

established the Federal Savings and Loan Insurance Corporation (FSLIC) in 1934 to provide insurance for the thrift industry.

The New Deal in banking appeared to be a great success. Bank failures almost disappeared. Even though the public was less inclined to run on the banks, thrifts, and insurance companies, there was little need for concern as the surviving institutions had become extraordinarily liquid and conservative in the wake of the collapse of the early 1930s. The long period of prosperity from the end of World War II to the early 1970s was marked by growing incomes and price stability. Although the New Deal legislation may have contributed to stability in the financial sector, the tight regulations left commercial banks, mutual savings banks, and life insurance companies with a shrinking share of intermediation. The more lightly and favorably regulated savings and loan associations, finance companies, pension funds, and mutual funds benefited and captured a greater share of the flow of funds. Chafing under New Deal regulations, commercial banks tried to grow in size by mergers, acquisitions, and bank holding companies when state laws limiting branching could not be changed. However, the courts limited mergers, and Congress ensured that one-bank and multibank holding companies remained under the supervision of the Federal Reserve in the Bank Holding Company Acts of 1956 and 1970.

Crisis, Competition, and the Emergence of Financial Services Conglomerates

Higher inflation, hard recessions, and crises between 1970 and 1990 gradually undermined the regulation governing the financial sector. Burdened by New Deal restrictions, commercial banks, mutual savings banks, and life insurance companies lost further ground not only to more lightly regulated intermediaries but also to financial markets. Commercial bank failures began to reappear in the 1970s and then burgeoned in the 1980s, as interest rates soared and real estate and oil booms and busts ravaged the industry. The wave of bank failures helped to ease opposition to mergers and branching, while automated teller machines (ATMs) crept around the restrictions on branching (Table Cj354–361). Merger policy relaxed, holding companies were allowed to buy out-of-state banks, and the Riegle-Neal Interstate Banking and Branching Efficient Act of 1994 cleared the final obstacles to nationwide branch banking.

Like banks, insurance companies faced a weak demand for their traditional products. Inflation and high interest rates of the early 1980s increased policy surrenders and policy loans, reducing companies' liquidity and producing a number of failures. To survive, insurance companies moved aggressively into new activities, including the pension and annuity business. Credit crunches in the 1960s led Congress to create the National Credit Union Administration in 1970 to provide short-term lending for troubled credit unions and the National Credit Union Share Insurance Fund (NCUSIF) to set up an insurance fund for them.

Although the savings and loan industry first enjoyed a rapid expansion, its profits and net worth disappeared when inflation rose unexpectedly. Congress tried to revive the industry with the Depository Institutions Deregulation and Monetary Control Act of 1980 and the Garn–St. Germain Act of 1982, which lifted interest rate ceilings and allowed thrifts to invest in riskier loans. These efforts did not make savings and loans solvent; instead, their losses made the FSLIC insolvent. The FSLIC and the FHLBB were closed, and

insurance of the remaining thrifts was transferred to the FDIC's new Savings Association Insurance Fund, while the Office of Thrift Supervision became their regulator. Insolvent thrifts were liquidated by the Resolution Trust Corporation.

Since the early nineteenth century, the segmentation of the financial industry into distinct types of intermediaries had been a steady feature of the American system. This narrow definition of intermediaries, bolstered by the New Deal banking laws, gradually began to erode in the 1980s. Many of the remaining barriers among commercial banks, securities firms, and insurance companies were dissolved by the Gramm-Leach-Bliley Act of 1999. The formation of financial conglomerates with highly diverse financial activities may be the hallmark and challenge of the twenty-first century.

References

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SECURITIES MARKETS

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Despite their central role in today's economy, the development of securities markets in the early United States has received relatively little attention from researchers, perhaps because the historical record of the banking sector, owing to reporting requirements, is far more accessible and complete. Nevertheless, securities markets, starting with informal groups of brokers in Boston, New York, Philadelphia, and Baltimore that traded securities in coffee houses and in the street shortly after the framing of the federal Constitution, have been a fundamental part of the U.S. financial landscape. By early 1792, trading in New York had become adequately voluminous and competition for brokering services so intense that a group of street brokers met beneath a buttonwood tree on Wall Street on May 17 to form an alliance for setting commissions and providing preferential treatment to trades among themselves as opposed to trades with nonmembers. And so with the "Buttonwood Agreement," the precursor of the New York Stock Exchange (NYSE) was born. By 1830, all of the nation's major cities had developed a network for the trading of debt and equity securities. As communications technologies improved in the late nineteenth century, however, trading became increasingly concentrated in New York, and that city's dominant position in the securities industry persists to this day. The data presented in this chapter offer an overview of the securities markets across the nineteenth and twentieth centuries and reflect the considerable progress that has been made to date in building the historical record of securities market activity from primary sources such as contemporary newspapers.

Common stock represents the residual claim to a firm's assets after all other obligations, including those to employees, suppliers, the government, and creditors, have been paid. This makes common stock the most risky of corporate securities; however, it has provided by far the largest cumulative return over the long term. As the value of a firm's common stock, which includes the potential of

the firm's current or future assets to generate future residual claims, depends on investor perceptions of fundamental characteristics of the firm and the overall economic conditions, common stocks tend to fluctuate more widely in price than other direct corporate claims. Preferred stocks operate much like debt in that they promise periodic fixed payments to shareholders. They differ importantly from debt, however, in that failure to keep these promises does not offer grounds for legal action by investors against the firm. Both types of equities are represented in the tables in this chapter.

The tables include a set of stock market price indexes and dividend yield records that track equity performance on an annual basis in New York from 1802 (series Cj797), with separate categories for industrial, railroad, and utilities stocks after 1870 (series Cj800–803). Because Boston was the premier market for trading industrial securities from early in the nineteenth century until New York surpassed it around 1900, the chapter also presents prices and dividend yields for those industrial and bank stocks traded in Boston both at auction and over the formal stock exchange from 1835 to 1897 (series Cj809–810). A wide range of indexes of market performance have become available in recent years, and the most widely used are represented here from their inception dates, including the Dow Jones Industrial Average, the Standard and Poor's 500 Index, the NYSE Composite, the NASDAQ Composite, and the Wilshire 5000 (series Cj804–807). The yields of high-grade preferred stocks also appear in series Cj815–816.

Although stocks often trade frequently in the secondary market after their issue, it is in the primary market, or the market for new securities, that corporations raise external funds for investments and new ventures. In this respect, the aggregate value of new issues reflects the business climate at a point in time because firms are more likely to raise funds when they can do so at low cost, or when interest rates are low. Although bonds are the securities whose prices are most directly linked to interest rates, these rates also figure prominently in determining the returns that investors will require to hold common stocks in a given risk class, and thus affect offering prices. The role of primary markets in the distribution of both initial public offerings (IPOs) and the new issues of firms that have sold stock to the public before ("seasoned" offerings) is one of mobilizing and directing an economy's resources to projects that offer the highest returns. The size of this market in each year since 1933 is included here to document the ebbs and flows of new corporate capital, along with that of new issues of state and local government securities (Table Cj817–830).

For financial markets to function well, investors must be able to sell their assets quickly at prices that reflect their intrinsic or "true" value. Though a high volume of transactions may simply reflect the disruptive phenomenon of "churning," it is also closely related to market liquidity. Where there is a liquid financial market, there will be firms hoping to raise funds and list there because listing provides a mechanism through which the venture capitalist can "cash in" on successful projects. Because firms hope to maximize their stock price and because a share in a liquid market will trade at a higher price than an identical share in an illiquid market, the existence of a liquid stock exchange will tend to concentrate transactions within an institutional structure where informational asymmetries are smallest, promoting efficiency in the asset allocation process.

A number of series for transactions quantities are reported in this chapter as a means of observing growth in the securities markets generally. They include the annual volume and value of shares traded on the NYSE from 1879, and those of bonds from 1910

(Table Cj857–858). Also included are the annual values of trades on all registered stock exchanges, and on the New York Curb/American Stock Exchange (AMEX) specifically from 1935 (series Cj853–854). Overall, activity on the AMEX and the regional stock exchanges has been small compared to that on the NYSE, but the emergence of the NASDAQ system (operated by the National Association of Securities Dealers, or NASD) has contributed very significantly to trading volume over the past decade, often exceeding that on the NYSE in terms of the number of shares changing hands. The chapter thus includes annual NASDAQ trades since its start in 1971 (series Cj855–856).

As participation in securities markets by institutions and individuals becomes more widespread, the role of mutual funds in channeling funds to the capital markets has become increasingly important. Mutual funds are popular because they save many investors, for a fee, the time and expense of maintaining portfolios with small holdings of any individual security. Such portfolios would be costly to adjust, yet mutual funds, by spreading management and maintenance costs across a number of investor accounts, can offer a diversified portfolio to investors at low cost. The table that presents the number, value, and net redemptions of mutual fund shares since the passage of the Investment Company Act in 1940 reflects the recent and rapid rise in ownership of these shares (Table Cj859–862).

To buy stocks, investors often tender cash to their brokers, yet brokers will also lend to their customers to finance security purchases. If many such loans are made during a bull market that later experiences an unanticipated correction, the brokerage industry and the economy in general could be adversely affected by defaults. To avoid the excessive use of credit in the purchase of stocks, the Federal Reserve limits the degree to which this can be done by imposing a "margin" requirement. As can be seen in Table Cj863–865, the margin requirement changed fairly frequently from 1934 on, but it has remained at 50 percent since January 1974.

DEBT AND THE FLOW OF FUNDS

John A. James and Richard Sylla

Production and consumption in a modern economy, as well as savings and investment, are financed by a wide variety of fund flows among economic sectors. These flows result at any given point in time in a complex structure of assets, liabilities or debts, and net worth.

For the U.S. economy, the most comprehensive source for data on financial flows and outstanding stocks of debt, as well as total financial assets (including equities in corporate and noncorporate business) and liabilities, are the flow-of-funds accounts maintained by the Board of Governors of the Federal Reserve System. These data begin with the year 1945 and extend to the present. They are updated quarterly and annually, and they can be accessed at the Federal Reserve Internet site. The flow-of-funds accounts are voluminous and can serve a multitude of purposes. To facilitate their use, the Federal Reserve publishes a *Guide to the Flow of Funds Accounts*. This chapter presents a sampling of the flow-of-funds data and the stocks of assets and liabilities resulting from