A bit about bank failures

There seems to be a widely held assumption that the first really serious round of bank failures in the United States started with, and in fact was caused by, the stock market collapse of 1929. That is hardly the case. Consider the following: There were roughly 31,000 commercial banks in the United States in 1921. (The number had nearly tripled during the first two decades of the twentieth century.) The vast majority of these were relatively small, unit (single office) banks. Illinois alone had nearly 2000 banks, and Nebraska, with a population of some 1.3 million, had one bank for every 1000 residents. During the period 1900 – 1920, bank failures averaged about 70 per year, or one of every 300 banks. The agricultural slump of the 1920s raised the failure rate to more than 600 per year, or one in 50. Between 1921 and 1930, half of all small banks in agricultural regions failed. Without doubt, the U.S. banking system entered the Great Depression in a less than strong, robust state.

The following table reflects FDIC estimates of bank failures per year leading up to its creation (with the Glass-Steagall Act of 1933).

Year	Number (of Suspensions)	Deposits (in thousands of dollars)	Losses to Depositors (as % of deposits of suspended banks)
1921	506	172,806	34.7%
1922	366	91,182	41.9%
1923	646	149,601	41.5%
1924	775	210,150	37.8%
1925	617	166,937	36.4%

1926	975	260,153	31.9%
1927	669	199,332	30.4%
1928	498	142,386	30.8%
1929	659	230,643	33.2%
1930	1,350	837,096	28.4%
1931	2,293	1,690,232	23.1%
1932	1,453	706,187	23.8%
1933	4,000	3,596,708	15.2%

When one considers that between 1929 and 1933, some 40+% of the commercial banks in the United States failed, is it surprising that the FDIC was created in 1934? Following that—

Year	failures	Year	failures
1934	9	1938	74
1935	26	1939	60
1936	69	1940	43
1937	77	1941	15
		1942	20

After 1942 the number of bank failures did not hit double-digits again until 1975 when it hit 13. From 1960 through 1975, the average number of bank failures per year was 6. And between 1975 and 1981, it averaged 11 per year. Then look:

Year	failures	Year	failures
1982	42	1988	279
1983	48	1989	207
1984	80	1990	189
1985	120	1991	127
1986	145	1992	122
1987	203	1993	41
		1994	13

You may wish to consult the following for more details/analysis

http://www.fdic.gov/bank/historical/reshandbook/ch1intro.pdf
See especially Chart 1 – 1. Chart dramatizes the era.

http://www2.fdic.gov/hsob/HSOBSummaryRpt.asp?BegYear=1934&EndYear=2007&State=1
For the numbers

What do you suppose happened to cause the raft of bank failures that occurred during the 1980s and early 1990s? Many of the politicians of the time attributed the phenomenon to greed and incompetence on the part of bankers. Sound familiar? The implication would seem to be that bankers were competent and not greedy from 1940 through 1980. From 1995 – 2007 the number of failures averaged 4.5 per year, with no failures in 2005 and 2006. Apparently we had selfless, competent bank management during that period.

The late Harry G. Johnson, former economics professor of the University of Chicago, is often quoted—actually paraphrased—as having asserted: ‘things are the way they are for very good reasons.’ If he was right, then it would seem to follow that the creation of deposit insurance around 1934 was not a random, or randomly timed, event. It would also seem to suggest that perhaps bankers did not suddenly become greedy and incompetent in 1982. Wonder what happened!

Passing thought: have you ever heard the word *iatrogenic*?

Note: Looking at numbers of bank failures can sometimes be a bit confusing. Different sources may give quite different numbers. There are at least a couple of reasons for this. First, there were few really solid banking statistics in the early (pre-FDIC) days, so many of the numbers are estimates. Second, many of the sets of data (post-FDIC) relate only to **commercial banks** (narrowly defined) and/or to those insured by the FDIC. Prior to 1980, savings and loans were not covered by FDIC, and were not considered “banks” in most studies. The DIDMCA of 1980 started to change all that. By 1989 (as a result of FIRREA) the FSLIC (which insured savings and loans) was abolished, and the term “bank” tended to be used in a broader, more inclusive, sense. Thus the more recent statistics relative to “bank failures” are not strictly compatible with earlier definitions and numbers.