

## Lecture 4: US Banking Evolution

### Overview

This lecture explores the **evolution of banking structures in the US** compared to Canada, focusing on how constitutional design, political interests, and economic geography shaped their drastically different financial outcomes.

- **US:** Chose **unit banking** (single-location banks), leading to chronic instability.
  - **Canada:** Chose **nationwide branching**, creating diversification, stability, and resilience.
  - Despite awareness of the structural problems, the US persisted due to entrenched **agrarian populist politics** and constitutional decentralization.
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### Canada vs. US: Parallel Pressures, Divergent Outcomes

- Both economies were **agrarian** in the 19th century.
  - Both faced **populist pushes** for unit banking, real estate subsidies, and deposit insurance.
  - **Canada rejected these proposals** at key moments (1850s, 1860s, 1911, 1923).
  - **US embraced them**, embedding fragility in the system.
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### The Role of Constitutions

#### Canada

- **Anti-revolutionary orientation:** Loyal to Britain, centralized authority.
- **Key features:**

- National government controls banking policy.
- “Anti-Tenth Amendment”: default power rests with the national gov’t.
- Senators appointed by the Crown (with property qualifications).
- Bank charters **renewed every 5 years** → discipline + adaptability.
- Exclusion of US banks preserved Canadian autonomy.

### United States

- **Revolutionary orientation:** Distrust of central authority.
  - Banking powers left to **states**, not national government.
  - Early national banks (1791, 1816) **allowed to lapse** after charters expired.
  - Result: **fragmented system** dominated by rural agrarian populists.
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## Structural Differences

- **US: Unit Banking**
    - Single-office banks, tied to local economies (e.g., corn & soybeans in Illinois).
    - Highly undiversified portfolios → vulnerable to local shocks.
    - Coordination among 20,000+ banks nearly impossible.
  - **Canada: Nationwide Branch Banking**
    - Fewer banks, each operating across provinces.
    - Diversified loan portfolios reduce systemic risk.
    - Coordination possible (e.g., Bank of Montreal leading collective rescues).
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## Political Economy of Banking

- **US Agrarian Populists (1815–1980):**
  - Favored **unit banking** for “local credit insurance.”
  - Advocated **debt moratoria** and **state-level deposit insurance** when crises hit.
  - William Jennings Bryan: key political champion of unit banking.
- **Canada:**
  - Similar rural populism existed, especially in the West.

- Constitution + Senate blocked them from altering national banking policy.
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### **Crisis Patterns (1873–1907)**

- Six major **US banking panics**: 1873, 1884, 1890, 1893, 1896, 1907.
  - **Characteristics**:
    - Always occurred at **seasonal peaks** (spring planting, fall harvest).
    - Triggered by **recessionary shocks**.
    - **Runs** driven by rational depositor risk-aversion, not just “irrational panic.”
  - **Outcomes**:
    - Generally mild compared to post-1970 crises.
    - Largest (1893) cost = 0.1% of GDP vs. median 16% of GDP in modern crises.
    - Managed via **New York Clearing House certificates** and temporary suspensions.
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### **Global Comparison (1870–1913)**

- Worldwide: **fewer, milder crises** compared to post-1970.
  - Major severe cases:
    - **Argentina (1890)**: Cedulas (mortgage-backed securities) + gov’t guarantees → twin crisis (banking + sovereign).
    - **Australia (1893)**: ~10% of GDP losses.
    - **Norway (1900)**: ~3% of GDP losses.
    - **Twin crises** (bank + currency collapse) were rare before WWI.
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## Post-Depression & Deregulation

- **Great Depression** reduced number of banks but did not abolish unit banking.
  - Unit banking persisted until the **1980s–1997** when:
  - Urbanization reduced rural populist power.
  - ATMs and shadow banking eroded unit banks' monopoly.
  - Global competitiveness required large nationwide banks.
  - Legal changes culminated in the **1994 Riegle-Neal Act**, permitting nationwide branching.
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## Key Takeaways

- **US instability** was not inevitable—it was a **political choice**.
  - **Unit banking** → undiversified risks, poor coordination, populist protectionism.
  - **Canada's centralized system** → nationwide branching, cooperative stability, stronger regulation.
  - **Lesson:** Stability is shaped less by bank mechanics (liquidity mismatch) and more by **institutional design + political bargains**.
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## Discussion Questions

1. Why did the US persist with unit banking despite knowing its instability?
2. How did geography (Atlantic access vs. Great Lakes) shape constitutional design?
3. Should depositor risk-intolerance be viewed as irrational panic or rational discipline?
4. In what ways did short-term political incentives undermine long-term financial stability?