ABSTRACT
An issue that has recently received a fair amount of attention in the banking literature has been the impact of financial sector development (and of banking in particular) on long-run economic growth. In this paper, I examine the impact of bank failures and of banking regulation (branch banking laws, state-sponsored deposit insurance) on state output growth from 1900 to 1940. Using standard growth convergence regressions I find that a one percent increase in the average number of bank failures is associated with a 3 to 10 percent reduction in output growth. This result survives even after correcting for the endogeneity of bank failures on growth, and after controlling for a large array of factors known to influence long-term growth. In addition, I find that states that adopted any kind of deposit insurance scheme grew, on average, 16 percent slower than their counterparts, while states that had adopted branch banking by 1900 grew, on average, 8 percent faster than their counterparts.