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CHAPTER 18 | **Did Universal Banks Play a Significant Role in the U.S. Economy's Boom-and-Bust Cycle of 1921–33? A Preliminary Assessment**

ARTHUR E. WILMARTH, JR.

Commercial banking organizations were leading participants in the U.S. securities markets during the great bull market of the 1920s.¹ Commercial banks again entered the securities markets during the 1990s, and their reentry coincided with another spectacular rise in the stock market. The stock market booms of the 1920s and 1990s were extraordinary events in U.S. economic history. As two scholars recently observed, the bull markets of 1923–29 and 1994–2000 “stand out, both in terms of their length and rate of advance in the market index [T]hese two booms were unique in character as well as magnitude.”²

The stock market crashes that followed both booms were also unparalleled. From 1929 to 1932, the total value of all common stocks listed on the New York Stock Exchange (NYSE) fell by nearly 85 percent, from US\$82.1 billion to US\$12.7 billion.³ From 2000 to 2002, the value of all publicly traded U.S. stocks declined by more than 40 percent, from US\$17 trillion to US\$10 trillion.⁴

In both the 1920s and the 1990s, commercial banking organizations were allowed to operate as “universal banks”—that is, diversified financial conglomerates that offered banking, securities, and insurance services.⁵ Is it merely a coincidence that the two most dramatic stock market booms and crashes in U.S. history occurred during periods when large commercial banks were major participants in the securities markets? Or did the exercise of universal banking powers contribute to the financial and economic conditions that produced both episodes? This chapter is the first installment of a longer-term project that seeks to answer these questions.

This chapter offers a preliminary assessment of the role played by universal banks in the economic boom-and-bust cycle of 1921–33. The first part reviews the successful challenge to universal banking mounted by Senator Carter Glass and other advocates of the Banking Act of 1933 (popularly known as the “Glass-Steagall Act”).⁶ The Glass-Steagall Act emphatically repudiated the concept of “department store banking” (an early version of universal banking).⁷ Sections 20 and 32 of the Act required commercial banks to divest the securities affiliates they had operated during the 1920s, while three other sections imposed further restrictions designed to separate banks from securities firms.⁸

Glass and his supporters contended that banks and their securities affiliates helped to produce an inflationary surge in the securities markets, resulting in an overproduction of securities and an unsustainable economic boom. Proponents of the Glass-Steagall Act also maintained that department store banking created conflicts of interest that prevented commercial banks from acting either as impartial lenders or as objective investment advisors. Glass and his colleagues claimed that universal banks provided excessive amounts of credit and used aggressive marketing campaigns to promote the sale of risky securities to unsophisticated investors. The Glass-Steagall Act reflected a widely shared belief that banks and their securities affiliates encouraged speculative and ultimately ruinous behavior by investors and business firms.

To evaluate the validity of these claims, the second part of this chapter examines the role of universal banks during the economic boom of the 1920s. In response to a relaxation of legal rules governing bank activities, banks greatly expanded their financing of business firms and consumers through five major channels—loans on securities, securities investments, public offerings of securities, real estate mortgages, and consumer credit. This financing surge enabled business firms and consumers to assume heavy debt burdens and to make risky investments that proved to be unviable when the U.S. economy entered a sharp recession in the summer of 1929. Many of the new investments in plant and equipment were devoted to speculative ventures that overestimated the near-term demand for products using new technologies. Supply also exceeded demand for new cars and for newly constructed residential and commercial real estate projects.

The crash of 1929 destroyed investor wealth and created great uncertainty among consumers and business firms. The business recession that began in the summer of 1929 was aggravated by the crash, and the decline in business activity exposed the hazardous levels of debt assumed by consumers and business firms during the boom years of the 1920s. Congress decided to separate banks from securities firms in 1933, based on its determination that universal banking had promoted a dangerous buildup of credit for speculative purposes.

The Glass-Steagall Act's barriers to universal banking were severely eroded by market forces and by a series of rulings issued by federal regulators and courts during the 1980s and 1990s. In 1989, federal regulators allowed bank holding companies to establish what were known as "Section 20 subsidiaries" for the purpose of underwriting debt and equity securities. By 1996, due to a progressive liberalization of the rules governing Section 20 subsidiaries, banking organizations could compete effectively with securities firms. In 1998, federal regulators allowed Travelers and Citicorp to merge, thereby creating Citigroup, the first U.S. universal bank since 1933. The creation of Citigroup placed great pressure on Congress to remove the Glass-Steagall Act's limitations on affiliations between commercial banks and securities firms.⁹

In 1999, Congress responded to these developments by enacting the Gramm-Leach-Bliley Act (GLBA).¹⁰ GLBA repealed Sections 20 and 32 of the Glass-Steagall Act and also authorized the establishment of universal banking organizations known as financial holding companies. Under GLBA, financial holding companies may establish separate subsidiaries that engage in a full range of banking, securities, and insurance activities.¹¹

The House and Senate committee reports on GLBA declared that the Glass-Steagall Act's restrictions on universal banking were (1) outdated in light of changing market conditions and (2) undesirable because they prevented U.S. financial institutions from providing innovative services to their customers in the most efficient manner.¹² The chief Senate sponsor of GLBA, Senator Phil Gramm, went even further. He denounced the Glass-Steagall Act as a misguided statute from the outset. In his view, Congress was frightened by the Depres-

sion and was driven by “demagoguery” to impose a “punitive ... artificial separation of the financial sector of our economy.”¹³

In claiming that the Glass-Steagall Act was an ill-conceived statute, Senator Gramm echoed the conclusions of works published by several scholars during the past two decades. As discussed in the final section of the chapter, modern scholars have criticized the Glass-Steagall Act on three principal grounds. First, critics argue that the Glass-Steagall Act was interest group legislation designed to protect traditional investment banks from competition with commercial banks in the securities underwriting field. Second, critics maintain that universal banks were safer than specialized banks and did not endanger the banking system. Third, critics claim that Congress did not have a substantial basis for its belief that universal banks were involved in unsound selling practices and other conflicts of interest.

Thus, Congress’s partial repeal of the Glass-Steagall Act in 1999 was consistent with a widely shared scholarly view that the 1933 legislation had been “[t]horoughly discredited.”¹⁴ However, since the bursting of the “new economy” stock market bubble in 2000, commentators have begun to reconsider the benefits and risks of universal banking. Investigations and court suits involving Enron and WorldCom revealed that Citigroup, J.P. Morgan Chase (Morgan Chase), and other universal banks played key roles in both scandals. For example, Citigroup, Morgan Chase, and other universal banks helped Enron to inflate its reported revenues and understate its reported debts by (1) extending loans that were disguised as prepay commodity trades and (2) arranging sham sales of Enron assets to off-balance-sheet entities controlled by Enron. In addition, Citigroup, Morgan Chase, Bank of America, and other universal banks served as underwriters for two large public offerings of WorldCom debt securities during 2000 and 2001. Those offerings enabled WorldCom to sell US\$17 billion of securities to investors at a time when the bank underwriters reportedly knew that WorldCom’s financial condition was rapidly deteriorating.¹⁵ Similarly, Italian authorities have alleged that Citigroup, Bank of America, and other universal banks aided and abetted a massive fraud committed by Parmalat’s managers.¹⁶

In 2003, federal regulators and the New York Attorney General, Eliot Spitzer, issued consent orders as part of a global settlement with 10 investment banking firms, including affiliates of five universal

banks (Citigroup, Morgan Chase, Credit Suisse, UBS, and U.S. Bancorp). According to those consent orders, the 10 firms encouraged their research analysts to attract and retain investment banking clients by issuing overly optimistic projections of future client performance and ignoring client risks that were known to the analysts and their investment banking colleagues.¹⁷ Federal regulators also issued consent orders finding that (1) Citigroup, Credit Suisse, FleetBoston, and Morgan Chase engaged in manipulative and abusive practices involving initial public offerings,¹⁸ and (2) Bank of America, Bank One, Canadian Imperial Bank of Commerce (CIBC), and FleetBoston allowed hedge fund operators to make late trades and market-timing trades in bank-sponsored mutual funds, resulting in large trading profits for the operators at the expense of ordinary investors in the mutual funds.¹⁹

The foregoing scandals and other examples of recent misconduct by universal banks will be reviewed in greater detail in a forthcoming installment of my project. These scandals have already proven to be very costly to universal banks. By August 2005, universal banks and other firms paid over US\$7 billion to settle Enron-related lawsuits, with US\$6.6 billion of that amount being paid by CIBC, Citigroup, and Morgan Chase. The same three banks paid an additional US\$400 million in penalties to settle Securities and Exchange Commission (SEC) charges related to their involvement with Enron.²⁰ Universal banks and other firms paid more than US\$6 billion to settle WorldCom-related lawsuits, with US\$5 billion of that amount being paid by Citigroup, Morgan Chase, and Bank of America. Universal banks and other firms also paid US\$4.4 billion to settle regulatory claims involving analyst conflicts of interest and abusive trading practices in mutual funds.²¹

In light of the growing evidence of conflicts of interest and other abuses involving universal banks during the economic boom from 1994 to 2000, several commentators have argued that federal regulators and Congress made a mistake in allowing commercial banks to establish new affiliations with securities firms. These commentators maintain that Congress underestimated the risks that (1) conflicts of interest would undermine the ability of universal banks to allocate credit and provide investment advice in an objective and impartial manner, and (2) competitive pressures in the securities underwriting

business would cause both universal banks and securities firms to promote unsound and speculative ventures.²²

From a practical viewpoint, it seems very unlikely that the Glass-Steagall Act's separation between commercial and investment banking could be revived. Even before GLBA's enactment in 1999, the effectiveness of Glass-Steagall had been significantly undermined by market forces and by decisions of federal regulators and courts that opened loopholes in the 1933 statute. For example, the rapidly growing markets for over-the-counter derivatives and syndicated loans have allowed banks to provide customers with financial instruments that are functionally equivalent to securities.²³ However, the recent scandals involving universal banks raise serious questions about the adequacy of the regulatory structure created by GLBA. In a forthcoming article, I will consider possible reforms that could mitigate the risks currently presented by universal banks.

Accordingly, this chapter does not propose a reenactment of the Glass-Steagall Act. However, it will offer a preliminary response to the modern, three-part critique of Glass-Steagall. First, I conclude that the 1933 legislation was *not* adopted for the purpose of protecting investment banks from competition with commercial banks. Second, it appears that Congress did have a substantial basis for its belief that universal banks created serious risks for the banking system and the general economy. Third, previous scholars have determined, based on the Pecora committee's investigation in 1933, that commercial banks and their securities affiliates did engage in unsound and abusive practices. I believe that the second and third issues warrant additional research, particularly since similar abuses appeared during the 1990s when major banks reentered the securities markets.

Congress's Repudiation of Universal Banking in the Glass-Steagall Act of 1933

The Glass-Steagall Act contained five provisions designed to separate commercial banks from the investment banking business.²⁴ Congress adopted these provisions based on the widely shared view that banks and their securities affiliates had played a major role in the boom and crash that occurred in U.S. securities markets and the broader economy from 1921 to 1933. As shown below, supporters of

the Glass-Steagall Act were convinced that banks and their securities affiliates had diverted credit away from sound business enterprises and, instead, promoted speculative ventures at home and abroad.

The Act's chief sponsor, Senator Carter Glass, and his principal advisor, Professor H. Parker Willis, subscribed to the "real bills doctrine." Adherents of that doctrine believed that commercial banks should restrict their operations to the acceptance of demand deposits and the extension of short-term loans to finance the production and sale of goods.²⁵ Senator Glass, Representative Henry Steagall, and other members of Congress alleged that large banks had abandoned sound banking principles during the 1920s and, instead, had promoted "stock-gambling" and an "overinvestment in securities of all kinds."²⁶ Glass, Steagall, and their supporters maintained that large banks had encouraged reckless speculation in two ways—first, by using their own funds to make excessive loans on securities and investments in securities, and second, by persuading retail investors and small correspondent banks to convert their deposits and investments in U.S. government securities into high-risk corporate, municipal, and foreign securities underwritten by bank securities affiliates.²⁷

Thus, Congress viewed the activities of banks and their securities affiliates as a fundamental cause of the economic boom and crash that occurred during the period 1921–33. Steagall, for example, declared that the entry of banks into the securities markets produced a situation in which

[o]ur great banking system was diverted from its original purposes into investment activities, and its service devoted to speculation and international high finance... . Agriculture, commerce, and industry were forgotten. Bank deposits and credit resources were funneled into the speculative centers of the country for investment in stocks [sic] operation and in market speculation. Values were lifted to fictitious levels.²⁸

Senator Frederick Walcott argued that this "gambling fever" and "flood tide of speculation" would never have occurred without the credit and distribution facilities provided by large banks and their securities affiliates. In Walcott's view, traditional investment banking firms like J.P. Morgan and Kuhn Loeb could never have arranged and financed the rapid expansion in securities underwriting, trading, and

selling that took place during the 1920s. Such an expansion required much broader distribution capabilities and “very expansive credit, which, of course, brought in the banks.” As for bank securities affiliates, “their growth has been phenomenal, coincident with the growth of the security business.”²⁹

Representative Hamilton Fish agreed that large banks and their securities affiliates were primarily responsible for the speculative “inflation” that led to the Crash of 1929 and the Great Depression:

[T]hese bank presidents ... got us into this inflation largely through these securities affiliates connected with the big banks. ...

All the time they were saying to their depositors, “You have got money in our banks, and you ought to take it out of our banks and invest it.” ... Those securities affiliates did more harm in promoting the inflation and the resulting deflation that caused the financial ruin of hundreds of thousands of bank depositors than any other agency in America. ...

There was an enormous inflation brought about because of the mass overproduction of stocks, bonds, and other securities largely emanating from these affiliates, ... and as a result it meant a mass overproduction of factories, commodities, real estate, and everything else—an enormous inflation that sooner or later had to crash. ...³⁰

While noting the dangers of speculation, Senator Robert Bulkley focused on conflicts of interest that were created by affiliations between banks and securities dealers. In Bulkley’s view, a bank connected with a securities affiliate could not provide fair and impartial investment advice to its depositors and its trust customers, because the bank had a vested interest in promoting securities that were underwritten or distributed by the affiliate. Nor could such a bank be expected to make objective lending decisions, because it would be tempted to make unsound loans to support its securities affiliate or the customers of that affiliate.³¹ Bulkley explained that

the greatest protection to depositors that we have given in [the Glass-Steagall Act] is ... [by] prohibiting a banker from having an interest contrary to his depositors, by prohibiting

him from being interested in securities which he recommends his depositor to buy, by ... removing the bankers from the temptation of using credit in such a way as to make a good background and foundation for the flotation [of] more security issues. ...³²

Similar concerns about conflicts of interest were expressed in a 1931 staff report prepared by a Senate subcommittee during hearings on the securities activities of banks. This report identified a number of potential dangers created by affiliations between banks and securities dealers, including the following:

(i) the bank might make risky loans or capital contributions to a securities affiliate, particularly as “[t]he bank is closely connected in the public mind with its affiliates, and should the latter suffer large losses it is practically unthinkable that they would be allowed to fail”;³³

(ii) the bank could purchase stock from a securities affiliate to “relieve the affiliate of excess holdings”;³⁴

(iii) the bank could make risky loans to a securities affiliate’s customers in order to “facilitate” the affiliate’s distribution of securities;³⁵

(iv) a securities affiliate might try to support the market price of the bank’s stock by using aggressive or manipulative trading practices;³⁶

(v) a securities affiliate might consider the bank’s depositors as “its preferred list of sales prospects,” and the depositors’ confidence in the bank would be severely shaken if they lost money after purchasing securities that were underwritten or distributed by the affiliate;³⁷ and

(vi) in general, the bank and its securities affiliate would be tempted to take greater risks because of their assumption that (a) the affiliate could rely on the “resources of the bank” and (b) the bank could remove poorly performing loans or investments from its balance sheet by transferring them to its affiliate.³⁸

As discussed in this chapter, the Senate investigation led by Ferdinand Pecora in 1933 focused much of its attention on alleged conflicts of interest involving large banks and their securities affiliates.

During Senate hearings in 1931 and Senate floor debates in 1932, participants frequently mentioned two major financial conglomerates—Caldwell and Company and Bank of United States—that collapsed during the autumn of 1930.³⁹ As discussed below, both organizations controlled securities subsidiaries that engaged in risky activities and relied heavily on loans provided by affiliated banks.⁴⁰ During final deliberations on the Glass-Steagall Act in 1933, members of Congress also commented on the recent failures of four large Detroit and Cleveland banks. All four banks had securities affiliates, and the failures of those banks helped to precipitate a nationwide banking panic culminating in President Roosevelt’s declaration of a national bank holiday in March 1933.⁴¹

Commercial banks and the Hoover administration strongly opposed Senator Glass’s proposed legislation in 1931 and 1932 and were successful in preventing its passage. However, the election of President Franklin Roosevelt and a heavily Democratic Congress in November 1932 greatly increased the political leverage held by Glass and his supporters. Glass himself made a nationwide radio address on Roosevelt’s behalf in the closing days of the 1932 campaign. In that speech, he condemned the “great banking institutions” for having used their “lawless affiliates” to sell worthless securities to American investors. During the spring of 1933, commercial banking interests lost all remaining power to block the Glass bill, due to the devastating impact of the nationwide banking panic and the public outrage triggered by the Pecora committee’s investigation of bank securities affiliates. In addition, many banks voluntarily decided to shut down their securities affiliates, because they could not afford to absorb the affiliates’ expenses and losses.⁴² Consequently, effective opposition to the Glass bill virtually disappeared and Congress passed the Glass-Steagall Act on June 16, 1933.⁴³

The Role of Banks in the Boom-and-Bust Cycle of 1921–33

As shown in the preceding section, the Glass-Steagall Act reflected Congress’s belief that commercial banks and their securities affiliates helped to generate an unsustainable economic boom during the late 1920s. Senator Glass had no doubt on this score, arguing that bank securities affiliates “were the largest contributors, next to the

gambling on the stock exchange, to the disaster which was precipitated on this country in 1929.”⁴⁴ The conclusions of Senator Glass and his supporters rested in part on the fact that the stock market boom of the 1920s coincided with the rapid expansion of bank involvement in the securities markets:

[F]rom just a common-sense, cause-and-effect standpoint, one could easily make a formidable argument against the security affiliate system. No sooner had [banks become major participants in the securities markets] than the great bull market had gotten under way! During the period from 1928 through 1930, commercial banks had substantially increased their market share of the new bond issues and had begun to make inroads into the equity market. No matter what significance one might give that development today, certainly to the national legislators of the early 1930s the probable correlation must have made a strong impression. This was particularly true of a financial “purist” like Carter Glass.⁴⁵

As described in this section, banks contributed to the economic boom of the late 1920s through five different channels—loans on securities, securities investments, public offerings of securities, real estate lending, and consumer credit. All of these channels generated a surge of new financing, which greatly increased the debt burdens of business firms and consumers and encouraged speculative investments by both groups.

Banks Became Leading Participants in the Securities Markets During the 1920s

The Rapid Expansion of Bank Securities Activities

During the decade preceding the stock market crash, banks greatly expanded their involvement in the securities markets in three areas: (1) making loans collateralized by securities (known as “loans on securities” or “security loans”), (2) making investments in securities, and (3) participating in the underwriting and distribution of securities. Bank loans on securities increased from US\$5.2 billion to US\$13 billion between 1919 and 1930. As a result, the share of total bank credit represented by security loans rose from 24 percent to

38 percent during that period. Banks accounted for more than 85 percent of all loans on securities made from 1919 to 1930.⁴⁶

Bank investments in securities grew from US\$8.4 billion to US\$13.7 billion between 1921 and 1930. Four-fifths of this growth resulted from purchases of higher-risk issues, including state and municipal bonds, corporate bonds, and foreign securities. As a consequence, holdings of low-risk U.S. government securities declined from 35 percent to 26 percent of bank investment portfolios during the same period.⁴⁷

Large banks also established a major presence in the securities underwriting business. The entry of banks into the underwriting business marked the final stage in the expansion of bank securities activities during the 1920s. During the early 1900s, the Comptroller of the Currency (the regulator of national banks) informally permitted national banks to establish bond departments so that they could compete with the investment banking activities conducted by state-chartered banks and trust companies. Through their bond departments, national banks actively bought and sold bonds issued by state and local governments and by domestic corporations. The McFadden Act of 1927 ratified the legitimacy of these bond departments, because the statute authorized national banks to buy and sell marketable debt securities.⁴⁸

Neither the original National Bank Act nor the McFadden Act allowed national banks to underwrite securities or to invest in equity stocks.⁴⁹ However, beginning in 1908 national banks circumvented this limitation on their authority by organizing separately incorporated securities affiliates that engaged in a full range of underwriting, distribution, and dealing activities involving both bonds and stocks. Prior to the Great Depression, neither Congress nor federal regulators interfered with the activities of bank securities affiliates.⁵⁰

Political and economic developments encouraged banks to expand their involvement in securities underwriting and distribution after 1920. During World War I, the federal government enlisted banks as major participants in the selling campaigns for the government's war bonds, known as "Liberty Loans." More than 20 million Americans bought Liberty bonds, and banks sold more than half of the US\$21 billion of Liberty bonds issued by the federal government.⁵¹ By participating in the Liberty bond campaigns, banks be-

came “familiar with the technique of distributing securities [and] gained many contacts with investors and won their confidence, partly because of their patriotic mission, partly because they offered bonds of unquestioned soundness.”⁵²

One of the leaders of the Liberty bond effort, Charles Mitchell, became president of the securities affiliate of National City Bank (NCB) in 1916 and became president of the Bank itself in 1921. Mitchell predicted that sales of Liberty bonds would create “a large, new army of investors in this country who have never heretofore known what it means to own a coupon bond and who may in the future be developed into savers and bond buyers.”⁵³ As Mitchell expected, the successful Liberty bond campaigns helped to stimulate a rapid growth in investor demand for corporate bonds and stocks during the economic boom of the 1920s. Politicians, economists, and financial analysts also promoted investor confidence in securities by proclaiming that the U.S. economy had entered a new era of permanent prosperity. Belief in this “new era” was based on several factors:

The first premise of the “new economics,” as [the new era] was otherwise called, was that the business cycle ... had been effectively abolished by the establishment of the Federal Reserve System in 1913. ... The Federal Reserve, with its ability to control interest rates and conduct “open market operations” ... was hailed in the 1920s as “the remedy to the whole problem of booms, slumps, and panics.” ...

Alongside the belief in the omnipotence of the Federal Reserve, a variety of additional explanations were offered for the endurance of the “Coolidge prosperity” which had commenced with the election of President Calvin Coolidge in 1924. ... They included the extension of free trade, the decline of inflation, and a more scientific style of corporate management. ...

The relaxation of the antitrust laws during Coolidge’s presidency allowed for a series of mergers of banking, railroad, and utility companies that promised greater economies of scale and more efficient production. Gains in productivity, which rose by over 50 percent between 1919 and 1927, were ascribed to increasing investment in research and development. ...

In 1927, John Moody, founder of the credit ratings agency, declared that “no one can examine the panorama of business and finance in America during the past half-dozen years without realizing that we are living in a new era.” In April of that year *Barron’s*, the investment weekly, envisaged a “new era without depressions.” ... Even Herbert Hoover’s acceptance speech in the summer of 1928, when he declared the end of poverty to be in sight, was marked by the prevailing “new era” optimism.⁵⁴

Faith in this new era of risk-free prosperity encouraged a spectacular growth of the securities markets during the 1920s.⁵⁵ A financial writer declared in 1924 that “[w]e are living in the day of the small investor, and the small investor is the real owner of Wall Street.”⁵⁶ Commercial banks had been the primary providers of credit to large corporations before 1920. During the 1920s, however, growing investor demand for securities permitted large corporations to reduce their borrowing from banks and to satisfy their funding needs by selling bonds and equity stocks.⁵⁷ Large firms used public offerings of securities to finance extensive new corporate investments in plant facilities, equipment, and office buildings.⁵⁸ A 1925 report by *Moody’s Investors Service* noted that the “vast new buying power [of American investors and businessmen] is almost dominating the security market ... and is seeking new avenues of expansion in all domestic industries and in foreign fields.”⁵⁹

In response to these developments, major banks expanded their investment banking activities in order to maintain and strengthen their relationships with retail and commercial customers. Banks sought to increase the loyalty of their retail customers by providing investment advice and by selling securities to their depositors and trust clients. Banks also hoped that securities underwriting services would offset the decline in their commercial lending business and strengthen their business relationships with large corporations.⁶⁰ Major banks therefore adopted a new strategy of “department store banking” designed to offer “complete financial facilities” to both retail and commercial customers.⁶¹

From 1922 to 1929, the number of banks engaged in underwriting securities, either through bond departments or securities affiliates, more than doubled, rising from 277 to 591.⁶² In 1927, banks and their affiliates originated 22 percent and participated in 37 percent of all domestic and foreign bonds issued in the United States. From 1929 to 1930, banks and their affiliates originated 45 percent and participated in more than half of all such bond issues.⁶³ Banks were also involved to a lesser degree in underwriting and distributing common and preferred stocks and shares of investment trusts.⁶⁴

NCB and Chase National Bank (Chase), the two largest U.S. banks, established securities affiliates with offices located across the nation and in major foreign cities. NCB's affiliate, National City Company (NCC), was organized in 1911 and acquired N.W. Halsey and Company in 1916. By 1929, NCC operated offices in more than 50 U.S. cities and several foreign cities, and NCC's sales representatives were also posted in many of NCB's foreign branches.⁶⁵ Chase's affiliate, Chase Securities Corporation (CSC), was organized in 1917 and acquired Harris Forbes & Co. in 1930, thereby establishing a similar network that included offices in more than 50 U.S. cities and several foreign cities.⁶⁶ Other large U.S. banks sought to compete by establishing securities affiliates with interstate sales offices. Like NCC and CSC, these affiliates often expanded by acquiring established investment banking firms.⁶⁷

The Role of Banks in Promoting the Stock Market Boom

By the end of the 1920s, due to their central role in distributing securities to the public, "commercial banks [were] by far the most important element in the investment banking business."⁶⁸ Commercial banks and their affiliates distributed more than half of all securities sold in the United States during the period from 1927 to 1931, and NCC was the largest retail distributor of securities during that period.⁶⁹ From 1921 to 1929, NCC was involved, as originator or as a syndicate participant, in selling one-fifth of all domestic and foreign bonds issued in the United States.⁷⁰

Contemporary observers concluded, and modern scholars agree, that the securities boom of the 1920s could not have reached the same magnitude without the involvement of large commercial banks and their securities affiliates. For several reasons, major banks were in a

preferred position to establish large-scale networks for distributing securities. Banks could easily extend loans to facilitate the sale of securities by drawing upon their deposits. In addition, banks could cultivate their close relationships with corporate issuers, and they could mobilize a large customer base that included depositors, trust customers, and small correspondent banks.⁷¹ The securities distribution facilities of banks and their affiliates were indispensable to the syndicate operations of the 1920s, because “the sales staffs and capital of existing private investment banking firms were not adequate to handle the great volume of securities being issued.”⁷²

NCC became a top securities underwriter based on the unrivaled “placing power” provided by its retail distribution system. NCC maintained close relationships with J.P. Morgan and Kuhn, Loeb, which led more than half of the syndicates in which NCC participated during the period from 1921 to 1929. The Morgan and Kuhn, Loeb firms relied heavily on NCC’s distribution network, because they had “no retail distribution [facilities] of their own.”⁷³

Under Charles Mitchell’s leadership, NCC developed a highly sophisticated program of mass advertising and direct marketing that was carefully designed to sell securities to middle-income investors. As already noted, NCC maintained a far-flung network of offices staffed by hundreds of sales representatives.⁷⁴ Its headquarters office sent out a steady stream of “flashes” to its regional offices containing investment recommendations and offers of cash prizes and other incentives for good performance by sales representatives.⁷⁵ Mitchell declared that NCC’s goal was to “spread the gospel of thrift and saving and investment” and to “bring the investment banking house to the people in such a way that they would look upon it as a part and parcel of their everyday life.”⁷⁶

NCC also advertised extensively in national magazines. NCC’s advertisements “assured prospective customers that if they saved, it would advise them how to invest.”⁷⁷ For example, one of NCC’s magazine advertisements advised customers that

... the investor should not try to decide alone. He can get the considered opinion of a world-wide investment organization—it is his for the asking. [NCC’s] judgment as to which

bonds are best for you is based on both strict investigation of the security and analysis of your own requirements.⁷⁸

Mitchell explained to his employees that NCC's goal was to win the confidence of small investors and to convince them that they should rely on NCC's recommendations. Mitchell readily admitted that the ordinary investor could not be expected to make informed decisions. He therefore acknowledged that NCC owed a duty of trust to its retail customers:

We have gained the confidence of the investor and we are building our institution upon that confidence. We want the public to feel safe with us. We are going to make more exacting our yard-stick, because the small investor who buys from us today a thousand or five hundred dollar bond is not in a position to know whether that security is good or not and must rely on us. ... [W]e recognize that as between ourselves and this small investor, the law of *caveat emptor* cannot apply, and that if we are to fulfill our trust, we must supply that which means safety and a reasonable return to him.⁷⁹

Unfortunately, Mitchell's recognition of NCC's duty of trust to its customers seemed to disappear whenever NCC needed to achieve its sales objectives. In one sales flash he warned sales representatives:

I should hate to think there is any man in our sales crowd who would confess to his inability to sell at least some of any issue of either bonds or preferred stock that we think good enough to offer. In fact, this would be an impossible situation and in the interest of all concerned, one which we would not permit to continue.⁸⁰

Mitchell and NCC were successful in winning the trust of small investors during the 1920s. By 1929, NCC was the "largest distributor of securities in the world," while its affiliate, NCB, was the "largest bank in the country ... and was challenging Britain's Midland Bank for the position of largest bank in the world."⁸¹ Along with J.P. Morgan, Jr., Mitchell and Albert Wiggin (president of Chase) were "leading social, political, and economic figures ... [who were] followed in the newspapers like movie stars or politicians."⁸² Critic Edmund Wil-

son described Mitchell as “the banker of bankers, the salesman of salesmen, the genius of the New Economic Era.”⁸³

Mitchell and Wiggin viewed themselves as guardians of the stock market, and they vigorously advocated the benefits of bank securities affiliates. Mitchell responded aggressively when the stock market weakened and interest rates on brokers’ call loans rose sharply in March 1929. Market participants feared that call loans might soon be scarce, because the Federal Reserve Board was pressuring banks not to provide credit for speculation in the stock markets. Mitchell stabilized the stock market by publicly announcing that NCB would make available up to US\$25 million in new call loans. He declared that “we have an obligation which is paramount to any Federal Reserve warning, or anything else, to avert any dangerous crisis in the money market.”⁸⁴

Similarly, on October 15, 1929, Mitchell tried to reassure investors by stating publicly that “[t]he markets generally are now in a healthy condition ... [and] values have a sound basis in the general prosperity of our country.”⁸⁵ When the Great Crash began in earnest nine days later, Mitchell, Wiggin, and other leading Wall Street bankers organized a publicly announced pool to support the stock market by purchasing pivotal stocks. However, the bankers’ pool could not arrest the steady slide of the stock market, and the bankers were shown to be powerless by October 29th.⁸⁶

John Kenneth Galbraith has observed that “[f]ew men ever lost position so rapidly as did the New York bankers in the five days from October 24 to October 29.”⁸⁷ During the 1931 Senate hearings, Wiggin asserted that “[t]he whole country is stock-minded ... [and] are waiting for a rebound to-day,” but his optimism seemed hollow.⁸⁸ During the same hearings, Wiggin, Mitchell, and other leading bank executives strongly opposed Senator Glass’s proposal to separate commercial banks from their securities affiliates. Wiggin argued that securities affiliates provided “an essential banking service in financing the large corporations ... and other clients of the banks.”⁸⁹ Mitchell disputed Senator Walcott’s suggestion that securities affiliates of banks had contributed to the “increase in public credence [sic] or gullibility” and had helped to generate a “whirlpool of speculation” in the securities markets. Mitchell claimed that “[t]he investment bankers of the country are not the framers of public opinion.

They must yield to the will of the investing public.”⁹⁰ Mitchell’s description of Wall Street bankers as the submissive servants of public opinion contrasted sharply with his lecture to NCC’s employees 12 years earlier, when he declared that NCC must spread “the gospel of thrift and saving and investment” and “bring the investment banking house to the people.”⁹¹

The public influence of Wiggin and Mitchell was already waning in 1931 and was completely destroyed by the Pecora committee’s investigation in 1933. Mitchell and Wiggin were personally disgraced and resigned as bank officers. NCB and Chase voluntarily decided to divest their securities affiliates in March 1933, even before Congress enacted the Glass-Steagall Act.⁹²

Bank Involvement in the Securities and Credit Markets Helped to Produce an Unsustainable Economic Boom During the 1920s

The Role of Banks in the Financing Boom

The rapid expansion of bank securities activities during the 1920s helped to generate an unprecedented boom in the securities markets. From 1919 to 1929, U.S. corporations issued US\$49 billion of securities, including US\$19.5 billion of stocks and US\$29.5 billion of bonds and notes. Annual offerings of corporate securities more than tripled during this period, rising from US\$2.7 billion in 1919 to US\$9.4 billion in 1929.⁹³ State and local governments issued more than US\$14 billion of debt securities during the 1920s, with the majority of that amount being sold during the second half of the decade.⁹⁴ Foreign governments and foreign corporations sold US\$11 billion of securities to U.S. investors between 1919 and 1929, with the largest amounts being offered during the period 1924 to 1928.⁹⁵ As indicated by these figures, all types of securities were issued in much greater volumes as banks and their affiliates expanded their role in the securities markets during the second half of the 1920s.

The extraordinary boom in the securities markets was also manifested by dramatic increases in trading volumes and price levels. Annual trading volume on the NYSE more than quadrupled during the 1920s, rising from 230 million shares in 1920 to 1.1 billion shares in 1929.⁹⁶ The Dow Jones Industrial Average (DJIA) recorded a sixfold

increase, rising from 64 in August 1921 to 381 in September 1929. The price-earnings ratio for the Standard & Poor's Composite Index of stocks also rose by a factor of six during the 1920s and reached 32.6 in September 1929, a record that endured until the great bull market of the 1990s reached its peak in early 2000.⁹⁷

Economists have concluded that the stock market boom produced a speculative bubble during 1928 and 1929.⁹⁸ Those are the same two years during which (1) commercial banks and their affiliates recorded the most rapid growth in their securities underwriting and retail sales activities, and (2) Wall Street investment banking firms responded by selling units in hundreds of investment trusts (forerunners of today's mutual funds) to small investors.⁹⁹ Mass-marketing techniques used by bank securities affiliates and by investment trusts attracted large pools of investment funds from middle-class individuals who had largely avoided the securities markets before 1920. This huge infusion of retail investor funds produced a spectacular growth in the total financing made available to U.S. corporations. One-third of all debt and equity securities issued by domestic companies from 1919 to 1929 were sold during the last two years of that period. Thus, the entry of commercial banks into the securities markets triggered an intense rivalry with securities firms, resulting in an overissue of new securities that contributed to the speculative bubble of 1928–29.¹⁰⁰

The existence of a bubble in the securities markets is further indicated by the stunning declines in stock and bond values, and the significant increases in bond defaults, following the Crash of 1929. Between September 1929 and July 1932, the DJIA fell from 381 to 41 and the aggregate value of all NYSE-listed stocks declined from US\$82.1 billion to US\$12.7 billion.¹⁰¹ More than a quarter of all domestic bonds issued during the 1920s defaulted during the 1930s, and default rates were particularly high for domestic bonds issued after 1926.¹⁰² Market values declined significantly even for those domestic bond issues that did not default during the 1930s.¹⁰³ Purchasers of foreign bonds suffered the worst losses. More than a third of all foreign bonds sold to U.S. investors during the 1920s had defaulted by 1937, including three-quarters of all bonds sold by Eastern European and Latin American issuers.¹⁰⁴

The Expansion of Bank Real Estate Loans and Consumer Credit

In addition to their rapidly growing involvement in the securities markets, commercial banks greatly expanded their real estate lending activities after World War I. Between 1913 and 1927, Congress passed statutes that significantly broadened the authority of commercial banks to make loans secured by real estate.¹⁰⁵ Bank real estate loans more than tripled from 1919 to 1929, with most of those loans being made in urban markets.¹⁰⁶ The rapid growth of bank real estate lending was part of a broader trend. Between 1919 and 1930, the total amount of U.S. nonfarm mortgage debt rose from US\$8 billion to over US\$30 billion. Banks, savings institutions, and life insurance companies held more than US\$24 billion of this debt, while the remaining US\$6 billion was held in the form of real estate bonds secured by mortgages on apartment buildings and office buildings. Commercial banks held about US\$5.5 billion of real estate loans and bonds on their balance sheets in 1930.¹⁰⁷

The dramatic growth of real estate financing during the 1920s fueled a spectacular real estate boom that mirrored the bull market in securities. From 1921 to 1929, more than US\$75 billion was expended on private and public construction projects, including almost US\$35 billion spent in building new housing units. Urban real estate values doubled during the same period. Construction of detached, one- to four-family homes declined after 1926, but construction of new apartment buildings and office buildings continued at a rapid pace until 1929.¹⁰⁸ As the Senate Banking Committee observed in 1933, the “immense increase in the volumes of real-estate bond issues and of real-estate mortgages both in banks and [other] financial institutions” created a speculative boom that resulted in many “overbuilt” urban real estate markets by 1929.¹⁰⁹

In addition to funds from newly issued securities and real estate loans, a third source of new financing during the 1920s was the growth of consumer nonmortgage credit. From 1919 to 1929, consumer installment debt rose from US\$1.9 billion to US\$4.9 billion and total consumer nonmortgage debt increased from US\$2.9 billion to US\$7.6 billion. Expanded consumer credit allowed Americans to buy vast quantities of cars, radios, phonographs, household appliances, furniture, jewelry, and other durable consumer goods. Postwar consumer purchases of durable goods were spurred by (1)

pent-up demand that could not be satisfied during the economic austerity of World War I, (2) increases in disposable income created by a decade of prosperity, and (3) improvements in convenience and entertainment offered by a wide range of new consumer products. For example, car registrations rose from 11 million to 26 million between 1921 and 1929, and automobile loans were the single largest source of consumer installment credit. Nonmortgage consumer credit was offered to consumers by manufacturers, merchants, consumer finance companies, and some commercial banks (including NCB). In addition, commercial banks provided most of the indirect financing for nonmortgage consumer credit by purchasing consumer installment notes or by making loans to manufacturers, merchants, and finance companies.¹¹⁰

The Vulnerability of the U.S. Economy to a Severe Economic Downturn in 1929

As shown in the preceding section, commercial banks participated in the financing boom of the 1920s through five different channels—loans on securities, securities investments, public offerings of securities, real estate lending, and consumer credit. The financing boom of the 1920s created two conditions that contributed to the onset and severity of the Great Depression. First, abundant credit allowed both the private and public sectors to assume heavy debt burdens, resulting in a national economy that was extremely fragile at the end of the 1920s. By 1929, total private and public debt probably exceeded US\$200 billion, with more than 80 percent of that amount being owed by private firms and individuals. This aggregate debt burden was more than double the nation's total annual income of US\$87 billion. Total debt service as a percentage of gross domestic product (GDP) rose to 9 percent for the United States in 1929, compared to only 3.9 percent for Canada.¹¹¹ This highly leveraged situation exposed consumers, state and local governments, and business firms to devastating financial shocks during the Great Depression.¹¹²

Second, the explosion of debt and equity finance during the 1920s encouraged excessive investments in real estate, industrial plant and equipment, and public facilities. From 1921 to 1929, almost US\$35 billion was invested in new housing, US\$55 billion was spent for new plant facilities and equipment, and at least US\$10 billion was

expended by public agencies for roads, schools, and public utilities.¹¹³ Industrial production increased by 40 percent from 1922 to 1929, reflecting large investments in new manufacturing facilities.¹¹⁴

Many of the housing subdivisions, apartment buildings, and office buildings constructed during the 1920s proved to be poorly planned and economically unviable when the real estate boom ended.¹¹⁵ Similarly, much of the new investment in plant and equipment was committed to speculative and ultimately unsuccessful ventures. Many high-flying companies of the 1920s were relatively young firms, which tried to exploit new technologies that had captured the imagination of Wall Street bankers and individual investors. The most fashionable and speculative stocks of the 1920s were issued by companies involved with aircraft, automobiles, chemicals, electrical equipment and appliances, electrical utilities, motion pictures, phonographs, radios, and retail stores. Du Pont, Fox Films, General Electric, General Motors, Montgomery Ward, Radio Corporation of America, RKO, United Aircraft and Transport, and Westinghouse were notable examples of the glamour stocks of the 1920s.¹¹⁶

Many younger firms in high-tech businesses failed during the 1920s or subsequently during the Depression, resulting in significant losses in both investment value and productivity. Those failures were consistent with a typical pattern of industrial development in which (1) numerous firms enter a new field with plans to exploit an emerging technology; (2) a highly competitive shakeout period ensues, resulting in the failure or absorption of most entrants; and (3) the industry evolves into a more stable oligopoly dominated by a few leading firms.¹¹⁷ For example, despite the tremendous increase in automobile production and sales during the 1920s, the number of car manufacturers declined from 104 to 30 and the number of automobile tire producers fell from 274 to 93 during the same decade.¹¹⁸ Similarly, Wall Street bankers and investors poured too much financing into radio, motion pictures, and other high-tech industries based on unrealistic expectations of how quickly those fields would produce steady growth and solid profits.¹¹⁹ Markets for automobiles, radios, and other high-tech goods were saturated by the end of the 1920s, as indicated by the rapid growth of business inventories during 1929.¹²⁰

The stock market bubble of 1928–29 produced a final burst of new investment funds for the U.S. economy. U.S. corporations issued US\$16.3 billion of bonds and stocks during those two years, accounting for one-third of all domestic corporate securities issued between 1919 and 1929. As previously noted, bank securities affiliates and investment trusts were instrumental in finding purchasers to absorb this huge volume of new securities.¹²¹ The final stage of the stock market boom encouraged many business firms to make speculative investments in commercial real estate and industrial facilities. Construction of apartment buildings, office buildings, and plant facilities rose sharply in 1928–29, along with investments in business equipment and inventories. It appears that the financing surge of 1928–29 induced firm managers to make costly new investments based on their expectation that demand would continue to grow in line with the boom years of 1924–28.¹²²

Unfortunately, the rosy expectations fueled by the stock market bubble proved to be unfounded. The U.S. economy began to weaken in the summer of 1929, as both construction activity and automobile production declined.¹²³ Consumption of durable goods by consumers plummeted following the crash of 1929, leading to a sharp drop in business investments in plant, equipment, and inventories. As a consequence, GDP declined by 10 percent and industrial output fell by 21 percent during the period 1929–30.¹²⁴ In view of the rapid declines in consumer consumption, industrial output, and business investment of 1929–30, it seems clear that the crash of 1929 triggered a severe economic downturn by (1) destroying investor wealth; (2) creating uncertainty among investors, consumers, and business managers; and (3) disrupting the stock market's ability to serve as a channel for continued financing.¹²⁵

To sum up, commercial banks were leading participants in the expansion of debt and equity financing during the 1920s. The surge of new financing fueled a speculative economic boom that encouraged consumers and business firms to assume heavy debt burdens and to make speculative investments. The boom left the U.S. economy in an extremely fragile condition at the end of 1929.¹²⁶

Commercial banks and other financial institutions were not solely responsible for the boom-and-bust cycle of 1921–33. The Federal Reserve’s decisions on monetary policy played a major role in both the boom and the collapse. A detailed analysis of the Federal Reserve’s actions during 1921–33 is beyond the scope of the present discussion. However, I will note three aspects of the Federal Reserve’s policy that have been heavily criticized by both contemporary and modern scholars.

First, the Federal Reserve adopted “easy-money” policies in 1924 and 1927, thereby encouraging the financing boom that continued through late 1929. In 1924 and again in 1927, the Federal Reserve cut the discount rate and purchased large amounts of government securities. Both episodes were motivated by domestic and foreign considerations. The Federal Reserve wanted to reduce interest rates to counteract mild downturns in the U.S. economy that occurred in 1924 and 1927. In addition, the Federal Reserve wanted to help the United Kingdom, France, and Germany in their efforts to reestablish the gold standard in 1924–25, and to preserve the gold standard in 1927. By producing easier credit conditions, the Federal Reserve’s policy actions in 1924 and 1927 supported the securities markets and helped to extend the nation’s economic prosperity. Unfortunately, the Federal Reserve’s actions also encouraged speculative behavior. The Federal Reserve’s apparent ability to fine-tune the economy and sustain the postwar boom led many financial institutions, investors, and business firms to believe that the business cycle had been tamed.¹²⁷

The Federal Reserve’s second error was to pursue an overly restrictive monetary policy in 1928–29. The Federal Reserve wanted to curb excessive speculation in the securities markets, but its actions had the unintended effect of increasing the real cost of credit for the general economy. Tight credit conditions, particularly in view of the continuing demand by investors for security loans, precipitated a sharp economic downturn in the summer of 1929.¹²⁸

The Federal Reserve’s third (and most fateful) mistake was that it failed to counteract the destabilizing effects of a series of regional banking panics, which began in late 1930 and culminated in the nationwide banking holiday of March 1933. The banking panics produced a severe contraction in the nation’s money supply by freezing

the deposits held by failed banks and by encouraging depositors in open banks to convert their deposits into currency. Bank failures also depressed economic activity by disrupting the flow of credit to businesses, especially small and medium-sized firms that could not obtain financing through the securities markets. The Federal Reserve failed to make sustained, large-scale purchases of government securities and bank acceptances in order to offset declines in the nation's money supply. In addition, the Federal Reserve did not act as lender of last resort for the banking system. Many economists believe that the Federal Reserve's failure to respond to the progressive collapse of the banking system turned the sharp recession of 1929–30 into the Great Depression of 1931–33.¹²⁹

The Federal Reserve's policy mistakes were important factors that help to explain the intensity of the speculative boom of the 1920s and the severity of the economic collapse of the early 1930s. Senator Glass himself assigned much of the blame to the Federal Reserve.¹³⁰ At the same time, there is substantial support for Glass's claim that banks and their securities affiliates bore significant responsibility for the boom-and-bust cycle of 1921–33. Contemporary scholars and members of Congress pointed out that banks and their affiliates played key roles in arranging the debt and equity financing that fueled the economic boom of the 1920s. Contemporary observers also stressed the linkage between the abundant financing of the 1920s and the leverage and overinvestment that aggravated the economic collapse of the 1930s.¹³¹

Two recent studies provide additional evidence supporting Senator Glass's view. Eichengreen and Mitchener documented the existence of a credit boom in the United States and several other countries during the second half of the 1920s. They also determined that this credit boom contributed to the economic slump of the 1930s, particularly in nations (like the United States) in which the credit boom was accompanied by a stock market boom.¹³²

Cole, Ohanian, and Leung found that productivity shocks accounted for about two-thirds of the output changes in 17 countries during 1929–33, while monetary/deflation shocks accounted for the remaining third. Consequently, they concluded that productivity shocks were more important than monetary factors in explaining the

collapse of economic output during the Great Depression. They also determined that productivity shocks during 1929–33 were linked to industrial activity and were expected by stock market investors to persist throughout the period. Finally, they found some support for the view that productivity shocks were correlated with financial market shocks, including banking panics.¹³³ The findings of both studies are broadly consistent with the understanding of Glass and his supporters. As discussed earlier, Glass and his colleagues maintained that excessive debt and equity financing during the 1920s generated over-investment and economic fragility, resulting in a collapse of economic output when the sources of that financing were disrupted by the Crash of 1929.

A Preliminary Reconsideration of the Modern Critique of the Glass-Steagall Act

Beginning in the 1980s, a number of scholars have argued that the Glass-Steagall Act was an ill-conceived law from the outset. These critics have raised three principal points. First, they contend that the Glass-Steagall Act was self-interested legislation that was promoted by traditional investment banks in order to expel commercial banks from the securities underwriting business. Second, they maintain that banks with securities affiliates were safer institutions and were more likely to survive the banking panics of the 1930s, in comparison with specialized commercial banks. Third, they contend that Congress was largely mistaken in its belief that universal banks had endangered the public interest through abusive selling practices and other conflicts of interest.

As to the first issue, I find no evidence indicating that investment banks were either supporters or intended beneficiaries of the Glass-Steagall Act. Regarding the second and third issues, I offer preliminary responses indicating that Congress had substantial reasons to believe that universal banks presented serious risks to the banking system and the broader economy.

Were Traditional Securities Firms Supporters or Intended Beneficiaries of the Glass-Steagall Act?

Several scholars have advanced an “interest group” explanation for the Glass-Steagall Act. They contend that traditional investment banks encouraged Congress to adopt the 1933 legislation in order to remove their commercial banking rivals from the securities underwriting business.¹³⁴ It is certainly true that, from the mid-1960s through the end of the 1980s, securities firms and their trade associations fought hard to maintain the wall of separation created by the Glass-Steagall Act. It was not until the early 1990s that leading securities firms decided to support universal banking legislation, after failing to overturn federal agency rulings that opened major loopholes in the Glass-Steagall Act.¹³⁵

Notwithstanding the securities firms’ modern defense of the Glass-Steagall barriers, the available evidence does *not* show that traditional investment banks were supporters or intended beneficiaries of the Act. Jonathan Macey, a proponent of the “interest group” explanation for Glass-Steagall, has acknowledged that “few hints of such favoritism can be gleaned from the legislative history or from the statutory language itself.”¹³⁶ Indeed, the “interest group” theory does not square with the known facts about the 1933 legislation.

The Investment Bankers Association of America (IBA), the leading trade association representing securities firms, actively opposed the legislation. During congressional hearings on the Glass bill in 1932, Allan Pope, president of the IBA, strongly condemned the provisions requiring commercial banks to leave the business of investment banking. Pope testified that he had met with “several hundred members” of the IBA in a dozen major cities, and “without a single exception” all those members opposed the Glass bill.¹³⁷ Pope argued that a mandatory separation between commercial and investment banking would be “highly deflationary” and would “practically stop the security and industrial business of the country.”¹³⁸ He further declared that the Glass bill was “so highly detrimental to the investment market to-day as to unquestionably affect in a ruinous manner the banks throughout the country as well as investment banks.”¹³⁹

Pope's testimony portrayed the IBA's membership as being firmly united in opposition to the Glass bill. It could be argued that Pope's testimony is not conclusive on this point. As Donald Langevoort has noted, "control of the [IBA] ... had fallen to the commercial bankers" by 1930.¹⁴⁰ Pope himself was executive vice president of the securities affiliate of the First National Bank of Boston.¹⁴¹ Accordingly, Pope might have been inclined to exaggerate the degree of consensus among the IBA's members in opposing the Glass bill. However, no investment bank testified in favor of the Glass bill, a fact that tends to support Pope's claim that the IBA's membership universally opposed the bill.

Edwin Perkins has drawn the opposite inference from the absence of any traditional investment bankers among the list of witnesses who testified at the 1931 and 1932 Senate hearings on the Glass bill. From this absence, Perkins inferred that "older investment banking houses who had been losing the competitive battle with the more aggressive commercial banks now thought they saw an opportunity to reestablish their former dominant position in the underwriting field" by supporting the Glass bill.¹⁴² This inference is contradicted, however, by the fact that leading partners of J.P. Morgan, the foremost private investment bank, strongly opposed the Glass-Steagall Act in their private dealings.¹⁴³ For example, during the summer of 1932, Russell Leffingwell, a Morgan partner with close personal connections to Franklin Roosevelt and the Democratic Party, wrote a personal letter urging Roosevelt to reject the Glass bill. Leffingwell argued that "we cannot cure the present deflation and depression" with the "prohibition and regulation stuff" proposed by Glass. Roosevelt, however, rebuffed Leffingwell's entreaty. Roosevelt declared that bankers were responsible for "grave abuses" during the period 1927-29, and it was therefore imperative for honorable bankers to "support wholeheartedly methods to prevent recurrence thereof."¹⁴⁴ Roosevelt subsequently made a campaign speech in which he urged the complete separation of commercial and investment banking.¹⁴⁵

J.P. Morgan's opposition to Glass-Steagall is further indicated by its decision in 1935 to abandon the securities business and remain a deposit-taking bank. Drexel & Co. (Morgan's affiliate in Philadelphia) and Brown Brothers Harriman (another leading private investment bank) made the same choice. Several partners from J.P. Morgan and Drexel resigned to form Morgan Stanley, a new investment bank-

ing firm. J.P. Morgan provided most of the initial financing for Morgan Stanley. During the early years of Morgan Stanley's operation, partners in the two firms maintained close relations, and they clearly hoped that Congress would amend or repeal Glass-Steagall so that they could once again operate as a single firm. Other traditional investment banks—including Kuhn, Loeb; Lazard Freres; and Lehman Brothers—opted to become securities firms. As indicated by these varying responses to the Glass-Steagall Act, it was doubtful whether traditional investment banks would actually benefit from the legislation, given (1) the heavily depressed condition of the securities markets during the early 1930s, and (2) Section 21 of the Act, which prohibited securities firms from accepting deposits.¹⁴⁶

Another problem with the “interest group” explanation of Glass-Steagall is that the Senate's investigation of Wall Street practices during 1932 and 1933 did not spare traditional investment banks. As discussed below, the Pecora committee's investigation in 1933 was particularly harsh toward NCB and Chase and their securities affiliates. However, the Senate's investigation also revealed highly unfavorable information about traditional securities firms, including (1) Halsey, Stuart's role in aggressively marketing securities issued by the Insull utility empire prior to its bankruptcy in 1932; (2) Lee, Higginson's similar promotion of securities issued by Ivan Kreuger's companies before they collapsed in 1932; (3) Goldman Sachs' sponsorship of Goldman Sachs Trading Corporation, a highly leveraged investment trust whose shares became worthless by 1933; (4) J.P. Morgan's similarly ill-fated sponsorship of three large investment trusts, and its practice of allocating shares of newly underwritten securities to “preferred lists” of influential politicians and businessmen at heavily discounted prices; and (5) Kuhn, Loeb's and Dillon Read's promotion of several investment trusts that inflicted large losses on ordinary investors.¹⁴⁷

As a consequence of the Senate's investigation, journalists harshly criticized J.P. Morgan and other private investment banks, and the public's reaction against investment banks was “almost as condemnatory” as the outcry against NCB, Chase and their affiliates. Public attacks on investment banks helped to persuade Congress to enact the Securities Act of 1933 despite the lobbying efforts of Wall Street bankers.¹⁴⁸ Hostility to investment banks also surfaced in Section 21 of the Glass-Steagall Act, which prohibited any person or firm

from accepting deposits if they engaged in the business of underwriting, selling, or distributing securities.¹⁴⁹

During the Senate debates on the Glass-Steagall Act, Senator Tydings of Maryland offered an amendment to Section 21. The Tydings amendment would have exempted investment banks from the prohibition on deposit taking if they satisfied certain safeguards. Tydings declared that he was in favor of separating commercial banks from the securities business. However, he argued, “private investment houses of the better class” (such as his constituent, Alexander Brown & Sons of Baltimore) performed a vital public service in “financing private businesses ... on long-term paper.” He warned the Senate that Section 21 would impair the availability of credit by undermining “the usefulness of bona fide, finely run and conducted private institutions.”¹⁵⁰

Senators Bulkley and Glass strongly opposed the Tydings amendment and persuaded the Senate to reject the amendment. Bulkley declared that an absolute prohibition on deposit taking by securities firms was “vital to the principles” of the Glass-Steagall Act. Glass agreed that this prohibition was a “vital provision of the bill,” because it would “confine to their proper business activities these large private concerns” and would “deny them the right to conduct the deposit bank business.” Glass reminded the Senate that private investment banks had “unloaded millions of dollars of worthless investment securities upon the banks of this country.” He also predicted that “there will be no difficulty ... in financing any business enterprise that needs to be financed at a profit in this country [because] large investment houses will be set up in this country, just as they have been in all of the countries of continental Europe, and in England.” In fact, Glass noted, officials of Chase’s securities affiliate were already taking steps to reorganize the affiliate as a separate investment bank.¹⁵¹

The public legislative history of Section 21, including the Senate’s defeat of the Tydings amendment, supports the view that the Glass-Steagall Act was designed to carry out a complete separation of the commercial and investment banking businesses. That history strongly undercuts the view that Glass and his supporters sought to protect securities firms from competition by commercial banks. Section 21 “severely hurt the private bankers” who chose to become se-

curities firms, because it deprived them of an important source of funding (i.e., deposits) and made them more dependent on loans from commercial banks.¹⁵² The successful opposition of Glass and Bulkley to the Tydings amendment clearly indicated that investment banks were *not* intended beneficiaries of the Glass-Steagall Act.¹⁵³

As Donald Langevoort has observed, the provisions and history of the Glass-Steagall Act demonstrate that the legislation had a “channeling objective”—to confine banks to “the traditional business of commercial and agricultural lending” and to prevent bank deposits from being used to fund loans for speculative purposes.¹⁵⁴ The available evidence—particularly with regard to Section 21—contradicts any inference that the Act was designed to favor securities firms.

Glass’s conduct two years later further undermines any such inference. Glass tried to include a provision in the Banking Act of 1935 that would have given commercial banks a limited authority to underwrite and sell debt securities (but not equity stocks). Under Glass’s proposal, commercial banks could have underwritten or sold debt securities to dealers or brokers (other than banks), or at public auction, under rules established by the Comptroller of the Currency. Glass argued that commercial banks should be granted a carefully limited power to sell debt securities because securities firms were not providing adequate long-term financing to industrial corporations.¹⁵⁵ Since Glass’s proposal would have allowed commercial banks to make a partial reentry into the securities underwriting business, it certainly did not reflect any desire to protect securities firms. Indeed, Glass explained that he was disappointed by the poor performance of securities firms in arranging long-term financing for industrial firms, contrary to his optimistic expectations in 1933.¹⁵⁶

The Senate adopted Glass’s proposal over the vocal opposition of Senator Robert LaFollette. In opposing Glass, LaFollette did not express any solicitude for securities firms. Instead, he reiterated the same arguments advanced in 1933 in favor of “a complete divorce and separation between investment and commercial banking in this country.” LaFollette declared that “the underwriting and sale of securities by commercial banks . . . served to wipe out the reserves and the savings of a lifetime which millions in this country had accumulated.” In LaFollette’s view, “the whole experience of the investing

public and of the people of the United States during the boom and the depression proves that [Glass's] proposal is loaded with dynamite as far as the investing public in the future is concerned."¹⁵⁷ Glass's proposal was opposed by the Roosevelt Administration and was omitted from the conference report on the 1935 legislation.¹⁵⁸ Thus, as in the case of the Glass-Steagall Act, the debates on Glass's proposal in 1935 did not indicate any congressional purpose to protect securities firms from competition.

Did Securities Activities Threaten the Safety of Banks During the 1930s?

George Benston has concluded that "[t]he evidence from the pre-Glass-Steagall period is totally inconsistent with the belief that banks' securities activities or investments caused them to fail or otherwise caused the financial system to collapse."¹⁵⁹ Benston relied extensively on a study by Eugene White, who found that "[f]ew banks with [securities] affiliates failed; and even though Congressional hearings may have uncovered some problems, the securities affiliates did not systematically undermine the capital or liquidity provisions of national banks."¹⁶⁰ White determined that 26.3 percent of all national banks failed during the period 1930–33, compared with only 6.5 percent of banks with securities affiliates and only 7.6 percent of banks with large bond departments. White noted, however, that "the typical bank involved in investment banking was far larger than average, while most of the failures were among the smaller institutions."¹⁶¹ Larger banks had a higher probability of survival during the Great Depression, because (1) their assets were more diversified in comparison to smaller banks, and (2) they were more likely to receive financial support from other banks and the Reconstruction Finance Corporation (RFC). Due to the higher survival rate for large banks, depositors shifted their funds from smaller banks to larger banks during the banking panics of 1930–33.¹⁶² Consequently, White's data on bank survival do not permit us to separate the impact of securities activities from the positive effect of larger size.

White also performed regressions based on data for bank failures during 1931. He concluded that, during that year, the presence of a securities affiliate "tended to reduce the likelihood of failure" while the presence of a bond department "did not increase the probability of failure." Again, however, White's regression analysis is not conclu-

sive, because his sample did not enable him to measure the impact of differences in bank size. In addition, White did not consider the significance of specific incidents in which major banks with securities affiliates failed during 1930, 1932, and 1933.¹⁶³

One problem in isolating the effect of securities activities on bank failures is that banks failed for various reasons during the Great Depression. It appears, however, that losses from defaulted real estate loans and depreciated securities investments were two of the most important causes of bank failures from 1930 to 1933. As described above, real estate lending and investments in higher-risk securities were two leading sources for the financing surge of the 1920s. Both activities required banks to invest in assets that were subject to potential liquidity problems, and both markets experienced speculative booms during the 1920s. It is therefore not surprising that both activities proved to be serious threats to bank solvency during the early 1930s.

Default rates rose rapidly for both residential and commercial mortgages and reached crisis proportions in 1931–32. Real estate values in many urban areas fell by a third or more in 1929–31, and a large number of urban real estate markets were essentially frozen by 1932. Banks often could not liquidate defaulted loans by foreclosing on the real estate collateral, because no buyers were available to pay any reasonable price for the property. The illiquid status of defaulted real estate loans was a significant factor explaining the loss of bank capital during the 1930s.¹⁶⁴

Many banks were also devastated by depreciation in their securities portfolios. As noted above, both domestic and foreign bonds experienced sharp increases in default rates and rapid declines in market values from 1931 to 1933.¹⁶⁵ Losses on South American and Eastern European bonds were especially severe, as three-quarters of those bonds defaulted during the 1930s.¹⁶⁶ An analysis of closed New York state banks found that their securities portfolios had suffered an average loss in market value of 37.5 percent. A similar study of closed Michigan banks determined that depreciation in their bond portfolios (particularly with regard to real estate bonds) was a primary reason for their failure.¹⁶⁷ From 1929 to 1932, the losses suffered by national and state member banks on securities

investments were comparable in magnitude to their losses on loans.¹⁶⁸ A recent study by Calomiris and Mason confirms that defaulted real estate loans and depreciated securities were important causes of bank failures.¹⁶⁹

Smaller banks suffered the greatest percentage losses from securities investments, because higher-risk securities represented a higher proportion of their investment portfolios. Among Federal Reserve member banks, country banks held larger amounts of foreign bonds and railroad bonds than reserve city banks did.¹⁷⁰ Some commentators blamed country bankers for their lack of prudence in pursuing higher yields without regard to risk.¹⁷¹ However, members of Congress and other commentators strongly criticized securities affiliates of commercial banks and traditional investment banks for aggressive marketing campaigns that encouraged unsophisticated country bankers to buy risky securities.¹⁷² Country banks relied heavily on their correspondent banks in major cities for a wide range of banking services, including investment advice and the sale of investment securities.¹⁷³ Allan Pope, executive vice president of First National Bank of Boston's securities affiliate, acknowledged in 1931 that country bankers sought his company's investment advice because they were "unfamiliar with the investment markets."¹⁷⁴ In 1932, he testified that 600 country banks relied on his affiliate for investment recommendations, "based on our broad expanse of knowledge." According to Pope, some country bankers had been specifically instructed by bank examiners to "take our advice in security matters."¹⁷⁵

Thus, it appears that bank securities affiliates contributed to the failure of many small correspondent banks by persuading them to invest in high-risk bonds, particularly foreign issues. The linkage between bank securities activities and bank failures is a worthwhile subject for future research, but for present purposes, I will simply note the following evidence indicating that bank securities affiliates did create significant risks for large banks and the banking system from 1930 to 1933.

The Failures of Several Key Banks with Securities Affiliates

Between 1930 and 1933, the failures or near-failures of several key banking organizations resulted, at least in part, from their involvement in securities activities. In 1930, Caldwell and Company and Bank of United States failed. Those failures precipitated the first banking crisis of the Great Depression. In 1932, the RFC was forced to provide large loans in order to (1) protect the depositors of Central Republic Bank and (2) ensure the survival of Bank of America. In 1933, the failure of four important banks with securities affiliates—two in Detroit and two in Cleveland—precipitated statewide banking holidays that helped to trigger a nationwide banking panic.

Caldwell and Company and Bank of United States

Caldwell and Company (CAC) established a large financial and industrial empire that covered much of the Southeast. CAC was a leading underwriter of municipal bonds, industrial revenue bonds, and real estate bonds throughout the Southern states. By the end of 1929, CAC controlled a large chain of banks with more than US\$210 million of assets, insurance companies with more than US\$230 million of assets, and newspapers and industrial companies with almost US\$50 million of assets. In early 1930, CAC merged with Banco Kentucky Company, which controlled 10 banks with assets of almost US\$140 million.¹⁷⁶

CAC obtained extensive loans from its bank affiliates, as well as other banks in the Southeast. CAC aggressively speculated in stocks on Wall Street. CAC also held large amounts of illiquid securities representing investments in its affiliates and unsold securities from its underwritten offerings.¹⁷⁷ CAC's entire financial structure was unsound and collapsed in November 1930. CAC's demise precipitated the failure of more than 130 banks in Arkansas, Kentucky, North Carolina, and Tennessee, thereby inflicting a severe economic shock on the Southeast's regional economy.¹⁷⁸

Bank of United States (BUS) was a New York City bank that expanded rapidly during the late 1920s by acquiring five other banks. By May 1929, BUS had 57 branches, US\$315 million of assets, and US\$220 million of deposits. BUS controlled three securities affiliates, three safe deposit companies, an insurance company, and dozens of

real estate affiliates.¹⁷⁹ BUS and its real estate affiliates made large loans to real estate developers and invested in real estate bonds. BUS also made substantial loans to its officers and securities affiliates for the purpose of financing continuous trading in units consisting of BUS stock joined with the stock of its major securities affiliate. By 1930, BUS had committed US\$16 million (equal to one-third of its capital) to support the price of its stock units. BUS was strongly motivated to maintain the price of its stock units, because BUS had agreed to repurchase those units at a guaranteed price from many of its shareholders, including depositors to whom BUS had actively marketed the units.¹⁸⁰

BUS was doomed when the real estate and stock markets slumped after the Crash of 1929. At the time of its failure in December 1930, BUS had outstanding more than US\$20 million of unpaid loans to its securities and real estate affiliates, as well as US\$11 million of unpaid loans to its officers and other persons that were collateralized by its stock units. BUS's affiliates incurred a loss of at least US\$16 million on their holdings of BUS stock units. Large amounts of BUS's real estate loans and bonds were either in default or likely to default.¹⁸¹ BUS failed after the New York state banking department and the Federal Reserve Bank of New York could not persuade members of the New York Clearing House Association (NYCHA) to provide support for an emergency merger of BUS with two other New York City banks.¹⁸² BUS's failure led to the collapse of Chelsea Bank, a smaller New York City Bank that was closely connected with BUS. Depositor runs began at two larger banks—Manufacturers Trust and Public National—that were also linked with BUS. Members of the NYCHA intervened to rescue those banks and avert a more widespread banking panic.¹⁸³

Scholars have debated whether BUS's failure aggravated the economic decline that was already under way in the United States. Regardless of its direct economic impact, there can be little doubt that BUS's failure had a significantly adverse impact on public confidence in banks. BUS ranked among the 30 largest commercial banks in the nation, and it was the largest single bank failure in U.S. history up to that time. Both domestic and international newspapers gave extensive coverage to BUS's failure, because of its name and its membership in the Federal Reserve System. Together with the collapse of CAC, the

failure of BUS produced a substantial outflow of currency from the banking system as depositors converted their deposits into cash. That outflow indicated a significant loss of confidence in the U.S. banking system.¹⁸⁴

The Chicago Banking Panics and Central Republic

In June 1931, a serious banking panic occurred in Chicago. During Chicago's real estate boom of the mid-1920s, the city's banks expanded rapidly and devoted much of their resources to real estate lending. As the result of numerous mergers, two giant banks—Continental Illinois Bank and Trust Company (Continental Illinois) and First National Bank of Chicago (First Chicago) controlled two-thirds of Chicago's banking resources by 1931. Many of the larger Chicago banks and their securities affiliates sold real estate bonds to investors with an explicit or implicit undertaking to repurchase the bonds upon request. Chicago banks and their securities affiliates distributed other types of securities, including municipal bonds and bonds issued by Samuel Insull's utility empire. Banks and their affiliates were also exposed to the securities markets as a consequence of their investment securities and security loans.¹⁸⁵

Given their heavy involvement in real estate activities, many Chicago banks became highly vulnerable after the city's real estate boom ended in 1928. By June 1931, a chain of banks controlled by the Foreman State Bank was faced with imminent depositor runs, because Foreman could no longer repurchase real estate bonds that its securities affiliate sold to depositors. To avoid the collapse of the entire Foreman chain, First Chicago agreed to acquire most of the Foreman banks with financial help from the Chicago Clearing House Association (CCHA). In addition, the National Bank of the Republic, which had been weakened by its own real estate problems, agreed to merge with Central Trust Company to form the Central Republic Bank and Trust Company (Central Republic). However, these measures did not prevent the demise of a chain of 12 banks controlled by John Bain, an aggressive real estate promoter. The Bain default was accompanied by the failures of another 20 banks. A full-scale panic was averted only when First Chicago and Continental Illinois publicly announced that they would support all of their local correspondent banks. The panic ended, but the resolution proved to be temporary.¹⁸⁶

In the summer of 1932, another and more serious banking panic struck Chicago. The real estate situation in Chicago had grown worse, and more than US\$1 billion of mortgages were in default. Chicago's economy was also shaken by the collapse of the highly leveraged Insull utility system in the spring of 1932. Samuel Insull's holding companies, headquartered in Chicago, controlled a network of public utility companies serving more than 5,000 communities in 36 states. Insull and his investment bankers, led by the Chicago firm of Halsey, Stuart, had promoted the sale of Insull holding company securities to small investors. The securities affiliates of First Chicago, Continental Illinois, and Central Republic had participated in the distribution of Insull securities to the public, and they also invested in Insull securities. By the time the Insull holding companies were declared bankrupt in 1932, US\$2.65 billion of Insull securities had been sold to 600,000 shareholders and 500,000 bondholders. Chicago banks extended more than US\$150 million of loans to Insull companies and to other borrowers who offered Insull securities as collateral. Insull interests owed US\$90 million to the three leading banks, with Continental Illinois holding two-thirds of those loans. The Insull debacle thus wiped out the personal savings of thousands of Chicago area residents and threatened the solvency of many Chicago banks.¹⁸⁷ In addition, the Chicago city government was facing its own revenue crisis and could not pay its employees or bondholders.¹⁸⁸

In this atmosphere of deepening economic crisis, Chicago residents lost faith in their banks. Thirty-six banks in Chicago failed between June 15 and 25, 1932. In sharp contrast to the 1931 panic, legions of frightened depositors descended on the three leading Chicago banks. Continental Illinois and First Chicago withstood the temporary panic among their depositors. In a dramatic gesture, Melvin Traylor, First Chicago's chairman, climbed on a pillar in the bank's lobby and persuaded a crowd of worried depositors to remain calm. Central Republic, however, could not withstand the pressure of escalating deposit withdrawals. On June 26th, Charles Dawes, chairman of Central Republic, informed Chicago's banking leaders and officials of the recently established RFC that he would have to close his bank unless a rescue plan was arranged to protect all of its depositors.¹⁸⁹

In contrast to their successful self-help plan in 1931, Continental Illinois, First Chicago, and the CCHA could not finance the rescue of Central Republic. Chicago's banking leaders and RFC examiners determined that Central Republic needed an infusion of US\$95 million to remain open. The Chicago banks told the RFC that they could only offer US\$5 million in loans, thus revealing their gravely weakened condition. With the encouragement of President Hoover, the RFC determined that Central Republic must be rescued, because the bank's failure would lead to depositor runs on Chicago's remaining banks and a likely collapse of the entire U.S. banking system. In practical effect, the RFC treated Central Republic as being "too big to fail." Accordingly, the RFC agreed to provide a US\$90 million loan, secured by all of Central Republic's assets. The RFC's loan allowed Central Republic to continue in operation temporarily, but the bank could not survive. The 5½ percent interest rate charged by the RFC substantially exceeded the bank's return on its assets. In October 1932, Central Republic transferred all of its deposits to a newly organized bank, and Central Republic was liquidated thereafter.¹⁹⁰

The RFC's protection of Central Republic's depositors temporarily calmed financial markets in Chicago and the nation. However, the incident revealed four very unpleasant facts about the nation's banking situation in mid-1932. First, bank failures, which had previously been confined to smaller and midsized banks (except for CAC and BUS), were spreading to large urban banks. Second, the most vulnerable urban banks were those that had engaged in extensive real estate and securities activities during the 1920s. Third, even the largest urban banks no longer had the resources to resolve serious banking panics without governmental assistance. Fourth, RFC loans provided only short-term relief and could not solve the fundamental problems confronting banks. The RFC required banks to pledge their best assets to secure 100 percent of the loans they received. RFC loans were made at penalty interest rates and could not exceed the estimated market or liquidation value of the banks' collateral. RFC loans also became a potential trigger for depositor runs after Congress required publication of the names of banks receiving RFC loans. For all these reasons, RFC loans failed to prevent a progressive collapse of the banking system during 1932 and 1933.¹⁹¹

Threats to the Survival of Bank of America

Bank of America, like other urban banks, expanded rapidly through mergers and acquisitions during the boom years of the 1920s. By 1930, Transamerica Corp., the parent holding company of Bank of America, was the third largest U.S. banking organization, trailing only Chase and NCB. Transamerica controlled more than 400 bank branches and US\$1.2 billion of banking assets in California, as well as a New York City bank with 35 branches and US\$400 million of assets. Transamerica also acquired a Wall Street securities firm, Bancamerica-Blair Corporation, which operated offices in 27 U.S. cities and 5 foreign countries.¹⁹² Transamerica and Bancamerica-Blair financed substantial stock-trading operations designed to support Transamerica's stock price. Both companies also actively invested in other stocks, and Bancamerica-Blair was a major distributor of securities to retail customers.¹⁹³

By 1931, Bank of America and Transamerica found themselves in great difficulty. Bank of America was rapidly losing deposits, and many of its residential and commercial real estate loans were in default or danger of default. Transamerica and Bancamerica-Blair suffered large losses on their stock investments and loans on securities. Elisha Walker, the recently elected chairman of Transamerica, decided to retrench. He engineered the sale of the New York City bank and Bancamerica-Blair to NCB in October 1931. Walker completed this transaction over the strenuous opposition of A.P. Giannini, the founder and former chairman of Bank of America and Transamerica.¹⁹⁴

A fight for corporate control ensued. Giannini prevailed in a proxy contest and regained control of Transamerica in February 1932. The RFC immediately offered to provide up to US\$100 million of credit to support Giannini's rehabilitation plan for Bank of America. The RFC ultimately loaned US\$65 million to Bank of America and Transamerica, thereby helping Giannini to rebuild Bank of America.¹⁹⁵ As in the case of Central Republic, the RFC determined that Bank of America's survival was crucial to the stability of the U.S. banking system. The RFC made US\$1.1 billion of loans to help banks between February 1932 and March 1933. Of that amount, US\$155 million, or 14 percent, was devoted to the support of Central Republic and Bank of America.¹⁹⁶

Major Bank Failures in Detroit and Cleveland in 1933

During the late 1920s, two major bank holding companies were created in Michigan through a series of mergers and acquisitions—the Detroit Bankers Company (Detroit Bankers) and the Guardian Detroit Union Group (Guardian). By 1931, both groups owned banks throughout the state of Michigan and controlled three-fifths of the banking resources in Detroit and the state as a whole. Detroit Bankers and Guardian flourished during the economic boom experienced by Detroit and Michigan during the 1920s, as a result of the automotive industry’s rapid expansion. Both organizations made large amounts of residential and commercial real estate loans. In addition, both companies established securities affiliates, which invested in the stocks of their parent holding companies and in other securities. Both groups also made security loans to finance investments by their officers, directors, and other persons in the groups’ holding company stocks and other stocks.¹⁹⁷

Both Detroit Bankers and Guardian were in serious trouble by 1932. Domestic production of automobiles, which was heavily concentrated in the area around Detroit, fell by three-quarters between 1929 and 1932. Detroit’s economy was devastated by a drastic decline in economic activity and high unemployment caused by the automotive industry’s severe slump.¹⁹⁸ By the end of 1932, property values in Detroit had fallen by nearly half, and there were no buyers to whom the banks could sell their foreclosed real estate. The two Detroit banking groups experienced cascading defaults on their real estate mortgages. About a third of Guardian’s total assets were committed to real estate loans or investments in real estate, while real estate commitments represented about 40 percent of the banking assets of Detroit Bankers.¹⁹⁹

Both banking groups also suffered heavy losses from their securities activities. The Guardian banks held large amounts of the holding company’s stock as collateral for loans, and the value of that stock plummeted from US\$350 to US\$5.50 per share by May 1932. In addition, the holding company, supported by its largest bank and major shareholders, obtained US\$7 million of loans from New York banks to enable its securities affiliates to carry depreciated securities in their inventories. A Guardian executive later acknowledged that one of Guardian’s securities affiliates inflicted “several millions” of losses

on the group.²⁰⁰ Similarly, by 1932 the largest bank in the Detroit Bankers group held US\$25 million of loans collateralized by the holding company's stock, which had fallen in value from US\$300 to US\$9 per share. From 1931 to 1932, Detroit Bankers incurred losses of at least US\$29 million on securities investments.²⁰¹

Guardian asked for the RFC's assistance in 1932, and the RFC provided an US\$8.7 million loan. In January 1933, Guardian asked for an additional US\$50 million to save itself from imminent collapse. However, the RFC determined that Guardian's available assets could only support a loan of US\$37 million. In a desperate effort to arrange a rescue package, the RFC and the Hoover Administration urged Henry Ford, Guardian's largest shareholder, to subordinate his deposits in Guardian's banks. Ford refused, and he also threatened to withdraw his deposits from banks owned by Detroit Bankers, a step that would have ensured their demise. To avoid the simultaneous failure of Guardian and Detroit Bankers, Michigan's governor declared a statewide bank holiday on February 14, 1933. Both banking groups were placed in receivership and were too weak to be reopened after the national bank holiday ended in March. With the help of the RFC, Ford and General Motors took the lead in organizing and capitalizing two new banks to serve the Detroit area.²⁰²

The Michigan bank holiday had a devastating effect on public confidence in banks across the country. For the first time, the RFC had failed in its efforts to rescue major urban banks that were considered essential to the stability of the banking system. Almost immediately, the two largest banking groups in Cleveland—the Union Trust Company (Union Trust) and the Guardian Trust Company (Guardian Trust)—suffered heavy deposit withdrawals.²⁰³ Similar to the big Detroit banks, Union Trust and Guardian Trust had grown rapidly during the 1920s and were heavily engaged in real estate lending and real estate investments. In addition, by 1933 the two groups held a total of US\$25 million of unpaid loans extended to the insolvent empires of Cyrus Eaton and the Van Sweringen brothers.²⁰⁴

Union Trust and Guardian Trust also resembled the Detroit banks in their extensive involvement in securities investment and trading activities. By 1932, Union Trust and Guardian Trust had incurred losses of US\$16.4 million and US\$6.6 million, respectively, from depreciation in their securities portfolios. Both groups included secu-

curities affiliates. Guardian Trust's securities affiliate was relatively small, but Union Trust's affiliate was a major regional distributor of securities. By 1933, the net worth of both affiliates was essentially zero, and together they owed about US\$5 million to their parent holding companies.²⁰⁵

The RFC extended about US\$30 million of loans to Union Trust and Guardian Trust in 1932, but the Cleveland banks were too deeply insolvent to be saved in 1933.²⁰⁶ On February 27, the Ohio legislature authorized all Ohio banks to impose stringent limits on deposit withdrawals. Those restrictions were immediately applied by the Cleveland banks. By March 4, every other state had followed Michigan and Ohio in declaring some type of bank holiday or other restriction on deposit withdrawals. Following the national bank holiday, Union Trust and Guardian Trust were liquidated. Many of their deposits were transferred to other Cleveland banks, which reopened with RFC assistance.²⁰⁷

Large Losses at Other Major Banks with Securities Affiliates

As shown above, the failures of several large banking organizations with extensive securities activities played key roles in the progressive collapse of the U.S. banking system from 1930 to 1933. In addition, three of the four banks with the largest securities affiliates in 1930—NCB, Chase, and Continental Illinois²⁰⁸—incurred heavy losses and experienced wrenching changes during the next few years. NCB's affiliate, NCC, suffered losses of US\$100 million during the period 1930 to 1933, including heavy losses on its equity investments. NCB was burdened with US\$80 million of frozen "bridge loans" extended to NCC clients in expectation of bond offerings that were never completed, as well as several million dollars of loans extended to NCB's officers to finance their purchases of NCB's stock. NCB recorded total losses of US\$170 million from 1930 to 1934, wiping out two-thirds of its shareholders' equity at the end of 1929.²⁰⁹

Chase's affiliate, CSC, wrote down its capital by US\$55 million during the period 1930 to 1933, reflecting heavy losses on its equity investments. Chase reported total losses of US\$130 million from 1930 to 1934, reducing its net worth at the end of 1929 by more than half. Many of Chase's losses resulted from (1) loans made to the Republic of Cuba to support CSC's underwriting of Cuban bonds, and

(2) loans and equity investments in support of General Theatres Equipment, a bankrupt company that had been a major client of CSC.²¹⁰

Continental Illinois suffered the worst losses in proportion to its capital, due in large part to its heavy involvement with Samuel Insull's utility system. Continental Illinois recorded US\$110 million of losses from 1932 to 1933. It was the first major bank to sell preferred stock to the RFC in connection with the recapitalization authority granted to the RFC under the Emergency Banking Act of 1933. Continental Illinois sold US\$50 million of preferred stock to the RFC and reduced its own common stock to US\$25 million, thereby recognizing that the RFC would hold the controlling interest in the bank. The RFC promptly designated a new chairman for Continental Illinois.²¹¹ NCB and Chase also each sold US\$50 million of preferred stock to the RFC in late 1933, a step that helped each of them to write off losses on depreciated investments and nonperforming loans.²¹²

The RFC bought more than US\$360 million of preferred stock from 40 of the 100 largest U.S. banks.²¹³ By the time the preferred stock program ended in 1935, the RFC had provided US\$1.3 billion of new capital to 6,800 banks. At that point, the RFC held one-third of all bank capital, and it was a stockholder in half of the nation's banks.²¹⁴ The magnitude of these figures indicates the weakness of the U.S. banking industry in 1933 and the strong need for government-sponsored recapitalization. The RFC staff determined that only 20 of the banks that sold preferred stock to the RFC had no real need for additional capital.²¹⁵ Together with the newly created program of federal deposit insurance, the RFC's preferred stock program played a key role in helping the banking system to recover after the national bank holiday.²¹⁶

Notwithstanding RFC help, the banks that had profited most from the boom years of the 1920s still bore painful scars from the Great Depression. In mid-1933, the stock prices for NCB, Chase, and Continental Illinois were all more than 90 percent below their peak 1929 values.²¹⁷ In sharp contrast to the 1920s, large banks no longer found it easy to raise new capital in the depressed securities markets of the early 1930s.²¹⁸ Responding to this "capital crunch," even the largest banks "scrambled to shed asset risk" by shifting from loans to highly

liquid assets like government securities and cash reserves.²¹⁹ The amount of outstanding bank loans fell almost in half from 1931 to 1935, while the percentage of bank funds invested in government securities nearly tripled during the period 1929 to 1934.²²⁰ Thus, the drought in new bank lending and the halting recovery of the nation's economy after 1933 can be attributed, at least in part, to the banks' desire to increase their liquidity and reduce their credit risk exposure, given the terrible losses they had suffered from 1930 to 1933.²²¹

Was Congress Correct in Believing That Securities Affiliates of Banks Were Linked to Conflicts of Interest and Other Abusive Practices?

Several modern scholars have contended that Congress in 1933 did not have solid evidence for its belief that securities affiliates of commercial banks had committed serious abuses. Those scholars have pursued two major lines of attack on the Glass-Steagall Act. First, in a series of studies, scholars have concluded that “on average, the [securities affiliates of] banks did not sell any worse securities than comparable investment banks.”²²² Second, George Benston has contended that the Pecora committee's investigation “reveals surprisingly little support for the charges of abuse” by NCB, Chase, and their securities affiliates. Benston concludes that “the record does not support the belief that the pre-Glass-Steagall period was one of abuses and conflicts of interest on the part of banks involved with securities transactions, either directly or through affiliates.”²²³

I intend to provide a more complete response to these findings in a future article, after I have completed a full review of the Pecora hearings. For purposes of the present discussion, I offer two preliminary comments. First, Congress's decision to adopt the Glass-Steagall Act was not premised on the view that the underwriting record of commercial banks was worse than the underwriting performance of investment banks. Instead, Congress concluded that the involvement of commercial banks in securities underwriting was dangerous because (1) it compromised the banks' ability to act as impartial allocators of credit and as objective providers of investment advice, and (2) it created a hypercompetitive underwriting market that encouraged both commercial and investment banks to promote speculative, high-risk issues. Second, a number of scholars have concluded, in

contrast to Benston, that the Pecora committee did uncover substantial evidence of abusive conduct by NCB and Chase, the two largest commercial banks with the two most important securities affiliates.

The Comparative Underwriting Performance of Commercial Bank Affiliates and Traditional Investment Banks

A number of scholars have examined the comparative underwriting record of commercial bank affiliates and traditional investment banks during the 1920s. Two early studies concluded that the performance of securities underwritten by commercial bank affiliates, in terms of default history and stability of market price, was about the same as the record for securities underwritten by traditional investment banks.²²⁴ Using regression analysis, three modern studies found that securities underwritten by commercial bank affiliates generally performed better than securities underwritten by investment banks.²²⁵ However, two of those studies determined that commercial bank affiliates underwrote higher-quality securities. In this regard, the bonds underwritten by bank affiliates (1) were typically issued in bigger amounts by larger and more seasoned issuers and (2) carried lower yields (i.e., higher prices to investors). Thus, the superior performance of bonds underwritten by commercial bank affiliates was consistent with the fact that those bonds exhibited lower risk and “were priced higher” at the time of their issuance.²²⁶ Bank affiliates were involved in syndicated offerings that typically included a larger number of underwriters, thereby indicating that bank affiliates were chosen for their “large distribution networks that [could] provide a comparative advantage in handling large, syndicated issues.”²²⁷

The foregoing studies indicate that the underwriting performance of commercial bank affiliates was generally comparable to the record for traditional investment banks, after taking account of the higher quality of bonds underwritten by the bank affiliates. However, two of the studies also identified outliers in the bank affiliate and investment bank groups. One study found that bonds underwritten by J.P. Morgan and Kuhn, Loeb, the leading private investment banks, compiled the best default performance among all underwriters for bonds issued during the period 1926 to 1930.²²⁸ In contrast, bonds underwritten by NCB and Chase, the two largest banks with the two most important securities affiliates, posted a default record that was inferior to the performance of bonds underwritten by other bank

affiliates and, in one study, was also worse than the performance of bonds underwritten by investment banks.²²⁹ In addition, the stock prices of NYSE-listed companies that issued bonds underwritten by NCB and Chase performed “somewhat more poorly” than NYSE-listed companies that issued bonds underwritten by other underwriters.²³⁰ Thus, the two commercial bank affiliates that were most prominent in the securities business, and that received the greatest scrutiny during the Pecora hearings, produced the worst overall record among bank affiliates.

Although the foregoing studies provide important data regarding the comparative underwriting performance of bank affiliates and investment banks, they do not respond to the core concerns of Congress in 1933. Congress did not enact the Glass-Steagall Act because it thought that commercial bank affiliates were more unscrupulous or less competent than traditional investment banks. Instead, Congress concluded that the involvement of commercial banks in securities underwriting was dangerous because (1) it promoted excessive competition within the underwriting business and encouraged *both* commercial banks and investment banks to abandon prudential standards and promote speculative, unsound issues, and (2) it undermined the ability of commercial banks to act as impartial allocators of credit and objective providers of investment advice. In addition, Congress determined that it was hazardous to link the lending capacity of deposit-taking banks with the placing power of securities underwriters. In Congress’s view, the linkage of the two activities had produced a financing surge that led to speculative overinvestment during the period 1924 to 1929 and economic catastrophe during the period 1930 to 1933. Accordingly, the Glass-Steagall Act was motivated by Congress’s desire to prevent excessive speculation in the financial markets that could spill over into the general economy. Congress believed that the removal of deposit-taking banks from the securities underwriting business was a prophylactic measure needed to accomplish its anti-speculative purpose.²³¹

During its deliberations on the Glass-Steagall Act, Congress did not focus on the comparative underwriting performance of commercial bank affiliates and investment banks because that comparison was not pertinent to its central objective. As indicated above, Congress clearly believed that investment banks engaged in abusive prac-

tices and promoted the sale of highly speculative securities (especially those issued by foreign governments, investment trusts, and utility holding companies) during the 1920s.²³² Congress's investigation of investment banks provided the impetus for several statutes designed to regulate the conduct of firms that issue and underwrite securities, including the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, and the Investment Company Act of 1940.²³³ Congress determined that its anti-speculative purpose could be accomplished by restricting the lending power of investment banks. Congress adopted Section 21 of the Glass-Steagall Act to prohibit investment banks from accepting deposits, thereby severing underwriters of securities from a major funding source.²³⁴ In contrast, Congress did not see any reliable means, short of strict separation, for keeping commercial banks from using their deposit-based lending capacity to promote speculative and destructive behavior in the securities markets.²³⁵

The Pecora Committee's Evidentiary Record

The hearing transcripts and summary report produced by the Pecora committee during its investigation of 1933–34 are the primary sources of evidence relating to allegations of conflicts of interest and other abusive practices involving securities affiliates of commercial banks.²³⁶ After reviewing those materials, George Benston concluded that the Pecora committee's investigation produced "very little evidence" of the alleged abuses.²³⁷ Relying in part on Benston's work, Raghuram Rajan and Luigi Zingales similarly contend that "there is little evidence of the purported abuses in the specific cases examined by the Pecora Committee."²³⁸ The conclusions of Benston, Rajan, and Zingales differ from the views of earlier scholars who reviewed the records of the Pecora investigation. I will not attempt to resolve this scholarly disagreement in this chapter. However, I intend to present my own evaluation of the Pecora hearings in a future article. For present purposes, I will provide a brief overview of the findings of scholars who have disagreed with Benston, Rajan, and Zingales.

Prior to Benston, W. Nelson Peach provided the most extensive analysis of the Pecora hearings. As Peach noted, the hearings focused particularly on NCB, Chase, and their securities affiliates (NCC and CSC). Peach determined that the Pecora investigation produced evidence of "[a] great many abuses and defects ... in connection with the

operation of security affiliates by national banks.”²³⁹ Peach grouped those alleged abuses into four general categories: (1) the sale of “unsound and speculative securities,” accompanied by prospectuses that contained “untruthful and misleading information”; (2) “pool operations” that manipulated the stock prices of industrial corporations and the affiliates’ parent banks; (3) “the use of affiliates for the personal profit of officers of banks and affiliates”; and (4) “the mixing of commercial and investment banking functions.”²⁴⁰ Subsequent scholars have agreed with Peach that the Pecora investigation provided substantial support for all of these allegations.

Regarding the first alleged abuse, Peach focused on the sale of foreign bonds, many of which had defaulted by the time of the Pecora investigation. Peach and subsequent scholars determined that commercial bank affiliates and traditional investment banks had been “indiscriminate” in underwriting speculative issues of foreign bonds, due to the lucrative fees that could be earned from that business. Peach and others charged that bank affiliates and investment banks sold foreign bonds to unsophisticated investors without disclosure of their inherent risks.²⁴¹ In concluding that bank affiliates sold foreign bonds while disregarding known risks, Peach and other scholars cited NCC’s decision to underwrite bonds issued by the Republic of Peru and the Brazilian state of Minas Gerais despite reports from NCC’s agents indicating that neither government would be able to repay its debts.²⁴²

Concerning the second alleged abuse, Peach and other scholars cited stock pool operations, in which NCC and CSC participated, that manipulated the stock prices of several major U.S. corporations. In addition, NCC and CSC helped to distribute shares of the same companies to public investors while their pool operations were artificially supporting the market price. Similarly, NCC and CSC maintained almost continuous pools to boost the stock prices for their parent banks while they actively promoted the distribution of those stocks to public investors.²⁴³

I will not recount Peach’s analysis of alleged abuses by officers of NCC and CSC, since those abuses were arguably the acts of rogue agents rather than conflicts of interest inherent in the bank-affiliate system.²⁴⁴ In addressing the fourth alleged abuse, Peach concentrated

on financial arrangements between banks and their securities affiliates. In one case, NCB transferred to NCC US\$25 million in defaulted Cuban sugar loans, which bank examiners had criticized. NCB accomplished this transfer by selling US\$50 million of its stock and using the proceeds to increase the capital stock of NCB and NCC by US\$25 million each. NCC transferred the US\$25 million it received to a subsidiary, which paid the same US\$25 million to NCB to buy the defaulted loans. NCC later wrote down the value of its subsidiary to US\$1. In practical effect, NCB had used NCC as a dumping ground for its bad loans and as camouflage to prevent its shareholders from realizing that proceeds of NCB's stock sale were being used to write off the loans.²⁴⁵

In a second case, Chase provided more than US\$10 million of loans to support a public offering of US\$40 million of Cuban bonds by CSC and other underwriters at a time when Cuba was highly unlikely to repay either the loans or the bonds.²⁴⁶ As noted above, Chase also lost US\$70 million on equity investments and loans it made to support CSC's underwriting activities for General Theatres Equipment, which declared bankruptcy in 1932.²⁴⁷ NCB suffered losses on US\$80 million of bridge loans it extended to clients of NCC in connection with bond offerings that could not be completed.²⁴⁸ In addition, unsound loans and investments made by banks to support the activities of securities affiliates were prominent features in the failures of CAC, BUS, and Central Republic.²⁴⁹ As Peach explained, the symbiotic relationship between banks and their securities affiliates grew out of their deliberate decision to market themselves as unified, full-service organizations. Peach concluded that Congress could not have enacted legislation to prevent banks from supporting their affiliates without destroying the business plan on which they had operated during the 1920s:

Affiliates and banks were legally separate corporations. In practice, however, they were parts of the same organization ... providing their customers with complete financial facilities under one roof. The close relationship between banks and affiliates was intentionally fostered, and it was due to their ability to convince the investing public that bank and affiliate were part of the same organization that affiliates were able to sell such a large volume of securities during the twenties. Since, when the securities were sold, the public had

been persuaded that bank and affiliate were parts of the same organization, the bank could not escape responsibility for the activities of its affiliate when the securities began to decline in value after the stock market crisis of 1929. It became necessary for banks to assist their affiliates because they were aware that any diminution in the good will of their affiliates would bring with it a corresponding diminution in their own. This is the chief difficulty in the affiliate system. ... Any legislation which sought to prevent such relationships and the advantages arising from them would automatically destroy the basis on which the affiliate system was established.²⁵⁰

The most prominent example of Peach's thesis was NCB. By 1929, NCB was a "global, all-purpose financial intermediary [that] provided corporations, households, and governments with commercial banking, investment banking, and trust services."²⁵¹ NCB and its affiliates operated as a single enterprise that worked together to "tailor financial packages to the customer's requirements."²⁵² Accordingly, the concept of an integrated, full-service financial intermediary was "the rationale underpinning National City's comprehensive strategy."²⁵³ Charles Mitchell publicly embraced this strategy when he declared that NCB's goal was to give its clients "a complete banking and investment and trust service. ... Now, if those businesses can be done by a single organization it is very much the better. ... Those are all functions which the average client likes to conduct under one roof, so to speak."²⁵⁴ As the conduct of NCB, Chase, and other banks demonstrated, the 1920s concept of full-service department store banking strongly encouraged commercial banks to support their securities affiliates whenever the affiliates encountered serious problems.²⁵⁵

The abuses catalogued by Peach, particularly those dealing with the use of bank resources to support securities affiliates, appear to be substantial and warrant further analysis of the evidence produced by the Pecora investigation. Peach's doubts about the wisdom of allowing banks to combine lending, securities investments, securities underwriting, and investment advice are similar to current concerns about the highly integrated nature of today's financial conglomerates. For the same reasons voiced by Charles Mitchell, financial conglomerates currently seek to create synergies by marketing their services under a unified brand and by presenting themselves to customers as a

single enterprise offering “one-stop shopping.” Moreover, these institutions routinely offer package deals that combine lending and securities underwriting services for corporate clients. The close relationships among affiliated subsidiaries within a financial conglomerate make it unlikely that structural firewalls will be able to prevent serious problems in one subsidiary from endangering the entire organization.²⁵⁶ Accordingly, a careful review of the Pecora committee’s investigation of NCB, Chase, and other universal banks of the 1920s may shed useful light on the potential risks of today’s financial conglomerates.

Conclusions and Directions for Further Research

Carter Glass, Henry Steagall, and their supporters offered a critique of universal banking that was more persuasive than their modern critics have acknowledged. In Congress’s view, universal banks helped to foster a speculative boom from 1924 to 1929 that produced high-risk investments, hazardous debt burdens, and overextended real estate and industrial sectors, all of which contributed to the economic bust of 1930–33. Congress also determined that problems created by universal banks were important factors in the progressive collapse of the banking system during the period 1930–33. Congress placed much of the blame for the Great Depression on policy mistakes made by the Federal Reserve System from 1924 to 1933. However, Congress believed that universal banks helped to lay the foundation for the economic calamity that occurred during the early 1930s.

Based on the analysis set forth above, I have reached the following tentative conclusions regarding the claims made by Glass and his supporters in 1931–33. First, universal banks contributed to the extraordinary economic boom of 1924–29 by significantly expanding their involvement in five separate financing channels—loans on securities, securities investments, public offerings of securities, real estate mortgages, and consumer credit. Second, the large-scale entry of commercial banks into the securities markets created competitive pressures that caused commercial bank affiliates and traditional investment banks to abandon prudential standards and promote highly speculative domestic and foreign ventures. Third, the financing surge of the 1920s produced unsustainable asset booms in both the real estate and securities markets. It also left the consumer and business sec-

tors in a highly fragile condition at the end of 1929, due to their heavy debt burdens and risky investments.

Fourth, universal banks also contributed significantly to banking problems during the period 1930–33. The largest universal banks, which were also money center banks, undermined the soundness of smaller correspondent banks by encouraging them to purchase high-risk securities during the 1920s. Losses on securities proved to be a major cause of bank failures during the 1930s. In addition, several large universal banks failed in 1930, 1932, and 1933. Those failures triggered regional banking panics and also caused a widespread loss of depositor confidence in the banking system. Other universal banks avoided failure only because they received timely assistance from the RFC. Failures or near-failures of universal banks typically resulted from decisions by bankers to make risky investments and loans to support their own stock prices and to prop up affiliates and customers of those affiliates.

The experience of the U.S. banking industry from 1921 to 1933 raises provocative questions about the possible linkages between financial liberalization, broader powers for banks, asset booms, banking crises, and economic depressions. The evidence reviewed above suggests a clear connection between the liberalization of bank powers after 1910 and the tremendous expansion of financing for consumers and business firms after 1920. The financing surge of the 1920s coincided with extraordinary asset booms in the real estate and securities markets, and with rapid growth in business facilities and inventories. When the easy availability of credit and equity financing ended in 1929, the asset booms collapsed, followed quickly by sharp declines in consumer demand and industrial production. Within a year after the collapse of the asset booms, serious banking problems began to emerge. Were all of these events causally related?

In searching for answers to this question, scholars have reviewed the experiences of other nations during the 1920s and 1930s. Scholars have found that nations with prominent universal banks (e.g., Austria, Belgium, France, Italy, and Germany) experienced severe banking crises because their banks were weakened by close linkages with troubled industries. In contrast, nations with specialized banks that were barred from engaging in securities dealing or underwriting (e.g., Canada and the United Kingdom) survived the 1930s without a major

banking crisis. In addition, the presence of effective lenders of last resort in Canada and the United Kingdom helped to stabilize their banking systems.²⁵⁷

A particularly interesting contrast can be drawn between the experiences of the United Kingdom and the United States during this period. The narrow powers, oligopolistic structure, and conservatism of major U.K. banks during the 1920s contrasted sharply with the broad powers, competitiveness, and aggressive policies of leading U.S. banks. The United Kingdom experienced no boom during the 1920s but also avoided any banking crisis or severe economic slump during the 1930s. Does the U.K. experience suggest that countries that forgo financial liberalization can avoid the threat of a boom-and-bust cycle but must assume the risks of economic stagnation? Many British leaders were unhappy with the performance of the U.K. banking industry during the 1920s. Indeed, the 1931 report of the Macmillan Committee on Finance and Industry called upon Parliament to allow U.K. banks to enter the securities markets, as U.S. banks had done during the 1920s.²⁵⁸ Of course, the Macmillan report was issued *before* the magnitude of the U.S. banking crisis became evident.

The experience of Japan since 1985 presents another instructive case study, which includes a number of features similar to the U.S. experience of 1921–33. Japan's government gradually deregulated its financial markets and followed a liberal monetary policy during the second half of the 1980s. During that period, Japan's economy benefited from a rapid growth in financing through increased bank lending and the issuance of new securities. The government allowed Japanese corporations to secure cheaper credit through increased access to the Japanese bond market and the Eurobond market. Because large Japanese corporations cut their demand for bank loans, Japanese banks eagerly expanded their involvement in real estate lending. Japanese banks were not allowed to engage in securities underwriting, but they were permitted to own corporate stocks. During the 1980s, Japanese banks built up huge portfolios of corporate shares to profit from the booming stock market and also to maintain strong cross-shareholding relationships with nonbank firms in the banks' respective corporate groups (*keiretsu*). Japanese regulators and the Basel Capital Accord of 1988 encouraged these stock investments by allowing Japanese banks

to rely on unrealized capital gains from their stock portfolios to satisfy a significant portion of their capital requirements.

The rapid expansion of securities issuances, securities investments, and bank loans produced a “bubble economy” in Japan during the late 1980s, as reflected in dramatic booms in the real estate and securities markets. Given the abundant sources of new financing, Japanese firms greatly increased their investments in production facilities, equipment, and real estate projects. In an effort to restrain the “bubble economy,” the Bank of Japan tightened its monetary policy significantly in 1990. The Bank of Japan’s restrictive monetary regime triggered a progressive collapse of both the securities and real estate markets. Japanese banks cut back on their lending, because they were burdened with severely depreciated stock portfolios and an estimated US\$1 trillion in nonperforming loans. The reluctance of Japanese banks to make new loans produced a severe “credit crunch” that lasted from the mid-1990s through 2004. Industrial production and consumer spending declined sharply during the 1990s, resulting in a prolonged economic slump. Despite more than US\$1 trillion of government stimulus programs and another US\$200 billion of government assistance for banks, the Japanese economy stagnated and several leading banks, securities firms, and insurance companies failed. Other major financial institutions survived only through government-supported mergers. Only in 2005 did analysts glimpse the beginning of a sustained recovery in the Japanese economy and banking system. As in the case of the worldwide Great Depression of the 1930s, analysts have studied the Japanese crisis to find clues to the apparent connections between financial liberalization, asset booms, and increased risks for systemic banking and economic crises.²⁵⁹

Finally, one might ask whether dangerous asset booms are more likely to occur during periods when major financial institutions face intense competitive pressures and also have a greater ability to exploit conflicts of interest. The concerns expressed by Congress in 1933 about universal banking powers—particularly with regard to conflicts of interest and links between lending and securities underwriting—have already been echoed by some commentators on the collapse of Enron and WorldCom and other financial scandals during the U.S. boom-and-bust cycle of 1994–2002.²⁶⁰ I intend to examine those

scandals in a forthcoming article and to evaluate whether reforms are needed in the supervision of financial conglomerates.

Notes

¹ The terms “bank” and “banking organization,” as used herein, include chartered banks, bank holding companies, and subsidiaries or affiliates thereof, unless the context indicates otherwise.

² Michael D. Bordo and David C. Wheelock, “Monetary Policy and Asset Prices: A Look Back at Past U.S. Stock Market Booms,” 86(6) *Review* (Federal Reserve Bank of St. Louis), at 24–25 (quote), 34–40 (November/December 2004); Robert Shiller, *Irrational Exuberance* 4–9 (Princeton, N.J.: Princeton University Press, 2000).

³ Barrie A. Wigmore, *The Crash and Its Aftermath: A History of the Securities Markets in the United States, 1929–1933*, at 640–43 (tbl. A.20) (Westport, Conn.: Greenwood Press, 1985).

⁴ E.S. Browing, “Year-End Review of Markets & Finance 2002: Investors Seek Ray of Hope,” *Wall Street Journal* (January 2, 2003), at R1.

⁵ See Arthur E. Wilmarth, Jr., “The Transformation of the U.S. Financial Services Industry, 1975–2000: Competition, Consolidation, and Increased Risks,” 2002(2) *University of Illinois Law Review* 215 [hereinafter Wilmarth, “Transformation”], at 223 n.23 (describing a “universal bank” as an organization that can engage, directly or through affiliates, in all aspects of the banking, securities, and life insurance businesses).

⁶ Act of June 16, 1933, c. 89, 48 Stat. 162.

⁷ See *infra* note 61 and accompanying text (discussing the strategy of “department store banking” employed by large banks that operated securities affiliates during the 1920s).

⁸ Sections 20 and 32 of the Glass-Steagall Act prohibited banks from either (1) affiliating with securities firms, or (2) sharing directors, officers, or employees with securities firms. Act of June 16, 1933, c. 89, §§ 20 and 32, 48 Stat. 188, 194. Sections 5(c) and 16 of the Act barred member banks of the Federal Reserve System from underwriting or dealing in securities (except for “bank-eligible” securities such as U.S. government securities), and Section 21 forbade securities firms from accepting deposits. *Id.* §§ 5(c), 16 and 21, 48 Stat. 165, 184, 189. For discussions of these provisions, see, for example, Melanie L. Fein, *Securities Activities of Banks* §§ 1.02 and 4.03 (New York: Aspen Publishers, 3rd ed. 2005); Patricia A. McCoy, *Banking Law Manual* § 7.01 and 7.02[1] (Newark, N.J.: LexisNexis Group, 2nd ed. 2004).

⁹ Fein, *supra* note 8, §§ 1.03–1.06 and 4.03; McCoy, *supra* note 8, §§ 7.01–7.03 and 7.04[1]; Wilmarth, “Transformation,” *supra* note 5, at 219–22, 306–07, 318–21.

¹⁰ Act of November 12, 1999, Pub. L. No. 106-102, 113 Stat. 1338.

¹¹ *Id.* §§ 101 and 103, 113 Stat. 1341, 1342. GLBA also permits banks to establish financial subsidiaries. Financial subsidiaries may conduct securities underwriting and dealing and insurance agency activities, but they may not engage in insurance underwriting. *Id.* § 121, 113 Stat. 1373. GLBA did not repeal Sections 5(c), 16, and 21 of the Glass-Steagall Act. Accordingly, while banks and securities firms may affiliate with each other, banks may not engage directly in securities underwriting and dealing activities, and securities firms may not engage directly in a deposit-taking business. For general overviews of GLBA and the surviving provisions of the Glass-Steagall Act, see, for example, Fein, *supra* note 8, §§ 1.07, 2.01, 2.02[E][6], 3.01 and 4.03; McCoy, *supra* note 8, ch. 7.

¹² H.R. Rep. No. 106–74 (pt.1), at 97–98 (1999); S. Rep. No. 106–44, at 3–6; *see also id.* at 5 (quoting Federal Reserve Board Chairman Allan Greenspan’s statement that “archaic statutory barriers to efficiency could undermine the competitiveness of our financial institutions, their ability to innovate and to provide the best and broadest possible services to U.S. consumers, and, ultimately, the global dominance of American finance”).

¹³ 145 Cong. Rec. S13913 (daily ed., November 4, 1999) (remarks of Sen. Gramm). Not all of GLBA’s proponents agreed with Senator Gramm. Some GLBA supporters indicated that the Glass-Steagall Act’s separation of commercial and investment banking served a beneficial purpose in the 1930s, but was no longer viable in light of changed conditions in the financial services marketplace. *See id.* at S13886 (remarks of Sen. Dodd); *id.* at 13890 (remarks of Sen. Bryan); *id.* at 13895 (remarks of Sen. Leahy).

¹⁴ James A. Fanto, “Subtle Hazards Revisited: The Corruption of a Financial Holding Company by a Corporate Client’s Inner Circle,” 70 *Brooklyn Law Review* 7, at 13 (2004).

¹⁵ For discussions of the involvement of universal banks in the Enron and WorldCom scandals, see, for example, Fanto, *supra* note 14, at 18–28; Fein, *supra* note 8, §§ 3.05[G][22], [23], and [27]; Hillary A. Sale, “Banks, the Forgotten (?) Partners in Fraud,” University of Iowa Legal Studies Research Paper No. 05-09, January 2005, <http://ssrn.com/abstract=673509>; Arthur E. Wilmarth, Jr., “Does Financial Liberalization Increase the Likelihood of a Systemic Banking Crisis? Evidence from the Past Three Decades and the Great Depression,” in Benton E. Gup, ed., *Too Big to Fail: Policies and Practices in Government Bailouts* 77 (Westport, Conn.: Praeger Publishers,

2004) [hereinafter Wilmarth, “Financial Liberalization”], at 85; *In re Enron Corp. Securities, Derivative & ERISA Litigation*, 235 F. Supp. 2d 549, 637–56, 695–704, 708 (S.D. Texas 2002); *In re WorldCom, Inc. Securities Litigation*, 346 F. Supp. 2d 628, 636, 645–55, 678–98 (S.D.N.Y. 2004); Third Report of Neal Batson, Court-Appointed Examiner, *In re Enron Corp.*, Case No. 01–16034 (AJG) (Bkrcty. S.D.N.Y., filed June 30, 2003), at 34–81; Final Report of Neal Batson, Court-Appointed Examiner, *In re Enron Corp.*, Case No. 01–16034 (AJG) (Bkrcty. S.D.N.Y., filed November 4, 2003), at 63–81, 101–04; Third and Final Report of Dick Thornburgh, Bankruptcy Court Examiner, *In re WorldCom, Inc.*, Case No. 02–13533 (AGC) (Bkrcty. S.D.N.Y., filed January 26, 2004), at 14–17, 112–218.

¹⁶ Guido A. Ferrarini and Paolo Giudici, “Financial Scandals and the Role of Private Enforcement: The Parmalat Case,” European Corporate Governance Institute Law Working Paper No. 40/2005, May 2005, <http://ssrn.com/abstract=730403>, at 11–12, 15–16, 37–38; David Reilly et al., “Parmalat Sues Bank of America Corp.,” *Wall Street Journal* (October 8, 2004), at A3; David Reilly and Alessandra Galloni, “Spilling Over: Top Banks Come Under Scrutiny for Role in Parmalat Scandal,” *Wall Street Journal* (September 28, 2004), at A1.

¹⁷ Fein, *supra* note 8, § 3.05[G][21]; Christine Hurt, “Moral Hazard and the Initial Public Offering,” 26 *Cardozo Law Review* 711, at 755–58, 783–84 (2005); Sale, *supra* note 15, at 39–40; Arthur E. Wilmarth, Jr., “The OCC’s Preemption Rules Exceed the Agency’s Authority and Present a Serious Threat to the Dual Banking System and Consumer Protection,” 23 *Annual Review of Banking and Financial Law* 244, at 348–49 (2004) [hereinafter Wilmarth, “OCC’s Preemption Rules”].

¹⁸ Fein, *supra* note 8, §§ 3.05 [G][18], [20], and [25]; Sean J. Griffin, “A Legal and Economic Analysis of the Preferential Allocation of Shares in Initial Public Offerings,” 69 *Brooklyn Law Review* 583, 592–96 (2004); Hurt, *supra* note 17, at 733–55.

¹⁹ Fein, *supra* note 8, §§ 3.05[G][28], [29] and [37]; Paul G. Mahoney, “Manager-Investor Conflicts in Mutual Funds,” 18(2) *Journal of Economic Perspectives* (Spring 2004), at 161, 173–77; James B. McCallum, “Mutual Fund Market Timing: A Tale of Systemic Abuse and Executive Malfeasance,” 12 *Journal of Financial Regulation and Compliance* 170 (2004); Wilmarth, “OCC’s Preemption Rules,” *supra* note 17, at 349–51; “Mutual Funds: CIBC Subsidiaries Agree to Pay US\$125M for Alleged Facilitation of Trading Abuses,” 37 *Securities Regulation & Law Report* 1250 (2005) [hereinafter CIBC Pays].

²⁰ Randall Smith, “CIBC to Pay \$2.4 Billion over Enron,” *Wall Street Journal* (August 3, 2005), at A3 (incl. “Settling for More” tbl.); Tamsin Carlisle and Ann Davis, “CIBC’s Penalty for Enron Role Is US\$80 Million,” *Wall Street Journal* (December 23, 2003), at C1.

²¹ David Boraks, “Will Regulatory Woes Produce Any Changes?” *American Banker* (December 27, 2004), at 1; Robin Sidel, “J.P. Morgan to Pay US\$2 Billion as Street’s Bill for Bubble Soars,” *Wall Street Journal* (March 17, 2005), at A1; CIBC Pays, *supra* note 19.

²² See, e.g., Roger Lowenstein, *Origins of the Crash: The Great Bubble and Its Undoing*, at 97, 154–55, 174–75, 212–13 (New York: Penguin Press, 2004); Joseph Steiglitz, *The Roaring Nineties: A New History of the World’s Most Prosperous Decade*, at 87–88, 140–69, 348 n.12 (New York: W.W. Norton & Co., 2003); Robert Kuttner, “No Sainthood for Greenspan,” *Business Week* (August 1, 2005), at 106; Kevin Phillips, “How Wealth Defines Power: The Politics of the New Gilded Age,” *American Prospect* (May 2003), at A8; Eliot Spitzer and Andrew G. Celli, Jr., “Bull Run,” *New Republic* (March 22, 2004), at 18. See also Jacob M. Schlesinger, “What’s Wrong? The Deregulators: Did Washington Help Set Stage for Current Business Turmoil?” *Wall Street Journal* (October 17, 2002), at A1 (citing former Federal Reserve Board Chairman Paul Volcker’s belief that “the changes to Glass-Steagall, though inevitable, came without sufficient deliberation by policymakers”; previously, Volcker had opposed the Board’s 1987 decision to begin relaxing Glass-Steagall’s restrictions on bank underwriting of securities because he believed that the move “posed dangers” to both banks and their customers).

²³ Wilmarth, “Transformation,” *supra* note 5, at 220–22, 318–26, 332–38, 378–81.

²⁴ See *supra* note 8 and accompanying text.

²⁵ For discussions of the “real bills doctrine” followed by Glass, Willis, and other policymakers (including Adolph Miller, an economist who was an influential member of the Federal Reserve Board from its establishment in 1914 through 1936), see, for example, Milton Friedman and Anna J. Schwartz, *A Monetary History of the United States, 1867–1960*, at 169, 191–93, 252–54, 407–11 (Princeton, N.J.: Princeton University Press, 1963); Allan H. Meltzer, *A History of the Federal Reserve, Volume I, 1913–1951*, at 70–71, 73–74, 138–39, 154–65, 186–88, 192–97, 245–50, 274–82, 398–400, 409–13 (Chicago: University of Chicago Press, 2003); W. Nelson Peach, *The Securities Affiliates of National Banks*, at 9–12, 169, 177 (Baltimore: The Johns Hopkins Press, 1941); Edwin J. Perkins, “The Divorce of

Commercial and Investment Banking: A History,” 88 *Banking Law Journal* 483, at 501–503 (1971).

²⁶ 77 Cong. Rec. 3725–26 (1933) (remarks of Sen. Glass); S. Rep. No. 73–77, at 8 (1933).

²⁷ See, e.g., S. Rep. No. 73–77, at 3–10 (1933); 77 Cong. Rec. 3725–26 (remarks of Sen. Glass); *id.* at 3835 (remarks of Rep. Steagall); *id.* at 3907 (remarks of Rep. Koppelman); *id.* at 4027–28 (remarks of Rep. Fish); 75 Cong. Rec. 9883 (1932) (remarks of Sen. Glass and Sen. Watson); *id.* at 9904, 9906 (1932) (remarks of Sen. Walcott and Sen. Dickinson); *id.* at 9910–13 (remarks of Sen. Bulkley).

²⁸ *Id.* at 3835.

²⁹ 75 Cong. Rec. 9904–9905 (1932) (remarks of Sen. Walcott).

³⁰ 77 Cong. Rec. 4028 (1933). See also 75 Cong. Rec. 9888 (1932) (remarks of Sen. Glass, alleging that securities affiliates of banks “were perhaps the greatest contributors to the riot of credit and inflation in 1928–29, with result that the country is now almost in an irreparable condition”).

³¹ 75 Cong. Rec. 9911–13, 9914 (1932).

³² *Id.* at 9914; see also 77 Cong. Rec. 3907 (1933) (similar remarks by Rep. Koppelman).

³³ Operation of the National and Federal Reserve Banking Systems: Hearings on S. Res. 71 before a Subcommittee of the Senate Committee on Banking and Currency, 71st Cong., 3d Sess. [hereinafter 1931 Hearings], Part 7 (App.), at 1063.

³⁴ *Id.* at 1064. The report noted that a “large New York institution” evidently purchased US\$5 million of foreign bonds from its securities affiliate during 1930. *Id.*

³⁵ *Id.*

³⁶ *Id.*

³⁷ *Id.*

³⁸ *Id.* The report also noted that securities affiliates of banks “show a much greater tendency to operate with borrowed funds than do [securities firms] which are independent of banks, the reason being that the identity of control and management which prevails between the bank and its affiliate tends to encourage reliance upon the lending facilities of the former.” *Id.* at 1058. In a 1971 decision, the U.S. Supreme Court reviewed the actual and potential conflicts of interest described by Senator Bulkley and the 1931 Senate staff

report. The Court characterized those conflicts of interest as being the “subtle hazards that arise when a commercial bank ... enters the investment banking business either directly or by establishing an affiliate to hold and sell particular investments.” *Investment Co. Institute v. Camp*, 401 U.S. 617, at 630–34 (1971) (quote at 630).

³⁹ For references to the collapse of Caldwell and Company, see, for example 1931 Hearings, *supra* note 33, Part 1, at 5–6, 18–19; *id.*, Part 5, at 633–35 (reprint of 1931 examination report of National Bank of Kentucky by the Comptroller of the Currency); 75 Cong. Rec. 9890 (1932) (remarks of Sen. Glass). For references to the failure of Bank of United States, see, for example, 1931 Hearings, *supra* note 33, Part 1, at 10, 116–17; *id.*, Part 7, at 1018, 1058–59, 1068; 75 Cong. Rec. 9905 (1932) (remarks of Sen. Walcott).

⁴⁰ See *infra* notes 176–84 and accompanying text.

⁴¹ See 77 Cong. Rec. 3906 (1933) (remarks of Rep. Dingell); *id.* at 3940 (remarks of Rep. McGugin); *id.* at 4034–36 (remarks of Rep. Truax). See also *infra* notes 197–207 and accompanying text (discussing the failures of the Detroit and Cleveland banks).

⁴² Vincent P. Carosso, *Investment Banking in America: A History*, at 348–53, 368–71 (Cambridge, Mass.: Harvard University Press, 1970); Peach, *supra* note 25, at 153–59; Perkins, *supra* note 25, at 510–24 (quoting Glass’s speech and noting that “[i]t was generally agreed to have been one of the most effective speeches of the [1932] campaign,” *id.* at 518–19); H. Parker Willis and John M. Chapman, *The Banking Situation*, at 84–102 (New York: Columbia University Press, 1934).

⁴³ Peach, *supra* note 25, at 159. See also, e.g., 77 Cong. Rec. 3835 (1933) (remarks of Rep. Steagall, stating that the “Glass bill ... finally passed [the Senate] without serious opposition”); *id.* at 4033 (remarks of Rep. Steagall, stating that “[e]verybody now regards these regulatory provisions [requiring banks to divest their securities operations] as wise and constructive”).

⁴⁴ 77 Cong. Rec. 3725 (1933); see also *id.* at 3726 (remarks of Sen. Glass, alleging that bank securities affiliates “were the most unscrupulous contributors, next to the debauch of the New York Stock Exchange, to the financial catastrophe which visited this country and was mainly responsible for the depression under which we have been suffering since”).

⁴⁵ Perkins, *supra* note 25, at 500.

⁴⁶ Raymond W. Goldsmith [né Goldschmidt], *The Changing Structure of American Banking*, at 87–88, 293 (tbl. 6), 297 (tbl. 11) (London: George Routledge & Sons, 1933). See also Wigmore, *supra* note 3, at 27 (reporting that loans on securities by banks and brokers “represented 18 percent of the

value of all listed stocks [in October 1929], an enormous proportion to be held on credit”).

⁴⁷ Wilmarth, “Financial Liberalization,” *supra* note 15, at 88–89.

⁴⁸ Act of Feb. 25, 1927, c. 191, § 2(b), 44 Stat. 1226. For discussions of the securities activities of banks prior to the McFadden Act, see Carosso, *supra* note 42, at 98–100, 129–31; Peach, *supra* note 25, at 16–21, 39–45, 50–51; Perkins, *supra* note 25, at 486–89; Willis and Chapman, *supra* note 42, at 176–81, 188–93, 206–13, 536–37. Congress understood that the McFadden Act would ratify “the right of national banks to continue to engage in the business of buying and selling investment securities. ... [T]his is a business regularly carried on by State banks and trust companies and has been engaged in by national banks for a number of years.” H.R. Rep. No. 69–83, at 3–4 (1926); S. Rep. No. 69–473, at 7 (1926).

⁴⁹ Peach, *supra* note 25, at 9–12, 45–51; Willis and Chapman, *supra* note 42, at 176–77, 536–37.

⁵⁰ Carosso, *supra* note 42, at 97–98, 235–36, 271–79; Peach, *supra* note 25, at 38–66, 143–59; Perkins, *supra* note 25, at 489–96; Willis and Chapman, *supra* note 42, at 181–87. In 1932, Senate investigators discovered an unpublished opinion prepared in 1911 and sent by Solicitor General Frederick Lehmann to Attorney General Charles Wickersham. The opinion declared that securities affiliates were unlawful under the National Bank Act. However, Wickersham did not take any formal action in response to Lehmann’s opinion. Peach, *supra* note 25, at 144–48; Perkins, *supra* note 25, at 517. During Senate floor debates in 1932, Senator Glass alleged that Lehmann’s opinion “clearly discloses ... that the activities of these affiliates are not only disastrous, as we now witness, but that they are absolutely illegal.” 75 Cong. Rec. 9888 (1932); *see also id.* at 9899–9904 (reprinting Lehmann’s opinion); *id.* at 10069–70 (further remarks of Sen. Glass regarding the Lehmann opinion).

⁵¹ Carosso, *supra* note 42, at 224–29; Peach, *supra* note 25, at 31–33; Perkins, *supra* note 25, at 491.

⁵² Peach, *supra* note 25, at 32–33.

⁵³ Carosso, *supra* note 42, at 228 (quoting Mitchell’s article published in *The Magazine of Wall Street* on June 9, 1917); Joel Seligman, *The Transformation of Wall Street*, at 24–25 (Boston: Northeastern University Press, 1995, rev. ed.).

⁵⁴ Edward Chancellor, *Devil Take the Hindmost: A History of Financial Speculation*, at 192–94 (New York: Farrar, Straus & Giroux, 1999) (footnotes omitted). For another colorful description of the optimism and specula-

tive spirit that pervaded the 1920s, see John K. Galbraith, *The Great Crash, 1929*, at 6–21, 57–61, 79–86 (Boston: Houghton Mifflin Co., 3rd ed. 1972).

⁵⁵ Carosso, *supra* note 42, at 240–45, 249–51; Chancellor, *supra* note 54, at 194–207.

⁵⁶ Carosso, *supra* note 42, at 251 (quoting article by Barnard Powers published in the *Magazine of Wall Street* on April 26, 1924).

⁵⁷ Harold van B. Cleveland and Thomas F. Huertas, *Citibank, 1812–1970*, at 128, 140–41 (Cambridge, Mass.: Harvard University Press, 1985); Goldsmith, *supra* note 46, at 55, 60–67; Peach, *supra* note 25, at 22–27.

⁵⁸ Barry Eichengreen and Krus Mitchener, “The Great Depression as a Credit Boom Gone Wrong,” Bank for International Settlements Working Paper No. 137, September 2003, <http://www.bis.org>, at 15–26, 42–45; Robert A. Gordon, “Cyclical Experience in the Interwar Period: The Investment Boom of the Twenties,” in *Conference on Business Cycles*, at 163, 206–15 (New York: National Bureau of Economic Research, 1951); Charles P. Kindleberger, *The World in Depression, 1929–1939*, at 44–46, 53–54, 59–61 (Berkeley: University of California Press, 1986, rev. ed.); Lionel Robbins, *The Great Depression*, at 30–54 (London: Macmillan & Co., 1934).

⁵⁹ Carosso, *supra* note 42, at 250 (quoting Moody’s report of January 8, 1925).

⁶⁰ *Id.* at 240–45, 249–51, 273; Cleveland and Huertas, *supra* note 57, at 135–41; Goldsmith, *supra* note 46, at 64–66, 130–34; Peach, *supra* note 25, at 24–25, 36–37; Perkins, *supra* note 25, at 493.

⁶¹ Goldsmith, *supra* note 46, at 108, 126–39; Peach, *supra* note 25, at 28–31, 34–37, 71–72 (quote at 72); Perkins, *supra* note 25, at 488. *See also* Cleveland and Huertas, *supra* note 57, at 135 (explaining that “National City [Bank] ... wished to bring to each customer all things financial”); *id.* at 158 (quoting Charles Mitchell’s belief that “the trend [in banking] is always toward giving to a clientele a complete banking and investment and trust service”).

⁶² Peach, *supra* note 25, at 83 (tbl. II).

⁶³ *Id.* at 109–10 (tbls. III & IV).

⁶⁴ *Id.* at 106–107; Carosso, *supra* note 42, at 283, 292, 331; Goldsmith, *supra* note 46, at 143–45; Peach, *supra* note 25, at 105–107; Randall S. Kroszner and Raghuram G. Rajan, “Is the Glass-Steagall Act Justified? A Study of the U.S. Experience with Universal Banking Before 1933,” 84 *American Economic Review* 810, at 813 (tbl. 2), 820–21 n.29 (1994); Terris

Moore, “Security Affiliate Versus Private Investment Banker—A Study in Security Originations,” 12 *Harvard Business Review* 478, at 482–83 (1934).

⁶⁵ Cleveland and Huertas, *supra* note 57, at 85–88, 123, 152–53; Peach, *supra* note 25, at 86–95.

⁶⁶ Peach, *supra* note 25, at 63–64, 67–68, 95–97.

⁶⁷ *Id.* at 58–70, 75–81, 98–104; *see also* Goldsmith, *supra* note 46, at 133–36.

⁶⁸ Carosso, *supra* note 42, at 279; *see also* Perkins, *supra* note 25, at 495 (stating that “commercial banks and their affiliates had become the dominant force in the investment banking field” by the end of the 1920s).

⁶⁹ Goldsmith, *supra* note 46, at 136–37. *See also* Peach, *supra* note 25, at 20 (stating that NCC “became the largest agency in the world for the distribution of securities to the public” during the late 1920s).

⁷⁰ Cleveland and Huertas, *supra* note 57, at 139, 140 (tbl. 8.1.), 141, 152–53.

⁷¹ Peach, *supra* note 25, at 20–21, 28–31, 34–37, 74–76 (quotes at 37, 75); *see also* Carosso, *supra* note 46, at 273–80; Cleveland and Huertas, *supra* note 57, at 135–46.

⁷² Carosso, *supra* note 42, at 275–76; *see also* Goldsmith, *supra* note 46, at 131–32 (stating that “the old private investment banking houses ... would not have been in a position to cope with [the] avalanche of new security issues” during the 1920s without the assistance of the securities affiliates of commercial banks); 1931 Hearings, *supra* note 33, at 539–40 (testimony of Allan M. Pope, stating that banks and their securities affiliates were essential participants in the “enormous increase in underwriting and distribution” of securities that took place during the 1920s, because banks provided extensive credit and their affiliates created large sales organizations to support the underwriting efforts of private investment houses); *supra* note 29 and accompanying text (citing Sen. Walcott’s similar view).

⁷³ Cleveland and Huertas, *supra* note 57, at 139, 141. *See also* Peter Rappaport and Eugene N. White, “Was There a Bubble in the 1929 Stock Market?” 53 *Journal of Economic History* 549, at 551 (1993) (noting that “[b]anks had a much broader customer base than traditional brokerage houses, and their securities affiliates sold stocks and bonds to many people who had little or no prior experience with investment in securities”).

⁷⁴ Peach, *supra* note 25, at 94 (stating that NCC maintained offices in more than 50 U.S. cities and several foreign cities and employed 350 salesmen in the United States alone).

⁷⁵ Seligman, *supra* note 53, at 24.

⁷⁶ Cleveland and Huertas, *supra* note 57, at 136 (quoting a lecture given by Mitchell to NCC employees in 1919).

⁷⁷ *Id.* at 136, 137.

⁷⁸ *Id.* at 138 (fig. 8.1) (reprint of NCC advertisement).

⁷⁹ *Id.* at 139 (quoting Mitchell's 1919 lecture to NCC employees).

⁸⁰ Seligman, *supra* note 53, at 24–25 (quoting telegram from Mitchell).

⁸¹ Cleveland and Huertas, *supra* note 57, at 157. In 1930, Chase became “the largest private banking institution in the world” when it merged with the Equitable Trust Company. Peach, *supra* note 25, at 95.

⁸² Wigmore, *supra* note 3, at 100.

⁸³ Seligman, *supra* note 53, at 25 (quoting Wilson's essay, “Sunshine Charley,” *New Republic*, June 28, 1933, at 59).

⁸⁴ Galbraith, *supra* note 54, at 42–43. At the time of Mitchell's public announcement, the Federal Reserve Board (the Board) and the Federal Reserve Bank of New York (the New York Bank) disagreed over the course of action that should be taken to discourage speculation in the stock market. The Board wanted to exert direct pressure on national banks and state banks that were members of the Federal Reserve, in order to persuade them to withhold credit for speculative purposes. Such direct pressure would have included a threat to deny discount privileges to any member bank that used such credit for the purpose of making loans on securities. On February 2, 1929, the Board warned the regional Federal Reserve Banks that they should not allow member banks to discount bills for the purpose of obtaining credit to make speculative loans on securities. Four days later, the Board issued a statement to the press warning about “the excessive amount of the country's credit absorbed in speculative security loans.” The New York Bank disagreed with both statements. The New York Bank opposed any direct controls on the use of credit and instead recommended that the discount rate be increased from 5 percent to 6 percent. Friedman and Schwartz, *supra* note 25, at 257–58.

The Board rejected the New York Bank's proposal, because (1) the Board did not want to raise the cost of credit for “legitimate commerce,” and (2) the Board believed that raising the discount rate by 1 percent would be a futile gesture and would not be effective in restraining the speculative activity occurring in the call loan market and the stock market. 1931 Senate Hearings, *supra* note 33, Part 1, at 142–44 (testimony of Gov. Adolph C. Miller of the Federal Reserve Board). It appears that Mitchell made his public announcement on March 25, 1929, stating that NCB would make available up

to US\$25 million of call loans, with the knowledge and at least the tacit support of George L. Harrison, governor of the New York Bank. However, Senator Glass publicly condemned Mitchell for “slapping the Federal Reserve Board squarely in the face.” Cleveland and Huertas, *supra* note 57, at 132–33, 383 n.57; Friedman and Schwartz, *supra* note 25, at 258–63.

⁸⁵ Galbraith, *supra* note 54, at 99.

⁸⁶ *Id.* at 105–20; *see also* Carosso, *supra* note 42, at 302–305; 1931 Hearings, *supra* note 33, Part 1, at 198–99 (testimony by Albert Wiggin, stating that the banker’s pool sought to support the stock market by purchasing “pivotal stocks,” which Wiggin defined as “active-market stocks”).

⁸⁷ Galbraith, *supra* note 54, at 119; *see also* Carosso, *supra* note 42, at 305 (stating that “[t]he reputation of the great bankers never recovered from the October quake”).

⁸⁸ 1931 Hearings, *supra* note 33, Part 1, at 190. Wiggin did not offer any specific prediction when Professor Willis asked, “How long will [the rebound] take?” *Id.*

⁸⁹ *Id.* at 191 (testimony of Albert Wiggin); *see also id.*, Part 2, at 298–99 (testimony of Charles Mitchell); *id.* at 404 (testimony of Melvin Traylor, chairman of the First National Bank of Chicago); *id.*, Part 3, at 539–43 (testimony of Allan Pope, Executive Vice President of the First National Old Colony Corp., a securities affiliate of the First National Bank of Boston).

⁹⁰ *Id.*, Part 2, at 295–96, 298 (colloquy between Sen. Walcott and Charles Mitchell). In his testimony before another Senate hearing in 1931, Mitchell acknowledged that “the policy of investment banking institutions” was “part of the machine that developed inflation” in the securities markets during the 1920s. However, he placed great emphasis on the demands of corporations and foreign countries for funds and the “obvious appetite on the part of the American public for investments.” Again, Mitchell cast investment bankers in a subordinate role, stating that they were “one of the tools by which the demands on each side operated to satisfy their requirements.” Cleveland and Huertas, *supra* note 57, at 175 (quoting Mitchell’s testimony).

⁹¹ *See supra* note 76 and accompanying text (quoting Mitchell’s 1919 lecture to NCC employees).

⁹² As discussed *infra* in the section entitled “The Pecora Committee’s Evidentiary Record,” the Pecora committee’s investigation identified a series of alleged abuses at NCB, Chase, and their securities affiliates. In addition, the investigation revealed that (1) in order to reduce his income taxes in late 1929, Mitchell created a “paper loss” of US\$2.8 million by selling NCB shares to his wife; and (2) Wiggin made US\$4 million in profits by making

short sales of Chase's stock following the crash of 1929. Carosso, *supra* note 42, at 330–35, 346–48; Seligman, *supra* note 53, at 23–30, 77–78.

⁹³ Carosso, *supra* note 42, at 243 (exh. 7).

⁹⁴ John B. McFerrin, *Caldwell and Company: A Southern Financial Empire* 9 (Nashville, Tenn.: Vanderbilt University Press, 1969 [1939]); Peach, *supra* note 25, at 37.

⁹⁵ Ilse Mintz, *Deterioration in the Quality of Foreign Bonds Issued in the United States, 1912–1930*, at 9 (tbl.1) (New York: National Bureau of Economic Research, 1951).

⁹⁶ Carosso, *supra* note 42, at 244 (exh. 8).

⁹⁷ Shiller, *supra* note 2, at 8–9; Wilmarth, “Financial Liberalization,” *supra* note 15, at 91.

⁹⁸ Galbraith, *supra* note 54, at 12–92; Shiller, *supra* note 2, at 6–9, 60–68, 82–88, 103–107, 156, 187–88, 192–95; J. Bradford DeLong and Andrei Shleifer, “The Stock Market Bubble of 1929: Evidence from Closed-End Mutual Funds,” 51 *Journal of Economic History* 675 (1991); Rappaport and White, *supra* note 73; Eugene N. White, “The Stock Market Boom and Crash of 1929 Revisited,” 4(2) *Journal of Economic Perspectives* 67 (Spring 1990) [hereinafter White, “Stock Market Boom”].

⁹⁹ Carosso, *supra* note 42, at 278–93; *id.* at 287 (exh. 12) (reporting that 591 investment trusts were organized during 1927–29); Goldsmith, *supra* note 46, at 130–37, 143–46.

¹⁰⁰ Carosso, *supra* note 42, at 242–85 (referring to the “veritable orgy of competition” that occurred between commercial banks and investment banking firms during the 1920s, *id.* at 255); *id.* at 243 (exh. 7) (showing that U.S. corporations issued US\$49 billion of debt and equity securities from 1919 to 1929, of which US\$16.3 billion were issued in 1928–29); George W. Edwards, *The Evolution of Finance Capitalism*, at 226–34 (New York: Augustus M. Kelley, 1967 reprint [1938]) [hereinafter Edwards, *Finance Capitalism*] (describing “overcompetition” resulting from the expansion of bank securities affiliates and the response of traditional securities firms, resulting in “the overissue of new securities” and “unsound selling practices”); Goldsmith, *supra* note 46, at 131–46 (describing investment trusts as “the weapon with which [the private investment banker] was able to counter the superior capital resources at the disposition of the security affiliates.” *Id.* at 143); White, “Stock Market Boom,” *supra* note 98, at 69–70 (stating that “the growth of the securities market, assisted by the establishment of investment trusts and securities affiliates,” attracted funds from “many ... new

investors [who] lacked experience in buying stock and monitoring firms, thus creating a favorable condition for a bubble”).

¹⁰¹ Wigmore, *supra* note 3, at 637–43 (tbls. A.19, A.20)

¹⁰² A 1933 study by George W. Edwards determined that 25.8 percent of domestic bonds issued during 1920–29 were in actual or pending default on December 31, 1931, including 31.7 percent of the bonds issued after 1926. Mintz, *supra* note 95, at 45–46 and tbl. 6 (summarizing the 1933 study by Edwards). A 1942 study by Edwards found that 30 percent of domestic corporate bond issues sold prior to the Glass-Steagall Act had defaulted by 1936. George W. Edwards, “The Myth of the Securities Affiliate,” 37 *Journal of the American Statistical Association* 225, at 225–26, 230 (1942) [hereinafter Edwards, “Securities Affiliate”]. Modern studies have produced similar results. See James S. Ang and Terry Richardson, “The Underwriting Experience of Commercial Bank Affiliates Prior to the Glass-Steagall Act: A Re-examination of Evidence for Passage of the Act,” 18 *Journal of Banking and Finance* 351, at 359, 363, 364 (tbl. 3) (1994) (finding that 21.1 percent of a sample of domestic corporate bonds issued from 1926 to 1930 (excluding utilities) defaulted by 1934, and 30.4 percent of such bonds defaulted by 1939); Manju Puri, “The Long-Term Default Performance of Bank Underwritten Securities Issues,” 18 *Journal of Banking and Finance* 397, at 400–401, 403 (tbl.1b) (1994) [hereinafter Puri, “Default Performance”] (finding that 19.2 percent of a sample of domestic industrial bonds issued from 1927 to 1929 defaulted within five years after their issue, and 28.6 percent of such bonds defaulted within seven years after their issue).

¹⁰³ The value of all NYSE-listed bonds fell from US\$47.4 billion in January 1931 to US\$30.6 billion in April 1933. George W. Edwards, “Control of the Security-Investment System,” 12 *Harvard Business Review* 1, at 4 (1933) [hereinafter Edwards, “Security-Investment System”]. In 1932, 56 percent of domestic corporate bonds (measured both in number of issues and in total face amounts) were trading at least 20 percent below their par values, and less than 6 percent of corporate bonds were trading at par or above. Lester V. Chandler, *America’s Greatest Depression, 1929–1941*, at 74 (tbl. 5–3) (New York: Harper & Row, 1970). Ang and Richardson found that a sample of domestic corporate bonds (excluding utilities) issued during the period 1926–30 had declined in value by more than 30 percent as of 1934, and by more than 50 percent as of 1939. Ang and Richardson, *supra* note 102, at 366–67, 368 (tbl. 5).

¹⁰⁴ Mintz, *supra* note 95, at 2 and n.3, 6, 33–34, 50–53.

¹⁰⁵ Willis and Chapman, *supra* note 42, at 199–201, 586–89. See Act of Feb. 25, 1927, § 16, 44 Stat. 1232 (authorizing national banks to make mortgage

loans with terms of up to five years); S. Rep. No. 69–473, at 11 (1926) (explaining that, prior to the 1927 statute, national banks could make mortgage loans with maturities of up to one year).

¹⁰⁶ Goldsmith, *supra* note 46, at 72–78, 293 (tbl. 6) (reporting that outstanding real estate loans made by all commercial banks increased from US\$1.4 billion to US\$5.0 billion during 1919–29); Willis and Chapman, *supra* note 42, at 591 (tbl. 133) (showing that outstanding real estate loans by national banks increased from US\$180 million to US\$1.5 billion during 1919–30).

¹⁰⁷ Chandler, *supra* note 103, at 8 (tbl. 1.5); Edwards, *Finance Capitalism*, *supra* note 100, at 244–46; Goldsmith, *supra* note 46, at 72–79, 105–106, 296 (tbl. 10); Benjamin Graham and David L. Dodd, *Security Analysis: Principles and Technique*, at 138–42, 741–42 n.19 (New York: McGraw-Hill Book Co., 2nd ed. 1940); Willis and Chapman, *supra* note 42, at 589, 591–609. *See also* Alexander J. Field, “Uncontrolled Land Development and the Duration of the Depression in the United States,” *52 Journal of Economic History* 785, at 786–87, 792–96, 799–801, 801 n.57 (1992).

¹⁰⁸ Chandler, *supra* note 103, at 16; Field, *supra* note 107, at 786–87, 795, 795 n.38; Goldsmith, *supra* note 46, at 77–79, 296 (tbl. 10); Gordon, *supra* note 58, at 201, 202 (tbl. 13), 203–207.

¹⁰⁹ S. Rep. No. 73–77, at 7 (1933); *see also* Goldsmith, *supra* note 46, at 79–81; Gordon, *supra* note 58, at 203–07; Willis and Chapman, *supra* note 42, at 606–09. Alexander Field found that the severely depressed real estate markets of the 1930s were produced by uncontrolled development and overbuilding during the 1920s, together with the fact that many housing subdivisions established during that decade were badly sited, poorly planned, and lacking in essential facilities (*e.g.*, adequate streets and utilities). Field, *supra* note 107, at 785–93, 798–803.

¹¹⁰ Chandler, *supra* note 103, at 15–17; Cleveland and Huertas, *supra* note 57, at 120–21; Eichengreen and Mitchener, *supra* note 58, at 36–42 (concluding that a majority of consumer goods purchased during the 1920s were financed with consumer credit); Goldsmith, *supra* note 46, at 61–64, 66–67; Gordon, *supra* note 58, at 188–91, 196–97, 203–205; Martha L. Olney, “Avoiding Default: The Role of Credit in the Consumption Collapse of 1930,” *114 Quarterly Journal of Economics* 319, at 320–23 (1999).

¹¹¹ Charles W. Calomiris, “Financial Factors in the Great Depression,” *7(2) Journal of Economic Perspectives* (Spring 1993), at 61, 73, 75–76 (reporting that total U.S. long-term and short-term debts in 1929 were estimated at US\$234 billion, compared to total national income of US\$87 billion); Chandler, *supra* note 103, at 8 (tbl. 1–5 (estimating total U.S. private and public

debt in 1929 at US\$191 billion, with US\$30 billion being owed by federal, state, and local governments).

¹¹² Ben S. Bernanke, “Nonmonetary Effects of the Financial Crisis in the Propagation of the Great Depression,” *73 American Economic Review* 257, at 260–61, 265–66, 270–74 (1983) [hereinafter Bernanke, “Nonmonetary Effects”]; Calomiris, *supra* note 111, at 73–79; Chandler, *supra* note 103, at 8–9, 69, 72–75; Olney, *supra* note 110, at 320, 323–33.

¹¹³ Chandler, *supra* note 103, at 16.

¹¹⁴ *Id.* at 15–16; Goldsmith, *supra* note 46, at 31–33.

¹¹⁵ Field, *supra* note 107; Goldsmith, *supra* note 46, at 78–81; Gordon, *supra* note 58, at 203–207; Willis and Chapman, *supra* note 42, at 606–609; S. Rep. No. 73–77, at 3, 7.

¹¹⁶ Chancellor, *supra* note 54, at 205–207; Eichengreen and Mitchener, *supra* note 58, at 42–45; Shiller, *supra* note 2, at 103–107; White, “Stock Market Boom,” *supra* note 98, at 70–71; Wigmore, *supra* note 3, at 54–56, 61–63, 66–71, 83–86; Willis and Chapman, *supra* note 42, at 614–15.

¹¹⁷ Steven Klepper, “Firm Survival and the Evolution of Oligopoly,” *33 Rand Journal of Economics* 37, at 43–45, 57–58 (2002); *see also* White, “Stock Market Boom,” *supra* note 98, at 78 (noting that “high-tech firms and utilities, with no history of dividends and possibly brilliant futures, became favorites in the boom [of the 1920s] even though their fundamentals were difficult to assess”).

¹¹⁸ Klepper, *supra* note 117, at 43–44.

¹¹⁹ Eichengreen and Mitchener, *supra* note 58, at 42–44; Wigmore, *supra* note 3, at 61–63, 85–87.

¹²⁰ Gordon, *supra* note 58, at 177 (tbl. 5), 181–82, 190, 196, 208–209.

¹²¹ *See* Carosso, *supra* note 42, at 243 (exh. 7); *supra* notes 60–86 and accompanying text.

¹²² Chancellor, *supra* note 54, at 199–211; Eichengreen and Mitchener, *supra* note 58, at 21–26, 42–45; Goldsmith, *supra* note 46, at 95–96; Gordon, *supra* note 58, at 177 (tbl. 5), 181–82, 187–88, 201–13; Kindleberger, *supra* note 58, at 43–46, 53–54, 59–61, 95–97, 103–104; Robbins, *supra* note 58, at 30–31, 36–46, 69; White, “Stock Market Boom,” *supra* note 98, at 69–81. *See also* James D. Hamilton, “Monetary Factors in the Great Depression,” *19 Journal of Monetary Economics* 145, at 155 (1987) (noting that “10 percent of total gross private domestic investment during 1929 represented inventory accumulations”).

¹²³ Kindleberger, *supra* note 58, at 103–104; Christina D. Romer, “The Nation in Depression,” 7(2) *Journal of Economic Perspectives* (Spring 1993), at 19, 21, 26, 28 [hereinafter Romer, “Nation in Depression”].

¹²⁴ Romer, “Nation in Depression,” *supra* note 123, at 21–23, 29–31; *see also* Chandler, *supra* note 103, at 15–20, 21 (tbl. 2–1); Gordon, *supra* note 58, at 208–14; Kindleberger, *supra* note 58, at 103–07, 112–16; Christina D. Romer, “The Great Crash and the Onset of the Great Depression,” 105 *Quarterly Journal of Economics* 597 (1990) [hereinafter Romer, “Great Crash”].

¹²⁵ Calomiris, *supra* note 111, at 73–76; Chandler, *supra* note 103, at 15–20; Eichengreen and Mitchener, *supra* note 58, at 8–12, 16, 21–26, 30–45, 54–55; Friedman and Schwartz, *supra* note 25, at 240, 244–48, 305–308; Kindleberger, *supra* note 58, at 43–46, 53–54, 59–61, 95–97, 103–107, 112–16; Romer, “Great Crash,” *supra* note 124, at 597–99, 604–23; Romer, “Nation in Depression,” *supra* note 123, at 21–31.

¹²⁶ *See, e.g.*, C. D. Bremer, *American Bank Failures*, at 111–24 (New York: Columbia University Press, 1935); Carosso, *supra* note 42, at 253–65, 271–81, 297–99; Friedman and Schwartz, *supra* note 25, at 240, 244–48; Goldsmith, *supra* note 46, at 86–98, 103–107, 133–42; James S. Olson, *Saving Capitalism: The Reconstruction Finance Corporation and the New Deal, 1933–1940*, at 3–8 (Princeton, N.J.: Princeton University Press, 1988); Peach, *supra* note 25, at 103–14, 139–42; Robbins, *supra* note 58, at 30–31, 43–54, 61–63, 69–72; Willis and Chapman, *supra* note 42, at 525–47; O. K. Burrell, “Essential Elements in Banking Reconstruction,” 12 *Harvard Business Review* 12, at 14–15, 17–20 (1933); Edwards, “Security-Investment System,” *supra* note 103, at 4–8.

¹²⁷ *See* Barry Eichengreen, *Golden Fetters: The Gold Standard and the Great Depression, 1919–1939*, at 190–93, 208–16 (New York: Oxford University Press, 1992); Eichengreen and Mitchener, *supra* note 58, at 3, 8–9, 21–24, 52; Friedman and Schwartz, *supra* note 25, at 240, 275, 287–89, 296; Goldsmith, *supra* note 46, at 35–36; Meltzer, *supra* note 25, at 170–78, 203–205, 252–54, 261–62; Robbins, *supra* note 58, at 44–54, 61–63; Peter Temin, *Lessons from the Great Depression*, at 19 (Cambridge, Mass.: MIT Press, 1989). Murray Rothbard has provided perhaps the strongest condemnation of the Federal Reserve’s monetary policies for being inflationary during the 1920s, particularly in 1924 and 1927. *See* Murray N. Rothbard, *America’s Great Depression*, at 104–45 (Kansas City, Mo.: Sheed & Ward, Inc., 3rd ed. 1975).

¹²⁸ As previously noted, during the period 1928–29 the Federal Reserve Board and the Federal Reserve Bank of New York carried on a prolonged

debate over whether the Federal Reserve should (1) apply direct pressure and other qualitative measures to discourage speculation in the stock market, or (2) use conventional open-market measures to restrain speculation such as raising the discount rate and selling government securities. See *supra* note 84 and accompanying text. Economists have generally concluded that (1) the Federal Reserve tried to curb speculation in the stock market by reducing the availability of credit for call money loans and other loans on securities, (2) the Federal Reserve's inconclusive actions in the period 1928–29 were not effective in preventing the final stages of the stock market boom, and (3) the Federal Reserve's actions created restrictive credit conditions in the general economy that triggered a recession in the summer of 1929. Eichengreen, *supra* note 127, at 216–26; Alexander J. Field, “A New Interpretation of the Onset of the Great Depression,” 44 *Journal of Economic History* 489 (1984); Friedman and Schwartz, *supra* note 25, at 254–66, 289–92, 297–98; Hamilton, *supra* note 122, at 145–49, 167–68; Meltzer, *supra* note 25, at 224–66; Romer, “Nation in Depression,” *supra* note 123, at 26–29; Temin, *supra* note 127, at 22–23.

¹²⁹ Ali Anari, James Kolari, and Joseph Mason, “Bank Asset Liquidation and the Propagation of the U.S. Great Depression,” 37 *Journal of Money, Credit and Banking* 753 (2005); Bernanke, “Nonmonetary Effects,” *supra* note 112; Ben S. Bernanke, “The Macroeconomics of the Great Depression: A Comparative Approach,” 27 *Journal of Money, Credit and Banking* 1, at 6–8, 12–20 (1995); Calomiris, *supra* note 111, at 68–73, 78–79; Eichengreen, *supra* note 127, at 249–53, 258–59, 293–98, 314–16, 323–29; Friedman and Schwartz, *supra* note 25, at 308–32, 342–59, 367–419; Kindleberger, *supra* note 58, at 128–30, 165–69, 182–96; Meltzer, *supra* note 25, at 271–413; Romer, “Nation in Depression,” *supra* note 123, at 32–34. Elmus Wicker has presented a somewhat different analysis of the banking panics of the Great Depression and the reasons for the Federal Reserve's lack of an effective response. Nevertheless, he believes that the Federal Reserve was at fault for failing to make aggressive open-market purchases of government securities in order to strengthen banks, restore depositor confidence, and prevent currency hoarding. See Elmus Wicker, *The Banking Panics of the Great Depression*, esp. at 17–23, 137–38, 151–65 (Cambridge, U.K.: Cambridge University Press, 1996).

¹³⁰ Perkins, *supra* note 25, at 498–503; 75 Cong. Rec. 9883–85 (1932) (remarks of Sen. Glass).

¹³¹ See, e.g., Edwards, *Finance Capitalism*, *supra* note 100, at 223–35, 282–86; Robbins, *supra* note 58, at 30–31, 36–56, 61–63, 69; Willis and Chapman, *supra* note 42, at 178–82, 188–94, 525–37, 610–15, 630–33; S. Rep.

No. 73–77, at 2–7 (1933); *supra* notes 26–30 and accompanying text (discussing views of members of Congress).

¹³² Eichengreen and Mitchener, *supra* note 58.

¹³³ Harold L. Cole, Lee E. Ohanian, and Ron Leung, “Deflation and the International Great Depression: A Productivity Puzzle,” National Bureau of Economic Research Working Paper No. 11237, <http://www.nber.org/papers/w11237>.

¹³⁴ See, e.g., George J. Benston, *The Separation of Commercial and Investment Banking: The Glass-Steagall Act Revisited and Reconsidered*, at 134–37 (New York: Oxford University Press, 1990); Jonathan R. Macey, “Special Interest Groups Legislation and the Judicial Function: The Dilemma of Glass-Steagall,” 33 *Emory Law Journal* 1, at 15–21 (1984); Raghuram G. Rajan and Luigi Zingales, *Saving Capitalism from the Capitalists: Unleashing the Power of Financial Markets to Create Wealth and Spread Opportunity*, at 220–24 (New York: Crown Books, 2003).

¹³⁵ See, e.g., Fein, *supra* note 8, §§ 1.06 (intro.), 1.06[E], [F], and [G]; David Hosansky, “Cover Story: Paralyzed Congress on Sidelines in Financial Services Evolution,” 55 *Congressional Quarterly* 2292 (1997); Michael Schroeder, “It’s Alive: Why Glass-Steagall, Reviled for Decades, Just Won’t Go Away,” *Wall Street Journal* (April 10, 1998), at A1; Andrew Taylor, “Banking: Glass-Steagall Rewrite Stalls as Industry Foes Do Battle,” 54 *Congressional Quarterly* 539 (1996).

¹³⁶ Macey, *supra* note 134, at 17–18.

¹³⁷ *Operation of the National and Federal Reserve Banking Systems: Hearings on S. 4415 before the Senate Committee on Banking and Currency*, 72nd Cong., 1st Sess. (1932) [hereinafter 1932 Hearings], Part 1, at 17 (quote), 24–30, 40–41. Pope had presented similar testimony in opposition to an earlier version of the Glass bill in 1931, when he was a member of the board of governors of the IBA. However, in 1931 Pope said that he was appearing “in the capacity of a private individual” and not speaking for the IBA. 1931 Hearings, *supra* note 33, Part 3, at 539–41; see also *supra* note 72 (quoting Pope’s 1931 testimony against the Glass bill).

¹³⁸ 1932 Hearings, *supra* note 137, Part 1, at 25, 40.

¹³⁹ *Id.* at 27.

¹⁴⁰ Donald C. Langevoort, “Statutory Obsolescence and the Judicial Process: The Revisionist Role of the Courts in Federal Banking Regulation,” 85 *Michigan Law Review* 672, at 697 (1987).

¹⁴¹ 1932 Hearings, *supra* note 137, at 16, 37 (testimony of Mr. Pope).

¹⁴² *Id.*

¹⁴³ Ron Chernow, *The House of Morgan: An American Banking Dynasty and the Rise of Modern Finance*, at 353–55, 376–77 (New York: Simon & Schuster, 1990).

¹⁴⁴ *Id.* at 354–55.

¹⁴⁵ Seligman, *supra* note 53, at 19. Similarly, the Democratic Party’s 1932 platform called for the “severance of affiliated securities from, and the divorce of the investment banking business from, commercial banks.” Perkins, *supra* note 25, at 518.

¹⁴⁶ Carosso, *supra* note 42, at 372–75; Chernow, *supra* note 143, at 374–77, 384–89; Perkins, *supra* note 25, at 167–68. *See infra* notes 149–53 and accompanying text (discussing the enactment of § 21 of the Glass-Steagall Act). According to an estimate published in the *Literary Digest* in 1934, about two-thirds of private banks chose to stay in the securities business despite the hardships involved in giving up their deposit-taking function. The loss of deposits was a serious blow to private banks, because it made them more dependent on loans from commercial banks. Carosso, *supra* note 42, at 372.

¹⁴⁷ Carosso, *supra* note 42, at 289–91, 317–20, 325–26, 328–29, 336–46; Chernow, *supra* note 143, at 359–74; Seligman, *supra* note 53, at 21–23, 31–37; Robert Sobel, *The Life and Times of Dillon Read*, at 86–91, 173–89 (New York: Truman Talley Books, 1991).

¹⁴⁸ Seligman, *supra* note 53, at 31–38 (quote at 37), 65–72; *see also* Carosso, *supra* note 42, at 339–51; Chernow, *supra* note 143, at 362–74; Sobel, *supra* note 147, at 187–88.

¹⁴⁹ Act of June 16, 1933, c. 89, § 21(a)(1), 48 Stat. 189.

¹⁵⁰ 77 Cong. Rec. 4179 (1933); *see also id.* at 4178 (text of Tydings’s proposed amendment).

¹⁵¹ *Id.* (remarks of Sen. Bulkley); *id.* at 4179–80 (remarks of Sen. Glass). Officials of Chase’s securities affiliate ultimately created First Boston in conjunction with officers of First National Bank of Boston’s securities affiliate. Chernow, *supra* note 143, at 375; Peach, *supra* note 25, at 165–66.

After defeating the Tydings amendment, Bulkley persuaded the Senate to adopt an amendment that expanded the scope of Section 21 so that it would encompass any person or firm engaged in the business of securities underwriting or distribution. The original version of Section 21 applied only to persons engaged “principally” in that business. Bulkley argued that “some of the great investment houses are engaged in so many forms of business that

there is some doubt as to whether the investment business is the principal one.” Accordingly, he convinced the Senate to delete the word “principally” in order to “accomplish a separation of the investment and deposit banking [business].” 77 Cong. Rec. 4180 (1933).

¹⁵² Langevoort, *supra* note 140, at 697; *see also* Carosso, *supra* note 42, at 372.

¹⁵³ Glass maintained close personal relationships with two J.P. Morgan partners—Russell Leffingwell and Parker Gilbert—who served as his deputies during his tenure as Secretary of the Treasury in the Wilson administration. In July 1933, a month after the enactment of Glass-Steagall, Glass sent a private letter to Leffingwell stating that the Roosevelt administration had forced him to accept Section 21 at the urging of Winthrop Aldrich, the new president of Chase. Chernow, *supra* note 143, at 355, 374–75, 751 n.86. However, Glass’s position as portrayed in his private letter clearly seems inconsistent with his vigorous public defense of Section 21 and his strong opposition to the Tydings amendment during the Senate debates on May 25, 1933.

¹⁵⁴ Langevoort, *supra* note 140, at 693–97 (quote at 696).

¹⁵⁵ S. Rep. No. 74–1007, at 16 (1935); 79 Cong. Rec. 11933–34 (1935) (remarks of Sen. Glass).

¹⁵⁶ 79 Cong. Rec. 11933 (1935).

¹⁵⁷ 79 Cong. Rec. 11932–33 (1935). LaFollette also claimed that the problem with U.S. industrial companies was not a lack of adequate financing. He contended that, during the 1920s, firms had built production facilities that far exceeded the demand for their goods. *Id.* at 11934.

¹⁵⁸ H.R. Rep. No. 74–1822, at 53 (1935) (Conf. Rep.); 79 Cong. Rec. 13706 (1935) (remarks of Rep. Steagall). Representative Steagall announced to the House of Representatives that Glass’s proposal had been removed from the conference report. That announcement was greeted with applause, indicating that House members strongly supported the maintenance of a strict separation between commercial and investment banking. *Id.*

¹⁵⁹ Benston, *supra* note 134, at 41.

¹⁶⁰ Eugene N. White, “Before the Glass-Steagall Act: An Analysis of the Investment Banking Activities of National Banks,” 23 *Explorations in Economic History* 33, at 52 (1986) [hereinafter White, “Glass-Steagall Act”]. For Benston’s discussion of White’s study, *see* Benston, *supra* note 134, at 32–34.

¹⁶¹ White, “Glass-Steagall Act,” *supra* note 160, at 40.

¹⁶² *Id.* (discussing advantages of greater diversification connected with size); Charles W. Calomiris and Joseph R. Mason, “Fundamentals, Panics, and Bank Distress During the Depression,” 93 *American Economic Review* 1615, at 1630–31 (2003) (same); Chandler, *supra* note 103, at 79–82 (discussing shifts of deposits from smaller to larger banks); Wigmore, *supra* note 3, at 121–22 (same); *infra* notes 183, 186, 190, 195–96, 211, and accompanying text (discussing support received by large troubled banks during 1930–33).

¹⁶³ White, “Glass-Steagall,” *supra* note 160, at 40–42. White also performed regressions indicating that the presence of a securities affiliate did not have an adverse effect on bank capital or liquidity. For a discussion of the failure or near-failure of several large banks with securities affiliates during 1930, 1932, and 1933, see *infra* the section entitled “The Failures of Several Key Banks with Securities Affiliates.”

¹⁶⁴ Chandler, *supra* note 103, at 73; Goldsmith, *supra* note 46, at 79–84; Wicker, *supra* note 129, at 16; Wigmore, *supra* note 3, at 228–29, 308, 317, 430–31; Willis and Chapman, *supra* note 42, at 596–609. See also Mintz, *supra* note 95, at 46–48 (describing R. J. Saulnier’s study of urban mortgage lending by life insurance companies, which found that, by the end of 1934, lenders had foreclosed on 24 percent of mortgages made from 1920 to 1924 and on 41 percent of mortgages made from 1925 to 1929).

¹⁶⁵ See *supra* notes 102–104 and accompanying text; see also Goldsmith, *supra* note 46, at 106 (reporting that, during the period 1931–32, market values for bonds declined by the following percentages: 36 percent for railroad bonds, 27 percent for public utility bonds, 22 percent for industrial bonds, 45 percent for foreign bonds, and 10 percent for U.S. government securities).

¹⁶⁶ Mintz, *supra* note 95, at 51–52 (incl. tbl. 9)

¹⁶⁷ Willis and Chapman, *supra* note 42, at 537–40 (describing study of 34 failed New York state banks); Robert G. Rodkey, “State Bank Failures in Michigan,” 7 *Michigan Business Studies* 101, at 101–102, 130–39 (1935–36) (presenting study of 163 failed Michigan state banks).

¹⁶⁸ Goldsmith, *supra* note 46, at 302 (tbl. 16) (showing that Federal Reserve member banks reported losses of US\$470 million in their securities portfolios during the period 1929–31, compared with US\$630 million of loan losses); Wicker, *supra* note 129, at 13–14 (showing that, during the period 1929–32, member banks reported US\$6.84 of losses for every US\$100 of securities investments, compared with US\$5.09 of losses for every US\$100 of loans).

¹⁶⁹ Calomiris and Mason, *supra* note 162, at 1630–33.

¹⁷⁰ Bremer, *supra* note 126, at 115–18; Goldsmith, *supra* note 46, at 105–106, 190–91; Wigmore, *supra* note 3, at 122–23.

¹⁷¹ Mintz, *supra* note 95, at 83–84; 1931 Hearings, *supra* note 33, Part 3, at 501–03 (testimony of Prof. Marcus Nadler).

¹⁷² See, e.g., 75 Cong. Rec. 9883 (1932) (remarks of Sen. Glass, declaring that “the great banks in the money centers choked the portfolios of their correspondent banks from Maine to California with utterly worthless investment securities”); *id.* at 9910 (remarks of Sen. Bulkley, stating that “the correspondent relationship ... furnished a peculiarly inviting system of distribution” for bank securities affiliates and investment banks, because country banks “were dependent either on their city correspondents or on private distributing houses for advice in the selection of investments”); 77 Cong. Rec. 3835 (1933) (remarks of Rep. Steagall); 77 Cong. Rec. 4176 (1933) (remarks of Sen. Wheeler, citing a Montana bank that failed due to losses on bonds it purchased from J.P. Morgan and other “big banks”); Goldsmith, *supra* note 46, at 106, 190–91 (stating that “the small bank inevitably became the victim of security salesmen’s offers and selling talks”).

¹⁷³ Eugene N. White, *The Regulation and Reform of the American Banking System, 1900–1929*, at 99–106, 149–51 (Princeton, N.J.: Princeton University Press, 1983); 75 Cong. Rec. 9882–83 (1932) (remarks of Sen. Glass).

¹⁷⁴ 1931 Hearings, *supra* note 33, at 542.

¹⁷⁵ 1932 Hearings, *supra* note 137, at 30. See also 75 Cong. Rec. 9883 (1932) (remarks of Senators Glass and Norris, alleging that federal bank regulators and examiners encouraged country banks to invest in risky securities to improve their performance).

¹⁷⁶ McFerrin, *supra* note 94, at 116–40.

¹⁷⁷ *Id.* at 119–25, 150–61.

¹⁷⁸ *Id.* at 176–88; Goldsmith, *supra* note 46, at 225–26; Kindleberger, *supra* note 58, at 130; Wicker, *supra* note 129, at 32–36, 52–55.

¹⁷⁹ Morris R. Werner, *Little Napoleons and Dummy Directors: Being the Narrative of the Bank of United States*, at 62–63 (New York: Harper & Brothers, 1933).

¹⁸⁰ *Id.* at 26–31, 93–130; Paul B. Trescott, “The Failure of the Bank of United States, 1930,” 24 *Journal of Money, Credit and Banking* 384, at 386–91 (1992).

¹⁸¹ Susan E. Kennedy, *The Banking Crisis of 1933*, at 2–4 (Lexington, Ky.: University Press of Kentucky, 1973); Trescott, *supra* note 180, at 391–95; Werner, *supra* note 179, at 135–39, 185–87.

¹⁸² Cleveland and Huertas, *supra* note 57, at 166, 395–96 nn.28–32; Friedman and Schwartz, *supra* note 25, at 309–10 n.9; Werner, *supra* note 179, at 197–208.

¹⁸³ Friedman and Schwartz, *supra* note 25, at 309–10 n.9; Goldsmith, *supra* note 46, at 227; Wigmore, *supra* note 3, at 125, 128.

¹⁸⁴ Cleveland and Huertas, *supra* note 57, at 166–67, 397 nn.34–35; Friedman and Schwartz, *supra* note 25, at 308–13; Trescott, *supra* note 180, at 385–86; Wicker, *supra* note 129, at 36–39, 49–52, 55–59 (questioning the macroeconomic significance of BUS’s failure, but acknowledging that the Federal Reserve “was not successful in restoring depositor confidence after the crisis had subsided,” *id.* at 59).

¹⁸⁵ Goldsmith, *supra* note 46, at 173–76; F. Cyril James, *The Growth of Chicago Banks*, at 942–67 (New York: Harper & Brothers, 1938); Wicker, *supra* note 129, at 69–70.

¹⁸⁶ Goldsmith, *supra* note 46, at 229–30; James, *supra* note 185, at 958–62, 996–1006; Wicker, *supra* note 129, at 70, 86.

¹⁸⁷ Richard D. Cudahy and William D. Henderson, “From Insull to Enron: Corporate (Re)Regulation After the Rise and Fall of Two Energy Icons,” 26 *Energy Law Journal* 35, at 51–69 (2005); James, *supra* note 185, at 1030–31; Arthur R. Taylor, “Losses to the Public in the Insull Collapse,” 36 *Business History Review* 188, at 188–95 (1962) (estimating that when liquidation of the Insull empire was completed in 1948, investors suffered a net loss of US\$638 million, equal to 24 percent of their original investment of US\$2.65 billion); Wigmore, *supra* note 3, at 152–54, 344–48; *Stock Exchange Practices: Hearings on S. Res. 84 and S. Res. 239 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 72 Cong., 2nd Sess., Part 5, at 1530–33, 1684–87, 1693–99, 1741–42 (1933).

¹⁸⁸ Charles W. Calomiris and Joseph R. Mason, “Contagion and Bank Failures During the Great Depression: The June 1932 Chicago Banking Panic,” 87 *American Economic Review* 863, at 867–68 (1997); Wigmore, *supra* note 3, at 406–407.

¹⁸⁹ James, *supra* note 185, at 1031–38; Jesse H. Jones with Edward Angly, *Fifty Billion Dollars: My Thirteen Years with the RFC (1932–1945)*, at 73–75 (New York: Macmillan Co., 1951); Wicker, *supra* note 129, at 112–14.

¹⁹⁰ Goldsmith, *supra* note 46, at 175–76; James, *supra* note 185, at 1038–40; Jones, *supra* note 189, at 74–81; Wicker, *supra* note 129, at 114; Wigmore, *supra* note 3, at 321; *Reconstruction Finance Corp. v. Central Republic Trust Co.*, 17 F. Supp. 263, 267–83, 295–301 (N.D. Ill. 1936).

¹⁹¹ Cleveland and Huertas, *supra* note 57, at 171–72, 402 nn.61–62; Friedman and Schwartz, *supra* note 25, at 325, 330–31 n.43; James, *supra* note 185, at 1044–46; Joseph R. Mason, “Do Lender of Last Resort Policies Matter? The Effects of Reconstruction Finance Corporation Assistance to Banks During the Great Depression,” 20 *Journal of Financial Services Research* 77, at 77–78, 87–91 (2001); Joseph R. Mason, “Reconstruction Finance Corporation Assistance to Financial Intermediaries and Commercial and Industrial Enterprises in the United States, 1932–37,” in Stijn Claessens et al., eds., *Resolution of Financial Distress: An International Perspective on the Design of Bankruptcy Laws* 167, at 172–78 (Washington: World Bank, 2001) [hereinafter Mason, “RFC Assistance”]; Olson, *supra* note 126, at 26–29, 67–68; Wigmore, *supra* note 3, at 321–25.

¹⁹² Goldsmith, *supra* note 46, at 195–98; Marquis James and Bessie R. James, *Biography of a Bank: The Story of Bank of America N.T. & S.A.*, at 142–43, 176–77, 193–204, 222–34, 268–78, 288–312 (New York: Harper and Brothers, 1954); Donald L. Kemmerer, *The Life of John E. Roventsky: Banker and Industrialist*, at 145–46 (Champaign, Ill.: Stipes Publishers, Ltd., 1977).

¹⁹³ Goldsmith, *supra* note 46, at 197–99; James and James, *supra* note 192, at 269–70 (explaining that Bancitaly Corp., the predecessor of Transamerica, was similar to an “investment trust” because it purchased the stocks of U.S. banks, railroads, industrial corporations, and European banks); *id.* at 281–90 (reporting that Bancitaly spent US\$60 million in purchasing Bank of America’s stock to stop a “bear raid” during 1928, resulting in a loss to Bancitaly of about US\$20 million); *id.* at 291–92 (describing the creation of Transamerica in 1929, to take over the business of Bancitaly); *id.* at 303 (stating that Transamerica purchased Occidental Life Insurance Co. and the controlling stock interest in General Foods in 1930); Kemmerer, *supra* note 192, at 160 (stating that Transamerica “bought all kinds of stock” on margin).

¹⁹⁴ Cleveland and Huertas, *supra* note 57, at 169; Goldsmith, *supra* note 46, at 199–200; James and James, *supra* note 192, at 313–31; Kemmerer, *supra* note 192, at 160–64; Wigmore, *supra* note 3, at 160, 253–54.

¹⁹⁵ James and James, *supra* note 192, at 331–58; Wigmore, *supra* note 3, at 318, 354 (stating that, despite Giannini’s rehabilitation program, “Bank of America at year end [1932] was still the most illiquid of the big banks”).

¹⁹⁶ Kennedy, *supra* note 181, at 39–42; Mason, “RFC Assistance,” *supra* note 191, at 177 (tbl. 8.1).

¹⁹⁷ Chancellor, *supra* note 54, at 208; Goldsmith, *supra* note 46, at 168–69, 204–205; Kennedy, *supra* note 181, at 77–80; Olson, *supra* note 126, at 28; Peach, *supra* note 25, at 100–03, 118; Ferdinand Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers*, at 234–36, 241–47 (New York: Augustus M. Kelley Publishers, 1968 [1939]); Wicker, *supra* note 129, at 117–18; Wigmore, *supra* note 3, at 51, 120–21, 434–36.

¹⁹⁸ Chandler, *supra* note 103, at 37–38, 44; Jones, *supra* note 189, at 55–57; Wigmore, *supra* note 3, at 276, 374, 407.

¹⁹⁹ Wigmore, *supra* note 3, at 437–48, 442 (tbl. 13.1, showing that Guardian National Bank of Commerce had foreclosed on almost one-third of its mortgage loans by March 1933).

²⁰⁰ Wigmore, *supra* note 3, at 435–36, 442 (tbl. 13.1, showing that, by March 1933, Guardian National Bank of Commerce had incurred US\$2 billion in losses from depreciated or defaulted bonds and had US\$5.8 billion of “doubtful” loans to its securities affiliate); *Stock Exchange Practices: Hearings on S. Res. 84 Before the Senate Comm. on Banking and Commerce*, 73d Cong., 1st Sess. (1933) [hereinafter 1933 Hearings], Part 9, at 4388–89 (quotation from testimony by Robert Lord), 3890–95, 4508, 4612, 4620–22, 4634, 4638–39.

²⁰¹ Detroit Bankers wrote down its assets by US\$22 million at the end of 1931 to reflect the declining value of its securities investments. 1933 Hearings, *supra* note 200, Part 11, at 5166–67, 5174, 5183–84. The parent holding company also suffered US\$7 million in losses on bank stocks that it acquired from a securities affiliate in order to prevent that affiliate’s bankruptcy. *Id.* at 5095–5106; *id.*, Part 12, at 5533.

²⁰² Jones, *supra* note 189, at 59–69; Kennedy, *supra* note 181, at 82–102, 193–95; James S. Olson, *Herbert Hoover and the Reconstruction Finance Corporation, 1931–1933*, at 102–104 (Ames, Iowa: Iowa State University Press, 1977); Wigmore, *supra* note 3, at 438–43.

²⁰³ Goldsmith, *supra* note 46, at 171, 236; Jones, *supra* note 189, at 69; Wigmore, *supra* note 3, at 444–46.

²⁰⁴ 1933 Hearings, *supra* note 200, Part 18, at 7982–85, 8013–17, 8019, 8054–57, 8123–28, 8189–95.

²⁰⁵ *Id.* at 7987, 7994–95, 8013, 8017–22, 8087–89, 8123–25, 8132–33, 8139–41, 8255–59.

²⁰⁶ *Id.* at 8025–28, 8146–57, 8251–53.

²⁰⁷ Goldsmith, *supra* note 46, at 238–39; Jones, *supra* note 189, at 69–71; Olson, *supra* note 126, at 28–29; Wicker, *supra* note 129, at 121, 126–29.

²⁰⁸ Peach, *supra* note 25, at 92–98 (reporting that NCB, Chase, and Continental Illinois operated the first, second, and fourth largest securities affiliates as of 1930).

²⁰⁹ Cleveland and Huertas, *supra* note 57, at 159–61, 171, 191, 390 n.44, 391–92 n.4.

²¹⁰ Goldsmith, *supra* note 46, at 140; Peach, *supra* note 25, at 133–39; Wigmore, *supra* note 3, at 173–75, 220–21, 238, 357–58, 468.

²¹¹ James, *supra* note 185, at 1087–90; Jones, *supra* note 189, at 47–49; Olson, *supra* note 126, at 125–26.

²¹² Cleveland and Huertas, *supra* note 57, at 191; Jones, *supra* note 189, at 35–36.

²¹³ Cyril B. Upham and Edwin Lamke, *Closed and Distressed Banks: A Study in Public Administration*, at 238 (Washington: Brookings Institution, 1934).

²¹⁴ Olson, *supra* note 126, at 82.

²¹⁵ Jones, *supra* note 189, at 34.

²¹⁶ Friedman and Schwartz, *supra* note 25, at 427; Mason, “RFC Assistance,” *supra* note 191, at 185–92; Olson, *supra* note 126, at 78–82.

²¹⁷ Wigmore, *supra* note 3, at 468, 470. *See also* Anthony Saunders and Berry Wilson, “An Analysis of Bank Charter Value and Its Risk-Constraining Incentives,” 19 *Journal of Financial Services Research* 185, at 193–94 (2001) (finding that banks with the highest charter values during the 1920s, based on the market value of their equity, had the highest systematic asset risk and showed the greatest loss in their charter values during the period 1930–34).

²¹⁸ For example, when Continental Illinois offered to sell preferred stock to its own shareholders in connection with its sale of preferred stock to the RFC, its shareholders subscribed for only US\$333 of the stock. Wigmore, *supra* note 3, at 468.

²¹⁹ Charles W. Calomiris and Berry Wilson, “Bank Capital and Portfolio Management: The 1930s ‘Capital Crunch’ and the Scramble to Shed Risk,” 77 *Journal of Business* 421, at 422, 452 (2004).

²²⁰ Olson, *supra* note 126, at 82 (reporting that bank loans fell from US\$38.1 billion to US\$20.3 billion during the period 1931–35, while the percentage

of bank funds invested in government securities rose from 21 percent to 58 percent during 1929–34). *See also* Cleveland and Huertas, *supra* note 57, at 199 (stating that NCB increased its liquidity ratio—*i.e.*, the ratio of government securities and excess reserves to deposits—from 40 percent to 60 percent during the period 1934–35).

²²¹ *See* Friedman and Schwartz, *supra* note 25, at 449–62; Olson, *supra* note 126, at 82, 103, 128–34, 168–80, 221–25.

²²² Rajan and Zingales, *supra* note 134, at 223.

²²³ Benston, *supra* note 134, at 107.

²²⁴ Edwards, “Securities Affiliate,” *supra* note 102, at 230–32 (comparing domestic corporate bonds underwritten by commercial bank affiliates and investment banks); Moore, *supra* note 64, at 483–84 (comparing securities underwritten by the eight largest commercial bank affiliates and the eight largest investment banks during 1921–32).

²²⁵ Ang and Richardson, *supra* note 102, at 365–75, 383–86 (comparing performance of domestic corporate bonds and foreign bonds underwritten by commercial bank affiliates and investment banks from 1926 to 1930); Kroszner and Rajan, *supra* note 64, at 817–22, 829–30 (comparing performance of domestic industrial bonds underwritten by commercial bank affiliates and investment banks from 1921 to 1929); Puri, “Default Performance,” *supra* note 102, at 401–15 (comparing performance of domestic industrial bonds and preferred stock and foreign government bonds underwritten by commercial bank affiliates and investment banks during the period 1927–29).

²²⁶ Puri, “Default Performance,” *supra* note 102, at 399 (quote), 415; *see also* Benston, *supra* note 134, at 131–32 (citing evidence indicating that a significantly higher percentage of U.S. corporate bonds underwritten by NCB’s affiliate during the period 1928–33 received investment grade ratings, in comparison to other domestic corporate bonds issued during that period); Kroszner and Rajan, *supra* note 64, at 824–26, 829–30; Manju Puri, “Commercial Banks in Investment Banking: Conflict of Interest or Certification Role?” 40 *Journal of Financial Economics* 373, at 375–76, 379–85, 397 (1996) [hereinafter Puri, “Commercial Banks”].

²²⁷ Puri, “Commercial Banks,” *supra* note 226, at 385 (quote), 388–89. *See also supra* notes 29, at 71–73, and accompanying text (explaining that the distribution networks established by commercial bank affiliates made them highly desirable as participants in the securities underwriting market).

²²⁸ Ang and Richardson, *supra* note 102, at 363–65.

²²⁹ *Id.* (finding that the default record for bonds underwritten by affiliates of NCB and Chase was inferior to the performance of other commercial bank affiliates and about the same as the performance of investment banks); Puri, “Default Performance,” *supra* note 102, at 405–13 (concluding that the overall default record for securities underwritten by affiliates of NCB and Chase was inferior to the comparable performance of all other underwriters). For evidence that J.P. Morgan and Kuhn, Loeb were the leading private investment bankers during the 1920s, see, e.g., Carosso, *supra* note 42, at 255–57; Wigmore, *supra* note 3, at 106. Peach concluded that the securities affiliates of NCB and Chase were “the two most important security affiliates in existence” at that time. Peach, *supra* note 25, at 114; see also *id.* at 63–64, 92–98; Chernow, *supra* note 143, at 304; Cleveland and Huertas, *supra* note 57, at 141–53; *supra* note 67 and accompanying text.

²³⁰ Ang and Richardson, *supra* note 102, at 374–83 (quote at 383).

²³¹ See *supra* the sections entitled “Congress’s Repudiation of Universal Banking in the Glass-Steagall Act of 1933”; “Bank Involvement in the Securities and Credit Markets Helped to Produce an Unsustainable Economic Boom During the 1920s”; and “Were Traditional Securities Firms Supporters or Intended Beneficiaries of the Glass-Steagall Act?”; Langevoort, *supra* note 140, at 693–97; Peach, *supra* note 25, at 139–42, 151–53, 169–79; Perkins, *supra* note 25, at 498–503, 518–19, 526; S. Rep. No. 73–77, at 3–10 (1933). The anti-speculative intent of the Banking Act of 1933 was also reflected in provisions that authorized Federal Reserve banks to prevent member banks from using discount window loans to finance speculation in securities. Meltzer, *supra* note 25, at 434; S. Rep. No. 73–77, at 9, 13, 14.

²³² See *supra* notes 147–51 and accompanying text.

²³³ Carosso, *supra* note 42, at 349–68, 375–84; Seligman, *supra* note 53, at 35–38, 51–100, 122–23, 127–32, 222–31.

²³⁴ See *supra* notes 150–54 and accompanying text.

²³⁵ Peach, *supra* note 25, at 141–42, 151–53, 175–79; Perkins, *supra* note 25, at 498–503, 518–19, 526.

²³⁶ Benston, *supra* note 134, at 43–44.

²³⁷ *Id.* at 107; see also *id.* at 208; *supra* note 223 and accompanying text.

²³⁸ Rajan and Zingales, *supra* note 134, at 223, 335 n.55.

²³⁹ Peach, *supra* note 25, at 113; see also *id.* at 114 (stating that “[i]nformation concerning these [abuses and defects] is limited largely to the extensive Senate investigation of stock exchange practices. A substantial portion of this investigation dealt with the activities of” NCC and CSC.).

²⁴⁰ *Id.* at 113.

²⁴¹ *Id.* at 114–15; *see also* Carosso, *supra* note 42, at 261–63; Mintz, *supra* note 95, at 63–85.

²⁴² Peach, *supra* note 25, at 115–16; *see also* Carosso, *supra* note 42, at 330–31; Kennedy, *supra* note 181, at 119–20; Seligman, *supra* note 53, at 26–28.

²⁴³ Peach, *supra* note 25, at 116–26; *see also* Carosso, *supra* note 42, at 331–32, 346; Kennedy, *supra* note 181, at 120–21; Seligman, *supra* note 53, at 28–29.

²⁴⁴ For a description of alleged abuses involving officers of NCC and CSC, *see* Peach, *supra* note 25, at 127–30; Carosso, *supra* note 42, at 333–35, 346–47; Kennedy, *supra* note 181, at 123–25; Seligman, *supra* note 53, at 26, 77–78.

²⁴⁵ Peach, *supra* note 25, at 131–33; *see also* Carosso, *supra* note 42, at 333; Kennedy, *supra* note 181, at 119.

²⁴⁶ Peach, *supra* note 25, at 131–39.

²⁴⁷ Wigmore, *supra* note 3, at 173–75, 332, 357; *see supra* note 210 and accompanying text.

²⁴⁸ *See supra* note 209 and accompanying text.

²⁴⁹ *See supra* notes 177–81, 187–90, and accompanying text.

²⁵⁰ Peach, *supra* note 25, at 142, 175.

²⁵¹ Cleveland and Huertas, *supra* note 57, at 156.

²⁵² *Id.* at 157–58.

²⁵³ *Id.* at 158.

²⁵⁴ *Id.* at 158, 402 n.60 (quoting Mitchell’s remarks presented on Jan. 10, 1933).

²⁵⁵ Peach, *supra* note 25, at 72 (quote), 141–42, 175–76; *see also* Goldsmith, *supra* note 46, at 108, 128–42.

²⁵⁶ *See, e.g.,* Wilmarth, “Transformation,” *supra* note 5, at 223–25, 303–04, 326–30, 411–13, 446–50, 454–57, 472–76.

²⁵⁷ *See, e.g.,* Ben Bernanke and Harold James, “The Gold Standard, Deflation, and Financial Crisis in the Great Depression: An International Comparison,” in R. Glenn Hubbard, ed., *Financial Markets and Financial Crises* 33, at 55 (Chicago: University of Chicago Press, 1991); Richard S. Grossman, “The Shoe That Didn’t Drop: Explaining Banking Stability Dur-

ing the Great Depression,” 54 *Journal of Economic History* 654, at 673–74 (1994); Isabel Schnabel, “The German Twin Crisis of 1931,” 64 *Journal of Economic History* (2004), at 822 *passim*; and the following papers published in Charles H. Feinstein, ed., *Banking, Currency, and Finance in Europe Between the Wars* (Oxford, U.K.: Clarendon Press, 1995): Charles H. Feinstein, Peter Temin, and Gianni Toniolo, “International Economic Organization: Banking, Finance, and Trade in Europe Between the Wars,” at 9, 20–23, 35, 38–40, 45; Joost Jonker and Jan Luiten van Zanden, “Method in the Madness? Banking Crises Between the Wars, an International Comparison,” at 77, 81–86, 90–91; Michel Lescure, “Banking in France in the Inter-War Period,” at 315, 317–18, 330–31; Fritz Weber, “From Imperial to Regional Banking: The Austrian Banking System, 1918–1938,” at 338 *passim*; Forrest Capie, “Commercial Banking in Britain Between the Wars,” at 396 *passim*.

²⁵⁸ See, e.g., the papers by Jonker and van Zanden and by Capie, cited *supra* in note 257; Perkins, *supra* note 25, at 526–27.

²⁵⁹ For discussions of the boom-and-bust cycle in Japan’s economy between 1985 and 2000, see, for example, Michael D. Bordo and Oliver Jeanne, “Boom-Busts in Asset Prices, Economic Instability, and Monetary Policy,” National Bureau of Economic Research Working Paper 8966, June 2002, at 3–7, 18–19; Elaine Browne, “Does Japan Offer Any Lessons for the United States?” 2001(3) *New England Economic Review* (Federal Reserve Bank of Boston), at 3; Mitsuhiro Fukao, “Japan’s Lost Decade and Its Financial System,” 26(3) *World Economy* (March 2003), at 365 *passim*; Takeo Hoshi and Anil K. Kashyap, “Japan’s Financial Crisis and Economic Stagnation,” 18(1) *Journal of Economic Perspectives* (Spring 2004), at 3 *passim*; Ryoichi Mikitani, “The Nature of the Japanese Financial Crisis,” in Ryoichi Mikitani and Adam S. Posen, eds., *Japan’s Financial Crisis and Its Parallels to U.S. Experience*, at 27 *passim* (Washington: Brookings Institution for International Economics, 2000); Yoshinori Shimizu, “Convoy Regulation, Bank Management, and the Financial Crisis in Japan,” in *id.* at 57 *passim*; Wilmarth, “Financial Liberalization,” *supra* note 15, at 79–80, 97 n.4; Bill Emmott, “The Sun Also Rises: A Survey of Japan,” *The Economist* (October 8, 2005) (beginning after p. 58); Yuka Hayashi, “Lenders Lift Japan’s Prospects: Banks’ Incipient Revival Is Pivotal to Embarking on Growth Cycle,” *Wall Street Journal* (August 16, 2005), at A14; “Japan’s Banks: Genesis,” *The Economist* (September 10, 2005), at 68.

²⁶⁰ See *supra* notes 15–22 and accompanying text.