Soothing the People's Panic: The Banking Crisis of the 1930s in Philadelphia

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[For many Philadelphians, the failure of Bankers Trust Company brought the Great Depression painfully close to home, perhaps for the first time. After all, it was the first large bank to fail in Philadelphia after the stock market crash the year before, and its closure left more than 100,000 depositors facing financial ruin.

However, Bankers Trust Company was not the only local bank to fall victim to the severe economic downturn. In the following essay, historian R. Daniel Wadhwani reviews the banking crises in Philadelphia during the 1930s, as well as the steps taken by the federal government to prevent these types of bank failures in the future. – Closed for Business editors]

“I remember crowds of people lined up outside, people were all lined up, snake like, hundreds of people,” recalled Walter Cook. “They were all out there, I couldn’t see which way they were going.” Cook was a teller for the First Penny Savings Bank in South Philadelphia during the banking panic that struck the city in October 1931. A couple of miles away, James Willcox, the president of the Philadelphia Saving Fund Society (PSFS), used a megaphone to bark instructions at a mob of depositors packed into the bank to withdraw savings. PSFS officers “made frequent trips through the crowds . . . talking to groups of depositors and endeavoring to reassure them that the Society had never been in better financial condition,” but they found most of their clients “thoroughly alarmed.” At the Frankford Trust Company in Northeast Philadelphia, worried depositors were standing in a line that spilled out onto the street when H. Shepard Royle, the owner of the Breslin Textile Company, walked by. He was so incensed by the crowd of “mostly foreigners” that, according to the description of a neighborhood paper, “he raised his voice in a forceful heart to heart address to them.” Royle apparently lacked Jimmy Stewart’s rhetorical skill in soothing panicked depositors; the bank’s deposits fell by 36 percent within a couple of weeks, almost putting it out of business.

So iconic are the images of the banking crises of the 1930s that they have come to represent the Great Depression itself. And indeed, their central place in historical memory is well deserved. More than 9,000 banks failed, about 30 percent of all institutions. (In comparison, approximately 350 banks have failed during our current economic crisis.) In all, 30 of Philadelphia’s 89 banks and trust companies and hundreds of the city’s building and loan associations failed between July 1930 and March 1933. Even the institutions that survived often
experienced crippling withdrawals as crowds of depositors converted their savings into cash. During this same period, deposits in the city had declined by 23 percent.

The United States actually experienced a series of severe regional panics that eventually culminated in March 1933 with a spiraling national crisis. Though countless smaller bank runs took place throughout the early years of the Depression, the four major episodes were in late 1931, April–August 1932, October 1932, and March 1933. Philadelphia was particularly hard hit during the latter two. These episodes were triggered by loss of depositor confidence in the region caused typically by a local event that led savers to question the solvency of their own institution. Because underlying developments had made the American banking system structurally weak, it was susceptible to panics and widespread failures.

This weakness in American banking was created by the proliferation of thousands of small financial institutions over the previous decades. Whereas other industrializing countries allowed the development of large regional and national financial institutions, American policymakers preferred rules and regulations that kept financial institutions relatively small, local enterprises; restrictions on the branching and expansion of banks combined with relatively easy incorporation helped ensure the proliferation of many small institutions. In the first three decades of the 20th century the growing affluence of American households also increased reliance on such institutions for everything from saving to investing to mortgage financing. These trends were given an additional boost in the 1920s as World War I liberty loans matured and bondholders used their proceeds to open bank accounts or invest in stocks. Philadelphia alone had thousands of financial intermediaries by the eve of the Depression.

The city’s financial institutions were rich in variety as well as in number. There were old and venerable financial establishments. PSFS, the nation’s first savings bank, was established in 1816. This and the city’s other three mutual savings banks were designed to allow working-class citizens to accumulate financial nest eggs securely. Some of Center City’s commercial banks were among the first in the nation to finance commerce and business development. These older institutions were generally stable and well-managed and had long been crucial to the economic health of the city.

But in the decades leading up to the Depression, and especially in the 1920s, many small, neighborhood-based commercial banks promising convenience and attractive terms were established in the fast-growing outlying neighborhoods of the city. Likewise, hundreds of building and loan associations were established to finance the booming real estate market; many of these specialized in risky second-mortgage finance with low down payments—the kind of easy mortgage financing terms all too familiar to Americans in more recent times.

The development of these financial services transformed the economic lives of ordinary Philadelphians, making mortgaged homeownership and financial asset holding increasingly common. But the thousands of small, undiversified, and geographically localized institutions turned out to be a house of cards, unable to weather the adversity of a significant economic downturn. Whereas our current crisis raised the dilemma of what to do with banks that are “too big to fail,” the panics of the Great Depression highlighted the problems caused by a banking system characterized by thousands of institutions that were “too small to survive.”
Depression hit such institutions in two ways: When investments and loans went bad and the prices of assets (including real estate) decreased, small institutions had few other investments to rely on. Also, panics and fears among depositors about the safety of the institutions created sudden demands for cash when the banks were least able to provide it.

Banking panics, perhaps like all panics, are driven by fears not entirely justifiable by observable facts. But while panics often seem chaotic to casual observers, the patterns in which depositors demanded their money reveal relatively consistent fears and concerns about financial institutions and markets, even if they are not based entirely on rational evaluation of the underlying health of particular institutions. Such patterns of concern and fear were clearly evident in how Philadelphians panicked in the 1930s.

Philadelphia’s Center City, the area with the greatest concentration of banks, experienced some depositor jitters, but it was the communities on the periphery of downtown that were struck the hardest; deposits fell by 15 percent in Center City during the course of the panic but plummeted by 41 percent in the outlying neighborhoods. The panic struck hardest in sections of the city with high proportions of recent immigrant and working-class depositors. North, Northeast, and South Philadelphia—areas where over 50 percent of the residents were either foreign born or first-generation Americans in 1930—saw deposits plummet by two to three times the rate of those in Center City. In comparison, the northwest corridor of the city, which included neighborhoods with higher proportions of native-born, middle- and upper-income residents, experienced much milder declines in deposits. The decrease in deposits there was almost as low as that of Center City and was largely confined to the working- and middle-income neighborhoods of Manayunk and Germantown.

Contemporary reports and eyewitness accounts support the conclusion that those who panicked were disproportionately working class and either foreign born or first-generation American. Internal reports and interbank correspondence on the panics almost always pointed out that “foreigners” were very heavily represented in the “crowds.” A PSFS management report on the “Flurry of October 1931” noted that “foreigners were particularly frightened.” PSFS officers, it noted, issued circulars in Polish, Italian, and Hebrew to reassure depositors.

These ethnic working-class savers were precisely the group that commercial banks, neighborhood trust companies, and building and loan associations had successfully wooed in the years since the previous panic in 1907, when relatively few ordinary Philadelphians had accounts at commercial institutions. The small outlying commercial institutions were the hardest hit by the panics of the Depression. Of the 20 banks and trust companies that failed in the panic of October 1931, 16 were headquartered in outlying neighborhoods. An article in the Central North Philadelphia News noted that most of the neighborhood banks that failed during the runs “had their birth during [World War I] or have sprung up like mushrooms since the war.”

Not all institutions suffered depositor discontent in the early 1930s. In fact, mutual savings banks and credit unions continued to grow as commercial banking collapsed. Nationwide, deposits in savings banks inched upward from $9.1 billion to $9.6 billion between 1930 and 1933 while in the same period deposits in commercial banks plummeted from $20.2
billion to $11.7 billion. This growth in savings bank deposits seems to be attributable to the
inflow of small savers, many of whom must have been fleeing the commercial banks. Thus,
while many Americans hoarded their savings, others shifted their money into the older mutual
savings banks, which promised special protections for small depositors.

In Philadelphia, deposits in the three Center City mutual savings banks grew by 18
percent between 1930 and 1932 while bank deposits in the city as a whole fell 21 percent. PSFS
alone gained 53,048 depositors (a 13 percent rise) during the panic-marred year of 1931.
Remarkably, many of the outlying branches of Philadelphia’s mutual savings banks had done
such a good job of casting themselves as neighborhood banks that a number of depositors
withdrew money from the branches only to redeposit it at the Center City office of the same
bank. A teller who worked at PSFS’s South Philadelphia branch during the panics recalled:

[W]e had so many Italians down there and they had the utmost confidence in
[the main downtown office at] 7th and Walnut. But that confidence didn’t carry
over to [the South Philadelphia branch at] Broad and McKean. That was just
like it was a different bank. We used to have them come in there and draw . . .
cash, hop on the trolley car on Snyder Avenue, go down to 7th, go up 7th, get
off at 7th and Walnut, put the money right back in at 7th and Walnut.

Maxwell Levinson, the former president of the Western Saving Fund Society, remembered
similar transfers of money taking place at his bank as depositors “moved their money from
what they thought was a poor bank to one that they thought was a well-established old bank.”

Perhaps even more remarkable than the success of the savings banks was the stability
displayed by credit unions. Between 1931 and 1933, the number of credit unions increased
from approximately 1,500 to 2,000 and their assets grew from $31 million to $40 million. Credit
unions remained tiny, financially vulnerable institutions, far smaller on average than even the
small commercial banks. Member distrust could easily have wiped them out.

The panics were largely local affairs, as the public sought to decipher which institutions
were insolvent and which were sound. Ultimately, however, it was a national policy response
which halted the panics and the banking crises and laid the foundations for key changes to the
national banking system.

In the last days of the Hoover administration, about half the states declared bank
holidays in an attempt to stem the latest wave of bank panics. This wave was building in early
March 1933; even as Roosevelt was taking his oath of office it looked like New York would soon
join the fold of states declaring bank holidays. The new president lashed out at the banks in his
inaugural address and suggested that fundamental reforms were in order. “[P]ractices of the
unscrupulous money changers stand indicted in the court of public opinion, rejected by the
hearts and minds of men,” he bellowed. “The money changers have fled from their high seats in
the temple of our civilization. We may now restore that temple to the ancient truths. The
measure of the restoration lies in the extent to which we apply social values more noble than
mere monetary profit.” The new president promised “an end to speculation with other people’s
money.”
In practice, Roosevelt was a much more cautious policymakers and the new administration acted to save the banking system rather than fundamentally change its institutional structure. The day after his inauguration, FDR declared a nationwide bank holiday and scheduled a special session of Congress to pass emergency legislation to halt the crisis. The Emergency Banking Act of 1933, pushed through Congress on March 9, 1933, called for the inspection and reopening of solvent banks, under regulatory stewardship when necessary. Insolvent institutions would be weeded out and liquidated. The act also appropriated funds to purchase preferred stock in the reopened banks in order to strengthen the capital base of these institutions. Later in 1933, the Home Owners Loan Act provided banks liquidity by creating a government agency to buy their nonperforming mortgage loans (i.e., their “toxic assets,” as we called them in the recent crisis) at 80 percent of their stated value. The two acts were designed to halt deterioration of public confidence in the banking system and to provide an infusion of capital.

Later that year, Congress moved to permanently allay public fears by passing national deposit insurance legislation. Deposit insurance had previously been viewed as special interest legislation favoring small banks. A handful of states had experimented with deposit insurance in the 1920s with disastrous results. Not surprisingly, then, Roosevelt and other major national policymakers initially opposed such a plan. But growing public pressure for such a scheme, especially after the bank holiday of March 1933, made it difficult to sideline. The successful reopening of the banks after the March crisis convinced many that as long as confidence remained in the government, the financial system could be saved. In mid-April 1933, Business Week reported that “Washington does not remember any issue on which the sentiment of the country has been so undivided or so emphatically expressed as upon this.” The proposal for federal deposit insurance gained daily converts in Congress as popular support grew. House Banking Committee chair Henry Steagall of Alabama refused to let any banking reform bill that did not contain deposit insurance pass his committee. The president asked Carter Glass, sponsor of a new banking reform bill in the Senate, to defer the insurance issue for about a year, but Glass replied that if he “didn’t write it into the bill Congress would.”

The Banking Act of 1933 established the Federal Deposit Insurance Corporation to provide insurance to banks. It expanded federal authority to regulate banks and prohibited practices that were considered risky for deposit-taking institutions, such as paying interest on checking accounts or combining commercial and investment banking functions. Federal deposit insurance addressed the public demand for safety while leaving the underlying institutional structure of banking largely intact. No other measure did more to diffuse the urgency of the banking crises for ordinary depositors. In the first four years of the Depression, depositors’ panics had struck thousands of banks. Since the introduction of FDIC, even though “speculation with other people’s money” is hardly a thing of the past, bank runs have not constituted a significant threat to insured banks, even during a financial crisis as large as the one which began in 2008. In that sense, the political and regulatory reactions to the banking panics of the 1930s had far greater long-term consequences than the panics themselves.
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