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# Consolidation and Crisis in the US Banking Sector 1980-2022

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## *Section 1: Introduction*

Much of the economic analysis of banking crises focuses on the interplay between concentration and stability. A common theory is that concentration is associated with greater stability, whereas competition is associated with instability.<sup>1</sup> In this view, there is a trade-off between, on the one hand, the higher prices and higher profits associated with a banking cartel, and on the other, frequent banking crises and lower prices caused by a fragmented sector. However, this theory is not entirely convincing. Principally, it tends to treat competition and concentration as independent variables, whereas in reality, causality works *both ways*: banks actively work to transform the structure of the system and transcend apparent constraints – whether through coordinating interest rates, influencing policy, or by transforming the business landscape through corporate amalgamation. In addition, the last two major banking crises in the US occurred in dramatically different conditions of concentration from one other, complicating any obvious empirical connection between concentration and stability.<sup>2</sup>

In this paper, I try to move beyond this hypothesis by investigating the relationship between corporate concentration and banking stability through the lens of *organized power*. Using a combination of quantitative and qualitative analyses, I make two claims. First, since the 1980s, the

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<sup>1</sup> See for instance Vives, “Competition and Stability in Banking”; Beck et al., *Bailing out the Banks*; McCormack, “Canadian Banking Stability through the Global Financial Crisis of 2007–8”; Barrell and Karim, “Banking Concentration And Financial Crises.”

<sup>2</sup> As a case in point, for both policy-makers *and* economists, the meaning and measurement of competition and concentration in the banking sector shifted in the 1980s to accommodate a more positive view of mergers (Dymski, 1999, 42). In other words, the definition of an ‘acceptable’ level of concentration is often a matter of politics more than anything else.

differential profitability of large banks has been driven by corporate amalgamation.<sup>3</sup> Second, crises tend to be followed by an increase in the pace of amalgamation. As a result, since the 1980s, banking crises have preceded a dramatic redistribution of resources and control to a handful of large banks. While it is not clear that concentration makes a banking crisis less likely, the evidence suggests that crisis *makes concentration more likely*. Though the research presented here is only tentative and exploratory, it indicates that since the 1980s, large banks have remade the business and regulatory landscape in ways that defy the logic of a simple binary relationship between concentration and stability, and that this needs to be taken into account when analysing the dynamics of banking crises.

The paper is structured as follows. Section 2 outlines and critiques a common theory of the relationship between concentration and crisis that I label, after Geoffrey McCormack, the “Concentration-Stability Hypothesis” (CSH).<sup>4</sup> Section 3 outlines an alternative theoretical framework: capital as power (CasP). This approach places organized power at the heart of its analysis and provides the theoretical justification for my empirical focus on corporate amalgamation and differential earnings. Section 4 presents quantitative evidence of the tight connection between these two dynamics in the case of the 25 largest US banks. It shows that since the 1980s, changes in differential profitability of the largest US banks are closely correlated with changes in corporate amalgamation. Section 5 gives a brief overview of two major banking crises and how policy makers removed barriers to merger activity and otherwise encouraged corporate amalgamation. Section 6 concludes by offering some thoughts on the implications of the findings in the context of a broader research agenda.

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<sup>3</sup> By ‘differential profitability’, I mean profitability measured against an average benchmark of the profitability of the 500 largest US firms (e.g., the S&P 500). More on this in section 3.

<sup>4</sup> McCormack, “Canadian Banking Stability through the Global Financial Crisis of 2007–8.”

*Section 2: the concentration-stability question*

The CSH argues that there is an inherent trade-off between banking stability and concentration. When the sector is fragmented, banks face greater competition and are therefore more likely to take greater risks than they would otherwise.<sup>5</sup> By contrast, when the banking sector is concentrated, high profits make excessive risk-taking unappealing.<sup>6</sup> For instance, in a comparison of US and Canadian banking structure, Brean et al argue that the Canadian banking system, which allows a small number of large banks to operate as a cartel, contributes to stability because the ability to charge higher interest rates (generating higher profits for the banks) discourages the banks from engaging in riskier profit strategies.<sup>7</sup> For policy-makers, this hypothesis implies taking a balanced approach to what is essentially a lose-lose situation: either deal with the higher prices associated with a powerful banking cartel, or endure the periodic crises associated with the ‘free market’.<sup>8</sup>

There are theoretical and empirical reasons to doubt the usefulness of this approach. First, it tends to assume that causality moves in only one direction – i.e., from the ‘market structure’ (either concentrated or competitive) to the behaviour of individual banks. Market structure is taken to be the independent variable determining bank behaviour, while the market structure itself is set by externally given factors: interest rates, the regulatory environment, the size and quantity of banking institutions, etc. In reality, however, causality goes both ways – individual banks actively work to shape and reshape both the policy environment and the organizational structure of the

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<sup>5</sup> Beck et al., *Bailing out the Banks*, 18.

<sup>6</sup> Beck et al, 18.

<sup>7</sup> Brean, Kryzanowski, and Roberts, “Canada and the United States,” 266.

<sup>8</sup> To be sure, most proponents of this theory offer extensive additional factors that explain why concentration may not necessarily entail greater stability. Yet it is worth asking at what point the recourse to extenuating circumstances dictates a reconsideration of the underlying hypothesis. Brean, Kryzanowski, and Roberts, “Canada and the United States,” 266.

sector. While some, like Beck et al, raise the possibility of a reversal of causal relations, the reversal is one where the ‘efficiency’ of different firms shapes the market structure. In effect, where researchers reverse causality, they still do not consider that firms actively seek to remake the business landscape and structural effects are judged incidental to other behavioural dynamics.<sup>9</sup> As such, the theory does not account for the fact that banks, and in particular large, politically connected banks, are highly motivated to try to act in ways that end up transforming the ‘market structure’—through mergers and acquisitions, by creating novel financial instruments that elude regulation and obscure financial risk, or even through outright collusion.<sup>10</sup> As I discuss below, since the 1980s, such tactics have indeed driven major changes in the sector. At best then, this means that any analysis of the banking sector must consider that the business landscape is always actively in the process of re-ordering ‘from the inside’, through actions that reinforce and/or undermine the fixity of any given macro-structural variable. At worst, it calls into question the basic logic of the CSH.

A closer look at the last two major banking crises since 1980 further complicates the picture. One CSH interpretation of this period is that of Beck et al, who argue that deregulation in the US banking sector in the 1980s represented a transition from a market structure of high concentration/low competition to one of increased competition and instability. “The Great Depression,” they claim, “led to the discontinuation of most standard competition policies in banking in order to foster financial stability” and by contrast the period after 1970 was characterized by “a swing of the pendulum towards deregulation, with more competition and innovation but also with many banking crises.”<sup>11</sup> This narrative is questionable for a number of

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<sup>9</sup> Beck et al, 20.

<sup>10</sup> E.g., the libor scandal. Vaughan and Finch, “Libor Scandal.”

<sup>11</sup> Beck et al, 1.

reasons. First, banking deregulation starting in the late 1970s was explicitly passed as a response to supposed financial instability. As Dymski notes, a combination of high nominal interest rates and limits on maximum rates of return for bank deposits led to an outflow of savings into less-regulated financial instruments (instruments in which depository banks were legally barred from investing).<sup>12</sup> It was in the context of “a combination of macroeconomic adversity and regulatory strictures” that “political leaders and industry regulators stepped in to save the reeling banking system.”<sup>13</sup> The question is, if competition causes instability, as the CSH argues, then why would policy-makers attempt to *increase* competition through deregulation *in response* to instability?

Second, Beck et al considers the banking sector in the 1970s to have a structure of low competition, because of the strict functional and geographic restrictions on banks.<sup>14</sup> Yet others argue that the banking crisis began in the 1970s in large part because depository banks faced *too much* competition from non-bank financial institutions that were not as heavily regulated and could promise higher returns on investment.<sup>15</sup> For instance, Georg Hanc notes that “competition increased from several directions: within the U.S. banking industry itself and from thrift institutions, foreign banks, and the commercial paper and junk bond markets.”<sup>16</sup> For their part, Berger et al acknowledge this and refer to it as “external competition” – competition coming from outside the banking sector proper.<sup>17</sup> However, whether it was internal or external, the question remains, why would policy makers *deregulate*—removing barriers around bank lending and corporate amalgamation—*as a response* to competition, if deregulation was understood to increase competition and thus make instability worse?

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<sup>12</sup> Dymski, *The Bank Merger Wave*, 36.

<sup>13</sup> Dymski, 39.

<sup>14</sup> Beck et al., *Bailing out the Banks*, 1.

<sup>15</sup> Dymski, *The Bank Merger Wave*, 37; Glasberg, Davita Silfen and Dan L. Skidmore, “The Role of the State in the Criminogenesis of Corporate Crime: A Case Study of the Savings and Loan Crisis,” 114.

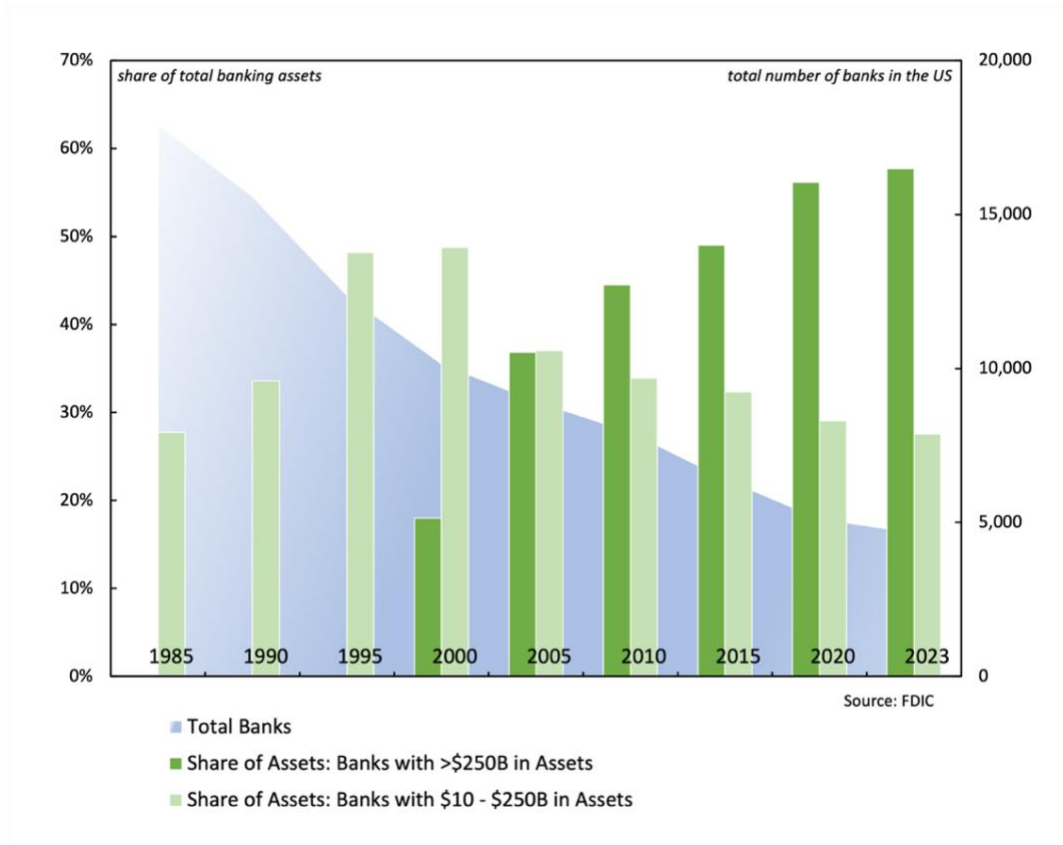
<sup>16</sup> Hanc, “The Banking Crises of the 1980s and Early 1990s: Summary and Implications,” 2.

<sup>17</sup> Berger et al., “The Transformation of the U.S. Banking Industry,” 57.

Third, the CSH fails to account for why the industry has undergone a rapid and dramatic increase in concentration nor why instability would return *after* such a consolidation had taken place. The deregulation of merger restrictions at the end of the 1970s set off and sustained a wave of corporate amalgamation. In effect, measures supposedly attempting to increase competition immediately resulted in rising levels of concentration.<sup>18</sup> This wave of consolidation spanned nearly three decades and saw the number of banking institutions in the US reduced by over 50% (see figure 1). In 1987, there were nearly 18,000 banking institutions, while the top forty-five banks owned 32% of all banking assets. By 2007, there were only 8,500 banking institutions and the top *six* banks owned 40% of all banking assets. Contrary to the crisis in the 1980s, the sub-prime mortgage crisis in 2008 arrived at a moment when the banking sector was arguably more concentrated than ever before. Was the 2008 crisis then a case of too much competition or too little?

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<sup>18</sup> Berger et al acknowledge that there must have good reasons for consolidation to take place, but it is strange that they do not explore the effects of consolidation on stability, given that it is by far the most important factor in changes in concentration in that period. Berger et al., “The Transformation of the U.S. Banking Industry,” 66-68.



**Figure 1: Concentration in the US Banking Sector, 1980-2023 (Source: FDIC)**

In sum, the behaviour of both banks and regulators since the 1980s does not fit the logic of the CSH and as such it does not appear to provide a satisfactory account of the historical relationship between concentration and stability in the US banking sector. As I show below, instead of treating competition and concentration as conceptually opposed, structurally determined factors shaping bank behaviour, a more productive approach has to consider instead how banks actively shape the structure of the banking landscape to their differential advantage.

*Section 3: the capital as power view: concentration as ‘breadth’*

Moving away from the CSH, this paper investigates the relation between concentration, profitability, and crisis through an engagement with the capital as power (CasP) political economic



framework. The CasP framework posits that what drives capitalists is not profit maximization *per se*, but the differential accumulation of organized social power (of which profit as one central manifestation).<sup>19</sup> Organized social power is relational concept, denoting the systematic domination of some individuals and groups over others. As such, accumulation is measured differentially simply because power can only be meaningfully measured against the power of others.<sup>20</sup> From this perspective, the goal of capitalists is to ‘beat the average’, where the average benchmark is intersubjectively set by the broader capitalist order.<sup>21</sup> In the context of investigating the behavior of the US banking sector, this approach two important implications. First, I do not focus on the banking sector as whole, but rather the most dominant firms within the sector. The focus on dominant capital groups follows from the concept of differential accumulation, as those who consistently beat the average rise to the top of the corporate hierarchy.<sup>22</sup> These are the firms that, often with the close support of government organs (as with the banking sector), wield power to their advantage in many ways, actively shaping society in their pursuit of differential accumulation.<sup>23</sup> Second, the concept of differential accumulation implies attention to differential, rather than absolute measures of financial performance. Thus in this paper, I place the differential

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<sup>19</sup> Nitzan, Jonathan and Bichler, Shimshon, *Capital as Power: A Study of Order and Creorder*, Ch. 14.

<sup>20</sup> This can be illustrated simply by thinking of how under capitalism, social goods are denominated in prices that change at different rates over time. As a result, a worker’s wages are worth more or less depending on the prices of the goods she needs to buy. This is why social scientists sometimes use a *differential measure—purchasing power parity* (PPP)—to compare social conditions between different locations. Nitzan, Jonathan and Bichler, Shimshon, 309.

<sup>21</sup> The importance of benchmarks is attested to by the proliferation of and central significance given to stock indexes like the S&P 500 and the Nasdaq. These indexes provide a benchmark representation of the dominant firms against which owners, investors and managers can measure their own holdings. Nitzan, Jonathan and Bichler, Shimshon, 310.

<sup>22</sup> For a longer discussion of dominant capital, see Nitzan, Jonathan and Bichler, Shimshon, 315-316.

<sup>23</sup> While power is expressed qualitatively in society in innumerable ways (the legal power of exclusion through private property rights, the power to tax or waive taxes, the power of advertising, the power to create credit) the central method of *quantifying* capitalist power is capitalization. Capitalization distills, or attempts to distill, any and all factors that might affect the future earnings of a given firm and discount the estimated future earnings back to its present value.

profitability of the most dominant banking groups (calculated as the largest 25 US banks by annual income, reselected annually) at the centre of my analysis.<sup>24</sup>

According to CasP, in their pursuit of differential accumulation, firms use two broad strategies: ‘breadth’ and ‘depth’.<sup>25</sup> ‘Breadth’ strategies consist of increasing the size of the organization faster than the average, which can be done either through the expansion of capacity (hiring employees, building factories, increasing production) or through corporate amalgamation (mergers and acquisitions).<sup>26</sup> ‘Depth’ strategies consist of raising the profit ‘intensity’ of the organization (e.g., profit per employee), which can be accomplished either by lowering costs or raising prices.<sup>27</sup> Importantly, each kind of strategy comes with risks. Increasing capacity too much, for instance, can cause prices to drop, reducing profit per unit. Raising prices, on the other hand, can cause overall sales to fall. As such, firms must make strategic choices to maintain and augment their differential profitability, and corporate amalgamation is a crucial element of this process.<sup>28</sup>

The CasP framework is useful to my investigation on at least three counts. First, it posits capital accumulation as an inherently *conflictual* and *distributional* process.<sup>29</sup> Thus crisis, or at least the threat of crisis, is closely intertwined with the processes of differential accumulation. As such, this approach provides a strong theoretical association between crisis and the behavior of dominant firms. Second, the conflictual dynamics of differential accumulation tend to transform society in unexpected ways, in effect changing the terms or rules in which the ‘game’ of accumulation is played. As such, the CasP framework is useful because it does not assume a binary

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<sup>24</sup> In this paper, differential profitability is calculated by dividing the average income of the largest 25 US banks by the average income of the largest 500 firms on the Compustat Capital IQ financial database. The ‘Compustat 500’ is similar to other benchmarks like the S&P 500.

<sup>25</sup> Nitzan, Jonathan and Bichler, Shimshon, *Capital as Power: A Study of Order and Creorder*, 328.

<sup>26</sup> Nitzan, Jonathan and Bichler, Shimshon, 328.

<sup>27</sup> Nitzan, Jonathan and Bichler, Shimshon, 328.

<sup>28</sup> Nitzan, Jonathan and Bichler, Shimshon, 330.

<sup>29</sup> Nitzan, Jonathan and Bichler, Shimshon, 315.

relationship between concentration and competition, where a more concentrated sector means less competition. In this approach, “the periphery of capital”—comprised of the many smaller firms outside the core— “constitutes a permanent threat to accumulation,” and so the need to redistribute upward does not necessarily decrease with increasing concentration.<sup>30</sup>

Third, CasP offers a strong theoretical link between the corporate amalgamation and *power*. In this view, amalgamation is an effective and reliable way to augment differential power because it increases the relative size of an organization without increasing the total productive capacity of the sector; it augments price-power; and it reduces risk.<sup>31</sup> These factors make it a highly appealing strategy for firms. While effective, however, amalgamation is limited by external factors. In particular, “by gobbling up takeover targets within a given corporate universe, acquiring firms are depleting the pool of future targets” meaning that “unless this pool is somehow replenished, the pace of amalgamation has to decelerate.”<sup>32</sup> When firms encounter problems (lack of takeover targets, threat of antitrust, regulatory barriers) and the pace of amalgamation decelerates, firms have to shift to other accumulation strategies.<sup>33</sup> Crucially, whereas amalgamation tends to lower risk, at least in the short term, alternative strategies can often entail higher risk. For example, a bank struggling to expand through amalgamation might decide to start giving out loans to riskier customers or investing in opaque and complex derivatives. The evidence presented in the next sections 4 and 5 gives some indication that this logic aligns with developments in the banking sector since the 1980s. Both crises were generally exacerbated by institutions taking on excessive amounts of risk, while the end of each crisis coincided with an

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<sup>30</sup> Nitzan, Jonathan and Bichler, Shimshon, 315.

<sup>31</sup> Nitzan, Jonathan and Bichler, Shimshon, 330.

<sup>32</sup> Nitzan, Jonathan and Bichler, Shimshon, 347.

<sup>33</sup> Nitzan, Jonathan and Bichler, Shimshon, 363.

increase in the pace of amalgamation, suggesting a trade-off between amalgamation and riskier accumulation strategies.

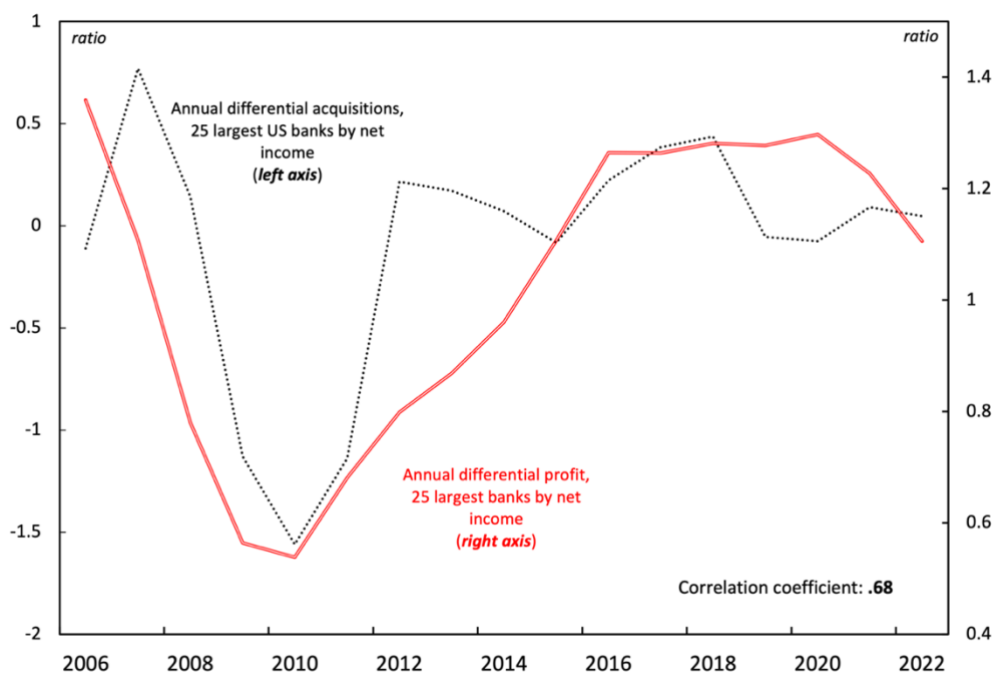
#### *Section 4: Differential profitability and mergers and acquisitions*

In this section, I examine quantitative evidence of corporate amalgamation in the US banking sector, and its relationship to the differential profitability of large banking firms. As noted above, the reason I focus on amalgamation is that: a) it is one of the most reliable and effective ways to differentially accumulate; and b) it is a prominent dynamic in the banking sector after 1980. The quantitative evidence suggests that not only are the two closely correlated, but that crisis may play a role in driving further consolidation.

While historical aggregate acquisitions spending data is difficult to find, we can get an empirical idea of the relation between amalgamation and differential profit by various means. Figure 2, for instance, shows the relationship between the differential profit of the 25 largest US banks (ranked by income) and their differential spending on acquisitions between 2006-2022.<sup>34</sup> Though the time period is short, the correlation between the two is strongly positive (.68), suggesting that since at least 2006, the ability for large banks to differentially accumulate is linked to their ability to differentially grow by buying and merging with other firms.

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<sup>34</sup> Differential profit is calculated as a ratio of the weighted average annual profit of the largest 25 US banks divided by the average profit of the 500 largest companies in the Compustat Capital IQ database. Differential acquisition spending is calculated as a ratio of the weighted average annual acquisition spending of the largest 25 US banks divided by the average acquisition spending of the 500 largest companies in the Compustat Capital IQ database. Both indexes are reselected annually by net income.



**Figure 2: Average differential cost of acquisitions and the differential profitability of the largest 25 banks (Source: Compustat Capital IQ)<sup>35</sup>**

Another way of measuring amalgamation is to calculate the change in total banking institutions since 1980. Since the vast majority of banks that become inactive are acquired or converted, rather than simply failing, changes in the overall number of banks serves as a rough proxy for the pace of consolidation. Even during the height of the savings and loan (S&L) crisis, mergers dwarfed bank failures (and failed banks tended to be smaller, meaning the net effect on concentration compared to mergers was negligible).<sup>36</sup> In addition, acquiring firms tend to be larger, meaning that changes in the size of the sector serve not only as a proxy for overall amalgamation, but likely as a proxy for the amalgamation activity of the largest banks.<sup>37</sup> On the other hand, one limitation of this approach is that it does not consider the size or value of the banks being acquired.

<sup>35</sup> Both series are smoothed to 3 year trailing averages to better show the general trend.

<sup>36</sup> Rhoades, Stephen A., “Bank Mergers and Banking Structure in the United States, 1980–98,” 22-25.

<sup>37</sup> Rhoades, Stephen A., “Bank Mergers and Industrywide Structure, 1980–94,” 22.

As such, it is an incomplete picture, especially given that the value of merger and acquisitions has grown over time as banks have gotten larger and the pool of firms has become more concentrated (see figure 1 above).<sup>38</sup> What this means that even if the *number* of banks acquired decreases, the capitalized *value* of the banks, and thus the acquisition cost, might decrease, stay the same, or increase. In short, like the use of acquisition cost, this measure only offers a partial view.

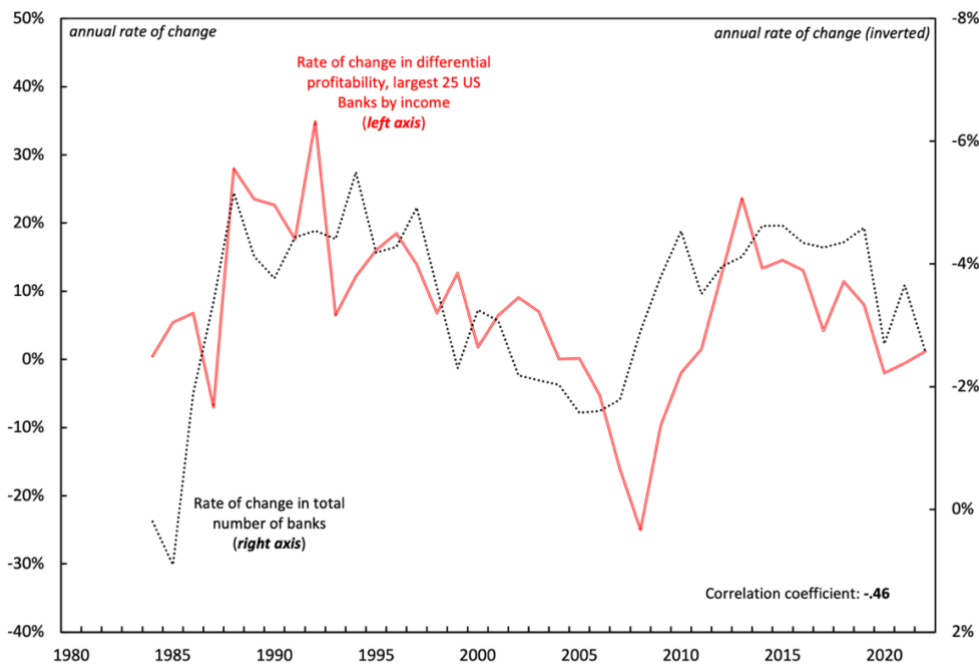
Nonetheless, Figure 3 shows that changes in the total number of banking institutions have a strong *negative* correlation with changes in the differential profitability of the large banks. In other words, the faster the overall banking sector shrinks, the faster the differential profitability of the largest banks rises. Again, this suggests that since the 1980s, large banks' ability to beat the average is closely tied to their ability to grow through amalgamation.

Beyond this general connection over time, it is worth noting how changes in differential profitability and corporate amalgamation relate to the occurrence of banking crises. If the sudden drop in the differential profitability of large banks is taken to represent the 'peak' of the S&L banking crisis (though it began in the 1970s), both crises were followed by a dramatic increase in the pace of amalgamation and a dramatic increase in the differential profitability of large banks. In both cases, the accelerated pace was also short-lived. Within a few years, the pace of amalgamation slowed, and differential profitability also levelled off. From a peak in the early 1990s, the rate of increase in differential profitability of the big banks slowed, following the reduction in the number of bank mergers. Because the size of deals got larger in the 1990s, the slowing pace here may be misleading. However, even if the slowing pace of amalgamation may have been offset by the increasing size of the deals, the effect on differential profitability was clearly waning. The rate of change in *differential profitability* of the top 25 banks dips below zero

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<sup>38</sup> Rhoades, Stephen A., "Bank Mergers and Banking Structure in the United States, 1980–98," 31.

in 2003 (implying the banks were trailing, rather than beating the average), five years before the 2008 crisis. Interestingly, it was around this time that the large banks started to become heavily invested in the ill-fated mortgage-backed security market, among other opaque, high-risk derivatives.<sup>39</sup> The timing suggests that the decision to engage in riskier investment strategies may be related to the decreasing pace of amalgamation – or at least a decrease in the future prospects for differential accumulation through amalgamation. After the 2008 crash, the pace of amalgamation also jumped back up, and the differential profitability of the big banks quickly followed, nearly returning to the previous rate of growth. However, this too was short-lived: the pace of amalgamation quickly flatlined and began to decline, and the pace of differential profitability began to decline again.



**Figure 3: Changes in differential profitability and changes in the total number of banking institutions (Sources: Compustat Capital IQ for profitability, FDIC for total banking institutions)**

<sup>39</sup> For instance, Simkovic notes that “by 2007, the top six subprime mortgage originators included divisions of Citi, HSBC, Countrywide, Wells Fargo, Merrill Lynch, and Chase.” Simkovic, “Competition and Crisis in Mortgage Securitization,” 224, 237.

### *Section 5: Crisis as an engine for overcoming barriers to consolidation*

In this section, I will briefly outline the series of regulatory changes and government actions following both crises to show how in both cases, the crisis provided justification for the removal or exceptional exemption of barriers to further consolidation, which had the principal effect of redistributing control over banking assets upward to the big banks.<sup>40</sup> In the case of the S&L crisis, policymakers removed long standing barriers to interstate banking starting in the late 1970s. In the case of the mortgage crisis, policymakers again took an active role in negotiating mergers, including with banks that were themselves in need of bailing out. In addition, post-crisis regulations like the Dodd-Frank Act were widely seen to have little effect in curbing further consolidation, and in some ways may have made consolidation more likely.<sup>41</sup>

#### *5.1 The S&L crisis*

Between 1966 and 1981, the ability for banks to consolidate through mergers and acquisitions was largely limited by regulation.<sup>42</sup> In one reading, the change in regulatory perspective emerged during this period as a response to a long period of struggle between banks and the Federal Reserve, in which banks sought ways to circumvent restrictions on interest and deposit rates by creating new investment instruments outside of regulatory control.<sup>43</sup> The struggle

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<sup>40</sup> This section is not intended to explicate the full complexity of events surrounding these crises, but rather to try to gesture at how one might interpret the quantitative evidence through the lens of the historical-contextual record.

<sup>41</sup> Brean, Kryzanowski, and Roberts, "Canada and the United States," 265; Aiello and Tarbert, "Bank M&A in the Wake of Dodd-Frank," 910.

<sup>42</sup> Although it is outside the scope of this paper, the story of banking regulation prior to the 1980s is more complex than one of uninterrupted restrictiveness. Numerous struggles and adjustments between banks and regulators from the passage of the 1927 McFadden Act, which heavily restricted banking power, to deregulation in the 1980s, imply that 'deregulation' is a perennial goal of the banking sector, and that they had some successes prior to the 1980s. Dymski, *The Bank Merger Wave*, 34-36.

<sup>43</sup> Dymski, 36.



between banks and regulators came to a head in the 1970s, when high interest rates pushed more depositors into various nonbank institutions offering more attractive rates of return on their savings.<sup>44</sup> Because S&Ls were specifically designed and regulated to provide affordable loans and mortgages to the middle class, they were particularly vulnerable to rising interest rates.<sup>45</sup> Business trade groups argued that the crisis was due to regulation – that restrictions were hampering the ability of banks to compete.<sup>46</sup> Federal regulators agreed, deciding that deregulation could provide “banks and thrifts more freedom to compete with nonbank financial firms.”<sup>47</sup> New policies not only removed interest rate limits, but also dismantled “restrictions on the intermingling of commercial banking, home banking, real estate, and securities investing.”<sup>48</sup> While at first deregulation appeared to ease the crisis, much of these profits were the result of a relaxing of regulations around the ability of banks to invest in riskier assets, which caused causing a boom in banking profits. By the late 1980s, many of these investments had failed to generate the expected returns and bank failures spiked, leading to a significant government bailout and further acceleration of the pace of consolidation.<sup>49</sup>

In response to this extended period of crisis (beginning in the 1970s and continuing through the 1980s) policy-makers removed successive barriers to amalgamation, while state and federal authorities often encouraged mergers as a perceived solution to financial instability – sometimes

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<sup>44</sup> Dymski, *The Bank Merger Wave*, 36.

<sup>45</sup> Glasberg, Davita Silfen and Dan L. Skidmore, “The Role of the State in the Criminogenesis of Corporate Crime: A Case Study of the Savings and Loan Crisis,” 115.

<sup>46</sup> Glasberg, Davita Silfen and Dan L. Skidmore, “The Role of the State in the Criminogenesis of Corporate Crime: A Case Study of the Savings and Loan Crisis,” 115.

<sup>47</sup> Dymski, 39.

<sup>48</sup> Glasberg, Davita Silfen and Dan L. Skidmore, “The Role of the State in the Criminogenesis of Corporate Crime: A Case Study of the Savings and Loan Crisis,” 115.

<sup>49</sup> Also contributing to the crisis was the fact that deregulation in the early 1980s created optimal conditions not only for over-leveraged risk taking, but for banking fraud. For an in-depth discussion of banking fraud, as well as the role of junk bonds (a key investment vehicle implicated in the crisis) in precipitating the S&L crisis, see Glasberg, Davita Silfen and Dan L. Skidmore.

even breaching existing interstate barriers for certain “moribund banks and thrifts.”<sup>50</sup> The change was rapid: before 1982, “except for grandfathering arrangements, not a single state permitted MBHCs [multiple bank holding companies] from other states to own banks within its borders,” whereas by 1990, “all but six small states accounting for less than 4 percent of gross domestic banking assets allowed some interstate activity.”<sup>51</sup> By 1994, the Riegle-Neal Interstate Banking and Branching Efficiency Act essentially removed the last remaining regulations limiting interstate bank mergers.<sup>52</sup> Despite the putative goal of rescuing smaller S&Ls and thrifts, the vast majority of merger and acquisition activity in this period was undertaken by the largest banks, while the banks which pursued amalgamation the most aggressively often became the biggest. As Rhoades notes, “the largest twenty-five banking organizations accounted for 11% of all mergers and acquired about 45% of all banking assets between 1980 and 1994,” despite making up only a tiny fraction of the several thousand existing banking institutions.<sup>53</sup> Whether or not it was initially triggered by pressures generated outside the depository banking sector, the crisis nonetheless provided the justification for a dramatic period of deregulation that allowed large banks to massively increase their differential size through amalgamation. Even when the crisis metastasized in the late 1980s, the policy playbook of encouraging consolidation remained the same.

### *5.2 The sub-prime mortgage crisis*

While there were several factors leading up to the 2008 crisis, the overall narrative is that deregulation in the banking industry led to massively over-leveraged investments in financial

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<sup>50</sup> Kane, “De Jure Interstate Banking,” 3.

<sup>51</sup> Berger et al., “The Transformation of the U.S. Banking Industry,” 70.

<sup>52</sup> Berger et al, 62.

<sup>53</sup> Rhoades, Stephen A., “Bank Mergers and Industrywide Structure, 1980–94,” 21-22.

derivatives that bundled mortgage debt into tradeable securities.<sup>54</sup> When the trajectory of housing prices slowed and reversed sometime in 2006, the value of a large number of these securities became suspect. The crisis proper was triggered by revelations that the large insurance company American Investment Group (AIG), as well as several big investment banks, were insolvent as a result of their positions in the mortgage-backed securities market.<sup>55</sup> The ensuing crisis led to wide-ranging government bailouts for the banking sector, as well as the collapse and fire sale of several large financial institutions. By November of 2008, the federal government had committed \$3.5 trillion to stabilizing the (US and global) financial system.<sup>56</sup>

Although there were arguably few regulatory barriers to consolidation left when the mortgage crisis occurred in 2007-2008, this crisis too justified a wave of government negotiated mega-mergers between some of the larger banking institutions. In addition, it precipitated a wider reacceleration of merger and acquisition activity which continued despite new regulation supposedly designed to increase the stability of the banking system. Thus, crisis again provided an opportunity for further consolidation, resulting in the further upward redistribution of control within the banking sector.

After a drop in the pace of amalgamation prior to 2008, banking concentration actually increased significantly in the years following the crisis.<sup>57</sup> Though many smaller banks were also taken over during this period, there were also several megadeals: Bear Sterns was acquired by JPMorgan, Merrill Lynch by Bank of America, and Wachovia, at the time the fourth largest bank in the US, was acquired by Wells Fargo.<sup>58</sup> Regulators played a central role in this process. Looking

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<sup>54</sup> “The U.S. Financial Crisis.”

<sup>55</sup> “The U.S. Financial Crisis.”

<sup>56</sup> Simkovic, “Secret Liens and the Financial Crisis of 2008,” 253.

<sup>57</sup> Rao-Nicholson and Salaber, “Impact of the Financial Crisis on Cross-Border Mergers and Acquisitions and Concentration in the Global Banking Industry,” 162.

<sup>58</sup> Chorafas, *Banks, Bankers, and Bankruptcies under Crisis*, 53-54.

to ‘the market’ to save firms facing bankruptcy, they encouraged and actively negotiated such mergers, even as some of the acquiring banks were themselves being bailed out by the government.<sup>59</sup> “The irony of this situation,” Chorafas notes, is that “strategically motivated banks capitalized on government policies that encouraged the financial industry to proceed with consolidation.”<sup>60</sup>

Even in the aftermath of the crisis, Aiello and Tarbert argue that the Dodd-Frank Act, touted as a transformational reform, may be “altogether insignificant” in the context of preventing further amalgamation.<sup>61</sup> They argue that a combination of factors: increased compliance costs from the new regulations; restrictions on leverage and securities investment; and crucially, “ripening conditions for industry consolidation,” meaning that regulators would continue to allow mergers based on worries about instability.<sup>62</sup> In addition, express limits on concentration in Dodd-Frank are both exceedingly high and can be waived by regulators at will, meaning that, depending on the government in office, firms can expect cooperation on merger deals.<sup>63</sup> As shown in figure 3 above, this prediction appears to have been borne out, as the pace of amalgamation remained elevated until 2020.

### *Section 6: Conclusion*

To return to the speculative hypothesis raised at the end of section 3: what can we now say about the deeper relationship between consolidation and crisis? The connection between differential profitability and corporate amalgamation suggests that the push for deregulation in the

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<sup>59</sup> Chorafas, 56.

<sup>60</sup> Chorafas, 56.

<sup>61</sup> Aiello and Tarbert, “Bank M&A in the Wake OF Dodd-Frank,” 910.

<sup>62</sup> Aiello and Tarbert, 910.

<sup>63</sup> Armstrong and Noonan, Laura, “Pressure Rises for US Bank Mergers after Biggest Tie-up since Financial Crisis; Banks,” 2.

1980s resulted in the largest banks dramatically augmenting their differential profitability through amalgamation. By the early 2000's however, banks may have become 'victims of their own success' and faced a dwindling pool of firms to acquire. The emerging threat of differential decumulation may have been a factor in the decision to aggressively pursue the risky investment strategies that led to the 2008 crisis. At least, the timing of the slowing of the pace of amalgamation by large banks and their subsequent large bet on sub-prime mortgage-backed securities is suggestive in this context.<sup>64</sup>

This hypothesis remains to be investigated further. However, at a minimum, the evidence indicates that the relationship between concentration and crisis in the banking sector should be revisited with new conceptual and empirical tools. The concentration-stability hypothesis does not convincingly explain the relationship between concentration and the last two major banking crises on either theoretical or empirical grounds. By contrast, even at this basic exploratory level, the capital as power approach offers novel insights. From this perspective, the dynamics of corporate amalgamation appear closely related to the differential accumulation of dominant banks, raising the possibility that banking crises may also be related, if not to amalgamation directly, then to the dynamics of differential accumulation more broadly. As US banks continue to grow larger (and the pool of acquisition targets continues to shrink) gaining a deeper understanding of these dynamics remains important.

Further investigation might also explore how this research might usefully engage with other discussions around monetary power. The increasingly integrated aims of regulators and large banks since the 1980s raises questions about how to conceptualize monetary power more

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<sup>64</sup> Interestingly, there is some evidence the stock market crash of 1987 was in part triggered by the possibility of new regulations that would hamper the ability of firms to engage in merger and acquisition activity. Mitchell and Netter, "Triggering the 1987 Stock Market Crash: Antitakeover Provisions in the Proposed House Ways and Means Tax Bill?" 64.

generally. The concept usually refers to the international influence of a government through its ability to issue currency and legislate monetary policy, and through other factors outside the government's direct control (like the international use of its currency). Hardie and Thompson, for instance, following Benjamin Cohen, link power in this sense to the monetary *autonomy* of the US government vis-à-vis other parties.<sup>65</sup> Similarly, Hyoung-kyu Chey argues that monetary power is intertwined with and can reinforce other forms of “hard power.”<sup>66</sup> What the above analysis indicates is that the monetary power of the US government is *also* intertwined with the power of large banks in a complex way, potentially blurring the conceptual lines between political and economic dynamics; between public and private forms of power; and between national governments and the ‘state of capital’.<sup>67</sup> In short, further study of the relationship between private banking power and governmental monetary power could have wider implications for international political economic scholarship.

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<sup>65</sup> Hardie and Thompson, “Taking Europe Seriously,” 781.

<sup>66</sup> Chey, “Theories of International Currencies and the Future of the World Monetary Order,” 56.

<sup>67</sup> Nitzan, Jonathan and Bichler, Shimshon, *Capital as Power: A Study of Order and Creorder*, 263.

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