

## NOTE

### GLASS VERSUS STEAGALL: THE FIGHT OVER FEDERALISM AND AMERICAN BANKING

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#### INTRODUCTION

ON October 3, 2008, President George W. Bush signed into law the Emergency Economic Stabilization Act of 2008 as a response to the subprime mortgage crisis.<sup>1</sup> 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 the marketplace,” said Federal Deposit Insurance Corporation (“FDIC”) Chairwoman Sheila C. Bair.<sup>2</sup> 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 on December 31, 2009, by which time it would presumably no longer be necessary; however, that turned out not to be the case. On May 20, 2009, the temporary increase was extended to December 31, 2013,<sup>3</sup> and only fourteen months later the measure was made

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<sup>1</sup> Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765 (codified as amended in scattered sections of 5, 12, 15, 26, and 31 U.S.C.).

<sup>2</sup> Press Release, Fed. Deposit Ins. Corp., Emergency Economic Stabilization Act of 2008 Temporarily Increases Basic FDIC Insurance Coverage from \$100,000 to \$250,000 Per Depositor (Oct. 7, 2008), <http://www.fdic.gov/news/news/press/2008/pr08093.html>.

<sup>3</sup> Fed. Deposit Ins. Corp., Financial Institution Letter 22-2009, FDIC Insurance Coverage: Extension of Temporary Increase in Standard Maximum Deposit Insurance Amount (May 22, 2009), available at <http://www.fdic.gov/news/news/financial/2009/fil09022.pdf>.

permanent when President Barack Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) into law on July 21, 2010.<sup>4</sup>

Though extraordinary, it would be inaccurate to describe this chain of events as unprecedented. If anything, the 2008 “bailout” of the U.S. financial system and subsequent passage of Dodd-Frank represent the logical conclusion to an earlier episode. In 1933, newly elected President Franklin Roosevelt confronted arguably the grimmest economic situation in our nation’s history: the Great Depression.<sup>5</sup> As in 2008 and 2010, debate on the extent to which the federal government should be responsible for the economic security of individuals centered on a specific policy tool: 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 Glass-Steagall Act<sup>6</sup> answered that question affirmatively. 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 reforms adopted following the subprime mortgage crisis.

Since the ratification of the U.S. Constitution, 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.”<sup>7</sup> This “unhelpful silence”<sup>8</sup> 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 clash of federalism: the debate over whether and to what ex-

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<sup>4</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 335, 124 Stat. 1376, 1540 (2010) (codified as amended at 12 U.S.C. § 1821 (2012)); Press Release, Fed. Deposit Ins. Corp., Basic FDIC Insurance Coverage Permanently Increased to \$250,000 Per Depositor (July 21, 2010), <http://www.fdic.gov/news/news/press/2010/pr10161.html>.

<sup>5</sup> See sources cited *infra* notes 25–26.

<sup>6</sup> See *infra* note 11.

<sup>7</sup> James Willard Hurst, *A Legal History of Money in the United States, 1774–1970*, at 134 (1973).

<sup>8</sup> *Id.*

tent the First Bank of the United States would establish branches, particularly Secretary of the Treasury Alexander Hamilton's role in the controversy; the U.S. Supreme Court's pronouncement that the federal government may establish corporations in *McCulloch v. Maryland*<sup>9</sup> and the Court's holding in *Veazie Bank v. Fenno* that the federal government's imposition of a ten percent tax on state bank notes was constitutional;<sup>10</sup> 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.<sup>11</sup> Each chapter in this seesaw narrative represents another clash between state and federal authorities vying to fill the 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,<sup>12</sup> wrote in his tribute to Alexander Hamilton: “No nation ever was or ever will be stronger than its public credit.”<sup>13</sup> The strength of the public credit is necessarily tied to the liquidity,<sup>14</sup> elasticity,<sup>15</sup> and uniformity of the money supply.<sup>16</sup> As the primary circulating

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<sup>9</sup> 17 U.S. (4 Wheat.) 316, 325–26 (1819).

<sup>10</sup> 75 U.S. (8 Wall.) 533, 539–40, 549 (1869).

<sup>11</sup> Banking Act of 1933, Pub. L. No. 73-66, 48 Stat. 162 (codified as amended in scattered sections of 12 U.S.C.). The Banking Act of 1933 is commonly referred to as the Glass-Steagall Act, as it will be throughout this Note.

<sup>12</sup> For the full text of the so-called Vandenberg Amendment, see 77 Cong. Rec. 3878 (1933).

<sup>13</sup> Arthur Hendrick 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).

<sup>14</sup> 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. 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. See David L. Scott, *Wall Street Words: An A to Z Guide to Investment Terms for Today's Investor* 213 (2003).

<sup>15</sup> 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 or supply in response to price or income changes. *Id.* at 124. 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.

<sup>16</sup> Alexander Hamilton, Final Version of the Report on the Establishment of a Mint, in 7 *The Papers of Alexander Hamilton* 570, 570–71 (Harold C. Syrett & Jacob E. Cooke eds., 1963) [hereinafter *Hamilton, Report on Mint Establishment*].

medium<sup>17</sup> evolved from gold bullion to bank deposits over the course of the first half of the nineteenth century,<sup>18</sup> banking became a quasi-public enterprise tied to the public interest and, consequently, 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, which inevitably raised the question: which government?

This question has arisen with great fervor after every major economic crash in American history.<sup>19</sup> 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 Note, 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—such as prudent capital requirements and competent oversight—were subordinated to attracting deposits. Acting head of J.P. Morgan & Co. Thomas Lamont aptly described the situation: “In banking, our country has forty-nine different sovereigns . . . Each one of these forty-nine officials is desirous of having as many institutions as possible registered under his jurisdiction.”<sup>20</sup> True to form, in response to the Panic of 1907, both the federal government and its state analogues enacted banking reform: the Federal Reserve Act of 1913<sup>21</sup> and the state

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<sup>17</sup> This term refers to any medium of exchange that can be passed in ordinary commerce as currency. See J.J. Janney, *State Bank of Ohio*, 2 Mag. W. Hist. 156, 174 (1885).

<sup>18</sup> *Veazie Bank*, 75 U.S. (8 Wall.) at 536–39, 548–49.

<sup>19</sup> See generally Charles P. Kindleberger & Robert Z. Aliber, *Manias, Panics and Crashes: A History of Financial Crises* (5th ed. 2005) (discussing common characteristics of financial crises in both U.S. and international history).

<sup>20</sup> Thomas W. Lamont, *Should America Adopt a Unified Banking System? Pro*, 12 Cong. Dig. 108, 108 (1933).

<sup>21</sup> Federal Reserve Act, Pub. L. No. 63-43, 38 Stat. 251 (1913) (codified as amended in scattered sections of 12 U.S.C.). America had been without a national bank since President Andrew Jackson’s war on the Second Bank of the United States resulted in nonrenewal of its charter. Donald R. Wells, *The Federal Reserve System: A History* 8 (2004). The Act called for the creation of private, regional Federal Reserve banks, each with its own branches that would be overseen by a Federal Reserve Board comprised of officials appointed by the President and confirmed by the Senate. §§ 2–3, 10, 38 Stat. at 251–53, 260. The major modification introduced by the Federal Reserve Act was oversight of the system by the Federal Reserve Board. Wells, *supra*, at 18. For more on the origins and history of the Federal Reserve Act, see *id.* at 7–20.

experiments with deposit insurance spanning 1909 to 1923.<sup>22</sup> As the Great Crash of 1929 made clear, none of these measures 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.”<sup>23</sup> The psychological effects of the crash reverberated across the nation,<sup>24</sup> and the lack of public confidence in the economy manifested in a dramatic decrease in the volume of bank deposits,<sup>25</sup> weakening the money supply and endangering the public credit. In his first inaugural address on March 4, 1933, 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.”<sup>26</sup> That action, with respect to repairing the economy, was the Glass-Steagall Act, particularly its federal deposit insurance provision, whereby the federal government took responsibility 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 the Act aimed to preserve the existing banking structure.<sup>27</sup> Preeminent bank consultant and commentator Carter Golembe claims that “[t]here seems to have been no American precedent”<sup>28</sup> for New York’s 1829 bank insurance scheme and stresses the importance of similar pre-Civil War efforts in Indiana, Michigan, Ohio, and Vermont.<sup>29</sup> Similarly, Professor David Moss of Harvard Business School argues that “the underlying problem being addressed in 1933 was essentially the same as in

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<sup>22</sup> These episodes will be covered in depth in Part I. In chronological order, the states that enacted deposit insurance legislation were: Oklahoma, Kansas, Nebraska, Texas, Mississippi, South Dakota, North Dakota, and Washington.

<sup>23</sup> Milton Friedman & Anna Jacobson Schwartz, *A Monetary History of the United States 1867–1960*, at 299 (1963).

<sup>24</sup> The state of affairs in New York City was so dire that there emerged a so-called “suicide myth” alleging that the Great Crash of 1929 had caused the suicide rate to increase. This urban legend gained such legitimacy that economist John Kenneth Galbraith felt compelled to refute the rumor with statistics. John Kenneth Galbraith, *The Great Crash 1929*, at 128–30 (50th anniversary ed. 1979).

<sup>25</sup> 75 Cong. Rec. 11,217 (1932) (statement of Rep. Henry Steagall).

<sup>26</sup> Franklin D. Roosevelt, *Inaugural Address* (Mar. 4, 1933), in *2 The Public Papers and Addresses of Franklin D. Roosevelt* 11, 15 (1938).

<sup>27</sup> See, e.g., Carter H. Golembe, *The Deposit Insurance Legislation of 1933: An Examination of Its Antecedents and Its Purposes*, 75 *Pol. Sci. Q.* 181, 182–83 (1960).

<sup>28</sup> *Id.* at 183.

<sup>29</sup> *Id.* at 184–87.

1829.”<sup>30</sup> 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.”<sup>31</sup> Golembe made a similar argument, 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.”<sup>32</sup>

Moss and Golembe are incorrect on two counts. First, the more accurate comparison for 1933 is 1791, not 1829. The 1829 New York Safety Fund was primarily concerned with spreading risk to insure against discrete bank failures leading to systemic runs.<sup>33</sup> 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 and the First Bank of the United States in 1791 posed the same question: How should the values and structure of American republican federalism be engrafted onto the banking system? Put differently, would full federal control, competitive dual federalism, or a compromise of cooperative federalism prevail as the theoretical model for American banking? In 1791 the answer was competitive dual federalism; 1933’s Glass-Steagall Act reversed that decision and chose cooperative federalism.

This Note’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 sought to maintain the competitive dual federalism status quo: Senator Carter Glass aimed to make bank regulation a federal enterprise, while Representative Henry Steagall pursued a state-centric model.<sup>34</sup> The eventual compromise embodied by the Vandenberg Amendment rejected dual federalism and either extreme of making federal or state authorities the locus of banking power, and instead 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 “local agents” of the Bank of the United States.<sup>35</sup> The contention advanced by Moss and Golembe that the Glass-

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<sup>30</sup> David A. Moss, *When All Else Fails: Government as the Ultimate Risk Manager* 120 (2002).

<sup>31</sup> *Id.*

<sup>32</sup> Golembe, *supra* note 27, at 200.

<sup>33</sup> See Moss, *supra* note 30, at 119.

<sup>34</sup> See *infra* Parts II (discussing Senator Carter Glass’s vision) and III (discussing Representative Henry Steagall’s vision).

<sup>35</sup> See generally Stuart Bruchey, *Alexander Hamilton and the State Banks, 1789 to 1795*, 27 *Wm. & Mary Q.* 347, 350–59 (1970) (discussing the evolution of Hamilton’s attitude to-

Steagall Act aimed to preserve the banking structure is incorrect. To the contrary, the Act rejected competitive dual federalism—and both federal and state-centric models—in favor of cooperative federalism.

This Note will argue that the Glass-Steagall Act fundamentally altered the existing banking structure by replacing competitive dual federalism with cooperative federalism. Part I will frame the competition between federal and state authorities for control over the banking structure by pinpointing the forces that resulted in state experiments with deposit insurance and the arguments that emerged from them. Part II will present the constitutionally and historically supported federal response to the Panic of 1907, typified by Senator Carter Glass, which would have served as a logical prelude to unification of the banking system under federal authority in 1933. Part III will posit that, counterintuitively, federal deposit insurance gained momentum as a viable alternative, largely through the efforts of Representative Henry Steagall, despite the failure of bank deposits at the state level. Part IV will conclude 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. STATE EXPERIMENTS WITH DEPOSIT INSURANCE

Justice Louis Brandeis once described state experimentation, with little risk to the rest of the country, as a “happy incident of the federal system.”<sup>36</sup> In making this observation, it is doubtful Justice Brandeis was thinking of state experiments with deposit insurance, which proliferated across the South and West during the early twentieth century. These experiments were not benevolent trials; rather, they represented state attempts to seize the upper hand in the competition for authority with federal banks. And unfortunately for both the states and the nation as a

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ward state banks and his early proposals to use state banks as branches of the Bank of the United States).

<sup>36</sup>*New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting) (“It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country.”).

whole, the result was not “happy”—it was sweeping failure.<sup>37</sup> The roots of this experimentation as competition trace back to the Constitution’s failure to clearly allocate authority between federal and state banks, and the resultant attempts to fill that authority gap. Those attempts are our starting point.

### 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 debates in 1791 about whether the First Bank of the United States should establish branches or, instead, to the adoption of the New York Safety Fund in 1829 makes all the difference. While 1791 was about federalism, 1829 was about insurance. State experiments with deposit insurance and the 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 whether federal or state authorities possessed the power to regulate banks, it gave the former a clear head start. By granting Congress the powers to “borrow Money on the credit of the United States,”<sup>38</sup> “regulate Commerce with foreign Nations, and among the several States,”<sup>39</sup> and “coin Money [and] regulate the Value thereof,”<sup>40</sup> the “federal Constitution gave a strong nationalist lead to policy regarding money.”<sup>41</sup> 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. States were explicitly forbidden from

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<sup>37</sup> See generally James T. Patterson, *The New Deal and the States: Federalism in Transition* 1–25 (1969) (discussing state governments’ experiments with progressivism in the 1920s). Patterson suggests that the overall record for state governments was “mediocre.” *Id.* at 10.

<sup>38</sup> U.S. Const. art. I, § 8, cl. 2.

<sup>39</sup> *Id.* cl. 3.

<sup>40</sup> *Id.* cl. 5.

<sup>41</sup> Hurst, *supra* note 7, at 134; see also *United States v. Marigold*, 50 U.S. (9 How.) 560, 567–68 (1850) (finding that the federal government’s power to coin and regulate the value of money indicates that it also controls national monetary policy and thus has the power to punish counterfeiting).



“coin[ing] Money”<sup>42</sup> or “emit[ting] Bills of Credit”<sup>43</sup> in addition to the more general prohibition of the Contracts Clause,<sup>44</sup> which “limited the states’ capacity to impose their own ideas of legal tender.”<sup>45</sup>

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.<sup>46</sup> 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 “currency moving from hand to hand,” and America’s liquid capital was increasingly held as bank deposits.<sup>47</sup> 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 importantly, governmental participation—making the ambiguity surrounding the authority of federal and state governments over banks a problem of paramount importance.

## 2. *Alexander Hamilton, State Bank Proponent*

Alexander Hamilton’s solution to this problem is likely 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. “[A]ll government,” Hamilton wrote, “is a delegation of power.”<sup>48</sup> Whether and to what extent the Bank of the United States would establish branches raised the question of how 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.”<sup>49</sup> Hamilton’s opinions and actions—inner conflict,

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<sup>42</sup> U.S. Const. art. I, § 10, cl. 1.

<sup>43</sup> *Id.*

<sup>44</sup> *Id.* (“No State shall . . . pass any . . . Law impairing the Obligation of Contracts.”).

<sup>45</sup> Hurst, *supra* note 7, at 134.

<sup>46</sup> *Veazie Bank*, 75 U.S. (8 Wall.) at 536–40.

<sup>47</sup> Owen D. Young, *Should America Adopt a Unified Banking System?* Pro, 12 Cong. Dig. 110, 112 (1933).

<sup>48</sup> Alexander Hamilton, *Final Version of an Opinion on the Constitutionality of an Act to Establish a Bank*, in 8 *The Papers of Alexander Hamilton*, *supra* note 16, at 97, 100 [hereinafter *Hamilton*, *Opinion on Bank Establishment*].

<sup>49</sup> John C. Miller, *Alexander Hamilton: Portrait in Paradox* 274 (1959).

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.<sup>50</sup> 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 a general circulation."<sup>51</sup> In rejecting Secretary of State Thomas Jefferson's objections to establishing a national bank, Hamilton predictably characterized state banks as "institutions which *happen* to exist to day, [and] for ought that concerns the government of the United States, may disappear to morrow."<sup>52</sup> Even so, in the event that a rivalry between state and national banks developed, Hamilton declared, "It can never be 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."<sup>53</sup> This statement clearly conveyed Hamilton's desire to institute a model of cooperative federalism with respect to banking, and introduced the critical question of branches.<sup>54</sup>

Under the charter of the First Bank of the United States, established on February 25, 1791, the directors of the National Bank were author-

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<sup>50</sup> See Alexander Hamilton, First Report on the Further Provision Necessary for Establishing Public Credit, *in* 7 The Papers of Alexander Hamilton, *supra* note 16, at 225, 225–35 [hereinafter Hamilton, First Report on Public Credit]; Alexander Hamilton, Final Version of the Second Report on the Further Provision Necessary for Establishing Public Credit (Report on a National Bank), *in* 7 The Papers of Alexander Hamilton, *supra* note 16, at 305, 305 [hereinafter Hamilton, Second Report on Public Credit].

<sup>51</sup> Letter from Alexander Hamilton to George Washington (Mar. 27, 1791), *in* 8 The Papers of Alexander Hamilton, *supra* note 16, at 217, 219 [hereinafter Letter to George Washington]. See generally *id.* at 217–23 (outlining arguments for establishing a national bank and describing the inability of existing state banks to adequately protect the interests of the United States).

<sup>52</sup> Hamilton, Opinion on Bank Establishment, *supra* note 48, at 102.

<sup>53</sup> Alexander Hamilton, Notes on the Advantages of a National Bank, Enclosure to Letter to George Washington, *supra* note 51, at 218, 223.

<sup>54</sup> See Bruchey, *supra* note 35, at 350–51.

ized to establish branches anywhere in the United States.<sup>55</sup> This presented three alternatives: maintain only one central office, open branches throughout the nation, or establish a small number of branches in large cities.<sup>56</sup> 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 it is important to note at the outset 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.<sup>57</sup> Those who advocated this position “proved to be more Hamiltonian than Hamilton himself.”<sup>58</sup> In surveying the branching strategies available to the First Bank, Hamilton appeared to support an arrangement whereby existing state banks would become the “local agents” of the National Bank.<sup>59</sup> But in November 1791, the directors of the First Bank rejected Hamilton’s model by declining a stock exchange—which would have had the effect of a joint venture—with the Bank of New York and resolved that branches be

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<sup>55</sup> James O. Wettereau, *The Branches of the First Bank of the United States*, 2 *J. Econ. Hist. (Supp.)* 66, 72 (1942).

<sup>56</sup> Joseph Stancliffe Davis, *Corporations in the American Colonies*, in *Essays in the Earlier History of American Corporations* 49, 53–54 (1917).

<sup>57</sup> See Miller, *supra* note 49, at 273.

<sup>58</sup> *Id.* at 273–74.

<sup>59</sup> 2 Fritz Redlich, *The Molding of American Banking: Men and Ideas* 245 (1951). Professor Stuart Bruchey also suggests that indirect evidence from Hamilton’s correspondence with Fisher Ames and Christopher Gore, *Boston Federalists*, supports Redlich’s judgment. Bruchey, *supra* note 35, at 352–55. 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 55, at 70; see also Miller, *supra* note 49, at 274–76 (explaining that Hamilton saw branching by the National Bank as overly risky, leading him to prefer the coexistence of state banks alongside the National Bank). Hamilton seemed to think “control over the Bank . . . would be dispersed, its resources overextended” and susceptible to mismanagement. Miller, *supra* note 49, at 274; see also Hamilton, *Second Report on Public Credit*, *supra* note 50, at 329–30 (citing possible mismanagement by local branches as a serious potential threat to the National Bank as a whole).

opened in Boston, New York, Baltimore, and Charleston.<sup>60</sup> 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*.”<sup>61</sup>

Unfortunately for Hamilton and cooperative federalism banking, the die had been cast in favor of competitive dual federalism and the first shots in the conflict 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. Proponents of federal banks seized the upper hand at the conclusion of the eighteenth century and maintained that position throughout the nineteenth century—as discussed in Part III—but supporters of state banks did not abate. The following Section now turns to their greatest challenge to federal preeminence in banking.

### *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 1790s. As a result of a series of episodes throughout the nineteenth century—notably the *McCulloch* and *Veazie Bank* decisions—state banks found themselves at a competitive disadvantage with federal ones, most obviously because national bank notes were insured by the full faith and credit of the U.S. Treasury.<sup>62</sup> But the national banking system went only so far; Treasury would insure national bank *notes* but not national bank *deposits*.<sup>63</sup> Congress considered instituting federal deposit insurance eighteen times between 1886 and 1900, but each time the measure

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<sup>60</sup> Wettureau, *supra* note 55, at 74–75.

<sup>61</sup> Letter from Alexander Hamilton to William Seton (Nov. 25, 1791), in 9 *The Papers of Alexander Hamilton*, *supra* note 16, at 538, 538.

<sup>62</sup> 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 U.S. Treasury still had to redeem the notes in full. Golembe, *supra* note 27, at 187.

<sup>63</sup> *Id.* The distinction is an important one. A bank note is currency issued by a bank and payable to the bearer on demand. See Scott, *supra* note 14, at 25. A note is a more limited instrument than a bank deposit, also known as a demand deposit, which refers to any money placed in a banking institution. See *id.* at 102. 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.

failed.<sup>64</sup> 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 lacked a virtually unlimited fund as insurance. In order to best approximate the security represented by the 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.<sup>65</sup> 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 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.<sup>66</sup> His articles, the best primary sources available, identify and elucidate the themes and arguments that emerged from the states' experiences with deposit insurance. Cooke had access to a variety of important constituencies,<sup>67</sup> 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 and federally unified banking

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<sup>64</sup> See Golembe, *supra* note 27, at 187.

<sup>65</sup> See Thornton Cooke, *The Collapse of Bank-Deposit Guaranty in Oklahoma and its Position in Other States*, 38 Q.J. Econ. 108, 108, 121–31 (1924) [hereinafter *Cooke, The Collapse of Bank-Deposit Guaranty*].

<sup>66</sup> See Thornton Cooke, *The Insurance of Bank Deposits in the West* (pt. 1), 24 Q.J. Econ. 85 (1909) [hereinafter *Cooke, Bank Deposits in the West I*]; Thornton Cooke, *The Insurance of Bank Deposits in the West* (pt. 2), 24 Q.J. Econ. 327 (1910) [hereinafter *Cooke, Bank Deposits in the West II*]; Thornton Cooke, *Four Years More of Deposit Guaranty*, 28 Q.J. Econ. 69 (1913) [hereinafter *Cooke, Four Years More of Deposit Guaranty*]; Cooke, *The Collapse of Bank-Deposit Guaranty*, *supra* note 65.

<sup>67</sup> Cooke's ties to the financial and legislative communities are striking in their number and quality. See, e.g., Cooke, *Bank Deposits in the West I*, *supra* note 66, 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 66, 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* note 66, 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.").

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 1790s had evolved into a full-scale controversy, with the branch banking-versus-unit banking dichotomy implicating a host of geographical, political, social, and ideological issues. Simply considering their organizational structures, 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 a backstop, but with it 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, which is perhaps indicative of the independent mindset of the less developed Western frontier. 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 prospect 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 Western United States because of a deep opposition to branch banking.<sup>68</sup> 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.”<sup>69</sup> This attitude persisted despite branch banking’s “superiority in respect to safety, economy, the equalization of rates for

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<sup>68</sup> 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.”).

<sup>69</sup> Thornton Cooke, *Branch Banking for the West and South*, 18 *Q.J. Econ.* 97, 97 (1904) [hereinafter *Cooke, Branch Banking*].

loans, and the diffusion of banking facilities.”<sup>70</sup> 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 sufficient, is easily debunked by empirical evidence to the contrary.<sup>71</sup> 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 the ardent antipathy toward branch banking on philosophical grounds. The objection was more rooted in culture and identity than in demonstrable competitive advantage. As Cooke described:

The American country banker is a personality that cannot be spared. He knows the people who visit his bank better than the city banker knows those who come to his own, for the country banker is a teller as well as a manager. Then, too, 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.<sup>72</sup>

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 high interest for deposits or low interest for loans, to ensure that country banks would not be able to compete.<sup>73</sup> It was with this mindset that country bankers

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<sup>70</sup> 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, 3 (1899).

<sup>71</sup> See Cooke, *Branch Banking*, *supra* note 69, at 98–100 (evidencing the severe undercapitalization of Western unit banks relative to national branch banks).

<sup>72</sup> *Id.* at 109.

<sup>73</sup> *Id.* at 112.

condemned branch banking as “unpatriotic, un-American, [and] unbusinesslike.”<sup>74</sup>

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 them.<sup>75</sup> No wonder then that the states that 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, despite what a modern reader might assume given the integrated and uniform nature of the extant banking structure. Rivalries and hard feelings remaining from the Civil War were compounded by wariness of Eastern businessmen and financial centers.<sup>76</sup>

The Western objection to branch banking 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.<sup>77</sup> This sectional rivalry animated the congressional debates over the deposit insurance provision of the Glass-Steagall Act. State versus federal became a proxy for Western

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<sup>74</sup> Kan. Bankers' Ass'n, Proceedings of the Fifteenth Annual Convention 113 (1902).

<sup>75</sup> Sprague, *supra* note 70, at 259.

<sup>76</sup> One manifestation of this mindset 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. The authoritative account on this topic is Matthew Josephson, *The Robber Barons: The Great American Capitalists, 1861–1901* (1934). 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.

<sup>77</sup> These feelings were bolstered by the longstanding trend of Western states becoming debtors to Eastern cities. Sprague, *supra* note 70, 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.”).



versus Eastern, as the contest evolved from a geographical dispute to a referendum on 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 1890s in the West was the emergence of Populism. The movement traced its genesis to the union of agrarian and free currency interests, and its presence became particularly strong in the West and South—not coincidentally, the regions encompassing the states that would eventually enact deposit insurance.<sup>78</sup> Populism's people-versus-elite ethos dovetailed with deposit insurance, a concept based on us (Western farmers) versus them (the federal government and Eastern banking interests). Another constant political theme among the states that considered deposit insurance<sup>79</sup> was 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.<sup>80</sup>

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.”<sup>81</sup> Political parties raced to make deposit insurance part of their platforms and competed to claim credit for it afterward. In Kansas, it was at different times supported by Populists, Republicans, and Democrats;<sup>82</sup> in Nebraska, Populists originally proposed the reform, but a Democratic governor was

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<sup>78</sup> For more on the history of the Populist movement, see Lawrence Goodwyn, *The Populist Moment: A Short History of the Agrarian Revolt in America* (1978), and John D. Hicks, *The Populist Revolt: A History of the Farmers' Alliance and the People's Party* (1931).

<sup>79</sup> 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 66, at 367–70.

<sup>80</sup> 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*, asks that his honest neighbor, *C*, should be robbed to make up for his loss. J. Laurence Laughlin, *Guaranty of Bank Deposits*, Address Before the State Bankers' Association of Nebraska 7 (Sept. 25, 1908).

<sup>81</sup> Cooke, *Bank Deposits in the West II*, supra note 66, at 359.

<sup>82</sup> *Id.* at 344–45.

subsequently elected on a deposit insurance platform;<sup>83</sup> and Republicans in South Dakota, not to be outdone by their Democratic rivals, added deposit insurance to their own platform.<sup>84</sup> 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 proved to be a successful tactic, one that Henry Steagall and others would later employ to great effect.

Beyond politics, guaranteeing deposits held an 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. This was a key reason deposit insurance persisted as a potential solution, notwithstanding its ultimate failure at the state level.

*C. Explanations for the Failure of State Deposit Insurance and Texas as a Model for Federal Deposit Legislation*

Even in this brief period of state bank preeminence, built on the competitive advantage of deposit insurance,<sup>85</sup> there were cracks in the system.<sup>86</sup> To legislators and potential depositors (the general public) in those states, however, these comparatively few, discrete failures were

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<sup>83</sup> Id. at 355.

<sup>84</sup> Id. at 358–59.

<sup>85</sup> Oklahoma is a good example of the stunning early success of state deposit insurance. Cooke, *Bank Deposits in the West I*, supra note 66, at 92–95. On February 29, 1908, there were 470 state banks with \$18,032,284 in individual deposits that held a total capital of \$6,233,216; by comparison, there were 312 national banks with \$38,298,247 in individual deposits that held a total capital of \$12,215,350. Id. at 92. These numbers demonstrate the primacy of national banks before deposit insurance, and tracking these metrics illustrates how state banks outperformed national ones after such legislation was passed. By June 23, 1909, there were 631 state banks with \$42,722,927 in individual deposits that 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 that held \$9,730,000 in total capital. Id. Similar legislation yielded comparable results in the other seven states that adopted deposit insurance. Cooke, *Bank Deposits in the West II*, supra note 66, at 355.

<sup>86</sup> The most notable of these was the default of the Columbia Bank and Trust Company, which held the most deposits in Oklahoma. For more on this episode, see Cooke, *Bank Deposits in the West II*, supra note 66, at 328–35.

interpreted as mismanagement of select banks rather than as signs of systemic weakness.<sup>87</sup> But bank failures in Oklahoma quickly became more a worrisome trend than merely isolated incidents, and by 1913 “[b]ank after bank” had failed.<sup>88</sup> Virtually all these failures were of state banks that were part of the deposit guarantee system,<sup>89</sup> demonstrating that this initiative had failed in record-setting fashion.<sup>90</sup> 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.<sup>91</sup> The most plausible of them, according to Cooke, was that a combination of adverse economic conditions and depositors’ imprudent selection of banks that engaged in careless practices led to failure.<sup>92</sup> 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,<sup>93</sup> the answer appears to have been the latter.

Cooke rejected state-mandated deposit insurance and attempted to make sense of what went wrong. He discussed one case of limited success, however, and it illustrates why, even though state-run deposit insurance failed, some at the federal level still viewed it as a viable reme-

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<sup>87</sup> Id. at 336.

<sup>88</sup> Cooke, *Four Years More of Deposit Guaranty*, supra note 66, at 71.

<sup>89</sup> Id. at 72–73 (“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.”).

<sup>90</sup> Id. at 75 (“[A] record of nearly thirty bank failures in five years, with almost all of them coming in three years, has not been equalled 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.”).

<sup>91</sup> 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 somewhat adverse. (6) The guaranty of deposits has relieved depositors of all necessity for care in selecting banks.”).

<sup>92</sup> Id. at 93–94.

<sup>93</sup> 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. Cooke, *The Collapse of Bank-Deposit Guaranty*, supra note 65, at 122. In Nebraska, there were twenty-five state bank failures in 1921 and twenty-two more in 1922. Id. at 124. Cracks were showing in the South Dakota system, but it was enacted much later than the other programs, so the full effects had not yet manifested themselves. Id. at 127. In North Dakota, sixty-four banks closed between 1920 and 1924. Id. at 128. 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. Id. at 129. Lastly, in Washington, one large bank failed and brought down the whole system. Id. at 130.

dy to the ongoing banking crisis of the 1920s and 1930s. Even after the Panic of 1907 and a difficult economic period due to poor weather conditions that crippled harvests across the West and South, Texas's deposit insurance program, according to one description, was "as sound as the Rock of Gibraltar."<sup>94</sup> In thirteen years of deposit guarantee, "Not one non-interest bearing and unsecured depositor ever lost a cent in a Guaranty Fund Bank of the State of Texas, even tho [sic] we have passed through the darkest period of the financial history of the State."<sup>95</sup> The contrast during the 1910s and early 1920s between Texas's experience and that of the other seven states is striking.

This was due to some unique features of the Texas plan.<sup>96</sup> One was an established capital-to-deposit ratio requirement that resembled the modern federally mandated capital-to-asset requirements. This innovation, well ahead of its time, provided an important constraint on irresponsible—or even just overly aggressive—banking practices. The second distinctive characteristic 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's subsequent assessments per annum were a quarter of deposits until the fund equaled two million dollars; further, it provided that, in the case of emergency or depletion of the fund, assessments could be raised to two percent.<sup>97</sup> Put succinctly, the fundamental differences between Texas's 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,<sup>98</sup> 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 require inspections for admission into the deposit-guaranteed national banking system. More significantly, the insurance

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<sup>94</sup> *Id.* at 131 (emphasis omitted) (quoting Letter from J.L. Chapman, Tex. Bank Comm'r, to author).

<sup>95</sup> *Id.* at 132.

<sup>96</sup> Linda M. Hooks & Kenneth J. Robinson, *Deposit Insurance and Moral Hazard: Evidence from Texas Banking in the 1920s*, 62 *J. Econ. Hist.* 833, 834 (2002); see also Cooke, *Bank Deposits in the West I*, *supra* note 66, at 98–99 (comparing the deposit insurance plans in Oklahoma, Kansas, Nebraska, South Dakota, and Texas).

<sup>97</sup> See Cooke, *Bank Deposits in the West I*, *supra* note 66, at 98–99.

<sup>98</sup> For more on Texas's experience, see Joseph M. Grant and Lawrence L. Crum, *The Development of State-Chartered Banking in Texas, from Predecessor Systems Until 1970*, at 74–87, 186 (1978), and Hooks & Robinson, *supra* note 96, at 834.

fund could be backed by the full faith and credit of the U.S. government. For proponents of a state-centric banking model, this was the takeaway of the failed state experiments with deposit insurance. Years later, Representative Henry Steagall pointed to the Texas plan 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.”<sup>99</sup> Advocates of a unified federal banking system, typified by Senator Carter Glass of Virginia, reached the opposite conclusion and adopted their own measure in response to the Panic of 1907: the Federal Reserve Act of 1913.

## II. 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 a well-established proposition that had longstanding 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. Between 1913 and 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 seeking federal unification. The first measure represented a more conventional alternative to the bold, innovative state experiments with deposit insurance, the second a longstanding 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 of 1913 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, which

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<sup>99</sup> 77 Cong. Rec. 3838–39 (1933) (statement of Rep. Henry Steagall).

imposed a ten percent tax on the circulating notes of state banks.<sup>100</sup> Functionally, this law was an effort to tax state banks out of existence. The Supreme Court upheld both measures as constitutional, providing tangible support for the notion that banking was a national enterprise, and more importantly, demonstrating that in the power struggle 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 Supreme Court famously upheld Congress's first attempt at unification in *McCulloch v. Maryland*.<sup>101</sup> Writing for the Court, Chief Justice Marshall found that Congress had the authority, pursuant to the Necessary and Proper Clause,<sup>102</sup> to establish a national bank.<sup>103</sup> The Court also found that Maryland did not have the power to tax the national bank.<sup>104</sup> Of greater significance was the Court's broad reasoning, which gave clear preference to the federal government in the banking sphere. Harkening back to Hamilton's notion that state banks "*happen* to exist to day, [and] for ought that concerns the government of the United States, may disappear to morrow,"<sup>105</sup> Marshall found that "the existence of State banks can have no possible influence on the question" of whether Congress had the authority to establish a national bank.<sup>106</sup> 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"<sup>107</sup> on the relationship between banking and federalism as an affirmative statement that there was no "intention to create a dependence of the government of the

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<sup>100</sup> Act of Mar. 3, 1865, ch. 78, § 6, 13 Stat. 469, 484.

<sup>101</sup> *McCulloch*, 17 U.S. (4 Wheat.) 316.

<sup>102</sup> U.S. Const. art. I, § 8, cl. 18 ("To make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers, and all other Powers vested by this Constitution in the Government of the United States, or in any Department or Officer thereof.").

<sup>103</sup> *McCulloch*, 17 U.S. (4 Wheat.) at 411–12, 424.

<sup>104</sup> *Id.* at 436; see also *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.").

<sup>105</sup> Hamilton, Opinion on Bank Establishment, *supra* note 48, at 102. See generally *supra* text accompanying notes 48–61.

<sup>106</sup> *McCulloch*, 17 U.S. (4 Wheat.) at 424.

<sup>107</sup> Hurst, *supra* note 7, at 134.

Union on those of the States.”<sup>108</sup> Marshall therefore reasoned that in executing its powers—including creating a national bank—“the choice of means implies a right to choose a national bank in preference to State banks, and Congress alone can make the election.”<sup>109</sup> His opinion concluded, “It is of the very essence of supremacy to remove all obstacles to its action within its own sphere.”<sup>110</sup> For Marshall, the sphere was banking and the national government was properly supreme.<sup>111</sup>

The second attempt at federal unification presented the inverse of the question the *McCulloch* decision addressed: Did the federal government have the constitutional power to destroy state banks by taxing them? In *Veazie Bank v. Fenno*, the Court answered “yes.”<sup>112</sup> 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.”<sup>113</sup> Congress did not merely reject Hamilton’s vision of cooperation with state banks; it escalated the competition by eschewing the strategy of merely building up national banks and instead attempted to tear down state ones.

*Veazie Bank* signified the completion of a shift in the nature of the competition between federal and state banks. In the years before the decision, most national bank proponents used federal resources to bolster national banks but simultaneously seemed to adopt an attitude of “live and let live” toward their state counterparts. Even so, a consensus began to form that coexistence was not tenable. In his first report to Congress, dated November 23, 1863, the Comptroller of the 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

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<sup>108</sup> *McCulloch*, 17 U.S. (4 Wheat.) at 424.

<sup>109</sup> *Id.*

<sup>110</sup> *Id.* at 427.

<sup>111</sup> These principles were restated and upheld in the subsequent case of *Osborn v. Bank of the United States*, 22 U.S. (9 Wheat.) 738, 859–61, 867–68 (1824). See also Walter Wyatt, *Constitutionality of Legislation Providing a Unified Commercial Banking System for the United States*, 19 Fed. Res. Bull. 166, 169 (1933) (discussing *Osborn* and using its holding as evidence that Congress could take whatever measures it considered necessary and proper to give effect to its right to create a bank).

<sup>112</sup> 75 U.S. (8 Wall.) at 534–35, 549.

<sup>113</sup> Wyatt, *supra* note 111, at 175.

lines, nor subject to State laws. Its internal commerce is national, and so should be its currency.”<sup>114</sup> The next year, the Comptroller asserted, “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.”<sup>115</sup> *Veazie Bank* signaled the end of that outlook. The definitive statement on the state of play came from Senator John Sherman of Ohio, Chairman of the Senate Finance Committee, who declared: “The national banks were intended to supersede the State banks. Both cannot exist together . . . .”<sup>116</sup> As the American Civil War came to a close, federal and state banks began their own quasi-civil war in earnest. Full reconstruction of the banking system 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.”<sup>117</sup> 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 proved inadequate.<sup>118</sup> He believed that “[t]he Siamese twins of disorder were an inelastic currency and a fictitious reserve system. . . . [T]he sum total of the idle bank funds of the nation was congested at the money centres for purely speculative purposes.”<sup>119</sup> Glass therefore presented Wilson with a plan that proposed “to make several reserve pyramids . . . out of the ever-toppling big one” by decentralizing credits, with reserve balances held in regional banks.<sup>120</sup> These regional banks 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.”<sup>121</sup> Glass thought on a macroeconomic level, seeing banks as part

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<sup>114</sup> *Id.* (emphasis omitted) (quoting 1863 Comptroller of the Currency Ann. Rep. 57).

<sup>115</sup> *Id.* at 176 (emphasis omitted) (quoting 1864 Comptroller of the Currency Ann. Rep. 54).

<sup>116</sup> Cong. Globe, 38th Cong., 2d Sess. 1139 (1865).

<sup>117</sup> Rixey Smith & Norman Beasley, *Carter Glass: A Biography* 90 (1939).

<sup>118</sup> *Id.* at 95–97.

<sup>119</sup> Carter Glass, *An Adventure in Constructive Finance* 60–61 (1927).

<sup>120</sup> Smith & Beasley, *supra* note 117, at 97.

<sup>121</sup> *Id.*



of an interlocking national economy, not as mere unitary islands. He convinced Wilson of this view, and, in his newly attained position as Chairman of the House Committee on Banking and Currency, teamed up with Senator Robert Owen of Oklahoma to operationalize his vision.<sup>122</sup>

Their joint effort, the Federal Reserve Act of 1913,<sup>123</sup> can fairly be characterized as the third major attempt to unify the banking system by providing a federal analogue to state deposit insurance. The title reads in full: “An Act [t]o 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.”<sup>124</sup> The Act called for the creation of at least eight, but not more than twelve private, regional Federal Reserve banks, each with its own branches, which would be overseen by a Federal Reserve Board comprised of public officials appointed by the President and confirmed by the Senate.<sup>125</sup>

The reform can be conceptualized as having two parts: standardizing the circulating medium to create a more elastic currency and spreading risk by restructuring national banks into 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”<sup>126</sup> 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, to make the money supply more elastic in order to prevent a replay of the Panic of 1907. The second part of the plan was to make sure this newly standardized money supply would be properly regulated. This was the purpose of the Federal Reserve banks, conceived

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<sup>122</sup> Id. at 104, 110–11.

<sup>123</sup> Federal Reserve Act, Pub. L. No. 63-43, 38 Stat. 251 (1913) (codified as amended in scattered sections of 12 U.S.C.). For more on the origins and history of the Federal Reserve Act, see Wells, *supra* note 21, at 7–20.

<sup>124</sup> 38 Stat. at 251.

<sup>125</sup> §§ 2, 10, 38 Stat. at 251–52, 260. The Federal Reserve Act drew heavily from the Aldrich-Vreeland Act, ch. 229, 35 Stat. 546 (1908). The Aldrich-Vreeland Act established the National Monetary Commission, § 17, 35 Stat. at 552, which in turn proposed a bill that would become the Federal Reserve Act. See Nat’l Monetary Comm’n, Report of the National Monetary Commission, S. Doc. No. 243, at 43–72 (2d Sess. 1912). The major innovation introduced by the Federal Reserve Act was that oversight of the system—in the form of the Federal Reserve Board—was placed in the hands of public officials, not private bankers. § 10, 38 Stat. at 260.

<sup>126</sup> Friedman & Schwartz, *supra* note 23, at 189.

as parallel institutions designed to jointly manage the uniform currency. The 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 institutionalized *Veazie Bank*'s insistence on a standard (federal) currency and the latter carried the spirit of *McCulloch*'s attempt to make banking a federal enterprise.

Glass had taken up the mantle of the movement to unify the banking system. His first effort, the Federal Reserve Act, was characterized by subtle compulsion. Glass endeavored to create a national system so attractive to, 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. This strategy was somewhat coercive, but it was not an overtly hostile attempt to destroy state banks. That is to say, it was more *McCulloch* than *Veazie Bank*. While the Federal Reserve Act was seen as a success—Glass later stated that the Federal Reserve System had been more valuable in financing, and therefore winning, World War I "than three Panama Canals"<sup>127</sup>—the Great Crash was proof positive to Glass and others that it had not gone far enough and that 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.<sup>128</sup> Glass would not repeat that mistake with his second attempt.

### C. *The Glass 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:

[W]hen 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

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<sup>127</sup> Carter Glass, *Truth About the Federal Reserve System* 7 (1922); Smith & Beasley, *supra* note 117, at 83–84, 180–81.

<sup>128</sup> Friedman & Schwartz, *supra* note 23, at 193–96; Hurst, *supra* note 7, at 82, 228–29, 236, 240.

systems, in order to enable national banks to compete with State banks.<sup>129</sup>

For Glass, this realization necessitated a full reexamination of the banking structure. This undertaking was authorized on May 5, 1930 with the adoption of Senate Resolution 71, a resolution “to make a complete survey of the [national and Federal Reserve banking] systems.”<sup>130</sup> 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 that the so-called Glass bill emerged.<sup>131</sup>

Nearly a year and a half later the Glass bill began to take shape.<sup>132</sup> Glass’s belief that a more forceful unification strategy was necessary<sup>133</sup> had been reinforced by the continued collapse of the dual banking system,<sup>134</sup> and in January of 1932, Glass introduced a second bill in the Senate.<sup>135</sup> Two features of this bill were particularly notable. First, it encouraged branch banking as a means of providing additional security to depositors,<sup>136</sup> second, it formed a “Federal Liquidating Corporation” that would use capital appropriated from the Treasury Department and levied by assessments on member banks to purchase the assets of closed member banks, thereby hastening payment to depositors.<sup>137</sup> Both measures

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<sup>129</sup> Operation of the National and Federal Reserve Banking Systems: Hearings Before a Subcomm. of the S. Comm. on Banking & Currency Pursuant to S. Res. 71, 71st Cong. 14 (1931) (statement of Sen. Carter Glass, Member, S. Comm. on Banking & Currency).

<sup>130</sup> 72 Cong. Rec. 8355 (1930).

<sup>131</sup> For a comprehensive legislative history of the Glass-Steagall Act that focuses 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* 41–65 (Ingo Walter ed., 1985).

<sup>132</sup> The first iteration of the Glass bill 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. See S. 4723, 71st Cong., 72 Cong. Rec. 10,973 (1930).

<sup>133</sup> In November of 1931, Glass had privately suggested to President Herbert Hoover that all banks engaged in interstate commerce be required to join the Federal Reserve System. See Smith & Beasley, *supra* note 117, at 306. Hoover referred the matter to Attorney General William D. Mitchell, who determined that the measure was unconstitutional. See Letter from Herbert Hoover to Carter Glass (Dec. 2, 1931) (on file with the Albert and Shirley Small Special Collections Library, University of Virginia).

<sup>134</sup> There were 2290 bank failures in 1931. Carter Glass, S. Comm. on Banking & Currency, *Operation of the National and Federal Reserve Banking Systems*, S. Rep. No. 72-584, at 6 (1932).

<sup>135</sup> S. 3215, 72d Cong., 75 Cong. Rec. 2403 (1932).

<sup>136</sup> *Id.* § 25.

<sup>137</sup> *Id.* § 12.

would have the macro effect of increasing the sphere of federal influence over bank regulation.

Glass introduced three more versions of his bill.<sup>138</sup> Of these, Senate Bill 4412, for which Glass submitted a report in April of 1932, best exemplifies Glass's view of the ideal relationship between federalism and banking. This is because the proposal was accompanied by the Senate committee's report based on the hearings conducted under Senate Resolution 71.<sup>139</sup> After identifying what it thought to be the primary defects of the existent banking system, the committee, in the report written by Glass, made its intention clear:

Specifically, what is proposed is the grant of power to establish branches of national banks not 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 laws.<sup>140</sup>

Glass expounded on this view while testifying before the Senate the next month. Directly invoking the constitutional authority of *Veazie Bank*, Glass defended his unifying branch banking proposal by declaring:

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 . . . .<sup>141</sup>

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 this banker quite differently than Thornton Cooke had years earlier.<sup>142</sup> 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

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<sup>138</sup> S. 245, 73d Cong., 77 Cong. Rec. 196 (1933); S. 4412, 72d Cong., 75 Cong. Rec. 8350 (1932); S. 4115, 72d Cong., 75 Cong. Rec. 6329 (1932). One of the bills Glass introduced passed the Senate in January of 1933. See S. 4412, 72d Cong., 76 Cong. Rec. 2517 (1933).

<sup>139</sup> See Glass, *supra* note 134, at 1.

<sup>140</sup> *Id.* at 11.

<sup>141</sup> 75 Cong. Rec. 9890–91 (1932) (statement of Sen. Carter Glass).

<sup>142</sup> See Cooke, *Branch Banking*, *supra* note 69, at 109.

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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.<sup>143</sup>

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 subcommittee hearings were exhaustive and the resultant Glass bill was detailed and definite. In his second attempt to unify the banking system under national control, Glass left no stone unturned. His thorough investigation had yielded empirical proof that competitive dual federalism was an unsustainable banking model. This provided him the impetus and confidence to change his strategy for bringing 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-rights Democrat” who subscribed to 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.”<sup>144</sup> It was a more nuanced approach than the direct tax at issue in *Veazie Bank*, 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.

### III. HENRY STEAGALL AND THE DEPOSIT GUARANTEE MOVEMENT

Henry Steagall had two political role models: William Jennings Bryan<sup>145</sup> and Woodrow Wilson.<sup>146</sup> In his own career, Steagall embraced many of the values previously championed by Bryan—support for Western and Southern agricultural interests, antipathy toward Wall

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<sup>143</sup> 75 Cong. Rec. 9892 (1932) (statement of Sen. Carter Glass).

<sup>144</sup> Id. at 9898 (statement of Sen. Carter Glass).

<sup>145</sup> See Jack Brien Key, Henry B. Steagall: The Conservative as a Reformer, 17 Ala. Rev. 198, 198 (1964).

<sup>146</sup> Id. at 200.

Street, and protection of states' rights—but the political strategy Steagall deployed to further those causes was conceptually modeled on Wilson's New Freedom movement.<sup>147</sup> 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."<sup>148</sup> This personal and political paradox made deposit insurance the perfect issue for Steagall and, conversely, made 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, but their failure signified the need for the full force of the federal government to accomplish those worthy goals.

*A. Fighting Branch Banking and Unification Through Opposition to the McFadden Bill*

Although federal banks had secured two major victories—*McCulloch* and *Veazie Bank*—in their battle 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 unit banking disappear. The National Bank Act of 1863, as amended in 1864, was simple in construction: The bank's "usual business shall be transacted at an office or banking house located in the place specified in its organization certificate."<sup>149</sup> Comptrollers, however, construed this seemingly unremarkable requirement to mean that national banks could not have branches, a broad interpretation that entrenched unit banking in the American fiscal system.<sup>150</sup> By placing a ban on branching by federal

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<sup>147</sup> The New Freedom movement comprised the reforms Woodrow Wilson promoted during his 1912 presidential campaign. While these campaign speeches and promises called for less government, in reality President Wilson 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 Antitrust Act, and the Federal Farm Loan Act. For more on Woodrow Wilson and the New Freedom movement, see Woodrow Wilson, *The New Freedom: A Call for the Emancipation of the Generous Energies of a People* (1921).

<sup>148</sup> Key, *supra* note 145, at 198.

<sup>149</sup> Act of June 3, 1864, ch. 106, § 8, 13 Stat. 99, 101–02 (codified as amended at 12 U.S.C. § 81 (2012)). The Act was later renamed "the National Bank Act." See Act of June 20, 1874, ch. 343, 18 Stat. 123.

<sup>150</sup> George S. Eccles, *The Politics of Banking* 49 (1982).

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 branch. The ban also made certain 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 twenty years; and no one can doubt that in the United States the movement would be quite as swiftly executed as in any European country.<sup>151</sup>

Henry Steagall shared this life-or-death view of the struggle between unit and branch banking and stood in support of the former during congressional hearings regarding the so-called McFadden bill. This proposed legislation, eventually enacted in 1927 as the McFadden Act,<sup>152</sup> included a provision allowing national banks to branch to the same extent as state-chartered banks.<sup>153</sup> Representative Steagall saw this conces-

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<sup>151</sup> Sprague, *supra* note 70, at 252–53; see also 67 Cong. Rec. 2839 (1926) (statement of Rep. Thomas Goldsborough) (quoting Professor Sprague for the proposition that unit banking and branch banking cannot coexist).

<sup>152</sup> McFadden Act, Pub. L. No. 69-639, 44 Stat. 1224 (1927) (codified as amended in scattered sections of 12 U.S.C.). For more information on the McFadden Act, see David F. Freeman, Note, Interstate Banking Restrictions Under the McFadden Act, 72 Va. L. Rev. 1119, 1123–28 (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 speech in Congress blaming the Federal Reserve for the Great Depression. 75 Cong. Rec. 12,595–603 (1932) (statement of Rep. Louis McFadden).

<sup>153</sup> § 7, 44 Stat. at 1228–29. The Supreme Court had explicitly decided the constitutionality of this matter in *First National Bank v. Missouri*, 263 U.S. 640 (1924), which upheld a Missouri statute providing “that no bank shall maintain in this state a branch bank or receive deposits or pay checks except in its own banking house.” *Id.* at 655–56, 659. The Court reasoned that such a statute did not conflict with the laws of the United States:

The 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.

sion as nothing short of a threat to the entire American banking framework. Should federal banks have branching rights coextensive with those of 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, and even combat, branch banking, Steagall's opposition to such a banking system was grounded more in his political philosophy than in 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?"<sup>154</sup>

Steagall's stance reflected a notion of federalism incongruous with both interpretations of the Constitution's text<sup>155</sup> and decisions of the Supreme Court<sup>156</sup> that Glass suggested had "completely swept away the rights of the States in matters relating to the banking business."<sup>157</sup> 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."<sup>158</sup> But Steagall's definition of "lead" was not the dictionary one, which would have suggested that he believed national banking authorities should control American banks. Nor did "national banking system" mean the Federal Reserve System; rather, 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 the Treasury Department's guarantee of every deposit in a state bank. It was the perfect unorthodox foil to the longstanding campaign for unification, as Steagall developed a compelling alternative by combining the Populist, anti-corporate, states' rights vision of federalism that emerged from the deposit insurance experiments with New Freedom-style federal funding.

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<sup>154</sup> 66 Cong. Rec. 1629 (1925) (statement of Rep. Henry Steagall).

<sup>155</sup> See *supra* notes 38–45 and accompanying text.

<sup>156</sup> See sources cited *supra* notes 9–10.

<sup>157</sup> 75 Cong. Rec. 9890 (1932) (statement of Sen. Carter Glass).

<sup>158</sup> 66 Cong. Rec. 1631 (1925) (statement of Rep. Henry Steagall).



*B. Federal Deposit Insurance as the Great Challenge to Unification*

After the Great Crash threw 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,<sup>159</sup> which passed in the House of Representatives on May 27, 1932<sup>160</sup> after four hours of debate.<sup>161</sup> His first argument was 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 is not going to 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 the banks."<sup>162</sup> This argument was reminiscent of those incorporated into the Populist platform at the turn of the century, as well as those invoked by supporters of state-mandated deposit guarantee plans. Steagall's public confidence argument also included a strain of what Golembe terms "protection of circulating medium."<sup>163</sup> State banks' failure to inspire confidence in the public through deposit insurance, which rendered them unable to gain deposits and protect the circulating medium, was not an indictment of the measure, just its magnitude.

In making this argument, supporters of deposit insurance returned to a familiar political playbook: claiming to have a public mandate for deposit insurance and accusing bankers of squelching the will of the people. They 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. Most members of the House 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.<sup>164</sup>

Never one to shy from casting himself as an 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

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<sup>159</sup> 75 Cong. Rec. 8273 (1932).

<sup>160</sup> H.R. 11,362, 72d Cong., 75 Cong. Rec. 11,453 (1932).

<sup>161</sup> Susan Estabrook Kennedy, *The Banking Crisis of 1933*, at 214 (1973).

<sup>162</sup> 75 Cong. Rec. 11,217 (1932) (statement of Rep. Henry Steagall).

<sup>163</sup> Golembe, *supra* note 27, at 200.

<sup>164</sup> 75 Cong. Rec. 11,239 (1932) (statement of Rep. John Cable).

understand that the purpose of the legislation is to afford them protection sorely needed and long denied.”<sup>165</sup> One should not, however, mistake Steagall’s fiery language and dramatic tone for inattention to reality or lack of a concrete plan.

To the contrary, Steagall had a 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, which could also be attributed to “ineffective examinations, insufficient scrutiny of the previous records of bankers, and unfavorable economic conditions following the period of settlement and rapid growth.”<sup>166</sup> 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.”<sup>167</sup> Cooke’s conclusion read like a tombstone for deposit insurance, and influential political leaders like Carter Glass and Franklin Roosevelt tended to agree.<sup>168</sup> 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 subscribe 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 its execution:

The State laws to insure bank 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 . . . .<sup>169</sup>

Steagall’s plan mirrored that of Texas but on a much grander scale. The federal deposit guarantee he proposed shared the same theoretical

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<sup>165</sup> Id. at 11,217 (statement of Rep. Henry Steagall).

<sup>166</sup> Cooke, *Four Years More of Deposit Guaranty*, supra note 66, at 109.

<sup>167</sup> Id. at 110.

<sup>168</sup> Kennedy, supra note 161, at 214–15.

<sup>169</sup> Henry Steagall, *Should America Adopt a Unified Banking System?* Pro, 12 Cong. Dig. 114, 114 (1933).

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, Steagall argued,<sup>170</sup> because nothing like his bank guarantee proposal had ever been implemented.<sup>171</sup> Addressing his colleagues in the House, Steagall explained: “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 with a few weak banks to support it.”<sup>172</sup> As Texas had proved for a short while, however, deposit insurance *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 and the Senate or of President Roosevelt.<sup>173</sup> The stage was thus set for a contemporary replay of the First Bank branching debates of the 1790s. Contrary to what Moss and Golembe argue,<sup>174</sup> neither unification nor a full federal deposit guarantee for state banks aimed to preserve the existing banking structure. On one end of the spectrum, the Glass bill represented the longstanding, 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, regardless 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.

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<sup>175</sup> was not the death knell of cooperative federalism for American banking after all. Just as Carter Glass became the torch-bearer for unification,

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<sup>170</sup> Id. (“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, who put their faith and money in banks chartered under Federal laws.”).

<sup>171</sup> A.L. Wiggins, *Should America Adopt a Unified Banking System?* Cong. Dig. 115, 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.”).

<sup>172</sup> 77 Cong. Rec. 3838 (1933) (statement of Rep. Henry Steagall).

<sup>173</sup> Kennedy, *supra* note 161, at 214–15.

<sup>174</sup> See Golembe, *supra* note 27, at 200; Moss, *supra* note 30, at 120.

<sup>175</sup> See Wettreau, *supra* note 55, at 74–75.

and Steagall served in the same capacity 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.

#### IV. THE VANDENBERG AMENDMENT AS COOPERATIVE FEDERALISM

No one will ever confuse Arthur Vandenberg for Alexander Hamilton. A noted opponent of the New Deal, Vandenberg generally opposed the expansion of federal power.<sup>176</sup> Yet the Michigan senator also held a decidedly Hamiltonian viewpoint: "In the last analysis government always was and always will be a matter of business."<sup>177</sup> This belief helps explain Vandenberg's abrupt about-face on federal deposit insurance, from an entrenched opponent of the legislation in December 1932<sup>178</sup> to a driving force behind its eventual passage in June 1933. The immediate cause of this reversal was the collapse of the banking system in Vandenberg's home state, which convinced him that government action was necessary.<sup>179</sup> Rather than default to a standard federal- or state-dominated approach, however, Vandenberg proposed a third option: a coordinated federal-state response. Building consensus between the rival banking sovereigns would not be easy, but Vandenberg was particularly well-suited for the task. He was a politician who favored 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."<sup>180</sup> True to form, Vandenberg would broker a deal progressive enough to accommodate Steagall while conservative enough to appease Glass, and pragmatic enough to evoke Alexander Hamilton.

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<sup>176</sup> See C. David Tompkins, *Senator Arthur H. Vandenberg: The Evolution of a Modern Republican, 1884–1945*, at 13, 120–21, 138, 220 (1970) (noting Vandenberg's support of states' rights and reduced federal taxation).

<sup>177</sup> Vandenberg, *supra* note 13, at 173.

<sup>178</sup> Tompkins, *supra* note 176, at 84.

<sup>179</sup> *Id.* For more on the Michigan banking collapse and Vandenberg's involvement, see Kennedy, *supra* note 161, at 77–102, and Tompkins, *supra* note 176, at 76–86.

<sup>180</sup> Tompkins, *supra* note 176, at 33 (quoting Letter from Arthur Vandenberg to Albert Beveridge (Feb. 21, 1922)).

*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.<sup>181</sup> 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. . . . [I]n 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 credits and investments, so that there will be an end to speculation with other people's money; and there must be provision for an adequate but sound currency.<sup>182</sup>

In more colorful language, Roosevelt restated a few of the primary goals of Alexander Hamilton's reports.<sup>183</sup> "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 money supply. The question, as in 1791, was what model of federalism should be superimposed on the banking structure to best accomplish those goals.

The flashpoint in these debates was whether the legislation would include a federal deposit insurance provision.<sup>184</sup> As argued throughout this

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<sup>181</sup> Roosevelt's first official act as President in 1933 came less than two days after his inaugural address when he issued a presidential proclamation declaring a national bank holiday from March 6 through March 9. The President singlehandedly shut down the banks of the United States. Roosevelt did so under the wartime measure of October 6, 1917, which, as amended by the Emergency Banking Relief Act of 1933, empowered the President to regulate or prohibit payment of deposits by all banking institutions as well as approve any bank transactions. Emergency Banking Relief Act of 1933, Pub. L. No. 73-1, § 2(b), 48 Stat. 1, 2 (codified as amended at 12 U.S.C. § 95 (2012)). For additional historical context, see Friedman & Schwartz, *supra* note 23, at 421. The Emergency Banking Relief Act was something of a bandage 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.

<sup>182</sup> Roosevelt, *supra* note 26, at 12–13.

<sup>183</sup> Hamilton, Report on Mint Establishment, *supra* note 16, at 570–71; Hamilton, First Report on Public Credit, *supra* note 50, at 225–35; Hamilton, Second Report on Public Credit, *supra* note 50, at 305.

<sup>184</sup> See generally Kennedy, *supra* note 161, at 214–18 (describing the "vipers' nest of controversy" over deposit insurance and the various positions taken by political players in the

Note, 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”<sup>185</sup> because that reform represented a challenge to the established order of federal preeminence in banking which dated back to branching by the First Bank, the holdings in *McCulloch* and *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 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 federal deposit insurance were, among others, Franklin Roosevelt and Carter Glass. Roosevelt initially threatened to veto any legislation containing a federal deposit insurance provision.<sup>186</sup> Glass was an even more entrenched adversary of a federal guarantee of bank deposits, having opposed the measure for thirty-five years.<sup>187</sup> Both favored unification, which had ample constitutional support,<sup>188</sup> and history suggested unification 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 born

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debate); Should America Adopt a Unified Banking System? Pro and Con Discussion, 12 Cong. Dig. 106 (1933).

<sup>185</sup> Kennedy, *supra* note 161, at 214.

<sup>186</sup> *Id.*

<sup>187</sup> 77 Cong. Rec. 3729 (1933) (statement of Sen. Carter Glass).

<sup>188</sup> See generally Wyatt, *supra* note 111, at 166–67 (reviewing Supreme Court precedents and concluding that these cases support congressional power to unify the national banking system). Walter Wyatt served as general counsel for the Federal Reserve. In connection with the Glass bill then under consideration, Senate Bill 4115, Wyatt prepared an opinion regarding the constitutionality of the Glass bill. He framed the issue as “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.” *Id.* at 166. In other words, Wyatt wrote a memo answering the question of whether unification of the banking system under federal control was constitutional. Wyatt found unification, and virtually any means by which the federal government chose to adopt it, constitutional, based on three independent congressional powers: (1) the power to create and maintain a banking system, *id.* at 166–67 (citing *Westfall v. United States*, 274 U.S. 256 (1927); *Farmers and Mechs. Nat’l Bank v. Dearing*, 91 U.S. 29 (1895); *McCulloch*, 17 U.S. (4 Wheat.) 316); (2) the power to provide a national currency, *id.* at 167 (citing *The Legal Tender Cases*, 79 U.S. (12 Wall.) 457 (1870); *Veazie Bank*, 75 U.S. (8 Wall.) 533); and (3) the power to regulate and protect interstate commerce, *id.* (citing *Chi. 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. 199 (1919)).

from conflict between the two, and the eventual realization that 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 passed the Glass bill: state-centric unit banking coupled with guaranteed federal deposit insurance or federal unification.<sup>189</sup> Predictably, a great many voices supported unification. Thomas Lamont, acting head of J.P. Morgan & Co., trumpeted the “immeasurable benefits” the Federal Reserve had “brought to American industry and commerce” and condemned the fractured, competitive state of American banking.<sup>190</sup> 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” to “mobilize all of our banking reserves into one central system, which is as it should be.”<sup>191</sup> Former congressman from New York and Federal Reserve Vice Chairman Edmund Platt echoed that sentiment, refuting the idea that branch banking was monopolistic and undemocratic, and touting the Glass bill.<sup>192</sup>

So why, with its established constitutional underpinning and the support of Roosevelt, Glass, and others, did full unification fail? The reasons, in short, were time and politics. The Great Crash and subsequent economic contraction forced Roosevelt’s hand sooner than he would have liked,<sup>193</sup> and the popular appeal of federal deposit guarantee pushed the President 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.

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<sup>189</sup> Kennedy, *supra* note 161, at 206, 218–19.

<sup>190</sup> Lamont, *supra* note 20, at 110.

<sup>191</sup> Young, *supra* note 47, at 112.

<sup>192</sup> Edmund Platt, *Should America Adopt a Unified Banking System? Pro*, 12 Cong. Dig. 112, 114 (1933).

<sup>193</sup> Notwithstanding the Emergency Banking Relief Act and proactive tone of his inaugural address, Roosevelt’s preference was actually to wait and enact banking legislation with a broader scope. Kennedy, *supra* note 161, at 220.

During the Great Crash and ensuing Great Contraction,<sup>194</sup> public confidence in the banking system had evaporated. Vice President Garner 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 without some guarantee.”<sup>195</sup> Bank deposits had been explicitly recognized as the circulating medium of the United States as early as *Veazie Bank*,<sup>196</sup> and if America’s citizens continued stuffing money under their mattresses instead of putting it in banks, the nation’s economy would remain at a standstill.

Along with lack of faith in the banking system, another source 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 Pecora Commission, an investigation into the causes of the Great Crash led by New York Assistant District Attorney Ferdinand Pecora.<sup>197</sup> The hearings aroused public indignation at the perceived predatory, speculative, and abusive practices of Wall Street.<sup>198</sup> This criticism had a strain of regional bias and distrust, as Wall Street was inextricably linked with the idea of large and centralized unified banking. The Commission’s investigation also gave greater weight to 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 10 years or less, three or four powerful banking institutions may control

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<sup>194</sup> See Friedman & Schwartz, *supra* note 23, at 299–300.

<sup>195</sup> Kennedy, *supra* note 161, at 214. In fact, a year earlier Steagall, speaking about Republican incumbent President Hoover, warned then-Speaker of the House Garner, a fellow Democrat: “You know, this fellow Hoover is going to wake up one day soon and come in here with a message recommending guarantee of bank deposits, and as sure as he does, he’ll be re-elected.” Bascom N. Timmons, *Garner of Texas: A Personal History* 179 (1948).

<sup>196</sup> *Veazie Bank*, 75 U.S. (8 Wall.) at 548–49.

<sup>197</sup> The Pecora Commission was an inquiry initiated in January 1933 by the Senate Committee on Banking and Currency to investigate the causes of the Great Crash of 1929. See generally Michael E. Parrish, *Securities Regulation and the New Deal* 1–4, 112 (1970) (discussing the centrality of financial regulation to the New Deal and the role of the “sensational” Pecora Investigation in the development of that regulation); Ferdinand Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers* 3–4 (1939); Michael Perino, *The Hellhound of Wall Street: How Ferdinand Pecora’s Investigation of the Great Crash Forever Changed American Finance* 35–36, 60–64, 119 (2010) (demonstrating the impact of the Pecora Commission on financial regulation).

<sup>198</sup> See, e.g., Perino, *supra* note 197, at 186–91, 221–22, 229.



the banking system of the country.”<sup>199</sup> Similarly, the Associated Independent Banks of America charged that the Glass bill was “based upon false reasoning” and claimed that “the American people realize that it is a wolf in sheep’s clothing.”<sup>200</sup> Though the latter contention was probably an overstatement, the fundamental point is that the Great Crash, the Pecora Commission, and the specter of deposit insurance made unification unrealistic.

The Pecora Commission investigation recalled an earlier episode. From May 1912 to February 1913, the Pujo Committee conducted a similar investigation into the practices of Wall Street.<sup>201</sup> In an ironic twist, the Pujo Committee’s findings contributed to increased federal regulation of the banking industry and the American economy, partly motivating the Sixteenth Amendment,<sup>202</sup> the Clayton Antitrust Act,<sup>203</sup> and the Federal Reserve Act. The Pecora Commission had the opposite effect. Trust in governmental powers had eroded. Still, the idea that the U.S. Treasury and Federal Reserve would become an unlimited, indiscriminating piggy bank to fund a state-centric unit banking system was considered as unrealistic as unification.

On May 10, 1933 both Glass and Steagall introduced bank reform bills. The Glass bill<sup>204</sup> 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 sought 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.<sup>205</sup> Steagall’s proposal, to the contrary, called for all banks to

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<sup>199</sup> Samuel G. Bratton, Should America Adopt a Unified Banking System? Con, 12 Cong. Dig. 107, 107 (1933).

<sup>200</sup> Associated Indep. Banks of Am., Should America Adopt a Unified Banking System? Con, 12 Cong. Dig. 113, 115 (1933).

<sup>201</sup> Arsène Pujo, H. Comm. on Banking & Currency, Concentration of Control of Money and Credit, H.R. Rep. No. 62-1593, at 13–17 (1913).

<sup>202</sup> U.S. Const. amend. XVI.

<sup>203</sup> Clayton Act, Pub. L. No. 63-323, 38 Stat. 730 (1914) (codified as amended at 15 U.S.C. §§ 12–27 (2012) and 29 U.S.C. §§ 52–53 (2006)).

<sup>204</sup> S. 1631, 73d Cong., 77 Cong. Rec. 3109 (1933).

<sup>205</sup> 77 Cong. Rec. 3729 (1933) (statement of Sen. Carter Glass) (“For 35 years in the other House, and up to this time in the Senate, I have opposed guaranteeing deposits, but this is not a Government guaranty 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 guaranty.”).

have free access to a guarantee fund fully backed by the federal government.<sup>206</sup> The familiar combatants, federal unification and state-centric unit banking, met again, and the American economy was once more caught in the crossfire.

### *C. The Vandenberg Amendment*

The destructive effects of this competition were felt acutely in Senator Arthur Vandenberg's home state of Michigan. In February of 1933, the national bank system in Michigan collapsed.<sup>207</sup> After failing to secure temporary funding to keep the banks open, on February 14, 1933, federal and state officials agreed to an eight-day bank holiday for all Michigan banks.<sup>208</sup> This episode was significant because it presaged Roosevelt's Emergency Banking Relief Act,<sup>209</sup> but it was even more important because of Vandenberg's response. In what came to be known as the Couzens Resolution,<sup>210</sup> 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."<sup>211</sup> The specifics of the plan, which ultimately failed—President Roosevelt declared the national bank holiday on March 6, 1933 before Michigan successfully reopened its 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.

This concept of limited deposit insurance, and the fact that Vandenberg was the first to propose it, is a perfect illustration of his political philosophy. As late as 1932, Vandenberg had declared himself "irrevo-

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<sup>206</sup> See Kennedy, *supra* note 161, at 218–19 (providing a summary Glass's and Steagall's banking reform proposals).

<sup>207</sup> See Tompkins, *supra* note 176, at 76–82 (describing Vandenberg's role in resolving the Michigan banking failure in early 1933).

<sup>208</sup> *Id.* at 78. In Detroit this date was thereafter sardonically referred to as "St. Ballantine's Day." President Hoover had dispatched to Detroit Arthur Ballantine, then serving as Undersecretary of the Treasury, to help Vandenberg and others secure the capital necessary to keep the banks open. *Id.* at 77–78.

<sup>209</sup> See *supra* note 181.

<sup>210</sup> S.J. Res. 256, 72d Cong., 76 Cong. Rec. 4691 (1933). The Couzens Resolution derived its name from Senator James Couzens of Michigan. See Tompkins, *supra* note 176, at 78–79.

<sup>211</sup> Tompkins, *supra* note 176, at 78.

cably opposed to a general Federal guaranty of bank deposits,<sup>212</sup> but the Michigan banking crisis had convinced him that “[w]hether we like it or not I think we have *got* to find a guarantee basis.”<sup>213</sup> Vandenberg’s position was thus practical, not ideological. His interest was in reestablishing an operable and sound banking system that would “end hoarding, release currency, relax and multiply credit, stabilize trade, facilitate new business, [and] build morale.”<sup>214</sup> It sounded a lot like Alexander Hamilton’s primary directive for creating a uniform money supply to protect and strengthen the public credit.

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 19, 1933, Vandenberg reprised his role as mediator and introduced an amendment to the pending Glass bill.<sup>215</sup> The so-called Vandenberg Amendment called for the creation of a federally funded “Temporary Bank Deposit Insurance Fund” that would immediately insure bank deposits up to \$2500.<sup>216</sup> The Vandenberg Amendment passed shortly thereafter and went to conference committee.<sup>217</sup> In the meantime, the Steagall bill overwhelmingly passed the House on May 23 and did the same in the Senate two days later.<sup>218</sup> The only remaining question was whether federal deposit insurance would be adopted.<sup>219</sup>

Unless the Vandenberg Amendment was jettisoned from the Glass bill, 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 remain necessary. Thus, deposit insurance would be both a cause and required effect of reform. This is why President Roosevelt, Senator 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 and reported that Woodin

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<sup>212</sup> Id. at 84.

<sup>213</sup> Id. (quoting Letter from Arthur Vandenberg to Roy A. Young (Feb. 25, 1933)).

<sup>214</sup> Id. at 82.

<sup>215</sup> 77 Cong. Rec. 3733, 3877–78 (1933) (statement of Sen. Arthur Vandenberg).

<sup>216</sup> 77 Cong. Rec. 3878 (1933).

<sup>217</sup> Kennedy, *supra* note 161, at 219.

<sup>218</sup> Id.

<sup>219</sup> Id.

had “opposed its enactment.”<sup>220</sup> Indeed, rumor circulated “that Roosevelt would kill the Glass bill if it contained deposit guarantee provisions.”<sup>221</sup>

That did not happen. After more than a week of conferences at the White House, Roosevelt adopted the temporary guarantee contained in the Vandenberg Amendment.<sup>222</sup> 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.”<sup>223</sup> The final form of deposit insurance adopted by the Glass-Steagall Act was neither a limited, temporary liquidating corporation nor a full federal guarantee of deposits.<sup>224</sup> Despite his reservations regarding any form of deposit guarantee, Roosevelt acquiesced for a number of reasons, including time pressure, the Pecora Commission findings, and popular support for deposit insurance.<sup>225</sup> The Vandenberg Amendment was palatable because it did not represent a total guarantee.<sup>226</sup> Perhaps more than anything, all parties recognized 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 the ideal application of American republican federalism to banking was not competition between the two, a federally unified branch banking system, or a state-centric unit banking approach. 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

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<sup>220</sup> Glass Bank Bill Passed By Senate, *N.Y. Times*, May 26, 1933, at 1.

<sup>221</sup> Kennedy, *supra* note 161, at 219; see also *Diary of J.F.T. O’Connor* (June 2, 1933) (on file with Bancroft Library, University of California, Berkeley) (relating rumors that Roosevelt was opposed to the Vandenberg Amendment because of its provision for deposit insurance). J.F.T. O’Connor served as Comptroller of the Currency from 1933 to 1938.

<sup>222</sup> Kennedy, *supra* note 161, at 219–20.

<sup>223</sup> *Id.* at 222 (quoting Roosevelt Hails Goal, *N.Y. Times*, June 17, 1933, at 1).

<sup>224</sup> Two good summaries of the important features of the legislation are provided by Friedman & Schwartz, *supra* note 23, at 434–36, 440, and Kennedy, *supra* note 161, at 220–21.

<sup>225</sup> One collection counts approximately 1500 telegrams from bankers and others throughout the United States endorsing the Glass bill. See *Telegrams: Glass Banking Bill, 1933* (on file with the Albert and Shirley Small Special Collections Library, University of Virginia).

<sup>226</sup> There was some disagreement on this point. Glass maintained that his “bill remained ninety-seven percent as it had passed the Senate.” Kennedy, *supra* note 161, at 221. Vandenberg, however, 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.” *Id.* (internal quotation marks omitted) (citing *Conferees Agree on Banking Bill*, *N.Y. Times*, June 13, 1933, at 1).

and prevent a loss of public confidence. Conversely, deposit insurance embodied the resistance to federal domination of banking and American capital established by the First Bank of the United States, *McCulloch*, *Veazie Bank*, and the Federal Reserve Act. The Vandenberg Amendment recognized the failure of competitive dual federalism banking and offered a compromise: a federally regulated asset pool in support of state banks. It was cooperative federalism, a solution Alexander Hamilton would have applauded.

#### CONCLUSION

This Note'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 Note 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 represented 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 and the reasoning of the holdings in *McCulloch* and *Veazie Bank*, through his Federal Reserve Act and Glass bill. Steagall emerged as the Populist product of the state experiments with deposit insurance from 1909 to 1923 and personified state-centric unit banking's bold, innovative challenge to federal banking preeminence. Finally, 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.

