Wars, Panics and Politics: The American Debate on a National Bank

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Central Banking in the U.S.

- First Bank of the U.S. (1791-1811)
- Second Bank of the U.S. (1816-1836)
- State Banking Era (1836-1863)
- National Banking Era (1863-1913)
- Federal Reserve Act (1913)
Some Definitions

• **Specie** – gold and silver
• **Redemption** – banks exchange (or redeem) paper money for specie
• **Suspension** – banks refuse to redeem their paper money for specie
• **Bank notes** – issued by banks (in lieu of deposits) and circulated as money
Colonial Period

• Used a mix of currency and coins
  – British pounds
  – French francs
  – Spanish milled dollars
• Shortage of money → barter
• Paid for imports with gold or silver
• Generally prohibited from issuing paper currency, but often ignored prohibition
Colonial Period

A Modest Enquiry
Into the Nature and Necessity
of a Paper-Currency.

PHILADELPHIA:
Printed and Sold at the New Printing-Office, near the Market. 1729.
Colonial Period
Colonial Period
Colonial Period

To Counterfeit is Death.

PHILADELPHIA:
Printed by JOHN DUNLAP.
1777.
Revolutionary War & Early National Period

Pennsylvania (1777)  Virginia (1776)
Revolutionary War & Early National Period

- Continental Congress issued currency in 1775
- Excessive issuance of continentals led to inflation
- “Not worth a Continental”
Financial Challenges after Revolution

- Shortage of money as economy expanded
- No uniform currency that was accepted at par value
- Government (federal and state) war debts
- Federal government lacked a fiscal agent
Fugio cent (1787) – 1st coin issued by the U.S.
Congress shall have the power...

“...to coin money, regulate the Value thereof, and of foreign Coin...”

- Article I, Section 8

No state shall...

“...coin Money; emit Bills of Credit; make any Thing but gold and silver Coin a Tender in Payment of Debts...”

- Article I, Section 10
Alexander Hamilton

- As the first Secretary of Treasury, Hamilton advocated,
  - National Mint
  - National bank
Revolutionary War & Early National Period

• Coinage Act of 1792
  – Created the U.S. Mint in Philadelphia
  – Set denominations for coins
  – Specified coins value in gold, silver and copper

• Coin shortage remained – private tokens and foreign coins still circulated
Hamilton’s Proposal – December 1790

• A national bank that would
  – Issue paper currency
  – Act as the government’s fiscal agent
  – Offer banking facilities for commercial transactions

• Structure
  – Shareholders vote based on ownership
  – Maximum ratio of loans to specie
  – Government would own 20%
Alexander Hamilton

Most commercial nations have found it necessary to institute banks; and they have proved to be the happiest engines that ever were invented for advancing trade.

-Alexander Hamilton, 1781
Debating a National Bank

Alexander Hamilton
- Ideas of David Hume and Adam Smith
- England’s use of public debt to build nation
- Deliver capital to build the financial system
- Consolidate and finance federal and state debt

Thomas Jefferson (also James Madison)
- Financial monopoly would undermine state banks
- National bank was unconstitutional
- Vision of an agrarian (not commercial) society
James Madison Objects

• “…was condemned by the silence of the Constitution; was condemned by the rule of interpretation arising out of the Constitution; was condemned by its tendency to destroy the main characteristic of the Constitution; was condemned by the expositions of the friends of the Constitution whilst depending before the public; was condemned by the apparent intentions of the parties which ratified the Constitution; was condemned by the explanatory amendments proposed by Congress themselves to the Constitution.”

First Bank of the United States
First Bank of the United States

- Privately held
  - 20% government owned
  - 70% foreign owned
- Only national bank
- Located in Philadelphia
- 8 branches
- 20-year charter lasted from 1791 to 1811
Branches of the First Bank of the U.S.
First Bank of the United States

Government’s fiscal agent
- Collected taxes (mainly customs duties)
- Transferred funds through branches
- Paying bills

Issued notes
- Circulated as currency
- Convertible into gold or silver
- Valid for payment of federal taxes

Private bank
- Accepted deposits
- Made loans (interest capped at 6%)
Note from the First Bank of the U.S.
First Bank of the United States

• Not a central bank in the modern sense, but some influence over the economy

• Rudimentary monetary policy through holdings of notes from state banks
  – To constrain money growth → redeem notes and reduce reserves of specie
  – To speed money growth → hold notes and allow reserves of specie to grow
State-Chartered Banks in the U.S.
First Bank of the United States

- Charter renewal rejected by a single vote in House and Senate in 1811
  - Federalists were out of power
  - Opposition of state banks
State Banking from 1811 – 1816

• War of 1812 reduced trade impacted customs duties

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<thead>
<tr>
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<th>Exports</th>
<th>Imports</th>
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<tbody>
<tr>
<td>1811</td>
<td>$61 M</td>
<td>$53 M</td>
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<tr>
<td>1816</td>
<td>$7 M</td>
<td>$13 M</td>
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• Federal government forced to rely on state banks to finance war

• Inflation as state bank notes grew 150%
Proposing a Second Bank

- John Jacob Astor
- David Parish
- Stephen Girard
- Jacob Barker
- Alexander Dallas
- John C. Calhoun
Madison Concurs

“...as being precluded...by repeated recognitions, under varied circumstances, of the validity of such an institution, in acts of the legislative, executive, and judicial branches of the government, accompanied by indications in different modes of a concurrence of the general will of the nation...”

Source: Banks and Politics in America, Bray Hammond, 1957, pp. 233-234
Second Bank of the United States
Second Bank of the United States

• Ownership
  – 80% privately held
  – 20% government

• 25 directors (5 appointed by President)

• Located in Philadelphia

• Grew to 25 branches

• 20-year charter
Second Bank of the United States
Second Bank of the United States

- Supported growing international trade
- Even larger relative to other banks and businesses than the First Bank
- Branches helped support westward expansion and the federal government’s land sales
- Exercised some control over money and credit through lending policies and state note holdings
First Second Bank of the United States

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**Economic Summit**

THE ECONOMY IN ACTION
Second Bank of the United States
Second Bank of the United States
State-Chartered Banks in the U.S.

- 1791: 3 banks
- 1792: 5 banks
- 1800: 24 banks
- 1811: 101 banks
- 1816: 205 banks
- 1830: 320 banks
- 1836: 563 banks

**Economic Summit**
THE ECONOMY IN ACTION

**Economic Education at the Dallas Fed**
Panics

1819

- Second Bank extended a large number of loans
- Increasing trade deficit → outflow of specie
- Bank contracted lending
- Bankruptcies, foreclosures, bank failures, falling real estate prices and a slump in agriculture and manufacturing

1825

- Stock market crash due to speculative investments in Latin America
- Worse in England, but led to a decline in economic activity in the U.S.

1833-34

- Brief recession followed by an expansion fueled by land speculation
## Opposition from Andrew Jackson

<table>
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<th>Distrust of Paper Money</th>
<th>Other Concerns</th>
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<td>• Land deal gone bad where Jackson accepted paper notes that became worthless</td>
<td>• States’ rights</td>
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<tr>
<td>• Felt that specie was the only medium of exchange</td>
<td>• Unchecked power in the hands of private citizens</td>
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<tr>
<td>• Distrusted banks (issuers of paper notes) and credit</td>
<td>• Bank lacked an effective form of regulation</td>
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Opposition from Andrew Jackson

• Bank was not a major factor in election of 1828
• Nicholas Biddle, president of Second Bank (1823—1836)
• Election of 1832
  – Jackson vetoes re-charter of the Bank that is supported by Henry Clay
  – After election, federal government’s deposits removed to state banks
• Bank’s charter expires in 1836
State Banking Era: 1836-1863

• Banks were chartered and regulated by states
• Several states (including Texas) banned banking
• Variety of notes exploded
State Banking Era: 1836-1863

- Notes were often not exchanged at face value
  - Lists published of discounts used.
  - State bank notes not a uniform currency.
    - In 1842, a $1 note from a Tennessee bank is exchanged for 80 cents in Philadelphia, while a $1 note from an Illinois bank is exchanged for only 50 cents.

- Increased number of state bank notes issued
  - By 1860, more than 1,300 banks issue 7,000 different types of notes used as currency.
State Banks
State Bank Notes and Deposits

Free Banking Era: 1837 – 1863

- First adopted in Michigan
- Charter by state legislature no longer necessary
- Anyone is free to engage in banking, but banking is not free
- States established their own regulations
Free Banking States

Ratio of Specie to Deposits and Notes in 1859

Free Banking Era
Banking in Texas

No corporate body shall hereafter be created, renewed, or extended, with banking or discounting privileges.

Constitution of the State of Texas
Article VII, Sec. 30
1845
Panics

1837
- Lack of specie led to suspension of note redemption
- Lack of liquidity led to bank failures

1857
- Collapse of the Ohio Life Insurance and Trust Company
- Led to banking panic
- More than 5,000 businesses failed in the first year of the panic
Independent Treasury System

• Federal government deposits in state banks
• Bank failures led to congressional action
  – 1836: financial reports to be filed with Treasury
  – 1846: established the Independent Treasury System to hold federal deposits
• Sub-treasury offices located throughout the country.
  – Not all offices were very secure
  – One Indiana sub-treasury office in tavern
The End of the State Banking Era

1861
- $50M financed at different banks
- Demand notes (greenbacks) are issued that are redeemable for specie “on demand”

1862
- Legal Tender Act creates United States Notes

1863 – 64
- Two National Bank Acts are passed
Legal Tender Note

**United States Note**

**The United States of America**

**TEN DOLLARS**

**This note is a legal tender for ten dollars subject to the provisions of section 3588 H.S.**

**Economic Summit**

**The Economy in Action**

**Economic Education at the Dallas Fed**
National Bank Act of 1864

“An act to provide a national currency, secured by a pledge of United States bonds, and to provide for the circulation and redemption thereof.”
National Bank Act

• Created federally chartered banks under the Comptroller of the Currency
• Established capital and reserve requirements
• Provided for supervision and examinations
• Created a uniform currency
State Banks Attacked

• Almost 1,600 in 1860, only 350 in 1865
• 10% tax placed on state bank notes – upheld by Supreme Court
  – Chief Justice Salmon P. Chase
• State banks introduce demand deposits
• Dual banking system still exists today
State and National Banks

Source: Banking and Monetary Statistics, Federal Reserve System, 1914-1941, p. 6
State and National Banks

New Forms of Paper Currency

• Fractional currency
• Greenbacks
  – Demand Notes (not backed by gold or silver)
  – Legal Tender Notes or U.S. Notes
• Gold certificates
• Confederate currency
• National bank notes
Fractional Currency
National Bank Notes

• Uniform currency that exchanged at face value
• Only issued against U.S. government bonds
• Issuing bank maintained a redemption fund with Comptroller
• Note holders had first lien on bank assets
• Note issue could not exceed bank’s capital
National Bank Notes
Panic of 1873

• Triggered by the collapse of Jay Cooke and Co.
  – largest bank in the U.S.
  – Agent for Northern Pacific Railroad bonds
• Cooke’s bank could not sell enough railroad bonds to cover obligations
• Led to a sell-off in the stock market
• Runs on other large financial institutions led to their failure
Gold Standard

• Debate about paying off greenbacks in specie
• Coinage Act of 1873
  – Mint gold dollars
  – Mint small-denomination silver coins – not silver dollars
  – Depressed the price of silver and established a gold standard, leading to a period of deflation and depression
• “Long depression” lasted until 1879
Panics

1882 – 1885

• Recession due to the end of the railroad construction boom
• Impacted other industries, particularly iron and steel

1884 (during the 1882-85 recession)

• European gold reserves were depleted
• Banks called in loans
Panic of 1893

• Sherman Silver Purchase Act (1890) had increased federal purchases of silver
  – Indebted farmers harmed by deflation
  – Silver mining companies with Western silver

• Panic of 1893
  – Sparked by failure of Philadelphia and Reading Railroad
  – Withdrawal of European investment led to a crisis in railroad finance
  – Stock market crash and a banking panic followed
  – Created a run on the U.S. gold supply
Bank Suspensions

Source: *Banking and Monetary Statistics 1914-1941*, Federal Reserve System, Table 66.
Gold Standard vs. Bimetallic Standard

- Key element of presidential politics and the Populist movement
- Election of 1896
  - William Jennings Bryan (pro-silver and pro-paper currency)
  - William McKinley (pro-gold standard)
- Cross of Gold speech
  - “…You shall not crucify mankind on a cross of gold.”
Panic of 1907

- Knickerbocker Trust Company failed leading to runs on other trust companies
- Widespread panic
  - Bank failures
  - Shrinking money supply
  - Deep recession
- J.P. Morgan, along with other bankers, served as lender of last resort and quelled the panic
Federal Reserve Act of 1913

- “To furnish an elastic currency”
- “To establish a more effective supervision of banking in the U.S.”
- To engage in other payment activities (such as check-clearing)
Questions?