FILLING THE "UNHELPFUL SILENCE": HOW THE DEPOSIT INSURANCE PROVISION OF THE GLASS-STEAGALL ACT TRANSFORMED THE AMERICAN BANKING SYSTEM

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ABSTRACT

In 1933, Congress passed the Glass-Steagall Act as a response to the Great Crash of 1929. Two basic responses to the banking crisis were on the table in the weeks before the Senate passed a bill proposed by Carter Glass and the House a measure framed by Henry Steagall: unification of the national banking system under federal control or preservation of the state unit banking system augmented by a full federal guarantee of deposits made in every American bank. The conflict between these two alternatives represented the final episode in the nearly 150 year-long struggle between state and federal authorities for control over the banking system.

The competition dated back to 1791 and posed the question: how should the values and structure of American republican federalism be engrafted onto the banking system? This Article begins by arguing that the answer to that query in 1791 was competitive dual federalism. It then frames this federal versus state competition before presenting the two broad ideologies that drove the struggle, as typified by Carter Glass and Henry Steagall. Next, this Article presents the so-called Vandenberg Amendment—adopted as part of the Glass-Steagall Act—as representative of a long-overlooked model of cooperative federalism for banking.

This Article concludes by suggesting that, contrary to the traditional scholarly account, the Glass-Steagall Act as shaped by the Vandenberg Amendment represented a fundamental change to the existing American banking structure, reversing the choice made in 1791 by rejecting a competitive dual federalism model in favor of a cooperative federalism one.

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INTRODUCTION

As a response to the subprime mortgage crisis, on October 3, 2008 President George W. Bush signed into law the Emergency Economic Stabilization Act of 2008.[1] One important provision of this legislation was a temporary increase on the basic limit of federal deposit insurance coverage from $100,000 to $250,000 per depositor. "This temporary increase in deposit insurance coverage should go far to help consumers maintain confidence in the banking system and in the marketplace," said Federal Deposit Insurance Corporation ("FDIC") Chairman Sheila C. Blair.[2] It was an incredible commitment—the federal government insuring individual depositors up to a quarter of a million dollars—designed to meet exceptional circumstances. The increase was scheduled to expire December 31, 2010, by which time it would presumably no longer be necessary; but that turned out not to be the case. On May 20, 2009 the temporary increase was extended to December 31, 2013, and only two months later the once-temporary measure was made permanent when President Barack Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") into law on July 21, 2010.[3]

Though extraordinary, it would be inaccurate to describe this chain of events as unprecedented. If anything, 2008's so-called "bailout" of the United States financial system and the subsequent Dodd-Frank Act represent the logical conclusion to a similar

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[1] Emergency Economic Stabilization Act of 2008, 12 U.S.C. §5201 (2008).
[2] Press Release, Federal Deposit Insurance Corporation, Emergency Economic Stabilization Act of 2008 Temporarily Increases Basic FDIC Insurance Coverage from $100,000 to $250,000 Per Depositor (Oct. 7, 2008).
[3] Dodd-Frank Wall Street Reform and Consumer Protection Act §343, 12 U.S.C. §5301 (2010); *see also* Press Release, Basic FDIC Insurance Coverage Permanently Increased to $250,000 Per Depositor (July 21, 2010).

series of events. In 1933, newly-elected President Franklin Roosevelt was confronted with arguably the grimmest economic situation in our nation's history: the Great Depression.[4] As in 2008 and 2010, determining the extent to which the federal government should be responsible for the economic security of individuals centered specifically on federal deposit insurance. In 1933, however, the question was not how much deposit insurance the federal government should provide individual depositors, but if it should do so at all. The answer given by 1933's Glass-Steagall Act was that it should.[5] It was a momentous choice that fundamentally altered the existing American banking structure, rejecting the extant competitive dual federalism model in favor of a cooperative federalism one. Knowing why and how that change was made is essential to understanding the modern American banking system, and is particularly relevant in light of banking reform following the subprime mortgage crisis.

Since the ratification of the United States Constitution in 1787 American banking had been based on a model of competitive dual federalism. While the Constitution clearly allocated some powers regarding regulation of the money supply among governmental entities, "both the text and the debates ignored the authority either of Congress or the states over banks."[6] This "unhelpful silence"[7] ignited a competition between federal and state authorities seeking to regulate banking. Along with the text of the Constitution itself, a number of episodes over the ensuing century and a half capture this struggle: the debate over whether and to what extent the First Bank of the United States would establish branches, particularly Secretary of the Treasury Alexander

[4] *See infra* notes 19, 20, 21, 22, 23, and 24.
[5] *See infra* note 10.
[6] JAMES WILLARD HURST, A LEGAL HISTORY OF MONEY IN THE UNITED STATES, 1774-1970, at 134 (1973).
[7] *Id.*

Hamilton's role in the controversy; the Court's pronouncement that the federal government may establish corporations in *M'Culloch v. Maryland*[8] and its later upholding as constitutional the federal government's imposition of a ten percent tax on state bank notes in *Veazie Bank v. Feno*;[9] state experiments with deposit insurance from 1909 to 1923; and, of course, the debate over and eventual passage of the Glass-Steagall Act in 1933.[10] Each chapter in this see-saw narrative represents another clash between state and federal authorities vying to fill the authority gap left by the Constitution.

The Constitution's silence on this matter should not be interpreted as ambivalence. A—perhaps *the*—principal challenge confronted by the new American republic was its massive public debt. Senator Arthur Vandenberg, whose amendment to the Glass-Steagall Act largely shaped the legislation,[11] wrote as part of his tribute *The Greatest American: Alexander Hamilton*, "No nation ever was or ever will be stronger than its public credit."[12] The strength of the public credit is necessarily tied to the liquidity, elasticity,[13] and uniformity of the money supply.[14] As the primary circulating

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[8] *M'Culloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819).
[9] *Veazie Bank v. Feno*, 75 U.S. (8 Wall.) 533 (1869).
[10] Banking Act of 1933, 12 U.S.C. §227 (1933). The Banking Act of 1933 is commonly referred to as the Glass-Steagall Act, as it will be throughout this paper.
[11] For the full text of the so-called Vandenberg Amendment, *see* 73 CONG. REC. 3,878 (1933).
[12] ARTHUR VANDENBERG, THE GREATEST AMERICAN: ALEXANDER HAMILTON; AN HISTORICAL ANALYSIS OF HIS LIFE AND WORKS TOGETHER WITH A SYMPOSIUM OF OPINIONS BY DISTINGUISHED AMERICANS 173 (1921).
[13] Liquidity and elasticity are terms used throughout this Article. Liquidity is defined as the degree to which an asset or security can be bought or sold in the market without affecting the asset's price. Liquidity is characterized by a high level of trading activity and assets that can be easily bought or sold are known as liquid assets. It is therefore safer to invest in liquid assets because it is easier for an investor to reclaim his money at a given time. Elasticity is a measure of a variable's sensitivity to a change in another variable. As it relates to the money supply, elasticity refers to the degree to which individuals change their demand/amount supplied in response to price or income changes. The basic concept is that a nation's economy is healthiest when the money supply is liquid, or elastic, enough to respond to changes in the marketplace.
[14] *Final Version of the Report on the Establishment of a Mint*, *in* THE PAPERS OF ALEXANDER HAMILTON VOLUME VII, SEPTEMBER 1790–JANUARY 1791, 570–607 (Harold C. Syrett & Jacob E. Cooke eds., 1963) [hereinafter HAMILTON PAPERS].

medium[15] evolved from gold bullion to bank deposits over the course of the first half of the nineteenth century, banking became a quasi-public enterprise, affected with the public interest and therefore partially the province of the federal government and its state counterparts. The task of managing the public credit increasingly became that of governmental bank regulation, and the question became: which government?

This question was asked with great fervor after every major economic crash in American history.[16] These include the Panic of 1819, the economic contraction following the Civil War, the Panic of 1907, and especially important for the purposes of this Article, the Great Crash of 1929. In the aftermath of each ordeal there were cries for reform, resulting in both federal and state action. Unfortunately these twin responses were generally ineffective, and worse, often resulted in a sort of "race to the bottom" between federal and state banks in which sound banking principles—prudent capital requirements, competent oversight, and so forth—were sometimes subordinated to attracting deposits. Then-head of J.P. Morgan & Co. Thomas Lamont aptly described the situation: "In banking, our country has forty-nine different sovereigns . . . each desirous of having as many institutions as possible registered under his jurisdiction."[17] True to form, in response to the Panic of 1907, both the federal government and their state analogues had enacted banking reform: the Federal Reserve Act of 1913[18] and the state

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[15] This term, a pseudonym for any medium of exchange that can be passed in ordinary commerce as currency, comes from a quote in John J. Janney, *State Bank of Ohio*, 2MAG. W. HIST. 4 (1885) which said of the mid-nineteenth-century Ohio banking insurance reform: "It did what it was designed to do, furnish a safe circulating medium for the people of the State."

[16] *See generally* CHARLES P. KINDLEBERGER & ROBERT ALIBER, MANIAS, PANICS, AND CRASHES: A HISTORY OF FINANCIAL CRISES (2005).

[17] *The 73d Congress Faces the Banking Problem: Should America Adopt a Unified Banking System?*, 12 CONG. DIG. 4, at 104 (1933) (Thomas W. Lamont) [hereinafter *Should America Adopt a Unified Banking System?*].

[18] Federal Reserve Act, 38 U.S.C. § 251 (1913). America had been without a national bank since Andrew Jackson's war on the Second Bank of the United States resulted in nonrenewal of its charter. The Act

experiments with deposit insurance spanning 1909 to 1923.[19] As the Great Crash of 1929 made clear, neither measure worked.

The cries for uniform, effective reform reached a crescendo after the Great Crash of 1929 and subsequent spate of bank failures, later termed "The Great Contraction."[20] As John Kenneth Galbraith wistfully put it, "Some years, like some poets and politicians and some lovely women, are singled out for fame far beyond the common lot, and 1929 was clearly such a year."[21] The psychological effects of the crash reverberated across the nation,[22] with the lack of public confidence in the economy manifesting itself in a dramatic decrease in the volume of bank deposits,[23] weakening the money supply and endangering the public credit. In his March 4, 1933 inaugural address Franklin Roosevelt asserted that by electing him President American citizens had "registered a mandate that they want direct, vigorous action. They have asked for discipline and direction under leadership."[24] The answer—insofar as repairing the economy—was the Glass-Steagall Act, particularly its federal deposit insurance provision whereby the federal government

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called for the creation of at least eight and not more than twelve private, regional Federal Reserve banks, each with their own branches, which would be overseen by a Federal Reserve Board comprised of public officials appointed by the President and confirmed by the Senate. The Reserve Act drew heavily from 1908's Aldrich-Vreeland Act. The major modification introduced by the Reserve Act was oversight of the system—in the form of the Federal Reserve Board—was placed in the hands of public officials, not private bankers. For more on the origins and history of the Federal Reserve Act, *see generally* DONALD WELLS, THE FEDERAL RESERVE SYSTEM: A HISTORY (2004).

[19] These episodes will be covered in depth by Part I. Ordered chronologically by the date each enacted deposit insurance legislation, the states were: Oklahoma, Kansas, Nebraska, Texas, Mississippi, South Dakota, North Dakota, and Washington.

[20] MILTON FRIEDMAN & ANNA JACOBSON SCHWARTZ, A MONETARY HISTORY OF THE UNITED STATES 1867-1960, AT 351–59 (1971).

[21] JOHN KENNETH GALBRAITH, THE GREAT CRASH 1 (1955).

[22] The state of affairs in New York City was so dire that there emerged a so-called "suicide myth," which alleged that the Great Crash of 1929 had caused the suicide rate to increase. This urban legend gained such legitimacy that Galbraith felt compelled to refute the rumor with statistics. *See id.* at 133–37.

[23] 73 CONG. REC. 11,217 (1932).

[24] President Franklin Roosevelt, First Inaugural Address (Mar. 4, 1933).

would be responsible for insuring, or guaranteeing, individual deposits in banks across the nation.

The traditional scholarly account of the Glass-Steagall Act traces its origins to the New York Safety Fund, established in 1829, and asserts that it aimed to preserve the existing banking structure. Preeminent bank consultant and commentator Carter Golembe claims "there seems to have been no American precedent" for New York's 1829 bank insurance scheme and stresses the importance of similar pre-Civil War efforts in Indiana, Michigan, Ohio, and Vermont.[25] Similarly, Harvard Business School professor David Moss argues that "the underlying problem being addressed in 1933 was essentially the same as in 1829."[26] As in 1829, Moss continues, in 1933 "public bank insurance was offered up as a way of preserving and strengthening that uniquely American institution, unit banking."[27] Golembe echoes Moss, positing that in 1933, "deposit insurance was advanced and accepted as a method of controlling the economic consequences of bank failures without altering the basic structure of the banking system."[28]

Moss and Golembe are incorrect on two counts. First, the right comparison for 1933 is not 1829, it is 1791. The Safety Fund was primarily concerned with spreading risk to insure against discreet bank failures leading to systemic runs. While that goal was certainly part of the movement for federal deposit insurance in 1933, the central issue was federalism. The debates over the Glass-Steagall Act in 1933 posed the same question as that confronted by the First Bank of the United States in 1791: how would the

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[25] Carter Golembe, *The Deposit Insurance Legislation of 1933: An Examination of Its Antecedents and Its Purposes*, 75 POL. SCI. Q. 181, 182–87 (1960).
[26] DAVID A. MOSS, WHEN ALL ELSE FAILS: GOVERNMENT AS THE ULTIMATE RISK MANAGER 120 (2002).
[27] *Id.*
[28] Golembe, *supra* note 25, at 200.

values and structure of American republican federalism be engrafted onto the banking system? Put another way—would full federal control, competitive dual federalism, or a compromise of cooperative federalism be the theoretical model for American banking? In 1791 the answer was competitive dual federalism; 1933's Glass-Steagall Act was all about reversing that decision and choosing cooperative federalism.

This Article's second point of disagreement with Moss and Golembe follows from that assertion. Neither of the major proposals to reform the banking system in 1933—Senator Carter Glass's vision (covered in Part II) nor Representative Henry Steagall's (discussed in Part III)—sought to maintain the competitive dual federalism status quo, the former sought to make bank regulation a federal enterprise and the latter a state-centric one. The eventual compromise embodied by the Vandenberg Amendment rejected dual federalism, or either extreme of making federal or state authorities the locus of banking power, and embraced cooperative federalism. Vandenberg's vision, the one eventually adopted, most closely resembled Hamilton's initial proposal in 1791 that existing state banks be made "agents"—or branches—of the Bank of the United States.[29] In the final analysis, Moss and Golembe's contention that the Glass-Steagall Act aimed to preserve the banking structure is incorrect. To the contrary, it rejected competitive dual federalism—or a federal or state-centric model—in favor of cooperative federalism.

This Article argues that the Glass-Steagall Act fundamentally altered the existing banking structure by rejecting competitive dual federalism in favor of cooperative federalism. Part I frames the competition between federal and state authorities for control over the banking structure by pinpointing the forces that resulted in state experiments

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[29] *See generally* Stuart Bruchey, *Alexander Hamilton and the State Banks, 1789 to 1795*, 27 WM. & MARY Q. 347 (1970).

with deposit insurance and the arguments that emerged from them. Part II presents the constitutionally and historically supported federal response to the Panic of 1907 as typified by Senator Carter Glass which, logically, would have served as a prelude to unification of the banking system under federal authority in 1933. Part III posits that, counterintuitively, federal deposit insurance gained momentum as a viable alternative, largely through the efforts of Representative Henry Steagall, despite bank deposit's failure on the state level. Part IV completes the argument by suggesting that the Vandenberg Amendment shaped the Glass-Steagall Act and carried forward Alexander Hamilton's often overlooked position on cooperative federalism as the ideal banking structure, reconstituting America's banking framework by rejecting a dual federalism model in favor of a cooperative federalism one.

I. "A Happy Incident of the Federal System"[30]? The Forces that Resulted in State Experiments with Deposit Insurance the Arguments that Emerged from Them

A. Antecedents and Context

In the grand scheme of things, thirty-eight years does not seem very significant. But whether one traces the origins of the Glass-Steagall Act to 1791's debates over whether the First Bank of the United States should establish branches versus the adoption of the New York Safety Fund in 1829 makes all the difference. 1791 was about federalism, 1829 was about insurance, and the state experiments with deposit insurance and eventual passage of the Glass-Steagall Act were concerned with the former, not the latter.

1. *The Federal Constitution's Allocation of Authority over the Money Supply*

While the Constitution was unhelpfully silent regarding which governmental entity possessed the power to regulate banks, it gave the federal government a decided head-start. By granting Congress the powers to "borrow Money on the credit of the United States,"[31] "regulate Commerce with foreign Nations, and among the several States,"[32] and "To coin Money [and] regulate the Value thereof,"[33] the "federal Constitution gave a strong nationalist lead to policy regarding money."[34] In addition to endowing the federal government with affirmative powers to regulate the money supply, the Constitution also placed important constraints on states' abilities to do the same.

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[30] *New York State Ice Co. v. Liebmann*, 285 U.S. 262, 311–12 (1932), Brandeis, J., dissenting ("It is a happy incident of the federal system that a single courageous state may, if its citizens choose, serve as a laboratory, and try a novel social and economic experiment with risk to the rest of the country."); *see generally* JAMES T. PATTERSON, THE NEW DEAL AND THE STATES: FEDERALISM IN TRANSITION (1969).
[31] U.S. CONST. art. I, § 8, cl. 2.
[32] *Id.*, cl. 3.
[33] *Id.*, cl. 5.
[34] JAMES WILLARD HURST, A LEGAL HISTORY OF MONEY IN THE UNITED STATES, 1774-1970, at 134; *see also United States v. Marigold*, 50 U.S. (9 How.) 560, at 567 (1850) (indicating policy for control of the system of money ultimately by the national government).

States were explicitly forbidden from "coin[ing] Money"[35] or "emit[ing] Bills of credit"[36] in addition to the more general prohibition of the Contracts Clause,[37] which "limited the states' capacity to impose their own ideas of legal tender."[38]

These Constitutionally apportioned federal powers and state constraints initially referred to the physical coining of gold bullion. But the new nation's economy outgrew gold coins. The rapid industrialization of the first half of the nineteenth century demanded a more elastic, liquid currency and individuals needed greater access to larger amounts of credit. The majority of business was no longer conducted by "moving currency from hand to hand"[39] and America's liquid capital was increasingly held as bank deposits. The key consequence of this development was that American banking became a quasi-public enterprise and therefore fell within the ambit of governmental oversight—and, more important, governmental participation—making the ambiguity surrounding the authority of federal and state authorities over banks a problem of paramount importance.

2. *Alexander Hamilton, State Bank Proponent*

Alexander Hamilton's solution to this problem is shocking to the modern reader. The great champion of centralized federal power and driving force behind the establishment of the First Bank of the United States was, counterintuitively, an advocate of cooperative federalism for banking. "All government" Hamilton wrote, "is a delegation of power."[40] The question raised by whether—and if so, to what extent—the

[35] U.S. Const. art. 1, § 10, cl. 1.
[36] *Id.*
[37] *Id.* ("No State shall . . . pass any . . . Law impairing the Obligation of Contracts.").
[38] HURST, *supra* note 34, at 134.
[39] *Should America Adopt A Unified Banking System?*, *supra* note 17, at 112 (Owen D. Young).
[40] *Final Version of an Opinion on the Constitutionality of an Act to Establish a Bank*, *in* 8 HAMILTON PAPERS, *supra* note 14, at 100.

Bank of the United States would establish branches was how that power would be allocated between national and state banks. For Hamilton, at least initially, the answer was that federal and state banks should work in concert, "while advocating centralized government, Hamilton seemingly drew the line at centralized banking."[41] Hamilton's opinions and actions—inner conflict, even—regarding the relationship between state banks and the Bank of the United States portend the debates Carter Glass, Henry Steagall, Arthur Vandenberg and others would have in 1933.

Hamilton's chief concern, shared by Vandenberg nearly 150 years later, was promoting the health of the public credit. This goal was the motivating factor behind Hamilton's desire to establish a national bank. When it came to the nation's economic well-being, Hamilton was more pragmatist than ideologue. He supported the establishment of a national bank because he believed it imprudent for the United States to depend on state banks, "so precarious a tenure and one so foreign from itself" because these local institutions could not serve as "engines of general circulation."[42] In rejecting Secretary of State Thomas Jefferson's objections against establishing a national bank, Hamilton predictably characterized state banks as "institutions which *happen* to exist to day, and ought for that concerns the government of the United States, may disappear to morrow."[43] Even so, in the event a rivalry between state and national banks developed, Hamilton declared "It can never be in the interest of the National Bank to quarrel with the local institutions. The local Institutions will in all likelihood either be adopted by the national Bank or establishments where they exist will be foreborne."[44] This statement

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[41] JOHN C. MILLER, ALEXANDER HAMILTON: PORTRAIT IN PARADOX 274 (1959).
[42] *Hamilton to Washington* (MAR. 27, 1791), *in* 8 HAMILTON PAPERS, *supra* note 14, at 217–23.
[43] *Opinion on the Constitutionality of an Act to Establish A Bank, in id.* at 102.
[44] *Id.*

clearly conveys Hamilton's desire to institute a model of cooperative federalism with respect to banking and introduces the critical question of branches.[45]

Under the charter of the First Bank of the United States, established on February 25, 1791, the directors of the National Bank were authorized to establish branches anywhere in the United States. This presented three alternatives: maintain only one central office, open branches throughout the nation, or establish a small number of branches in large cities.[46] There was perhaps no more divisive issue throughout the century and a half long struggle between national and state banks than the branch banking question. Distilled to the most basic description, branch banking refers to a system whereby banks conduct their business, like accepting deposits or making loans, away from their home offices. The counterpoint to this system is unit banking, which prohibits having more than one full-service office. These competing models are discussed in greater depth below, but at this point it is important to note that the differences between branch and unit banking systems implicate more than how deposits and loans are made—they reflect the ideological divide between a federally unified or state-centric banking system.

With that in mind, many Federalists saw branching by the First Bank as an opportunity to destroy state-run unit banks.[47] Those who advocated this position "proved to be more Hamiltonian than Hamilton himself."[48] In surveying the branching strategies available to the First Bank, Hamilton appeared to support an arrangement whereby

[45] Bruchey, *supra* note 29, at 351.
[46] JOSEPH S. DAVIS, ESSAYS IN THE EARLIER HISTORY OF AMERICAN CORPORATIONS 53–54 (1917).
[47] *See generally* James O. Wettereau, *The Branches of the First Bank of the United States*, 2 J. ECON. HIST. 66, (1942); *see*, *e.g.*, *Fisher Ames to Hamilton* (Aug. 15, 1791), *in* 9 HAMILTON PAPERS, *supra* note 14, at 55 ("any connection between the [federal and state] Banks wd. be generally disagreeable").
[48] MILLER, *supra* note 41, at 273–74.

existing state banks would become the "agents"—or branches—of the National Bank.[49] But in November, 1791 the directors of the First Bank rejected Hamilton's model by declining a stock exchange—which would have the effect of a joint venture—with the Bank of New York and resolved that branches be opened in Boston, New York, Baltimore, and Charleston.[50] In private correspondence, Hamilton bitterly lamented "that the whole affair of branches was *begun*, *continued*, and *ended*; not only without my participation but *against my judgment*."[51]

Unfortunately for Hamilton and cooperative federalism banking, the die had been cast in favor of competitive dual federalism and the first shots in the civil war between federal and state banks had been fired. Thus began a struggle that would define American banking for nearly 150 years. The competition inspired passion on both sides and no quarter was granted by either until the passage of the Glass-Steagall Act in 1933. Federal banks had seized the upper hand at the conclusion of the eighteenth century and maintained that position throughout the nineteenth century—as covered in Part III—but the state banks did not abate. We now turn to their greatest challenge to federal preeminence in banking.

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[49] FRITZ REDLICH, THE MOLDING OF AMERICAN BANKING II 245 (1951). Bruchey also suggests that indirect evidence from Hamilton's correspondence with Fisher Ames and Christopher Gore, Boston Federalists, supports Redlich's judgment. A "profound distrust" of a national bank with branches seems to have been at the heart of Hamilton's opposition to a federally unified banking system. Wettereau, *supra* note 47, at 70, 76, 78; *see also* MILLER, *supra* note 41, at 273–77. He seemed to think "control over the Bank . . . would be dispersed, its resources overextended" and susceptible to mismanagement. MILLER, *supra*, at 274; *see also* 7 HAMILTON PAPERS, *supra* note 14, at 329–30.
[50] Wettereau, *supra* note 47, at 74–75.
[51] *Hamilton to Seton* (Nov. 25, 1791), *in* 9 HAMILTON PAPERS, *supra* note 14, at 538–39.

B. State Experiments with Deposit Insurance from 1909 to 1923

State deposit insurance represented the boldest challenge to federal banking superiority. State banks had been playing catch-up since the 1790's. As a result of a series of episodes throughout the nineteenth century—notably the *M'Culloch* and *Veazie Bank* decisions—state banks found themselves at a competitive disadvantage to federal ones. The most obvious reason being that national bank notes were insured by the full faith and credit of the United States Treasury.[52] But the national banking system when only so far. Treasury would insure national bank *notes* but not national bank *deposits*.[53] Eighteen times between 1886 and 1900 Congress considered instituting federal deposit insurance, but the measure failed eight times.[54] Some state banks saw and seized this opportunity, taking the step that federal banks would not by fully guaranteeing deposits.

The challenge for state banks was that they did not have a virtually unlimited fund as insurance. In order to best approximate the security represented by Treasury's backing, between 1907 and 1917 eight states—Oklahoma, Kansas, Nebraska, Texas, Mississippi, South Dakota, North Dakota, and Washington—introduced systems that created a common bank insurance pool funded by levying a fee on the deposits made in each state bank. That fund, the logic went, would provide security for the depositors of any one bank in the event of failure. In this way state banks, many of them Western unit

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[52] According to the Comptroller of the Currency's First Annual Report on November 2, 1863, even if the pledged securities were insufficient to redeem the notes of failed national banks, "the notes . . . must still be redeemed in full at the treasury of the United States." Golembe, *supra* note 25, at 187.
[53] The distinction is an important one. A bank note is a negotiable promissory note issued by a bank and payable to the bearer on demand. A note is a more limited instrument than a bank deposit, which refers to any money placed in a banking institution. Bank deposits are made to deposit accounts, such as savings, checking, and money market accounts, and the account holder has the right to withdraw any deposited funds, as set forth in the terms and conditions of the account. Put simply, a note only refers to a loan negotiated with a banking or financial institution; a deposit is any money put in a bank—far wider-reaching and more expensive to insure.
[54] GEORGE S. ECCLES, THE POLITICS OF BANKING 91 (1983); Golembe, *supra* note 25, at 187.

banks, aimed to compete with federal banks for deposits; and for a short while, compete they did.

Fortunately for modern scholars, this phenomenon captured the interest of Kansas City banker Thornton Cooke. Between 1909 and 1923 Cooke observed, recorded, and analyzed the rise and fall of state-mandated deposit insurance in Oklahoma and the other seven states that adopted similar measures.[55] His articles, the best primary sources available, explicate the themes and arguments that emerged from the state experiences with deposit insurance. Cooke had access to a variety of important constituencies,[56] which lends a great deal of credibility to his narrative. Among the most important themes that emerge from Cooke's articles are the debate regarding the relative merits of unit and branch banking as proxies for state-centric versus federally-unified banking systems, the political influences at play, particularly Populism, and most importantly, the impact of differing conceptions of federalism on banking regulation.

1. *The Debate Between Unit Banking and Branch Banking*

By 1909 the difference of opinion over the branching question initially broached in the 1790's had evolved into a full-scale controversy, with the branch banking versus unit banking dichotomy implicating a host of geographical, political, social, and

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[55] Thornton Cooke, *The Insurance of Bank Deposits in the West*, 24 Q.J. Econ. 85, (1909) [hereinafter Cooke, *Bank Deposits in the West*]; Thornton Cooke, *The Insurance of Bank Deposits in the West II*, 24 Q. J. ECON. 327, (1910) [hereinafter Cooke, *Bank Deposits in the West II*]; Thornton Cooke, *Four More Years of Deposit Guaranty*, 28 Q. J. ECON. 69, (1913) [hereinafter Cooke, *Four More Years of Deposit Guaranty*]; Thornton Cooke, *The Collapse of Bank-Deposit Guaranty in Oklahoma and its Position in Other States*, 38 Q.J. ECON. 108, (1923) [hereinafter Cooke, *The Collapse of Bank-Deposit Guaranty*].

[56] Cooke's ties to the financial and legislative communities are striking in their amount and quality. *See, e.g.*, Cooke, *Bank Deposits in the West*, *supra* note 55, at 86 ("The information is derived from personal observations, official sources, and conversation and correspondence with many Oklahoma bankers."); Cooke, *Bank Deposits in the West II*, *supra* note 55, at 342 ("The office of the Comptroller of the Currency informs the writer that it is not practicable to announce how many state banks have applied for authority to convert."); Cooke, *Bank Deposits in the West II*, *supra*, at 357 ("[T]he Secretary of the State Banking Board, in a letter to the writer, expresses the opinion that few banks have been organized for the purpose of taking advantage of the guaranty law.").

ideological issues. Just by thinking about their organizational structure, one can begin to understand the different theories of banking and federalism each represented. Branch banking depends on a central bank, which functions as a nerve center connecting all the smaller banks. In the event of a failure, there is always a failsafe, but with that comes increased regulation from the top. Unit banking is a more autonomous model in which a single bank can fail or succeed all by itself, perhaps indicative of the less developed, more independent Western frontier mindset. The major weakness of a unit banking system is that there is no diversified safety net. Unit banking is a trade-off: greater independence and the potential of higher rewards in exchange for less outside oversight and security. The innovation of deposit insurance aimed to preserve unit bank autonomy while mitigating the accompanying risks.

This reform gained traction in the West because of a deep opposition to branch banking.[57] For country bankers, branch banking symbolized more than a different framework for the deposit and distribution of capital. Even if branch banking could furnish benefits, Western bankers "almost unanimously insisted that . . . such a system would still be undesirable on personal, political, economic, and philosophical grounds."[58] This attitude persisted despite "[Branch banking's] superiority in respect to safety, economy, the equalization of rates for loans, and the diffusion of banking facilities."[59] Western bankers' first claim, that there were no comparative benefits to be gained from a system of branch banking because the Western banking structure was sound and

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[57] *See* EUGENE NELSON WHITE, THE REGULATION AND REFORM OF THE AMERICAN BANKING SYSTEM: 1900-1929, at 191 (1983) ("The states in which deposit insurance was adopted had, by previous legislation, all firmly established unit banking within their boundaries and were all in relatively undiversified regions where business prosperity in general depended on one or two commodities.").
[58] Thornton Cooke, *Branch Banking in the West and South*, 18 Q. J. ECON. 97, 97 (1903).
[59] O. M. W. Sprague, *Branch Banking in the United States*, 17 Q. J. ECON. 242, 242 (1903). For a more extensive outline of the benefits of branch banking, see R.M. Breckenridge, *Branch Banking and Discount Rates*, 6 SOUND CURRENCY 1, 2 (1899).

sufficient, is easily debunked by obvious proof to the contrary.[60] The real reason that system was not adopted, and deposit insurance was instead attempted as a proxy for the security offered by the branch banking model, was due to ardent antipathy toward branch banking on philosophical grounds. The objection was more rooted in culture and identity than in demonstrable competitive advantage. As described by Cooke:

> The country banker is a personality that cannot be spared. He knows the people who visit his bank better than the city banker knows those to come to his own, for the country banker is constantly driving over his territory, counting the cattle mortgaged to him, observing their condition and estimating their weight and selling price. He watches the seeding and the harvest, and keeps track of the country's development by the new barbed-wire fences that block his short cuts, one by one. He knows his clients in their own homes, knows who is wasteful and who is getting ahead. He learns the character of the men who are at the beginning of production, and often he makes character and ability the basis for bank loans.[61]

Branch banking therefore represented an entirely different way of life that threatened to marginalize a prominent class of Western businessmen and fundamentally alter Western economic communities. Another element of Western opposition to branch banking was distrust of cities and city bankers. Many Western bankers feared that the "great city banks" would use unfair means, like paying such high interest for deposits or such low interests for loans that country banks would not be able to compete.[62] It was with this mindset that country bankers condemned branch banking as "unpatriotic, un-American, [and] unbusiness-like."[63]

The fears held and accusations leveled by Western bankers against branch banking had more than a minor hint of geographic rivalry. There existed a pervasive "vague fear and distrust of the money centres" directly proportional to the distance from

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[60] *See* Cooke, *supra* note 58, at 99–109.
[61] *Id.* at 109.
[62] *Id.* at 112.
[63] Resolutions of the Kansas Bankers' Association, *Proceedings*, at 113 (1902).

them.[64] No wonder then that the states which declined to allow branch banking and instead adopted deposit insurance were Oklahoma, Kansas, Nebraska, Texas, Mississippi, South Dakota, North Dakota, and Washington. All were frontier polities with agriculturally-driven economies far from "money centres" like Boston and New York. The potential for sectional jealousy and distrust was not insignificant, as a modern reader might assume given the currently extant integrated, uniform banking structure. Rivalries and hard feelings remaining from the Civil War were compounded by wariness of Eastern businessmen and financial centers.[65]

The distillation of the Western objection to branch banking finds that it was predicated on philosophical and cultural objections, not the technical differences between unit and branch banking. It was driven largely by geographical and economic differences, along with distrust of Eastern financial centers and the industrialists who controlled them.[66] This sectional rivalry underlies the Congressional debates over the deposit insurance provision of the Glass-Steagall Act, when the language transitioned from Western versus Eastern to state versus federal, re-evolving from a geographical

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[64] Sprague, *supra* note 59, at 259.
[65] One manifestation of this phenomenon was the distrust—or even dislike—of so-called "robber barons." The term, assigned mostly to prominent Eastern industrialists like John Jacob Astor, Andrew Carnegie, J.P. Morgan, John D. Rockefeller, and Cornelius Vanderbilt carried a negative connotation for exploitive, overly-aggressive, and unfair business practices and morals. Extrapolating that sentiment to the potential effects of branch banking, one can imagine the sectional discord that might have ensued should the control of several great branch systems have gone to the East, particularly to New York. The authoritative account on this topic is MATTHEW JOSEPHSON, THE ROBBER BARONS: THE GREAT AMERICAN CAPITALISTS, 1861-1901 (1934).
[66] These feelings were bolstered by a long-standing phenomenon whereby Western states had become creditors to Eastern cities. Sprague, *supra* note 59, at 255 ("A very large part of the country has constantly presented the phenomena of an active people possessing little capital, with rich resources, which, however, have been too unlimited in amount to be very satisfactory as a commercial asset. In the attempt to develop these resources they have borrowed from a distance, not necessarily too much for the most rapid development, but so much as to bring upon them certain difficulties and discomforts . . . . This geographical separation of debtor and creditor has been the cause of much agitation for cheap money, and also of the ill feeling and distrust with which Eastern moneyed institutions have been regarded.").

dispute to a referendum on the trajectory of the relationship between banking and American federalism.

2. The Popular Appeal of Deposit Insurance

Popular politics would play a significant role in this redefinition. The most important political development during the 1890's in the West was the emergence of Populism. The movement traced its genesis to the merger of the agrarian Farmers' Alliance and the free-currency driven Greenback Party, and its presence became particularly strong in the West and South; non-coincidentally, the regions that were home to the eventual deposit insurance states.[67] There was also another constant political theme among the states that considered[68] deposit insurance: politicians versus bankers. Many Western bankers opposed deposit insurance largely on the basis that such legislation would burden successful banks by forcing upon them the responsibility of insuring their less successful counterparts. In their view deposit insurance amounted to robbing Peter to pay Paul.[69]

If there was one thing politicians in Western states—Democrats, Republicans, and Populists alike—could agree on, however, it was to disagree with bankers. Deposit insurance was a "vote catcher."[70] Political parties raced to make deposit insurance part of their platforms and competed to claim credit for it afterward. In Kansas deposit

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[67] For more on the history of the Populist movement, see generally LAWRENCE GOODWYN, THE POPULIST MOMENT: A SHORT HISTORY OF THE AGRARIAN REVOLT IN AMERICA (1978); JOHN D. HICKS, THE POPULIST REVOLT: A HISTORY OF THE FARMERS' ALLIANCE AND THE PEOPLE'S PARTY (1931).

[68] Colorado and Missouri debated but did not pass bank deposit legislation. For more on the experiences of Colorado and Missouri, see Cooke, *Bank Deposits in the West II*, *supra* note 55, at 367–70.

[69] Professor J. Laurence Laughlin, then head of the University of Chicago's Department of Political Economy and later an important influence on the creation of the Federal Reserve System, articulated that sentiment in equating deposit insurance to a situation where "A, who had been robbed by B, ask(s) that his honest neighbor, C, should be robbed to make up for his loss." J. Laurence Laughlin, Guaranty of Bank Deposits: An Address before the State Bankers' Association of Nebraska at Lincoln (Sep. 25, 1908).

[70] Cooke, *Bank Deposits in the West II*, *supra* note 55, at 359.

guarantee was at different times supported by Populists, Republicans, and Democrats;[71] in Nebraska Populists originally proposed the reform but only a few years later a Democratic Governor was elected on a deposit insurance platform;[72] and Republicans in South Dakota, not to be outdone by their Democrat rivals, added deposit insurance to their own platform.[73] Deposit insurance held apparent appeal for politicians of all stripes because it was premised on the idea of levying a small tax on bankers, a traditionally unpopular constituency, to insure the deposits of everyone else; a political proposition as simple as it was elegant. The political strategy of portraying oneself as a crusader for the common man against unsympathetic bankers would prove to be a successful tactic; one which Henry Steagall and others would later employ to great effect.

Beyond politics, guaranteeing deposits had a basic, undeniable popular appeal that—when compounded with a distrust of bankers following the Great Crash and ensuing bank failures—created a public mandate for action and reform. States had struck an ideological, political, and popular chord with their bold plan to guarantee deposits, a key reason deposit insurance persisted as a potential solution notwithstanding its ultimate failure at the state level.

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[71] *Id.* at 344–45.
[72] *Id.* at 355.
[73] *Id.* at 358–59.

C. Explanations for Failure and Texas as a Model for Federal Deposit Legislation

Even in this brief period of state bank preeminence due to the competitive advantage of deposit insurance,[74] there were cracks in the system.[75] To legislators and potential depositors (the general public) in those states, however, these comparatively few discreet failures were interpreted as mismanagement of those banks, not a comprehensive system failure. But bank failures in Oklahoma quickly became more worrisome trend than isolated incident, and by 1913 "bank after bank" had failed.[76] Virtually all these failures were of state banks that were part of deposit guarantee systems,[77] demonstrating that this initiative had failed in record-setting fashion.[78] The test case for state-mandated deposit insurance, Oklahoma, had experienced a meteoric rise and equally dramatic fall in fewer than four years. At the time, several theories attempting to explain the failure were advanced,[79] with the most prominent of them being that adverse economic conditions and depositor indiscretion in selecting banks combined

[74] Oklahoma was one striking example of the stunning early success of state deposit insurance. On February 29, 1908, there were 470 state banks with $18,032,284 in individual deposits which held a total capital of $6,233,216; by comparison, there were 312 national banks with $38,298,247 in individual deposits which held a total capital of $12,215,350. These numbers demonstrate the primacy of national banks before deposit insurance, and tracking those metrics illustrates how state banks outperformed national ones after the legislation was passed. By June 23, 1909, there were 631 state banks with $42,722,927 in individual deposits which held $10,270,800 in total capital; while the number of national banks had decreased to 230, with only $38,111,948 in individual deposits which held $9,730,000 in total capital. Similar legislation yielded comparable results in the other seven states that adopted deposit insurance. Cooke, *Bank Deposits in the West*, *supra* note 55, at 88.
[75] The most notable of these was the default of the Columbia Bank and Trust Company, which held the largest deposits in Oklahoma. For more on this episode, see Cooke, *Bank Deposits in the West II*, *supra* note 55, at 328–35.
[76] Cooke, *Four More Years of Deposit Guaranty*, *supra* note 55, at 72.
[77] *Id.* at 73 ("Only three national banks have failed in Oklahoma during the same time. Many of the state bank failures must be due to recklessness and incompetence.").
[78] *Id.* at 75 ("[A] record of thirty bank failures in five years, with almost all of them coming in three years, has not been equaled in the United States for a long time, the most recent parallel being perhaps the experience of some western states during and after the panic of 1893.").
[79] *Id.* at 93 ("(1) The Banking Department was for a long time in politics. (2) Unsound banks were admitted and guaranteed at the outset. (3) The record of bankers has not been properly traced. (4) There has been procrastination in closing insolvent banks and timidity in the face of losses. (5) Economic conditions have been someone adverse. (6) The guaranty of deposits has relieved depositors of all necessity for care in selecting banks.").

with careless banking practices to result in failure. In its simplest form, Oklahoma's experience posed the question: was it a poor harvest, thoughtless depositing, and negligent banking that caused these failures, or was it deposit insurance? As demonstrated by subsequent failures in other states,[80] the answer appears to be the latter.

Cooke's final foundational article, *The Collapse of Bank-Deposit Guaranty in Oklahoma and its Position in Other States*, is an indictment of state-mandated deposit insurance and an attempt to make sense of what went wrong. There was one case of limited success, however, and it is illustrative of why state-run deposit insurance failed but was still seen by some at the federal level as a viable remedy to the ongoing banking crisis during the 1920's and 1930's. Even after the Panic of 1907 and a difficult economic period due to poor weather conditions that crippled harvests across the West and South, in 1923 Texas' deposit insurance program was described as "sound as the Rock of Gibraltar."[81] In thirteen years of deposit guaranty, "*Not one non-interest bearing and unsecured depositor ever lost a cent in a Guaranty Fund Bank of the State of Texas, even tho we have passed through the darkest period of the financial history of the State*."[82] The contrast during the 1910's and early 1920's between Texas' experience and that of the other seven states is striking.

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[80] In 1923 Kansas experienced twenty-three state bank failures while, with a single exception, there had not been a national bank failure in ten years; in Nebraska there were twenty-five state bank failures in 1921 and twenty-two more in 1922; cracks were showing in the North Dakota and South Dakota systems but they were enacted much later than the other programs so the full effects had not yet manifested themselves; in Mississippi twenty-one state banks had failed as of 1923 (the law went into effect in 1915) with fourteen of those coming in 1921 and 1922; and in Washington one large bank failed and brought down the whole system. *See generally* Cooke, *The Collapse of Bank-Deposit Guaranty*, *supra* note 55.

[81] *Id.* at 132 (quoting a letter from Texas Bank Commissioner J.L. Chapman to Cooke).

[82] *Id.*

This was due to some unique features of the Texas plan.[83] One was an established capital-to-deposit ratio requirement which resembled something like the modern federally-mandated capital-to-asset requirements. This innovation, well ahead of its time, provided an important constraint on irresponsible—or even just overaggressive—banking practices. The second distinctive characteristic of the Texas plan was that it had the highest assessments of any deposit insurance plan. Oklahoma was the only other state that taxed one percent of deposits on the first assessment, but Texas' subsequent assessments per annum were a quarter of deposits until the fund equaled $2,000,000; further, it provided that in the case of emergency or depletion of the fund assessments could be raised to two percent.[84] Put succinctly, the fundamental differences between Texas' plan and the others were increased regulation in the form of minimum capital requirements and a bigger insurance fund.

Though the Texas plan eventually failed,[85] these were features that could—and would—be replicated and strengthened at the federal level. Instead of minimum capital requirements, federal regulators could set standards and inspections for admission into the deposit-guaranteed national banking system. More significantly, the insurance fund could be backed by the full faith and credit of the United States government. For proponents of a state-centric banking model, this was the takeaway point of the failed state experiments with deposit insurance. Years later, Henry Steagall pointed to "the

[83] Cooke, *Bank Deposits in the West*, *supra* note 55, at 98–99; *see also id.* at 88–89 (table entitled "The Chief Provisions of Recent Legislation Upon Bank Deposit Insurance," which compares the deposit insurance plans in Oklahoma, Kansas, Nebraska, South Dakota, and Texas). *See generally* Linda M. Hooks & Kenneth J. Robinson, *Deposit Insurance and Moral Hazard: Evidence from Texas Banking in the 1920s*, 62 J. ECON. HIST. 3 (2002).
[84] *See supra* note 83.
[85] Texas's deposit insurance plan enjoyed more success than that of the other seven states, but it too would eventually fail. For more on Texas's experience, *see* JOSEPH M. GRANT AND LAWRENCE L. CRUM, THE DEVELOPMENT OF STATE-CHARTERED BANKING IN TEXAS 74–87 (1978); *see generally* Hooks & Robinson, *supra* note 83.

State of Texas" for the proposition that "proof is indisputable that bank-deposits guaranty, if conducted in accordance with established rules and principles of insurance, can easily be made effective at a cost easily borne."[86] Advocates of a unified federal banking system, typified by Senator Carter Glass of Virginia, reached an opposite conclusion and adopted their own measure in response to the Panic of 1907: the Federal Reserve Act of 1913.

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[86] 73 CONG. REC. 3,838 (1933).

II. "Insurance to the Entire Banking Community of the United States"[87]: Carter Glass and the Continued Effort to Unify the Banking System under Federal Control

Unification of the banking system under federal control was the obvious response to the Panic of 1907. The idea of unifying the banking system was not a new one—to the contrary, it was well a well-established proposition that had long-standing constitutional and ideological support. Proponents of unification had sought to consolidate authority over the banking system throughout the nineteenth century, and the Panic of 1907 followed shortly thereafter by the First World War presented the perfect opportunity to complete that endeavor. During the period from 1913 to 1933, no one typified this position more than Carter Glass. Glass co-sponsored the Federal Reserve Act of 1913 and introduced his own banking bill in 1932 that sought federal unification. The first measure represented a more conventional alternative to the bold, innovative state experiments with deposit insurance; the second a long-standing counterpoint to Henry Steagall's counterintuitive proposals for federal deposit guarantee legislation. In both instances, Glass assumed the role of standard bearer for federal unification.

A. Early Attempts at Unification

The Federal Reserve Act can be seen as Congress's third attempt to create a unified banking system for the United States. The first was, of course, the establishment of the First Bank of the United States in 1791. The second was the Congressional act of March 3, 1865[88] which imposed a ten percent tax on the circulating notes of state banks; functionally an effort to tax state banks out of existence. Both measures were upheld as constitutional by the Supreme Court, providing tangible support for the notion that

[87] 77 CONG. REC. 3,727 (1933).
[88] Act of March 3, 1863, 12 Stat. 670.

banking was a national enterprise; and more importantly, demonstrating that in the civil war between federal and state banks there were virtually no constraints on federal action. In a banking system predicated on competitive dual federalism, the federal government simply had more bullets.

The first of these was supplied by Chief Justice John Marshall in *M'Culloch*.[89] The central holdings of this foundational case were that Congress had the authority to establish a national bank pursuant to the "necessary and proper clause"[90] and that Maryland did not have the power to tax such an institution created by Congress.[91] Of greater significance was the Court's broad reasoning, which gave clear preference to the federal government in the banking sphere. Hearkening back to Hamilton's notion that state banks "*happen* to exist to day, and ought for that concerns the government of the United States, may disappear to morrow,"[92] Marshall found that the "the existence of state banks can have no possible influence on the question"[93] of whether Congress had the authority to establish a national bank. The national bank would have carte blanche, irrespective of the existence or wishes of extant state banks.

Marshall's reasoning relied on a creative reading of the Constitution. He construed the Constitution's "unhelpful silence"[94] on the relationship between banking and federalism as an affirmative statement that there was no "intention to create a

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[89] *M'Culloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819).
[90] *Id.* at 324. U.S. CONST. art. 1, § 8, cl. 4. ("To make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers, and all other Powers vested by the Constitution in the Government of the United States, or in any Department or Officer thereof.").
[91] *Id.* at 431. ("That the power to tax involves the power to destroy; that the power to destroy may defeat and render useless the power to create; that there is a plain repugnance in conferring on one government a power to control the constitutional measures of another, which other, with respect to those very measures, is declared to be supreme over that which exerts the control, are propositions not to be denied.").
[92] *See supra* notes 42–43.
[93] *M'Culloch*, 17 U.S. at 424.
[94] *See supra* notes 6–7.

dependence of the Government of the Union on those of the States."[95] Marshall therefore reasoned that in executing its powers—including, according to *M'Culloch*, creating a national bank—the "choice of means implied a right to choose a national bank in preference to State banks, and Congress alone can make that election."[96] The Court forcefully concluded, "It is the very essence of supremacy, to remove all obstacles to its action within its own sphere."[97] For Marshall, the sphere was banking and the national government was properly supreme.[98]

The second attempt at federal unification presented the inverse question to the one the *M'Culloch* had addressed: did the federal government have the constitutional power to destroy state banks by taxing them? In *Veazie Bank*,[99] the Court answered "yes." In the wake of the Civil War, Congress imposed a ten percent tax on state bank notes with "the avowed purpose of . . . creat[ing] a uniform currency by driving the circulating notes of State banks out of existence and, if necessary, by driving all State banks into the national banking system."[100] Congress and the national banks had gone beyond rejecting Hamilton's vision of cooperation with state banks, escalating the competition by eschewing the strategy of merely building national banks up and instead attempting to tear state ones down.

Veazie Bank signified a shift in the nature of the competition between federal and state banks. Before the tax, most national bank proponents used federal resources to bolster national banks, but had simultaneously seemed to adopt an attitude of "live and let

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[95] *M'Culloch*, 17 U.S. at 424.
[96] *Id.*
[97] *Id.* at 427.
[98] These principles were restated and upheld in the subsequent case of *Osborn v. United States Bank*, 22 U.S. (9 Wheat.) 738 (1824); *see also* Walter Wyatt, *Constitutionality of Legislation Providing A Unified Commercial Banking System For the United States*, 19 FED. RES. BULL. 133, 169 (1933).
[99] *Veazie Bank v. Feno*, 75 U.S. (8 Wall.) 533 (1869).
[100] Wyatt, *supra* note 98, at 175.

live" toward their state counterparts. *Veazie Bank* signaled the end of that outlook. In his first report to Congress dated November 23, 1863, the Comptroller of Currency rejected the notion that "the national banks can not supersede the State banks without breaking them down" and declared that "the whole system of State banking, as far as circulation is regarded, is unfitted for a commercial country like ours . . . . Its immense trade is not circumscribed by State lines, nor subject to State laws. Its internal commerce is national and so should be its currency."[101] A year later, the Comptroller contended "as long as the two systems are contending for the field, (although the result of the contest can be no longer doubtful), the Government can not restrain the issue of paper money."[102] The definitive statement on the state of play comes from Senator John Sherman of Ohio, Chairman of the Finance Committee, who declared "The national banks were intended to supersede the State banks. Both can not exist together."[103] It was ironic that just as the American Civil War was coming to a close, federal and state banks began their own civil war in earnest. Full reconstruction of the banking structure was not undertaken until 1933, but the next attempt at unification—Carter Glass's first—would come in 1913.

B. Founder of the Federal Reserve

The telegram read, "Confined by attack of cold. Would you be kind enough to come to Princeton."[104] Carter Glass would of course make the trip to President-elect Woodrow Wilson's home in order to propose his vision for a new national banking system. In Glass's view, the national banking system established after the Civil War had

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[101] *Id.* (quoting First Annual Report of the Comptroller of the Currency, Nov. 28, 1863).
[102] *Id.* at 176 (quoting Second Annual Report of the Comptroller of the Currency, Nov. 25, 1864).
[103] 38 CONG. REC. 1,139 (1865).
[104] RIXEY SMITH, CARTER GLASS: A BIOGRAPHY 76 (1939).

proved inadequate.[105] He believed the weaknesses were "the Siamese twins of disorder . . . an inelastic currency and a fictitious reserve system . . . . The sum total of the idle bank funds of the nation was congested as the money centers for speculative purposes."[106] Glass therefore presented Wilson with a plan which proposed to make several reserve pyramids out of the "ever-toppling big one," decentralizing credits by reserve balances to be held in regional banks which would then issue federal reserve notes thereby creating "a flexible currency founded on commercial assets, the intrinsic wealth of the nation, rather than on bonded debt."[107] Glass thought on a macroeconomic level, seeing banks as part of an interlocking national economy, not as mere unitary islands. He convinced Wilson, and in his newly attained position as Chairman of the House Committee on Banking and Currency teamed with Senator Robert Owen of Oklahoma to operationalize his vision.

Their joint effort, the Federal Reserve Act of 1913,[108] can fairly be characterized as the third major attempt to unify the banking system; the federal analogue to state deposit insurance. The title in full reads as follows: "An Act to provide for the establishment of Federal reserve banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes."[109] The Reserve Act called for the creation of at least eight and not more than twelve private, regional Federal Reserve banks, each with

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[105] *Id.* at 67.
[106] *See generally* CARTER GLASS, AN ADVENTURE IN RECONSTRUCTIVE FINANCE (1927).
[107] SMITH, *supra* note 104, at 97.
[108] Federal Reserve Act, 38 U.S.C. § 251 (1913). For more on the origins and history of the Federal Reserve Act, see generally DONALD WELLS, THE FEDERAL RESERVE SYSTEM: A HISTORY (2004); ELMUS WICKER, THE GREAT DEBATE ON BANKING REFORM: NELSON ALDRICH AND THE ORIGINS OF THE FED (2005).
[109] 38 U.S.C. § 251.

their own branches, which would be overseen by a Federal Reserve Board comprised of public officials appointed by the President and confirmed by the Senate.[110]

The reform can thus be conceptualized as having two parts: standardizing the circulating medium to create a more elastic currency and spreading risk by restricting national banks as a branching system. By consolidating "gold, national bank notes, subsidiary silver and minor coin, and an assemblage of assorted relics of earlier monetary episodes—greenbacks, silver dollars, silver certificates, and Treasury notes of 1890"[111] into a single uniform currency, the Federal Reserve Act aimed to create a money supply that could rapidly expand or contract based on need—in other words, making the money supply more elastic in order to prevent a replay of the Panic of 1907. The second part of the plan was making sure this newly standardized money supply would be properly regulated. This was the purpose of the federal reserve banks, conceived as parallel institutions designed to jointly manage the uniform currency. The Reserve Act's two-part plan of creating an elastic currency managed by parallel, centralized banking institutions aimed to remedy Glass's "Siamese twins of disorder;" the former measure carried forward the spirit of *Veazie Bank* and the latter *M'Culloch*.

Glass had assumed the mantle of the movement to unify the banking system. His first effort, the Federal Reserve Act, was characterized by subtle compulsion. He endeavored to create a national system so attractive, and conferring such great benefits on its member banks, that state banks would be compelled to join; and would then be subject to federal standards and regulation. That is to say, it was more *M'Culloch* than *Veazie*.

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[110] The Federal Reserve Act drew heavily from 1908's Aldrich-Vreeland Act, which had established the National Monetary Commission which ultimately recommended the Federal Reserve Act of 1913. The major innovation introduced by the Reserve Act was oversight of the system—in the form of the Federal Reserve Board—was placed in the hands of public officials, not private bankers.
[111] FRIEDMAN & SCHWARTZ, *supra* note 20, at 189.

While the Reserve Act was seen as a success—Glass later stated his steadfast belief that the Federal Reserve System had been central in the United States' "winning" World War I[112]—the Great Crash was proof positive to Glass and others that it had not gone far enough and a more direct effort at unification was necessary. Indeed, scholars have persuasively argued that the Federal Reserve System was too broad and unfocused a mandate.[113] Glass would not repeat that mistake with his second try.

C. The "Glass Banking Bill"

The key revelation that led Glass to this new posture was that the model of competitive dual federalism would not work. He argued that "when we have had occasion to propose modifications of either the Federal Reserve Act or the National Banking Act it has seemed to me that instead of creating a national standard of sound banking which the State systems might be induced to follow, we have introduced into the national banking system some, if not many, of the abuses of the State systems, in order to enable national banks to compete with State banks."[114] For Glass, this realization necessitated a full reexamination of the banking structure. This undertaking was authorized on May 5th, 1930 with the adoption of Senate Resolution 71, "a resolution to make a complete survey of the national and federal reserve banking systems."[115] A subcommittee of the Senate Committee on Banking and Currency was charged with the task, and Glass was designated as its chairman. It was from these hearings on the

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[112] Senator Carter Glass, Truth About the Federal Reserve System, Speech in the Senate of the United States 3–4 (Jan. 15 and 16, 1922); *see also* SMITH, *supra* note 104, at 180–81.

[113] FRIEDMAN & SCHWARTZ, *supra* note 20, at 189–96; HURST, *supra* note 34, at 82, 228, 229, 236, 240, 248.

[114] *Operation of the National and Federal Reserve Banking Systems: Hearings Pursuant to S. Res. 71 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 71 CONG. REC. 999 (1931).

[115] 72 CONG. REC. 8,355 (1930).

Operation of the National and Federal Reserve Banking System[116] that the so-called "Glass Banking Bill"[117] emerged.

Nearly a year and half later the Glass Bill began to take shape.[118] Glass's belief that a more forceful unification strategy was necessary[119] had been reinforced by the continued collapse of the dual banking system in 1931[120] and in January of 1932 Glass introduced a second bill in the Senate.[121] Two features of this bill were particularly notable. First, it encouraged branch banking as a means of providing additional security to depositors; second, a "Federal liquidating corporation" was to be formed, its function being to use capital appropriated from Treasury and levied by assessments on member banks to purchase the assets of closed member banks, thereby hastening payment to depositors. Both measures would have the macro effect of increasing the sphere of federal influence on bank regulation.

Glass would introduce three more versions of his own bill.[122] Of these, April 1932's S.4412 best exemplifies Glass's view of the ideal relationship between federalism and banking because this proposal was accompanied by the Senate subcommittee's

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[116] *See supra* note 114.
[117] For a comprehensive legislative history of the Glass-Steagall Act focusing on Glass's contributions, see Edward J. Kelly III, *Legislative History of the Glass-Steagall Act*, *in* DEREGULATING WALL STREET: COMMERCIAL BANK PENETRATION OF THE CORPORATE SECURITIES MARKET 41–66 (Ingo Walter ed., 1985).
[118] The first iteration of the Glass bill, S. 4723, had actually been proposed on June 17, 1930, but it did not reflect the hearings pursuant to Senate Resolution 71 and ultimately bore little resemblance to the final version of the Glass bill.
[119] In November of 1931 Glass had privately suggested to then-President Hoover that all banks engaged in interstate commerce be required to join the Federal Reserve System. *See* SMITH, *supra* note 104, at 306. Hoover referred the matter to Attorney General William D. Mitchell, who determined that measure unconstitutional. *See* "Letter from President Hoover on November 13, 1931, enclosing a statement of his concerning Mortgage Discount Banks," Carter Glass Papers, Box 4.
[120] There were 2,290 bank failures in 1931. Operation of the National and Federal Reserve Banking Systems, S. REP. NO. 584, at 6 (1932).
[121] S. 3215, 75 CONG. REC. 2,403 (1932).
[122] S. 4115, 75 CONG. REC. 6,329 (1932); S. 4412, 75 CONG. REC. 8,350 (1932); see also opposition to branch banking by Senator Long in *id.* at 1452, and response by Glass, *id.* at 2208, and bill's passing the Senate at 76 CONG. REC. 2,517 (1933); S. 245, 77 CONG. REC. 196 (1933).

report[123] based on the investigation held under Senate Resolution 71. After identifying what it thought to be the primary defects of the existent banking system the subcommittee, through Glass, made its intention clear: "Specifically, what is proposed is the grant of power to establish branches of national banks no merely in the towns and cities in which they are located but also outside of such limits at any point within the borders of the State in which they exist, irrespective of State law."[124] Glass expounded upon this view testifying before the Senate the next month. Directly invoking the constitutional authority of *Veazie*, Glass defended his unifying, branch banking proposal by declaring that "Congress, sustained by a decision of the Supreme Court . . . completely swept away the rights of the States in matters relating to the banking business . . . . Therefore I have come to the conclusion that it is no invasion of the rights of the States for Congress to authorize a national bank to establish branches."[125]

In doing so, Glass made a direct assault on state-centric unit banking. He disputed what he took to be the romantic, inaccurate conception of the "country banker," characterizing him quite differently than Thornton Cooke had years earlier.[126] Glass held forth:

> It is, therefore, obvious that the problem is largely one of small rural bank failures. Right here, I pause to say what I have repeatedly said before in discussing this question – that the appeal of the little bank, so called, against the "monopolistic" tendencies of branch banking, is misleading . . . . The fact is that the little banker is the "monopolist." He wants to exclude credit facilities from any other source than from his bank. He wants to monopolize the credit accommodations of his community.[127]

[123] *See supra* note 120.
[124] *Id.* at 11.
[125] 71 CONG. REC. 9,890–91 (1932).
[126] *See supra* notes 58, 60, 61.
[127] 71 CONG. REC. 9,892 (1932).

From these comments and his proposed legislation, it is apparent that Glass and the unification movement he typified had determined that competitive dual federalism banking was untenable and that the solution was federal unification. The hearings on the *Operation of the National and Federal Reserve Banking System* were exhaustive and the resultant Glass Banking Bill that emerged from them was detailed and definite. In his second attempt to unify the banking system under national control Glass left no stone unturned. His thorough investigation yielded empirical proof that competitive dual federalism was an unsustainable banking model, providing him the impetus and confidence to change his strategy for brining state banks under federal regulation from one of subtle compulsion to a more direct campaign of overt recruitment, with negative consequences for state banks that failed to comply.

Though Glass still professed to be a "State-right Democrat" who "believe[s] in the Jeffersonian theory of State rights" he maintained that allowing national banks to branch did not implicate an issue of state rights "because the State is not precluded from putting its State banks on a level of competition with national banks."[128] It was a more nuanced approach than *Veazie Bank*'s direct tax, but Glass and other unification proponents knew full well that state banks could not compete with national branch banks. The choice for state banks seemed clear: join the Federal Reserve System or perish. Henry Steagall instead proposed a third option: *federal* deposit insurance.

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[128] *Id.* at 9898.

III. "THE CITIZENSHIP OF THIS COUNTRY DESIRES AND DEMANDS THIS LEGISLATION"[129]: HENRY STEAGALL AND THE DEPOSIT GUARANTEE MOVEMENT

Henry Steagall had two political role models: William Jennings Bryan[130] and Woodrow Wilson.[131] In his own career Steagall embraced many of the values previously championed by Bryan—support for Western and Southern agricultural interests, antipathy toward Wall Street, and protection of state's rights—but the political strategy Steagall deployed to further those causes was conceptually modeled on Wilson's "New Freedom"[132] movement. Steagall's means and ends were thus something of a contradiction, he "espoused the agrarian myth of self-sufficiency while advocating state and Federal interference in the economy."[133] This personal and political paradox made deposit insurance the perfect issue for Steagall and, vice versa, Steagall the ideal advocate for—and symbol of—that policy. Steagall's conception of federalism may have been state-centric *laissez faire*, but the way he went about turning ideal into reality was more New Freedom than Populism. He believed state experiments with deposit guarantee reflected substantively the correct values and policy, and that their failure signified the need for the full force of the federal government to accomplish that worthy goal.

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[129] 75 CONG. REC. 11,217 (1932).
[130] Jack Brien Key, *Henry B. Steagall: The Conservative as a Reformer*, 17 ALA. REV. 198, 198 (1964).
[131] *Id.* at 200.
[132] "New Freedom" refers to the campaign speeches and promises of Woodrow Wilson's 1912 presidential campaign. While these speeches called for less government, in reality the President oversaw an expansion of federal power. Notable reforms included the Underwood Tariff Act of 1913, the establishment of the Federal Reserve System and Federal Trade Commission, the Clayton Anti-Trust Act, and the Federal Farm Loan Act. For more on Woodrow Wilson and the New Freedom, see generally WOODROW WILSON, THE NEW FREEDOM: A CALL FOR THE EMANCIPATION OF THE GENEROUS ENERGIES OF A PEOPLE (1921).
[133] Key, *supra* note 130, at 198.

A. Fighting Branch Banking and Unification Opposing the McFadden Bill

Although federal banks had secured two major victories—*M'Culloch* and *Veazie Bank*—in their pseudo-civil war with state banks during the nineteenth century, the system was called *competitive* dual federalism for a reason: advocates of the state, or unit, banking system refused to let it disappear. The National Bank Act of 1863, as amended in 1864, was simple in construction: "And its [the bank's] usual business shall be transacted at an office or banking house located in the place specified in its organization certificate."[134] This was the legislation that had entrenched unit banking in the American fiscal system. By placing a ban on branching by federal banks, the National Bank Act of 1864 ensured that unit banking would survive because federal banks were prohibited from branching and state banks were unlikely to; that the uniquely American dual federal and state banking system would persist; and that there would be competition between the two systems. After the failure of state-run deposit insurance, the debate over branch versus unit banking, a proxy for federal versus state banks, intensified on the national level. Professor O.M. Sprague had presciently predicted this state of affairs in 1903:

> The supposition that the two systems might continue together side by side is extremely improbable. In every country where the branch-banking system prevails the process of bank amalgamation has gone on very rapidly, particularly during the last 20 years, and no one can doubt that in the United States the movement would be quite as swiftly executed as in any European country.[135]

Henry Steagall shared this life-or-death view of the struggle between unit and branch banking, and took his stand in support of the former during the Congressional hearings regarding the so-called McFadden Bill. This proposed legislation, eventually

[134] GEORGE S. ECCLES, THE POLITICS OF BANKING 49 (1982) (quoting The National Bank Act of 1864, 13 Stat. 100).
[135] Sprague, *supra* note 59, at 252–53; *see also* 69 CONG. REC. 2,839 (1926).

enacted as the McFadden Act in 1927, [136] included a provision allowing national banks to branch to the same extent as state-chartered banks.[137] Representative Steagall saw this allowance as nothing short of threatening the entire American banking framework. Should federal banks have branching rights coextensive with the states' bestowed upon them, Steagall saw no end to the potential growth of branch banking in the United States. Like the Western states that had adopted deposit insurance as a measure to avoid, even combat, branch banking, Steagall's opposition to such a banking system was grounded more in his political philosophy than technical differences between unit and branch banking. He made himself crystal clear on this issue, condemning "the principle of branch banking" as "un-American, monopolistic, and destructive" before challenging his Congressional colleagues "Will any member of the Banking and Currency Committee look a Member in the face and say branch banking is desirable anywhere? Will any Member of the House face this proposition and say that branch banking is desirable anywhere?"[138]

Steagall's stance reflected a notion of federalism incongruous with both interpretations of the Constitution's text[139] and decisions of the Supreme Court[140] that

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[136] 12 U.S.C. §§ 36, 81. For more information on the McFadden Act, see David F. Freeman, *Interstate Banking Restrictions Under the McFadden Act*, 72 VA. L. REV. 6, 1119–53 (1986). It is also worth noting that Representative Louis Thomas McFadden of Pennsylvania was a fierce opponent of the Federal Reserve System, making a twenty-five minute long speech in Congress blaming the Federal Reserve for the Great Depression. 75 CONG. REC. 12,595 (1932). He also believed Wall Street bankers funded the Bolshevik Revolution through Federal Reserve banks and once tried to impeach President Herbert Hoover.

[137] The Supreme Court had explicitly decided this matter in 1924. *First Nat'l Bank v. Missouri*, 263 U.S. 640 (1924) (upholding a Missouri statute providing "that no bank shall maintain in this state a branch bank or receive deposits or pay checks in its own banking house.") The Court reasoned that such a statute did not conflict with the laws of the United States because "[t]he extent of the powers of national banks is to be measured by the terms of the federal statutes relating to such associations, and they can rightfully exercise only such as are expressly granted or such incidental powers as are necessary to carry on the business for which they are established." *Id.* at 656.

[138] 68 CONG. REC. 1,629 (1925).

[139] *See supra* notes 31, 32, 33, 35, 36, and 37.

[140] *See supra* notes 8, 9.

Glass suggested had "completely swept away the rights of the States in matters relating to the banking business."[141] Instead, Steagall believed the "national banking system should . . . blaze the way. It should lead, the States and the financial institutions of the country to follow after it along sound lines and sound principles of banking."[142] But Steagall's definition of "lead" was not the dictionary one, which might suggest he believed national banking authorities should control American banks; nor did "national banking system" mean the Federal Reserve System, it meant the state-centric unit banking system codified in 1864. Achieving this objective required federal resources in service of state goals. Put more concretely, Steagall envisioned a state-centric banking system made more robust by virtue of the United States Treasury guaranteeing every deposit in a state bank. It was the perfect unorthodox foil to the long-standing campaign for unification, as Steagall developed a compelling alternative by combining the Populist, anti-corporate, states' rights vision of federalism that had emerged from the experiments with deposit insurance with New Freedom-style federal funding.

B. Federal Deposit Insurance as the Great Challenge to Unification

With the Great Crash having thrown the nation's economy into chaos, Steagall seized the moment and made his great push for federally guaranteed bank deposits. On April 14, 1932 Steagall introduced a deposit insurance bill, which passed in the House of Representatives on May 25[143] after four hours of debate.[144] His first argument was one based on restoring public confidence in the banking system. Steagall reasoned, "We can not have a general revival of business . . . until normal banking is resumed . . . and it will

[141] *See supra* note 125.
[142] 68 CONG. REC. 1,631 (1925).
[143] 75 CONG. REC. 11,211–39 (1932).
[144] SUSAN ESTABROOK KENNEDY, THE BANKING CRISIS OF 1933, at 214 (1973).

not be resumed until the public who furnish the money with which the banks do their business, take their money out of hiding and put it back in banks."[145] This argument was reminiscent of those incorporated as part of the Populist platform at the turn of the century as well as those invoked by supports of state-mandated deposit guarantee plans. Steagall's public confidence argument also included a strain of what Golembe termed "protection of circulating medium."[146] State failures to inspire confidence in the public through deposit insurance—therefore rendering themselves unable to gain deposits and protect the circulating medium—was not an indictment of the measure, just the magnitude.

In making this argument, Steagall returned to a familiar political playbook: he claimed to have a public mandate for deposit insurance and accused bankers of squelching the will of the people. He framed the debate in near-apocalyptic terms: "The people of the United States are confronted with an emergency as serious as war. Misery is widespread. [We] have seen suffering and distressed bank depositors—the destruction of their business and the loss of their homes. Thousands have been reduced to poverty and despair. Life savings, security for old age, have dwindled to almost nothing."[147] Never one to shy from casting himself as advocate of the common man, Steagall proclaimed "The citizenship of the country desires and demands this legislation. They know where their interest lies and they understand the purpose of the legislation to afford them protection sorely needed and long denied."[148] One should not, however, mistake

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[145] 75 CONG. REC. 11,217 (1932).
[146] Golembe, *supra* note 25, at 191.
[147] 75 CONG. REC. 11,239 (1932).
[148] *Id.* at 11,217.

Steagall's fiery language and dramatic tone for an inattention to reality or lack of a concrete plan.

To the contrary, Steagall had a very definite model for federal deposit insurance: a more robust version of the failed state deposit insurance experiments. In his postmortem on state deposit insurance, Thornton Cooke concluded that deposit guarantee was not solely responsible for such disastrous results, "but guaranty plus ineffective examinations, insufficient scrutiny of the previous records of bankers and unfavorable economic conditions following the period of rapid settlement and rapid growth."[149] Unit banking had revealed itself to be fundamentally flawed because of the "impossibility of limiting the size of single risks or avoiding the concentration of risks in single localities."[150] Cooke's conclusion read like a tombstone for deposit insurance and influential political leaders like Carter Glass and Franklin Roosevelt tended to agree. Taking that conclusion a step further, Glass, Roosevelt, and others saw deposit insurance as the final failed attempt to sustain state unit banking and a clarion call for federal unification. Henry Steagall, unsurprisingly, did not ascribe to that notion.

Where Cooke, Glass, Roosevelt, and others saw failure, Steagall saw opportunity. To Steagall, the failings of state deposit insurance had not been conceptual, but in the execution:

> The state laws to insure depositors against loss from failed banks were pioneers in a new field. Because of bad banking, lax enforcement, and weak regulation, the guaranty funds finally proved insufficient to pay losses in a period of panic. The State depositors insurance laws pointed the way to a sound national insurance system. Such a guaranty fund sufficiently financed and properly administered will afford the security that depositors are justly entitled to.[151]

[149] Cooke, *The Collapse of Bank-Deposit Guaranty*, at 109.
[150] *Id.* at 110.
[151] *Should America Adopt a Unified Banking System?*, *supra* note 17, at 114 (Henry Steagall).

Steagall's plan was Texas, but on a much grander scale. The federal deposit guarantee he proposed shared the same theoretical underpinnings as state deposit guarantee, but in practice it was wholly different. The state experiences spanning 1909 to 1923 had no bearing on whether a federally-funded plan would succeed, argued Steagall, because nothing like his bank guarantee proposal had ever been considered.[152] Just as "no fire insurance company could succeed if all the risk were centered in one community," "no bank deposits insurance plan could succeed with one State as a unit and with a few weak banks to support it."[153] As Texas had proved for a short while, however, deposit *could* succeed with competent oversight and sufficient reserves.

Though Steagall's deposit insurance bill passed the House of Representatives, it did not gain the approval of Carter Glass's Senate, nor that of President Roosevelt. The stage was thus set for a modern replay of the First Bank branching debates of the 1790's. Neither option for reform in 1933—unification nor a full federal deposit guarantee for state banks—aimed to, as Moss and Golembe argue, preserve the existing banking structure. On one end of the spectrum, the Glass Banking Bill represented the long-standing, constitutionally-supported effort to vest complete authority over the banking system in the federal government; on the other, Steagall's bold, nonconformist proposal of full federal deposit guarantee available to all banks irrespective of whether they were state or national sought to create a federally-funded-state-centric system. Both visions rejected the status quo of competitive dual federalism, but neither was ultimately adopted.

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[152] *Id.* at 115 (1933) ("But the facts are that no fund has yet been accumulated in any bank guaranty plan that has been sufficient to take care of a major disaster.") (A.L. Wiggins).
[153] 73 CONG. REC. 3,838 (1933).

In the end, it appears the First Bank's rejection of a formal offer of partnership with the Bank of New York and resolution to open branches in Boston, New York, Baltimore, and Charleston in November 1791[154] was not the death knell of cooperative federalism for American banking after all. Just as Carter Glass became the torch bearer for unification, and Steagall served as the same for state unit banking supported by deposit insurance, Senator Arthur Vandenberg emerged as the intellectual heir of Alexander Hamilton's vision of a banking model predicated on cooperative federalism.

[154] *See supra* note 50.

IV. "In the Last Analysis Government Always Was and Always Will Be a Matter of Business"[155]: The Vandenberg Amendment as Cooperative Federalism

A. 1791 Revisited

After nearly 150 years of competitive dual federalism banking, the struggle between federal and state banks had left the American economy battered and bloody. The need for reform was apparent to all involved.[156] President Roosevelt captured this sentiment, thundering during his first inaugural address:

> Practices of the unscrupulous money changers stand indicted in the court of public opinion, rejected by the hearts and minds of men . . . in our progress toward a resumption of work we require two safeguards against a return of the evils of the old order; there must be a strict supervision of all banking and credit investments; there must be an end to speculation with other people's money, and there must be a provision for an adequate but sound currency.[157]

In more colorful language, Roosevelt had restated a few of the primary goals of Alexander Hamilton's *Report on the Establishment of a Mint*[158] and *Opinion on the Constitutionality of an Act to Establish a Bank*.[159] "Supervision of all banking and credit investments" and "a provision for an adequate but sound currency" were modern analogues of promoting the health of the public credit and creating a standardized, elastic

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[155] VANDENBERG, *supra* note 12, at 173.
[156] Roosevelt's first official act as President came less than two days after his inaugural address, when he issued a Presidential Proclamation declaring a national bank holiday from March 6th to March 9th. The President had singlehandedly shut down the banks of the United States. Roosevelt did this by invoking wartime measures conferring broad powers over banking and currency upon the President, and Title I of the Emergency Banking Act further amended the wartime measure by empowering the President to regulate or prohibit payment of deposits by all banking institutions as well as approve any bank transaction. The Emergency Banking Act was something of a band-aid for a bullet wound and is more important for its consequences than its substance. Roosevelt's choice of banking reform as his first initiative demonstrated the centrality of the perceived need for such reform at that juncture. For the full text of the act, see Emergency Banking Relief Act of 1933, 12 U.S.C. § 1-502 (1933); for additional historical context see FRIEDMAN & SCHWARTZ, *supra* note 20, at 421.
[157] *See supra* note 24.
[158] *See supra* note 14.
[159] *See supra* note 40.

money supply. The question, as in 1791, was what model of federalism should be superimposed on the banking structure would best accomplish those goals.

The flashpoint in these debates was whether a federal deposit insurance provision would ultimately be adopted as part of the legislation.[160] As argued throughout this Article, deposit insurance was a bold, innovative measure introduced by the states to compete with federal banks. The debates over deposit insurance "uncovered a vipers' nest of controversy"[161] because that reform represented a challenge to the established order of federal preeminence in banking dating back to branching by the First Bank, *M'Culloch*, *Veazie Bank*, and the passage of the Federal Reserve Act. The National Bank Act of 1864, specifically its prohibition of branching by federal banks in contravention of state laws, was really the only toehold remaining for the state unit banking system. Federal deposit insurance threatened to change everything by putting federal resources in service of a state-centric unit banking system.

Standing in the way of that vision were, among others, Franklin Roosevelt and Carter Glass. The President initially threatened to veto any legislation containing a federal deposit insurance provision.[162] Glass was an even more entrenched adversary of a federal guarantee of bank deposits, having opposed the measure for thirty-five years.[163] Both favored unification, which undoubtedly had ample constitutional support,[164] and

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[160] *See supra* note 54.
[161] KENNEDY, *supra* note 144, at 214.
[162] *Id.* at 214–15.
[163] 77 CONG. REC. 3,729 (1933).
[164] *See generally* Wyatt, *supra* note 98, esp. 166–67. Wyatt was the General Counsel of the Federal Reserve. In connection with the Glass bill (S. 4115), then under consideration, Wyatt prepared an opinion regarding the constitutionality of the Glass bill. He framed the issue: "The question presented, therefore, is whether in order to provide for a more effective operation of the national banking system and the Federal reserve system, Congress has the power under the Constitution to restrict the business of receiving deposits subject to withdrawal by check to national banks." In other words, Wyatt wrote a memo answering the question of whether unification of the banking system under federal control was constitutional. Wyatt

history suggested that would be the likely outcome. That, of course, did not come to pass; but neither did Steagall's vision of federally supported state-centric unit banking. Rather, the ultimate solution was borne from conflict between the two—and the eventual realization neither model could work.

B. The Last Episode of Competitive Dual Federalism Banking

Two basic responses to the banking crisis were on the table in the weeks before the House passed the Steagall bill and the Senate the measure framed by Glass:[165] federal unification or preservation and strengthening of the unit banking system under state law, coupled with fully guaranteed federal deposit insurance equally available to all banks.[166] Predictably, a great many voices supported unification. J.P. Morgan & Co. acting head Thomas Lamont trumpeted the "immeasurable benefits" the Federal Reserve had "brought to American industry and commerce" and condemned the fractured, competitive state of American banking.[167] Fellow banker Owen D. Young proposed that all banks holding themselves out to the public as doing a national business "should be required to be members of the Federal reserve system" which would "at once mobilize all our banking reserves into one central system, as it should be."[168] Former New York Congressional Representative and Vice Chairman of the Federal Reserve Edmund Platt

found unification, and virtually any means by which the federal government chose to adopt it, constitutional based on three independent Congressional powers: (i) the power to create and maintain a banking system, *Id.* at 167 in WYATT (citing *Westfall v. United States*, 274 U.S. 256 (1927); *Farmers and Mechs. Nat'l Bank v. Dearing*, 91 U.S. 29 (1895); *M'Culloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819)); (ii) the power to provide a national currency, *Id.* at 167 in WYATT (citing *Legal Tender Cases*, 79 U.S. (12 Wall.) 457 (1870); *Veazie Bank v. Feno*, 75 U.S. (8 Wall.) 533 (1869)); and (iii) the power to regulate and protect interstate commerce, *Id.* at 167 in WYATT (citing *Bd. of Trade v. Olsen*, 262 U.S. 1 (1923); *Stafford v. Wallace*, 258 U.S. 495 (1922); *United States v. Ferger*, 250 U.S. 195 (1919)).

[165] *Banking Chaos Seen As Spur to Reform*, N.Y. TIMES, Mar. 8, 1933, at 3.

[166] KENNEDY, *supra* note 144, at 206, 218–19.

[167] Lamont, *supra* note 17, at 104.

[168] Young, *supra* note 39, at 112.

echoed that sentiment, refuting the idea that branch banking was monopolistic and undemocratic, and touting the Glass bill.[169]

So why, for all its long-standing constitutional underpinning bolstered by the support of Roosevelt, Glass, and others, did full unification fail? In short, time and politics. The Great Crash and subsequent economic contraction forced Roosevelt's hand sooner than he would have liked,[170] and the popular appeal of federal deposit guarantee forced it in a different direction than he desired. Deposit guarantee was a politically popular proposition in 1933 for the same reasons it had been in 1909: it placed a small tax on an unpopular constituency (bankers) for the benefit of individual depositors, provided economic security, and appealed to a basic sense of fairness.

But deposit insurance had evolved into something more than a popular policy. It had become a supposed life-raft for a sinking economy. During the Great Crash and ensuing Great Contraction[171] public confidence in the banking system had evaporated. Vice President Garner had told Roosevelt of federal deposit guarantee, "You'll have to have it, Cap'n, or get more clerks in the Postal Savings banks. The people who have taken their money out of the banks are not going to put it back in without some guarantee."[172] Bank deposits had been explicitly recognized as the circulating medium of the United States as early as *Veazie Bank*, and if America's citizens continued stuffing

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[169] *Should America Adopt a Unified Banking System?*, *supra* note 17, at 112, 114 (Edmund Platt).
[170] Notwithstanding the Emergency Banking Relief Act and proactive tone of his inaugural address, Roosevelt's preference was actually to wait and enact wider-reaching banking legislation. KENNEDY, *supra* note 144, at 220.
[171] *See supra* note 20.
[172] KENNEDY, *supra* note 144, at 214. In fact, a year earlier Representative Steagall had warned then-Speaker of the House and fellow Democrat Garner of Republican incumbent President Hoover, "You know, this fellow Hoover (a Republican) is going to wake up one day and come in here with a message recommending guarantee of bank deposits, and as sure as he does, he'll be reelected." BASCOM N. TIMMONS, GARNER OF TEXAS, A PERSONAL HISTORY 179 (1948).

money under their mattresses instead of putting it in banks, the nation's economy would remain at a standstill.

Along with a lack of faith in the banking system, another element of the mounting political pressure for reform was the condemnation of those ostensibly running and overseeing the banking system. This outrage was captured by the so-called Pecora Commission, an investigation into the causes of the Great Crash led by New York Assistant District Attorney Ferdinand Pecora.[173] The hearings aroused public indignation at the perceived predatory, speculative, and abusive practices of Wall Street. This criticism had a strain of regional bias and distrust, as Wall Street was inextricably linked with the idea of large, centralized, unified banking. It also had the effect of giving greater weight to the equally many and forceful anti-unification arguments like that made by New Mexico Senator Sam Bratton, who suggested that if the Glass bill were passed "in the course of ten years or less, three or four powerful banking institutions might control the banking system of the country,"[174] and the Associated Independent Banks of America which charged that the Gill bill was "based on false reasoning" and "the American people realize it is a wolf in sheep's clothing."[175] Though the latter charge was perhaps an overstatement, the fundamental point was that the Great Crash, subsequent Pecora Commission, and specter of deposit insurance, made unification unrealistic.

Pecora's investigation recalled an earlier episode. The Pujo Committee, a similar investigation into the practices of Wall Street, took place from May 1912 to January

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[173] The Pecora Commission was an inquiry begun on March 4, 1932 by the United States Senate Committee on Banking and Currency to investigate the causes of the Great Crash of 1929. For more information on this subject, see generally MICHAEL E. PARRISH, SECURITIES REGULATION AND THE NEW DEAL (1970); FERDINAND PECORA, WALL STREET UNDER OATH: THE STORY OF OUR MODERN MONEY CHANGERS (1939); MICHAEL A. PERINO, THE HELLHOUND OF WALL STREET: HOW FERDINAND PECORA'S INVESTIGATION OF THE GREAT CRASH FOREVER CHANGED AMERICAN FINANCE (2010).
[174] *Should America Adopt a Unified Banking System?*, *supra* note 17, at 107 (Samuel G. Bratton).
[175] *Id.* at 115 (Associated Independent Banks of America).

1913.[176] In an ironic twist, the Pujo Committee had contributed to an increased role for the federal government in the banking industry specifically and in regulating the American economy in general, motivating in part the Sixteenth Amendment,[177] the Clayton Antitrust Act[178] and, of course, the Federal Reserve Act. The Pecora Commission had a somewhat opposite effect. Trust in the powers that be had eroded, and the time constraints imposed by extreme circumstances ensured they would not be able to gain it back. Still, federal preeminence in banking was so well-established that the idea of the United States Treasury and Federal Reserve becoming an unlimited, undiscriminating piggy bank to fund a state-centric unit banking system was as unrealistic as unification.

On May 10th, 1933 both Glass and Steagall introduced bank reform bills, the former in the Senate and the latter in the House. Glass's Bill[179] was more conservative, providing for an insurance fund and federal liquidating corporation that would manage the assets of failed banks. More importantly, the Glass bill hoped to compel banks to join the Federal Reserve System in order to benefit from the insurance fund, which Glass maintained was *absolutely not* a government guarantee.[180] Steagall's proposal, to the contrary, called for all banks to have free access to a one-hundred-percent-federally-backed guarantee fund.[181] There again met the familiar combatants, federal unification

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[176] *Report of the Committee Appointed Pursuant to House Resolutions 429 and 504 to Investigate the Concentration of Control of Money and Credit,* H.R. REP. NO. 6340-1593 (1913).
[177] U.S. CONST. amend. XVI.
[178] Clayton Antitrust Act, 15 U.S.C. §§ 12–27, 29 U.S.C. §§ 52–53 (1914).
[179] S. 1631, 73d Cong., 1st Sess., 77 CONG. REC. 3,109 (1933).
[180] 77 CONG. REC. 3,727 (1933) ("For thirty-five years in the other House, and up to this time in the Senate, I have opposed guaranteeing deposits, but this is not a Government guarantee of deposits. The Government is only initially involved to the extent of $150,000,000, to which it was never entitled except by law . . . . The Government is only involved in an initial subscription to the capital of a corporation that we think will pay a dividend to the Government on its investment. It is not a Government guarantee.")
[181] For a summary of these proposals, see KENNEDY, *supra* note 144, at 218–19.

versus state-centric unit banking; the American economy once more caught in the crossfire.

C. The Vandenberg Amendment and Why it Passed

The destructive effects of this competition were felt acutely in Senator Arthur Vandenberg's home state of Michigan. In February of 1933, the Michigan national bank system collapsed.[182] After failing to secure temporary funding to keep the banks open, shortly after midnight on February 14, 1933 [183] federal and state officials agreed on an eight-day bank holiday for all Michigan banks. This episode is significant because it presaged Roosevelt's Emergency Banking Relief Act,[184] but more important for our purposes, because of Vandenberg's response. In what came to be known as the "Couzens Resolution,"[185] Vandenberg suggested that the best method to reopen Michigan's national banks would be to pass a joint congressional resolution authorizing the Comptroller of the Currency to issue the same regulations for opening national banks as those which state banking officials would use to reopen state banks.[186] The specifics of the plan and its ultimate failure—President Roosevelt declared the national bank holiday on March 6th, before Michigan successfully reopened their own banks—are not as important as the spirit of Vandenberg's proposed solution: federal and state authorities working in concert to solve the banking crisis.

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[182] For more details on Vandenberg's role in resolving the Michigan banking failure in early 1933, see C. DAVID TOMPKINS, SENATOR ARTHUR H. VANDENBERG: THE EVOLUTION OF A MODERN REPUBLICAN, 1884-1945, at 76–82.
[183] This date was thereafter sardonically known by Detroiters as "St. Ballantine's Day." Ballantine was the Undersecretary of the Treasury at the time, who President Hoover had dispatched to Michigan to help Vandenberg and others secure the capital necessary to keep the banks open. *Id.* at 78.
[184] *See supra* note 156.
[185] Named for Michigan's senior senator who, ironically, refused to support the measure. TOMPKINS, *supra* note 182, at 78–79.
[186] *Id.*; *see also* S.J. RES. 256, 72 CONG. REC. 4,691, at 5,061 (1933).

This was in keeping with Vandenberg's political ethos. He was a progressive conservative who called for reforms "progressive enough to meet our new emergencies with new methods, yet . . . conservative enough to remember and to profit by American political and constitutional history."[187] Limited deposit insurance in 1933 fit that description perfectly. As late as December 1932, Vandenberg had declared himself "irrevocably opposed to a general Federal guaranty of bank deposits"[188] but the Michigan banking crisis had convinced him "whether we like it or not I think we have *got* to find a guarantee basis."[189] Vandenberg's position was thus practical, not ideological. His interest was in re-establishing an operable and sound banking system that would "end hoarding, release currency, relax and multiply credit, stabilize trade, facilitate new business, [and] build morale."[190] It sounded a lot like Alexander Hamilton's primary directive of creating a uniform money supply thereby protecting and strengthening the public credit.

So with Glass and Steagall waging their own version of the ideological battle between the First Bank of the United States and the Bank of New York, Arthur Vandenberg emerged with a modern modification of Hamilton's vision of cooperative federalism banking. On May 19th, 1933, Vandenberg reprised his role as mediator and introduced an amendment to the pending Glass Bill.[191] The so-called Vandenberg Amendment, as described in the Introduction, called for the creation of a federally funded Temporary Bank Deposit Insurance Fund which would immediately insure bank deposits

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[187] TOMPKINS, *supra* note 182, at 33 (quoting *Arthur Vandenberg to Albert J. Beveridge*, Feb. 21, 1922, Beveridge Papers).
[188] *Id.* at 84 (quoting *Vandenberg to Roy A. Young*, Oct. 24, 1932); *see also* 72 CONG. REC. 948 (1932).
[189] TOMPKINS, *supra* note 182, at 84 (quoting *Vandenberg to Young*, Feb. 25, 1933).
[190] *Id.* at 82.
[191] *See supra* note 11.

up to 2500 dollars.[192] Vandenberg's Amendment passed shortly thereafter and went to conference committee.[193] In the meanwhile, the Steagall bill overwhelmingly passed the House on May 23 and did the same in the Senate two days later.[194] The only remaining question was whether federal deposit insurance would be adopted.

Unless the Vandenberg Amendment was jettisoned, there would be no unification; and if there was to be no unification—no reliance on the branch-banking principle to prevent bank runs—something like deposit insurance would be necessary. This was why President Roosevelt and Glass, and Treasury Secretary William H. Woodin, were rumored to be against the amendment. An article on the front page of the *New York Times* described Roosevelt as "lukewarm toward" Vandenberg's amendment while it reported Woodin was "opposed its enactment."[195] Indeed, rumor circulated that Roosevelt would kill the Glass bill if it contained deposit guarantee provisions.[196]

As we now know, that did not happen. After a more than a week of conferences at the White House, Roosevelt adopted the temporary guarantee represented by the Vandenberg Amendment.[197] President Roosevelt signed the Glass-Steagall bill into law on June 16, 1933, calling it the "second most important banking legislation enacted in the history of the country."[198] The final form of deposit insurance adopted by the Glass-Steagall Act[199] was neither a limited, temporary liquidating corporation nor a full federal guarantee of deposits. Despite his reservations regarding any form of deposit guarantee,

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192 *Id.*
193 KENNEDY, *supra* note 144, at 219.
194 *Id.*
195 *Glass Bank Bill Passed By Senate*, N.Y. TIMES, May 26, 1933, at 1.
196 KENNEDY, *supra* note 144, at 219; *see also* J.F.T. O'CONNOR, DIARY, microfilm copy at Franklin Delano Roosevelt Library, June 2, 1933.
197 KENNEDY, *supra* note 144, at 220.
198 *Id.* at 222.
199 Two good summaries of the important features of the legislation are FRIEDMAN & SCHWARTZ, *supra* note 20, at 434–42; KENNEDY, *supra* note 144, at 220–22.

Roosevelt acquiesced for a number of reasons—time pressure, the Pecora Commission and popular support for deposit insurance,[200] that the Vandenberg Amendment was palatable because it did not represent a total guarantee[201]—but perhaps more than anything was recognition of all involved that competitive dual federalism banking had proved destructive to the American economy and that collaboration between federal and state banking was necessary.

The lesson of the 150 year-long struggle between federal and state banks was that neither competition between the two, nor a federally-unified branch banking system nor a state-centric unit banking one, was the ideal application of American republican federalism to banking. The failure of state deposit insurance had shown there needed to be centralized control and a large enough pool of assets to cover disparate failures and prevent a loss of public confidence and ensuing bank run. Conversely, deposit insurance embodied resistance to federal domination of banking and American capital established by the First Bank of the United States, *M'Culloch*, *Veazie Bank*, and the Federal Reserve Act. The Vandenberg Amendment represented a recognition of the failure of competitive dual federalism banking and a compromise between the two solutions: a federally regulated asset pool in support of state banks. It was cooperative federalism; a solution Alexander Hamilton would have been proud of.

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[200] For a sample, see approximately 1,500 favorable telegrams, Glass Papers, Box 259.

[201] There was some disagreement on this point. Glass maintained that his bill remained ninety-seven percent as it had passed the Senate, but Vandenberg called it a "grudging surrender on the part of Secretary Woodin and Wall Street to the irresistible mid-continent revolution typified by my immediate temporary deposit amendment." *See Deposit Insurance*, N.Y. TIMES, Jun. 15, 1933, at 13–14.

CONCLUSION

This Article's major assertion is that, contrary to the traditional scholarly account, the Glass-Steagall Act of 1933 as shaped by the Vandenberg Amendment represented a fundamental change to the American banking structure. The choice in 1933 was the same as the one in 1791: how should the values and structure of American republican federalism be engrafted onto the banking system? The Glass-Steagall Act reversed the decision made in 1791 by rejecting competitive dual federalism in favor of cooperative federalism. This Article focuses on the period from 1791 to 1933, and particularly on Glass, Steagall, Vandenberg, and the Glass-Steagall Act of 1933, because that was the time during which the relationship between federalism and banking was determined, tested, and reformulated, and the actions of those individuals capture that story.

Carter Glass and Henry Steagall typified the broader ideologies that drove the struggle between federal and state banks, and Arthur Vandenberg the compromise that eventually resolved the contest. Glass became the standard bearer for federal unification, carrying forward the well-established, constitutionally-supported position of the First Bank of the United States, *M'Culloch*, and *Veazie Bank*, with his own Federal Reserve Act and Glass Banking Bill. Henry Steagall emerged as the Populist product of the state experiments with deposit insurance spanning 1909 to 1923, personifying state-centric unit banking's bold, innovative challenge to federal banking preeminence. Finally, Arthur Vandenberg introduced a modern version of Alexander Hamilton's conception of cooperative federalism banking. These ideologies, however, did not begin with Glass, Steagall, and Vandenberg, and they did not disappear with them either. The question of which model of republican federalism should be applied to American banking is not time-bound, and the answer is as relevant today as it was in 1791 and 1933.