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Desirable bank failures

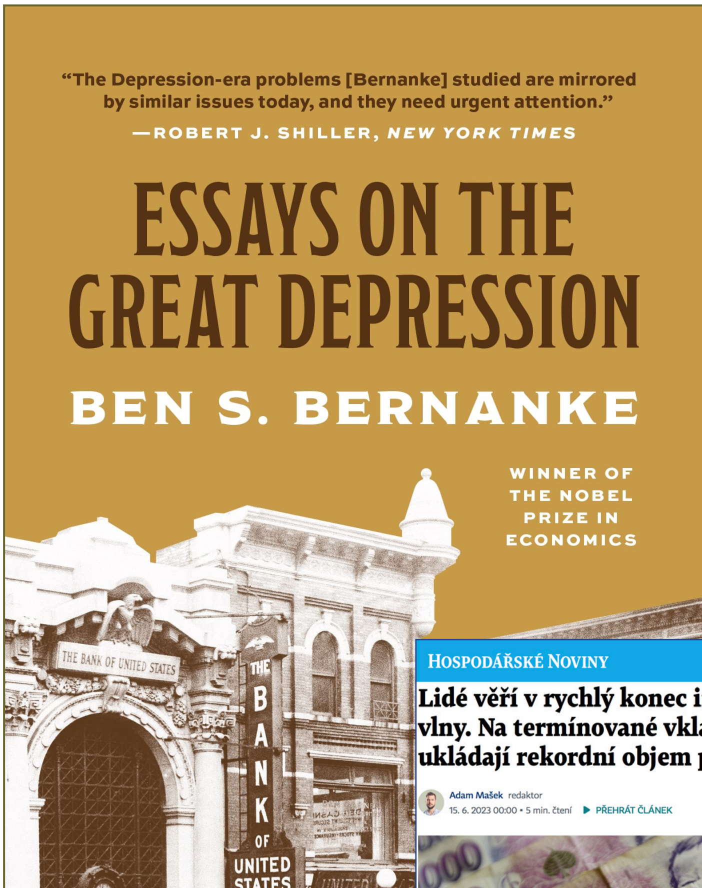
In the words of his publisher, Ben Bernanke helped as chairman of the U.S. Federal Reserve during the time of the global financial crisis of 2007-2008 to avert a greater financial disaster than the Great Depression. And he did so by drawing directly on what he had learned from years of studying the causes of the economic catastrophe of the 1930s - work for which he was later awarded the Nobel Prize in Economic Sciences.

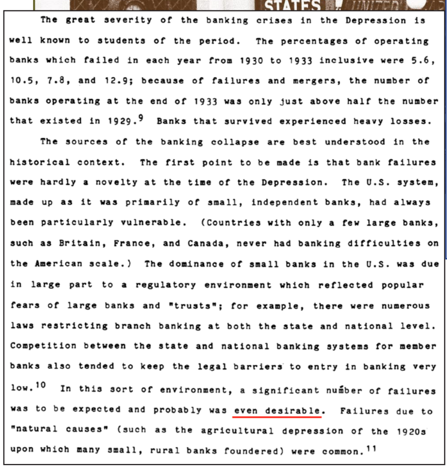
The Norwegian Nobel Committee said that the foundations of modern banking research were laid in the early 1980s by Bernanke and his fellow co-Nobelists of 2022, Douglas Diamond and Philip Dybvig. Bernanke used statistical analysis and historical source research to demonstrate how failing banks played a decisive role in the global depression of the 1930s, the Committee said. "Bernanke's research shows that bank crises can potentially have catastrophic consequences. This insight illustrates the importance of well-functioning bank regulation."

In one of his papers from the period, Non-monetary Effects of the Financial Crisis in the Propagation of the Great Depression, Bernanke notes that the number of banks in the U.S. at the end of 1933 was only just above half the number that existed in 1929, due to failures and mergers. This means that nearly half of all U.S. banks disappeared over a period of fewer than five years. There were no significant runs on banks between World War I and 1930, Bernanke says, but bad financial news from around the world in 1930-1932 was like "sparks around tinder."

"A significant number of failures was to be expected and probably was even desirable," he says, because of the nature of the environment. There was a predominance of small banks, due in large part to a regulatory environment that reflected popular fears of big banks and trusts, and there were numerous laws restricting branch banking at both the state and national level. Competition between the state and national banking systems for member banks also tended to keep the legal barriers to entry very low, he says.

Bernanke doesn't explain exactly why it was "probably even desirable" for a significant number of banks to fail, but it's apparent that he was looking at it from the systemic or policy level and not from that of those who lost their money. He presumably considers individual depositors less important than the common good.





The great severity of the banking crises in the Depression is well known to students of the period. The percentages of operating banks which failed in each year from 1930 to 1933 inclusive were 5.6, 10.5, 7.8, and 12.9; because of failures and mergers, the number of banks operating at the end of 1933 was only just above half the number that existed in 1929.[9] Banks that survived experienced heavy losses.

The sources of the banking collapse are best understood in the historical context. The first point to be made is that bank failures were hardly a novelty at the time of the Depression. The U.S. system, made up as it was primarily of small, independent banks, had always been particularly vulnerable. (Countries with only a few large banks, such as Britain, France, and Canada, never had banking difficulties on the American scale.) The dominance of small banks in the U.S. was due in large part to a regulatory environment which reflected popular fears of large banks and "trusts"; for example, there were numerous laws restricting branch banking at both the state and national level. Competition between the state and national banking systems for member banks also tended to keep the legal barriers to entry in banking very low.[10] In this sort of environment, a significant number of failures was to be expected and probably was even desirable. Failures due to "natural causes" (such as the agricultural depression of the 1920s upon which many small, rural banks foundered) were common.[11]

Bernanke said in the New York Times last week that the U.S. banking system appears to be stable at the moment but that you never know. "I've learned from painful experience that one never says never; it's always possible." He added that further bank runs could be prevented by raising the ceiling for deposit insurance.

This comment sidestepped what remains one of the biggest current issues in global finance. Fed Chair Jay Powell stated on March 22 that the Fed, working with the Treasury Dept. and the FDIC deposit-insurance agency, had taken decisive actions to protect the U.S. economy and to strengthen public confidence in the banking system after problems emerged at a number of small banks. "These actions," he said, "demonstrate that all depositors' savings and the banking system are safe." When asked a few minutes later about this, he said that the Fed stood ready to use its tools to protect depositors if there were a threat of serious harm to the economy or to the financial system. "And I think depositors should assume that their - that their deposits are safe," Powell said.

HOSPODÁŘSKÉ NOVINY

Lidé věří v rychlý konec inflační vlny. Na termínované vklady ukládají rekordní objem peněz

Adam Mašek redaktor
15. 6. 2023 00:00 • 5 min. čtení ▶ PŘEHRÁT ČLÁNEK

Termínované vklady díky zajímavým úrokovým sazbám zažívají svou renesanci. Autor • Lukáš Bíba

Banky u termínovaných vkladů nabízejí v průměru úrokovou sazbu okolo šesti procent. Nejvýhodnější jsou ty s fixací na šest měsíců. I proto je o ně nyní podle bank větší zájem než o spořicí účty.

The Fed, Treasury and FDIC are still essentially offering a blanket guarantee to all U.S. depositors, but this is of course unrealistic and can't be sustained if it is ever put to the test. Yet depositors are inherently relying on this guarantee. This applies indirectly even to those in the Czech Republic who are piling into time deposits. If the Fed suddenly dropped its guarantee and dozens of U.S. banks started to fail, the lid would also blow on the financial systems in the CR and other countries.

High inflation has led to a decrease in risk aversion, and someone is probably going to have to pay. Bank crises can potentially have catastrophic consequences, the Nobel Committee said, but it can also be "desirable" for a significant number of banks to fail, Ben Bernanke concluded.

If such a crisis arose, what might policymakers want to achieve this time? Bank bail-ins? A new gold-backed international settlement system? Or perhaps the introduction of central-bank digital currencies that carry no credit or liquidity risk?

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