Glass-Steagall Act

From Wikipedia, the free encyclopedia

The Glass-Steagall Act of 1933 established the Federal Deposit Insurance Corporation (FDIC) in the United States and included banking reforms, some of which were designed to control speculation.[1] Some provisions such as Regulation Q, which allowed the Federal Reserve to regulate interest rates in savings accounts, were repealed by the Depository Institutions Deregulation and Monetary Control Act of 1980. Provisions that prohibit a bank holding company from owning other financial companies were repealed on November 12, 1999, by the Gramm-Leach-Bliley Act.[2][3]

Glass-Steagall Act

Full title	Banking Act of 1933
Acronym / colloquial name	Glass-Steagall Act
Enacted by the	73rd United States Congress
Effective	June 16, 1934
Citations	
U.S. Statutes at Large	48 Stat. 162 (1933)
Codification	
Legislative history	

- **Introduced in the** House of Representatives **as** H.R. 5661 **by** Rep. Henry B. Steagall (D-AL) **on**
- **Signed into law by President** Franklin Delano Roosevelt **on** June 16, 1933

Major amendments

American Homeownership and Economic Opportunity Act, Gramm-Leach-Bliley Act, Depository Institutions Deregulation and Monetary Control Act

Contents

Background

Two separate United States laws are known as the Glass-Steagall Act.

Both bills were sponsored by Democratic Senator Carter Glass of Lynchburg, Virginia, a former Secretary of the Treasury, and Democratic Congressman Henry B. Steagall of Alabama, Chairman of the House Committee on Banking and Currency.

The first Glass-Steagall Act was passed in February, 1932 in an effort to stop deflation and expanded the Federal Reserve's ability to offer rediscounts on more types of assets such as government bonds as well as commercial paper.[4] The second Glass-Steagall Act was passed in 1933 in reaction to the collapse of a large portion of the American commercial banking system in early 1933.

Although Republican President Herbert Hoover had lost reelection in November 1932 to Democratic Governor Franklin D. Roosevelt of New York, the administration did not change hands until March 1933. The lame-duck Hoover Administration and the incoming Roosevelt Administration could not, or would not, coordinate actions to stop the run on banks affiliated with the Henry Ford family that began in Detroit, Michigan, in January 1933. The Federal Reserve chairman Eugene Meyer was equally ineffectual.

While many economic historians attribute the collapse to the economic problems which followed the Stock Market Crash of 1929, some economists attribute the collapse to gold-backed currency withdrawals by foreigners who had lost confidence in the dollar and by domestic depositors who feared that the United States would go off the gold standard[5], which it did when President Roosevelt signed Executive Order 6102, The Gold Confiscation Act of April 5, 1933.[6]

According to a summary by the Congressional Research Service of the Library of Congress:

> In the nineteenth and early twentieth centuries, bankers and brokers were sometimes indistinguishable. Then, in the Great Depression after 1929, Congress examined the mixing of the “commercial” and “investment” banking industries that occurred in the 1920s. Hearings revealed conflicts of interest and fraud in some banking institutions’ securities activities. A formidable barrier to the mixing of these activities was then set up by the Glass Steagall Act.[7]

First Glass-Steagall Act

The first Glass-Steagall Act was the first time that currency (non-specie, paper currency etc.) was permitted to be allocated for the Federal Reserve System.

Second Glass-Steagall Act

The second Glass-Steagall Act, passed on 16 June 1933, and officially named the **Banking Act of 1933**, introduced the separation of bank types according to their business (commercial and investment banking), and it founded the Federal Deposit Insurance Corporation for insuring bank deposits. Literature in economics usually refers to this simply as the Glass-Steagall Act, since it had a stronger impact on US banking regulation.[8]

Impact on other countries

The Glass-Steagall Act has had influence on the financial systems of other areas such as China which maintains a separation between commercial banking and the securities industries.[9][10] In the aftermath of the financial panic of 2008-9, support for maintaining China's separation of investment and commercial banking remains strong.[11]

Repeal of the Act

> *See also Depository Institutions Deregulation and Monetary Control Act of 1980, the Garn-St. Germain Depository Institutions Act of 1982, and the Gramm-Leach-Bliley Act of 1999.*

The bill that ultimately repealed the Act was introduced in the Senate by Phil Gramm (Republican of Texas) and in the House of Representatives by Jim Leach (R-Iowa) in 1999. The bills were passed by Republican majorities on party lines by a 54-44 vote in the Senate[12] and by a 343-86 vote in the House of Representatives [13]. After passing both the Senate and House the bill was moved to a conference committee to work out the differences between the Senate and House versions. The final bill resolving the differences was passed in the Senate 90-8 (1 not voting) and in the House: 362-57 (15 not voting). ' The legislation was signed into law by President Bill Clinton on November 12, 1999. [14]

The banking industry had been seeking the repeal of Glass-Steagall since at least the 1980s. In 1987 the Congressional Research Service prepared a report which explored the case for preserving Glass-Steagall and the case against preserving the act.[7]

The argument for preserving Glass-Steagall (as written in 1987):

1. Conflicts of interest characterize the granting of credit -- lending -- and the use of credit -- investing -- by the same entity, which led to abuses that originally produced the Act.

2. Depository institutions possess enormous financial power, by virtue of their control of other people’s money; its extent must be limited to ensure soundness and competition in the market for funds, whether loans or investments.

3. Securities activities can be risky, leading to enormous losses. Such losses could threaten the integrity of

deposits. In turn, the Government insures deposits and could be required to pay large sums if depository institutions were to collapse as the result of securities losses.

4. Depository institutions are supposed to be managed to limit risk. Their managers thus may not be conditioned to operate prudently in more speculative securities businesses. An example is the crash of real estate investment trusts sponsored by bank holding companies (in the 1970s and 1980s).

The argument against preserving the Act (as written in 1987):

1. Depository institutions will now operate in “deregulated” financial markets in which distinctions between loans, securities, and deposits are not well drawn. They are losing market shares to securities firms that are not so strictly regulated, and to foreign financial institutions operating without much restriction from the Act.

2. Conflicts of interest can be prevented by enforcing legislation against them, and by separating the lending and credit functions through forming distinctly separate subsidiaries of financial firms.

3. The securities activities that depository institutions are seeking are both low-risk by their very nature, and would reduce the total risk of organizations offering them -- by diversification.

4. In much of the rest of the world, depository institutions operate simultaneously and successfully in both banking and securities markets. Lessons learned from their experience can be applied to our national financial structure and regulation.[7]

Financial events following the repeal

The repeal enabled commercial lenders such as Citigroup, which was in 1999 the largest U.S. bank by assets, to underwrite and trade instruments such as mortgage-backed securities and collateralized debt obligations and establish so-called structured investment vehicles, or SIVs, that bought those securities.[15] It is believed by some including Elizabeth Warren[16], co-author of *All Your Worth: The Ultimate Lifetime Money Plan* (Free Press, 2005) (ISBN 0-7432-6987-X) and one of the five outside experts who constitute the Congressional Oversight Panel of the Troubled Asset Relief Program, that the repeal of this act contributed to the Global financial crisis of 2008–2009[17] [18], although some believe that the increased flexibility allowed by the repeal of Glass-Steagall mitigated or prevented the failure of some American banks.[19]

The year before the repeal, sub-prime loans were just 5% of all mortgage lending. By the time the credit crisis peaked in 2008, they were approaching 30%. Although, this correlation is not necessarily an indication of causation, as there are several other significant events that have impacted the sub-prime market during that time. These includes the adoption of mark-to-market accounting, implementation of the Basel Accords, the rise of adjustable rate mortgages etc. [20]

See also

- Subprime mortgage crisis
- Global financial crisis of 2008

References

1. ^ "Frontline: The Wall Street Fix: Mr. Weill Goes to Washington: The Long Demise of Glass-Steagall". *www.pbs.org*. PBS. 2003-05-08. http://www.pbs.org/wgbh/pages/frontline/shows/wallstreet/weill/demise.html. Retrieved on 2008-10-08.
2. ^ "The Repeal of Glass-Steagall and the Advent of Broad Banking" (PDF). http://www.occ.treas.gov/ftp/workpaper/wp2000-5.pdf.
3. ^ "GRAMM'S STATEMENT AT SIGNING CEREMONY FOR GRAMM-LEACH-BLILEY ACT". http://banking.senate.gov/prel99/1112gbl.htm.
4. ^ http://mises.org/rothbard/agd/chapter11.asp
5. ^ http://mises.org/rothbard/agd/chapter12.asp
6. ^ *Gold Confiscation Act*, http://www.the-privateer.com/1933-gold-confiscation.html

7. ^ ***a b c*** http://digital.library.unt.edu/govdocs/crs/permalink/meta-crs-9065:1
8. ^ "FDIC: Important Banking Legislation". http://www.fdic.gov/regulations/laws/important/index.html.
9. ^ (PDF) *Developing Institutional Investors in the People's Republic of China*, paragraph 24, http://www.worldbank.org.cn/english/content/insinvnote.pdf
10. ^ Langlois, John D. (2001), "The WTO and China's Financial System", *China Quarterly* **167**: 610–629, doi:10.1017/S0009443901000341
11. ^ "China to stick with US bonds", *The Financial Times* (paragraph 9), http://www.ft.com/cms/s/0/ba857be6-f88f-11dd-aae8-000077b07658.html, retrieved on 2009-02-11
12. ^ *On Passage of the Bill (S.900 as amended)*, http://www.senate.gov/legislative/LIS/roll_call_lists/roll_call_vote_cfm.cfm?congress=106&session=1&vote=00105, retrieved on 2008-06-19
13. ^ *On Agreeing to the Conference Report - Financial Services Modernization Act*, http://clerk.house.gov/evs/1999/roll276.xml, retrieved on 2008-06-19
14. ^ http://www.govtrack.us/congress/bill.xpd?bill=s106-900#votes
15. ^ Barth et al. (2000). "Policy Watch: The Repeal of Glass-Steagall and the Advent of Broad Banking" (PDF). *Journal of Economic Perspectives* **14** (2): 191–204. http://www.occ.treas.gov/ftp/workpaper/wp2000-5.pdf.
16. ^ http://www.thedailyshow.com/video/index.jhtml?videoId=224262&title=elizabeth-warren-pt.-2&byDate=true
17. ^ http://www.telegraph.co.uk/finance/comment/liamhalligan/4623601/Outrage-at-bonuses-wont-solve-the-mess-were-in.html
18. ^ *Who's More to Blame: Wall Street or the Repealers of the Glass-Steagall Act?*, http://www.fool.com/investing/general/2009/04/06/whos-more-to-blame-wall-street-or-the-repealers-of.aspx?source=ihpsitcl10000001, retrieved on 2009-04-07
19. ^ http://meganmcardle.theatlantic.com/archives/2008/09/hindsight_regulation.php
20. ^ The Subprime Mortgage Market Collapse:A Primer on the Causes and Possible Solutions http://www.heritage.org/research/economy/bg2127.cfm

External links

- Glass-Steagall Act - Further Readings
- On the systematic dismemberment of the Act from PBS Frontline
- Back to the Twenties Through the Looking Glass - Steagall Hour long Wizards of Money MP3 explaining the Glass-Steagall Act, background to it and impact of it.

Retrieved from "http://en.wikipedia.org/wiki/Glass-Steagall_Act"
Categories: Legal history of the United States | United States federal banking legislation | History of the United States (1918–1945) | Federal Deposit Insurance Corporation | 1933 in law
Hidden categories: Cleanup from July 2007 | All pages needing cleanup | All articles with unsourced statements | Articles with unsourced statements from March 2009