REVIEW ESSAY

Bank Failure: The Politicization of a Social Problem

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and Geoffrey P. Miller**

BANKRUPT: RESTORING THE HEALTH AND PROFITABILITY OF OUR BANKING SYSTEM. By Lowell L. Bryan. New York: Harper Collins. 1991. 315 pp. \$22.95.

THE FUTURE OF AMERICAN BANKING. By James R. Barth, R. Dan Brumbaugh, Jr. & Robert E. Litan. M.E. Sharpe, Inc. 1992 (forthcoming).

THE FUTURE OF BANKING. By James L. Pierce. New Haven: Yale University Press. 1991. 163 pp. \$25.00.

WHY BANK REGULATION FAILED: DESIGNING A BANK REGULATORY STRATEGY FOR THE 1990s. By Helen A. Garten. New York: Quorum Books. 1991. 192 pp. \$45.00.

I. INTRODUCTION

Several books have been written recently on the collapse of the banking industry in the United States. These books are enlightening to the extent they detail the economic problems facing the industry and propose constructive solutions for resolving the crisis. Unfortunately, the books fail to provide a convincing account of the *cause* of the current problems in the banking industry. Ultimately, the problems facing the American banking industry are political, not economic. Thus, solving the banking crisis will require meaningful change in the underlying political environment. While these books adequately explain how a rational regulatory system would deal with our current problems, they fail to explain why such a system does not exist.

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II. THE UNDERPINNINGS OF THE CURRENT CRISIS: POLITICAL AND ECONOMIC

Two obstacles must be overcome before meaningful reform of the banking industry can take place. First, the political impediments blocking reform efforts must be removed. Although many commentators agree that politics inhibits reform, no one has offered a satisfactory explanation of why meaningful reform has yet to occur. The political system has, over time, managed to generate substantial regulatory change in areas such as civil rights and the environment. The banking crisis is singular in its inability to spark meaningful reform.

The second obstacle to reform stems from lack of understanding about the economic underpinnings of the banking crisis. Banks fail for the same reasons other firms fail. In a competitive economy, firms fail for one of two reasons: Either they are inefficient or they are obsolete. An inefficient firm fails because it is unable to supply services or products at competitive prices. An obsolete firm fails because consumer demand is too low to generate a price that is sufficiently high to cover the firm's average cost of production. Any meaningful reform proposal must recognize and address the ineluctable fact that the latter problem, and not the former, plagues the banking industry.

Contrary to popular belief, U.S. banks are failing in record numbers not because they are run by incompetent or inefficient management, but because they offer an antiquated, obsolete package of goods and services to consumers who have an ever-increasing array of superior, low-cost substitutes from which to choose. Unfortunately, there are severe political costs to politicians and regulators who attempt to deal with the industry's obsolescence.

A. *Political Impediments to Reform*

Historically, the banking industry was a heavily regulated, highly protected cartel¹ that reflected a simple political deal: In exchange for their willingness to be used in ways convenient to politicians, banks would earn the monopoly profits enjoyed by cartels. The problem with cartels is that they generally contain the seeds of their own destruction. Their super-competitive profits attract new entrants which compete away the economic rents previously earned by members of the cartel. In banking, the entrants were financial institutions like insurance companies, investment banks, pension funds, and credit unions that legally could compete with commercial banks but did not have to comply with the costly regulations restricting banks' activities. Because banks deal in the most fungible of all commodities—money—no amount of political clout was sufficient to bar entry by these new competitors because new technology had made it increasingly easy to evade existing regulation:

Developments in computer and communications technology have reduced

1. See Bryan, p. 12.

the economic role of commercial banks These permanent and fundamental changes in the environment for conducting financial business cannot be halted by statutory prohibitions, and the longer the law refuses to recognize that fundamental and permanent changes have occurred, the less relevant it will be as a force for stability and competitive fairness in our financial markets. Attempts to hold the present structure in place will be defeated through the inevitable loopholes that innovation forced by competitive necessity will develop

The significance of these technological developments is that the key role of banks as financial intermediaries has been undermined.²

But the disappearance of the abnormal returns once earned by banks has not led to the abolition of the competitive restrictions imposed upon the banking industry for the past sixty years. The banking industry resists change—or pursues change only half-heartedly—because those segments of the banking industry that could not compete in a reformed regulatory environment continue to voice strong opposition to change.

Thus, despite the fact that the banking industry is not earning monopoly profits due to relentless expansion (both through new entry and through internal expansion),³ there is still strong internal opposition to reforming the banking industry. As a consequence, the banking industry faces the costs associated with a regulatory structure prohibiting it from engaging in many profitable ventures, without the concomitant benefits associated with membership in a properly functioning cartel.

In addition to intra-industry opposition, the behavior of politicians and the government bureaucracy that regulates banks and thrifts also has a destructive influence on banking reform. We can best illustrate this fact with three examples. The first example concerns the lack of attention given to the issue by the 1992 presidential candidates. Despite the fact that the collapse of the banking industry and the impending bankruptcy of the Federal Deposit Insurance Corporation (FDIC) are the most severe economic problems confronting the nation, both parties' candidates ignored the issue almost entirely.⁴ This is exactly what happened in 1988 when George Bush and Michael Dukakis appeared to have reached an implicit understanding to ignore the savings and loan crisis until after the election. Candidates for elected office realize that meaningful reform has political consequences, and neither party is willing to face those consequences by seriously advocating reform.

Second, every major political scandal in the United States since Watergate has had some connection to the banking industry. The list of politicians tainted by their association with the industry is not short. For example, former Representative Tony Coelho of California and former House Speaker

2. Alan Greenspan, *Statement before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate (Dec. 1, 1987)*, 74 FED. RESERVE BULL. 91, 93 (1988).

3. See Bryan, pp. 55-60 (discussing internal expansion).

4. See, e.g., Jim McTague, *Why You Won't Hear Candidates Talk of Banking*, AM. BANKER, Feb. 26, 1992, at 1.

Jim Wright of Texas were both forced out of office, in large part, because of their unethical dealings with banks.⁵ While the Senators who comprised the Keating Five survived their brush with the Senate Ethics Committee, their careers were permanently tarnished by their association with the scandal.⁶ On the Republican side, Neil Bush's problems at Silverado clearly did not help George Bush's efforts to disassociate his party from the banking mess.⁷ From a purely political standpoint, any reform oriented politician first must overcome an immediate credibility problem as a result of both parties' past involvement in highly publicized scandals.

The final, most telling, indication of the current crisis' political underpinnings is the increased politicization of the bureaucracy regulating banks and thrifts. As regulatory agencies become more responsive to popular opinion, the regulatory process becomes more guided by political expediency than by economic reality.⁸ This result can be illustrated by the actions of M. Danny Wall, who, as chairman of the Federal Home Loan Bank Board, systematically understated the magnitude of the savings and loan crisis,⁹ and by the misguided early resolution program proposed by T. Timothy Ryan, the director of the Office of Thrift Supervision (OTS), in February, 1992.¹⁰

Other political impediments to reform are a result of societal disinterest in the banking crisis. Some of this apathy is a direct result of policies and programs implemented by the government. The deposit insurance system is the primary culprit. Despite the fact that a substantial portion of most people's disposable wealth is tied up in bank demand deposits, most depositors have no incentive to galvanize into an effective political coalition to bring banks under a rational regulatory scheme. As we have pointed out in another context, prior to the implementation of deposit insurance, depositors gained protection for their investments by requiring banks to operate under a system of double liability. This system called for receivers of failed banks to determine the extent of the insolvency and then assess shareholders for an amount up to the par value of their stock.¹¹ Under the current regime, depositors and financial markets have no incentive to demand this sort of private sector protection. In other words, deposit insurance

deprives insured depositors of any incentive at all to press for constructive change in banking regulation. Banks can lobby for unsafe, anticompetitive

5. Robert Sherrill, *The Looting Decade: S & Ls, Big Banks and Other Triumphs of Capitalism*, THE NATION, Nov. 19, 1990, at 589, 602-03.

6. Jerry Roberts, *How Big Risks Lead to Scandal for Lincoln S & L*, S.F. CHRON., Dec. 19, 1989, at A1.

7. Michael Isikoff, *As Race Heats Up, So Does Scrutiny of Bush's Family; Relatives' Business Affairs Become Target*, WASH. POST, July 4, 1992, at A1.

8. See generally Mark J. Roe, *A Political Theory of American Corporate Finance*, 91 COLUM. L. REV. 10, 32-53 (1991) (citing fragmentation of the financial industry in the United States as an example of the political forces shaping the regulatory process).

9. David R. Sands, *Wall resigns as S & L Regulator, cites 'a corruption of the truth,'* WASH. TIMES, Dec. 5, 1989, at A1.

10. Rep. Gonzalez Criticizes S & L Plan, STAR TRIB., Feb. 26, 1992, at 3D.

11. See Jonathan R. Macey & Geoffrey P. Miller, *Double Liability of Bank Shareholders: History and Implications*, 27 WAKE FOREST L. REV. 31 (1992).

regulations without fear that consumer groups will challenge the regulations on the ground that they endanger the interests of depositors. The fact that depositors are insured thus deprives the regulatory process of a much needed voice, which, in the absence of such insurance, would fervently press for regulations that protected depositors' interests.¹²

Even if government-sponsored deposit insurance were removed, the banking crisis would nonetheless receive little public attention. The general public has less incentive to participate in the political process on banking issues because banking is perceived (probably correctly) as being both more complex and more boring than many other public policy issues. Therefore, unlike environmental or civil rights issues, people derive less ideological satisfaction from political participation geared towards reforming the financial services industry.¹³ As a consequence, unlike many other regulatory agencies, "banking agencies are not going to find themselves confronted with an array of consumer groups when they are called upon to make policy as it relates to bank risk."¹⁴ Since the public interest is not likely to be expressed in any coherent way, banking policy will not be particularly responsive to the public interest.

Likewise, the fact that banking is more complex than other issues of public policy (such as abortion and school prayer) makes banking regulation particularly susceptible to domination by special interest groups. The complexity of the bank regulatory structure raises the cost to the general public of becoming informed and knowledgeable about bank regulation and reform. Broadly speaking, it is irrational for members of the general public to obtain information about issues concerning bank reform due to the high costs of obtaining such information and the low probability that such information can be used to affect legislative outcomes.¹⁵ But for banks and other special interests, it is cost effective to master the complex issues of bank regulation. These groups have a direct economic stake in such issues, and, as a by-product of their ordinary business operations, bank regulation provides the information they need about regulatory initiatives.¹⁶ Moreover, even if the general public is able to galvanize into an effective political coalition for the purpose of influencing banking legislation, once such legislation is passed, special interest groups will be relentless in their efforts to influence the day-to-day implementation of regulations.¹⁷

In sum, because of the combination of multi-industry activity by powerful interest groups associated with regulation, the lack of public concern or oversight due to the complex and boring nature of banking regulation, and the protection afforded by federal deposit insurance, the usual problems as-

12. Jonathan R. Macey, *The Political Science of Regulating Bank Risk*, 49 OHIO ST. L.J. 1277, 1284 (1989).

13. *Id.* at 1287.

14. *Id.* at 1288.

15. *Id.* at 1289.

16. *Id.*

17. See Dwight R. Lee, *Politics, Ideology and the Power of Public Choice*, 74 VA. L. REV. 191, 197 (1988).

sociated with regulation (particularly those of special interest group domination of the law-making process) are magnified dramatically in the context of banking regulation. The current political process creates perverse economic incentives leading to inappropriate regulation of the banking industry. Until the political process can be brought under control, the U.S. banking industry will continue to deteriorate, and the domestic economy will continue to decline. Unfortunately, while meaningful reform of the banking industry is economically mandatory, it is politically undesirable from the perspective of any one regulator. In other words, the reform proposals that make the most economic sense are the ones most unpalatable to the special interest groups controlling the political process.

B. *The Economics*

While it is commonplace to blame problems in the banking industry on either rapid expansion within the industry,¹⁸ or regulatory capture that enabled banks to enter new lines of business,¹⁹ these answers fail to explain fully the current crisis. Rapid expansion of, and entry into, the industry can explain why profits have declined over time in the financial services industry, but they do not account for the industry's rapid rate of losing money. Economic theory predicts only that entry and expansion will compete away monopoly profits. It does not predict that firms will expand and enter a monopolized industry beyond the point at which normal market rates of return can be earned; yet this is precisely what has happened in the banking industry.

Banks are failing in record numbers because banking market forces and technological advances have rendered commercial banking largely obsolete and have enhanced the role of investment banking as the primary vehicle through which capital is allocated in the economy. These market forces and technological advances have eliminated the informational advantages once available only to commercial banks, thus increasing the competition for assets and forcing banks to take more risks in order to compete. The resulting asymmetry between banks' assets and liabilities raises serious questions about the continuing viability of traditional commercial banks as sound economic entities.

Historically, banks profited because they had distinct informational advantages that enabled them to make highly informed credit decisions. According to the "checking account hypothesis,"²⁰ because of their access to exclusive information on the finances of borrowers, banks are the best monitors of borrowers. Small and medium-sized businesses usually have

18. Bryan, pp. 67-69.

19. Garten, pp. 3-5.

20. Leonard I. Nakamura, *Commercial Bank Information: Implications for the Structure of Banking* 9 (Nov. 21-22, 1991) (paper presented at the Conference on Structural Change in Banking, New York University, School of Law and Salomon Center, Stein School of Business) (unpublished manuscript, on file with the *Stanford Law Review*).

their deposit accounts at the same banks at which they have lines of credit.²¹ By examining the checks written against a commercial customer's checking account and the deposits into the account, a bank loan officer can determine the size of the payroll, the salaries of the firm's key personnel, the amount of money paid for supplies, the identity of the firm's major customers, and the seasonal pattern of the business' receipts.²² With this information readily available, banks obtained a significant competitive advantage over other sorts of financial intermediaries.²³ As Alan Greenspan has observed:

The heart of financial intermediation is the ability to obtain and use information. The high cost of gathering and using facts in the past meant that banks and other intermediaries could profit from their cumulative store of knowledge about borrowers by making significantly more informed credit decisions than most other market participants. These other market participants were thus obliged to permit depository intermediaries to make credit decisions in financial markets and therefore allow bank credit to substitute for what would otherwise be their own direct acquisition of credit market instruments.²⁴

Unfortunately for commercial banks, the advance of computer and telecommunications technology has dramatically reduced the costs of recording, transmitting, and processing information.²⁵ These technological advances have made it possible for firms in need of capital to bypass commercial banks and go directly to the capital markets for funds. For borrowers, "[o]n-line data bases, coupled with powerful computers and wide-ranging telecommunication facilities, can now provide potential investors with virtually the same timely credit and market information that was once available only to the intermediaries."²⁶ Thus, the demand for banks' specialized skills in valuing assets has declined in the information age. Borrowers reduce costs by cutting out the middleman.

In addition to the decline in demand for banks' asset valuing skills, changing financial markets have provided alternate vehicles for raising capital and securing credit, both services once supplied primarily by bank commercial lending departments. In particular, the development of secondary and new issues markets for trading securities has made it increasingly easy for business firms to raise capital through public offerings of securities, or securitization.²⁷ Other alternative financial mechanisms for raising capital that have intruded on the services provided by banks include mortgage-backed securities,²⁸ consumer receivables financing,²⁹ consumer loan-backed

21. *Id.* at 14-22.

22. *Id.* at 14.

23. *Id.*

24. See Greenspan, *supra* note 2, at 93.

25. *Id.*

26. *Id.*

27. Jonathan R. Macey & Geoffrey P. Miller, *America's Banking System: The Origins and Future of the Current Crisis*, 69 WASH. U. L.Q. 769, 772-73 (1991).

28. Mortgage-backed securities are interests in a pool of mortgages packaged and sold by lending institutions to provide liquid funds and usually, to shift the default risk of the mortgages to the purchaser of the securities.

securities,³⁰ and the explosive growth of the commercial paper market.³¹ Furthermore, the increasing sophistication of these secondary trading markets permits investors to rely on market forces rather than the judgments and evaluative skills of commercial bankers.³² Therefore, as these financial markets have developed, both "the information, evaluation and [the] transaction services provided by commercial banks are increasingly displaced by newer and more efficient forms of financial intermediation."³³

But the steady decline in commercial banks' overall share of the financial markets has not been distributed randomly over their assets. Rather, securitization has removed the *best* assets from banks' balance sheets, resulting in an increasingly risky commercial banking industry. The distinctive characteristic of commercial banks is that they specialize in analyzing and holding in their portfolios nonstandardized, or "information-problematic," credit risks.³⁴ In general, credit risks can be viewed as lying along a continuum, with "information-problematic" borrowers at one end, and borrowers with few information problems at the other.³⁵ Typically, those borrowers with few information problems will not utilize bank borrowing, but instead will "issue traded securities (along with commercial paper and medium-term notes)."³⁶ But information-problematic borrowers either will be denied access to the capital markets by lenders who are unwilling to extend credit to borrowers about whom they have insufficient information, or else they will obtain capital from commercial banks, S & Ls, and other depository institutions that specialize in lending money to borrowers with information problems.

All else being equal, it is more expensive to obtain credit from commercial banks than capital markets. Banks, which hold loans in their portfolios, have carrying costs and monitoring costs that other financial intermediaries do not have; these other financial intermediaries keep substantial blocks of risky assets off of their balance sheets. And, as the quality of the nation's securities markets has improved, and as technological advances have driven down information costs, assets once considered information-problematic and

29. Companies package and sell interests in their short-term, consumer notes to obtain lower interest rates than those that would be available if the loans were based on the company's entire balance sheet.

30. Consumer loan-backed securities are identical in form to mortgage-backed securities. The difference is that banks pool automobile and credit card loans.

31. "Commercial paper" is the trade name for short-term (less than nine months) promissory notes that financial and industrial corporations issue to raise capital. See Jonathan R. Macey, Note, *A Conduct-Oriented Approach to the Glass-Steagall Act*, 91 YALE L.J. 102, 104 (1981).

32. Macey & Miller, *supra* note 27, at 773; see also Jonathan R. Macey & Geoffrey P. Miller, *Good Finance, Bad Economics: An Analysis of the Fraud-on-the-Market Theory*, 42 STAN. L. REV. 1059 (1990) (explaining that investors can rely on efficient securities markets to price securities).

33. Macey & Miller, *supra* note 27, at 774.

34. ROBERT E. LITAN, WHAT SHOULD BANKS DO? 14 (1987).

35. Allen N. Berger & Gregory F. Udell, The Impact of Securitization on the Bank Liquidity Problem 6 (Nov. 21-22, 1991) (paper presented at the Conference On Structural Change in Banking, New York University, School of Law and Salomon Center, Stein School of Business) (unpublished manuscript, on file with the *Stanford Law Review*).

36. *Id.*

not securitizable (like credit card receivables and home mortgages) are now being securitized and sold. Thus, banks that once had a portfolio of assets ranging from the extremely risky to the extremely safe are seeing the safer assets stripped out of their balance sheets to be traded in the securities markets. Only those assets that cannot be securitized because of information problems remain.

In sum, market developments and technological advances have left American banks with a simple choice: shrink or become riskier. As we have stated elsewhere:

As assets that are more easily susceptible to monitoring are stripped out of banks' assets and securitized, banks are faced with the following choice: they can either shrink by declining to replace securitized assets with new assets, or else they can . . . make loans to borrowers with more severe information problems than previously had been made.³⁷

Not only has the business of banking become riskier, the fundamental economic justification for banking, as traditionally conceived, has evaporated over time. According to the traditional conception of banking, combining deposit-taking with commercial lending allowed commercial bankers to obtain important information by monitoring deposit accounts and enabled them to reduce the risks associated with their lending activities. But, for several reasons, changing market forces lead us to question whether combining these two activities into a single entity is still justified. First, it is becoming more rare for borrowers, particularly large borrowers, to concentrate their deposit activities and borrowing with a single bank.³⁸ This tendency has, in turn, reduced the information advantages to banks of combining these two activities. In addition, the disadvantages of combining lending and deposit-taking have worsened due to the asymmetry between the term-structure of banks' assets and the term-structure of their liabilities. Banks' assets come in the form of long-term and highly illiquid loans, while their liabilities come in the form of short-term, highly liquid deposits. As noted above, the process of stripping away and securitizing of liquid, less problematic assets has made the asset side of banks' balance sheets increasingly illiquid.³⁹ By contrast, the emergence of deposit brokers and the development of electronic funds transfer technologies have enabled depositors to shift their deposit funds among competing banks virtually instantaneously, leaving the liquid assets on the liability side of banks' balance sheets and increasing the asymmetry.

The combination of these changes raises doubts about the continuing economic viability of commercial banks. While there will always be a need for lending and for deposit-taking, the question is: Whether it continues to

37. Jonathan R. Macey, *Securitization: Its Effect on the Future of Banking* 6 (Nov. 21-22, 1991) (paper presented at the Conference On Structural Change in Banking, New York University, School of Law and Salomon Center, Stein School of Business) (unpublished manuscript, on file with the *Stanford Law Review*).

38. Nakamura, *supra* note 20, at 3, 15.

39. See text accompanying note 37 *supra*.

make economic sense to *combine* these two functions in a single entity. In light of (1) the diminishing role played by deposit accounts as a source of information for bank loan officers; (2) the recent trends in securitization, which reduce the liquidity of banks' assets; and (3) the increased mobility of deposits, which increases the liquidity of banks' liabilities, it seems doubtful that banks can remain viable economic entities in their own right.

Instead, it appears that banks remain viable only because federally subsidized deposit insurance enables them to attract operating funds (in the form of deposits) at below-market rates. If market forces alone controlled the evolution of the financial services industry, we believe the traditional lending activities conducted by banks and funded by demand deposits would instead be conducted by equity-based nonbanking institutions. By funding personal and commercial lending with equity rather than debt in the form of insured deposits, the asymmetry between the term-structure of banks' debt and banks' equity would be eliminated. Shareholders' equity claims could be freely sold in the secondary markets, but as these claims would be nonredeemable, they would not impair banks' liquidity. Moreover, the diversification available to equity investors would enable them to cope better with the increasing riskiness associated with banks' lending activities in the current era of securitization.

Similarly, financial institutions that specialized in attracting and maintaining demand deposit accounts could design their portfolios to match their liabilities by purchasing highly liquid short-term assets. In sum, it is the artifact of deposit insurance that makes it possible for commercial banks to mismatch the maturity structure of their assets and their liabilities. Absent deposit insurance, "rational depositors would prefer to place their deposits at banks that matched the maturity structure of bank assets with those of bank liabilities."⁴⁰

III. RECOMMENDATIONS FOR REFORM

Any proposal to reform the banking industry must appreciate both the political and economic underpinnings of the current crisis. The need for reform is self-evident. But it is not enough simply to assert that regulatory reform is needed. Some recognition must be made of the fact that "[e]nlightened statesmen will not always be at the helm."⁴¹ Any reform proposal must also deal with the perverse political incentives—either by adjusting the incentives of regulators, or else by reducing the role of government regulation and increasing the role of market forces in designing solutions to the endemic problems of the banking industry. The irreversible economic forces and the increasing efficiency of the securities markets have rendered our traditional commercial banking system obsolete.

Unfortunately, the authors of the current wave of books on the banking crisis fail to understand that the traditional role of banks as financial in-

40. Macey, *supra* note 12, at 1281.

41. THE FEDERALIST NO. 10, at 19 (James Madison) (Roy P. Fairfield ed., 2d ed. 1981).

intermediaries combining commercial lending and deposit-taking is obsolete. They also fail to appreciate that accomplishing meaningful reform of the bank regulatory system will require more than reiterating the painfully obvious observation that there is something dreadfully wrong with the current system.

A. *Lowell Bryan's Common-Sense Approach*

Bankrupt: Restoring the Health and Profitability of Our Banking System is the best of the current crop of books about the banking crisis written for popular audiences. Lowell L. Bryan, a consultant with McKinsey & Company, has written highly accessible, yet sophisticated, descriptions of both the origins of the modern banking industry and of its current status as ward of the regulatory state. Unfortunately, Bryan fails to link these two sets of descriptions and does not connect fundamental market forces that have altered the business of banking with the need for reform. Moreover, the impact of Bryan's considerable knowledge about banking is diminished by his political naïveté and his poor understanding of the economics of financial markets.

To his credit, Bryan recognizes that "[o]ur current approach to regulating banks is bankrupt."⁴² He also recognizes that consolidation in the banking industry is an important part of any solution to the problems of the banking industry.⁴³ In his view, consolidation resulting in "[a] more compact industry of large, robust banks will be able to compete in the global marketplace for financial services."⁴⁴ But Bryan fails to understand that economic forces mean that banks do not need to consolidate simply to become bigger and to compete more effectively in world markets. Rather, banks *must* consolidate because there has been a decline in the economy's need for the services that banks provide. Therefore, any consolidation that takes place in the banking industry should be accompanied by *shrinkage* in the industry.⁴⁵ The operation of the economic forces described in the preceding section makes it inevitable that the banking industry will shrink.

A second weakness in Bryan's discussion is his failure to recognize the basic problem of asymmetry in the liquidity of bank assets and liabilities. Bryan embraces the idea of core banking, which he defines as banking that serves "the needs of individuals, small business borrowers, and mid-size companies."⁴⁶ Bryan's notion of core banking would permit banks to con-

42. Bryan, p. 207.

43. Bryan, pp. 198-99.

44. Bryan, p. 207.

45. Because shrinkage of the banking industry is inevitable, one relevant question is whether the shrinkage in the industry will continue to manifest itself in the form of bank failures (which harm the economy and impose enormous hardship on taxpayers), or in the form of mergers and hostile takeovers (which are low-cost substitutes for bank insolvencies). See generally Jonathan R. Macey & Geoffrey P. Miller, *Bank Failures, Risk Monitoring, and the Market for Bank Control*, 88 COLUM. L. REV. 1153 (1988) (discussing the problems arising from bank failures and suggesting that procedural reforms making acquisition of banks more feasible would serve valuable monitoring functions).

46. Bryan, p. 213.

tinue both to make illiquid commercial loans, as well as to take deposits.⁴⁷ Thus, his proposal does nothing to eliminate the basic asymmetry problem that lies at the root of the current bank failure embroglio. Indeed, Bryan recognizes that his core bank proposal would have limited effect on banks' balance sheets; in fact, over 90 percent of the current non-money center bank loans are to borrowers who would be eligible to borrow from banks under his core bank proposal.⁴⁸ A better, more useful conception of core banking would restrict banks' activities in order to reduce the asymmetry between bank assets and bank liabilities to mitigate the problems.⁴⁹

Another weakness in Bryan's presentation is his failure to understand the fact that banks compete with other financial institutions. Bryan believes that setting terms and conditions on bank lending would be a good idea. Furthermore, since all core banks would face the same restrictions, these restrictions would not place banks at a competitive disadvantage in the financial markets.⁵⁰ Unfortunately, this suggestion ignores the fact that banks compete with mortgage companies, finance companies, investment banks, manufacturers who lend money through subsidiaries, and retailers who offer credit cards. By making banks less competitive than other financial institutions, restrictions on bank lending would make banking more, rather than less, risky.

By contrast, a true narrow bank would entirely decouple lending and deposit-taking and eliminate the traditional justification for deposit insurance. Depositors' money would be backed by short-term, highly liquid money market instruments. Depositors who want absolute assurance that they will be able to recover the full value of the funds they have placed on deposit can place their funds in institutions that invest only in short-term U.S. government securities.

Bryan finished his book in February, 1991, at a time when meaningful reform seemed possible:

Fortunately, President Bush, the Treasury department, the Federal Reserve, the Federal Deposit Insurance Corporation, and many members of Congress are well aware that the problems in the banking industry need to be addressed now, and that a new answer is needed. . . .

As this book was being completed, . . . the Treasury proposed a set of structural reforms that are headed in the right direction. These proposals provide a good first step.⁵¹

Given the current political situation and inactivity in this public policy area, it is apparent that Bryan was overly optimistic.

Thus, while Bryan thoroughly understands the need for fundamental reform in the banking industry, he fails to mention that political reality is likely to make such reform impossible. For example, at one point, Bryan

47. Bryan, pp. 213-18.

48. Bryan, p. 215.

49. LITAN, *supra* note 34, at 6.

50. Bryan, p. 217.

51. Bryan, pp. 6-7.

provides a succinct account of the way bureaucrats and politicians conspired to understate the severity of the savings and loan crisis.⁵² At a time when several bank experts (including Bryan) were estimating that economic losses in the S & L industry were climbing to the \$100 billion level, a modest \$15 billion recapitalization bill for the S & L industry was derailed after massive lobbying by the U.S. Savings League, a trade association for the industry.⁵³

On the surface it is certainly paradoxical that the thrift industry trade association wanted to derail a bailout of its own industry. After all, it seems intuitive that lobbyists representing an industry on the verge of collapse would pull out all the stops to qualify for bailout status. Closer scrutiny, however, reveals that the existence of federally sponsored deposit insurance accounts for the seemingly inconsistent lobbying tactics of the thrift industry. In most industries, when a firm is tottering on the brink of insolvency, it has a difficult time attracting new credit. But in the banking industry, the suppliers of capital are depositors—who are federally-insured and thus indifferent to the financial health of the banks to which they extend credit by means of new deposits. Because deposit insurance was already in place, the savings and loan industry did not need a formal, federal bailout. From its standpoint, it had a more attractive alternative: a “homemade” bailout.

For banks, a homemade bailout is simple to do. Management of an insolvent S & L simply offers a sufficiently high rate of interest on demand deposits to attract enough new capital to keep operating. Insolvent financial intermediaries can keep doing this for a very long time. The scheme ends only when regulators finally close the bank, or there is literally not enough money in the bank's vault to pay depositors. Ultimately, the thrift industry's plan for a homemade bailout exponentially raised thrift losses caused by bank failures by artificially keeping “dead” thrifts alive too long.

Why would regulators permit the S & L industry to engage in these homemade bailouts? The answer lies in regulators' preoccupation with short-term results. From the regulators' perspective, the advantage of a homemade bailout is that it *delays* the inevitable disbursement of government funds. Bank regulators do not benefit from employing strategies that reduce the ultimate costs to taxpayers. Instead, regulators benefit by reducing the disbursements of government funds occurring while they are in office.

Congress and the public seem to gauge the severity of the banking crisis by peculiar measures. The following criteria are particularly important: (1) the dollar amount of the FDIC's disbursements each year; (2) the number of banks that have been declared insolvent each year; and (3) whether private investors who have purchased insolvent banks have succeeded in making a profit. The public appears to think that banking regulators perform better in years in which they spend less money rescuing failed banks. But this method of evaluating regulatory performance only leads to a bureaucratic strategy

52. Bryan, p. 73.

53. Bryan, p. 73.

that delays the recognition of the banking industry's losses, making the ultimate resolution of the problem far more costly.

Similarly, a regulatory agency's decision to recognize a particular bank as insolvent is highly subjective. Bank regulators have strong incentives to postpone the recognition that a financial institution is insolvent in order to create the false impression that the regulatory process is somehow improving or solving the bank failure problem. This delay has the effect of exacerbating losses over time. In addition to these perverse incentives, the high turnover among bank bureaucrats, particularly mid-level bureaucrats, heightens the short-term focus. By delaying the disbursements and closings of failed banks, these regulators can force their successors to take the blame for their recalcitrance.⁵⁴ Finally, the public, fueled by extravagant press accounts, presumes that the government somehow has been ripped off whenever private investors who invest in failed banks succeed in making a profit. This perception has been fueled by the publicity surrounding the transactions engineered by M. Danny Wall, the Director of the Office of Thrift Supervision (OTS).⁵⁵ Wall approved dozens of bailouts providing millions of dollars in tax incentives and government guarantees to private investors in the form of yield maintenance agreements and repurchase guarantees.⁵⁶

B. Barth, Brumbaugh, and Litan's Economic Approach

By far the best book on the banking crisis to date is *The Future of American Banking* by Barth, Brumbaugh, and Litan.⁵⁷ The book provides a frank and dire assessment of the economic status of the nation's banking system. The authors explain how the FDIC's accounting practices lead to wildly optimistic estimates of the financial condition of the nation's banks.⁵⁸ They also painstakingly demonstrate how the banking industry's financial condition has continued to deteriorate over time.⁵⁹

Interestingly, the authors produce data showing that the healthiest banks are the nation's smallest banks.⁶⁰ This finding supports the arguments made in this essay about the effects of securitization and the declining role of bank monitoring.⁶¹ Unlike large banks, small banks typically specialize in making small loans, which cannot easily be securitized. Thus, the balance sheets of smaller banks have not deteriorated in quality the way the balance sheets of larger banks have; the best assets of these smaller banks simply cannot be

54. See Jonathan R. Macey, *It's Time for Bush to Pay the Piper on the S & L Bailout*, L.A. TIMES, Apr. 22, 1990, at M4.

55. See, e.g., Stephen Labaton, *Favoritism Found in Savings Cases*, N.Y. TIMES, Nov. 13, 1990, at A1.

56. See Sherrill, *supra* note 5, at 610-12.

57. This book had its genesis in 1990, when its authors were commissioned by the House Subcommittee on Financial Institutions Supervision, Regulation and Insurance to analyze the current and prospective condition of the commercial and savings banks insured by the FDIC's Bank Insurance Fund (BIF).

58. Barth, Brumbaugh & Litan, p. 28.

59. Barth, Brumbaugh & Litan, p. 41.

60. Barth, Brumbaugh & Litan, p. 44.

61. See text accompanying notes 19-40 *supra*.

stripped out and securitized because of their size. In addition, the small borrowers that comprise the clienteles of these small banks are more likely to maintain checking accounts with the same institutions from which they borrow. Consequently, the traditional argument that checking accounts serve as a valuable source of information for lenders continues to apply to small banks.⁶²

Among the more eye-opening observations the authors make is that Citicorp, the nation's largest bank, probably is insolvent because its tangible capital is less than its liabilities.⁶³ Using a variety of accounting techniques and market-based measures of financial stability, the authors successfully show the "counterfeit nature of reported capital" and prove that the real condition of the nation's banks is far worse than had been thought.⁶⁴

In addition, the authors document the effects that securitization has had on the profitability of banks' traditional lending operations:

Powerful advances in computer technology significantly improved information processing and helped develop new kinds of financial assets that began to erode the role of banks in lending. Probably most important, technological advances helped launch the securitization of finance, that is, the packaging of individual loans or other assets into bundles sold in the market in various forms of securities.

....

... Simply put, securitization has been one way in which technological development has been eliminating the need, or demand, for depositories.

....

... By turning formerly illiquid depository assets into liquid securities that can be held by many firms and individuals, securitization has been undermining the traditional depository function and therefore its return on capital.⁶⁵

They also show how bank profitability is being eroded by increased competition in the various types of firms seeking consumer deposits. Money market funds, credit unions, and other forms of depository institutions all compete with banks for the right to handle (for a fee) the funds of people wanting safe, short-term receptacles for their cash.⁶⁶

Thus, while most of their observations are not new, the real contribution of the Barth *et al.* book is its demonstration that the dim condition of many of the nation's banks is even worse than is currently believed. To deal with this situation the authors propose an increase in bank capital, improvements in financial reporting, earlier regulatory intervention, private reinsurance, nationwide banking, and a lenient merger policy. Each of these suggestions is worthy of consideration. None of them are new, and none deal with the fundamental reality that, at its core, the banking problem is as much a polit-

62. See Nakamura, *supra* note 20, at 14-15.

63. Barth, Brumbaugh & Litan, pp. 74-75.

64. Barth, Brumbaugh & Litan, p. 77.

65. Barth, Brumbaugh & Litan, pp. 84-86.

66. Barth, Brumbaugh & Litan, p. 107.

ical problem as an economic problem. Despite the theoretical merit of these observations, none are likely to make a difference unless regulatory and bureaucratic incentives can be changed dramatically.

For example, the authors consider early intervention, which requires regulators to close banks whose capital-to-asset ratios decline below a certain level, to be the most important of their policy prescriptions. On its face, the merit of this suggestion is clear. If a financial institution can be closed and liquidated at the precise moment that it becomes insolvent—when its assets just equal its liabilities added to the costs of liquidation—then insolvency costs to the FDIC and the taxpayer are zero. Unfortunately, the reality of the banking business makes early closure an unreasonable regulatory option. This is because banks' assets traditionally are kept in highly illiquid assets that are, by definition, extremely difficult to value. Consequently, if regulators were to close banks when the *market value* of their assets equalled the market value of their (highly liquid) liabilities, then they would have to close virtually all of the nation's banks, since banks' assets typically have very little immediate market value.

Similarly, the authors' proposal for early intervention ignores the fact that such early intervention is unlikely to save the FDIC or taxpayers much money unless the agency changes its strategy for resolving insolvent financial institutions. Currently, regulators at both the OTS and the FDIC strongly prefer failure resolution strategies that merge insolvent financial institutions with other financial institutions to strategies that simply liquidate the unhealthy institutions.⁶⁷ Indeed, despite the statutory requirement, which stipulates that the FDIC must employ the most cost-effective resolution strategy,⁶⁸ the FDIC has shown a proclivity to bail-out insolvent banks with cash infusions rather than liquidate such banks when suitable merger partners are unavailable.⁶⁹

Unless the FDIC and the OTS somehow gain courage and liquidate more insolvent banks, the authors' early resolution strategy will achieve little in the way of savings for the FDIC. Moreover, regulators' current preference for mergers and bailouts does nothing to achieve the much needed banking consolidation discussed at length by Barth *et al.*⁷⁰

C. *Books Which Fail to Describe the Problem or Propound Useful Solutions*

Unfortunately, the books by James Pierce and Helen Garten do not meet the high standards set by Barth *et al.* and by Bryan in their comprehensive accounts of the banking problem. The solutions proposed by Pierce and

67. See Bill Atkinson, *Hearing May Mean Life or Death for Ryan's Thrift Rescue Program*, AM. BANKER, Mar. 24, 1992, at 1.

68. The Federal Deposit Insurance Corporation Act of 1991, Pub. L. No. 102-242, 105 Stat. 2236 (codified in scattered sections of 5 U.S.C., 12 U.S.C., and 15 U.S.C.).

69. See Jonathan R. Macey, *Needless Nationalization at the FDIC*, WALL ST. J., Feb. 14, 1992, at A10.

70. Barth, Brumbaugh & Litan, pp. 197-205.

Garten reflect the naïve view that more regulatory oversight is the answer to the banking industry's problems.

1. *Pierce's preliminary attempt.*

While Pierce discusses securitization, he fails to understand how finance-related innovations have diminished investor's demand for the traditional banking services.⁷¹ Yet Pierce recognizes that fundamental changes of some sort are affecting the industry.⁷² Unlike the authors of the two books already reviewed, Pierce is not particularly clear about the nature of these changes or possible regulatory responses to them. Pierce appears to advocate protecting the stability and integrity of the nation's monetary system as a top regulatory priority.⁷³ This proposal seems misguided, especially since the current check-clearing and payment mechanism is one of the few areas in banking regulation where the status quo is working well.

Despite the absence of a viable theoretical predicate for his proposal, the substance of Pierce's idea, while unoriginal, is similarly objectionable. His proposal differs hardly at all from the "narrow" bank scheme offered earlier by Robert Litan and others.⁷⁴ While Litan would limit investments by federally insured banks to short-term Treasury securities,⁷⁵ Pierce would permit such banks to invest in highly liquid, money market instruments.⁷⁶

2. *Garten's failed attempt.*

Professor Garten's book is a compilation of her previous law review articles on banking regulation. Like Pierce's analysis, Garten's writing lacks sophistication about the origins of the current banking crisis, thus depriving the book of much intellectual force by reducing it to a set of assertions about reform. Garten's ultimate conclusion is that new regulatory strategies may be insufficient to enable the industry to emerge from its current difficulties. Because Garten also makes it clear that she distrusts market forces, the reader is left with the belief that the author simply does not understand some core issues.

Professor Garten has suggested that part of the problem with reform of the banking industry may lie in regulatory capture.⁷⁷ Capture theory posits that, over time, regulatory agencies become dominated and controlled by the industries they regulate.⁷⁸ Unlike more sophisticated theories of regulation, capture theory singles out a particular interest group—like commercial

71. Pierce, pp. 83-84.

72. Pierce, pp. 127-28.

73. Pierce, p. 136.

74. Pierce, p. 138.

75. LITAN, *supra* note 34, at 165.

76. Pierce, p. 137.

77. Garten, pp. 4-8.

78. See MARVER H. BERNSTEIN, *REGULATING BUSINESS BY INDEPENDENT COMMISSION* 3-4 (1955); HARMAN ZIEGLER, *INTEREST GROUPS IN AMERICAN SOCIETY* 119-20 (1964); see also Avery Leiserson, *Interest Groups in Administration*, in *ELEMENTS OF PUBLIC ADMINISTRATION* 314, 314-16 (Fritz Morstein Marx ed., 1946).

banks—that systematically prevails in the struggle to influence the regulatory process, and “predicts a regular sequence, in which the original purposes of a regulatory program are later thwarted through the efforts of the interest group.”⁷⁹ Garten has argued that deregulation in banking can be explained by the fact that “[w]ell-organized groups (such as bankers) with a substantial stake in the outcome will determine the production of regulation.”⁸⁰

Yet Garten ultimately rejects capture theory as an explanation for the regulatory process because she does not find it useful.⁸¹ In particular, she apparently does not understand why regulatory grants of broad new powers to banks are typically accompanied by the imposition of restrictions that place banks at a disadvantage in their attempts to compete against other financial intermediaries such as insurance companies, investment banks, and brokerage firms.

Professor Garten’s analysis fails to recognize the economic theory that she is attempting to apply to the banking problem. Capture theory has not survived as a convincing theory of regulation.⁸² The theory is useless in most contexts, because it “has no predictive or explanatory power at all when a single agency regulates separate industries having conflicting interests.”⁸³ Capture theory may be a promising theory for explaining the behavior of regulatory agencies like the Comptroller of the Currency, that have regulatory responsibility over a single industry. But the theory breaks down in the context of agencies, like the Federal Reserve Board, which have regulatory responsibility over a number of different competing industries. These multi-industry agencies will respond to the political pressures exerted by their various constituencies by fashioning compromises designed to maximize the political support received by the agency from all the industries it regulates.⁸⁴

Thus, a more sophisticated “political support maximization model” would predict that single-industry regulatory agencies like the Comptroller will generally produce regulations that favor banks. But in the case of multi-industry agencies like the Federal Reserve, the theory predicts that the agency will tend to produce regulations consisting of political compromises that reflect both the relative political strength and the intensity of preferences of *all* of the competing interests it regulates.⁸⁵

This type of political compromise can be found in the Federal Reserve regulations allowing banks to compete against securities firms, but only on terms and conditions that leave them at a distinct competitive disadvantage.

79. Richard A. Posner, *Theories of Economic Regulation*, 5 BELL J. ECON. & MGMT. SCI. 335, 342 (1974).

80. Garten, pp. 4-5.

81. Garten, pp. 5-6.

82. See, e.g., Macey, *supra* note 12, at 1284; Posner, *supra* note 79, at 342.

83. Posner, *supra* note 79, at 342.

84. See generally Jonathan R. Macey, *Organizational Design and Political Control of Administrative Agencies*, 8 J.L. ECON. & ORGANIZATION 93 (1992).

85. Macey, *supra* note 12, at 1284-85.

Perhaps the most striking example of this tendency is the Fed's decision to permit bank holding company affiliates to underwrite and deal in commercial paper and other securities, but to limit their involvement in such activities to at most a 5 percent share of the total market for that activity.⁸⁶ The limitation on market share was designed to prevent banks from taking too much of the securities markets away from the investment banks and securities firms that comprise an important part of the Fed's natural constituency.⁸⁷

Thus, although Professor Garten is correct in her observation that the regulatory process produces odd results, she is absolutely wrong in her assertion that economic theories of regulation "are of limited use in explaining the curious way in which deregulation is actually occurring in banking."⁸⁸ Consistent with the political support maximization model, single-interest group regulatory agencies generate results that reflect the preferences of their lone constituencies, while multi-interest group agencies generate the sorts of compromises described above.

IV. CONCLUSION

As might be expected, there is great variety in the quality of books written about the banking crisis. The Barth *et al.* and the Bryan books are the most impressive of the lot. They understand and attempt to deal with the systemic problems facing the banking industry. Their substantive proposals for restructuring the banking industry also make sense.

86. William W. Wiles, *Orders Issued Under Section 4 of the Bank Holding Company Act*, 73 FED. RESERVE BULL. 473 (1987).

87. See *National Courier Ass'n v. Board of Governors of the Fed. Reserve Sys.*, 516 F.2d 1229 (D.C. Cir. 1975). In *National Courier*, the D.C. Circuit upheld a Federal Reserve Board determination that permitted bank holding companies and their affiliates to enter the document courier business, but limited the sorts of materials these companies could transport, putting the companies at a competitive disadvantage. *Id.* at 1240-41. The holding companies and their affiliates could transport their own internal documents, as well as commercial papers such as checks and negotiable instruments exchanged among banks and banking institutions, but were not permitted to transport documents and papers deemed not to be of a commercial nature. *Id.*

Similarly, Fed limitations regarding the data processing services bank holding companies can offer reflect a propensity on the part of the Fed to balance the demands by banks and bank holding companies that they be allowed to expand their operations into new and more profitable areas against the demands by other industries that they be protected from the competitive effects of such expansion. See *Association of Data Processing Servs. Orgs., Inc. v. Board of Governors of the Fed. Reserve Sys.*, 745 F.2d 677 (D.C. Cir. 1984).

The problem with the compromise reached by the Fed was that it ignored the significant economies of scale in many areas of the securities business, particularly in the commercial paper segment of that industry. As a consequence of these economies of scale, firms must do a substantial volume of business—and capture a substantial market share—or else they cannot earn a competitive rate of return. Thus, the Fed's market share limitation, which was intended as a simple political compromise, had the practical effect of severely reducing the ability of banking organizations to compete with securities firms in these new lines of business.

Moreover, there was no basis in law for imposing a market share limitation on the activities of banks' affiliates. Ultimately, the Fed's determination was overturned by the Second Circuit, despite the deference normally given to determinations of administrative agencies. *Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys.*, 839 F.2d 47 (2d Cir. 1988), *cert denied*, 486 U.S. 1059 (1988).

88. Garten, p. 5.

In the Pierce, Bryan, and Barth *et al.* books, the reader is left with the clear impression that the banking crisis could be solved if only regulators, Congress, and the executive branch could muster the political will to overcome the combination of bureaucratic inertia and interest-group intransigence that has blocked fundamental reform efforts to date. While the approaches of these three authors differ, *any* of the various proposals would be a marked improvement over the current system.

The authors have a diverse range of economic perspectives. For example, Brumbaugh is a Chicago-school economist, while his co-author Litan, an economist at the Brookings Institution, is closer to Lester Thurow in his intellectual orientation. Pierce and Bryan are middle-of-the-road social engineers without particularly strong ideological leanings. But these authors have achieved a remarkable degree of consensus about how the banking system ought to be reformed. Given the severity of the banking crisis and this general consensus about reform strategy among policy experts, one might think that meaningful reforms would be quickly implemented. But this has not been the case.

Since 1980, five pieces of so-called major banking legislation have been enacted.⁸⁹ Nevertheless, none of them has instituted meaningful reform. The only conclusion that one can draw from this incredible history is that the problems facing the banking industry are political, not economic. The investment banking and insurance industries do not want banks to intrude on their turf and are willing to lobby relentlessly to insure that they do not. Banking regulators realize that if the banking industry declines in importance, as it should, they will become less relevant as policymakers. Thus, the bureaucratic instincts of self-preservation cause them to align themselves with those forces opposing meaningful reform.

But, while the forces resisting change are powerful and well organized, the forces in favor of change are either politically damaged or so widely disbursed as to render them ineffective. Many commercial banks and S & Ls recognize the need for change. But, similar to the 1930s, the banking industry has been blamed for the current crisis and is politically weak. Expanded powers that would enable banks to diversify their activities beyond the traditional areas of lending and deposit-taking continue to be perceived as imposing even more risk on the deposit insurance system. While expanded powers *would* impose more risk on the deposit insurance system, such risks could be eliminated. Bank risk would fall if their insured deposit-taking activities were isolated within the confines of a narrow bank. Unfortunately, taxpay-

89. The Deposit Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 (codified in scattered sections of 12 U.S.C. and 15 U.S.C.); the Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469 (codified in scattered sections of 11 U.S.C., 12 U.S.C., 15 U.S.C., 20 U.S.C., and 42 U.S.C.); the Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, 101 Stat. 552 (codified in scattered sections of 2 U.S.C., 12 U.S.C., 15 U.S.C., and 31 U.S.C.); the Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183 (codified in scattered volumes and sections of the U.S. Code); and the Federal Deposit Insurance Corporation Improvement Act of 1991, Pub. L. No. 102-242, 105 Stat. 2236 (codified in scattered sections of 5 U.S.C., 12 U.S.C., and 15 U.S.C.).

ers generally resist calls to curtail the reach of deposit insurance, because they see such reforms as imposing significant risks without concomitant benefits. The general public also views calls for narrow banks with suspicion, since the limited earning powers of such banks would reduce investor returns in demand deposit accounts.

What should be clear from reading the books written by Barth *et al.* and Bryan is that the problems facing the banking industry are capable of satisfactory resolution. No impervious technological or structural barriers stand in the way. Rather, in our view, the implicit message in both of these books is that numerous economic solutions are available. Unfortunately, bureaucratic intransigence, congressional corruption, and executive neglect all have combined to deprive the American public of much needed banking reform.