BANK FAILURES AND DEPOSIT INSURANCE

BANK FAILURES AND DEPOSIT INSURANCE

Address by Dr. Edison H. Cramer, Chief of the Division of Research and Statistics, Federal Deposit Insurance Corporation, before the Charleston Sertoma Club, Charleston, South Carolina, February 14, 1958.

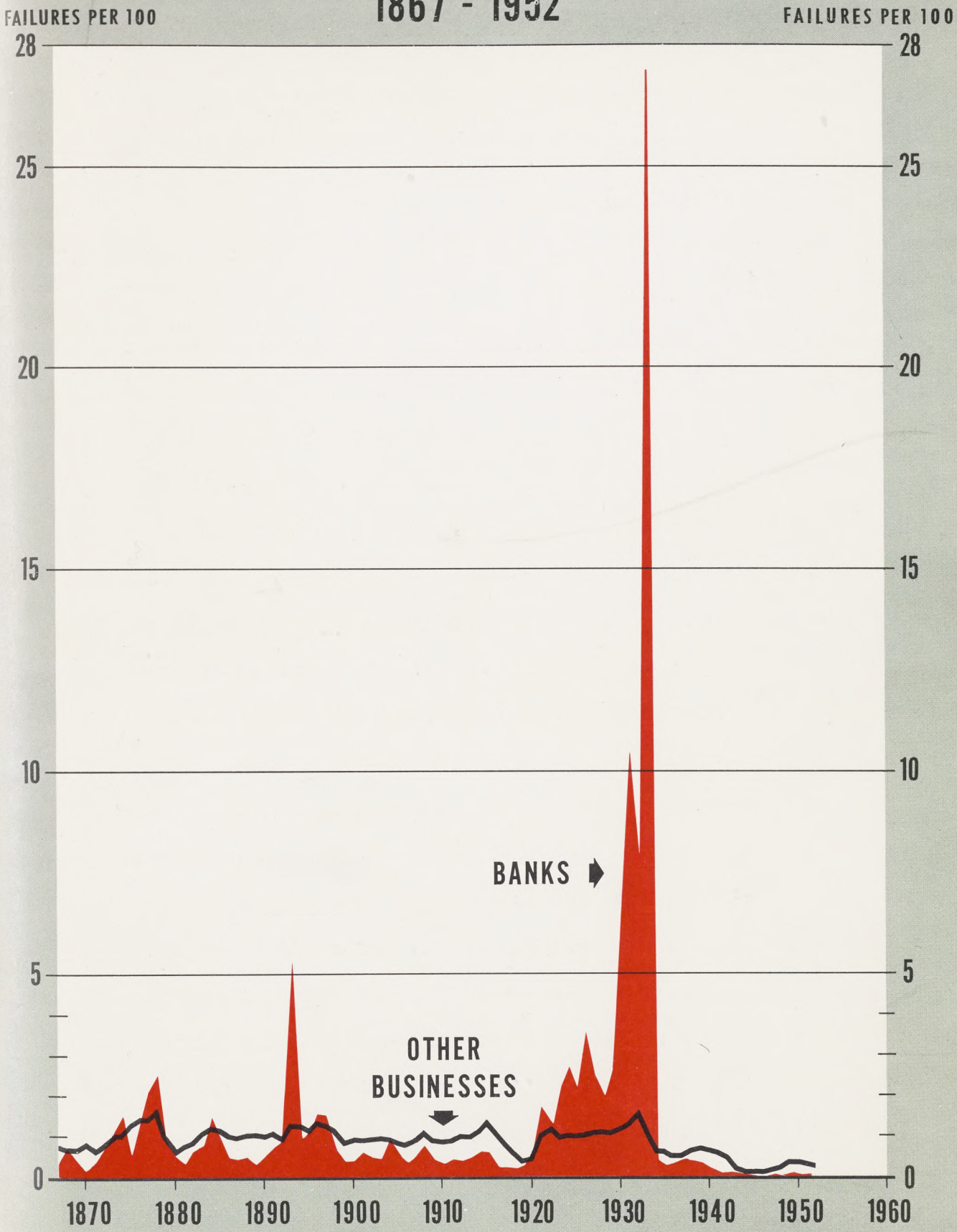
When Ken Foote invited me to visit him in Charleston this spring and lecture to his class at The Citadel, I was glad to accept because I was a college professor for over 20 years. Naturally, I enjoy returning to the classroom to discuss with students some of the important economic problems confronting the country. Moreover, during my 20 years of teaching I had many fine young men and women as students, and Ken Foote was one of the best.

Then when he asked me to speak to Sertoma, I accepted the invitation because he asked me to talk about the Federal Deposit Insurance Corporation. Naturally I am very proud to be associated with the organization that during the last 25 years has done so much to stabilize banking and business, and I like to talk about it. I shall begin with a brief review of the historical instability of banking as it existed during a large part of the 19th century and for the first 33 years of this century.

Record of instability. So that we could see graphically the record of bank failures in the United States over the past three quarters of a century, I studied the available statistical data and prepared a chart showing failures in banking and business during the period 1867 to 1952. The rate of failure in banking is depicted by the red silhouette, and the black curve furnishes as a point of reference the rate of

FAILURES IN BANKING AND BUSINESS

1867 - 1952



Division of Research and Statistics
FEDERAL DEPOSIT INSURANCE CORPORATION
CHART NO. 62

failure for other types of business. The statistical problems involved in analyzing these data were such that it is impossible to say the presentation is precisely accurate. Nevertheless, the overall picture for this period as shown on this chart, in my opinion, is a fair representation of the historical facts. You will note that for long periods of time the record of banking was substantially better than for other types of business. However, during other periods the troublesome problem of banking instability is apparent. Generally speaking, the times when bank failures were relatively more than business failures were times of deep depression and stagnation.

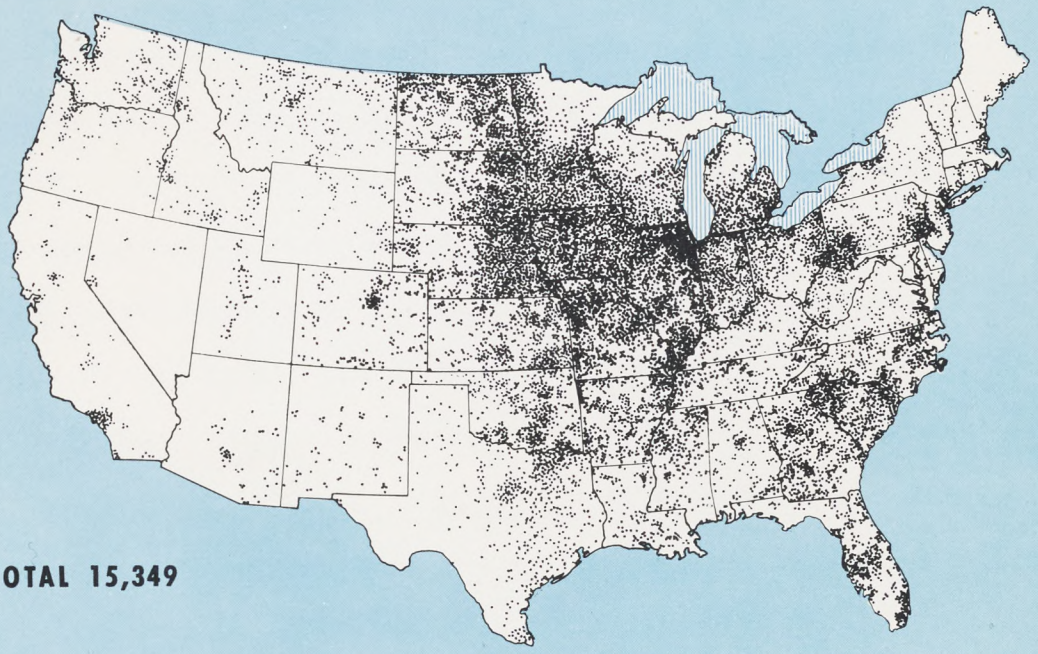
Now I should like to have you look at the top of the other chart. It pictures the facts regarding bank failures in a somewhat different form. On this map is a dot representing each bank failure for the period 1915-1933. The total suspensions during this 19-year period were over fifteen thousand. The distribution, as you can see, was widespread. Agricultural States appear to have been particularly vulnerable but no area really escaped, irrespective of the economic bases supporting the economy. The problem became acute in the great depression in the early 1930's.

It is apparent from these charts that the problem of bank failure which had plagued the nation for so long was growing worse in the early 1930's. As a result there were those who contended that instability in banking was 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

FAILURES IN BANKING

NINETEEN YEAR PERIOD BEFORE FEDERAL DEPOSIT INSURANCE

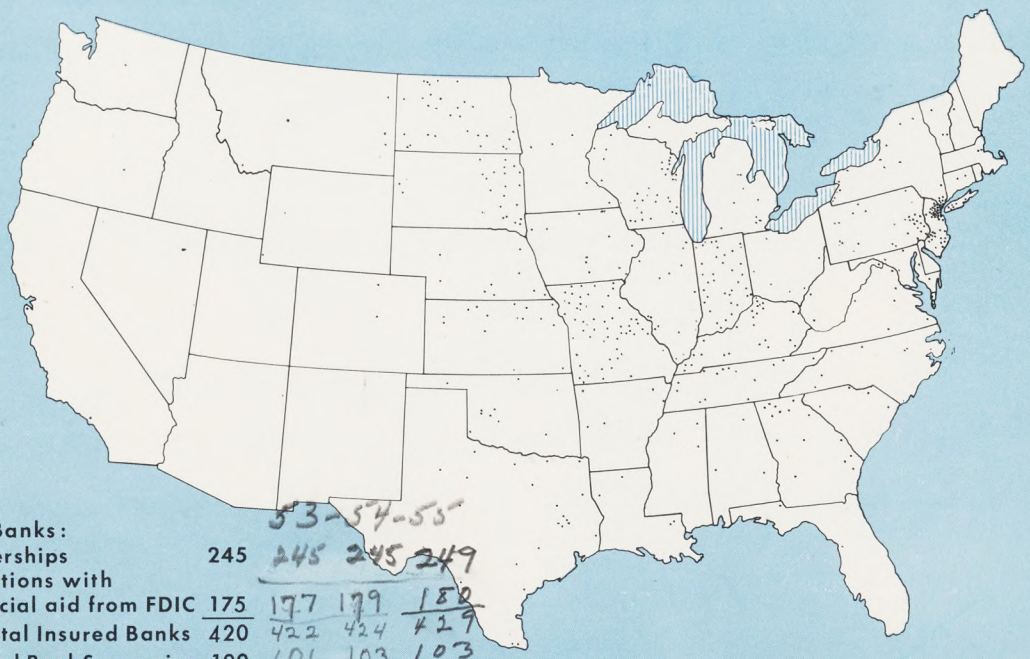
JANUARY 1, 1915 – DECEMBER 31, 1933



TOTAL 15,349

NINETEEN YEAR PERIOD AFTER FEDERAL DEPOSIT INSURANCE

JANUARY 1, 1934 – DECEMBER 31, 1952



		53	54	55
Insured Banks:				
Receiverships	245	245	245	249
Absorptions with financial aid from FDIC	175	177	179	180
Total Insured Banks	420	422	424	429
Noninsured Bank Suspensions	100	101	103	103
Grand Total	520	523	527	532

Division of Research and Statistics
FEDERAL DEPOSIT INSURANCE CORPORATION

CHART NO. 61

structure of banking in other commercial nations where instead of 14,000 or 15,000 individual banks (at one time close to 30,000), there were a few huge institutions operating elaborate systems of branches. The critics of the dual banking system placed great emphasis on the record of banking instability and particularly the record 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. Many economists recommended unlimited branch banking as the most practical solution, others worked out schemes for requiring banks to keep 100 percent reserves against deposits, and still others suggested nationalization of our banking system.

Deposit insurance legislation. Fortunately, a few students of banking and a majority of members of the Congress realized that the dual system of banking was too valuable to scrap in its entirety, and they determined to correct the evil of bank failure in some other way. Before discussing the solution that was found by them, I want to turn briefly to another historical factor. Until about the middle of the 19th century, 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 the guaranteed portion of the money supply declined in importance.

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 Democratic platform of 1908 contained this plank, "We pledge ourselves to legislation under which the national banks shall be required to establish a guaranty fund for the prompt payment of the depositors of any insolvent national bank, under an equitable system which should be available to all State banking institutions wishing to use it." 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.

Solution to bank failure problem. Adoption by the Congress in 1933 of the principle 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.

Now I should like to picture the facts regarding bank failures for another 19-year period, beginning with 1934 when deposit insurance became effective. You will note that there are not many black spots on the map. The total number of bank failures was only 520, of which 420 were insured and 100 noninsured banks. If the chart had been brought up to date, the number of insured bank failures would have been 12 larger, or a total of 432, and a few more (5) noninsured banks would have been added.

Last December the Corporation completed 24 years insuring bank deposits. Something of the success of its operation is suggested when

the record of bank failure during the prosperous 1920's is compared with this experience. In each year from 1921 to 1933 more banks failed than have failed during the past 24 years. Moreover, 398 of the 432 insured bank failures occurred during the first half of the Corporation's life. During the last 12 years the average has been less than 3 per year.

These facts point to a conclusion which, so far as I can see, is inescapable. The long recognized and troublesome problem of bank failure 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 and stabilized by the adoption of Federal deposit insurance legislation. Deposit insurance has fostered the confidence of depositors in banks, and it seems reasonable to expect that never again will multitudes of sound banks be swept away because depositors are panicky.