BOOK REVIEWS

U.S. Bank Deregulation in Historical Perspective
Charles W. Calomiris
New York: Cambridge University Press, 2000, 359 pp.

This is a very interesting and useful collection of previously published articles written or coauthored by one of the most productive, careful, and insightful economic historians now active. The topics he deals with in these essays include the stability of the banking system, deposit insurance, universal banking, and the competitiveness of investment banking. Because the articles appeared previously as chapters of books, they might not be readily available to interested readers, which makes this volume all the more welcome.

Calomiris provides an introductory essay that attempts to knit together the following chapters. The essay, itself, is well worth reading. However, because he did not attempt to rewrite the chapters so that they would, indeed, be integrated, the parts do not sum to a whole.

Chapter 1 is on "Regulation, Industrial Structure, and Instability in U.S. Banking: An Historical Perspective." He puts forth voluminous evidence showing that "the single most important factor in banking instability [in the United States] has been the organization of the banking industry" (p. 3), notably state-imposed and federally permitted restrictions on branching. Branching restrictions inhibit diversification, thus making banks more vulnerable to economic downturns. Reviewing a large body of evidence on banking panics in United States, Scotland, England, Canada, and Australia (all of which permitted nationwide branching), he finds that branching restrictions are responsible for the much larger number and severity of U.S. banking failures and panics. Calomiris then presents political theories and empirical evidence from the U.S. historical record to uncover why those restrictions were imposed. "The answer," he says, "lies in the institutional and historical peculiarities of the American political experience: the protection of local interests ensured by federalism, the distinctly American method for allocating power among national legislators . . . and legal precedents established by the Supreme Court, which gave states great latitude in the chartering of banks" (pp. 67–68).

Chapter 2 is on "The Origins of Banking Panics." Calomiris and his coauthor, Wharton professor Gary Gorton, review and analyze data on 13

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panics from 1814 through 1914. They say that "a banking panic occurs when debt holders at all or many banks in the banking system suddenly demand that banks convert their debt claims into cash (at par) to such an extent that the banks suspend convertibility of their debt into cash or . . . avoid suspension of convertibility by issuing clearing-house loan certificates" (p. 96). They delineate and review studies on two alternative explanations for banking panics. One is the deposit-withdrawal hypothesis, which posits that banking is inherently unstable, because depositors suddenly and randomly withdraw their funds (formalized in an often-cited 1983 article by Douglas Diamond and Philip Dyvig). In contrast, Calomiris and Gorton put forth the asymmetric information hypothesis, which emphasizes that depositors face an inherent difficulty in determing the risks banks are taking with their funds. Should economic conditions worsen, depositors have reason to fear that their bank will incur losses. As a result, depositors have reason to "panic." Calomiris and Gorton delineate differences in the implications of the alternative hypotheses, such as the sources of shocks (e.g., random or unusual deposit withdrawals vs. adverse economic news), the interactions of the shock and banks' locations or assets (e.g., banks fail where there are idiosyncratic money-demand shocks vs. when the value of their assets decline), and the conditions necessary to resolve a panic (e.g., time to convert assets into cash vs. time to evaluate the value of banks' assets). Following an extensive review of published studies and new analyses of data that speak to the hypotheses, Calomiris and Gorton conclude that the random-deposit-withdrawal hypothesis is not supported by the data, which is more consistent with the asymmetric-information hypothesis. I find their choice between the hypotheses persuasive. I wish, though, that they had devoted more than a few of the over 70 pages of this chapter into developing more than cusorily the regulatory implications of their findings, and considering alternative hypotheses of the causes for banking instability during the national banking period (such as gold outflows that caused deposit contractions).

Chapter 3, coauthored with Eugene White, is on the origins of federal deposit insurance. The authors consider and explain why this legislation was favored, unsuccessfully, by legislators from some states and then was adopted with near unanimity in 1933. They find that states that adopted unit banking tended to support deposit insurance, as these states had smaller banks and higher rates of bank failure. Credible (federal) deposit insurance allowed state legislators to continue their support for unit banking. The cataclysm of the Great Depression turned the issue into one of national interest. From their analysis of political economy, Calomiris and White conclude that the forces that lead to the passage of regulatory legislation are complex, and depend on whether an issue fulfills the private interests of those who expect to benefit from the legislation and attracts public attention and influential politicians.

Calomiris uses the last three chapters of the book to show how restrictions on branch banking have been responsible for much (perhaps most) of the inefficiencies of the U.S. banking system. In "The Costs of Rejecting Universal Banking" (chapter 4), he contrasts U.S. and German banking during 1870–1914. Universal banking, the exemplar of which is Germany, allows banks to lend on lower initial terms in expectation of a profitable long-term relationship. It also decreases the likelihood of bank failure, because it allows banks to grow larger, which results in more effective portfolio diversification. Calomiris acknowledges, but dismisses, concerns about conflicts of interest, higher financing costs from firms tied to universal banks, and promotion of inefficient cartels, because they are not supported by reasoning or evidence. From his extensive review of the historical record, he concludes that the evidence "suggests that German industrial growth was helped, and American growth was hindered, by their respective financial systems" (p. 265).

The following chapter (coauthored by Daniel Raff) reviews underwriting costs from the 1920s through the 1970s. A wealth of data are presented and analyzed. They find that spreads, which were relatively high before 1940, fell probably as a result of improvements in financial technology, which offset the costs of the United States' regulatory policies that prevented banks from following the German universal banking model.

The final short chapter examines more recent developments in the U.S. banking industry. These have brought a form of integrated, customer-relationship "universal" banking to the United States, to the benefit of consumers and the economy in general.

In short, *U.S. Bank Deregulation in Historical Perspective* is an excellent empirical compilation with great analyses of data that are relevant to many of the issues that confront us today.

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