The Crisis in American Banking

Edited by
Lawrence H. White

1993

New York University Press
New York and London

4

Bankers as Scapegoats for Government-Created Banking Crises in U.S. History

Richard M. Salsman

Introduction

If there is anything more tragic than our current banking crisis, it is that the crisis is being blamed on the wrong group, on the bankers, instead of on the primary culprit, government intervention. The tragedy lies in failing to identify the fundamental cause of the problem, thereby ensuring its continuance. Bankers are not entirely innocent of wrongdoing in the present debacle, but to the extent that bankers have been irresponsible, it has been primarily government intervention that has encouraged them to be so. More widely, it is irresponsible government policy that has made the U.S. banking crises of the past century so frequent and seemingly so inevitable. Government has created these banking crises—sometimes inadvertently, at other times with full knowledge—by making it nearly impossible to practice prudent banking. Having done so, government has then pointed to bad banking practices as sufficient cause for still further interventions in the industry.

I. The Context of the Current Banking Crisis

The view that today's banking crisis is due primarily to the mismanagement and fraud of private bankers underlies most popular accounts of the crisis.[1] Critics are inclined to blame private bankers for banking instability because they wrongly believe that unregulated banking systems are inherently unstable and that regulation is required to restrain some natural tendency of private bankers to engage in mismanagement and fraud. Central banking is said to provide a restraining influence on the destabilizing urges of the private banking system, while free banking is seen as inherently prone to instability. The recent, burgeoning literature on free banking overthrows this conventional wisdom and defends free banking as an inherently stable system made unstable only by legal restrictions and central banking-related interventions.[2] In this view, bad banking comes not from free markets but from perverse public policy.

Guided by erroneous assumptions about the nature of free banking and central banking, analysts of the current crisis typically stress the symptoms (bad banking practices), and overlook the underlying disease (government intervention), as the cause of our problems. For example, many commentators and bank regulators are satisfied to cite anecdotal evidence from the current banking crisis to draw the obvious conclusion that bankers like Charles Keating are incompetent and dishonest, and then to claim that these and similar cases represent the sum and substance of an explanation of the banking crisis. Such figures simply are not representative of the entire industry. While there is no denying that bankers such as Charles Keating exist, we can only understand the fundamental cause of our banking crisis by identifying the institutional arrangements that make such bankers possible. As I argue below, central banking and legal restrictions have institutionalized unsafe banking.

Today's banking crisis is only the latest in a long series of U.S. banking crises blamed on bankers but actually caused by government intervention. A quick review of our banking history makes the point. The mere mention of "wildcat banking" conjures up images of reckless banking practices on the American frontier in the nineteenth century, even though it was government intervention that promoted such practices.[3] "Money panics" in the late nineteenth century were always cause for alarm, political demagoguery, and reform movements aimed at checking the "power" of bankers, even though government intervention brought on those panics as well.[4] The stock market crash of 1929 and the collapse of more than a third of all banks in the Great Depression of the early 1930s were blamed on "excesses" in the financial system and by the bankers of the time, although it was later demonstrated that irresponsible Federal Reserve policy created the boom and the bust.[5] In the past decade, the stupendous demise of the S&L industry, the breakdown of commercial banking, and the collapse of deposit insurance are only the latest examples of crisis in American banking. But these too, are scandals laid primarily at the feet of the bankers, even though government intervention made them possible (Salsman 1990).

In the next section I discuss the nature of banking crises and offer a framework for understanding why bankers are made scapegoats for such crises. In the following sections I discuss three important banking episodes in the United States over the past century, episodes not only characterized by crisis but also followed by reforms intended to preclude future crises: 1) the money panics of the late nineteenth century, especially the panic of 1907, and the Federal Reserve System that followed, 2) the banking collapse of the early 1930s, which brought still further reforms, and 3) the banking problems of the late 1970s that were again followed by reforms in the early 1980s aimed at preventing future instability. Finally, I examine the current banking crisis in light of the historical pattern. In each of these cases I show how misguided reforms flowed naturally from the view that bankers, not government, caused the crises, and that the reforms only perpetuated future instability instead of fundamentally curing it. The historical pattern is as tragic as it is repetitive, because the recurring failure to properly identify government intervention as the culprit in these banking crises has brought only further interventions and further crises. Only if we understand the pattern and break it can we undertake truly effective reform.

II. The Nature of Banking Crises and the Need for Scapegoats

Historically, banking crises have been characterized as either temporary scrambles for liquidity lasting a few weeks or months, or prolonged periods of banking deterioration involving not only illiquidity but also falling asset prices, declining solvency, and bank failure extending over a few years. The "money panics" in the United States during the national banking era are examples of the former type of crisis, while the banking collapse of the early 1930s is an example of the latter type. As Anna J. Schwartz (1986) has observed, the occasional distress suffered by overextended debtors is not sufficient to warrant the label "crisis"; only major disruptions in the payments system or widespread credit defaults closely associated with breakdowns in money itself fit the bill. Moreover, bank runs of limited scope or depositor runs on a limited number of particular banks do not constitute a crisis. Rather, crises entail widespread failures or runs on the banking system itself (Calomiris and Gorton 1991; Tallman 1988).

Where do the fundamental origins of banking crises lie? Some have argued that fractional reserve banking is inherently prone to panics, because deposits that can be withdrawn on demand are primarily invested in longer-term assets instead of cash. But recent research has shown that countries other than the United States with fractional reserve systems have been panic free and that "banking panics are not inherent in banking contracts—institutional structure matters" (Calomiris and Gorton 1991). The phrase "institutional structure" designates the legal and economic framework within which banks operate. Some frameworks clearly promote stability, while others invite crises.

That bankers could be the source of banking crises seems a remote possibility, considering the damage to the health and reputation of the industry that panics bring. There is little evidence in economic theory or history to suggest that private bankers—any more than businesspeople in other fields—would naturally tend to disrupt or destroy their own industry, and therefore their own livelihoods. There is considerable evidence, on the other hand, that governments tend to work to the detriment of the market. The "public choice" revolution in economics has overturned the long-held assumption that government actions are conducted in the "public interest." Instead, the public choice school holds that government pursues its own power, one that is often at odds with optimal market outcomes. Public choice insights about governmental power seeking call for a new perspective on central banking and banking regulation. I have argued elsewhere (Salsman 1990, 119–24) that the primary purpose of central banking is to finance larger government, to provide funds above and beyond those obtained through taxing and borrowing powers. In the United States, such funds have been needed to finance wars, including the Civil War and World War I, but also to finance a growing welfare state that began in the progressive era, when the Federal Reserve was created. Other writers (Goodhart 1988; Glasner 1989, ch. 2) have located the origins of foreign central banks, as well, in governments' desire to secure access to financial resources by endowing particular banks with monopoly powers over money. The basic revenue-raising purpose of central banking carries with it a functional tendency to undermine the financial condition of the private banking system (Salsman 1990, 39–78). The powerful interventions of government central banks and the extensive legal restrictions imposed on the actions of private banks are therefore an obvious starting point for discerning the source of banking instability.

A public choice perspective leads to skepticism about the traditional rationales for central banking and bank regulation. History turns out to warrant such skepticism. The traditional "public interest" perspective claimed that central banks were needed to "fight inflation" or "promote economic growth" or "lower interest rates" or "smooth the business cycle" or "insure full employment." Prior to the establishment of central banking in this century, however, the United States enjoyed much lower inflation and interest rates, greater rates of economic growth, narrower cyclical swings, and lower unemployment. Bank regulation is traditionally justified on the grounds that bankers are reckless in its absence. But extensive research has shown that bankers are more reckless when they have access to government deposit insurance and a lender of last resort, attributes not of free markets but of central banking regimes (Benston et al. 1986).

Public choice theory can also inform us about the tendency of government to make bankers scapegoats for banking crises. Although governments take actions that undermine markets, they do not wish to be seen as disrupters of markets or destroyers of the living standards markets deliver. By deflecting attention away from their own disruptive actions toward those of a scapegoat, governments can escape voter wrath and preserve their powers for another day. If banking crises were widely attributed to central banking and legal restrictions—as they were in Andrew Jackson's day—there might be general agitation for the removal of such interventions. Governments that benefit from central banking and legal restrictions will naturally promote an alternative view.

It is true that government officials in the United States have been blamed in part for today's banking crisis, but seldom in a way that questions government intervention at root. The U.S. government is more often blamed for allegedly "deregulating" banks, for being insufficiently strict in its regulatory oversight, or for being too eager to protect unscrupulous bank executives from regulatory scrutiny. In such cases government is blamed, not for promoting instability through intervention, but for being insufficiently interventionist.

We turn now to an examination of historic banking crises in the

United States, showing how and why bankers have been made scapegoats for government-sponsored instability.

III. Money Panics and Banking Crises in the National Banking Era: Precursor to the Federal Reserve System

During the "national banking era" in the United States (1863–1913), the banking system suffered periodic "money panics" that were significant enough to provoke government investigations—and growing criticism—of private banking practices. Throughout this era, all currency-issuing U.S. banks operated under legal restrictions imposed by the National Currency Acts of 1863 and 1864.[6] Since the investigations generally failed to recognize that the crises were caused by legal restrictions on banks, they paved the way for banking reforms that extended government interventions still further in money and banking.

Historians have identified five episodes of "money panics," or banking crises, in the fifty years between the Civil War and the formation of the Fed in 1913. The banking crises occurred in the years 1873, 1884, 1890, 1893, and 1907.[7] These crises differed considerably from the crises experienced in the twentieth century, the era of central banking. They were briefer, milder, and involved acute illiquidity, whereas in this century crises have involved prolongued periods of recession and depression, widespread bank failure, and chronic insolvency. That the basic solvency of banks was not an issue during the national banking era is confirmed by the relative capital strength of the banking system, even during the five crises. For example, in 1893, the banking system enjoyed a capital ratio (capital as a percent of total assets) of 25%, nearly four times the level maintained by banks today (Salsman 1990, 107).

During the occasional bouts of illiquidity that arose in the post-Civil War banking system, depositors and banks found it difficult, if not impossible, to convert deposits into currency. The illiquidity that did arise was seasonal in nature, not secular; on an absolute level, the liquidity ratio of the banking system (cash assets as a percent of demand deposits) appeared to be high during the national banking era (above 20%), again, well above the ratios maintained by banks today. However, the sharp, seasonal variations in liquidity and occasionally large differences in the relative liquidity levels of particular banks proved troublesome. In some cases banks attempted to build liquidity during crises by contracting call loans, instead of preserving it by suspending the convertibility of deposits. In this respect, depositors were less harmed by the illiquidity than were borrowers. Loan contractions led to occasional bankruptcies and bank failures, which for the most part were well contained. But the panics were brief and did not interfere with long-term economic growth. They typically followed the onset of recessions and did not cause them. Moreover, the costs of the panics in terms of bank failures, depositor losses, or lost output were relatively minor.[8] If anything, the panics infused markets with a renewed sense of caution and conservatism. Overall, of course, the national banking era coincided with a period of unprecedented growth and prosperity for the country. Banks played a significant role in financing the post-Civil War economic expansion, supporting it on footings of sound money and credit.

Although banks were more liquid on an absolute basis during the national banking era than they are today, a relatively greater portion of their reserves were kept in the form of deposits at other banks than was held directly in their own vaults. In particular, in the spring and summer, agricultural banks in rural areas tended to keep reserve balances on deposit at correspondent banks located in cities, primarily in New York. This arrangement explains the seasonal nature of the liquidity crises that were occasionally suffered. In the spring and fall months, agricultural banks would draw on their deposits at city banks to meet higher currency demand associated with planting (spring) and harvesting (fall) activities (Sprague 1910, 19–20; Chari 1989, 11). At other times these interbank deposits were held in New York banks, which typically invested them in call loans—loans to acquire securities. The city banks often paid interest to rural banks for these deposits, because competition compelled them to pass along the interest they could earn by investing the deposits in call loans.

Although these call loans were normally considered liquid and a worthy use of short-term demand deposits, banks found it quite difficult to liquidate them en masse when the fall crop was a healthy one and rural bank withdrawals were heavy. Moreover, the call loans themselves were said to contribute to speculative price rises on stock exchanges, creating inflated values that were not supportable when liquidity was withdrawn. Loan defaults often followed, disrupting business, but the process was seen as a cleansing mechanism as well. Excesses were liquidated and did not accumulate into potentially greater problems in the future.

The liquidity crises of the nineteenth-century U.S. banking system were not an inevitable consequence of unregulated banking. Instead, they were a direct result of distortive interventions in the banking system imposed by government through the national banking acts. These interventions, discussed at length below, included reserve requirements, branching restrictions, and bond-collateral restrictions on currency issuance.

These legal restrictions fostered illiquidity in the banking system in two important ways. First, minimum reserve requirements actually made it impossible for banks to use those reserves for redemption purposes. The intent behind minimum reserve ratios was to ensure bank liquidity, but the exact opposite result was achieved. Only reserves in excess of minimum reserve requirements actually could be used to meet deposit withdrawals. Thus, even if a central reserve city bank met its reserve requirement, it faced a reduction of that ratio (and a violation of the banking laws) with every marginal request for deposit redemption. To preserve or restore its reserve ratio in the face of such withdrawals, it had to build reserves either by acquiring additional reserves or by contracting loans. Ironically, because the actual reserves on hand were just sufficient to meet regulatory liquidity requirements, they could not be used directly to meet demands for liquidity. Of course, this perversity is common to all minimum reserve requirements. Precisely those reserves that are required for liquidity are not available to meet depositor requests for liquidity. Unrestricted by rigid reserve requirements, the banks would have been in a far better position to meet rising demands for liquidity. During this time, the United States was the only major country in the world that had legal reserve requirements (Friedman and Schwartz 1963, 118 note 44).

Second, by segregating the banking system into "country banks," "reserve city banks," and "central reserve city banks," the reserve requirements imposed by government under the national banking system encouraged an unstable inverted "pyramid of reserves" that was susceptible to breakdown during sharp, seasonal variations in the demand for liquidity.[9] Country banks were required to maintain reserves equivalent to 15% of their deposits, two-fifths of which had to be held as cash in their vaults. The rest could be held as deposits at reserve city banks, which typically earned interest. In turn, reserve city banks, located in fifteen designated cities, had to maintain reserves equal to 25% of deposit liabilities, half of which could be held as deposits in central reserve city banks, primarily large New

York City banks. Finally, the central reserve city banks were required to maintain minimum reserve ratios of 25%. The central reserve city banks tended to invest their correspondent balances in call loans, normally the most liquid investment available. When crops were harvested in the fall and the country banks demanded cash, New York banks were forced to meet the withdrawals of interbank deposits by demanding payment on call loans. Had country banks not been encouraged by the National Currency Acts to hold reserves as deposits in reserve city banks, they would have been better equipped to control their own reserves and to satisfy directly seasonal changes in demand for cash. New York banks would have had little reason to invest their funds in call loans.

Branching restrictions imposed by law also encouraged reserve pyramiding by preventing country banks from being branches of banks with head offices in financial centers. Banks with widespread branching networks would have been able to shift reserves flexibly to branches where the demand for cash was greatest, instead of relying on the capacity of other banks to meet requests for cash in a pinch. Branching restrictions also prevented banks from diversifying their assets, a pervasive source of instability that plagues our system even today. Again, the United States was the only major country in the world to impose such onerous branching restrictions.

The illiquidity inherent in the national banking system was also a direct consequence of the bond-collateral provisions spelled out in national legislation. Banks could only issue bank notes, or currency, if the notes were secured by bonds issued by the federal government. The basic purpose of the collateral provision, as Secretary of the Treasury Samuel Chase made clear, was to assist the Union government in financing the Civil War by fostering a demand for its debt. But the provision was also promoted as a way to provide a "uniform" currency and to protect noteholders against ultimate loss—two "public interest" rationalizations that have been interpreted sympathetically by historians.

Whatever the motives of government, the legal restrictions imposed on bank currency fostered illiquidity by making the note issues of banks "inelastic." Banks could not freely expand and contract their note circulation in accordance with the needs of trade, but instead were confined to issuing notes in accordance with the exigencies of government finance. This meant that banks could not easily satisfy shifts in the public's ratio of deposits to currency. The restrictions became ever more onerous as the national banking era progressed, because the U.S. Treasury was reducing the total national debt available to collateralize bank notes in anticipation of resuming specie payments in 1879. Even after resumption, the supply of required collateral was diminishing, especially relative to trade. The relative scarcity put a premium on eligible bond collateral, making note issue excessively costly (Smith 1936, 149). There were also burdensome administrative delays imposed by the Treasury when it approved and shipped out currency, delays that were most binding when the demand for currency was greatest and the state of panic most acute (Horwitz 1990, 640–41).

The money panics of the nineteenth century did not reflect a lack of confidence in banks by depositors but only the fact that it was illegal for bankers to freely meet shifts in depositors' demand for currency relative to checking deposits. As Friedman and Schwartz (1963, 295, note 77) have argued, the panics of the national banking era "resulted much less from the absence of elasticity of the total stock of money than from the absence of interconvertibility of deposits and currency." A system of free banking would have delivered superior results. As George Selgin (1988b, 626) has expained:

> When banks are unrestricted in their ability to issue bank notes, each institution can meet increases in its clients' demands for currency without difficulty and without affecting its liquidity or solvency. . . . The supply of currency is flexible under unrestricted note issue because bank note liabilities are, for a bank capable of issuing them, not significantly different from deposit liabilities. . . . The issue of notes in exchange for deposits merely involves offsetting adjustments on the liability side of the the bank's balance sheet, with no change on the asset side.

Unfortunately, the national banking laws did not permit unrestricted note issue, and therefore banks were forced to meet increased currency demand by paying out reserves and making painful adjustments to their loan assets. Had banks been able to issue notes without inflexible bond-collateral provisions, and with only the requirement that the notes be redeemed in a medium mutually agreed to by bank and noteholder, there would have been no system-wide liquidity crises to speak of in these decades.

Bankers were innovative in trying to offset the perverse effects of these legal restrictions on currency issuance. Sometimes they permitted their reserve ratios to fall temporarily below the 25% legal minimums in order to meet depositor withdrawals and prevent suspensions. The banks would restore their ratios once the stringency passed. In addition, in each of the panics the clearinghouses of central reserve city banks created "clearinghouse certificates" that were used in place of currency to settle reserve clearings between members, thereby preserving the more limited supply of currency needed to meet depositor withdrawals (Timberlake 1984; Gorton 1984). In other cases, bankers and businesses simply issued private currency, bypassing banking laws (Andrew 1908). As a last resort, convertibility was restricted or suspended for brief periods (but only in the panics of 1873, 1893, and 1907) (Gorton 1985). By all these measures, banks were able to minimize the contraction of loans that otherwise would have been necessary to meet withdrawals. But despite the role played by legal restrictions in fostering illiquidity and other distortions in the nineteenth-century banking system, and despite the innovative attempts by banks to overcome these distortions, the banks themselves were largely blamed for the crises. They were condemned as lawbreakers for going below minimum reserve requirements. City banks especially were blamed for paying interest on deposits, for luring country banks into opening correspondent accounts, for financing speculation, and for issuing "unauthorized currency" in the form of clearinghouse certificates.

Government reports implied that fraud, mismanagement, and bank failures were the prime causes of the money panics. In one report, for example, the comptroller of the currency said the 1873 crisis was caused by the payment of interest on deposits and by the financing of speculation by banks. The comptroller (quoted by Sprague 1910, 81) further blamed the few banks that failed during the crisis for having started it, and said the failures were due to "the criminal mismanagement of their officers or to the neglect or violation of the national bank act on the part of their directors." One of the "criminal violations" referred to involved lowering reserve ratios below legal minimums to meet withdrawals. The comptroller, John Jay Knox, simply dismissed the complaint of bankers that legal reserve requirements made those reserves unavailable to depositors, insisting instead that "the provision requiring that a reserve shall be kept on hand at all times was intended to protect the depositor and to keep the bank in funds for the purpose of responding at all times to the demands of its creditors." To suggest that the requirement was harmful, he said, "is equivalent to declaring that the national currency act was intended to provide for the destruction of the very institutions it created."[10] The comptroller recommended increased government intervention into banking: closer scrutiny of bank lending practices, prohibitions on the payment of interest on deposits, and swift prosecution of banks that violate minimum reserve requirements.

Government officials generally did not criticize the reserve requirements, the reserve pyramiding, or the note issuance restrictions imposed under the national banking laws. Where criticisms were voiced, they were not sufficiently adopted to reform the laws. In its report on the crisis of 1873, the Treasury recognized that "with a fixed amount of circulation of bank notes and of United States legal-tender notes not redeemable in coin and with gold above par with currency, there must be each year times of redundancy and times of scarcity of currency, depending wholly on demand, no method existing for increasing the supply. With a circulating medium redeemable in coin, a redundancy is corrected by the export, and a scarcity by the import of specie from other countries." On the basis of this insight, the Treasury recommended "a permanent return to the sound basis of specie payments and a gold standard to which all our paper issues shall be made of equal value."[11] A specie resumption act was passed in 1875 and the United States resumed specie payments on legal tender notes in 1879. The absolute ceiling on aggregate national bank note circulation was lifted and bond-collateral requirements were eased very slightly in 1900. But the main features contributing to illiquidity persisted, and money panics remained a near certainty.

The 1893 panic stemmed not from banker wrongdoing but from uncertainty over the federal government's willingness and ability to maintain the gold standard in the face of pressure from silver interests and other inflationists (Friedman and Schwartz 1963, 104–118). Once uncertainty set in, the destabilizing features of the national banking system outlined above made the situation worse. This time, remarkably, both the comptroller of the currency and the U.S. Treasury Department advocated the repeal of the bond-collateral provisions in their 1894 annual reports. Treasury Secretary Carlisle (quoted in Friedman and Schwartz 1963, 117–18, note 44) went further and even recommended the repeal of legal reserve requirements, arguing that

> every prudent bank, if left free to conduct its deposit and discount business in the manner most advantageous to its own interests and the interests of its patrons, will undoubtedly keep on hand a reasonable reserve to meet not only all the ordinary demands upon it, but to provide for such emergencies as are liable to occur . . . but it ought not be prohibited by law from using such reserve for the only purposes it was designed to accomplish. . . . To provide for a reserve which can not be utilized even at a time of greatest stringency and distrust without incurring penalties of forfeiture, affords a most striking illustration of the impolicy of legislative interference with the natural laws of trade and finance.

Unfortunately, the insights and recommendations of the Treasury were ignored by legislatures, bankers were again blamed for the panic, and the destabilizing "legislature interference" recognized by Secretary Carlisle remained in place.

The panic of 1907 was the last of the money panics under the national banking era, but it was the most important because it was a precursor to passage of the still more interventionist Federal Reserve Act. The exact origins of the panic are widely debated still today. Sprague's authoritative account has demonstrated the considerable financial strength and prudent lending postures of the reserve city and central reserve city banks prior to the crisis, so there is little reason to suspect speculative influences played a major role (Sprague 1910, 216–24). "But there was another influence," remarked Sprague (1910, 230–31), "potent during this period, which tended positively to encourage unsound banking—a large government surplus." In and of itself, a surplus reflected sound public finance. But the surplus meant that government securities, required to back bank currency, were in short supply. As before, seasonal instability set in, and the reserve pyramid started to topple. This time, trying to overcome the illiquidity that ensued, Secretary of the Treasury Shaw engaged in a series of disruptive operations, depositing and then suddenly withdrawing government deposits from banks in need of cash (Sprague 1910, 230–32). His efforts to manage the equivalent of a game of musical chairs were futile, if not destabilizing.

Congress further undermined confidence in financial markets in the summer of 1907, when it conducted hostile investigations of the railroad and mining industries in keeping with the age of "trust-busting" and the wishes of President Theodore Roosevelt (Groseclose 1980, 16–25). This, in turn, led to the failure of some trust companies, notably Knickerbocker Trust Company, due to falling securities values. Unlike the banks, trust companies had a disproportionate share of assets in securities and call loans, making them more vulnerable; meanwhile, only six banks failed during the panic (Calomiris and Gorton 1991, 157). Nevertheless, after the impact of the securities losses, the 1907 panic snowballed for reasons not terribly different from those in earlier panics. Legal restrictions prevented banks from satisfying changes in the deposit/currency ratio, when fall crops started to move. Again, bankers tried to respond by resorting to clearinghouse certificates and emergency currency.

Banks ran the risk of being charged with breaking the law for issuing "unauthorized" currency (Horwitz 1990, 641–43). But government officials could not ignore the effectiveness of the issues in ameliorating the 1907 Panic, and legalized the procedure via the Aldrich-Vreeland Act of 1908 (otherwise known as the "Emergency Currency Act"). The act effectively "decriminalized" the issuance of emergency currency, selectively permitting groups of banks to issue currency, when needed, on the basis of usual banking assets, not government bonds. The act was only intended as a temporary measure, and emergency currency was only allowed to supplement, not replace, the bond-based currency already in circulation. Nevertheless, the concept behind the Aldrich-Vreeland Act proved eminently successful on the one occasion when it was relied upon before the Federal Reserve was formed. The beginnings of a liquidity panic, resulting from the outbreak of World War I in the summer of 1914, were blocked by the issuance of $400 million in emergency currency, representing nearly one-quarter of total currency in the hands of the public after issue. When anxieties diminished, the currency was withdrawn and retired. According to Friedman and Schwartz (1963, 172, 693–94), the act "provided an effective device for solving a threatened interconvertibility crisis without monetary contraction or widespread bank failures." In fact, they contend that the experience of the summer of 1914 showed that the Aldrich-Vreeland Act alone was capable of preventing future panics, that a Federal Reserve was unnecessary, and that emergency currency powers available to the private banking system would have been sufficient even to forestall the 1929–33 crisis.[12]

Despite distortions imposed by government under national banking laws, and the innovative solutions of private bankers to overcome those distortions, the banking community was made a scapegoat for the 1907 crisis, and additional government intervention was recommended. Congress initiated two full-scale investigations to achieve these purposes. First, acting on a requirement of the Aldrich-Vreeland Act, it formed the National Monetary Commission to study the prospects for reforming the banking system. The commission published over twenty volumes applauding the alleged virtues of foreign central banking systems, clearly pushing a foregone conclusion. Although the commission formally recommended a "private" solution (incorporating a National Reserve Association among banks in the United States) to currency panics, its predominantly favorable views on central banks abroad, and its inability to fully recognize and advise repeal of the interventionist defects of the national banking laws, paved the way for the creation of what has turned out to be a powerful central bank, the Federal Reserve, in 1913.

A major impetus to establishing the Fed, however, came from another congressional committee bent on making bankers the scapegoats. The House Committee on Banking and Currency convened a subcommittee in April 1912 "to investigate the concentration of money and credit" in private hands (Cleveland and Huertas 1985, 67). Chaired by Louisiana Representative Arsene Pujo, and in operation through February 1913, the "Pujo Committee" lambasted Wall Street banks for conducting an allegedly abusive, clandestine, and conspiratorial "money trust," supposedly to the detriment of sound banking, market liquidity, and the economy at large. After months of investigation the Pujo Committee concluded that five firms—J. P. Morgan, First National Bank, National City Bank, Guaranty Trust Company, and Bankers Trust Company—had interlocking directorships in various financial and industrial companies with total capital of $22 billion (Cleveland and Huertas 1985, 67, 359 note 53, 360 note 54). The growth of these banks, and their relationships, reflected the massive growth in the country's industrial base, and the need to pull together a legislatively fragmented banking structure (Chernow 1990, 153). But they were suspected of wrongdoing all the same, even though the committee never proved that such relationships caused or worsened the periodic money panics or instabilities of the pre-Fed era. The committee did claim, incredibly, that city banks may have purposely starved country banks of liquidity at crucial times. Of course, the committee ignored the basic illegality of meeting currency demand under national bank laws, and it made no attempt to reconcile its charge with the opposite conclusion contained in a report of the National Monetary Commission, that city banks had caused panics by overly favoring the country banks with attractive correspondent services (see Sprague 1910). Publicity rather than objectivity appears to have been the major consideration of these reformers and other "trust-busters" at the turn of the century.

Animosity toward private bankers was common among politicians. In debate over the Federal Reserve Act, Senator Hitchcock (quoted in Timberlake 1989, 5) expressed the prevailing sentiment against concentrations of power, except in the hands of government: "We believe in government control, real and actual, all the time," he said, "and we do not believe that the banking interests in any community should be entrusted with that power." Presidential candidate Woodrow Wilson (quoted in Cleveland and Huertas 1985, 67), in one bit of tortured logic, claimed that "Wall Street brought on the 1907 Panic, got the people to demand currency reform, brought the Aldrich-Vreeland currency bill forward and, if it dares, will produce another panic to pass the Aldrich central bank plan. We need reform," he urged, "but not at the hands of Wall Street." He also (Cleveland and Huertas 1985, 360 note 55; Chernow 1990, 149) called the Wall Street banking community "the most dangerous of all monopolies," and said, "a concentration of the control of credit . . . may at any time become infinitely dangerous to free enterprise" —a warning not against proposals for a central bank but against private banks.

As president two years later, Wilson would sign the bill forming the Federal Reserve, granting the government itself monopoly powers over money and credit in the United States. He did so even though Wall Street did not produce the panic he expected; in fact, as mentioned above, private banks positively suppressed a panic caused by government declarations of war. The momentum for increased intervention was fueled by the tendency (common on later occasions as well) for leading bankers to appease their critics in politics and the media and even to assist Congress in drafting laws bringing further intervention to the industry.[13]

While there were a few insightful contemporary critics of the national banking system (e.g., Noyes 1910), most reformers unfortunately did not recognize the benefits of free branching, unrestricted note issue, and decentralized reserve management. They correctly saw panics as reflecting an "inelastic currency," but somehow blamed bankers instead of the law for their inability to manage the currency properly. Instead of freeing the note issue, they recommended that government nationalize the note issue. Instead of repealing the inherent rigidities of the national banking laws, they condemnned the alleged inordinate concentration of financial resources and management in a few, inept, private hands, and called for its concentration in still fewer, albeit government, hands, at the Federal Reserve. Instead of having the control of capital in Wall Street, they demanded that control be shifted to Washington. They apparently had no conception that much greater ineptitude might follow such a shift. Failing to locate the underlying source of nineteenth-century U.S. banking panics in the distortive interventions of the national banking laws, reformers erected a superstructure of central banking that would eventually prove more destabilizing.

IV. The Banking Crisis of the 1930s and the Expansion of Federal Reserve Powers

The stock market crash of 1929, the banking crisis of 1931–1933, and the Great Depression suffered in the 1930s were disasters of unprecedented proportion in the history of U.S. finance. Nearly one-third of all banks failed. Legal restrictions on banks that prevented branching and the diversification of risks meant that most failures were of small, single-office banks tied by law to undiversified pockets of the economy. Legal prohibitions on private note issue were also harmful, as neither banks nor clearinghouse associations were permitted to issue currency to meet depositor claims. The economic impact of the banking collapse was profoundly damaging, as the money supply and income fell by a third, business investment plummeted, and unemployment reached 25%.

The basic cause of the banking crisis was the Fed's monopoly on the issuance of money and its attendant power to manipulate money and credit in defiance of market preferences. Erratic inflations of the money supply by the Fed in the 1920s encouraged the real estate and stock market speculation for which that decade became known (Rothbard 1975, 126–52). To foster monetary inflation, the Fed had actively countered the long-established, conservative rules of the gold standard. Instead of tightening monetary policy in response to gold outflows (which signaled relatively higher prices in the United States than in foreign countries), the Fed chose to replace its gold holdings with government debt instruments, in the process loosening monetary policy at precisely the wrong time.[14] The Fed decelerated its inflating in 1928, and the stock market crashed the following year. By gross mismanagement of system liquidity in the following four years, the Fed brought on the collapse of the banking system, and the Great Depression (Friedman and Schwartz 1963, chapter 7). The Fed had supposedly been established as a better alternative to the speculations of private bankers and as a means of providing an elastic currency to prevent banking panics, but on both counts it failed blatantly. In the 1920s, it supplied too much money and fostered speculation and unsound lending, while in the crisis of the 1930s it supplied too little currency and failed to satisfy a large-scale shift in depositors' demand for currency.[15]

As a monopoly issuer of currency, the Fed's performance was universally destructive, for without the Fed's monopoly, the market would have had no unilateral source of speculative excess, and in troubled times could have turned to more reliable providers of currency. A fully free, private banking system would not have been wholly free of mistakes, but neither would the entire system be exposed to unilateral mismanagement of a government agency, as it was under central banking. The proper response to this disaster would have been to limit sharply (or abolish) the Federal Reserve, return gold and the management of the gold standard to the private banking system, eliminate reserve requirements, permit the issuance of currency by banks (this time without bond collateral provisions), and repeal branching restrictions. But because the proper cause of the crisis was not identified, wholly opposite reforms were enacted. As in earlier crises, a congressional commission was formed that made the bankers scapegoats and laid the foundation for still greater grants of legislative power to the Federal Reserve and other banking regulatory agencies. Among other things, the Pecora Commission (named for the legal counsel to the Senate Banking Committee, Ferdinand Pecora) condemned bankers for promoting speculations, stock price manipulation, and fraud. The commission charged that private bankers caused the collapse of their own industry in particular and of economic activity in general.

The Pecora Commission set the moral tone for the banking reforms of the 1930s. The commission did not engage in dispassionate analysis of the banking industry or government policies, nor did it explore remedies in any scientific manner. Rather, its hearings were infused with indignation against the banking community, charging that it had worked in near-conspiratorial manner to bust the stock market, bring down banks, and wreck the economy. Its emotion-laden bias colored the legislation that was passed during and soon after the hearings. Although other, more dispassionate sessions were conducted around the time of the Pecora hearings, the damage inflicted on the reputation and credibility of the financial community by the commission made it easier for lawmakers to justify comprehensive interventionist reforms.[16] Senator Carter Glass, chairman of the Senate Banking and Currency Committee, conducted hearings that eventually brought legislation separating commercial and investment banking. As one writer (Flannery 1985, 69) contends, the Pecora hearings "became a watershed in Glass's drive to divorce investment banking from deposit banking in the United States."

The Pecora hearings focused on National City Bank, its chairman Charles Mitchell, and its brokerage affiliate, National City Company, charging not only that they engaged in financial malpractice and fraud but also that such activity was representative of the entire financial community and responsible for the stock market crash, the banking collapse, and the Depression. This broad charge was never substantiated, and the fact that National City and bankers were scapegoats was clear, even to Pecora. He later admitted to picking Mitchell as his lead witness not because of suspicions of wrongdoing but because "National City was one of the very largest banks in the world, and had but recently been surpassed by the Chase National. The prestige and reputation of these institutions was enormous. They stood, in the mind of the financially unsophisticated public, for safety, strength, prudence, and high-mindedness, and they were supposed to be captained by men of unimpeachable integrity, possessing almost mythical business genius and foresight" (Pecora 1939, 71). Instead of simply assuming that the banks' sterling reputation was wholly undeserved, Pecora and his fellow congressional investigators might better have considered that bankers would not wish to throw such an asset away in a suicidal flourish.

The Pecora Report charged that National City's securities affiliate failed to disclose material facts, pursued high-pressure sales tactics, traded in the stock of National City Bank, obtained customer referrals from the bank, and took bad loans off the books of the bank (Kelly 1985, 52). Importantly, the Pecora hearings did not show that these practices weakened the bank or its affiliate, or in any way contributed to the general crisis.[17] In fact, with a historical perspective devoid of the emotionalism of the time, these practices appear relatively innocuous. Although Pecora's charges referred to technical matters, the message to the public was that a grand immorality had been perpetrated. The public took the message to heart. One historian (Chernow 1990, 356) recalls that "as people followed the hearings on their farms and in their offices, on soup lines and in Hoovervilles, they became convinced that they'd been conned in the 1920s. Yesterday's gods were no more than greedy little devils." Another writer (Flannery 1985, 70–71) observes that the "publicity surrounding National City Bank chairman Charles Mitchell's testimony generated widespread and intense public reaction. Bankers came to be viewed as venal, selfish, and perhaps responsible for the depression." A history of the National City Bank (Cleveland and Huertas 1985, 172) recounts that "as crisis followed crisis and the depression deepened, the public mood darkened. Shock and dismay gave way to anger and bitterness and a need to assign blame. Wall Street bankers became the object of the public's mounting wrath." Media coverage contributed to the search for scapegoats: "as the depression deepened, the press increasingly pictured banks as villains rather than victims. Bankers, Charles Mitchell foremost among them, were reviled as 'banksters' " (Cleveland and Huertas 1985, 160).

These hostile images of bankers were reinforced in Congress by politicians like Senator Wheeler of Montana, who said (quoted in Cleveland and Huertas 1985, 356), "The best way to restore confidence in the banks would be to take these crooked presidents out of the banks and treat them the same way we treated Al Capone when he failed to pay his income tax." When the most respected banker of the day, J.P. Morgan, Jr., was brought before the Pecora Commission, he was primarily ridiculed for having paid no income tax in the previous three years (Cleveland and Huertas 1985, 366). No evidence was uncovered to suggest that his bank or its syndicates had caused the crisis. Instead, the commission criticized the Morgan bank for what could as easily have been interpreted as its business success, namely, its extensive dealings with the country's top companies, and for its prominent role as a "bankers' bank." The vilification of the bankers extended right up to the White House. In his first inaugural address in 1933, President Roosevelt (quoted in Cleveland and Huertas 1985, 190) blamed the crisis on the country's leading bankers, and referred to them as "the unscrupulous moneychangers" who "through their own stubbornness and incompetence, have admitted their failure, and have abdicated . . . from their high seats in the temple of civilization." With criticism of bankers coming from every quarter—Congress, the White House, the media, and the public—the punitive system of banking regulation enacted in the 1930s was inevitable.

The most respected academic expert on banking at the time, H. Parker Willis of Columbia University (quoted in Flannery 1985, 71), took a different view:

> A fair examination of the facts disclosed by the Senate investigation leaves the feeling that but few persons, relatively, have been examined, and that these, while often "prominent" are not in themselves representative of either banking or business. We must, accordingly, reject entirely the notion that—so far as these inquiries show—there has been a revelation of demonstrated crookedness on the part of American finance, trade, and banking at large. There has been nothing of the sort.

Willis was the principal advisor to Senator Glass on legislative reforms, but his assessment was ignored by Glass, who was instrumental in giving greater powers to government banking agencies after the crisis. The fact that neither Willis nor the politicians he advised in the 1930s placed much blame for the crisis on the central bank may be explained by the fact that both Willis and Glass had also played key roles in the drafting of the Federal Reserve Act in 1913.[18]

Other congressional hearings in the 1930s focused more on the poor lending experience of lenders (such as that of National City Bank in Latin America) and less on bankers' moral turpitude. But the bankers were blamed nonetheless. Senator Couzens of Michigan (quoted in Cleveland and Huertas 1985, 185) claimed that "unreasonable salaries and bonuses lead to unsound banking and unsound sales of securities." Bankers were criticized for their paychecks, for financing real estate and stock speculations, for supporting securities affiliates with commercial loans, and for being insufficiently liquid to survive depositor runs on their institutions. Private depositors were criticized for wanting to convert their deposits or for "hoarding" gold. But there was virtually no criticism of the Federal Reserve for its inflation of money and credit in the 1920s, or for its mismanagement of the discount window in the early 1930s. There was also no criticism of the regulatory restrictions on branching that prevented diversification and kept many banks small and vulnerable to failure.

Some congresspeople, eager to pin the blame for the crisis on private bankers, claimed that the small percentage of commercial banks with securities affiliates had caused each of the important disasters, from the stock market crash to the banking collapse to the Great Depression. Senator Glass, in sponsoring legislation forceably separating commercial and investment banking, declared, "These 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 were mainly responsible for the depression under which we have been suffering since. They ought speedily to be separated from the parent and in this bill we have done that" (77 *Congressional Record*, 19 May 1933, 3726).

The separation was finalized in the Banking Act passed in June 1933.

The facts about the role of securities activities in commercial bank failures do not support Glass's view. First, commercial banks had been involved in the securities business, through brokerage subsidiaries, well before the 1920s.[19] Second, fewer than 8% of the national banks with the biggest securities operations failed during the crisis, while over 26% of all national banks failed. More important, most failures involved smaller state banks that did not conduct securities businesses. Finally, in many cases the presence of securities affiliates actually reduced the probability of bank failure (White 1986). Even in the few cases where banks were found to have failed due to a fall in security values, economist William F. Shughart, II (1988, 605) has argued that "it is disingenuous to accuse bankers of bad management after the fact when unanticipated events have caused the realized rate of return on a particular asset to be less than expected." In short, the securities activities of commercial banks were not responsible for the stock market crash, the banking crisis, or the depression (Flannery 1985). Reformers nevertheless played on the sensationalism of these events and pinned blame squarely on bankers.

In passing the Glass-Steagall Act, Congress was able to divide and conquer the banking industry. Brokerage firms would have a protected securities market all to themselves, and commercial banks would not face competition from brokerage firms taking deposits. Passage was assured once bankers tried to appease the politicians. In March 1933, after much criticism, National City Bank and Chase National Bank agreed voluntarily to divest their securities affiliates, and the American Bankers Association, after early opposition, also caved in to pressure and supported the act.[20] Before it was also targeted, J. P. Morgan's bank had applauded the actions of President Roosevelt, especially his demolition of the gold standard.[21] The U.S. Treasury also benefited by the act because it purged commercial bank portfolios of private securities, which increasingly had competed with government securities for loanable funds in the 1920s (Shughart 1988, 600, 610–11).

The money and banking reforms that were adopted in the 1930s reflected entirely the misconceptions about what had caused the crisis. Instead of reining in or abolishing the Fed, Congress granted it still greater powers, including the centralization of power at the Board of Governors in Washington. Instead of removing political motives associated with Fed policymaking, the Glass-Steagall Act permitted the Fed to back its issues of currency with government debt, whereas in the original Federal Reserve Act it had to back them with commercial paper and gold (Friedman and Schwartz 1963, 191, note 4). Instead of returning the supply of gold and the management of the gold standard to the private banking system, the government criminalized the private ownership of gold, confiscated gold holdings of banks and citizens, abrogated the gold clauses of Treasury bond indentures, and devalued the dollar.[22] Instead of giving banks the power to issue currency and satisfy the changing preferences of the public for currency relative to deposits, the government gave the Fed a virtually unlimited capacity to issue money. Instead of permitting banks to become safer through free branching and the diversification of loans and deposits, it erected a system of government deposit insurance to "guarantee" deposits. In the process, flat-rate "insurance" assessments were imposed on banks that effectively taxed prudent institutions for the benefit of reckless ones. Even Franklin Roosevelt (1938, 37) recognized at the time that federal deposit insurance "would put a premium on unsound banking in the future." Instead of leaving banks free to make credit decisions on a sound basis, the Fed and other banking agencies assumed greater influence over bank lending policies, and forceably separated commercial and investment banking. On the pretext that bad lending flowed inevitably from the payment of interest on deposits, government imposed ceilings on the rates banks offered. Finally, instead of abolishing reserve requirements, government actually raised them in the mid-1930s, precipitating a second depression in 1937–1938.

In every respect, government interventions in money and banking were expanded and intensified in the early 1930s, despite the sorry record of interventionism. This result was made possible by a diversion of attention, by intense muckraking investigations of private banking activities, and by the virtual absolution of all government sins associated with the crisis. The work of the Pecora Commission positioned private bankers as scapegoats for a government-created crisis and provided justifications for ensuing legislation. The reforms that were passed did not solve the fundamental problems associated with central banking and legal restrictions, but only further undermined sound money and banking.

V. Institutionalized Inflation and the Deterioration of Banking in the Postwar Period, 1945–1980

Compared to the instability of today, the money and banking system appeared quite stable in the postwar decades leading up to the banking reforms of the early 1980s. But closer examination reveals that these decades were characterized by prolonged and profound deterioration. The money and banking reforms of the 1930s set the stage for an unprecedented wave of inflation that began building after World War II and accelerated in the 1960s and 1970s, encouraging speculative lending practices at thrifts and commercial banks. These decades were marred by chronic deficit spending and inflation, both of which were made possible by the fiat money-creating power of the Federal Reserve, power that had been significantly enhanced in the reforms of the 1930s. In addition, during these decades interest rates were high and volatile, reflecting inflation expectations, and exposing banks and thrifts to damaging maturity mismatches.

The postwar commercial banking system in the United States suffered a secular deterioration in its financial condition that closely mirrored the ongoing debasement of the dollar. For example, the aggregate capital ratio of the banking system declined from over 14% at the end of the Great Depression to under 7% in the early 1980s (Salsman 1990, 52–75). Other measures of financial performance in the banking industry—such as asset quality, profitability, and liquidity—showed similarly grim trends. Boom-and-bust patterns, such as the real estate debacle of the mid-1970s, appeared quite similar to those of the 1920s. As the credit ratings of banks fell below those of top customers, banks lost sound lending business to the commercial paper market and floundered to make up the difference with loans against real estate, to the stock market, to Socialist foreign governments, highly leveraged companies, and overextended consumers. On the liability side, banks suffered a massive outflow of depositor funds to relatively unregulated money market mutual funds, a process of "disintermediation" made possible by a combination of inflation (causing high rates) and legal ceilings on bank deposit interest rates (Regulation Q). By the late 1970s, banks were fleeing the Federal Reserve system to escape the costs of maintaining reserves (which paid no interest) and losing deposits.

S&Ls were even worse off than banks, straining under inflation rates and interest rates that reached as high as 14.5% and 21.5%, respectively, in the late 1970s. The Fed's inflationist policies proved destructive to the S&Ls, whose business consisted of making long-term fixed rate home mortgages funded by short-term savings deposits. When interest rates increased, S&Ls could not reprice their assets quickly enough to reflect new market yields. They also suffered from disintermediation, along with banks. In 1979 alone, when Treasury Bill rates were as much as 6% above permissible bank rates, savings accounts at banks and thrifts fell by over $12 billion.

This prolonged postwar deterioration in money and banking—culminating in the "dollar crisis" of the late 1970s—was made possible by the government's fiat money monopoly, the widespread acceptance of Keynesian economics, and the chronic deficit spending and inflationism that resulted from both. Following the inflation of the 1960s, the last link of gold to the dollar (convertible for foreign central banks) was severed in 1971, ushering in still higher rates of inflation thereafter. Few of the difficulties suffered by banks and thrifts would have arisen had government not sponsored inflation and interest rate controls.

Unfortunately, popular explanations for postwar deterioration in money and banking blamed bankers, not government. Inflation and high interest rates were blamed not on the money monopolist, the Federal Reserve, but on greedy businesspeople and bankers. The dollar crisis was blamed on "international speculators," instead of on the sole issuer of dollars, the Fed.[23] Disintermediation was blamed on "competitive pressures" emanating from the relatively unregulated mutual fund industry, whose accounts paid market rates of interest. Banks were blamed for leaving the Federal Reserve System and making it difficult to conduct monetary policy. They were blamed for creating holding companies, even though these were devised to overcome branching and business line restrictions, in order to diversify income sources. They were criticized when they tried to achieve efficiencies through mergers; for example, the merger of Manufacturers Trust and the Hanover Bank faced four years of regulatory obstacles in the early 1960s. Banks were blamed for speculative lending, and S&Ls were blamed for lending long while borrowing short, even though government housing credit agencies had encouraged them to do so.

By failing again to properly identify the cause of the postwar deterioration in money and banking, government once again enacted reforms that failed to solve the basic problems inherent in central banking and instead provided the impetus for the further deterioration we are experiencing today. Instead of permitting a greater variety of income sources, Congress passed the Bank Holding Company Act in 1956 to restrict banks' well-intentioned diversification strategies. Instead of discouraging overcapacity and encouraging cost efficiencies, the Justice Department and federal courts blocked or delayed the bank mergers that would make them possible. Instead of encouraging diversification, the 1970 Douglas Amendment to the Bank Holding Company Act placed limits on branching. Instead of abandoning Federal Reserve inflationism when the dollar weakened in the late 1960s, President Nixon abandoned the international gold standard. Instead of controlling Federal Reserve inflationism in the 1970s, Nixon and Carter both imposed controls during the decade on the symptoms of that policy, ever-rising wages, prices, and credit. Instead of addressing the reasons why banks were fleeing the Federal Reserve System, legislation in 1980 simply required all depository institutions to be members.[24] Instead of addressing the underlying deterioration of banks and thrifts and the diminished confidence of depositors, the 1980 reforms nearly tripled federal insurance coverage, from $40,000 per deposit account to $100,000. The 1980 reforms established a six-year phaseout of deposit interest rate ceilings to address disintermediation, but the business that flowed to the mutual funds never returned, and many institutions were left fatally weakened by the previous controls. The Garn-St. Germain Act of 1982 tried to remedy this weakness by granting thrifts wider lending powers, but the combination of greater latitude in asset choice, together with a massive expansion of the federally insured deposits funding those assets, was a sure prescription for recklessness.

None of the reforms of the early 1980s would have been necessary had blame been properly placed on deficit spending, inflationism, and legal restrictions on banks. The only proper response to the deterioration would have been to identify and eradicate its root cause, central banking and legal restrictions. Government policy-makers should have rejected Keynesian-inspired deficit spending policies. They should have restrained or abolished the engine of inflation that is the Federal Reserve. They should have scaled back and ultimately abolished deposit insurance, and permitted full branching, merger, and investment banking powers. Ultimately, they should have denationalized gold and considered the adoption of free banking on a gold standard.

VI. The Present Banking Crisis

If the banking reforms of 1980 and 1982 had attacked the root cause of the banking problem, we would have seen some improvement in the banking system in the rest of the decade. Instead, the deterioration of banks and thrifts accelerated, despite months of unbroken economic growth. The extent of the thrift debacle in the United States is by now well known. Nearly a third of the thirty-one hundred S&Ls in existence in 1980 have since failed or reached insolvency while being propped up by government assistance. Nearly 20% of the $1 trillion of assets in the industry became "nonperforming" in the decade of the 1980s. The industry's deposit insurance fund was depleted in less than four years after reaching a high of $6 billion in 1985. Estimates of the total cost of the S&L debacle have reached $500 billion (or $130 billion on a present value basis over thirty years), and due to legislation passed in 1989, the costs will be borne directly by taxpayers.[25]

There has also been massive deterioration in the commercial banking industry. Since 1980, U.S. banks have failed at rates unseen since the Great Depression. Even in inflation-adjusted terms, the largest bank failures in our history have occurred in the last decade. Whether lending to LDCs, to "leveraged buyouts," or to commercial real estate projects, bankers have made lending mistakes of stupendous proportion in recent decades. Since at least 1984, when it bailed out the failed Continental Illinois, the government has offered a de facto bailout promise to all creditors of those banks it deems "too big to fail," regardless of the detrimental effects of such a policy on sound banking practice. In perhaps the ultimate sign of desperation, the Federal Reserve has been using its discount window to bail out insolvent banks (large and small alike), far beyond its original purpose of providing liquidity.[26] The deposit insurance system for commercial banks has also collapsed. As recently as 1987 the fund of the Federal Deposit Insurance Corporation (FDIC) reached a peak of $18 billion, but was expected to be insolvent by the end of 1991, and in the red by as much as $60 billion in a few years. The ratio of insurance funds to insured deposits, which was never high to begin with, fell gradually from 1.16% in 1980 to .60% at the end of 1990. The burden of this collapse is being shouldered by the more prudent banks that have survived but must now pay higher insurance premiums into the fund. FDIC premium rates have tripled since 1988.

The cumulative burdens placed on the banking system by government inflation, deposit insurance, and branching restrictions have begun to intensify the rate of deterioration of the industry in this decade. Skyrocketing federal budget deficits and the Fed's ongoing commitment to finance them through monetary inflation have contributed significantly to a near doubling of the money supply between 1982 and 1990. By transmitting inflation to the banking system through open-market operations, the Fed has indirectly encouraged reckless lending. The near tripling of deposit insurance coverage has also promoted risk taking by depository institutions. Finally, the continuation of the majority of restrictions on branching has ensured a relatively undiversified mix of bank assets that are therefore prone to downturns in regional economies.

The private banking system is still reeling under the onslaught of central banking. But there is one bank in the United States that has succeeded in resisting this deterioration, that has prospered both in reputation and financial resources with every passing decade, and that has grown to become the largest, most profitable bank in the country. That bank is none other than the Federal Reserve, which earned $24 billion in 1990 alone, on an asset base of approximately $300 billion.[27] These profits far surpass the earnings of all the banks in the United States combined. Moreover, the Fed's rate of return on assets is nearly eight times the level earned by private banks. The "monopolistic concentration of unbridled financial power" that reformers had vilified nearly a century ago has truly come to pass after all these years, and it is ironic to consider that it would not have been possible without their help and the help of their descendents.

As might be expected, popular analysis sees the present current banking crisis as a result not of unbridled Federal Reserve power, but of banker mismanagement, fraud, and "deregulation." A widely publicized study issued by the comptroller of the currency in 1988 concluded, on slim evidence, that mismanagement and fraud were the main causes of modern-day banking failures.[28] In 1990 the U.S. Justice Department reported that more than four hundred people had been convicted of fraud at thrifts in 1988 and 1989, creating losses of $6.4 billion; as troubling as this may appear, it is noteworthy that the loss represents less than 5% of the total estimated loss of the thrift debacle. The Justice Department also reported recently that losses at commercial banks attributable to fraud are lower still than those at thrifts, even though the banking industry is three times as large, and losses from fraud have increased recently.[29]

There is little doubt that the competence and probity of bankers in the United States has deteriorated precipitously throughout this century, whereas bankers were rightly seen as conservative and incorruptible in the nineteenth century, when our system was freer. But the fact remains that a significant portion of the loss associated with today's banking crisis simply is not explained by fraud. Yet government officials have persisted in suggesting otherwise.

Contrary to the claims of a sensationalist media and self-serving regulatory agencies, fraud has not been responsible for the crisis in our banking system, and there is nothing inherent in the business of banking that would necessarily invite it. Fraud is the proximate, not the fundamental cause of bank failure, and failures have been widespread even in the absence of fraud, as in the 1930s. In fact, to the extent that there is greater fraud in banking today, it is positively encouraged by government incentives, such as deposit insurance. Any government that guarantees the liabilities of an entire industry invites the incompetent and the fraudulent, despite all the regulatory efforts expended to resist them. A liability is a promise to deliver some value. If a regime is erected that tends to remove the responsibility for delivering on that promise, those who are irresponsible about meeting promises will necessarily be attracted to it.

More fundamentally, central banking itself institutionalizes unsound and dishonest banking, increasing the likelihood that incompetent, dishonest bankers will be found amidst the rubble of bank failures. Monetary inflation is the most significant form of this institutionalized dishonesty. Wealth does not come from the issuance of paper money. At root, inflation of the money supply constitutes a continuous series of defaults on the part of government, and a highly deceptive means of securing economic resources at the expense of unsuspecting victims. Nonetheless, there are repeated calls for an "easy" monetary policy and a constantly booming economy in which prudent bankers are virtually indistinguishable from those who are incompetent, dishonest, or merely lucky. Deposit insurance goes further still, forcing the prudent to pay the bills of the reckless. In free banking systems, management excellence is rewarded; mismanagement and fraud are minimized, and when they do occur, those harmed by such banks can turn to government courts for justice and remedy. But under central banking, frauds such as inflation are basic components of government policy, and there is no place to turn, certainly not to government, for restitution. Central banking does not insure integrity or competence in money and banking—it actively undermines them by supporting, protecting, and institutionalizing their opposites.

Today's bankers are also charged with gross mismanagement, though there is little evidence that management failings alone have brought on the crisis. A long history of evidence does exist, however, that mismanagement in banking tends to occur in clusters, especially under systems of central banking. Those in the Austrian school of economics, such as Friedrich A. Hayek (1932), have demonstrated how the manipulation of money and credit by government central banks causes widespread malinvestments of economic resources. Policies aimed at artificially lowering the market's "natural" rate of interest makes some economic projects seem more profitable than they would be if the cost of capital were determined in a purely market context. Bank credit skills are undermined in the process; when the central bank inflates and money is easy, it appears that every loan is a good one, and when the central bank tightens, it seems none are good. When money and credit are constantly manipulated by government, bankers find there is an ever-diminishing connection between their lending policies and the success or failure of those policies in practice. By the nature of their work, bankers are unavoidably ensconced in the manipulation of money and credit that surrounds them. They know it best only when they must periodically translate "malinvestment" into "loan losses." The long-term decline in management competence in the banking industry is real, but it is inherent in central banking, not in the banking profession per se.

Banks have found it difficult in recent decades to attract competent management; but notably, it is a difficulty shared only by other industries that are similarly characterized by significant government intervention or protection, such as utilities. Fortunately, most bankers today are competent, conscientious, and honest—as they have been throughout U.S. history. To their credit, they have developed innovative solutions to the inherent instability imposed by central banking. When restrictions imposed on note issue under the National Banking System caused money panics, they developed "clearinghouse certificates" and other forms of private currency that consumers demanded. When restrictions imposed by the Glass-Steagall Act in the 1930s prevented banks from underwriting securities and doing business with the best U.S. companies, they invented term loans. When branching and new product opportunities were blocked by law and narrowly constrained banks in the 1950s, they created

holding companies to permit growth and diversification. When interest rate ceilings and restrictions on deposit gathering, together with inflation-driven high interest rates, led to an outflow of deposits in the 1960s and 1970s, they created certificates of deposit and "Eurodollar" accounts. When central banking brought volatility to foreign exchange markets and interest rates in the 1970s and 1980s, they created hedging products to enhance stability. More recently, in response to central banking's double-digit growth rates in money and credit that ballooned bank balance sheets and dwarfed capital, they invented "securitization," the process of preserving liquidity and capital adequacy by packaging loans and selling them in the secondary markets. To the extent that there has been any stability in the banking sector under central banking, it has been achieved by the creative efforts of skilled private bankers—in spite of central banking, not because of it.

Explanations of today's banking crisis that blame "deregulation" are probably the most misguided. The fact is, the commercial banking and thrift industries remain the most regulated sectors of the U.S. economy, and the historical trend has been for government to increase its intervention in these industries—notwithstanding occasional superficial changes in the rules by which the industries must operate. In truth, the argument against "deregulation" simply rests on the mistaken view that banker mismanagement and fraud are responsible for banking instability. Regulation is seen as restraining such impulses, while the relaxation of such restraints is thought to invite fraud and mismanagement. The argument that "deregulation has caused the banking crisis" is simply another way of saying that, left to their own devices in a free or freer environment, bankers will inevitably be incompetent or fraudulent. To blame "deregulation" for banking system deterioration is an unwarranted attempt to resurrect the fallacy that free banking is inherently unstable. That this charge is leveled in today's context—when we have a banking system thoroughly infused with central banking features and legal restrictions—is truly remarkable. That the charge is leveled by influential voices and proposed in legislative chambers is as true today as ever. Lowell Bryan, a prominent bank consultant at McKinsey and Company, has advocated recently that government reimpose controls on deposit interest rates, and legislate lending standards for banks, on the grounds that the banking crisis was caused by banks left free in these areas.[30]

Popular arguments that purport to explain the deterioration of today's banking industry have the case reversed. It is believed that government intervention is the solution to banking instability, whereas in fact it is most assuredly the cause of it. Government intervention has undermined the safety of virtually all banks and S&Ls—and yet critics cite "deregulation" as the problem. Government has created a chaotic monetary environment and a deposit insurance regime that rewards imprudence—and yet blame is directed against "banker mismanagement." Government has stolen and hoarded private gold stocks, has cheated creditors and money holders with an intentional policy of chronic inflation, has covered up bad banking with deceptive "regulatory accounting"—and yet bankers are deemed fraudulent and dishonest. With every mismanagement and deception conducted by central banking, and every instability it promotes, its favorable reputation only seems to grow, not diminish, while its power to inflict still further damage is extended, not constrained.

VI. Summary

Throughout U.S. history, bankers generally have been made scapegoats for banking crises that were essentially government created. Conventional explanations failed to correctly identify the true cause of these crises, and as a result, government intervention in money and banking grew considerably. Because the U.S. government has intervened in money and banking to enhance its own power, it has worked actively to blame the banking community for the detrimental effects of its interventions, in order to preserve its monetary privileges. Underlying this tragic pattern is the mistaken view that free banking is inherently unstable, while central banking promotes safe and sound banking. Interpretations of today's banking crisis continue the pattern. Only when this pattern is broken, when the damaging influence of central banking is fully recognized and fundamental reforms in favor of free banking and a gold standard are enacted, will future crises in the U.S. money and banking system be prevented.

Notes

1. Examples include Mayer (1990) and Pizzo, Fricker, and Muolo (1989). This theme of banker culpability has been applied equally to the S&L crisis, the banking crisis, and of course to problems on Wall Street.

2. See White (1989a; 1989b), Selgin (1988a), and Salsman (1990). "Free banking" means an unregulated system of money and credit, including the competitive issuance by private banks of currency convertible into some widely-accepted outside money, such as the precious metals. The system operates in the absence of a central bank and of any legal restrictions on bank operations; banks are subject only to the contract law and general bankruptcy law that apply to other industries.
3. Rockoff (1975; 1991) has demonstrated that wildcat banking was promoted by states that required privately issued bank notes to be collateralized by state bonds valued at par. This requirement was imposed primarily to ensure a source of financing for states. When the market value of the bonds fell below par value, there was an encouragement for bankers to over-issue notes and engage in fraud.
4. White (1983) and Smith (1936, 146–166) have shown that the inelastic currency of the post-Civil war period was due primarily to regulations requiring that private banknotes be collateralized by securities of the Federal government. These regulations impaired flexibility by making it difficult for banks to accommodate increases in the demand for currency relative to checking deposits. This problem is discussed more fully below.
5. Rothbard (1975) has shown that the inflation of the money supply by the Federal Reserve in the 1920s made the speculative boom possible and the resulting bust necessary. Friedman and Schwartz (1963, chapter 7) have shown that the Federal Reserve prolonged the banking crisis and the Great Depression by its inept management of the discount window and open-market operations. Phillips, McManus, and Nelson (1937) say the crisis of the 1930s was made possible exclusively by Federal Reserve mismanagement.
6. Other banks continued to operate as state-chartered institutions.
7. For a detailed discussion of each episode, see Sprague (1910).
8. Tallman (1988) makes this point. Calomiris and Gorton (1991, 114) show that the worst loss per deposit dollar during this era was only 2.1 cents, and the worst experience with bank failure rates was only 1.28%, in the Panic of 1893.
9. Chari (1989) demonstrates that these institutionally-imposed reserve pyramids made the U.S. banking system prone to panics, whereas Canada and Britain avoided both pyramids and panics.
10. Excerpts of the Comptroller's report are provided in Sprague (1910, 336).
11. Excerpts of the Treasury's report are provided in Sprague (1910, 330–31).
12. While their enthusiasm for this currency reform is understandable, Aldrich-Vreeland still did not permit banks full branching powers, unrestricted note issue, or unregulated reserves. On the other hand, to

the extent that the 1930s deflationary crisis was the inevitable result of the Federal Reserve's inflationary policies in the 1920s—a position endorsed by Phillips, McManus, and Nelson (1937) and Rothbard (1975), but not by Friedman and Schwartz—then in the Fed's "absence" the private banking system would never have faced the crisis of the early 1930s.

13. Cleveland and Huertas (1985, 59–61) describe the role of the National City Bank.
14. The procedure, referred to as "sterilizing" gold flows, was undertaken repeatedly in the 1920s, as described by Friedman and Schwartz (1963, 279–87), and was justified both as a means of "insulating" the U.S. from foreign economic influences, and of "assisting" Great Britain's return to the gold standard. According to the authors, "it probably would have been better . . . to have permitted the gold-standard rules to operate fully."
15. For evidence on the Fed inflating and encouraging speculation in the 1920s, see Rothbard (1975, chapter 5); for evidence on the Fed falling to meet the growing demand for currency, see Selgin (1988a, 638) as well as Friedman and Schwartz (1963, chapter 7). The sharp increase in the demand for currency, a demand that could not be met legally by banks and would not be supplied voluntarily by the Fed, is signified by the fall in the deposit-currency ratio from nearly twelve times in 1929 to less than five times in early 1933 (see Friedman and Schwartz 1963, 333). In turn, this falling ratio precipitated a collapse in the stock of money.
16. For example, in hearings held on the mix of commercial and investment banking, Senator Glass and others argued for a separation by defending the real bills doctrine, but made frequent references to the Pujo report to strengthen the case. See Kelly (1985, 48, 51–53).
17. During the depression, the National City Bank's capital ratio increased from 12% in 1929 to 15% in 1932, while the ratio of its brokerage affiliate rose from 62% to 70% over the same period. Unlike other banks, National City had also strengthened its liquidity to face the crises (Cleveland and Huertas 1985, 160–61, 169).
18. On the role of Willis, see Flannery (1985, 85, note 12); on the role of Glass, see Kelly (1985, 45).
19. See Kelly (1985, 43) and Flannery (1985, 67–69). Also, Friedman and Schwartz (1963, 244–45) point out that loans on securities were 38% of total bank loans in 1929, but had been only 3% in 1914.
20. See Kelly (1985, 52–53 and notes 148 and 152), who contends that Chase and National City were also motivated to weaken the competitive position of the rival Morgan bank. The Chairman of Chase National Bank, Winthrop Aldrich, actually assisted Senator Glass in drafting the legislation (Kelly 1985, 3, note 157).

21. See Chernow (1990, 357–59). This was the same Morgan Bank that in 1895 had defended the gold standard so courageously that it bailed out the U.S. Treasury with a $65 million gold loan, permitting the federal government to avoid suspending specie payments (Friedman and Schwartz, 1963, 111, note 35).
22. Gold coin and gold certificate confiscation was accomplished under the Emergency Banking Act signed into law by President Roosevelt on March 9, 1933 and included the power to declare the infamous "bank holiday." Gold clauses were abrogated under a separate act passed in 1933.
23. In October 1979 the Fed did concede the need to control the money supply and contain inflation, but by August 1982, when Mexico defaulted on its dollar-denominated debts, the Fed had again abandoned concern for inflation.
24. This was the contradictory and ill-named "Depository Institutions Deregulation and Monetary Control Act" of 1980. The "deregulation" was of deposit interest rates, over time. The "control" included the membership mandate, changes in reserve requirements, and extensions of FDIC coverage.
25. The "Financial Institutions Reform, Recovery, and Enforcement Act" of 1989 not only provided for a $50 billion taxpayer bailout (only one-tenth of the long-term expected cost of the S&L crisis) but granted significant interventionist powers to the Federal Deposit Insurance Corporation to regulate and seize banks with complete discretion. More recently, Congress has said it will replenish the bank deposit insurance fund *before* it grants banks "wider powers."
26. A study released in June 1991 by the Banking Committee in the U.S. House of Representatives found that 530 of the 2,990 banks that drew from the Fed's discount window between January 1985 and May 1991 failed within three years and that the Fed routinely lends to banks with the lowest possible rating that can be given by bank regulators. According to the report, Fed lending has allowed uninsured depositors to withdraw funds before banks are closed, shifting losses to the FDIC.
27. The bulk of the Fed's assets consist of interest-bearing government securities, while its liabilities primarily consist of non-interest-bearing Federal Reserve Notes (the country's monopoly currency) and non-interest-bearing deposits that count as reserves for member banks. The balance sheet alone explains the considerable profit margins the Fed generates. The Fed transfers most of its annual profit to the treasury, further evidence that the interests of government take precedence over those of the private banking system.
28. *Bank Failure: An Evaluation of the Factors Contributing to the Failure of the National Banks*, Office of the Comptroller of the Currency, Washington, D.C., 1988. This report continues a long tradition of similar

studies issued by the OCC over the years, all of which carefully evade the question of whether fraud has caused *systemic* instability (see Benston et al., 1986, 2–4).

29. "Banking-Fraud Convictions Nearly Double," *American Banker*, 1 August 1991.
30. See Lowell Bryan's "Banks Need Caps on Loans, Rates," *American Banker*, 19 June 1991, 4. New York Representative Charles Schumer, a member of the House Banking Committee, introduced legislation reflecting Bryan's plan during the summer of 1991.

References

Andrew, A. Piatt. "Substitutes for Cash in the Panic of 1907." *Quarterly Journal of Economics* (August 1908).

Benston, George J., et al. *Perspectives on Safe and Sound Banking: Past, Present, and Future*. Cambridge: MIT Press, 1986.

Calomiris, Charles W., and Gary Gorton. "The Origins of Banking Panics: Models, Facts, and Bank Regulation." In *Financial Markets and Financial Crises*, edited by R. Glenn Hubbard. Chicago: University of Chicago Press, 1991.

Chari, V. V. "Banking without Deposit Insurance or Bank Panics: Lessons from a Model of the U.S. National Banking System." *Quarterly Review* (1989). Federal Reserve Bank of Minneapolis.

Chernow, Ron. *The House of Morgan: An American Dynasty and the Rise of Modern Finance*. New York: Atlantic Monthly Press, 1990.

Cleveland, Harold van B., and Thomas F. Huertas. *Citibank, 1812–1970*. Cambridge: Harvard University Press, 1985.

Flannery, Mark J. "An Economic Evaluation of Bank Securities Activities Before 1933." In *Deregulating Wall Street: Commercial Bank Penetration of the Corporate Securities Market*, edited by Ingo Walter. New York: Wiley, 1985.

Friedman, Milton, and Anna J. Schwartz. *A Monetary History of the United States, 1867–1960*. Princeton: Princeton University Press, 1963.

Glasner, David. *Free Banking and Monetary Reform*. New York: Cambridge University Press, 1989.

Goodhart, Charles. *The Evolution of Central Banks*. Cambridge: MIT Press, 1988.

Gorton, Gary. "Private Clearinghouses and the Origins of Central Banking." *Business Review* (1984). Federal Reserve Bank of Philadelphia.

———. "Bank Suspensions of Convertibility." *Journal of Monetary Economics* (March 1985): 177–93.

Groseclose, Elgin. *America's Money Machine: The Story of the Federal Reserve*. Westport, Conn.: Arlington House, 1980.

Horwitz, Steven. "Competitive Currencies, Legal Restrictions, and the Origins of the Fed: Some Evidence from the Panic of 1907." *Southern Economic Journal* (1990).

Kelly, Edward J. "Legislative History of the Glasis-Steagall Act." In *Deregulating Wall Street: Commercial Bank Penetration of the Corporate Securities Market*, edited by Ingo Walter. New York, Wiley, 1985.

Mayer, Martin. *The Greatest-Ever Bank Robbery: The Collapse of the Savings and Loan Industry*. New York: Macmillan, 1990.

Noyes, Alexander Dana. *Thirty Years of American Finance: A Short Financial History of the Government and People of the United States Since the Civil War, 1865–1896*. New York: Putnam, 1910.

Office of the Comptroller of the Currency. *Bank Failure: An Evaluation of the Factors Contributing to the Failure of National Banks*. Washington, D.C., 1988.

Pecora, Ferdinand. *Wall Street Under Oath: The Story of Our Modern Money Changers*. New York: Simon and Schuster, 1939.

Phillips, C. A., T. F. McManus, and R. W. Nelson. *Banking and the Business Cycle: A Study of the Great Depression in the United States*. New York: Macmillan, 1937.

Pizzo, Stephen, Mary Fricker, and Paul Muolo. *Inside Job: The Looting of America's Savings and Loans*. New York: McGraw-Hill, 1989.

Rockoff, Hugh. *The Free Banking Era: A Re-examination*. New York: Arno, 1975.

———. "Lessons from the American Experience with Free Banking." In *Unregulated Banking: Chaos or Order?*, edited by Forrest Capie and Geoffrey E. Wood. New York: St. Martin's, 1991.

Roosevelt, Franklin D. *The Public Papers of Franklin D. Roosevelt*. New York: Random House, 1938.

Rothbard, Murray. *America's Great Depression*. Kansas City, Mo.: Sheed and Ward, 1975.

Salsman, Richard M. *Breaking the Banks: Central Banking Problems and Free Banking Solutions*. Great Barrington, Mass.: American Institute for Economic Research, 1990.

Schwartz, Anna J. "Real and Pseudo-Financial Crises." *Financial Crises and the World Banking System*, edited by Forrest Capie and Geoffrey E. Wood. New York: St. Martin's, 1986.

Selgin, George A. *The Theory of Free Banking: Money Supply Under Competitive Note Issue*. Totowa, N.J.: Rowman and Littlefield, 1988a.

———. "Accomodating Changes in the Relative Demand for Currency: Free Banking vs. Central Banking." *Cato Journal* 7 (1988b): 621–41.

Shughart, William F., II. "A Public Choice Perspective of the Banking Act of 1933," *Cato Journal* 7 (1988): 595–613.

Smith, Vera C. *The Rationale of Central Banking and the Free Banking Alternative*. Indianapolis: Liberty Press, 1990. Orig. pub. 1936.

Sobel, Robert. *Panic on Wall Street: A History of America's Financial Disasters.* New York: Macmillan, 1968.

Sprague, O. M. W. *History of Crises Under the National Banking System.* Washington, D.C.: Government Printing Office, 1910. Study sponsored by the National Monetary Commission.

Tallman, Ellis. "Some Unanswered Questions about Bank Panics." *Economic Review* (December 1988). Federal Reserve Bank of Atlanta. December 1988.

Timberlake, Richard H. *The Origins of Central Banking in the United States.* Cambridge: Harvard University Press, 1978.

———. "The Central Banking Role of Clearinghouse Associations." *Journal of Money, Credit, and Banking* (February 1984).

———. "Seventy-Five Years of Monetary Control." *Durell Journal of Money and Banking.* (November 1989): 2–9, 30–38.

White, Eugene N. *The Regulation and Reform of the American Banking System, 1900–1929.* Princeton: Princeton University Press, 1983.

———. "Before the Glass-Steagall Act: An Analysis of the Investment Banking Activities of National Banks." *Explorations in Economic History* (1986): 33–55.

White, Lawrence H. *Competition and Currency: Essays on Free Banking and Money.* New York: New York University Press, 1989a.

———. "The Growing Scarcity of Banknotes in the United States, 1865–1913." Unpublished manuscript. University of Georgia, 1989b.

Contributors

Richard M. Salsman is Vice President and Economist at H. C. Wainwright and Co., Economics, Inc., in Boston and an adjunct fellow of the American Institute for Economic Research. He is the author of *Breaking the Banks: Central Banking Problems and Free Banking Solutions* (1990). He lectures widely on money, banking, and economics.