The Repeal Of The Glass- Steagall Act And The Current Financial Crisis

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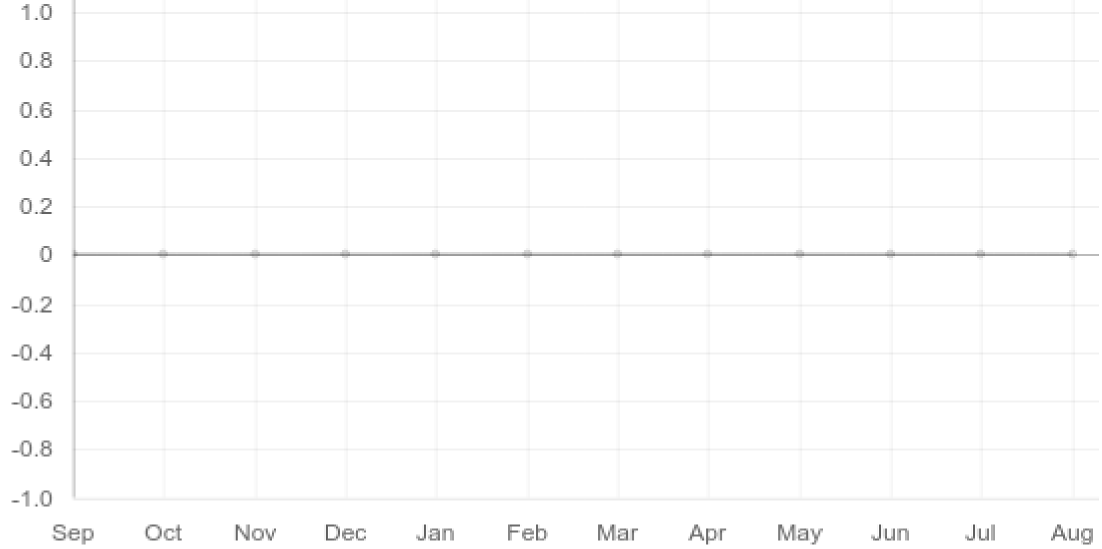
Abstract

The Glass-Steagall Act was passed in 1933 in response to the failure of the banks following the Great Depression. One out of every five banks failed in the aftermath of the stock market crash. Legislators and regulators questioned the role the underwriting of securities played in the financial collapse. Many believed these investment banking activities caused a conflict of interest in that banks often suggested that their customers purchase securities the banks had underwritten. They believed that this conflict of interest contributed significantly to the stock market crash and the bank failures. The Glass-Steagall Act forced banks to choose between being a commercial bank or an investment bank, in effect constructing a wall between commercial banking and investing banking activities. The Glass- Steagall Act was the first law signed by President Franklin D. Roosevelt upon taking the oath of office. Almost immediately upon enactment, the financial community lobbied to have the Act repealed. Over the years, this persistent lobbying led to a continual reinterpretation and liberalization of the Glass-Steagall Act, until the Act was repealed in 1999. On the dawn of repeal, the late Senator Paul Wellstone made an impassioned plea on the Senate floor. He said the repeal of Glass-Steagall would enable the creation of financial conglomerates which would be too big to fail. Furthermore, he believed that the regulatory structure would not be able to monitor the activities of these financial conglomerates and they would eventually fail due to engaging in excessively risky financial transactions. Ultimately, he said, prophetically, that the taxpayers would be forced to bail out these too-big-to-fail financial institutions. Clearly, Senator Wellstone was in the minority as the legislation repealing the Glass-Steagall Act was passed in both the House and the Senate with large majorities. President Bill Clinton signed the legislation into law in late November, 1999. It has now been over ten years since the repeal of Glass-Steagall and the United States is in the grip of the largest financial crisis since the Great Depression. Legislators and regulators are again questioning the role that the investment banking activities of commercial banks have played in a financial crisis. Some believe the repeal of Glass-Steagall contributed significantly to the current financial crisis. Others believe that if Glass-Steagall had still been in place, the financial crisis would be much worse. This paper examines the role that the repeal of Glass-Steagall played in the current financial crisis.



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