When Regulation Was Too Successful—The Sixth Decade of Deposit Insurance

A History of the Troubles of the U.S. Banking Industry in the 1980s and Early 1990s

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PRAEGER

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Preface

History requires the practitioner to ascertain and interpret facts. Although not easy, the first task, ascertaining facts, is relatively straightforward. In an effort such as the subject of this book, the facts are not hidden or secret. They are largely part of the public record in the archives of the media and government bodies. It is with the second task that difficulties arise. In interpreting those facts, in placing them in a perspective, the historian brings certain intellectual baggage to the table and makes subjective judgments. The underlying judgment of this book is that the disaster encountered by the savings and loan industry and the difficulties survived by the banking industry in the 1980s and early 1990s were the inevitable result of many decades of restraints on marketplace activity. The search for current culprits that occupied much of the time and effort of federal government policy-makers in both legislative and executive branches was largely misplaced. Bad guys took advantage of the situation, but the situation was the product of laws and regulations that had long since been subverted by technology and the marketplace. Others might disagree with this conclusion. I only ask that they consider the arguments with an open mind.

The intellectual baggage I brought to this effort can be attributed in large measure to many years of association and friendship with one of the more remarkable students of American banking. Carter H. Golembe has been writing about banking for almost 50 years. He has been a federal banking official, an industry consultant, and a banking director. Most importantly, he is a keen observer and perceptive analyst. His *Golembe Reports* has long been, and remains, the nation's most thought-provoking publication on the public policy aspects of banking.

Although much of my interpretation of the events of the 1980s and early 1990s is the result of my exposure to Carter's ideas and arguments, I am sure he would not agree with everything in this effort. Ultimately, this book is my own interpretation, and any errors of fact are mine. The preparation of this work for publication was done largely by my wife Rhonda, an editor and indexer of the first order.

Finally, a disclaimer. During the preparation of this book, I was on the staff of the Federal Deposit Insurance Corporation (FDIC). The interpretations, opinions, and views herein, however, were developed in my capacity as a mere taxpayer and should most certainly not be construed as those of the FDIC or any of its divisions or offices.

Introduction

In 1983, the Federal Deposit Insurance Corporation proudly celebrated its 50th birthday. The occasion was marked by the publication of a history of the deposit insurer's first half-century: *The Federal Deposit Insurance Corporation: The First Fifty Years*. Although low-key, the work was largely laudatory, leaving the reader with an impression of an agency characterized by quiet competence and possessed of the confidence that comes from successfully meeting difficult challenges over a long period of time.

Concerning the future, the FDIC acknowledged growing risk and instability in the banking system but predicted that the adequacy of the insurance fund and its historical relationship to the level of deposits would continue. The net worth of the insurance fund was then in excess of $15 billion, and the ratio of the fund to insured deposits was 1.22 percent. The ratio had never been below 1 percent.

Eight years later, at year-end 1991, the bank insurance fund stood at a red-ink nadir of a negative $7 billion. From year-end 1983 to year-end 1992, 1,394 banks failed, more than twice the 673 banks that had failed in the first 50 years of the FDIC's existence. Also between 1983 and 1992, the number of commercial banks fell more than 20 percent, from 14,469 institutions at year-end 1983 to 11,462 institutions at year-end 1992. The decline has continued: at year-end 1997, the number of commercial banks was 9,143, a decline of 37 percent since 1983.

What happened?

This work attempts to answer that question. The study is an examination of the banking industry's troubles of the 1980s and early 1990s, troubles that at times approached the level of a crisis. Unlike the more infamous savings and loan crisis, however, the banking troubles did not result in the decimation of an industry or a massive taxpayer bailout. The banking industry survived, and indeed today seems healthy and very much a central, fundamental component of the U.S. financial system. Nevertheless, some of the lessons that a study of the troubles could provide may not have been fully accepted. The initial government responses to the shakeout were dominated by those who believed that detailed control, regulation and supervision are the answer. Yet the underlying causes of the banking difficulties of the 1980s and early 1990s may well have been many decades of too much control, regulation, and supervision, and not enough reliance on market forces. If this contention is correct but is not the basis for legislative and regulatory oversight of the industry, banking's apparent recovery from the difficulties may not be as complete as it appears to have been, or long-lasting. Continued unwise public policies regarding the banking industry could produce, at some point in the years or decades ahead, another period of turmoil and another flirtation with the federal treasury.

Government policies and actions are the primary focus of this look at the banking troubles of the 1980s and early 1990s. The banking industry is a private sector industry and responds to many of the dynamics of the free market. But the industry was and is one of the most regulated segments of the economy. Government plays a role that is much more activist and central than is the case with the vast majority of other industries. A private sector focus for a history of the period is not impossible, but this present effort will concentrate on public policies—the activities of the Congress and government agencies.

The FDIC, the federal deposit insurance agency created in the depths of the Great Depression, was at the center of the efforts to deal with the banking troubles of the 1980s and early 1990s. Thus this study of those troubles is also a review of the FDIC's sixth, and most turbulent, decade of existence. A focus on the FDIC is further appropriate because deposit insurance, the agency's reason for being, had a causal role in the banking troubles. Deposit insurance was a major contributor to banking industry stability from the mid–1930s to the late 1970s. But as described in Chapter 1, the deposit insurance system also slowly germinated the seeds from which sprouted the difficulties of the 1980s.

Because what happened to and with the banking industry and the New Deal deposit insurer were reflections of trends and events in larger arenas, the study begins with an extended look at banking industry history and at the changing environment within which the FDIC and the other federal regulators operated. Although the banking industry is the primary focus of attention, pertinent matters concerning the remainder of the depository institutions industry, and concerning the financial industry in general, are also covered. The background material is presented in two chapters. In Chapter 1, an excess capacity interpretation of banking industry history is advanced. The argument is that what happened in the FDIC's sixth decade was in large part a consequence of a shakeout of industry excess capacity built up over a period stretching back to the nation's earliest days. Chapter 2 is an overview of the financially turbulent 1980s and the buildup to the decade.

After this look at the big picture, the focus turns to the banking industry's troubles. Chapter 3 broadly summarizes those troubles and their more notorious companion, the savings and loan (S&L) crisis. The subsequent chapters consider the banking troubles in greater detail, concentrating on several topics: too big to fail; the Texas experience; Congress's eventual acceptance that a crisis indeed existed in the S&L industry and the effects this acceptance had on banking and its regulation; the peaking of the banking problems in 1990 and 1991; and the industry's extraordinary recovery.

Finally, the government's actions during the banking troubles are assessed, and several observations on the future are offered. The government record contains both successes and failures. Unfortunately, the characterization of "successes" and "failures" is not a value-free effort, and the values or standards that one brings to the determination are not the subject of universal agreement. The basic question of how to view the survival of the banking industry and its recovery in the 1990s provides an example of the interpretation problem. Were the industry's survival and recovery a vindication of the existing regulatory structure, or did they amount to a near miss for a seriously flawed system? That question and subsidiary matters will be addressed, although definitive answers remain elusive.

The FDIC has published its own, official study of its decade of testing. As a detailed review of the decade, the study is commendable. The detail, however, can obscure several points. First, the study gives only passing attention to the deficiencies in banking industry structure that had developed as a result of many decades of close government control. These deficiencies provided the fertile ground from which sprang the troubles of depository institutions. Second, the FDIC's study acknowledges only obliquely the political battles that the troubles generated as Congress, the administration of the moment, independent agencies, and the many interested parties attempted to come to grips with what was occurring. Legislative solutions were not the products of a logical, rational process in which consensus was reached after the enlightened give-and-take of informed debate. Perhaps the FDIC's status as a government agency prevented it from describing in depth the reality of vehement disagreements, unmitigated self-interest, messy compromises, and sometimes ineffectual and sometimes excessive outcomes that constitute the legislative process. Finally, the FDIC's study spends considerable time on the techniques of bank supervision. Although important at one level, this topic can easily be accorded too much responsibility for the troubles of the decade. Would near-perfect supervision have prevented what transpired? No more than the near-perfect sand castle can withstand the ocean's waves.

THE COMPLEXITY OF REGULATION

The banking industry is not only one of the most pervasively regulated sectors of the economy; it is also subject to one of government's more complex regulatory schemes. A reader unfamiliar with that scheme might benefit from a brief—very brief—primer.

Banks are one of two types of institutions commonly referred to as depository institutions. The second type of depository institution is today called the savings association. Prior to legislation enacted in 1989—the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA)—the term most often applied to this second type of depository institution was "savings and loan association." Savings associations are also called thrifts. The use of "thrift" can sometimes be confusing, however, because the term can also encompass savings banks, one of two sub-categories of banks, the other and far larger subcategory being commercial banks. In many ways, credit unions—another type of institution—resemble banks and more especially savings associations, but credit unions are usually not included within the definition of depository institutions.

Three federal regulators share responsibility for banks. The Office of the Comptroller of the Currency (OCC), established in 1864, regulates national banks, which are generally the larger banks. The OCC is an agency in the Department of the Treasury. The independent Federal Reserve Board, established in 1913, regulates state-chartered banks that are members of the Federal Reserve System. The Federal Reserve also regulates companies that own banks. These companies are called bank holding companies. Bank and bank holding company regulation is not the principal function of the Federal Reserve Board. The principal function is the formulation and implementation of monetary policy. The independent Federal Deposit Insurance Corporation, established in 1933, insures deposits, currently for up to $100,000, in practically all banks and savings associations. The FDIC also regulates state-chartered banks that are not members of the Federal Reserve System. Because a banking organization organized in a holding company structure is regulated at both the bank level and the holding company level, it may have direct contact with more than one of the federal banking regulators. The holding company is under the supervision of the Federal Reserve, but the subsidiary bank or banks may be regulated by the OCC, the Federal Reserve, or the FDIC.

Savings associations are regulated by the Office of Thrift Supervision (OTS), which like the OCC is an agency in the Treasury Department. Prior to the enactment of FIRREA in 1989, the federal regulator of the S&L industry was the independent Federal Home Loan Bank Board, and the federal insurer for S&L deposits was its subsidiary, the Federal Savings and Loan Insurance Corporation.

Further complicating this regulatory structure is the fact that state-chartered banks and thrifts are also regulated by state regulators.

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Excess Capacity

The troubles of the banking industry and the FDIC in the 1980s did not emerge from a void. The foundations had been laid over many decades. Indeed, what happened to the bank and thrift industries during the 1980s was a consequence of events, decisions, and developments that reached back to the nation's founding. The events, decisions, and developments produced a depository institutions industry that was, as the 1970s ended, ripe for extensive consolidation. In the language of economists, the depository institutions industry had become burdened with excess capacity. In the language of common folk, there were just too darn many banks and thrifts.

Three topics summarize the events, decisions, and developments that over the almost two centuries of the nation's existence led to excess capacity in the depository institutions industry: geographic restraints, product limitations, and deposit insurance.

GEOGRAPHIC RESTRAINTS

The geographic restraints had the longest lineage. They arose from the federal nature of the United States. Under a federal system, power is divided between the national and state governments. One of the motivations that led to the Constitutional Convention in 1787 was dissatisfaction with the impediments the newly independent states were able to impose to interstate and foreign commerce under the Articles of Confederation. Although the Constitution created a relatively strong national government and eliminated many of the state impediments to commerce, the states retained much power over economic activity.

One source of state power was the ability to license or charter business enterprises. With the exceptions of the first, 1791–1811, and second, 1816–1836, Bank of the United States, banks were among those business enterprises that required state permission to function. And again with the exceptions of the two congressionally authorized banks, few attempts to establish a bank with operations in more than one state appear to have been undertaken. The hostility of state politicians and authorities was likely one reason for the nondevelopment of interstate banking organizations. Probably at least as important, however, was that the optimum bank size—the use of the term implies a broad, ill-defined range rather than a precise point—in the first half of the nineteenth century was not large. That optimum size increased with improvements in transportation, communications, and organizational capabilities, but the increase was slow and incremental. Banks developed as small, local organizations, and very few "natural" banking markets were hampered by state boundaries. Banking services over distances were provided through various types of correspondent relationships.

Thus the role of state governments in authorizing and controlling economic activities combined with the narrow geographic service areas of early banks to make state boundaries the outermost limits of banks' physical presences. This situation was further solidified when the national banking system came into being during the Civil War. The national banking system checked the growth of branch banking and consequently hindered the development of one important means by which banks could have expanded their service areas.

Branch banking was fairly common before the Civil War. The first and second Bank of the United States both had multiple, interstate facilities. The first Bank had 8 branches, and the second Bank had 25 branches. Within states, state-authorized banks had varying degrees of branching powers. Branch banking was particularly common in the South and the West. According to one compilation, 27 banks in 14 states in 1848 had a total of 143 branches. In 1860, 39 banks in 13 states had 222 branches.[1] The laws that brought the national banking system into existence, however—the National Currency Act of 1863 and the National Bank Act of 1864—did not provide for branch banking. And the initial attitude of the new agency, the Office of the Comptroller of the Currency, overseeing national banks was not favorable toward branching. Most of the state banks with branches that converted to the new national charters became single office institutions. Not only did interest in branch banking wane, opposition to the concept became widespread. Nevertheless, a number of states still permitted their state-chartered banks to have multiple offices.

Not until the end of the century was interest rekindled, in part due to a dearth of banking services in small communities, and not until the 1920s did economic pressure for more banking facilities became pronounced. The inability of national banks to branch put them at an increasing disadvantage to state-chartered institutions. In 1927, Congress through the McFadden Act allowed national banks to branch within cities to the same extent as could state banks. The branching power was expanded in the Banking Act of 1933 to permit branching by national banks throughout a state to the same extent as state authorities permitted branching by state banks. But branching still had its opponents. Indeed, one of the motivations for the establishment of federal deposit insurance in other provisions of the 1933 act was a desire to strengthen the banking system through an alternative other than widespread branching, which many believed would threaten the thousands of local, community banks.[2]

In the decades following passage of the 1933 act, most states slowly relaxed their branching rules. Unit banking gave way to some degree of branching; restrictive branching gave way to branching over wider areas or statewide. Until very recently, however, state boundaries remained as ultimate barriers to bank branching.

Another means of geographic expansion—both within states with restrictive branching laws and interstate—began attracting interest in the early 1950s. A few organizations turned to the holding company structure as a means of engaging in activities not permitted banks and of establishing banking offices beyond the barriers erected by branching laws. In 1956, the Bank Holding Company Act put limits on the potential of holding companies. The product limitations are noted shortly. Regarding geographic limitations, the Douglas Amendment to the Act prohibited ownership of banks by out-of-state holding companies unless this ownership was specifically permitted by state law. Until the 1980s, few states had such laws.

The consequence of this long history of geographic restrictions on banking operations was an industry organized along, and both protected and constrained by, political boundaries, notably state lines but also in many instances city and county limits. How did these geographic restrictions affect industry structure? The answer, of course, requires a fair degree of speculation. But it is certainly logical to argue that in the absence of the pervasive influence of state and local boundaries, the banking industry would have developed in a much more concentrated direction. Fewer banks would likely have been established. The number of banking offices—banks and branches—might not have been substantially different, but the number of independent banks would probably have been much lower.

A more concentrated banking industry, with fewer banks, would not necessarily have resulted in a less competitive industry. Indeed, the geographic barriers to bank activities most likely produced a lower overall level of competition in the industry than otherwise would have been the case. Banks in many areas were protected from the full rigors of a competitive marketplace. Because of the geographic restrictions, the nation very probably ended up with more banks than would have existed in a competitively unfettered environment.

Ironically, the anticompetitive effects of geographic restrictions—and to a lesser extent product limitations—were probably exacerbated by enthusiastic enforcement of the antitrust laws. In the 1960s, 1970s, and early 1980s, even a modicum of overlap in the markets of banks desiring to combine would provoke a substantial antitrust challenge. The result was another limitation on the ability of banks to grow. Laws restricting geographic expansion limited the ability of banks to expand beyond their existing geographic markets, and antitrust laws limited the ability of banks to grow by merger within their markets. Thus as technology and the marketplace were raising the optimum size for an organization providing banking services, artificial constraints were severely hampering the ability of banks to respond. Further restricting the ability of banks to grow were state and federal requirements, enforced with varying degrees of vigor at different times, that new branches be justified by a showing of need in the community. Such a showing was more difficult if the area was being served by another bank or branch. Consequently, a bank could be doubly stymied: it could not acquire the other bank because of the alleged reduction in competition, and it could not open a competing branch because the increase in competition was allegedly not warranted.

PRODUCT LIMITATIONS

Product limitations had less clear origins and less certain effects than did geographic restraints. Varying interpretations of the historical record regarding such limitations have been offered. The interpretation suggested herein is that what began as legal buttressing of normal economic specialization gradually became legal impediments to meeting the changes of normal economic growth and development. The result was a financial industry with an excessive number of service and product providers.

The relationship between the government and private sectors for much of U.S. history prior to the New Deal years is sometimes described by the term laissez-faire. Governments allegedly left businesses largely alone, and the latter functioned, developed, and changed according to the dictates of the marketplace. This simplistic situation, however, was never fully the case. Governments, particularly state governments, were involved in a variety of ways in the business world. A few private sector endeavors, some toll roads, for example, received affirmative government backing in the form of monopolies and even outright monetary support. A far greater number of commercial and financial enterprises were dependent on government for charters and licenses under which to operate.

In the early years of the development of commerce and finance, these charters and licenses generally matched the contemplated business with the marketplace. The fit may not have always been precise, but it usually was fairly close. The law—the charters, licenses, and statutes that standardized the procedure—took its cue from how economic life functioned and what economic life demanded. At some ill-defined point, however, the tail began to wag the dog. The charters and licenses did not just reflect the needs of the marketplace, they also shaped and directed how the marketplace developed. As economic life became more complex, as specialization increased, change was channeled by the charters, licenses, and statutes of earlier, simpler times. In some cases, this channeling might have followed natural economic courses. In other cases, however, the channels might have become more like canals, forcing economic development in directions it would not have otherwise gone.

This interpretation of the flow of U.S. economic history might be particularly apt in the field of finance. Banking and insurance were, and are, businesses narrowly defined. Initially, the narrowness was contained in charters granted by legislatures for individual institutions. Later, when states adopted laws, such as the free banking laws, permitting the more widespread formation of financial institutions, the narrowness was set forth in statutes.[3] Financial specialization became codified in enactments of state legislatures. Banks, building and loan associations, credit unions, trust companies, life insurance companies, property and casualty insurance companies—these and other types of financial institutions were given narrow product markets in which to operate. Specialization also resulted from attempts to correct perceived abuses, actual or potential. For example, the Glass-Steagall Act of 1933, which partially separated commercial and investment banking, was a response to what were thought at the time to be widespread abuses in the underwriting, distribution, and sale of securities. These abuses in turn were thought to be a significant contributor to the banking and economic problems of the early 1930s. The Bank Holding Company Act of 1956 and the Bank Holding Company Act Amendments of 1970, which among other things made the combination of banking and other financial businesses subject to approval and scrutiny by the Federal Reserve Board, were enacted in part to prevent the development of financial conglomerates with their supposedly attendant undue concentrations of power and conflicts of interest.

Legally mandated financial specialization not only limited the products that financial organizations could offer; equally as important, it created markets protected by law from many competitive influences. Participants and customers benefitting from the situation constituted politically powerful interest groups that made changes in the government-mandated specialization exceedingly difficult. Over the longterm, legally mandated financial specialization hindered marketplace-driven changes in the financial industry, restricted the ability of institutions to offer new products and services, and prolonged the life of inefficient organizations. As technology and the marketplace evolved, legal product limitations became more confining. In short, legally mandated financial specialization contributed to the development of banking, insurance, and securities as separate industries, resulting in more players in the financial arena than would have otherwise been the case.

A DIGRESSION—BANKING AND COMMERCE

In recent decades, a part of the debate over product limitations has involved a banking-commerce controversy. The issue is whether banking and commerce—"commerce" meaning not other financial businesses such as insurance and securities but nonfinancial businesses—should be allowed to intermingle. In the search for support for their respective positions, proponents of the different sides of the controversy have turned to history. One side has argued, frequently from a review of statutes, charters, and other legal documents, that banking and commerce have been strictly separated throughout much of the nation's existence.[4] The other side has found considerable evidence of substantial and long term intermingling.[5] A digression into this controversy might be helpful in illuminating the complexities of the topic of product limitations and in supporting the assertion that over the years these limitations have become more confining.

Searchers of the historical record in the banking-commerce controversy often have become sidetracked. One false path has been a focus on activities rather than on ownership. The questions investigated have included: Have both banking and commercial functions been performed in the same entity? At any point in the nation's history, have banks been significantly engaged in commercial activities? Have commercial enterprises also functioned as banks?

The answers to these questions are obscured by the way business was organized and conducted in much of the nineteenth century. Unrelated activities in a single entity were the exception. As with the complexity of many aspects of social, political, and economic life, complexity in the internal organization and functions of business enterprises has increased considerably over the 200 years of the nation's existence. Thus searching for examples of multiple businesses being performed within a single entity in the nation's early years is not likely to be a productive endeavor.

A more appropriate historical focus than activities within a single enterprise is common ownership of businesses engaged in unrelated or only semirelated activities. And at least as significant as common ownership are interlocking directories as ways of binding businesses together. When these topics are investigated, the historical record becomes much more varied. Particularly in the latter part of the nineteenth century, common ownerships and interlocking directories were frequently found.[6] Indeed, the so-called Money Trust was alleged to control much of American industry at the turn of the century. This small group of bankers, most prominently J. Pierpoint Morgan, owed its power to directorships, voting trustees, stock holdings, and of course access to funds. Hostility to the Money Trust was an important political force in the early twentieth century, and the Trust's power was the subject of one of the more famous congressional investigations in U.S. history, the Pujo Committee hearings in 1912. Concern about the Money Trust helped produce several major laws, including the Federal Reserve Act of 1913.

Exactly how organized and conspiratorial the Money Trust was is still subject to debate. What is clear, however, is that in the latter decades of the nineteenth century and the first decade or so of the twentieth century, a significant degree of common control existed between banking and commerce. A relatively small group of bankers was the principal source of funds for large-scale commercial ventures. The funds came from both the bankers themselves and from investors who relied on the bankers for advice. And through corporate boards and voting trusts, the bankers had significant says in the policies of, and ready access to information on, commercial enterprises. One historian has characterized the U.S. economy in the half century before World War I as being "financier-centered" and credits the small group of powerful financiers with channeling the capital that produced growth in the important industries of the time: railroads, steel, electricity, and telephones.[7]

The close relationship between banking and commerce that existed in turn-of-the-century America—a relationship bordering in many instances on common control—began changing shortly before and during World War I. To ward off legally mandated divestitures of their cross-holdings, the Money Trusters curtailed some of their activities. The large borrowings by the national government during the war significantly expanded the securities distribution business. A sizeable proportion of the new government bonds went to the common man, and firms handling this retail bond distribution for the government grew. After the war, a 10-year stock market boom further increased consumer interest in the securities business.

In 1933, the Glass-Steagall Act, enacted in response to perceived causes of the stock market crash of 1929 and the subsequent Great Depression, largely separated the commercial and investment banking businesses. By separating the two, the act reduced the power of each, and the combined power of both, regarding nonbanking sectors of the economy. Segmentation of banking dispersed power over a greater number of entities, thus diluting the ability to exert control. Power dispersion and power reduction go hand-in-hand. After World War II, the growth in the retail securities business and the several-decades-long economic expansion further eroded the combined power of the now separate banking and securities industries. The growth in the retail securities business, and in securities ownership, continued the dispersion of the power that arose from the ability to provide or channel funds. In addition, the long economic expansion, stretching with only minor interruptions from 1945 to 1973, enabled corporations to look inward for financing: the reinvestment of profits met a substantial proportion of the fund needs of many enterprises. Finally, the Bank Holding Company Act of 1956 and the Bank Holding Company Act Amendments of 1970 came close to enshrining as national policy the separation of commercial banks and commercial organizations.

Thus, over much of the twentieth century a retreat has been underway from the high point of common control in banking and commerce that existed in the Money Trust's heyday. The retreat has not been a rout. In part as a result of affiliations among corporate boards of directors, a significant degree of influence between banking and commerce is prevalent today. Bankers sit on the boards of commercial enterprises, and businessmen sit on the boards of banks. Still, partly as a result of legal mandates, banking-commerce affiliations are not as pervasive today as they appear to have been a century ago.

The point to be gleaned from this digression into the banking-commerce controversy is that at least at the ownership level, a rigid separation of banking and commerce has not been the norm in U.S. economic history. The trend regarding banking-commerce affiliations has been toward more legal restrictions. This trend in the direction of the law appears to be opposite to trends fostered by technology and the marketplace that are breaking down economic barriers separating the development and marketing of divergent products and services. The growing legal separation of banking and commerce most likely has not been as economically harmful—has not been anywhere near as great a producer of excess capacity—as have product limitations within the financial industry itself. But the legal reinforcements of the separation are the result of a mind-set that has tended to look at products and services individually and on a stand-alone basis. Such a mind-set produced the product limitations in the financial industry that in turn contributed to the growth over many decades of the industry's excess capacity.

DEPOSIT INSURANCE

The third factor that together with geographic restraints and product limitations resulted in excess capacity in the banking industry was deposit insurance. Federal deposit insurance, the FDIC's raison d'être, was one of the major New Deal initiatives to forestall future financial crises. At the state level, deposit insurance experiments dated back to 1829, although all had been abandoned by 1933. Calls for federal deposit insurance were common in the latter part of the nineteenth century and