Regulatory responses to the financial crises of the Great Depression: Britain, France and the United States

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The regulatory responses to the financial crises of the Great Depression have greatly varied between Britain, France and the United States, the world’s leading financial powers in the interwar year –from extremely severe measures in the United States to belated and somewhat milder ones in France, and no regulation at all in Britain, at any rate before the end of the Second World War. This is in sharp contrast with the measures that followed the financial debacle of 2007-2008 –without being uniform, they have nonetheless been far more homogenous. How to account for such differences, whether in rhythm, intensity, and actual policy? Everywhere, ‘lessons’ were drawn from the Great Depression, but were they the same lessons?

As can be seen in the essays presented in this volume, regulatory responses to violent crises in general, and financial crises in particular, are the result of a combination of factors –the nature and violence of the shock, its perception, the weight of public opinion, the demand for change, the role of experts, the power struggle between interest groups, the very process of regulatory change.

In the case of the Great Depression, the severity of the financial crises, which in some cases could consist in a succession of shocks of varying degrees of intensity, played of course a decisive role. Equally important was the depth and length of the downturn and, as far as perception was concerned, the connections established between financial crisis and economic crisis. Other factors were also at work: the history of financial crises and the way past crises were handled and debated; the existing regulatory framework, or its non-existence; the economic power, social status, and political influence of the financial elites, and the relative antagonism of public opinion towards big business and high finance; the frequency of financial scandals; the political context within which the financial crises occurred and the regulatory responses were framed.

This paper intends to take into account most if not all these factors in order to understand the regulatory responses to financial crises in Britain, France and the United States during the Great Depression. The paper is divided in four parts: the first considers the financial and economic crises in the three countries, the second looks at how they were perceived, the third discusses the regulatory measures that followed, and the fourth concludes. The approach is, as much as possible, comparative. The various factors accounting for regulatory responses are integrated into the text but are more specifically discussed in part three..

I

The Great Depression of the 1930s –sometimes simply referred to as 1929– remains the most serious economic crisis in modern history and the yardstick by which other downturns have been measured since then. Is it a repeat of 1929? The question has been raised time and again: in 1974, for instance, with the onset of ‘stagflation’ following the first oil shock; in 1982, when Mexico defaulted on its sovereign debt; or in 1987, when the New York Stock Exchange’s fall in one day, on 19 October (over
22 per cent), was actually higher than in October 1929. And of course, 2008 has been repeatedly compared with 1929 and the ensuing ‘Great Recession’ unanimously judged the most severe contraction to happen since then.

However, on account of its duration and its effects, the Great Depression was on a far grander scale than any other crisis. It consisted of four interrelated shockwaves: the Wall Street crash of October 1929, a series of banking crises occurring over a period of five years, the collapse of the world’s monetary order, and an economic slump of dramatic proportions. World industrial output dropped by 36 per cent between 1929 and 1932, world trade by 25 per cent in volume and 48 per cent in value, the price of manufactured goods fell by 26 per cent and that of raw materials by 56 per cent.\(^1\) Between 1930 and 1933, the average unemployment rate in manufacturing industry reached 28.4 per cent in the United States and 34.2 per cent in Germany, the two countries most affected by the depression.\(^2\)

Narrowly defined, 1929 was a stock market crash on Wall Street, not a banking crisis. The New York Stock Exchange soared after 1925, partly as a result of the euphoria of the 1920s, but largely because of the progress of the American economy and particularly the rationalisation of production and the introduction of new management methods. The top-performing shares of the period, such as RCA (Radio Corporation of America) or General Motors, reflected the companies’ profitability and growth prospects. However, a bubble was clearly forming from 1928, especially in the new technologies.\(^3\) Public confidence started to be shaken in the summer of 1929 by increasingly clear signs of an impending recession, and share prices started to fall in early October. One thing then led to another. The brokers were overwhelmed by the volume of sales, there were more frequent margin calls, and the ticker tape fell further and further behind the transactions. Without constant information on the share price levels, traders lost track of their positions and panic gripped the Stock Exchange on Thursday 24, Monday 28 and Tuesday 29 October, after the attempts by the market’s main players to stabilise share prices.\(^4\) The New York banks, supported by the Federal Reserve, increased their loans and managed to prevent a lack of liquidity and a series of bank failures. Having lost 30% since its peak in August, the New York Stock Exchange stabilised in the first few months of 1930, as did the production and employment indices.

The ‘Great Depression’ was not primarily caused by the Wall Street Crash of October 1929. Its main causes lay in the international monetary system of the time, the gold standard, which was a fixed exchange rate system, and in the monetary policies that this system generated. As Barry Eichengreen has clearly shown, the first symptoms of the crisis were seen as early as 1928, and were mainly the result of the Federal Reserve’s decision to raise interest rates from spring 1928 in order to curb the wave of speculation on the New York Stock Exchange. That decision led to the interruption of America’s capital exports and forced the central banks of countries dependent on that capital to

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adjust their balance of payments, to adopt restrictive policies to defend their currency’s parity, and become more deeply entrenched in the crisis. This was typically the case with Germany, as well as other non-European countries such as Australia and Argentina. In the United States itself, the economic downturn reflected in the fall in industrial output in August 1929 became a deep depression not because of the Wall Street Crash, though this did not help, of course, but because of the restrictive policy adopted by the Federal Reserve from 1930 and, in particular, 1931.5

The banking crises of the thirties happened once the economic crisis was well under way, between 1931 and 1934. Unlike the debacle of 2008, they were more caused by, rather than a cause of, the economic crisis, even though they helped to exacerbate the situation. Moreover, these banking crises did not break up simultaneously in all countries –despite the global nature of the Great Depression. Some, like the United Kingdom, escaped them almost completely. In others such as France, the crisis was protracted, but never very acute. Not surprisingly, the most serious banking crises occurred in the countries where the economic depression was most severe, the United States and Germany.

The first banking crisis to hit a major economy took place in the United States, in the autumn 1930: 256 banks failed in November (with $180 million deposits) and 352 in December ($352 million).6 However, it appears to have been a regional rather than a national crisis, without incidence of panic. About 40 per cent of bank failures took place in the St Louis District, mainly as a result of the collapse of one bank, Caldwell & Co., of Nashville, Tennessee, the largest investment bank in the South. In terms of deposits of failed banks, 45 per cent were in two Districts, St Louis and New York.7 The share of New York, where only six banks failed, was due to the failure of the Bank of United States, a fairly large bank, with $160 million deposits,8 which collapsed on 11 December. A poorly managed bank, as was the Caldwell bank, it had grown somewhat recklessly in the 1920s and had been insolvent for several months. A plan to rescue it through a merger with four other banks, organised by the Clearing House and the Federal Reserve of New York, came to no avail and, being insolvent, the bank was allowed to fail. Intervention by the Fed prevented panic from spreading to the New York money market and the impact of the crisis remained limited, though confidence was never fully restored.9

1931 was the year of the banking crises during the Great Depression, especially in Europe, but also in the United States10 Austria was the first casualty with the failure of the Credit-Anstalt, in Vienna, in May 1931.11 The run on Austria was followed by a run on Germany. Panic erupted on 13 July 1931 when the Darmstädter und National Bank (Danat Bank), one of Germany’s three largest banks, did not open its doors, and government intervention just managed to recover the situation.12

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8 By comparison, the deposits of National City Bank, the United States’ largest bank, reached $1500 million in 1930.
12 On the German banking crisis, see in particular, see K.E. Born, Die Deutsche Bankenkrise 1931, Munich, 1967; H. James, ‘The Causes of the German Banking Crisis of 1931’, Economic History Review, 38, 1984; T. Balderston,
From Germany, the crisis moved to Britain. But it was a very different type of financial crisis—a currency, not a banking crisis, which alleviated rather than aggravated the economic crisis. It was not the City’s big banks that were in danger. They held out well and, unlike in other countries, no major British bank had to close its doors. The merchant banks, on the other hand, were hit harder: with the contraction in international trade, the value of bills of exchange on the London discount market fell from £365 million to £134 million between 1929 and 1933. The introduction of exchange control in Germany dealt them an even more severe blow. Negotiations with the Weimar government led in September 1931 to an agreement stipulating that interest on German commercial debts would be paid in convertible currencies but the principal would be frozen. Other agreements would follow until August 1939, setting up mechanisms to reimburse a part of the acceptances in Reichsmarks; but the bills would not really be repaid before the 1950s. As in 1914, the most vulnerable banking houses were those that were the most involved in financing German trade and that found themselves with sizeable sums of unconvertible acceptances: by 1936, £9.3 million for Kleinworts—three times the firm’s capital—and £4.9 million for Schroders. While these two large houses extricated themselves by drawing on their reserves and by borrowing from the Westminster Bank, smaller ones, which had in fact never fully recovered from the effects of the First World War, like Fredk. Huth & Co. and Goschen & Cunliffe, disappeared from the scene.

But Britain’s real crisis was that of the pound sterling, undermining for good the foundations that had underpinned its dominant position for more than a century. Pressure on the pound had been almost constant since its return to the gold standard in 1925; but it intensified from 1929, owing to a loss of confidence in a British currency generally considered overvalued, with the Bank of England having to face increasingly frequent withdrawals of gold. The situation worsened during the summer of 1931 under the triple effect of the German crisis, the gap between foreign short-term claims on London and the British gold and currency reserves, and the extent of the budget deficit. The crisis took on a political dimension when the Labour government resigned on 24 August, faced with the need to reduce its budget deficit in order to be able to obtain two loans, totalling £80 million, from the United States and France. A government of national unity, still chaired by the Labour Prime Minister, Ramsay MacDonald was formed, but the announcement of a new budget on 10 September did not soothe anxieties. Withdrawals of funds continued, and on 21 September 1931 the British government suspended the pound’s gold convertibility, which henceforth floated in relation to the main currencies. It was immediately followed by twenty-five countries, mainly from the British Empire, Eastern Europe, Scandinavia, as well as key trading partners like Portugal and Argentina.

Britain’s abandonment of the gold standard marked the end of an era—the long nineteenth century world economic order centred on Britain and the pound sterling. But its effects were highly beneficial

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to the British economy, as the Bank of England, relieved from its duty to defend the pound’s parity, could embark on a policy of cheap money. Britain was the first country to emerge from the depression, unlike the countries which remained on gold.

The effects of the pound’s exit from gold were rapidly felt in the United States. A second banking crisis had already hit the country between April and August 1931, with 563 banks failures totalling $497 million deposits. However, it had remained fairly localised, with four Federal Districts accounting for about three quarters of the casualties: Chicago, in the first place (one third), as well as Minneapolis, Cleveland and Kansas City. The third crisis, in September and October, was more serious –817 banks failed, with deposits amounting to $747 million– and of a more nationwide character, despite the high share of three Districts (Chicago, Philadelphia and Cleveland) and the absence of crisis in New York. Pressure on the dollar and gold losses—more than $369 million between 21 September and 8 October—led the Federal Reserve to raise its discount rate from 1½ to 2½ per cent on that date, two and a half weeks following Britain’s departure from gold, and to 3½ per cent one week later. The suspension of the pound’s convertibility appears to have aggravated the banking crisis in the United States—the number of banks’ failures increased significantly in October—mainly because, coming on top of the Austrian and German crises, it further undermined a badly shaken confidence in the financial system. However, the situation eased up at the end the year, as confidence was this time boosted by the announcement by President Hoover, on 13 October, of the formation of the National Credit Corporation, whose objective was to rediscount banks’ liquid but frozen assets.

Banking crises in the United States did not end in 1931. The number of bank’s failures remained comparatively high in 1932, without, however, the outbreak of a major panic. The open-market policy of the Federal Reserve and the loans by the Reconstruction Finance Corporation—a government owned agency created in January 1932 to replace the National Credit Corporation, conceived as a banks’ voluntary association—eased the situation. However, this action backfired in January 1933 when a decision by Congress required the Reconstruction Finance Corporation to publish a list of all the loans it had made the previous year. Such loans were seen as a sign of weakness and lead to bank runs. The crisis was met with moratoria and bank holidays starting, on a small scale, in Nevada in November 1932, followed by Iowa and Louisiana. But it was the decision by the Governor of Michigan to declare, on 14 February 1933, a state wide bank holiday that sparked a panic which, in less than three weeks, was to completely paralyse the America banking system. Moratoria and bank holidays accentuated the drain on banks in other states, not least in New York, where leading banks were dangerously dragged into the crisis. National City Bank lost 33 per cent of its correspondents’ deposits and 12.5 per cent of its domestic deposits in February 1933. Roosevelt’s uncertainty about a possible devaluation of the dollar during his long interregnum—he was elected on 8 November 1932—exacerbated the situation. By the time of his inauguration on 4 March 1933, forty-eight states had imposed banking restrictions, with banks being closed in thirty-three of them. On 6 March, Roosevelt declared a national bank holiday, at his first press conference on the 8th he stated clearly that the dollar would remain on the gold standard—it was eventually

16 Wicker, Banking Panics of the Great Depression, pp. 66-68. The crisis in Chicago was mainly a sequel of a sequel of a property boom.
17 Wicker, Banking Panics of the Great Depression, pp. 67, 86-97.
devalued on 19 April—and on the 9th Congress passed the Emergency Banking Act, which provided the legal basis for reopening the banks—a series of measures which restored confidence. One half of the country’s banks, with 90 per cent of total banking resources, were judged capable of reopening for business on 15 March 1933, and their soundness guaranteed by the government; another 45 per cent were to be reorganised before being licensed; and the remaining 5 per cent (about 1,000 banks) would have to close permanently.20 In total, more than 10,000 banks, out of nearly 25,000 in existence in 1929, closed their doors up until 1933.

The banking crisis was protracted but less acute in France, the other financial power of the day. There was no real panic, despite the collapse of two big banks and a score of small regional and local banks. Altogether 670 banks failed between October 1929 and September 1937.21 Most of them were small, often family-owned local and regional banks. They played a dynamic role in the French economy during the 1920s, especially through their support of local industry. However, unlike the big deposit banks, which remained highly liquid throughout the period, they overcommitted themselves during the years of prosperity, becoming extremely vulnerable in times of crisis. Their difficulties could be aggravated by the attitude of the local branches of the Banque de France, as some of them dramatically tightened the conditions at which they were prepared to rediscount bills. Amongst the big banks, the Banque Nationale de Crédit (BNC), the country’s fourth largest bank, suspended payments in 1931: it had lost about 20 per cent of its deposits between January and August when a run, starting in October, brought the loss to three quarters by the end of the year.22 In order to prevent a panic, depositors benefited from a state guarantee. The bank was built up again the following year, with help from the State, under the name of Banque Nationale pour le Commerce et l’Industrie (BNCI). The Banque de l’Union Parisienne, the second largest investment bank, shaken by the crises in Germany and central Europe, experienced serious difficulties that brought it to the brink of bankruptcy in 1932; but it was saved by the joint intervention of the Banque de France and the main Parisian banks.23

Despite their global character, with contagious effects spreading across the globe, the financial crises of the Great Depression retained clear national characteristics, determined as much by domestic as by international conditions.

II

The ‘never again’ feeling is a good indicator of the perception of a financial crisis—of its severity, the risks of relapse and how to prevent it. Perhaps surprisingly, this ‘never again’ feeling has rarely been present in financial crises in advanced economies since the late nineteenth century, probably because very few of them had really devastating effects—whether in economic, political, or human

22 H. Bonin, La Banque nationale de crédit. Histoire de la quatrième banque de dépôts française en 1913–1932, Paris, 2002, pp. 165-77. From about 3700 millions francs in August 1931, its deposits had fallen to under 1,000 million by the end of the year.
terms. The exception is of course the Great Depression, on account of both the strength of the feeling and its durability.

The Great Depression has been analysed time and again by economists and historians. As Ben Bernanke put it: ‘To understand the Great Depression is the Holy Grail of macroeconomics’. This status of the Great Depression as a one of the defining moments in the world’s history somewhat blurs the distinction between the perception of contemporaries and that of ensuing generations. The financial regulations inherited from the Great Depression go beyond the immediate measures taken as a response to the banking crises, whatever their significance, and include the war and even the postwar years. The same goes with the analyses and interpretations of the crisis. Not only has the Great Depression become the reference against which subsequent crises have been judged, it has also altered the way subsequent crises have been dealt with—not least thanks to a far better understanding of economic and financial crises, from Keynes onwards.

When considering how the financial crises of the Great Depression were perceived by contemporaries, two points should be borne in mind. First, these crises were only part of a much broader phenomenon, however intricate their links with the dire state of the economy. A first, general reaction was the sense of the sheer enormity of the depression – the worldwide dimension of the crisis, the human misery of mass unemployment, the apparent collapse of capitalism, and also the rise of political extremism and growing international instability. The second is that, whatever the global character of the slump, it was felt very unevenly across countries, and analyses greatly differed as to the causes, nature and impact of the financial crises.

These differences were not only due to the severity of the financial crises, already discussed above, but also to their effect on the ‘real’ economy. The United States were hardest hit, with a level of GDP in 1938 still 12 per cent lower than in 1929, whereas it had grown by 10 per cent in Britain. GDP per head fell by more than 30 per cent in the United States, between 1929 and 1933. In Britain, it had already reached its lowest point in 1931, having fallen by 6.5 per cent before the economy started to recover following the exit from the gold standard. France was in between, with GDP in 1938 still below (by 4 per cent) its 1929 level, and GDP per head falling by 16 per cent between 1929 and 1932; but unemployment remained consistently lower than in the two Anglo-Saxon powers –0.6 per cent between in 1930-33, as against 14.7 per cent in Britain and 18.2 in the United States; and 3.5 per cent in 1934-38, as against 8.7 per cent in Britain and 18.3 per cent in the United States.

The perception of the nature of the financial crises and the causes of the depression was also different. Far more emphasis was put on the stock market crisis in the United States than in either Britain or France. This is not surprising given the role played by the Wall Street crash of 1929 in the narrative of the financial crisis and the Great Depression –the excesses of the 1920s, characterized by the euphoria of growth, speculative fever, inexperience and also, at times, fraud, and the inevitable, and spectacular bubble burst. No such crash took place in either the London Stock Exchange or the

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27 See J.K. Galbraith, The Great Crash, 1929, Boston, 1954, who more than anyone else popularized this view. For Galbraith, the raging bull market from early 1928 was conditioned by a popular belief in the market’s
Paris Bourse, which were not really part of the drama. But it also true that the stock market fell much deeper in the United States: in New York, the market was down 89 per cent from its 1929 peak when it bottomed out in July 1932, while in Paris stocks had fallen by 57 per cent during the same period; they didn’t reach their lowest point before August 1936, soon after the signature of the Matignon agreements, having by then lost three quarters of their value since 1929. In Britain, shares continued to fall until June 1932, but never lost more than a third of their value. Moreover, with the democratisation of share ownership in the United States, losses were borne by a much wider investing public than in France or even Britain. There might have been as many as 15 million holders of securities in America in 1925 (the highest estimate), though no more than 600,000, or barely 4 per cent, were believed to own 75 per cent in value. Nevertheless the figure of the small investor held a central place in the collective imagination of the day, and his or her participation in subscriptions was sought after, as shown by the low value of various shares.

The financial scandals that shocked American public opinion in the 1930s and shaped its vision of the crisis tended to revolve around stock market operations and the deceit of small investors by unscrupulous bankers. This was clearly the case during the Senate investigation into banking and stock exchange practices, which greatly contributed to the pillorying of Wall Street’s leading bankers and financiers, with its findings echoed in the popular press and resonating with the public. The hearings went on for two years, from April 1932 to May 1934, and took a particularly energetic turn with the appointment, in January 1933, of Ferdinand Pecora as counsel of the Senate Committee on Banking and Currency. Witnesses included Charles Mitchell, chairman and former president of National City Bank and its investment bank affiliate, National City Company; Albert Wiggin, his counterpart at Chase National Bank and Chase Securities Corporation; Jack Morgan, senior partner of J.P. Morgan & Co., and Thomas Lamont, the firm’s foremost partner; Albert Kahn, a senior partner in Kuhn Loeb & Co., Wall Street’s second largest investment bank; Clarence Dillon, senior partner of Dillon Read & Co., another top investment bank, which rose to prominence in the twenties; Richard Whitney, chairman of the New York Stock Exchange; and others.

These Wall Street grandees were not held responsible for bringing their banks to the brink of collapse: the major banks had indeed survived four banking crises and, however weakened, still stood firm in the depth of the depression. They were mainly accused of malpractices judged harmful to investors and condemned by a public opinion increasingly hostile to the financial world. Abuses, breach of trust and self-enrichment, in various guises, were recorded. National City Company, for example, advised investors to buy South American stock (especially two loans for Minas Geraes, a state in the Brazilian Republic, and three Peruvian government loans) that it had issued, and knew to be low grade, with no information about risks or market conditions. Kuhn Loeb issued investors in a holding company (the Pennroad Corporation) not with actual shares but with certificates carrying no voting rights. Dillon Read structured the capital of two of its investment trusts (United States and Foreign Securities Corporation and United States and International Securities Corporation) in such a perpetual rise, by the forming of investment trusts and holding companies, and by the tremendous leverage caused by the increasingly widespread practice of margin buying.

way as to exert complete control with less than 10 per cent of their capital. J.P. Morgan allocated the stock of one of its holding companies (the Alleghany Corporation) to a ‘preferred list’ of influential friends. National City Bank, through its affiliates, took part in stock pools, especially in copper; and National City Company was used to trade in the stock of its parent company in order to prop it up. Albert Wiggins sold short the shares of his own bank, Chase National, in the midst of the stock market crash, netting $4 million. Charles Mitchell, whose earnings exceeded one million dollars in 1929 (his basic salary was $25,000) did not pay any income tax in that year, nor did Jack Morgan and his partners in 1931 and 1932.30

Financial scandals took a more political turn in France. One of the most resounding was the failure of the Banque Oustric in November 1930 and the revelations of corruption of several politicians. First in line was Raoul Péret. As Finance minister in 1926, he authorised the listing on the Paris Bourse of Snia Viscosa, an Italian synthetic fibres company, days before leaving his post. And he became legal adviser to the Banque Oustric the following year. Obtaining such a listing was extremely difficult, due to the government’s efforts to check capital flight. Péret’s decision, taken against the recommendation of his advisers, marked the beginning of the big time for Albert Oustric, the son of a café proprietor in Carcassonne. His standing rose considerably, he gained control over a number of companies, mainly through the purchase of founders’ shares, and was admitted to the board of some of France’s leading companies, including the Automobiles Peugeot, which were to suffer heavy losses as a result of their involvement in his affairs. Oustric was becoming increasingly reckless, paying inflated prices to gain control of an ever growing number of businesses. The bubble burst with the fall of the stock market and on 7 November 1930, the Banque Oustric went into liquidation dragging other banks down with it, whose resources had been heavily drawn upon by Oustric.

The ‘Stavisky affair’ broke out a few years later, on 8 January 1934, when the body of Alexandre Stavisky, a Ukrainian born businessman with connections in political and media circles, was discovered in a chalet in Chamonix. A few days earlier, on 24 December 1933, the manager of the Crédit municipal de Bayonne, a semi-public local bank, had been arrested. He was involved with Stavisky in the issue, through his bank, of false bonds amounting to a total of 200 million francs, all with the tacit agreement of the deputy and mayor of Bayonne, Dominique-Joseph Garat; another bank linked to Stavisky, the Crédit municipal d’Orléans, had also issued 70 million francs of such bonds. Thanks to his political connections, Stavisky had been able to place these bonds, which did not enjoy any state guarantee, with insurance companies. Moreover, despite being charged for fraud and forgery, Stavisky was not being tried thanks to support in high places involving the left of centre Radical Party in power. On 6 February 1934, a demonstration against ‘the thieves’, organised by the extreme right parties, ended with sixteen deaths after the guard fired at the crowd, and led to the resignation of Edouard Daladier, the Radical Prime Minister, intensifying political tensions in France.

In Britain, the revelations of frauds and embezzlement, such as those following the collapse of the company promoter Clarence Hatry in 1929, remained primarily financial scandals, despite heavy losses suffered by shareholders.

In the end, Britain was more concerned with the fate of the pound than its fairly stable banking system. In France, politico-financial scandals tended to overshadow a lingering though never really

acute banking crisis. In the United States, the banking system remained, as in 1907, the main culprit, despite the creation, in the interval, of the Federal Reserve, which was supposed to have stabilised it. More than elsewhere, the blame was put on the speculative excesses of the 1920s and the financial crisis, and more generally the depression, linked to the Wall Street crash of October 1929.  

III

Regulatory measures were adopted in different conditions in the United States, France, and Britain. In the United States, they almost immediately followed the high point of the banking crisis in March 1933: less than four months after the bank holiday declared by Roosevelt, the Securities Act, on the capital market, and the Banking Act, on banks, had become effective. They were completed by further legislation in the following years, all in a climate of intense and widespread hostility towards Wall Street, including in the White House. In France, legislation was passed several years later, in 1941, after the country had been defeated and was occupied by Germany, transferred its capital to Vichy, and promoted a ‘national revolution’. Nevertheless, similar measures had been envisaged by the Popular Front government in 1936-38, reflecting a broad consensus towards reform. And the banking law was renewed, with minor amendments, after Liberation in 1944.

In the United States, a series of radical reforms were introduced within the framework of the New Deal. The securities Act, passed in 1933, contained various provisions aimed at improving the quality of information about the securities offered and traded on the stock exchange. The banking Act, better known under the name of its two promoters as the Glass-Steagall Act, decreed the complete separation of commercial banking activities (taking deposits and making loans) from investment banking activities (issuing, distributing and trading securities), including if these activities were shared between parent companies and subsidiaries or through either the cross-holding of shares or overlapping directorships; it also introduced Federal deposit insurance.

Other laws completed this New Deal legislation, in particular the Securities Exchange Act of 1934, which created the Securities and Exchange Commission (SEC); the Banking of 1935, which reformed the Federal Reserve System, centralising the conduct of monetary policy with the seven members of the Board of Governors in Washington; and the Investment Companies Act of 1940, which codified the rules governing investment companies.

While the Securities Act had little incidence on the activities of investment banks, the Banking Act transformed the banking profession in the United States: the commercial banks parted from their subsidiaries involved in securities transactions, whereas the vast majority of private banks opted for investment banking. The major exception was J.P. Morgan & Co, Wall Street’s most famous bank, which chose to become a commercial bank, a decision that led several partners to resign and to found an investment bank, Morgan, Stanley & Co.  Federal deposit insurance was compulsory for banks that were members of the Federal Reserve System, but optional and conditional for the others. The insured institutions paid a premium based on a percentage of their total assets, as a contribution to a guarantee fund intended to pay the depositors of a bankrupt bank. Six months after voting on the law, 14,000 banks had already decided to insure their clients, for a maximum sum of

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5,000 dollars per deposit. Another federal regulation – Regulation Q – set a maximum interest rate that the banks could pay on savings deposits.

Despite its impact on American banking, the separation between commercial and investment banking did not really address the main cause of the banking crises: most of the small banks that failed between 1930 and 1933 were only commercial banks, and they failed because of the depression, their fragility, and the failure of the Federal Reserve to come to their aid. Conversely, the large New York and major city banks, which had securities affiliates, survived the crisis. And while there might have been conflicts of interests between commercial and investment banking, there is no evidence that the banks engaged in the two activities took more risks in the sort of securities they underwrote and marketed than specialised investment banks. On the other end, the introduction of deposit insurance, in other words the government commitment to make banks safer to depositors, could justify a measure limiting risk taking, though as a federal measure, it had long met with strong opposition. How then to account for these regulatory responses? The decision was the result of a number of interrelated factors, including the understanding of the banking crises, the impact of public opinion, the political climate, and the role of key individuals.

The severity of the banking crises left most commentators, regulators and practitioners at first incredulous and then mainly helpless in the face of the disaster. Proposals for reshaping the financial system were influenced by previous experiences of banking crises and banking reform and prevailing opinions in matters of banking practices. In that respect, the orthodox view regarding a sound banking system was still very much influenced by the ‘real bills doctrine’ and based on the functioning of the English banking system, where commercial banks confined themselves to short term loans for commercial purposes and didn’t engage in any type of investment banking activities. This was, in particular, the view held by H. Parker Willis, a professor at Columbia University and one of country’s leading experts on financial matters. Pushed somewhat to background by the move of American banks towards a ‘universal’ banking model and the boom of the 1920s, the old banking orthodoxy strongly reasserted itself in the aftermath of the stock market crash of 1929, blaming speculative excesses on deviations from this line. Despite the changes that had taken place in American banking for over a quarter of a century, a new banking theory had yet to emerge. The alternative was to more tightly regulate the existing system, in particular the investment banking affiliates of the commercial banks – as advocated by a number of banks’ representatives. It didn’t prevail in large part because of the severity of the crisis, which strongly fuelled anti-bankers feelings and called for more radical solutions.

The sequels to the previous financial crisis, the panic of 1907, also played a role in the framing of the new regulations. In 1912, the Pujo Committee – named after its chairman Arsène Pujo – was appointed to investigate the heavy involvement of bankers on the boards of manufacturing companies and the concentration of issues in the hands of a few investment banks. The inquiry

35 This was for example the position of L.E. Wakefield, the chief executive of the First Bank of Minneapolis, a strong advocate of government regulation in the investment banking field; Perkins, ‘Divorce’, p. 514.
findings might have been inconclusive, yet by then a sizeable part of the population appeared to believe in the existence of a ‘money trust’ controlling the country’s business. The conviction that financial power was excessively concentrated was reinforced by the Wall Street crash, the banking crises and the depression, providing further arguments in favour of splitting banking activities.

The press amplified these analyses, though only to a certain extent. Of the ‘Big Five’ newspapers (Chicago Tribune, Los Angeles Times, New York Times, Wall Street Journal, and Washington Post), only the New York Times tended to publish articles on proposed legislation painting government actors in positive light and hardly delving into Wall Street’s side of the story. Conversely, the Wall Street Journal published more articles favouring the status quo and denying the need for regulation from Washington. These were, not surprisingly, the two newspapers most interested in covering financial matters, especially the regulation debate. The Chicago Tribune, Los Angeles Times and Washington Post, were more centrist, publishing articles focusing primarily on facts rather than policy; and when policy issues were discussed, articles tended to cover both sides of the story roughly equally. On the other hand, the press coverage of the Pecora inquiry undoubtedly had a strong impact on the outcome of the banking legislation, exacerbating anti-bankers sentiments and forcing politicians to take greater account of public opinion.

Interest groups were thus overshadowed by public opinion and in any case, many commercial and investment bankers were increasingly favourable to the new legislation. The former, with little in the way of business in investment banking, saw an opportunity to reduce their costs and offload their investment banking activities; while the latter were increasingly fearful of the competition from commercial banks’ affiliates. Even the leaders of the large integrated banks, not least National Citibank and Chase National Bank, anticipated the trend and announced the demerger of their security affiliates before the passing of the Act.

On the political stage, the narrative of the crisis emphasizing bankers’ speculative excesses was strongly supported by the Democratic Senator Carter Glass—the main architect of the Federal Reserve in 1913, a former secretary of the Treasury, and widely seen as the preeminent expert on banking and financial matters in the Senate. His long term adviser was the economist H. Parker Wills. For Carter Glass, security affiliates led to unsound practices on the part of commercial banks and should be separated from them. His proposal was part of the Democratic campaign in 1932 and was

37 I am grateful to Joe Oehmke, of Duke University, for conducting the research in Historical Newspaper Archives.
38 See, e.g., any of the articles about Fletcher; “Norbeck Blames the Stock Market,” http://search.proquest.com/docview/99710822/13EBF97AFBA5FF3573A/27?accountid=10598; “Urges Real Value of Stock Be Listed,” supra; and similar.
personally endorsed by Roosevelt. The November election thus marked a decisive shift in favour of the new regulation.42

The other narrative of the crisis related to the losses suffered by depositors, which mounted to unprecedented levels between 1929 and 1933 and spread across the entire country.43 This considerably strengthened the position of the supporters of deposit insurance, for whom it appeared profoundly unjust that depositors should bear the losses caused by bankers’ malpractices. Such feelings reached their paroxysm in early 1933, with the deepening of the banking crisis and the hearings of the Pecora inquiry. Yet there were still fierce opponents to deposit insurance, including President Roosevelt, his Secretary of the Treasury William Woodin, Senator Carter Glass, and the American Bankers’ Association, mainly on the ground that it would encourage moral hazard.44 The main advocate of deposit insurance was the Democrat Representative Henry Steagall, chairman of the Committee on Banking and Currency, and a staunch supporter of small single unit banks, seen as the prime beneficiaries of deposit insurance.

The Glass-Steagall Act was the result of a political compromise, as the separation between commercial and investment banking would only be voted in the House of Representatives if the bill included deposit insurance, and vice versa. Both measures had been contemplated for a long time. Both measures, especially deposit insurance, appeared as a solution to prevent the recurrence of banking crises. Yet only exceptional circumstances could lead to their adoption.

Financial regulation did not go so far in the major European economies, including Germany, where universal banking managed to survive. In France, the law introduced by the Vichy government, upheld and completed in 1944, controlled and regulated banking activities that until then had been open to any newcomers. Henceforth, banks had to be registered according to their type of activity. The law made a clear distinction between an investment bank and a deposit bank. However, this distinction had a long tradition in France and was often referred to as the ‘doctrine Henri Germain’, from the name of the founder and chairman of the Crédit Lyonnais, who shaped it in the wake of the financial crisis of 1882. The new law also defined a number of specialised institutions, according to their operations or clientele, including finance companies and discount houses. One of the consequences of the new banking law, and of the anti-Semitism of the regime, was the disappearance of specialised private banks, mostly Jewish. Henri Ardant, the leading banker under Vichy and guiding spirit behind the reform, attempted to rationalize the banking system by getting rid of what he called its ‘most sordid’ elements – no less than 63 percent of French banks. However, small banks still enjoyed protection in Vichy France and the number of local banks only fell by 22 percent (from 262 to 205) between 1940 and 1944.45

In France, the regulatory response was thus not a response to the banking a crisis. It was a belated acceptance of the need to regulate the banking industry after some seventy years of inconclusive and highly politicised debates—since the beginning of the Third Republic in 1870.46 Until the 1941 legislation, banking remained totally unregulated in France. Even the accession to power of the

42 Perkins, ‘The divorce of commercial and investment banking’.
44 Bankers also considered that deposit insurance meant that well managed banks would subsidise poorly run ones; Calomiris and White, ‘The origins of federal deposit insurance’, p. 193.
46 See Andrieu, La banque sous l’occupation.
Popular Front in June 1936, at the height of the depression, did not change the situation, despite the left’s declared aim of ‘controlling the economy’. The Popular Front acted decisively regarding the central bank, swiftly reforming the status of the Banque de France – though coming short of nationalising it – in order to reduce the influence of the regents, its directors who mostly belonged to the haute banque and symbolised the enduring power of the ‘200 families’. On the other hand, the Popular Front dithered about the commercial banks, which were fiercely opposed to any form of legislation. Significantly, they contended that the relatively mild character of the banking crisis in France vindicated the smooth working of the country’s banking system. A committee charged with investigating the ‘organisation of credit’ was appointed by the government and convened between November 1936 and June 1937, but saw little cooperation from the banks, was violently attacked by the rightwing press, and never published a report. When financial regulation was eventually introduced in 1941, it was as a result of the trauma of defeat and occupation rather than as a response to the financial crisis of the 1930s.

Britain, for its part, steered clear of the trend towards greater regulation of the banks, probably because there had not been any bank bankruptcies during the thirties, the financial system was more specialised than elsewhere, and the Bank of England effectively monitored it to ensure that it was working properly.

IV

With the exception of the United States, the measure of financial regulation taken in the wake of the Great Depression appear relatively mild and little intrusive. As far as European countries were concerned, state intervention in banking affairs was as much a result of the depression as a consequence of the economic and political context of the thirties and, even more, the Second World War.

Britain is a case in point. From an informal regulatory framework, mainly based on the personal persuasion of the Bank of England’s Governor, it emerged from the War with a nationalised central bank, though its governing structure at first remained virtually unchanged; and clearing banks still in the private sector but under the Treasury’s and the Bank of England’s strict control – as Keynes put it, in no need to be nationalised as in actual fact they already had been. The London Stock Exchange was not only tightly regulated by the authorities, but its dealings were regarded with suspicion – options, considered highly speculative, were only reintroduced in May 1958 after an interruption of 19 years. In effect, the London Stock Exchange set itself up as the regulator of the securities market, with all the caution and conservatism that that implies.48

In France, most of the financial sector came under state control after Liberation. The Bank of France was nationalized, together with the four big deposit banks (Crédit lyonnais, Société générale, Comptoir national d’escompte de Paris, and Banque nationale pour le commerce et l’industrie) and all major insurance companies – though the banques d’affaires, led by the Banque de Paris et des Pays-Bas, remained in private hands. The State’s grip ended up stifling the Parisian capital market, not only when it came to foreign issues, but also issues by French companies. The Paris Bourse


became pretty sluggish. Having lost two-thirds of the nominal value of its securities through nationalisations, it went through a ‘long depression’ that lasted until the 1980s.\textsuperscript{49}

The ‘lessons’ from the Great Depression must thus be put in their proper context. The regulations which characterized the third quarter of the twentieth century were the result of an exceptional historical period marked by two world wars, the redrawing of international boundaries, a devastating economic crisis, massive political upheavals and shifts in ideological outlooks—the ‘Thirty Years War’ of the twentieth century. This led to an ideological shift which, combined with a generational change, favoured state intervention and a more organised form of capitalism. Even in the United States, where the regulatory framework was essentially set up in the wake of the crisis, the Glass-Steagall Act appears to have been more ideological than pragmatic and was rooted in Americans’ instinctive distrust of financial concentration and power, already denounced by the Pujo Commission of Enquiry at the beginning of the century. Reactions to the crisis, in particular the necessity to do something, were thus motivated by a combination of economic and political considerations and, despite national differences, had their roots in a common Zeitgeist—a sense that solutions should be found in state intervention rather than market mechanisms.