PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS

The Long Road to the U.S. Banking Union: Twists, Turns, and Lessons for Europe

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Overview

I. U.S. banking union evolved over 200+ years; neither sequence, nor pace are inevitable
II. State and federal financing needs drove banking policy for 100+ years; what changed?
III. Banking union is a political project shaped by opportunistic crisis response and vulnerable to reversals

I. Long Road, No Magic Sequence

1789-1790 – Political union, partial fiscal union (Constitution, national debt)

1791-1811, 1813-1836 – Failed attempts at central bank and banking union (BUS, SBUS)

1863-1865 – Political union, partial monetary and banking union (NBA, creation of OCC)

1913 – More fiscal and monetary union (XVI Amendment, Federal Reserve)

1933-1935 – More* banking and fiscal union (federal deposit insurance, Fed LOLR reforms, federal spending)

1956 – More banking union (federal regulation of holding companies, BHCA)

1994-1999 – Banking union (end geographic and functional boundaries)

I. Features of U.S. Banking

- Dual chartering and supervision
  - Competition between states and federal government, and among states
- Late monetary union
- Geographic restrictions and fragmentation
- Regional variation (eg, branching)
- Activities and affiliation restrictions, functional fragmentation
  - Within financial industry
  - Specialized charters

II. Bank-Sovereign Links: Capture and Competition

Ownership

Taxation

Chartering conditions

(bond buying, reserves and haircuts)

Special mandates

Credit policy

Insurance

(state funds, mutual schemes, federal insurance)

Liquidity support

(state and private clearinghouses, central bank)

Supervision

II. Bank-Sovereign Links *circa* 1910: National Banks as Just Another Competitor

NATIONAL BANKING SYSTEM AND FEDERAL BOND ISSUES

By Milton E. Ailes,
Vice-President Riggs National Bank, Washington, D. C. Formerly Assistant Secretary of the Treasury.

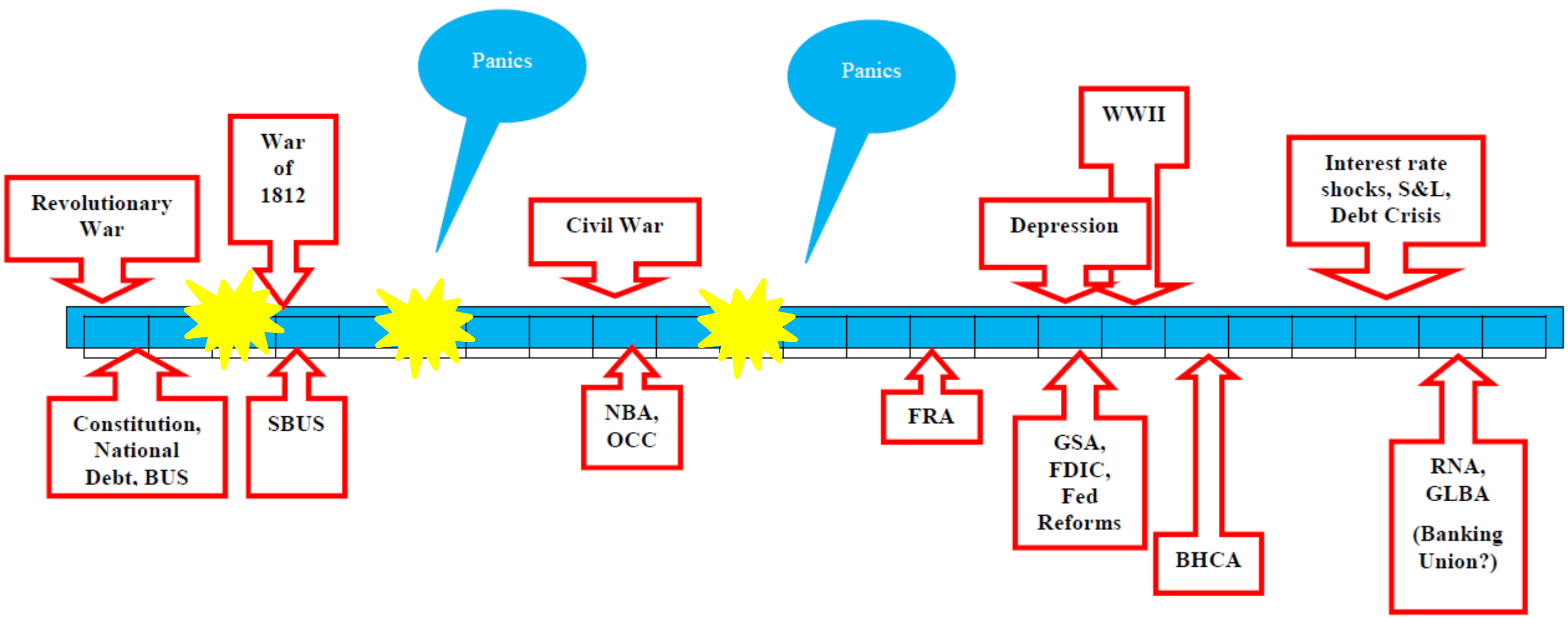
The interest bearing debt of the United States on August 15, 1910, aggregated $913,316,590, as follows: four per cent loan of 1925, $118,489,000; three per cent bonds of 1908-18, $63,945,460; two per cent consols of 1930, $646,250,150; two per cent Panama bonds of 1936 and 1938, $84,631,980. Roundly, eighty per cent of this entire debt is held by the national banks.

It will be observed that the history of national banking is closely interwoven with that of government bonds. Forty-seven years ago the system was established to help make a market for them.

II. Bank-Sovereign Links: What Changed in the 20th Century?

- Crises and contagion
- Monetary union
- Fiscal union
- Banking reforms:
  - Deposit insurance
  - Geographic diversification
  - Consolidation
  - Federal preemption

III. Political Opportunities and Reversals



III. Political Opportunities and Reversals

- Crises create openings for big reforms, but …
- Produce provisional compromise solutions, and …
- Entrench competing constituencies, which …
- Can exacerbate geographic and functional fragmentation over time

On the other hand …

- Big technocratic centralization projects (BUS, SBUS) have few/amorphous constituents and make attractive political targets

Concluding Thoughts

- U.S. banking union took a LOOONG time
- No magic sequence or pace
  - US almost mirror image of Europe
- Banks begin as captive state (federal: war) financing vehicles
  - Do monetary and fiscal union take this pressure off banks?
- Banking union is a political project with multiple constituents
  - Crises can disrupt old coalitions
  - Not a one-way march, vulnerable to reversals