

THE PLACE OF DEPOSIT INSURANCE IN TODAY'S BANKING

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Providence, R. I.
February 21, 1952

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It is a real pleasure to help you celebrate your Golden Anniversary. Any organization which has grown in stature and service as you have must have a sound idea behind it. By hitching the development of banking to the professional development of bank personnel, the American Institute of Banking enlisted the full support of our most unique resource, education. I say "unique," because education is about the only resource which we can give to others and still keep ourselves.

The Federal Deposit Insurance Corporation feels a strong kinship to the American Institute of Banking, and not entirely because we regard much of our examining work as educational. As you probably know, we have made extensive use of the educational facilities provided by your national organization. The most important part of the educational program for its examiners, started by the Corporation in 1946, consists of the correspondence courses conducted by the American Institute of Banking. Right now we have about 300 examiners enrolled in such courses. We also have 33 examiners enrolled at the School of Banking at the University of Wisconsin and the Graduate School of Banking held at Rutgers University. Personally, I am proud of my AIB Standard Certificate and of the fact that I am a member of the faculty of the Graduate School of Banking, Rutgers University.

You asked Mr. Cook to speak on "The Place of Deposit Insurance in Today's Banking." He prepared a talk that was based on his many years' experience as a banker and as a supervisor of banks. At first I was inclined to read his speech, but on second thought I decided to approach the subject from a slightly different angle.

Before taking up the question which you asked me to have discussed today, I would like to make a few comments about the relation of banking to the problems of depression and of inflation, apart from the specific role of deposit insurance. It has long been believed that the basic cause of all severe business fluctuations originates in some way from the operation of the banking system. In September, 1837, nearly one hundred and fifteen years ago, President Van Buren, in a message to a special session of Congress, attributed the great crisis of that year to the banks; and twenty years later, President Buchanan, in his annual message to Congress in December, 1857, likewise blamed the banks for the crisis of that year. A historian of banking theory has said that the presidents were expressing the opinion of the majority of the contemporary students of the problem. ^{1/} If you were to go through the bills relating to banks introduced into the Congress during and following every business depression, you would see that this belief has been prevalent ever since the time of George Washington and Alexander Hamilton. That is to say, members of Congress

^{1/} Richardson, Messages of the Presidents, III, 325 ff. and V 437 ff; and Harry E. Miller, Banking Theories in the United States Before 1860, p. 105.

and students of banking for one hundred and fifty years have recognized that in order to maintain vigorous commercial and industrial activity, banking stability is a necessary condition.

Prior to the Civil War, to be sure, our economy was in a primitive stage of development. Banking played a somewhat less important role at that time. However, there were periods of unsettlement in the financial community, and these disturbances affected a substantial portion of the population.

With the rise of the modern dual system of free enterprise banking in the United States since the Civil War, the question of banking stability grew in importance and urgency. So that we could see graphically the situation which prevailed in the United States over this period, we studied the available statistical data and prepared a chart showing failures in banking and business during the period 1867-1950. The rate of failures in banking is depicted by the red silhouette and the black curve furnishes, as a point of reference, the rate of failure for other types of business. The statistical problems involved in the arrangement and presentation of these data are difficult. Nevertheless, I am confident the overall picture for this period is a fair representation of the historical facts.

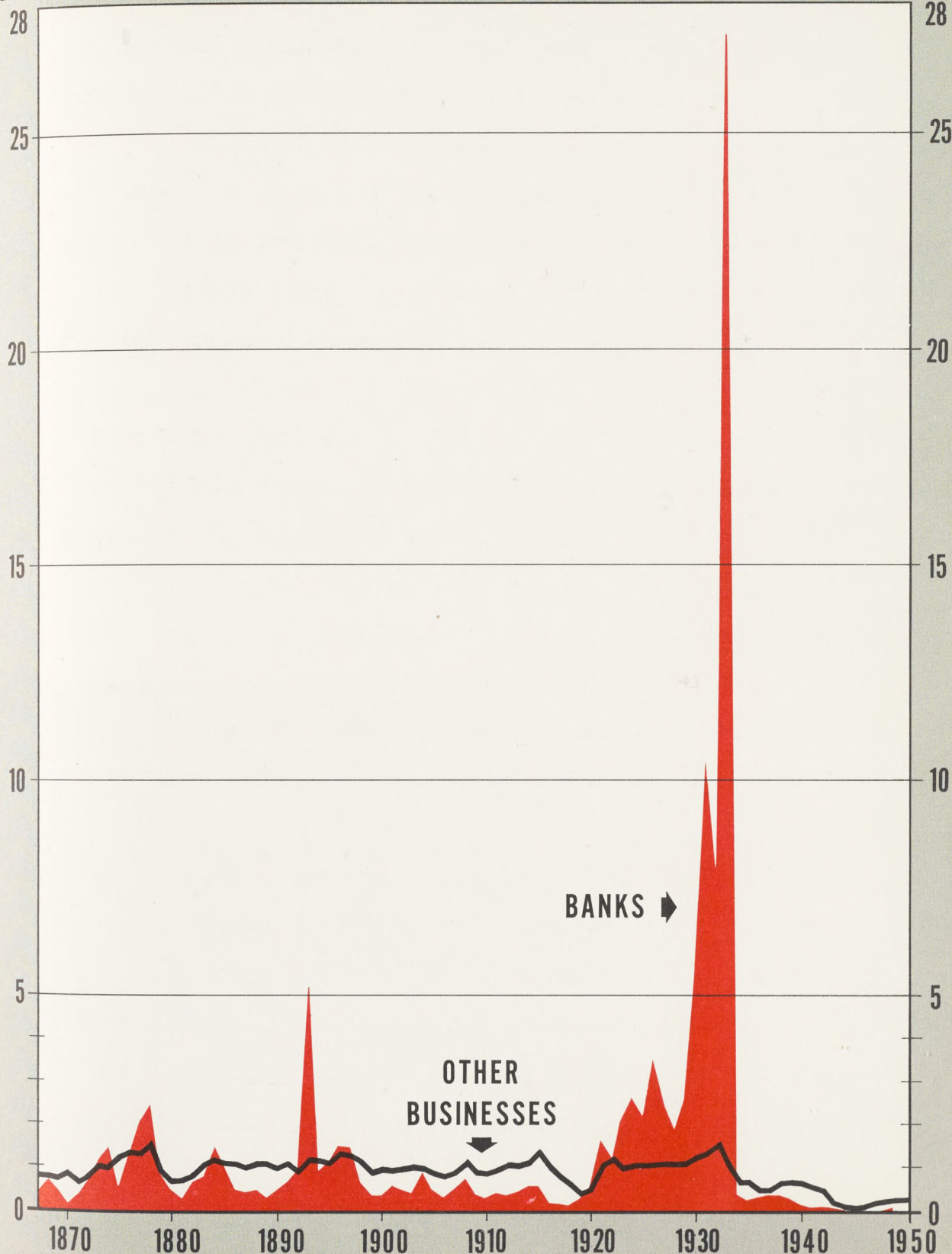
Taking a long view of the situation which has prevailed since the development of the dual banking system, you will note that over the period the banking community has been remarkably free from disturbances. As a matter of fact, for long periods of time the record of banking was

FAILURES IN BANKING AND BUSINESS

1867 - 1950

FAILURES PER 100

FAILURES PER 100



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CHART NO. 29

conspicuously better than for other types of business. However, the troublesome problem of banking instability and its effect on business continued to pester the nation. This problem became acute in the great depression in the early 1930's.

Now, as you know, there were those who contended that instability in banking is an inherent characteristic of our dual banking system with its multiple chartering authorities and thousands of individual banks. The proponents of that theory pointed to the structure of banking in other commercial nations where instead of 13,000 or 14,000 individual banks, there were a few huge institutions operating elaborate systems of branches. Moreover, the proponents of the theory placed great emphasis on the historical record of banking instability since the Civil War, and particularly in the 1920's and early 1930's. This record, it was contended, was so bad that nothing could be done to mend the banking system, and very drastic plans for its total reorganization were proposed. These proposals ranged all the way from crack-pot ideas like "Technocracy" and the "Townsend Plan" to nationalization of our banking system. Many economists proposed unlimited branch banking as the most practical solution.

Before discussing the typically American solution to this perplexing problem, I want to turn briefly to another historical factor. Prior to the Civil War, bank notes were the principal medium of exchange. The National Bank Act of 1863 placed a Federal guarantee on this circulating medium. But bank deposits gradually replaced bank

notes and other forms of currency, and became our most important supply of money.

By the middle of the 1880's, deposits had become over four-fifths of the circulating medium. The problem of protecting them was sufficiently acute to bring about the introduction in the Congress of bills providing for the guarantee of deposits. Four bills for this purpose were introduced in the House of Representatives in 1886. Fourteen more were introduced in the Congress prior to 1900. In the 60th Congress, following the panic of 1907, about thirty proposals were made for deposit guarantee legislation. The Senate version of the Federal Reserve Act in 1913 carried such a provision, but the banking and currency committee of the House was instrumental in taking it out of the Act.

For the entire period from 1886 to the establishment of the Federal Deposit Insurance Corporation in 1933, 150 bills for the guarantee or insurance of deposits are known to have been introduced in the Congress.

The foregoing figure does not include Bills proposing the establishment and operation of banks of deposit by the government itself. Numerous proposals of this type were introduced. Some called for a Bank of the United States with a system of branches and others for the expansion of the Postal Savings System to provide for receipt of deposits and their transfer by check at Post Offices throughout the nation. The number of such proposals has never been tabulated.

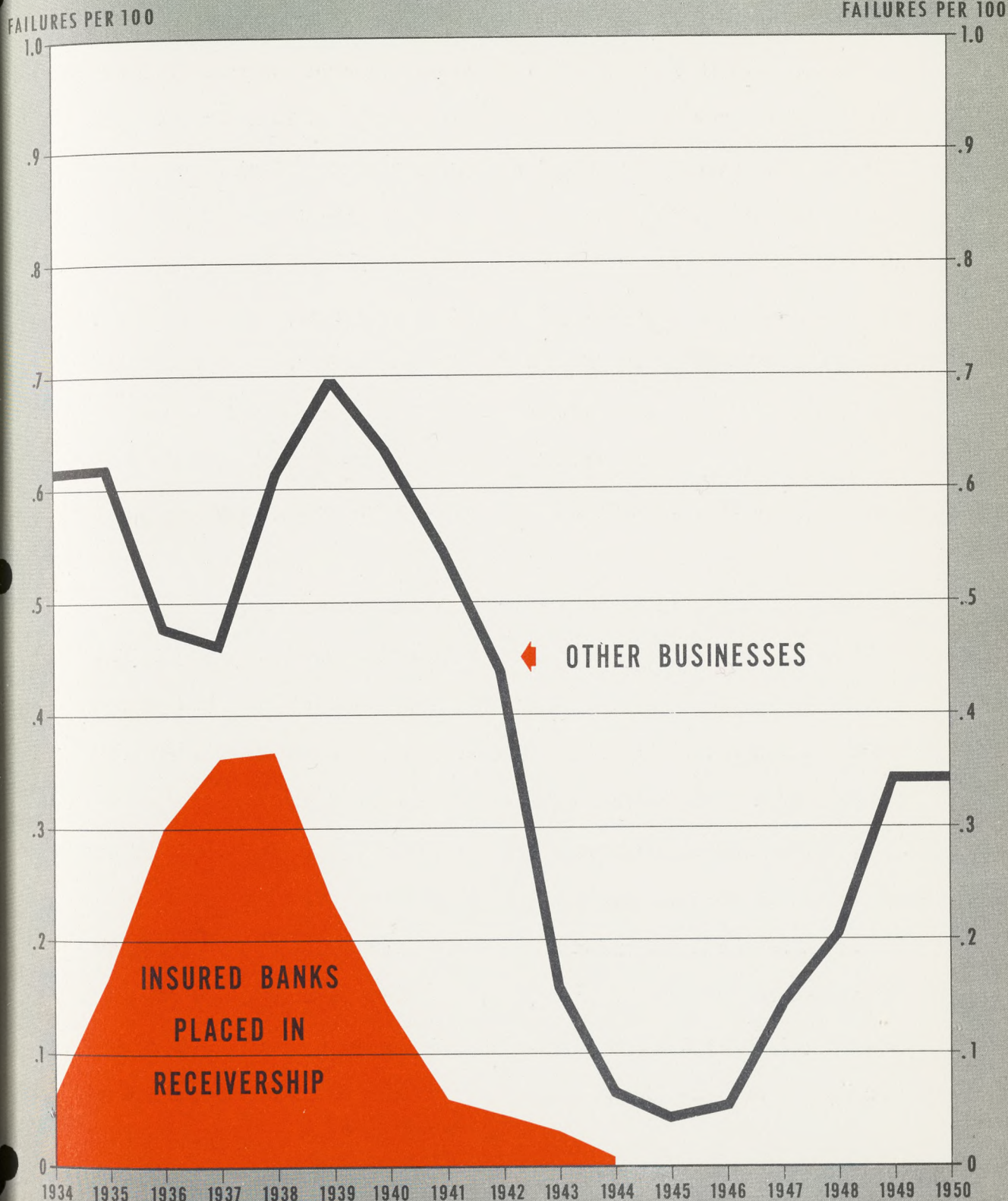
The great depression and the banking debacle in the spring of 1933 convinced the Congress that insurance of bank deposits--our principal circulating medium--could no longer be delayed. It was in this atmosphere of desperate emergency that the Federal Deposit Insurance Corporation was created. Many students of banking and most bankers believed it could not possibly succeed, but were willing to try it as a last resort.

As you can see by reference to this chart, there was a great change after 1934. The rate of failures in banking dropped to a very small figure and then for all practical purposes vanished from the picture. It is obvious that new forces were at work in our economy--forces which brought about a sharp decline in the failure rates for banks.

Now, I should like to picture the facts regarding banking stability in somewhat different terms. Here are two spot maps showing bank suspensions for the period 1917-1933 and for the period 1934-1950. Both maps cover a seventeen year period, the one before and the other after the Federal Deposit Insurance Corporation was established. The total suspensions in the first period were 15,145. The distribution, as you know, was widespread; no area really escaped irrespective of the economic bases supporting the local economy. Agriculture, industry, trade, and commerce all seem to be equally vulnerable. The burdens of banking disorder and instability in this period could not be endured for any great length of time and remedies were imperative.

FAILURES IN BANKING AND BUSINESS

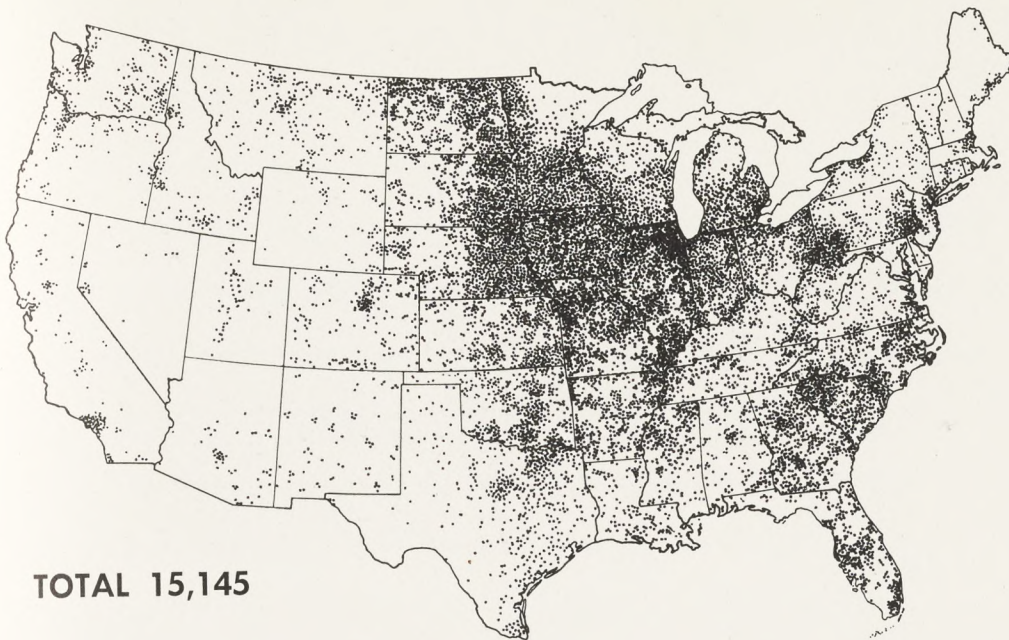
1934 - 1950



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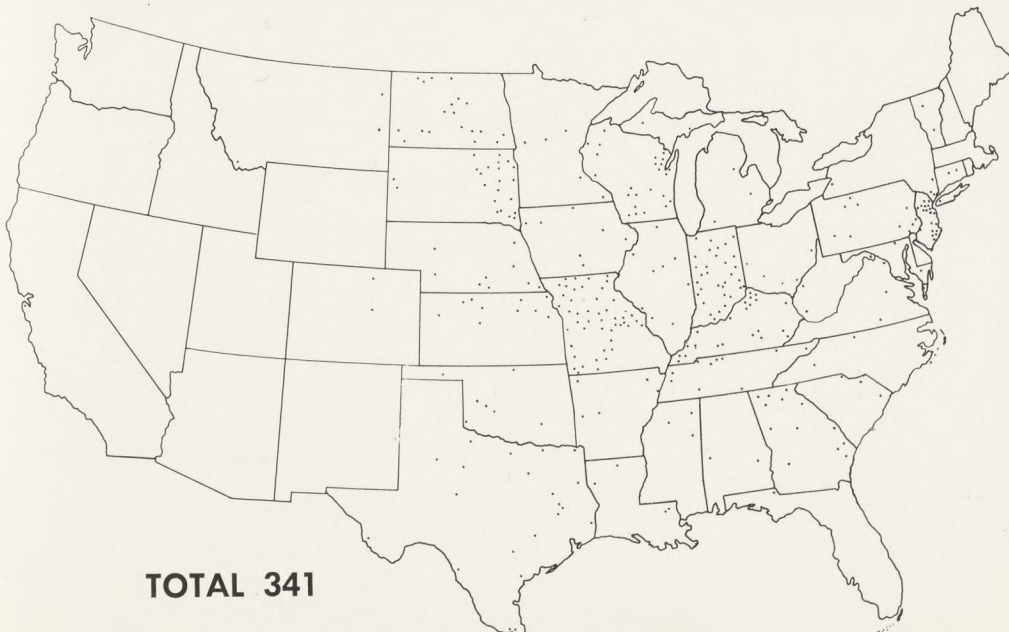
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BANK SUSPENSIONS 1917 to 1933



TOTAL 15,145

BANKS PLACED IN RECEIVERSHIP 1934 to 1950



TOTAL 341

Banks Insured by FDIC • NO RECEIVERSHIPS since MAY 1944

For comparison, let us look at another seventeen year period, 1934-1950. There are not many black spots on the map. The total number of bank receiverships is only 341, ninety-seven of which were in noninsured banks. Another important fact is that no bank insured by the Federal Deposit Insurance Corporation has been placed in receivership since May, 1944. These facts point to a conclusion which so far as I can see is inescapable. The long recognized and troublesome problem of banking instability was faced in the early 1930's. A way to solve the problem was developed--and it was a typically American solution. The banking structure was strengthened by the adoption of federal deposit insurance legislation.

Adoption by the Congress in 1933 of the principal of deposit insurance was an exercise of its sovereign power to provide and control the nation's circulating medium or supply of money, and the responsibility imposed upon the Congress by the Constitution of the United States to regulate the value of money. The monetary responsibility which the Congress has given the Federal Deposit Insurance Corporation is definite and precise. The Corporation has been given the duty of preventing the destruction of the circulating medium by reducing the number of bank failures, and the restoration to a community in which a failure occurs of a portion of the money supply extinguished by the failure.

Deposit insurance has thus fostered the confidence of depositors in our banking system. Depositor confidence and banking

stability go hand in hand. Each is dependent on the other. It seems reasonable to expect that never again will multitudes of sound banks be swept away because of depositor panic. Continuation of stability in banking will preserve the confidence of depositors in their banks and promote the serenity that prevents panic. The place, then, of deposit insurance in today's banking is the protection of depositors in such a way that confidence in the banking system is created and thus banking stability maintained.