage a representative to vote against his constituent interests on one bill in exchange for promised votes on another bill, or perhaps in exchange for party support for introducing a "private" bill to benefit a select group of his supporters. Poole and Rosenthal suggest that party discipline is likely to be most important in close votes. In votes that are not close, the party will free members to vote their constituents' interests, since there is no benefit from trading votes. These considerations suggest that voting patterns, particularly in close votes, may reveal little about constituent interests, especially on issues that are not viewed as the highest priorities of one's constituents.

In the case of congressional voting on deposit insurance bills, there is an even better reason to look for an alternative to representatives' voting records as a measure of constituent interests—namely, the scarcity of voting data. Of the 150 bills that were introduced into Congress to establish federal deposit insurance between 1886 and 1933, only one bill ever came to a roll call vote (amended HR 7837 in December 1913). Of these 150 bills, 147 never emerged from the House or Senate committees that were given the responsibility of considering them. This is a very poor batting average. From the 49th to the 73d Congress (from 1886 to 1933), 5 percent of bills introduced were enacted into

law, of which roughly one-third were "private" bills, that is, bills benefiting particular named individuals (Bureau of the Census 1975, 1081–82). Thus deposit insurance bills suffered an unusually low chance of emerging from committee, much less being enacted into law.

To understand these facts, it is useful to review the procedures for the consideration of bills by Congress.[4] The process in the House begins with bills being dropped into a "hopper" on the clerk's desk. In the Senate, the sponsor must gain recognition on the floor and make the announcement of the bill's introduction. These bills are then assigned to a committee to analyze and perhaps amend the bill. Most bills die in committee. If a bill makes it out of committee, the House or Senate can vote on the bill or send it back to committee, where, as before, it typically dies. Once bills reach the House or Senate after making it out of committee, there are several possibilities. In the House, a bill gets placed before the Committee as a Whole (which is made up of at least one hundred representatives). A bill must pass through the Committee as a Whole before the House of Representatives can vote on the bill. The Committee as a Whole, assuming there is a quorum of one hundred members, cannot have a roll call vote. Instead they vote by voice, division (standing), or teller (lining up and being counted on a pro or con side of the aisle). If a bill makes it out of the Committee as a Whole, it can be voted on by voice, division, or roll call. However, it takes a one-fifth approval—assuming there is a quorum—to be granted a roll call. In the House, roll calls are time-consuming events and do not happen often.

In the Senate, roll call votes occur relatively more often because there are fewer members and it does not use up much time. But the Senate also utilizes voice votes and division votes. As in the House, it takes one-fifth of senators present to approve a roll call. This minimum can be hard to achieve sometimes, as senators can be present at a quorum call but exit soon after, leaving only a handful of senators on the floor for the vote on the motion for yeas and nays.

It is likely that the authors of deposit insurance bills (prior to 1932) were aware that their efforts would fail. One indication of their unlikely success is that deposit insurance bills were typically not introduced by the chairmen of committees that would consider the bills, or even by members of the committees. Committee members, and particularly their chairmen, enjoy considerable power in determining whether a bill will be successful. Bills not introduced by committee chairmen, or subcommittee chairmen, stand little chance of emerging from the committee.[5] From 1886 through 1931, 120 bills were introduced

4. For additional details see Berman 1964; Froman 1967; Davidson and Oleszek 1981; Morrow 1969; Reid 1980.

5. The power of the committee chairmen is difficult to exaggerate (Berman 1964, 212). One of their key powers lies in their ability to hold up a bill in committee. They can do this by refusing to schedule a bill for a hearing or by setting meeting times when the bill's proponents cannot possibly attend. Committee chairmen also hire and fire most of the committee's staff, assign members to subcommittees, and lead floor debates on bills reported from their committees, among other things. They can form subcommittees in such a way that they can kill a bill by sending it to

on deposit insurance. In only twenty-one of these cases were they introduced by members of the committees that would consider them, and in only one case (notably in 1908) was a bill introduced by a committee chairman.

Congressmen and senators who introduced these unpromising bills often did so repeatedly over many years, possibly as a signal to constituents that the failure of such legislation was not due to a lack of effort on their part. If this is correct, then it seems reasonable to suppose that the identities of those introducing legislation are a good indicator of strong constituent interests in that legislation. In the empirical patterns we report, we focus on the differences between states whose representatives authored bills and other states, examining correlations between authorship and economic indicators at the state level. We confine most of our analysis to the period prior to the national banking crises of September 1931–March 1933. In 1932 and 1933, when nine of the thirty bills introduced were authorized by committee members (including three by Chairman Steagall and one by Senator Glass), the likelihood of passage was known to be higher, and the link between the identity of authors and constituent interests may have been weaker (given the compromises being engineered, authors may have been chosen to maximize the chance of successful passage). We also discuss voting patterns for the 1913 roll call votes in the House and Senate.

5.2.4 Empirical Evidence on the Characteristics of States with Authors of Bills

We define states whose congressmen or senators authored deposit insurance bills as "authoring states," and the remaining states as "nonauthoring states." Appendix table 5A.1 presents the full list of bills introduced; their date and congressional session; their authors; each author's house of Congress, party affiliation, and state; and whether the author (if a congressman) represents a "large-city" constituency or its complement, which we call a "rural" constituency. If the author is a "large-city" congressman, we state the name of the city contained within his congressional district. Table 5A.1 also indicates whether the bill specified mutual guarantee or government guarantee of deposits, and which banks would have been included in the insurance system.

Both major parties account for large numbers of proposals, with fifty-eight bills introduced by Republicans and ninety introduced by Democrats, but the relative authorship of Democrats and Republicans shifted somewhat over time.

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a subcommittee stacked with members opposed to the bill, or they can push through bills they support by sending the bill to a committee stacked in its favor.

The committee chairman, or ranking minority committee member, will customarily agree as a matter of courtesy to introduce a bill originating in the White House. The bills from the executive branch typically get the most attention from committees. Deposit insurance bills introduced into the House of Representatives between 1886 and 1933 were referred to the Committee on Banking and Currency. Senate deposit insurance bills were referred to the Committee on Finance until 1919, and thereafter referred to the Senate Committee on Banking and Currency.

Eleven Republicans authored bills from 1886 to 1906, compared to only six authored by Democrats. From 1907 through 1933, thirty-six Democrats and twenty-eight Republicans authored bills.

One interesting pattern shown in table 5A.1 is the changing regional composition of authoring states over time. For the first twenty-five bills introduced (covering 1886–1906), the regional composition of authors is very diverse. Eastern states (Pennsylvania, New York, New Jersey, and Ohio) account for eleven of the twenty-five bills and six of the nineteen authors, ten authors hailed from the Middle West and West (Wisconsin, Missouri, Kansas, Nebraska, Washington, and North Dakota), and three were southerners (Virginia, Mississippi, and Alabama). For the next eighty-nine bills (covering 1907–February 1931), authorship is highly concentrated in the West and Middle West, which accounts for sixty-six of the bills introduced, with the South accounting for the remaining nineteen bills (thirteen of which are authored by Mississippians and Alabamans). During this period, bills introduced by easterners are confined to four bills introduced by Pennsylvanians in 1907 and 1908.

For the final period (covering December 1931–May 1933), the regional mix again becomes more diverse. Of the thirty-six bills introduced during this period, seven states that had not been "authoring" states in the previous twenty years (New York, Ohio, California, Michigan, Tennessee, Florida, and Virginia) account for eighteen of the bills introduced. This change in 1931 is also visible in the change from a nearly universal rural identity of authors prior to 1931 to a mixture of rural and urban authors from 1931 through 1933. Of the eighty bills introduced in the House prior to December 1931, only four were authored by congressmen who could be regarded as coming from major cities (Omaha, Denver, Chicago, and Atlanta). From December 1931 through 1933, five of twenty-six bills were introduced by House members from Chicago, New York City, Columbus, Detroit, and Tulsa.

What explains the changes over time in the locational composition of authors? Tables 5.2 through 5.4 present evidence on differences in the characteristics of these two sets of states for various time periods. In analyzing cross-sectional characteristics of authoring and nonauthoring states, we focus on the period before December 1931, prior to the emergence of a congressional consensus in favor of federal insurance. The dates over which variables are defined often are indicated by data availability. Given the small sample size, we emphasize median comparisons, which provide a better gauge than means because they are relatively insensitive to outliers.

For the twentieth century, the authoring states tend to differ from other states in ways consistent with the view that special interest groups in those states, which stood to benefit from cross-subsidization of risk, encouraged deposit insurance proposals by their elected officials in Washington. The banking systems of authoring states were more vulnerable than those of nonauthoring states by several of the measures reported in tables 5.2 through 5.4. Authoring

Table 5.2 **Bank Characteristics in Authoring and Nonauthoring States**

	State Banks						National Banks					
	Authoring			Nonauthoring			Authoring			Nonauthoring		
	Mean	Med.	S.D.	Mean	Med.	S.D.	Mean	Med.	S.D.	Mean	Med.	S.D.
Bank-failure rate (%)[a]												
1864–96	0.54	0.45	0.47	0.51	0.43	0.29	0.39	0.37	0.27	0.32	0.24	0.32
1907–10	0.13	0.04	0.20	0.20	0.04	0.46	0.12	0.10	0.12	0.15	0.00	0.21
1921–29	4.23	4.67	2.86	1.98	1.07	2.36	2.25	1.76	1.76	0.96	0.37	1.45
Average bank size												
1896	465	212	553	408	207	565	837	697	656	596	491	312
1910	448	251	594	1008	430	1720	1030	857	630	1202	864	925
1919	813	449	963	1768	847	2727	1969	1681	1067	2409	1720	2041
1929	729	545	703	3113	940	5243	2025	1615	859	3335	2634	2456
Small-Town bank suspensions relative to total[b]												
1920–31	0.94	0.97	0.07	0.85	0.90	0.19	0.95	0.97	0.07	0.86	0.92	0.21
Deposit-loss rate (%)												
For failed banks,												
1920–31[c]	44.8	40.6	11.2	30.3	31.6	22.4	40.9	49.3	18.6	35.1	31.4	18.4
For all banks, 1920s[d]	1.77	2.19	1.05	0.73	0.04	1.29	1.07	0.91	0.92	0.41	0.08	0.84

Sources: Data on bills introduced are from table 5A.1. Bank-failure rates for 1864–96 are from Upham and Lamke 1934, 246. For 1896–1929, data on numbers of national and state banks for each state are reported in Board of Governors 1959. Data on bank failures after 1896 are given in Comptroller of the Currency 1907–29. Data on bank suspensions, their location, and deposit loss rates are constructed from Goldenweiser et al. 1932, 5:183–97.

Notes: Authoring states are those where one or more of the state's representatives or senators introduced a federal deposit insurance bill. Authorship is categorized into three periods: 1886–98, 1905–19, and 1920–February 1931. The authoring states in each of these periods are matched by date with items listed in the table. For example, average bank size (1910) is matched with authoring during 1905–19.

[a]Bank-failure rates for 1921–29 are defined as the ratio of the sum of each year's liquidated banks to the sum of each year's surviving banks. For the periods prior to the 1920s, bank-failure rates are defined as the ratio of average annual failures during the period divided by the number of banks in 1896 plus the number of failures during the period.

[b]Small towns had populations of under twenty-five thousand.

[c]The deposit-loss rate for failed banks is one minus the ratio of payments from assets to proven claims.

[d]The deposit-loss rate for all banks is the product of the bank-failure rate for 1921–29 and the deposit-loss rate for failed banks.

Table 5.3 Characteristics of Authoring and Nonauthoring States

	Authoring States			Nonauthoring States		
	Mean	Median	S.D.	Mean	Median	S.D.
Branching indicator unit = 0, branch = 1						
1910[a]	0.29	0	0.47	0.52	1	0.51
1925[b]	0.22	0	0.44	0.41	0	0.50
Branching ratio[c]						
1910	0.03	0.00	0.04	0.07	0.03	0.09
1920	0.03	0.00	0.03	0.10	0.02	0.13
1930	0.07	0.01	0.11	0.17	0.02	0.22
Non-Fed members relative to all banks						
1919	0.70	0.73	0.16	0.61	0.63	0.17
1929	0.66	0.69	0.11	0.61	0.61	0.17
Business-failure[d] rate (%)						
1909–13	0.81	0.81	0.28	0.99	0.94	0.37
1921–29	1.09	1.13	0.29	1.05	0.96	0.39
Farm to total population						
1920	0.47	0.46	0.13	0.32	0.31	0.18

Sources: Data on bills introduced are from table 5A.1. These data, as well as data on Federal Reserve members and nonmembers, are taken from Board of Governors 1976, 298, 24–33. Branching indicator for 1910 is constructed from Calomiris 1992b, 86–87. Business-failure rates are derived from U.S. Bureau of the Census 1909–29. Data on farm and nonfarm population are from Leven 1925, 259.

Notes: Authoring stats are those where one or more of the state's representatives or senators introduced a federal deposit insurance bill. Authorship is categorized into three periods: 1886–98, 1905–19, and 1920–February 1931. The authoring states in each of these periods are matched by date with items listed in the table. For example, the branching ratio (1910) is matched with authoring during 1905–19.

[a]The branching indicator distinguishes states that allow new branches to open from other states.

[b]The branching indicator equals one if at least one branch exists, and if continuing branching (however limited) is allowed, as described in Board of Governors 1926.

[c]The ratio of bank offices operated by branching banks relative to total bank offices in the state.

[d]Business-failure rates are annual averages for commercial enterprises.

Table 5.4 Deposit Insurance Bills and Their Authors

	All States		Authoring States[a]	
Bills/Authors per State	Mean	Median	Mean	Median
Bills introduced, 1886–98 (18 bills)	0.4	0	1.8	2
Authors of bills, 1886–98 (15 authors)	0.3	0	1.5	1
Bills introduced, 1905–19 (63 bills)	1.7	0	5	3
Authors of bills, 1905–19 (32 authors)	0.6	0	1.8	1
Bills introduced, 1920–Feb. 1931 (29 bills)	0.9	0	4.3	3
Authors of bills, 1920–Feb. 1931 (15 authors)	0.5	0	2.2	1

Source: Data on bills introduced are from table 5A.1.

[a]An authoring state is one in which one or more of its representatives or senators introduced a federal deposit insurance bill.

states had much higher bank-failure rates and higher deposit loss rates on failed banks in the 1920s.

The greater vulnerability of authoring states' banking systems in the 1920s is partly explained by the structure of their banking systems, which tended to be dominated by small, unit banks. There is a strong association between unit banking and the support for deposit insurance legislation. States committed to unit banking tended to be supporters of deposit insurance. Nonauthoring states tended to rely relatively more on branch banking. Furthermore, consistent with standard historical writings on the links between agrarian populism and deposit insurance, we find that states promoting federal deposit insurance legislation had a higher ratio of rural-to-total population and a greater proportion of bank failures in towns of less than twenty-five thousand inhabitants.

Comparisons across states for the nineteenth century reveal no apparent difference between authoring and nonauthoring states. The increase in the regional concentration of support for deposit insurance in the twentieth century is mirrored in starker differences between the authoring and nonauthoring states. In the nineteenth century, within-state differences may have been as important as cross-state differences in risk, making it difficult to detect the role of special interests at the state level. Later, differences across states seem to be more important than differences within states. This is largely explained by the changes in various states' regulations of branching, and the stability branching brought to these states' banking systems. From 1900 to 1930, the number of branching banks in the United States rose from 87 to 751, and the number of branches rose from 119 to 3,522. This movement toward branching was concentrated in a few states, and many of these had been states with early supporters of deposit insurance legislation (notably Ohio, New York, Pennsylvania, and New Jersey). During the first decade of the twentieth century, as the branching movement took hold in these states, their elected officials disappeared from the list of congressmen and senators authoring deposit insurance bills. These four states alone saw increases in the number of banking offices operated by branching banks from 56 in 1900 to 1,534 in 1930.

The branch-banking movement of the early twentieth century created profound differences across states in the propensity for failure, which encouraged high-risk unit-banking states to attempt to free ride on the stability of branch-banking states through the establishment of national deposit insurance. As the agricultural banking crisis wore on in the grain and cotton belts in the 1920s, those states became the staunchest advocates of deposit insurance legislation. Not surprisingly, representatives of states that had passed state-level deposit insurance between 1907 and 1917 (Oklahoma, Texas, Nebraska, North Dakota, South Dakota, Washington, Texas, and Mississippi) were among the most frequent authors of bills for national insurance from 1907 through 1931, accounting for fifty-five of ninety-five bills introduced during this period. The collapse of the state insurance systems in the 1920s created a new urgency for protection at the national level in the face of the collapse of so many state banks.

Nebraska and Oklahoma, whose banks were among the smallest, least-diversified, and lowest-capitalized banking systems in the country during the 1920s, led the movement for national insurance plans. Of the thirty-four bills proposed between 1921 and 1931, fourteen were introduced by representatives of Oklahoma and Nebraska.

5.2.5 The 1913 Roll Call Votes

The only federal deposit insurance bill on which roll call votes were taken was amended HR 7837, which was voted on by both houses of Congress in December 1913. The bill was proposed as an addition to the Federal Reserve Act, and it originated in the Senate. The bill passed the Senate with 54 yeas, 34 nays, and 7 not voting. It then went to the House, where it was defeated with a vote of 295 nays, 59 yeas, 78 not voting, and 2 "present." These votes are described in detail in table 5.5.

In the Senate, where the vote was close, party discipline was enforced more rigorously, and the vote was essentially along party lines. Forty-seven of fifty-four yeas were cast by Democrats, and all nays were cast by Republicans. Four Republicans and three Democrats declined to vote. While votes along party lines provide little evidence of state constituent interests, the states of the senators casting "renegade" votes (those who went against their party) are interesting to examine. Five of the seven Republican senators who voted yea were from states that had enacted or soon would enact deposit insurance at the state level (Nebraska, South Dakota, and Washington).

The other two Republican senators who voted yea were from California and Massachusetts. While both of these states allowed some branch banking by 1913, they were both essentially unit-banking states at that time, and both states had suffered unusually high recent spates of bank and business failures, as shown in table 5.6. Unlike the rural states supporting deposit insurance, bank failures in these two states (and in Pennsylvania) were associated with substantial commercial distress. Massachusetts saw three of its national banks fail from 1907 to 1913. From 1907 through 1913, sixteen banks were liquidated by order of the superintendent of banking in California, and one national bank was placed into receivership by the comptroller. These rates of bank failure had not been seen in California since the mid-1890s. California law did not explicitly disallow branching, but banks were only allowed to branch with the permission of the state superintendent of banking, and the superintendent would not grant permission without the approval of local banks in the town where the proposed branch would be located. When economic distress threatened the solvency of unit banks, A. P. Giannini's requests to open branches were granted, beginning with the San Jose branch of the Bank of Italy in 1909, which received the explicit endorsement of local bankers and planters. Progress remained slow until 1916, when the revealed benefits of branching and the precedents established by Giannini helped to encourage widespread approval for branching. Similarly, in Massachusetts only fourteen banks had

Table 5.5 House and Senate Voting Patterns on Amended HR 7837, December 1913

State	House Voting												Senate								
	Democrats			Republicans			Other Parties[a]			State Total			Democrats			Republicans			State Total		
	Y	N	N/V	Y	N	N/V	Y	N	N/V	Y	N	N/V	Y	N	N/V	Y	N	N/V	Y	N	N/V
AL		8	2								8	2	1						1		
AR		7									7		2						2		
AZ		1									1		2						2		
CA		3		4	2	1		1		4	6	1				1	1		1	1	
CO		4									4		2						2		
CT		4	1								4	1					2			2	
DE		1									1		1				1		1	1	
FL	1	3	1							1	3	1	2						2		
GA	6	6	1							6	6	1	2						2		
IA		2	1		7	1					9	2					2			2	
ID				1	1					1	1						2			2	
IL	3	9	8	2	1	2	1	1		6	11	10	1				1		1	1	
IN		11	1								11	1	2						2		
KS		4		1	1	1				1	5	1	1				1		1	1	
KY		7	2	1		1				1	7	3	1				1		1	1	
LA		6	2								6	2	1		1				1		1
MA		7	1		6	2					13	3				1		1	1		1
MD		5	1								5	1	1				1		1	1	
ME		1			2	1					3	1	1					1	1		1
MI		2		1	8	1	1			2	10	1					2			2	
MN		1			8	1					9	1					2			2	
MO		12	2		2						14	2	1		1				1		1
MS	6	3								6	3		2						2		
MT	1	1								1	1		2						2		
NC	2	8								2	8		2						2		
ND					3						3						2			2	
NE	1	2		3						4	2		1			1			2		
NH		2									2		1				1		1	1	
NJ		7	3		1	1					8	4	2						2		
NM		1									1						1	1		1	1
NV						1						1	2						2		
NY		21	10		7	5					28	15	1				1		1	1	
OH	2	15	2		2	1				2	17	3	1				1		1	1	
OK	3	3			2					3	5		2						2		
OR					2		1			1	2		2						2		
PA	1	8	3	3	9	9	1			5	17	12					2			2	
RI		1	1		1						2	1					2			2	
SC	1	6								1	6		2						2		
SD					1	2					1	2				2			2		
TN		7	1	1	1					1	8	1	2							2	
TX	11	5	3							11	5	3	1		1				1		1
UT					2						2						2			2	
VA		9	1								9	1	2						2		
VT					2						2						2			2	

Table 5.5 (continued)

State	House Voting												Senate								
	Democrats			Republicans			Other Parties[a]			State Total			Democrats			Republicans			State Total		
	Y	N	N/V	Y	N	N/V	Y	N	N/V	Y	N	N/V	Y	N	N/V	Y	N	N/V	Y	N	N/V
WA					2	1		1			3	1				2			2		
WI		3			8						11						2			2	
WV		1	1		3	1					4	2	1				1		1	1	
WY					1						1						1	1		1	1
Totals	38	207	48	17	85	32	4	3		59	295	80	47		3	7	34	4	54	34	7

Source: Voting records are taken from Roll Call Voting records available through the Interuniversity Consortium for Political and Social Research.

Note: Y, N, and N/V correspond to yea, nay, and no vote.

[a]Includes the Progressive Republicans, Progressives, and Independents.

branches in 1910, with a total of sixteen branches in operation. By 1930, fifty-eight banks were operating 128 branches.

The House vote was not nearly as close as that in the Senate, and there is little evidence of any attempt to enforce party discipline in the House. Thus the House vote should provide a better indication of constituent interests. The fact that roll call votes divide into three categories—yea, nay, and abstention—complicates any attempt to measure support and opposition for a bill. As a first step toward measuring support for the legislation, we divide states into two groups according to their degree of opposition to the bill. We designate states as relatively strong supporters (weak opponents) if the proportion of nay votes in that state is less than two-thirds and the proportion of yea votes is greater than 20 percent. We chose these thresholds to place a sufficient number of states in the supportive group for purposes of comparison. Changes in the choice of thresholds will affect our relative sample sizes but not our qualitative results. By our measure, there are thirteen states designated as relatively strong supporters of the legislation. These include California, Florida, Georgia, Idaho, Illinois, Kansas, Mississippi, Missouri, Montana, Nebraska, Oklahoma, Pennsylvania, and Texas. Five of these states are among the eight states that passed deposit insurance legislation at the state level (Kansas, Mississippi, Nebraska, Oklahoma, and Texas). These thirteen states are not the same as the fourteen states whose congressmen introduced deposit insurance legislation between 1905 and 1919 (the definition of interest in deposit insurance used in table 5.2), but there is substantial overlap. Seven states are in both groups, including the five "supporting" states that enacted state-level deposit insurance, as well as Missouri and Pennsylvania. Table 5.6 shows that supporting states (the thirteen from the House vote) had more fragile banking systems than did other states, as measured by median comparisons of bank size, branching ratios, rural population ratios, and business- and bank-failure rates.

Table 5.6 **House of Representatives Vote on Federal Deposit Insurance in 1913: Comparison of Characteristics of Thirteen "Supportive" and Thirty-Five "Unsupportive" States**

	Relatively Supportive States			Relatively Unsupportive States		
	Mean	Median	S.D.	Mean	Median	S.D.
State bank-failure rate (%), 1907–10	0.13	0.12	0.12	0.19	0	0.45
National bank-failure rate (%), 1907–10	0.14	0.10	0.19	0.14	0	0.19
Average state bank assets, 1910	434	211	493	949	387	1648
Average national bank assets, 1910	1107	759	766	1154	873	862
Business-failure rate (%), 1909–13	1.07	1.03	0.31	0.87	0.78	0.35
Branching indicator unit = 0, branch = 1, 1910	0.31	0	0.48	0.49	0	0.51
Branching ratio, 1910	0.03	0	0.05	0.62	0.03	0.09
Farm to total population 1920	0.39	0.42	0.17	0.33	0.31	0.18

Sources: See tables 5.2 and 5.3.

Note: A supportive state is defined as one for which at least 20 percent of its representatives voted yea, and no more than two-thirds nay on the December 1913 bill to establish federal deposit insurance (HR 7837). Other definitions are given in tables 5.2 and 5.3.

The relative strength of voting support in the House by the congressmen from states that had passed insurance legislation at the state level may reflect a variety of factors, including a fragile unit-banking system, recent high rates of bank failure and business failure, and competitive considerations. On the latter point, national banks in insured states (which had been excluded from participation in state insurance plans by a ruling of the comptroller of the currency) may have desired to have access to a national insurance plan to be able to compete with the existing state insurance systems in their states, and may have lobbied harder than national banks in other states for the bill.

By the same token, in noninsured state systems, small rural unit banks may have opposed the bill more than similar banks in insured states. The reason small state unit banks in many other states might have opposed amended HR 7837 is that it stipulated that membership in the federal insurance system was restricted to *Federal Reserve member banks,* and many of them would not be Fed members. The original intent of the Federal Reserve Act was to encourage all banks (through the benefits of access to the discount window) to join the Federal Reserve System, but the costs of compliance with Fed regulations—especially reserve requirements—kept many small banks from joining (White 1983, 64–125, 177–87). A small rural bank that may have expected to opt out of the Federal Reserve System in 1913 would not have wanted its competitors

who were Fed members to have access to federal insurance. The presence of state insurance, therefore, would reduce the incentives of small banks to lobby against the federal insurance plan, since state insurance offered a means to have insurance without joining the Fed. Indeed, as we discuss below, some small banks may have opposed federal deposit insurance in the 1930s initially because it did not extend membership to non-Fed members. Congressional supporters of rural unit banks eventually succeeded in the 1930s in opening up membership in the Federal Deposit Insurance Corporation (FDIC) to state banks that were not members of the Fed.[6]

Thus far we have shown that prior to 1931 state support for federal deposit insurance legislation, measured either by the propensity to author legislation or to vote for it, was related to the benefits that a state could expect to receive from the legislation. Unit banking, small average bank size, and high rates of bank failure all were associated with support for legislation. Initially, support was not regionally concentrated, and not correlated with banking performance at the state level. But by the 1920s, many states that previously had been supportive of deposit insurance legislation changed course. They liberalized their branching laws, developed more concentrated and stable banking systems, and became opponents rather than supporters of national deposit insurance. The "stability gap" across states widened in the 1920s due to regionally concentrated depression in the agricultural sector, and to differences in branch-banking laws at the state level. These developments reduced the relative importance of within-state variation in the costs and benefits of deposit insurance and increased the across-state variation in the degree of support for deposit insurance. By the twentieth century, we find evidence consistent with the view that states that stood to benefit from the cross-subsidization of risk in a national deposit insurance plan supported legislation, while those that enjoyed relatively stable banking systems opposed it. The widening "stability gap" between unit and branch-banking systems during the 1920s made it unlikely that deposit insurance legislation would be passed in Congress.

6. As a first attempt to test the importance of the Fed membership provision in limiting support for the legislation in the House, we compared the Fed membership ratios in 1919 of the "supporting" states with those of twenty-five other "similar" states with stronger voting opposition to insurance in 1913. Given the importance of bank size for the Fed membership decision, we controlled for this influence by excluding from the group of "similar" states the relatively large-bank, high-population density states of New York, New Jersey, Delaware, and all new England. We also compared the group of twenty-five states with the eight supporting states that did not have state-level deposit insurance plans. If the Fed membership requirement was important for explaining opposition to the bill in the House on the part of some rural states, one should expect to find that Fed membership ratios were higher for the eight "supporting" states than for the rural states that strongly opposed federal legislation. The comparison may not be as relevant for the five supporting states with state-level insurance because small rural state banks in those states might not have been harmed as much by the membership limitation. Comparisons of means and medians between the eight noninsured, "supporting" states and the twenty-five-state control group provided weak evidence in favor of the view that states with more banks that expected to remain outside the Fed system would have had been more likely to oppose deposit insurance.

In light of this evidence, which is consistent with the standard Stigler-Posner-Peltzman view of the role of special interest groups in pushing through legislation, the 1930s are a surprising aberration. According to the standard political-economy paradigm, declining rents of special interests should result in elimination of special interest regulations (or in this case, reductions in the probability of passage). By this logic, the continuing failure of unit banks in the early 1930s should have extended the trend toward bank consolidation. The continuing erosion of the relative economic and political capital of unit bankers should have meant a further decline in the likelihood of federal deposit insurance.

Neither of these predictions was fulfilled. By late 1931, representatives of eastern states that had not supported deposit insurance for decades introduced federal deposit insurance bills. Many of these authors represented urban, not rural, constituencies. Federal banking legislation providing for deposit insurance passed by nearly unanimous consent in 1933. This and other federal legislation slowed or reversed the trends toward greater bank consolidation, expansion of branching, and expanded bank powers, all of which had been hailed as great progress in light of the bank failures of the 1920s. What explains this reversal in direction and the puzzling increase in the breadth of support for federal deposit insurance in the 1930s? The detailed narrative of the next section shows how events and political strategy by the proponents of federal deposit insurance turned the tide in favor of its passage.

5.3 The Debate over Federal Deposit Insurance during the Depression

5.3.1 Bank Distress, 1930–1932

Following the 1929 stock market crash, interest in bank reform, which had moved slowly in the twenties, stirred. In his December 1929 annual message to Congress, President Herbert Hoover called for Congress to establish a joint commission to consider banking reform. The House and the Senate ignored the president's request for a cooperative effort and passed resolutions to initiate their own investigations. However, 1930 was an election year and little was accomplished after Congress adjourned on 3 July (Burns 1974, 7–9). The elections of 1930 split control of Congress, giving the Democrats control of the House. For deposit insurance's future, there was also a crucial change in the chairmanship of the House Banking and Currency Committee. The new Democratic chairman would have been Otis Wingo (D-AR), but his sudden death in 1930 allowed Henry B. Steagall (D-AL) to take control and alter the course of banking reform. A devoted follower of William Jennings Bryan, one of the first post–Civil War proponents of deposit insurance, Steagall had already introduced bills for deposit insurance in 1925, 1926, and 1928. Although Wingo's position on deposit insurance is unclear, he never authored a bill. Wingo and Steagall agreed on most issues and fought hard to contain branch

banking, but they approached the problem differently. In the struggle over the McFadden Act in 1926–27, Wingo was willing to compromise to place new limits on branching, whereas Steagall demanded that branching be eliminated entirely.[7] For Steagall, deposit insurance was essential to the survival of unit banks; the House committee now had a chairman whose position on deposit insurance was unyielding and who would use the power of his office to secure it.

The many bank failures of late 1930 pushed the issue of banking reform to the fore and led President Hoover to ask Congress in January 1931 to establish the Reconstruction Finance Corporation (RFC) to support smaller banks and financial institutions. Congress did not immediately respond to this call, and Hoover organized a series of meetings with bankers and businessmen in October 1931, which resulted in the establishment of the National Credit Corporation. Through this private corporation, banks pooled funds to lend to weak banks on assets not eligible for discount at the Federal Reserve banks. Although $500 million in funds was made available, the corporation had only lent out $155 million to 575 banks by the end of the year (Burns 1974, 14–15; Upham and Lamke 1934, 7; Jones 1951, 14).

The rise in bank failures beginning in late 1930 spurred congressional action on two fronts to increase bank liquidity. First, Congress passed the Glass-Steagall Act of 1931, which liberalized the Federal Reserve's discounting rules as of 21 February 1932. Second, Congress passed the Reconstruction Finance Corporation Act on 22 January 1932. The RFC was authorized to make collateralized loans to financial institutions for up to three years. The RFC moved faster than its private predecessor. By the end of the first quarter of 1932, it had disbursed $124 million, and by 31 December it had provided 7,880 loans totaling $810 million. In addition to improving the liquidity of open banks, the RFC was empowered to make loans to closed banks to speed the process of liquidation and repayment of depositors. During 1932, the RFC disbursed $42 million in loans to closed banks (Upham and Lamke 1934, 145–87). Thus the RFC improved the confidence of depositors in open banks and the pace of payment to depositors in suspended banks. These actions indirectly reduced the demand for deposit insurance.

While these two acts of Congress may have alleviated some pressures on the banks, and some analysts concluded that the RFC helped to arrest the number of suspensions (Upham and Lamke 1934, 150–51), bank failures continued at an alarmingly high level. But the RFC could not combat the effects of the Federal Reserve's persistently deflationary policy. The decline in bank failures was assisted by the Federal Reserve's open market purchase of $1 billion from April to July 1932, a policy that Friedman and Schwartz (1963, 347–48) have emphasized was not continued after Congress adjourned.

Pressure on banks continued unabated, as all banks could not qualify for

7. See the *Congressional Record* 1926, 2854, 3226–27.

RFC assistance. As in previous financial crises, locally declared moratoria and holidays were used to offer banks protection from anxious depositors. Oregon acted first in 1930, passing a law that allowed banks to suspend payments for sixty days, during which they were to arrange for longer voluntary restrictions with depositors. In 1931, Florida banks were granted the power to restrict withdrawals to 20 percent of deposits. By mid-1932, Massachusetts, Michigan, and Virginia adopted similar laws. As the crisis deepened in 1932, mayors in small towns and cities in the Midwest declared holidays when restriction on withdrawals were set in place. The Indiana Commission for Financial Institutions surveyed the number of banks restricting payment as of May 1932. Replies were obtained from thirty-five states that indicated that 658 banks in their jurisdiction had restricted payments, a number that certainly understates the total (Upham and Lamke 1934, 11–13).

5.3.2 Initial Attempts at Insurance and the Deepening Banking Crisis

The number of bills submitted to both the House and Senate for deposit insurance began to rise in late 1931. In the 71st Congress (April 1929–March 1931), six bills were submitted to the House of Representatives, where they died in committee. Between the opening of the first session of the 72d Congress in December 1931 and its closure in July 1932, five bills were submitted to the Senate and fifteen to the House of Representatives. The only bill to leave committee was Steagall's second bill introduced on 14 April 1932. The House passed the bill quickly on 27 May 1932, when, after a voice vote, it was given unanimous assent. Despite this success, the bill died in the Senate Banking and Currency Committee, where Senator Glass, an adamant opponent of deposit insurance, held sway. Pushing his own panacea, the separation of commercial and investment banking, Glass sponsored banking reform bills that made no progress in Congress, especially the House, where there was strong sentiment for some form of deposit insurance. By the end of the year, Glass would not accede to deposit insurance, but he did include a provision for a Liquidation Corporation to speed up the liquidation of failed banks (Burns 1974, 25).

An impasse had been reached in Congress where Congressman Steagall would not agree to any bill that failed to include deposit insurance, and Senator Glass would not consent to any bill that included it. There was little in the elections of 1932 to encourage the supporters of deposit insurance. Sensing victory in the elections, the Democratic Party adopted several planks on bank reform, but these all bore the imprimatur of Senator Glass. The party called for quicker methods of realizing on assets for the relief of deposits in suspended banks, more rigid supervision to protect deposits, and the separation of commercial and investment banking. Roosevelt supported these planks and took Glass's side. The presidential candidate was himself strongly opposed to the idea of guaranteeing deposits (Burns 1974, 22–24). Clearly, the Democratic landslide did not make the adoption of deposit insurance certain.

The banking situation continued to deteriorate in late 1932. The most im-

portant source of trouble, the continued deflationary monetary policy, was not reversed. In addition, the effectiveness of the RFC may have been compromised. In July 1932, Congress required that the names of banks receiving RFC loans be published beginning in August. Banks may have feared damage to their reputation or a run if they borrowed from the RFC. The problem became worse when, in January 1933, after a House resolution, the RFC made public all loans extended before 1933. Although the law only required reports to be made to the president and the Congress, the Speaker of the House, John Nance Garner, instructed the clerk to make the reports public on the grounds that they wanted to prevent favoritism in the loans. Availability of funds was not reduced, but new loans to open banks in the fourth quarter of 1932 were smaller than in any of the previous three quarters (Friedman and Schwartz 1963, 325; Upham and Lamke 1934, 148).

As more banks failed, the crisis in the payments systems intensified. Restrictions on withdrawals that had been local or voluntary proved insufficient. The first state banking holiday was declared in Nevada on 31 October 1932, when runs on individual banks threatened to involve the whole state. This holiday was originally set for a twelve-day period but was subsequently extended (Friedman and Schwartz 1963, 429). Iowa declared a holiday on 20 January 1933, and Louisiana declared a holiday to help the banks in New Orleans on 3 February. Grave banking problems spread to the industrial Midwest. The Detroit banks were on the verge of collapse with over a million depositors, and Michigan declared a bank holiday 14 February. In the second week of the holiday, depositors were permitted to draw out only 5 percent of their balances. In Cleveland, all but one bank suspended payments on 27 February, restricting withdrawals to under 5 percent (Jones 1951, 69–70). Even when the RFC stepped in, it could not halt suspensions. By July 1932, sixty-five Chicago banks had obtained RFC loans, but by February 1933 only eighteen remained open (Upham and Lamke 1934, 156). Declarations of holidays and moratoria picked up momentum. By 3 March, holidays limiting withdrawals had been declared by executive order or legislation in thirty-six states. On 4 March, the banking-center states of Illinois, Pennsylvania, New York, and Massachusetts were among six more states that declared holidays (Patrick 1993, 132).

The holidays increased withdrawal pressures on banks in other states, especially on the New York City banks. There was also fear of a run on the dollar, as many believed the new administration would devalue the dollar (Wigmore 1987). The Federal Reserve responded by raising discount rates in February 1933, and it failed to offset this contractionary move, scarcely increasing its total holdings of government securities (Friedman and Schwartz 1963, 326).

5.3.3 The National Banking Holiday, RFC Policy, and the Rejection of a Bailout

In this crisis atmosphere, Franklin D. Roosevelt immediately ordered the suspension of all banking transactions on 6 March 1933. Transactions were

suspended for a period of four days, during which banks could make change, cash government checks, and conduct other activities where no cash payment was required. The president's authority for this action was based on the Trading with the Enemy Act, but he sought specific authority from Congress as soon as it reopened on 9 March 1933. Within an hour of its receipt, Congress passed the Emergency Bank Act, which confirmed the proclamation of 6 March and gave the president and the secretary of the treasury the authority to regulate the business of banks during any such emergency period as the president might designate. The president issued a proclamation on 9 March extending the previous proclamation until further notice. The next day an executive order authorized the secretary of the treasury and the supervisory authorities in each state to permit the opening of banks after they obtained a license either from the secretary or from the state supervisory authority if they were not Fed members. On 11 March, Roosevelt announced a schedule for reopening the commercial banks. Licensed member banks in the twelve Federal Reserve Bank cities could open on 13 March. Licensed member banks in 250 cities with clearinghouse associations could open on 14 March, and all other licensed member banks could open on 15 March. The schedule for opening nonmember state banks was left to the discretion of state banking authorities.

Although most banks were reopened, a significant fraction of the industry remained shut down. At the end of 1932, two months before the banking holiday, there were 17,796 active commercial banks in operation with $28.2 billion in deposits (seasonally adjusted). Between 31 December 1932 and 15 March 1933, 447 banks were suspended, merged, or liquidated. When the holiday ended, the 11,878 licensed banks had $27.4 billion in deposits on 14 March 1933 while the 5,430 unlicensed banks held $4.5 billion. The unlicensed banks included 1,621 Fed member banks and 3,709 nonmember banks with $2.9 and $1.6 billion in deposits, respectively. The unlicensed banks were left in limbo to be opened later or finally closed (Friedman and Schwartz 1963, 421–27, and tables 13 and 14). Their depositors had only extremely limited access to funds—5 percent of their total deposits (Upham and Lamke 1934, 5). The decline in deposits was tied to the closing of banks. Between December 1932 and 15 March 1933, deposits in banks open for business fell by one-sixth, and 70 percent of this decline was accounted for by the deposits on the books of banks not licensed to open (Friedman and Schwartz 1963, 426–28).[8]

The licensing process was not very rapid. Between 15 March and 30 June, the number of unlicensed banks fell from 5,430 to 3,078, reducing the deposits

8. Friedman and Schwartz (1963, 328–30) have thus argued that the banking holiday was far more restrictive than any of the earlier suspensions as far back as 1814. Banks had not been closed down entirely for a day, but now they were closed for a minimum of six business days. In the earlier episodes, banks had continued most activities except the unlimited payment of deposits on demand, and sometimes were able to expand loans under these circumstances. In 1933, access to all deposits was denied. Friedman and Schwartz conclude that "the 'cure' was close to being worse than the disease" (330).

in suspended banks from $4.5 billion to $2.2 billion. Of the 2,352 banks processed, 1,964 banks with deposits of $642 million were reopened, and 388 banks with deposits of $1,189 million were suspended, liquidated, or merged. By 30 December 1934, there were still 1,769 unlicensed banks with $1 billion in deposits, and it took until December 1936 to dispose of these institutions. Overall, of the banks unlicensed on 15 March 1933, 3,298 reopened for business with $1.5 billion in deposits, while 2,132 with deposits of $2.5 billion were closed or merged.

The RFC seems to have played a modest role in stabilizing the banking system. The banks that were immediately opened were very strong and required little assistance. In fact, RFC outstanding loans to open banks declined continuously from $677 million at the end of the first quarter of 1933 to $462 million by the end of the year, and its purchases of capital obligations remained small until December 1933 (Upham and Lamke 1934, 149, 188–206). The RFC shifted its activity to providing capital for the reopening of weak banks and making loans to speed up the process of liquidating insolvent banks.[9]

The RFC Act had given authority to the corporation to make loans to closed banks for liquidation or reorganization, and empowered receivers to borrow from the corporation, setting a ceiling of $200 million on these types of loans. Loans were offered on the estimated recovery from pledged assets. Loans outstanding for this purpose rose from $48 million at the end of the first quarter 1933 to $100 million by the end of the second quarter. In June, the ceiling was lifted, and by the end of the year loans totaled $292 million (Upham and Lamke 1934, 162–87). These loans were intended to speed up the process of paying out depositors of closed institutions.

There were attempts to force the RFC to liberalize its loan procedure. Numerous bills were introduced to Congress to provide for partial or complete payoff of bank depositors. Representatives from Michigan and Ohio, where some of the largest banks had been closed, pushed for this legislation. The most active sponsor of these proposals was Representative Clarence J. McLeod of Michigan. His first bill, introduced on 13 April 1933, mandated the RFC to loan 70 percent of the book value of bank assets. In the next session of Congress, McLeod introduced a bill to purchase all assets of closed national banks at a price sufficient to pay all depositors in full and liquidate the assets over a ten-year period. The 73d Congress was pressed to pass a new McLeod bill, lobbied by the Hearst newspapers and the governors of several states. While President Roosevelt opposed these measures, Speaker Rainey, Majority Leader Burns, and Chairman Steagall were reportedly in favor of some form of payoff. Finally, in May 1934, 119 members of the House signed a petition to force the

9. The RFC was financed by the Treasury. By 30 June 1934, the Treasury had subscribed to $50 million of the RFC's capital and bought $3.3 billion of its notes, bearing interest ranging from 1/8 to 3 percent (Upham and Lamke 1934, 229–32).

bill to a vote (53 Democrats, 61 Republicans, and 5 Farmer-Laborites). Testifying against this proposal in the House Banking Committee, the secretary of the treasury estimated that a payoff of deposits of $2,500 or less in banks that had failed since 1 January 1930 would cost the Treasury over $1 billion (Upham and Lamke 1934, 181–87). The bill failed to win passage. Thus, while Congress would become willing in mid-1933 to vote for deposit insurance, it was never willing to countenance a bailout.

5.3.4 How Federal Deposit Insurance Was Won

While Congress rejected a bailout of depositors, a battle ensued over whether deposit insurance would be included in a reform bill. Flood's (1991) survey of the contemporary deposit insurance debate reveals that it was extremely well-informed and considered all the issues that are today believed to be pertinent to deposit insurance. This is not surprising in light of the collapses of state deposit insurance systems in the 1920s, which had been observed and commented upon frequently. Indeed, the American Bankers Association (1933) provided a detailed quantitative analysis of the state insurance system failures as part of its campaign against federal deposit insurance. Opponents of deposit insurance used this evidence as an example of the moral-hazard costs of providing government guarantees to depositors.

Proponents of deposit insurance did not try to dismiss the potential importance of such costs. Rather, they argued that deposit insurance could avoid moral-hazard costs if properly designed. Furthermore, they argued that deposit insurance was necessary and fair. Supporters of deposit insurance argued it was a matter of simple justice that depositors not be forced to bear the losses from bankers' mistakes or folly. On the other side, bankers argued that it was unjust for well-managed banks to subsidize poorly run banks. The president of the American Bankers Association pointed out that deposit insurance would mean a net transfer from big banks, where most deposits were, to smaller state-chartered banks, where most of the losses were. The money center banks all emphasized that it was not an actuarially sound insurance plan, as premiums were not set by exposure to risk.

The character of the bank failures of the 1930s and the widespread losses suffered by depositors throughout the country were a new and important ingredient in the political debate after 1932. Figure 5.1 reports data on the number of failing national banks, and figure 5.2 shows the percentage of proven claims paid one, two, and three years after national banks were placed in receivership. From 1929 to 1933, as the number of banks failing increased, the percentage of deposit claims recovered fell dramatically. In prior decades, bank failures had sometimes been numerous, but never had there been so many bank failures at such high cost, and never had this cost been spread throughout the country. In the recession of 1920–21, there were large losses for the relatively few banks that failed. In the 1920s, the number of failures rose, but recoveries were

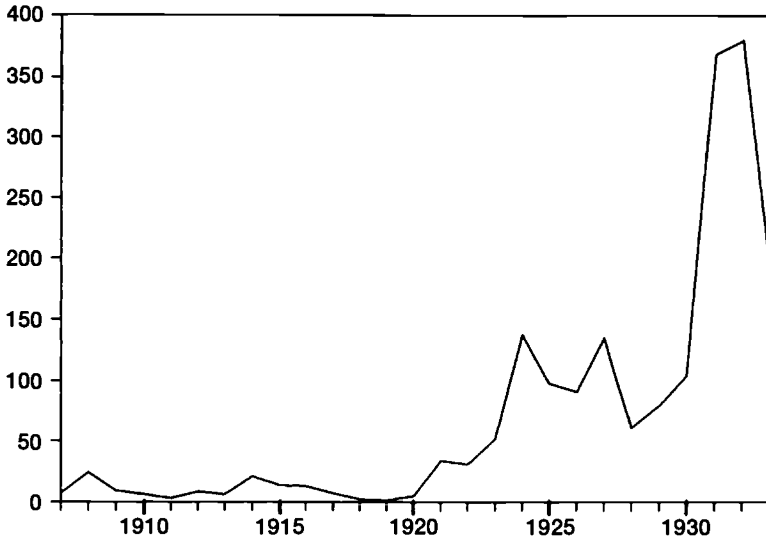

Fig. 5.1 Number of national banks placed in receivership, 1907–33
Source: Comptroller of the Currency 1907–36.
Note: The data for 1933 cover the period from 1 January to 31 August.

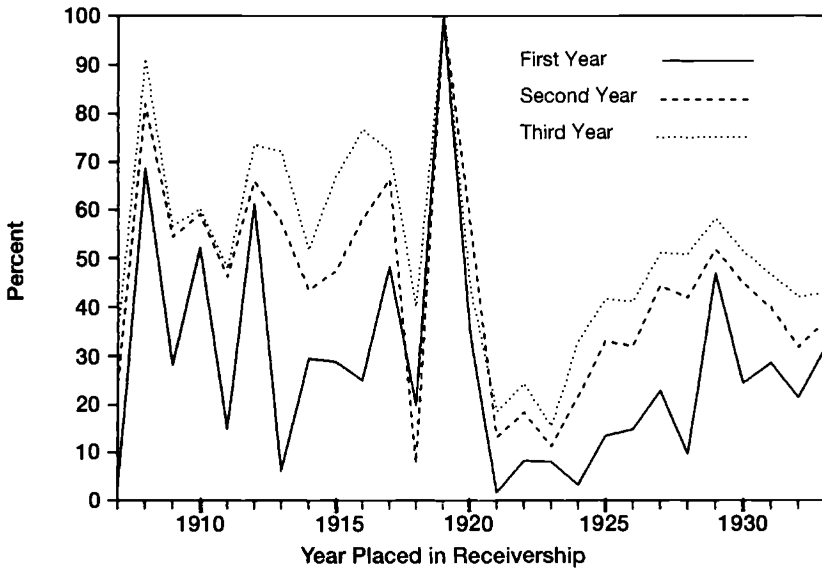

Fig. 5.2 Proven claims paid on national banks in receivership, 1907–33
Source: Comptroller of the Currency 1907–36.
Note: The data for 1933 cover the period from 1 January to 31 August.

fairly high, and losses were concentrated in a few states. But in the 1930s, failures rose and recoveries fell; few people in the country did not know someone who had lost substantial wealth as the result of the banking collapse. Thus the expected value of a dollar deposit fell precipitously.

The severity of these costs, however, by itself was not enough to produce success for the proponents of deposit insurance. Even after the banking crisis of 1933, there still was formidable opposition to deposit insurance. President Roosevelt, Secretary of the Treasury Woodin, Senator Carter Glass, the American Bankers Association, and the Association of Reserve City Bankers all remained opposed to deposit insurance. While not offering any formal position, the leading officials of the Federal Reserve did not favor insurance. On the other side, Vice President John Nance Garner, Jesse Jones of the RFC, and Chairman Steagall favored deposit insurance.

Perhaps most important, the severity of losses during the early 1930s changed the *location* of the debate over deposit insurance. For decades, deposit insurance had been one of the hundreds of issues coming before Congress repeatedly. Like most others, it received relatively little attention from the general public, and its fate was determined by the relative weights of special interests measured on hidden scales in smoke-filled rooms. The banking crisis had the attention of the public, and the costs of the crisis were one of the major public concerns of the time. The debate over banking reform thus moved from the smoke-filled room to the theater of public debate. Once it became a focal issue of relevance for the election of 1934, the contest between proponents and opponents became a struggle for the hearts and minds of the public. Public support would be courted, and public support—not just special interests—would govern congressional voting.

Public attitudes were shaped in part by events and debates of the 1930s other than those that pertained directly to deposit insurance. People's perceptions of banks had been changed by the events of the Great Depression, and the way those events were interpreted at the time. In particular, many influential contemporaries were arguing that banks were the perpetrators rather than the victims of the Great Depression. Bankers were sometimes referred to as gambling "banksters" in the popular press. Some critics of banks argued simply that bankers were to blame because depositors placed funds with bankers for safekeeping, and such funds should not have been risked at the depositors' expense. By 1933, it had become commonplace to blame the stock market crash and the Depression on the recklessness and greed of large, reserve-center banks. The press and the Pecora hearings blamed the speculative excesses of the 1920s on the big-city bankers, depicting the depositor—and to some extent the bank shareholder—as a victim of bankers' greed.[10] The Pecora hearings,

10. Stockholders of national banks were liable for extended (double) liability on their capital contributions in the event of asset shortfall when the bank failed. Double liability was repealed

which were widely covered in the press, involved little evidence or systematic discussion, and their conclusions have been questioned by subsequent scholarship (White 1986; Benston 1989; Kroszner and Rajan 1993). The hearings provided scapegoats for the financial collapse of 1929–33 and a springboard for new regulation.

The challenge for Steagall and his allies was to break the deadlock with Glass by wooing the public, and by offering Glass something he wanted—namely, the separation of commercial and investment banking. Steagall's strategy for winning the public debate was to respond to the actuarial and fairness concerns of critics of deposit insurance, while stressing the evils of large-scale banking and the unfairness of making depositors pay for bankers' errors. Steagall responded to critics by emphasizing that his system would only cover the small depositor because of the ceilings on deposits insured. The actual ceiling set in 1933 for insured deposits of $2,500 covered 97 percent of depositors and 24 percent of deposits (Board of Governors 1933, 414). Moreover, his bill provided for less than 100 percent coverage even of small deposits, which he argued would reduce problems of moral hazard. Finally, in comparison to the state systems, a federal system with its broader geographic coverage (including industrial areas) would diversify and strengthen the plan.

Steagall also wanted to allow membership in the insured system for state banks who were not members of the Federal Reserve System. As Keeton (1990, 31) points out, this may have been a crucial ingredient for receiving support from small rural banks who were not members of the Fed. Many of these banks earlier had joined forces with big-city banks to oppose deposit insurance legislation. Apparently, for many small, rural banks, the value of the cross-bank subsidy from flat-rate federal deposit insurance was not as great as the costs of complying with Fed regulations, and so their support for insurance hinged on allowing state nonmember banks to join.

On 11 March, Glass introduced a bill that was very similar to his previous bank reform bill—once again, without deposit insurance. The president called a White House conference attended by Treasury officials, representatives of the Federal Reserve Board, and Senator Glass. Working on the basis of the

for new national bank share issues in 1933, and for all outstanding issues in 1935 (Macey and Miller 1992, 38). The earlier repeal of double liability for new shares reflected the perceived need to spur new investment to replenish bank capital stock. But the repeal of double liability for bank stockholders reflected other currents of thought that also favored federal deposit insurance. Prior to the 1930s, extended liability of shareholders was deemed an adequate means of protecting depositors, and there was little concern for shareholders, possibly because bank shares (like other stock) were much more closely held prior to the mid-1920s. In the 1930s, bank stockholders' losses were large (with recoveries totaling roughly half their capital contributions to the bank), and these losses did not prevent the collapse of the banking system or large losses to depositors (Macey and Miller 1992, 34). Stockholders, who by now tended to be largely firm "outsiders," were viewed as innocent victims of bank management. Thus the double-liability provision was deemed both unfair and ineffectual in limiting bank runs by the mid-1930s (Macey and Miller 1992, 34–38).

Glass bill, there were further conferences and consultations for the next six weeks, with Glass a frequent visitor. Senator Duncan Fletcher, chairman of the Banking and Currency Committee, and Steagall were also polled (Burns 1974, 80). The most hotly contested issue was deposit insurance, which neither the president nor Glass wanted included in the bill. But congressional pressure was building. Twenty-five Democratic house members signed a petition in support of a guarantee in early March (Burns 1974, 89–90). Key congressmen, like Senator Arthur Vandenberg (R-MI), became outspoken insurance advocates after local bank failures generated enormous constituent pressure.[11] Patrick (1993, 176) argues that mounting public pressure in support of deposit insurance at this juncture partly reflected anti-big-bank sentiment due to the coincident resumption of the Pecora hearings, with testimony from J. P. Morgan and George Whitney that made front-page news. Glass reportedly told the White House that, if insurance was not put into the administration bill, Congress would include it anyway. Glass reportedly yielded to public opinion because "Washington does not remember any issue on which the sentiment of the country has been so undivided or so emphatically expressed as upon this."[12]

In mid-May, Glass and Steagall each introduced their own bills with changes in the structure of the Federal Reserve, separation of commercial and investment banking, equal branching rights for national banks (which had more limited rights than state banks), and a plan for the creation of the FDIC (Burns 1974, 81). Both bills included specifications made by the Roosevelt administration that deposit coverage be based on a sliding scale and that there be a one-year delay in the start of the insurance corporation. Accounts were to be 100 percent insured up to $10,000, 75 percent for deposits between $10,000 and $50,000, and 50 percent for funds in excess of $50,000. Deposit insurance was to be financed by assessments levied on banks, the Federal Reserve Banks, and $150 million from the Treasury. It would begin on 1 July 1934 (Burns 1974, 90).

Glass's original bill required all FDIC member banks to join the Federal Reserve, but he was blocked by a coalition led by Steagall in the House and Huey Long in the Senate, joined by Senator Vandenberg, who feared this would end state-chartered banking. Long, who had blocked Glass's bill in the previous Congress with a ten-day filibuster, virulently opposed Glass's branching provisions. Long and Steagall extolled deposit insurance as a means of survival for the small banks and the dual banking system (Flood 1991, 51–52). Eager for a bill to separate commercial and investment banking, Glass

11. The large bank failures of Detroit had converted Vandenberg into a supporter of deposit insurance. His switch reveals a response to the more general interests of his constituents rather than the special interests of bankers. He had come on board Steagall's ship, but he did not change his basic beliefs. In his testimony on the Federal Deposit Insurance Act of 1950, he opposed raising the insurance limit from $5,000 to $10,000 because "there is no general public demand for this increased coverage. It is chiefly requested by banker demand in some quarters for increased competitive advantage in bidding for deposits" (Senate 1950, 50–51).

12. "Deposit Insurance," *Business Week*, 12 April 1933, 3.

finally agreed to support deposit guarantee and the coverage of nonmember banks in exchange for more Federal Reserve authority. The prohibition of interest payments on deposits appears to have been another part of this elaborately crafted compromise. Glass argued that the prohibition of interest was necessary to reduce the flow of interbank deposits to reserve centers, where funds were often invested in securities. Consistent with his desire to break the link between commercial and investment banking, Glass viewed the investment of interbank deposits in the securities market as a destabilizing influence on banks.[13]

This carefully crafted compromise bill reflected the tenuous balance of power between the dominant factions in the House and Senate. However, in a maneuver reflecting the ability of individuals to use congressional rules to alter the balance of power, the bill was radically amended by a proposal of Senator Vandenberg. His amendment proposed to create a temporary deposit insurance fund, thereby offering deposit insurance more quickly. The amendment of the bill was engineered by Vice President Garner, who was presiding over the Senate, while it sat as a court of impeachment in the trial of a district judge. In a surprise move that enabled him to seize control of the agenda, Garner temporarily suspended the court proceedings and ordered the Senate into regular session to consider the amendment presented by Vandenberg. The amendment—establishing a temporary fund effective 1 January 1934 to provide 100 percent coverage up to $2,500 for each depositor until a permanent corporation began operation on 1 July 1934—was overwhelmingly adopted (Federal Deposit Insurance Corporation 1984, 41–43). The bill was almost derailed in a joint conference committee on 12 June, but survived to pass both houses of Congress the next day. Glass was forced to make another concession and permit nonmember banks to join under the amendment's terms. The American Bankers Association urged its members to telegraph the president to veto the bill. Although the president was opposed to the Vandenberg amendment, Glass warned him not to delay, and Roosevelt signed the Banking Act of 1933 on 16 June 1933.

Under the provisions of the Banking Act, the Temporary Deposit Insurance Fund would begin operations on 1 January 1934. Only those banks certified as sound could qualify for insurance (Burns 1974, 120). The capital required to establish the FDIC was contributed by the Treasury and the twelve Federal Reserve banks. Banks joining the FDIC were assessed 0.5 percent of insurable deposits, of which one-half was payable immediately and the remainder on call. All Federal Reserve member banks were required to join the FDIC; other

13. Golembe (1975, 64) rejects Glass's stated motivation for restriction of interest rates on deposits and argues that interest rate restrictions were simply a payoff to big banks to reduce their opposition to the Banking Act of 1933. Golembe provides no evidence in support of this interpretation. Moreover, big banks continued to devote energy to overturning deposit insurance during and after the inclusion of a provision for an interest rate ceiling, so it is hard to see any effect of interest rate restrictions on big bankers' willingness to accept deposit insurance.

licensed banks could receive FDIC protection upon approval of the FDIC so long as they became Fed members within two years.

Throughout 1933, many banks still were adamant in their opposition to insurance. The American Bankers Association at its annual meeting adopted a resolution to recommend that the administration postpone initiation of deposit insurance (Burns 1974, 125). They hoped that Congress would reconvene and make some adjustment, but they were sorely disappointed. When the Temporary Deposit Insurance Fund was given a one-year extension in 1934 and permanent deposit insurance was postponed, Steagall pushed his agenda further. Steagall wanted to increase the deposit coverage from $2,500 to $10,000. Although Roosevelt opposed this change and pointed out that 97 percent of depositors already were protected, Congress followed Steagall's lead and set the account limit at $5,000 (Burns 1974, 127–28). In addition, compulsory membership in the Fed was postponed from 1 July 1936 until 1 July 1937. Bankers gradually gave up their opposition and accepted that deposit insurance would remain in place (Burns 1974, 129).

The temporary system was extended to 1 July 1935 by an amendment in 1934, and to 31 August 1935 by a congressional resolution signed by the president. On 23 August, 1935, the permanent system finally became effective under Title 1 of the Banking Act of 1935, which created the FDIC and superseded the original permanent plan, liberalizing many of its provisions. All members of the Federal Reserve System were required to insure their deposits with the FDIC. Nonmember banks with less than $1 million in deposits could obtain insurance upon approval of the FDIC, but were required to submit to examination by the FDIC. The insurance limit was set at $5,000 for each depositor. Insured banks were charged a premium of one-twelfth of 1 percent of their deposits payable semiannually. This was a substantial reduction from 0.5 percent, half of which was paid to the temporary fund, which was returned to banks upon its closure.

5.3.5 Winners, Losers, and Political Entrepreneurs

By 1935, it had become clear who had won and who had lost from the provisions of the permanent deposit insurance plan. Small, rural banks, and lower-income individuals (with small deposit accounts) were clear winners, while large, big-city banks, wealthy depositors, and depositors in failed banks were the losers. Depositors of relatively stable urban banks effectively subsidized the deposits in less stable rural banks. Under the 1935 law, wealthy depositors contributed premiums as a fraction of all their deposits (through their banks), but only received protection on deposits up to $5,000, providing an effective subsidy from the rich to the poor. Depositors in failed banks were not bailed out despite the strenuous efforts by some congressmen on their behalf. Furthermore, the presence of deposit insurance removed one of the main motivations for allowing further consolidation and branching in banking, which would have mainly benefited larger banks. Small, rural banks now had access to federal

government insurance at low cost. In particular, access to federal insurance did not require small banks to pay the high regulatory cost of joining the Fed, and insurance protected virtually all of their deposits.

Some who benefited most from federal deposit insurance—small depositors and small, rural banks—were not very visible advocates of insurance from the beginning of the insurance debate. As Keeton (1990) points out, not all small, rural banks supported deposit insurance, as some insurance plans would have created more costs than benefits for small banks. In particular, small banks were concerned that Fed membership might be a requirement for deposit insurance, or that the fee structure of deposit insurance might be designed in a way that would put them at a disadvantage. Similarly, the gains small depositors received did not reflect any initial active lobbying effort on their part, although their voice was clearly heard after the banking crises. Small depositors were not a well-organized, coordinated special interest pushing for legislation to create a transfer of resources from the rich to the poor. The public's role was important, but it was not the initiator of the legislation. The public reacted to overtures by congressional advocates of deposit insurance who sought to use public support as a lever against their opponents in Congress.

Without the "political entrepreneurship" of Steagall and others, the beneficiaries of deposit insurance would not have played an important role in influencing legislation. Steagall, Long, and other politicians with populist constituencies made deposit insurance a focal issue, and thus made public opinion an important ingredient in the outcome. They also shepherded bills through Congress, making sure the details of the bills (premiums, membership limitations, deposit coverage) would protect the interests of small, unit banks, and they knew that these banks would be grateful for the help, even if they had not pushed for it. In the standard Stigler-Posner-Peltzman view of the political economy of regulation, rent-seeking special interest groups typically are identified as the political entrepreneurs who define which issues are important and push for their passage. In the case of federal deposit insurance, entrepreneurial politicians defined an issue they thought would be beneficial to their constituents, structured the forum in which it would be debated to serve their purposes, and organized constituent support for their proposals.

5.4 Lessons for Models of Political Economy

What general lessons for the political economy of regulation can be culled from the fifty-year struggle over federal deposit insurance? We would emphasize three general caveats to the standard Stigler-Posner-Peltzman view that rent-seeking special interests define and determine regulatory outcomes.

First, there is more than one theater of action in the political process. If the proponents of regulation can succeed in drawing sufficient public attention to their issue, then politicians will respond to public pressure, not just to special interests. Second, influential politicians, not just special interests, may be insti-

gators of regulation and may play an especially important role in determining which issues become "focal" to the general public, and in winning public support. Third, while public opinion may have been somewhat informed, it is not likely that the public anticipated all the changes wrought by its support for federal deposit insurance. Furthermore, once public support had been won during the debate of 1932–34, the theater of debate predictably shifted back to the smoke-filled room as the attention of the public moved on to other issues. After the hurdle of establishing deposit insurance had been cleared and the public was no longer easily mobilized, the special interests within banking struggled among themselves over changes in the law. The Federal Deposit Insurance Act of 1950 was a compromise that offered something to all banks and looks more like a creature of the Stigler-Posner-Peltzman paradigm. The act increased the insurance limit, as desired by small banks, and introduced a scheme for a partial rebating of assessments that pleased large banks. Once unit bankers had been given a new lease on life by deposit insurance, they were able to exert influence over other regulation, as well. Progress in permitting expanded scope and scale of banking was stalled.[14]

It is interesting to contrast the deposit insurance debate of the 1930s with that of the 1990s. Deposit insurance reform to protect the interest of the taxpayers has fallen far short of the ambitious plans outlined by many would-be reformers. In part, this seems due to the fact that the issue simply has not captured the imagination of the population, even in the face of a $200 billion loss in the savings and loan industry, and the possibility of large losses to the FDIC. It was hardly mentioned in the election of 1992. Why has no political entrepreneur in the House or Senate come forward as Steagall did, with a bold plan to make reform a focal issue in the public eye? One possible explanation is that hard-headed economic arguments about incentives do not play as well in the public theater as soft-hearted populist arguments about fairness. Another explanation is that politicians do not see big benefits for their most influential constituencies from supporting a major reform. No political entrepreneur has yet appeared who can assemble a powerful enough coalition to upset the existing balance of special interests.

14. For a discussion of the political and regulatory reversal of interest in expansion of branching after 1933, see Doti and Schweikart 1991.

Appendix

Table 5A.1 Characteristics of Authors of Federal Deposit Insurance Bills and Amendments

Item	Intro Date	Cong.	Title	Author	Party-State	City District[a]	Type[b]	Banks Covered in Bill's Provisions
1	1886/1/11	49th	Rep.	Price	R-WI		B	National
2	1886/2/1	49th	Rep.	Sawyer	R-NY		B	National
3	1886/2/15	49th	Rep.	Hutton[c]	D-MO		B	National
4	1886/3/1	49th	Rep.	Brumm	R-PA		B	National
5	1888/1/4	50th	Rep.	Brumm	R-PA		B	National
6	1891/12/10	52d	Sen.	Hiscock[c]	R-NY		B	National
7	1892/3/23	52d	Rep.	Clover	O-KS		G	National
8	1893/8/14	53d	Sen.	Hunton	D-VA		G	National
9	1893/9/9	53d	Rep.	Babcock	R-WI		B	National
10	1893/9/22	53d	Rep.	Bryan	D-NE		B	National
11	1894/3/26	53d	Rep.	Mercer	R-NE	Omaha	B	National
12	1895/1/3	53d	Sen.	George	D-MS		G	National
13	1897/1/5	54th	Sen.	Peffer	O-KS		G	National
14	1897/3/15	55th	Rep.	Fowler[c]	R-NJ		B	National and state
15	1897/7/15	55th	Rep.	Lewis	D-WA		G	National
16	1897/7/15	55th	Rep.	Jenkins	R-WI		G	National
17	1898/1/5	55th	Rep.	Jenkins	R-WI		B	National
18	1898/2/1	55th	Rep.	Fowler[c]	R-NJ		B	National
19	1905/2/27	58th	Rep.	Webber	R-OH		G	National
20	1905/12/4	59th	Rep.	Bates	R-PA		B	National
21	1906/1/19	59th	Rep.	Bates	R-PA		B	National
22	1906/2/14	59th	Rep.	Bates	R-PA		B	National
23	1906/3/5	59th	Rep.	Gronna	R-ND		B	National
24	1906/12/13	59th	Rep.	Underwood	D-AL		B	National
25	1906/12/17	59th	Rep.	Bates	R-PA		B	National
26	1907/12/2	60th	Rep.	Candler	D-MS		B	National

(continued)

Table 5A.1 (continued)

Item	Intro Date	Cong.	Title	Author	Party-State	City District[a]	Type[b]	Banks Covered in Bill's Provisions
27	1907/12/2	60th	Rep.	Norris	R-NE		B	National
28	1907/12/2	60th	Rep.	Sheppard	D-TX		B	National
29	1907/12/2	60th	Rep.	Russell	D-TX		B	National
30	1907/12/2	60th	Rep.	Gronna	R-ND		B	National
31	1907/12/2	60th	Rep.	Underwood	D-AL		B	National
32	1907/12/2	60th	Rep.	Bates	R-PA		B	National
33	1907/12/16	60th	Rep.	Campbell	R-KS		G	National
34	1907/12/16	60th	Rep.	Reeder	R-KS		B	National
35	1907/12/19	60th	Rep.	Chaney	R-IN		B	National
36	1907/12/19	60th	Rep.	Underwood	D-AL		B	National
37	1907/12/21	60th	Sen.	Owen	D-OK		B	National
38	1908/1/6	60th	Rep.	Hinshaw	R-NE		B	National
39	1908/1/6	60th	Rep.	DeArmond	D-MO		B	National
40	1908/1/8	60th	Sen.	Culberson	D-TX		B	National
41	1908/1/7	60th	Sen.	Brown	R-NE		B	National
42	1908/1/8	60th	Rep.	Fulton	D-OK		B	National
43	1908/1/8	60th	Rep.	Fowler[d]	R-NJ		B	National
44	1908/1/8	60th	Rep.	Davidson	R-WI		B	National
45	1908/1/8	60th	Rep.	McHenry[c]	D-PA		G	National and state
46	1908/1/9	60th	Sen.	Nelson	R-MN		B	National
47	1908/1/14	60th	Rep.	Adair	D-IN		B	National
48	1908/1/15	60th	Sen.	Owen	D-OK		B	National
49	1908/1/27	60th	Rep.	Bates	R-PA		B	National
50	1908/1/27	60th	Sen.	Gore	D-OK		B	National
51	1908/1/30	60th	Rep.	Crawford[c]	D-NC		G	National and state
52	1908/2/7	60th	Rep.	Williams	D-MS		B	National and state
53	1908/2/12	60th	Sen.	Owen	D-OK		B	National

54	1908/2/17	60th	Sen.	Brown	R-NE		B	National
55	1908/3/15	60th	Sen.	McCumber	R-ND		B	National
56	1908/3/13	60th	Sen.	Nelson	R-MN		B	National
57	1908/3/16	60th	Rep.	Bates	R-PA		B	National
58	1908/3/25	60th	Sen.	Owen	D-OK		B	National
59	1909/3/18	61st	Rep.	Sheppard	D-TX		B	National
60	1909/3/24	61st	Rep.	DeArmond	D-MO		B	National
61	1909/5/3	61st	Rep.	Underwood	D-AL		B	National
62	1909/12/10	61st	Rep.	Candler	D-MS		B	National
63	1909/12/10	61st	Rep.	Russell	D-TX		B	National
64	1910/2/28	61st	Rep.	Rucker	D-CO	Denver	B	National
65	1910/6/16	61st	Sen.	Jones	R-WA		G	National
66	1911/7/26	62d	Rep.	Candler	D-MS		B	National
67	1911/12/12	62d	Rep.	Sheppard	D-TX		B	National
68	1913/11/10	63d	Sen.	Williams[c]	D-MS		B	National
69	1913/11/25	63d	Sen.	Hitchcock	D-NE		B	Federal Reserve members
70	1913/12/1	63d	Sen.	Owen	D-OK		B	National
71	1913/12/18	63d	Sen.	Owen	D-OK		B	National
72	1913/12/23	63d	Sen.	Williams[c]	D-MS		B	Federal Reserve members
73	1914/1/16	63d	Rep.	Kinkaid	R-NE		B	National
74	1914/3/10	63d	Sen.	Owen	D-OK		B	Federal Reserve members
75	1914/9/12	63d	Rep.	Barton	R-NE		B	Federal Reserve members
76	1915/12/6	64th	Rep.	Kinkaid	R-NE		B	National
77	1915/12/7	64th	Sen.	Williams[c]	D-MS		B	National
78	1915/12/10	64th	Sen.	Owen	D-OK		B	Federal Reserve members
79	1917/4/4	65th	Sen.	Owen	D-OK		B	Federal Reserve members
80	1917/4/6	65th	Sen.	Williams[c]	D-MS		B	National
81	1918/2/18	65th	Rep.	Shouse[c]	D-KS		G	National
82	1918/2/18	65th	Sen.	Owen	D-OK		G	National
83	1918/4/23	65th	Sen.	Shaforth	R-CO		G	National

(continued)

Table 5A.1 (continued)

Item	Intro Date	Cong.	Title	Author	Party-State	City District[a]	Type[b]	Banks Covered in Bill's Provisions
84	1919/5/26	66th	Sen.	Williams	D-MS		B	National
85	1919/5/26	66th	Sen.	Owen[c]	D-OK		B	Federal Reserve members
86	1920/12/13	66th	Rep.	McClintic	D-OK		B	National Federal Reserve members
87	1921/4/11	67th	Rep.	McClintic	D-OK		B	National Federal Reserve members (in approving Federal Reserve districts)
88	1922/9/16	67th	Rep.	Smith	R-ID		B	National Federal Reserve members (in approving Federal Reserve districts)
89	1923/2/3	67th	Sen.	Brookhart	R-IA		B	Cooperative national
90	1923/12/5	68th	Rep.	McClintic	D-OK		B	National Federal Reserve members (in approving Federal Reserve districts)
91	1924/1/1	68th	Sen.	Brookhart	R-IA		B	Cooperative national
92	1924/3/1	68th	Sen.	Jones	R-NM		B	Federal Reserve members
93	1924/3/10	68th	Rep.	Thomas	D-OK		B	Federal Reserve members
94	1924/4/30	68th	Rep.	Doyle	D-IL	Chicago	G	National
95	1925/2/9	68th	Rep.	Steagall[c]	D-AL		B	Federal Reserve members
96	1925/12/14	69th	Rep.	Hastings	D-OK		G	Federal Reserve members
97	1926/3/6	69th	Rep.	Thomas	D-OK		B	Federal Reserve members
98	1926/3/23	69th	Rep.	Steagall[c]	D-AL		B	Federal Reserve members
99	1926/12/6	69th	Rep.	Brand[c]	D-GA		B	Federal Reserve members (except banks in states with insurance)

100	1926/12/6	69th	Rep.	Howard	D-NE		B	National
101	1926/12/11	69th	Rep.	Brand[c]	D-GA		B	Federal Reserve members (except banks in states with insurance)
102	1927/12/5	70th	Rep.	Hastings	D-OK		G	Federal Reserve members
103	1927/12/5	70th	Rep.	Howard	D-NE		B	Federal Reserve members
104	1927/12/13	70th	Rep.	Brand[c]	D-GA		B	Federal Reserve members (except banks in states with insurance)
105	1928/2/16	70th	Rep.	Hastings	D-OK		G	Federal Reserve members
106	1928/2/20	70th	Rep.	Hastings	D-OK		G	Federal Reserve members
107	1928/5/26	70th	Rep.	Steagall[c]	D-AL		B	Federal Reserve members
108	1929/4/15	71st	Rep.	Howard	D-NE		B	Federal Reserve members
109	1929/12/12	71st	Rep.	Brand[c]	D-GA		B	Federal Reserve members (except banks in states with insurance)
110	1930/1/6	71st	Sen.	Brookhart[c]	R-IA		B	Cooperative National
111	1930/3/26	71st	Rep.	Steagall[c]	D-AL		B	Federal Reserve members
112	1930/6/12	71st	Rep.	Hastings	D-OK		G	Federal Reserve members
113	1930/1/10	71st	Rep.	Hare	D-SC		B	Federal Reserve members
114	1931/2/28	71st	Rep.	Ramspeck	D-GA	Atlanta	B	National
115	1931/12/8	72d	Rep.	Howard	D-NE		B	National
116	1931/12/8	72d	Rep.	Beam	D-IL	Chicago	G	National
117	1931/12/8	72d	Rep.	Hastings	D-OK		G	Federal Reserve members
118	1931/12/9	72d	Rep.	Hare	D-SC		B	Federal Reserve members
119	1931/12/9	72d	Sen.	Brookhart[c]	R-IA		B	Cooperative national
120	1931/12/17	72d	Rep.	Lamneck	D-OH	Columbus	B	Federal Reserve members
121	1932/1/4	72d	Rep.	LaGuardia	R-NY	New York	B	Federal Reserve members; state members have option to withdraw

(continued)

Table 5A.1 (continued)

Item	Intro Date	Cong.	Title	Author	Party-State	City District[a]	Type[b]	Banks Covered in Bill's Provisions
122	1932/1/26	72d	Sen.	Lewis	D-IL	Chicago	G	Federal Reserve members
123	1932/2/8	72d	Rep.	Shallenberger	D-NE		B	Federal Reserve members
124	1932/2/20	72d	Rep.	Jenkins	R-OH		B	Federal Reserve members
125	1932/2/26	72d	Sen.	Fletcher[c]	D-FL		G	Federal Reserve members
126	1932/3/2	72d	Rep.	Disney[c]	D-OK	Tulsa	B	Federal Reserve members
127	1932/3/5	72d	Rep.	Cable	R-OH		B	Banks and DIs; non–Federal Reserve have withdrawal option
128	1932/3/7	72d	Sen.	Fess	R-OH		B	Banks and DIs; non–Federal Reserve have withdrawal option
129	1932/3/7	72d	Rep.	Steagall[c]	D-AL		B	Federal Reserve members
130	1932/3/7	72d	Rep.	McClintic	D-OK		B	Federal Reserve members
131	1932/3/21	72d	Rep.	Taylor	R-TN		G	Federal Reserve members
132	1932/4/13	72d	Rep.	Strong[c]	R-KS		G	National
133	1932/4/14	72d	Rep.	Steagall[d]	D-AL		B	Federal Reserve members and sound nonmembers
134	1932/5/21	72d	Sen.	Fletcher[c]	D-FL		B	Federal Reserve members and sound nonmembers
135	1932/12/23	72d	Sen.	Vandenberg	R-MI		B	Federal Reserve members and sound nonmembers
136	1933/3/9	73d	Rep.	Jenkins	R-OH		B	Federal Reserve members
137	1933/3/9	73d	Rep.	Taylor	R-TN		G	Federal Reserve members

138	1933/3/10	73d	Sen.	Vandenberg	R-MI		B	Federal Reserve members and sound nonmembers
139	1933/3/10	73d	Sen.	McAdoo	D-CA		B	Federal Reserve members and sound nonmembers
140	1933/3/11	73d	Sen.	Fletcher	D-FL		B	Federal Reserve members and sound nonmembers
141	1933/3/14	73d	Rep.	Hastings	D-OK		G	Federal Reserve members
142	1933/3/14	73d	Rep.	Johnson	D-TX		B	Federal Reserve members and sound nonmembers
143	1933/3/15	73d	Rep.	Whitely	R-NY		B	Federal Reserve members and sound nonmembers
144	1933/3/16	73d	Rep.	Church[c]	D-CA		B	Federal Reserve members and sound nonmembers
145	1933/3/17	73d	Rep.	Shallenberger	D-NE		B	Federal Reserve members
146	1933/4/20	73d	Rep.	Carter	R-CA		B	Federal Reserve members
147	1933/5/9	73d	Rep.	McLeod	R-MI	Detroit	B	Federal Reserve members
148	1933/5/10	73d	Rep.	Steagall[d]	D-AL		B	Federal Reserve members and sound nonmembers
149	1933/5/15	73d	Sen.	Glass[e]	D-VA		B	Federal Reserve members
150	1933/5/17	73d	Rep.	Steagall[d]	D-AL		B	Federal Reserve members and sound nonmembers

Source: Data are available through the Interuniversity Consortium for Political and Social Research.

[a]City district refers to the large-city congressional districts of representatives introducing bills.

[b]*B* = bill in which banks provide mutual insurance; *G* = bill in which the government provides a guarantee.

[c]Member of the House or Senate committee to which the bill was referred.

[d]Chair of the House or Senate committee to which the bill was referred.

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