News Release

THE FEDERAL RESERVE BANK of ST. LOUIS

SHOULD COMMERCIAL AND INVESTMENT BANKING BE REUNITED?

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ST. LOUIS -- A growing chorus of bankers, industry analysts and policymakers are calling for the repeal of the Glass-Steagall Act, Depression-era legislation that mandated a separation between commercial and investment banking. And for the first time in decades, that wish appears to have a good chance of being granted.

In "Commercial and Investment Banking: Should This Divorce be Saved?" an article in the April 1995 issue of *The Regional Economist*, the St. Louis Fed's quarterly review of business and economic issues affecting the Eighth Federal Reserve District, Economist Michelle A. Clark examines the

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events that led to this separation, the pros and cons of allowing these industries to reunite and three current proposals to repeal the Glass-Steagall Act, including one that would allow banks to affiliate with commercial firms like General Motors.

Congress separated commercial and investment banking in the 1930s because it believed banks' underwriting of investment securities and other investment banking activities led to conflicts of interest and contributed to the stock market crash of 1929 and the bank failures that followed.

"However, a number of academic studies have shown that the separation was unnecessary because banks' investment banking practices were not abusive, nor did they significantly contribute to massive bank failures," says Clark.

Clark cites a number of benefits that would likely stem from Glass-Steagall repeal, including: the addition of new capital to the U.S. banking system; product diversification, which reduces banks' dependence on lending as a source of profits; and increased efficiency in the banking industry through cost savings from large-scale production or joint production of banking and securities products.

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"Permitting banks to diversify into other lines of business, while at the same time building adequate safeguards to ensure that insured deposit funds are not jeopardized, will promote efficiency and stability in the U.S. banking system and more choices for U.S. consumers and businesses," says Clark.

Two additional articles complete the publication. In "A Fed Focused on Price Stability: The Benefits of a Single Target," Economist Kevin L. Kliesen examines the benefits of price stability and why legislative action is needed to ensure that price stability is the primary goal of monetary policy. Economist Adam M. Zaretsky looks at TennCare, Tennessee's solution to escalating Medicaid costs, in "Revamping Medicaid: One State's Attempt at Reform."

The Federal Reserve Bank of St. Louis has branches in Little Rock, Louisville and Memphis. It serves the Eighth Federal Reserve District, which includes all of Arkansas, eastern Missouri, southern Indiana and Illinois, western Kentucky and Tennessee, and northern Mississippi.

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