

“Depression-Era Bank Failures: The Great Contagion or the Great Shakeout?”

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Federal Reserve Bank of Richmond *Quarterly*, Winter 2005, 39-54

Discussion Questions

1. In *A Monetary History of the United States: 1867-1960*, Milton Friedman and Anna Schwartz attribute the widespread bank failures that occurred during the Great Depression to contagion. Why, according to Walter, is the reason for the large number of bank failures do to an industry shakeout rather than contagion?
 - a. What does Walter mean by “contagion.”
 - b. What does Walter mean by a shakeout?
 - c. Why, according to Walter, was the banking industry ripe for a shakeout in the years of the Great Depression?
 - d. What evidence presented by Walter is most compelling that forces other than panic contributed to bank failures that occurred during the Depression?
 - e. Why, according to Walter, is it appropriate to compare the banking industry with others that experienced shakeouts?

2. As Figure 4 shows, bank failures dropped to near-zero with the creation of the Federal Deposit Insurance Corporation and the bank-deposit insurance in 1934. Why according to Walter does this fact by itself not rule out a banking industry shakeout as part of the explanation for the bank failures in the earlier years of the Great Depression?
 - a. Why, according to Walter, might deposit insurance end contagion?
 - b. Why, according to Walter, might failures have ended in 1934 even though other forces beside contagion were causing bank failures?

3. In recent classes, we have studied the impact of asymmetric information problems on financial firms and industries.
 - a. How are adverse selection and moral hazard relevant to the bank failures of the 1920's and 1930's?
 - b. How are adverse selection and moral hazard relevant to an analysis of the cost and benefits of bank deposit insurance?

4. What is your view?
 - a. Was creation of the FDIC necessary to halt the bank failures that occurred in the Great Depression?
 - b. Have the benefits of deposit insurance outweigh the costs?