

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

Princeton Williams

*Senior Economic Education Specialist*

Federal Reserve Bank of Dallas



# Wars

American  
Revolution

War of 1812

Civil War

# Panics

Colonial shortages

“Not worth a  
Continental”

Post war inflation  
and debt

19<sup>th</sup> Century  
Banking Crises

Panic of 1907

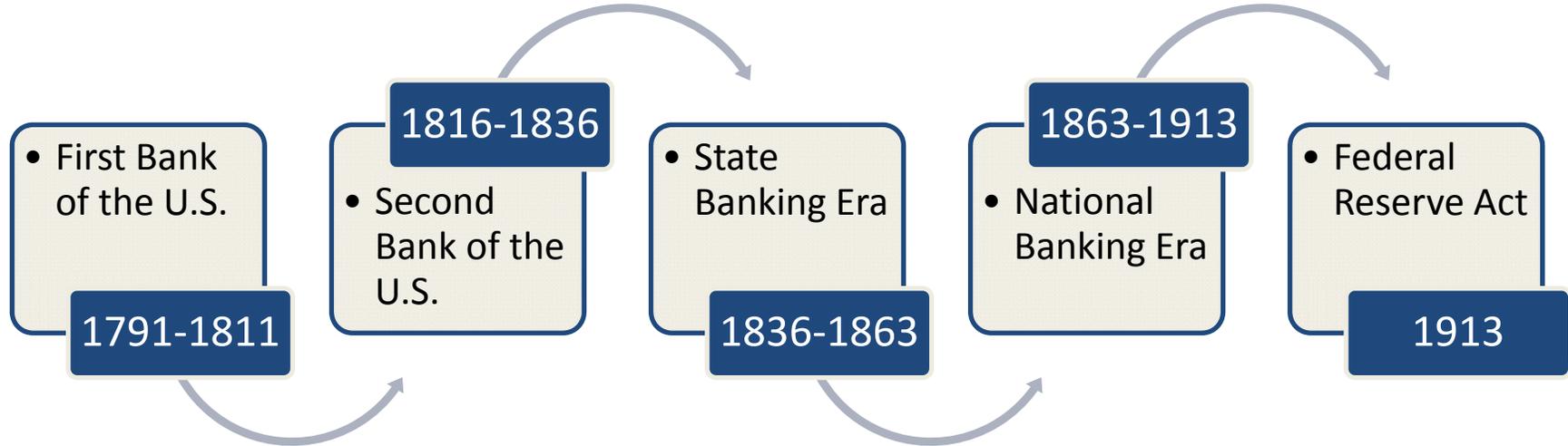
# Politics

Hamilton vs.  
Jefferson

Jackson vs. Clay  
(and Biddle)

# Central Banking in the U.S.

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# Some Definitions

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- ***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



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# Colonial Period

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- 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

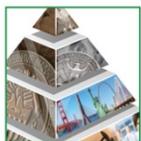
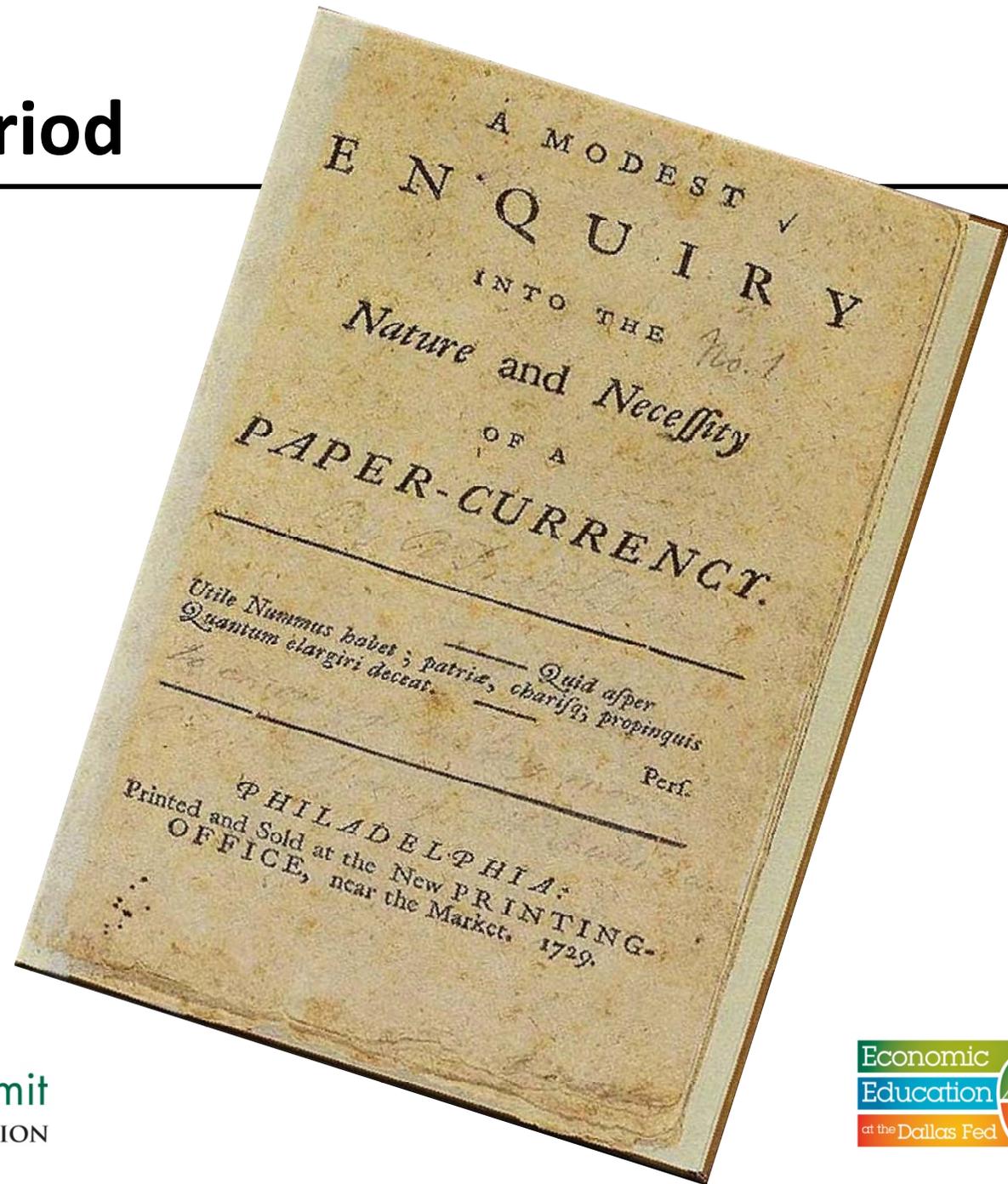


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# Colonial Period

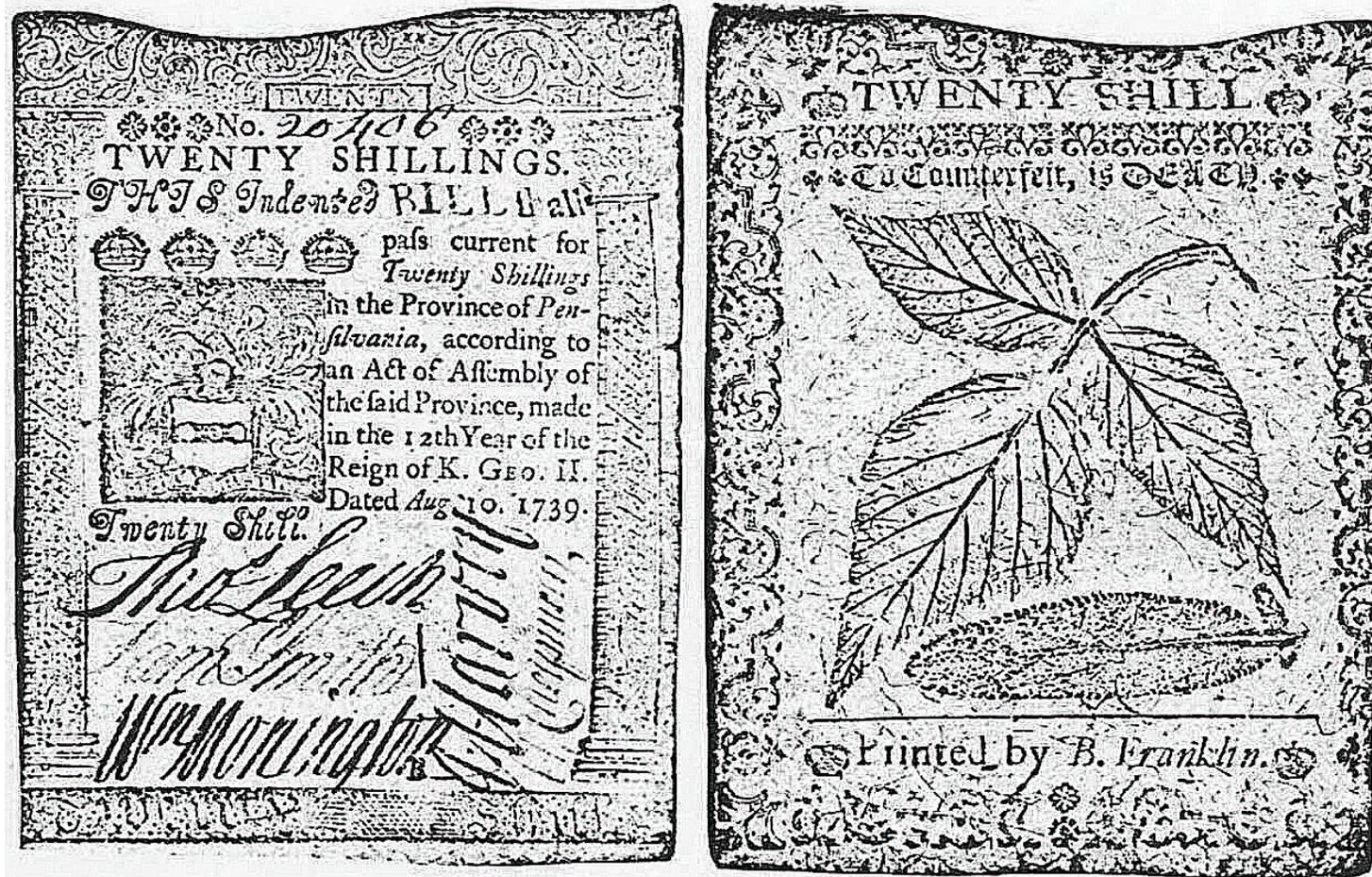
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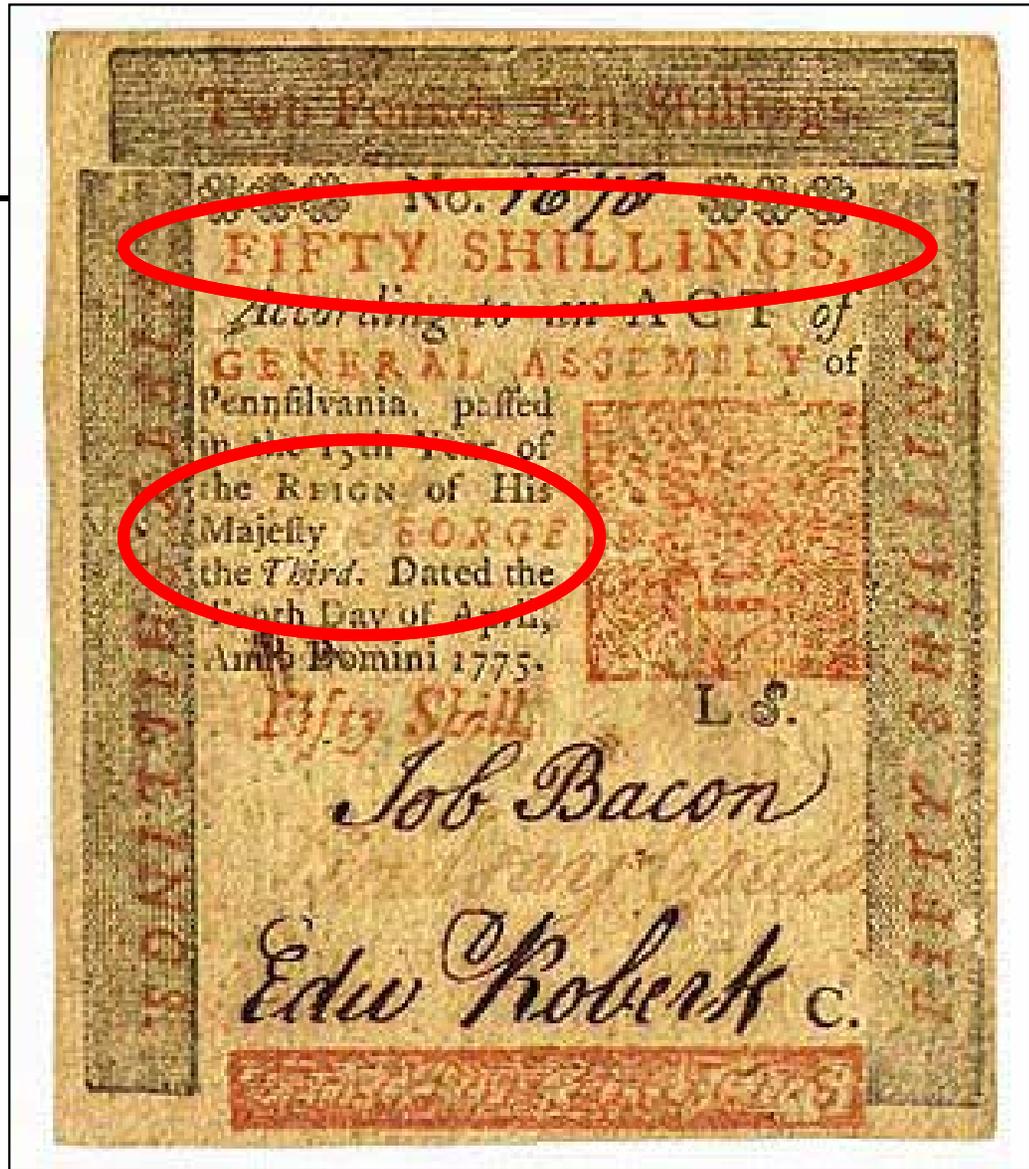
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# Colonial Period



# Colonial Period

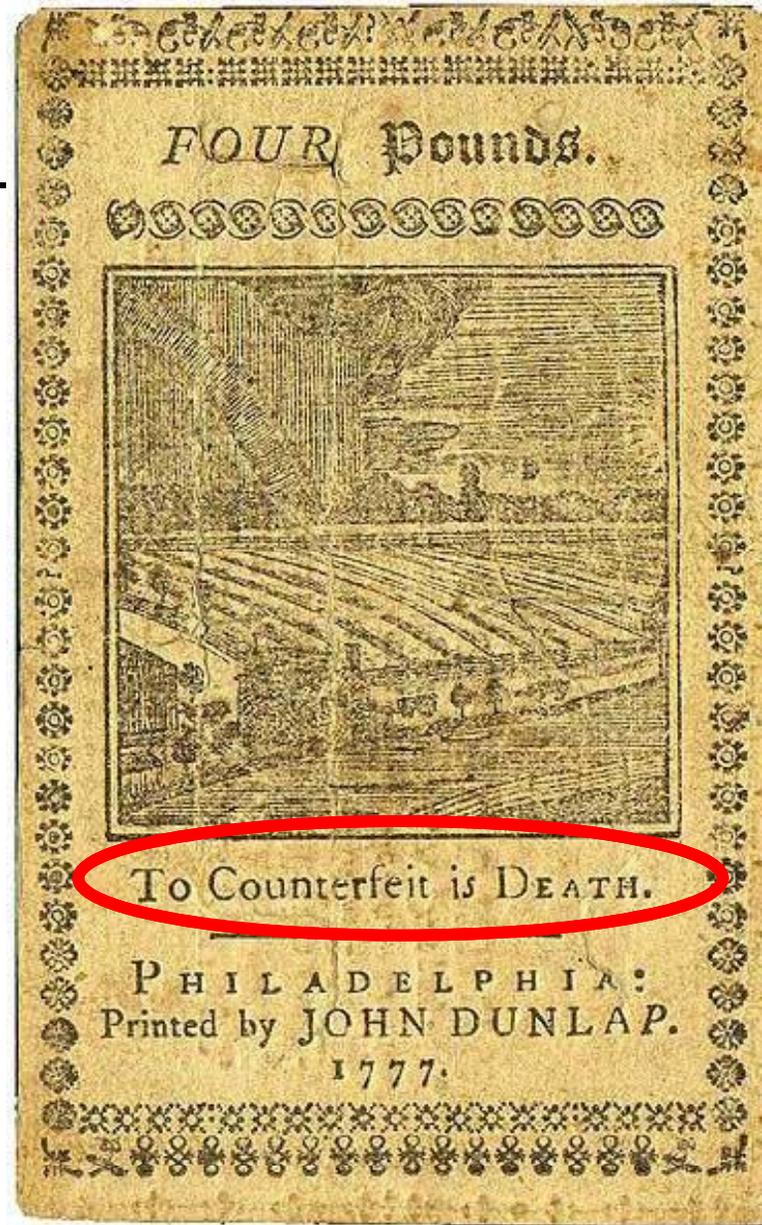


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# Colonial Period

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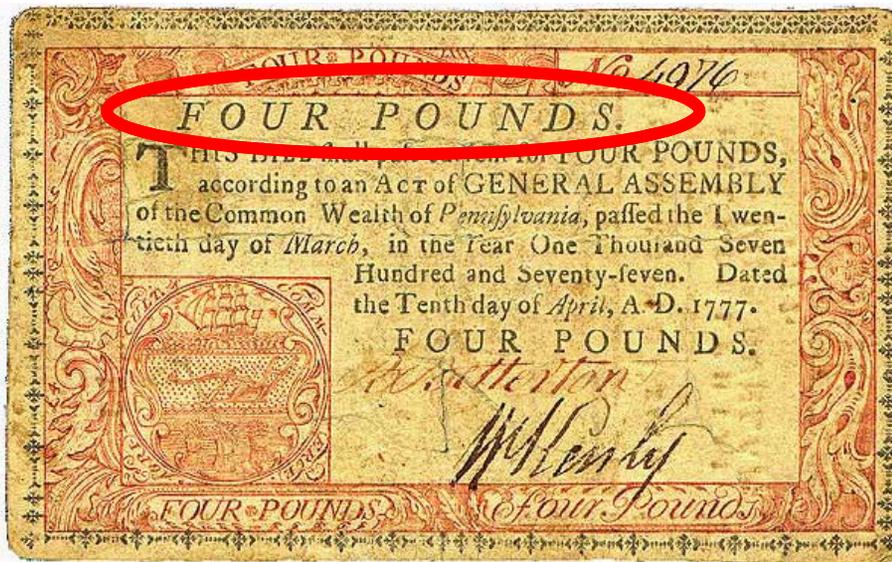


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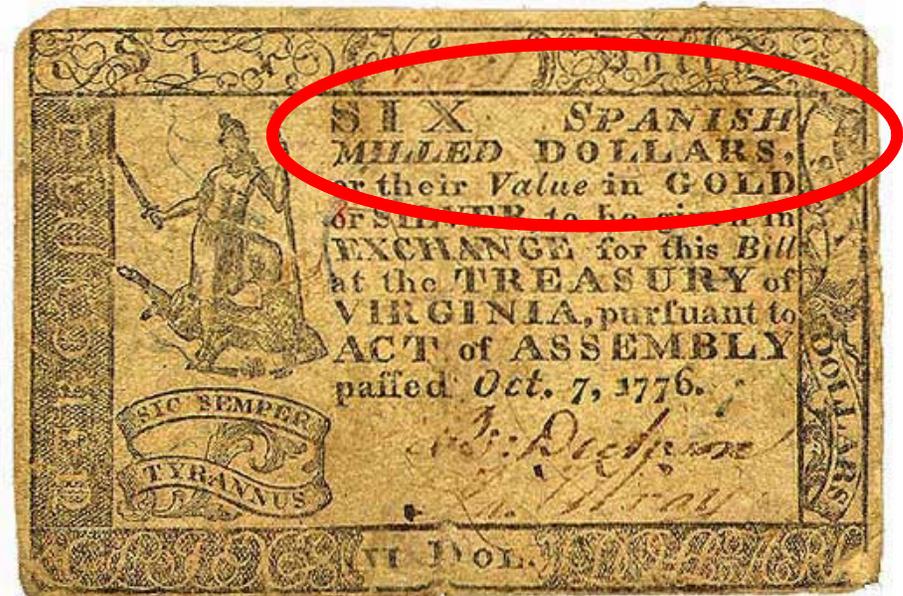


# Revolutionary War & Early National Period

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**Pennsylvania (1777)**



**Virginia (1776)**

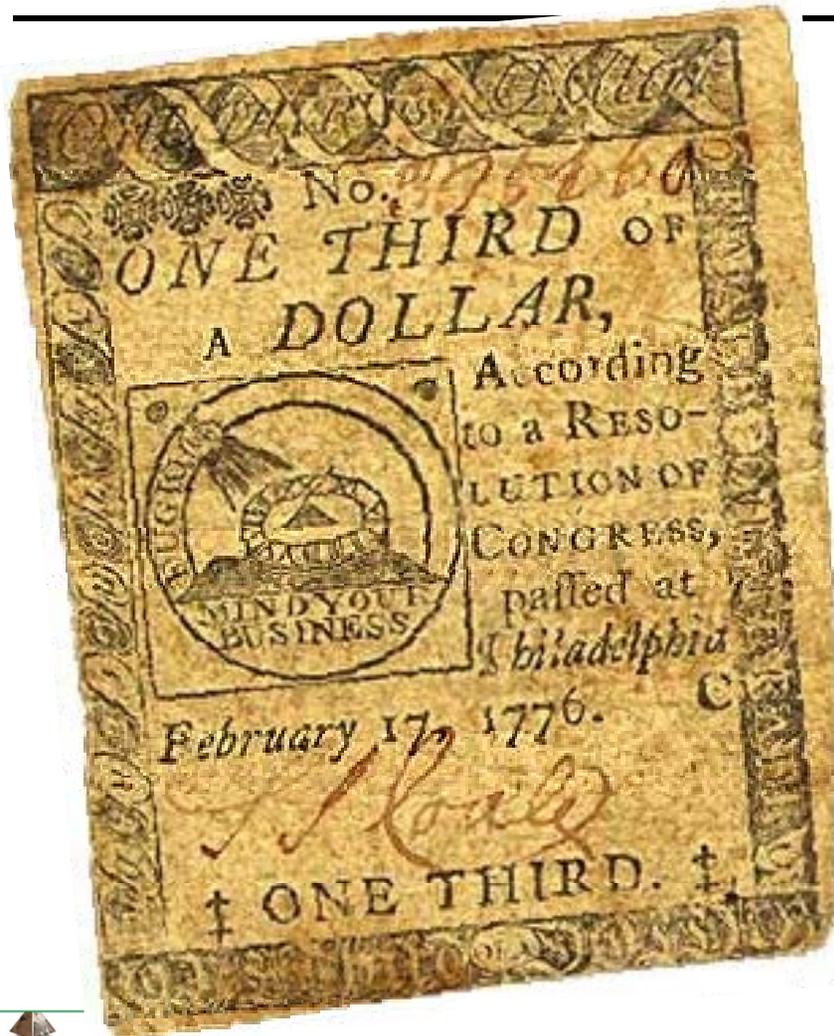


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# Revolutionary War & Early National Period

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



# Financial Challenges after Revolution

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- 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



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# Fugio cent (1787) – 1<sup>st</sup> coin issued by the U.S.

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# U.S. Constitution

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**Congress shall have the power...**

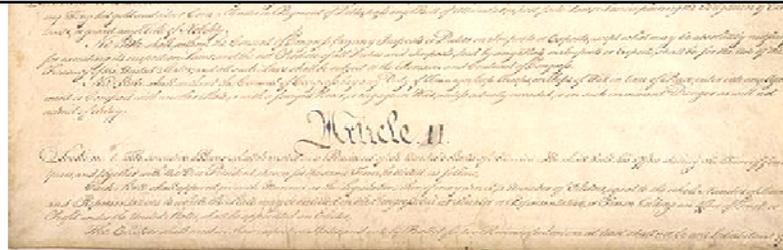
***“...to coin money, regulate the Value thereof, and of foreign Coin...”***

**- 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**



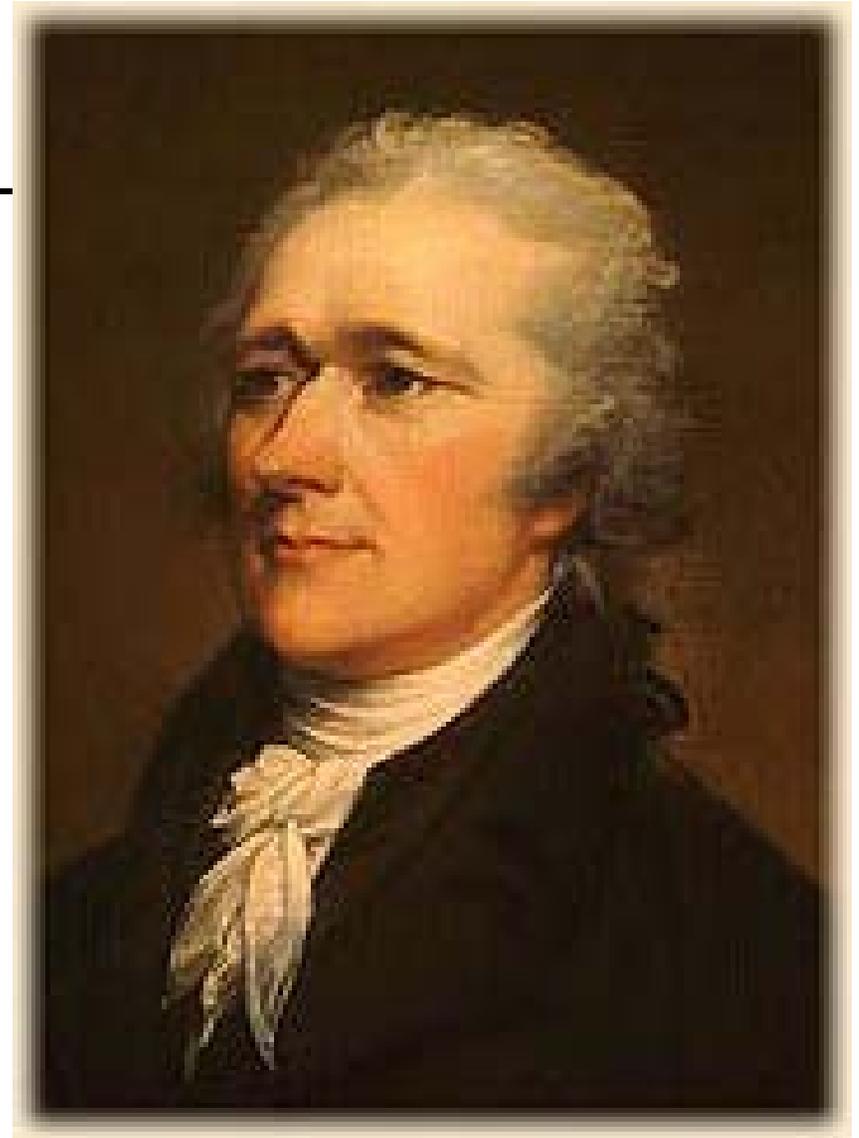
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# Alexander Hamilton

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- As the first Secretary of Treasury, Hamilton advocated,
  - National Mint
  - National bank



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# Revolutionary War & Early National Period

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- 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



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# Hamilton's Proposal – December 1790

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- 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%



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# Alexander Hamilton

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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



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# Debating a National Bank

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## 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

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- *“...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.”*

Source: *Banks and Politics in America*, Bray Hammond, 1957, pp. 115-116.



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# First Bank of the United States

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# First Bank of the United States

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- Privately held
  - 20% government owned
  - 70% foreign owned
- Only national bank
- Located in Philadelphia
- 8 branches
- 20-year charter lasted from 1791 to 1811



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# Branches of the First Bank of the U.S.

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# First Bank of the United States

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## 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%)



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# Note from the First Bank of the U.S.

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# First Bank of the United States

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- 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

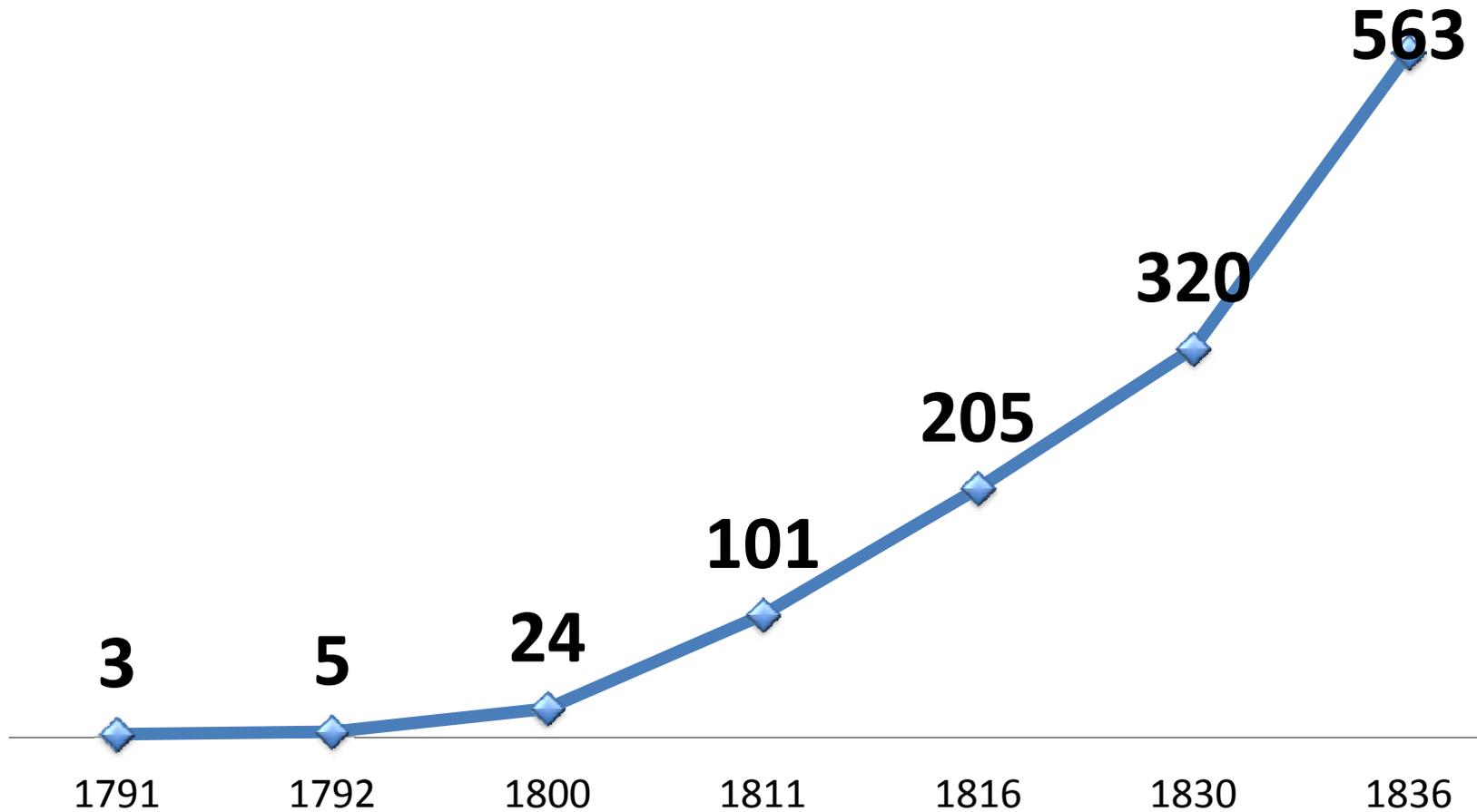


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# State-Chartered Banks in the U.S.

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# First Bank of the United States

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



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# State Banking from 1811 – 1816

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- War of 1812 reduced trade impacted custom duties

	Exports	Imports
1811	\$61 M	\$53 M
1816	\$7 M	\$13 M

- Federal government forced to rely on state banks to finance war
- Inflation as state bank notes grew 150%



# Proposing a Second Bank

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



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# Madison Concurs

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*“...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



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# Second Bank of the United States

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# Second Bank of the United States

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- Ownership
  - 80% privately held
  - 20% government
- 25 directors (5 appointed by President)
- Located in Philadelphia
- Grew to 25 branches
- 20-year charter



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# Second Bank of the United States

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# Second Bank of the United States

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- 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



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# ~~First~~ Second Bank of the United States

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## Government's fiscal agent

- Collected taxes (mainly customs duties)
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- Paying bills

## Issued notes

- Circulated as currency
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## Private bank

- Accepted deposits
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# Second Bank of the United States

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# Second Bank of the United States

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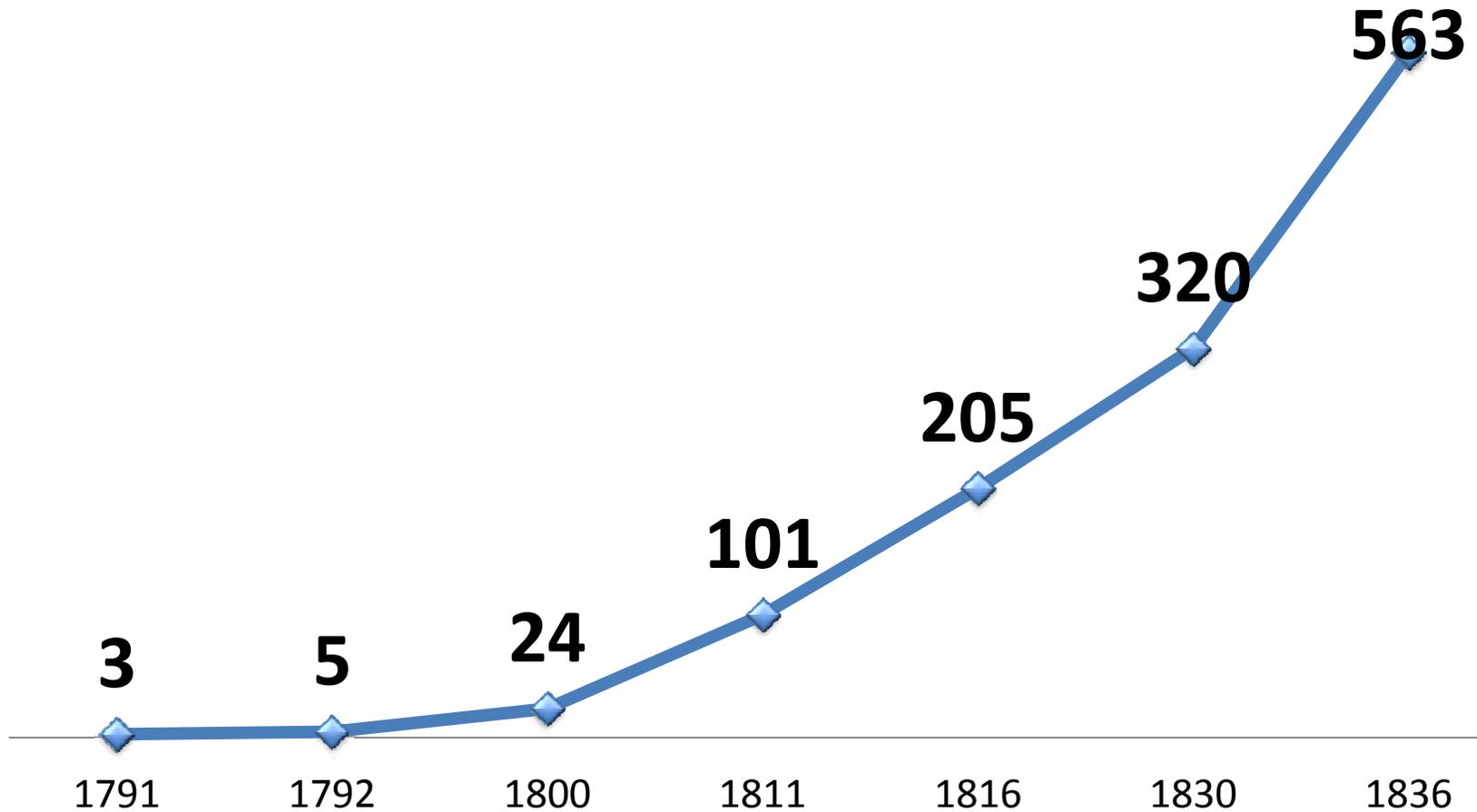


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# State-Chartered Banks in the U.S.

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# Panics

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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



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# Opposition from Andrew Jackson

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## Distrust of Paper Money

- Land deal gone bad where Jackson accepted paper notes that became worthless
- Felt that specie was the only medium of exchange
- Distrusted banks (issuers of paper notes) and credit

## Other Concerns

- States' rights
- Unchecked power in the hands of private citizens
- Bank lacked an effective form of regulation



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# Opposition from Andrew Jackson

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- 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



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# State Banking Era: 1836-1863

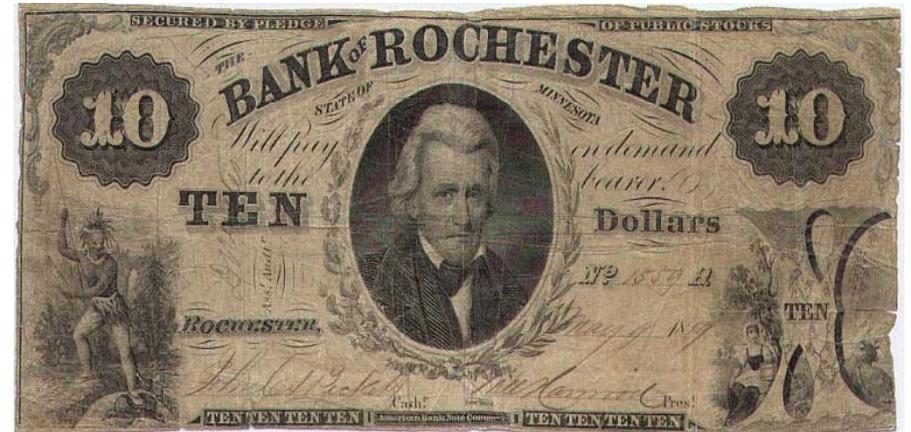
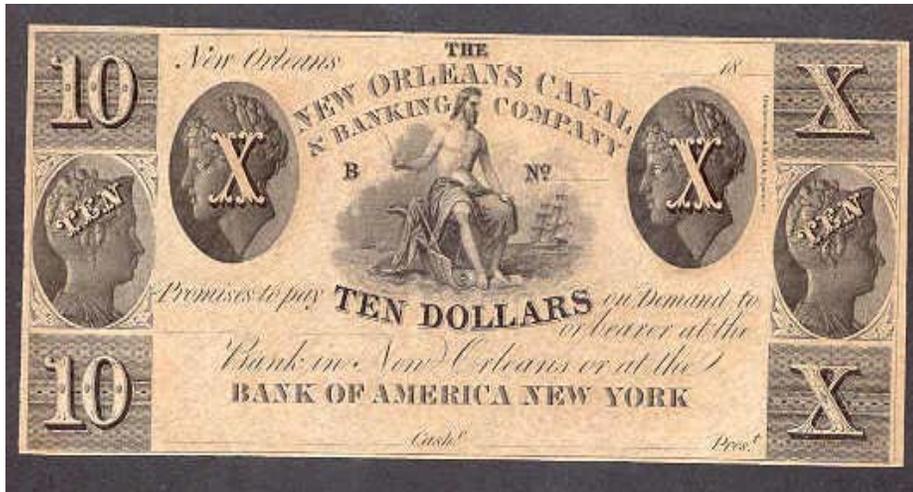
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- Banks were chartered and regulated by states
- Several states (including Texas) banned banking
- Variety of notes exploded



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# State Banking Era

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# State Banking Era: 1836-1863

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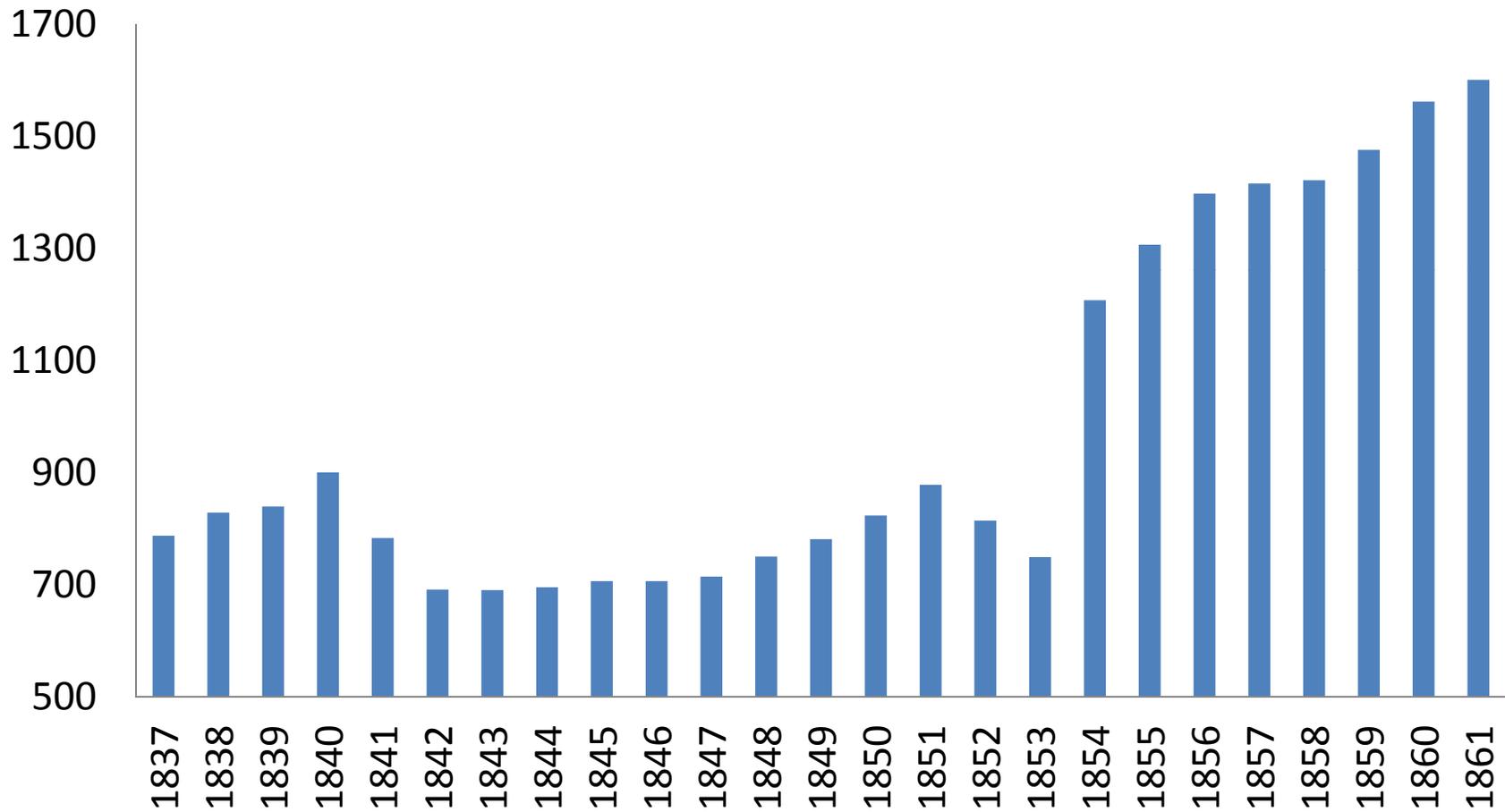
- Notes were often not exchanged at face value
  - Lists published of discounts used.
  - State bank notes not a uniform currency.
    - In 1842, a \$1 note from a Tennessee bank is exchanged for 80 cents in Philadelphia, while a \$1 note from an Illinois bank is exchanged for only 50 cents.
- Increased number of state bank notes issued
  - By 1860, more than 1,300 banks issue 7,000 different types of notes used as currency.



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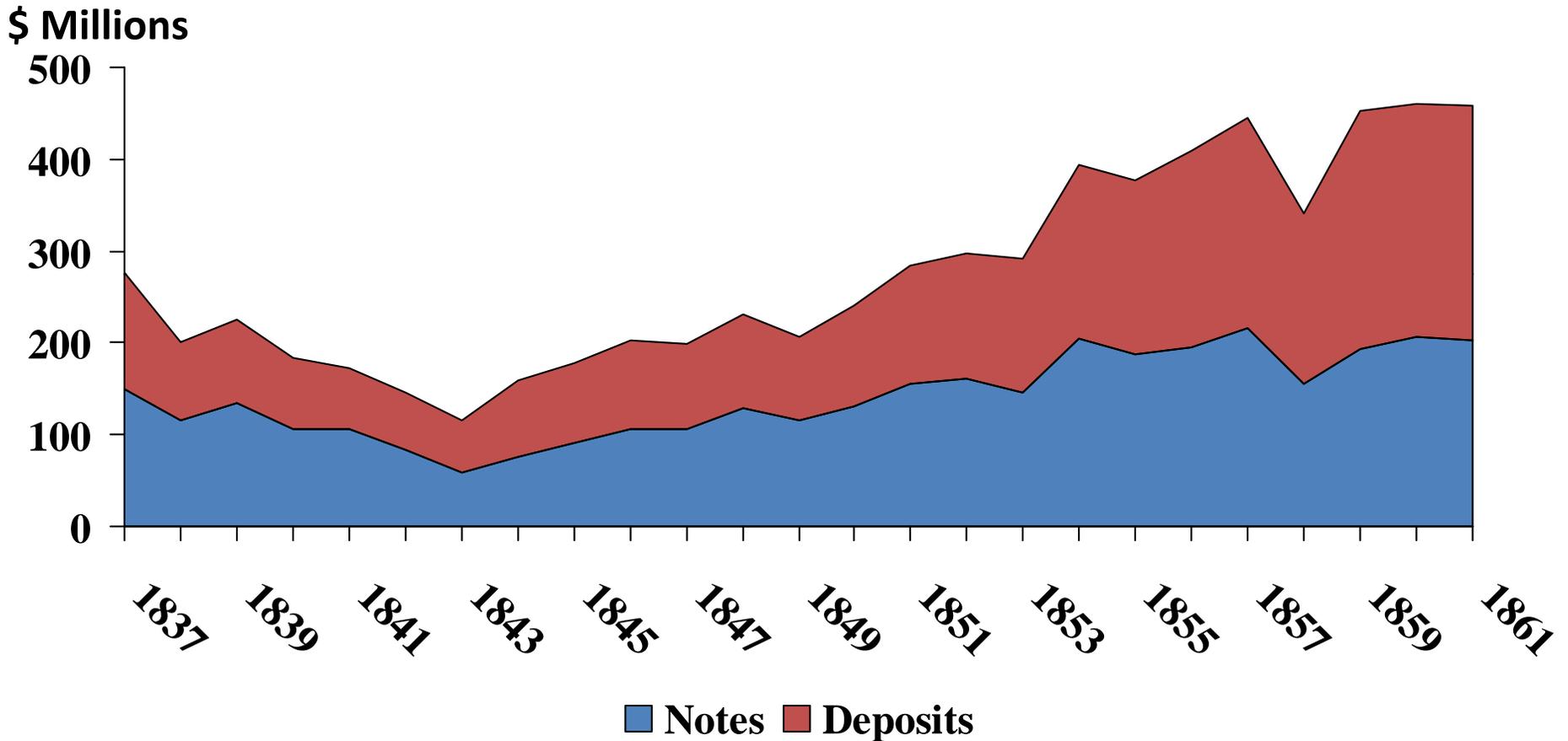
# State Banks



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# State Bank Notes and Deposits



Source: *The Economics of Money and Banking*, Lester V. Chandler, 4<sup>th</sup> ed., 1964, p. 140.



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# Free Banking Era: 1837 – 1863

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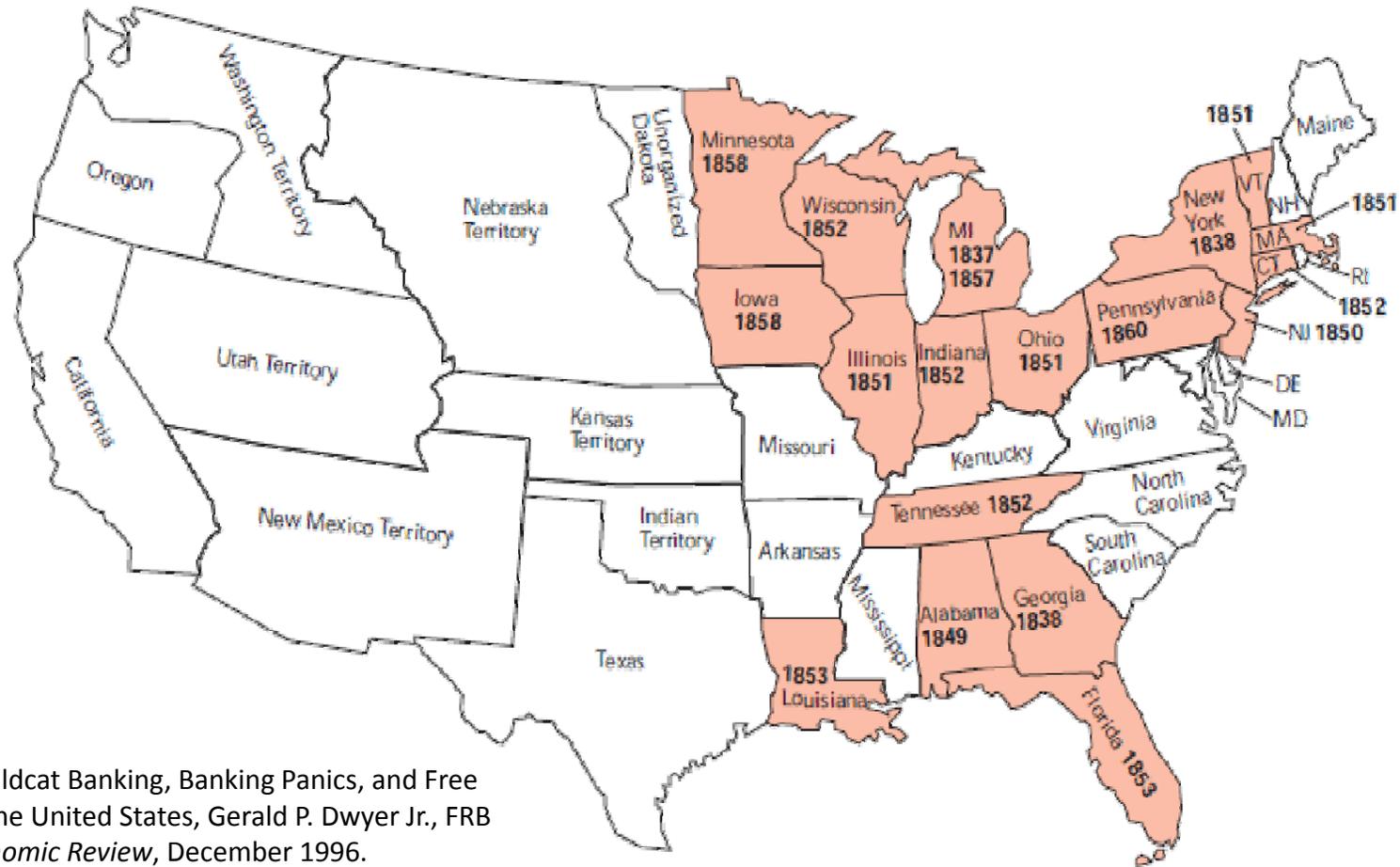
- First adopted in Michigan
- Charter by state legislature no longer necessary
- Anyone is free to engage in banking, but banking is not free
- States established their own regulations



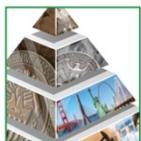
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# Free Banking States



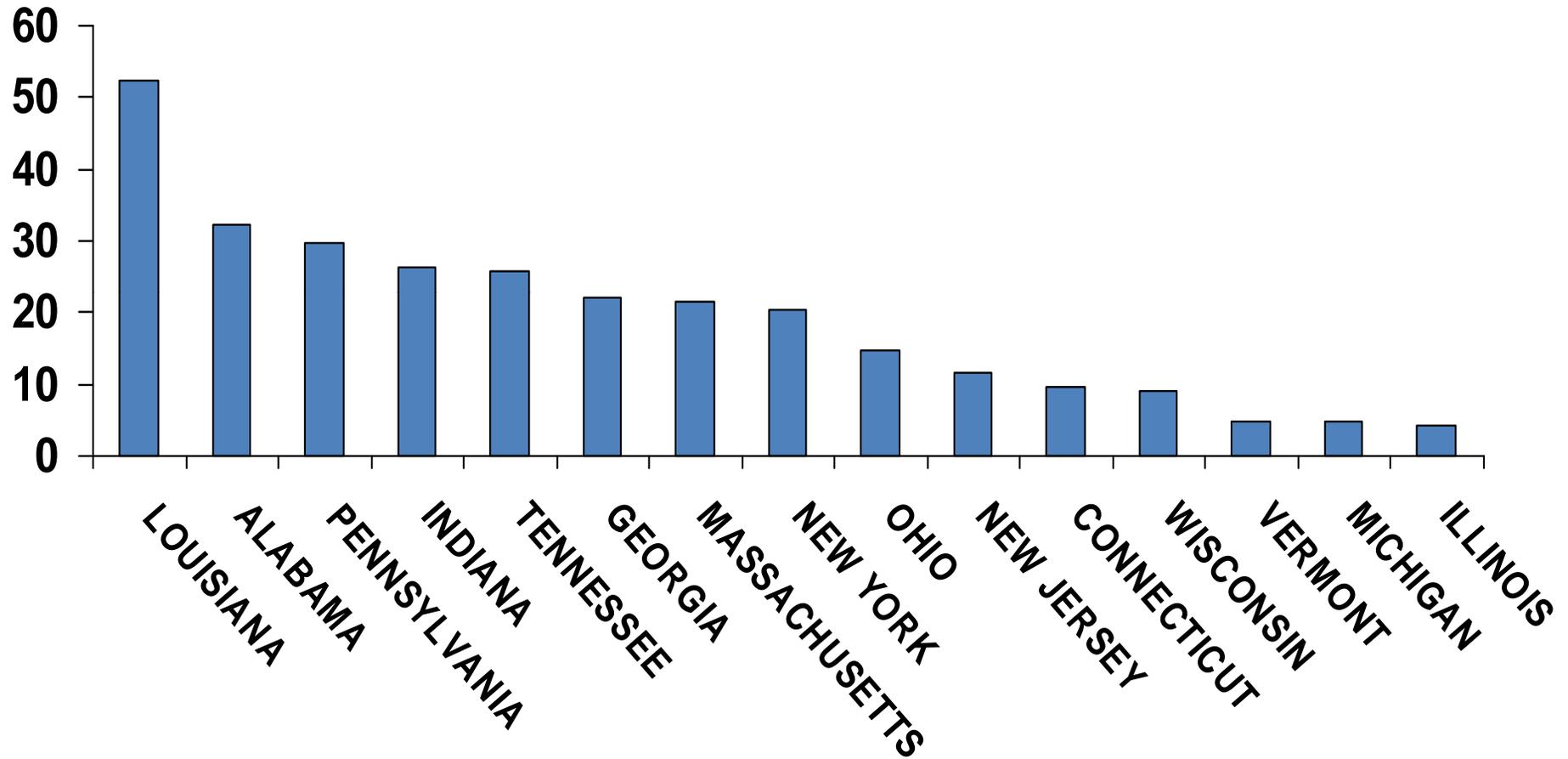
Source: "Wildcat Banking, Banking Panics, and Free Banking in the United States, Gerald P. Dwyer Jr., FRB Atlanta *Economic Review*, December 1996.



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# Ratio of Specie to Deposits and Notes in 1859



Source: *Banks and Politics in America*, Bray Hammond, 1957, p. 716.



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# Free Banking Era



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# Banking in Texas

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***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**



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# Wildcat Banking?

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# Panics

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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



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# Independent Treasury System

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- 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



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# The End of the State Banking Era

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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



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# Legal Tender Note

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# National Bank Act of 1864

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



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# National Bank Act

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



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# State Banks Attacked

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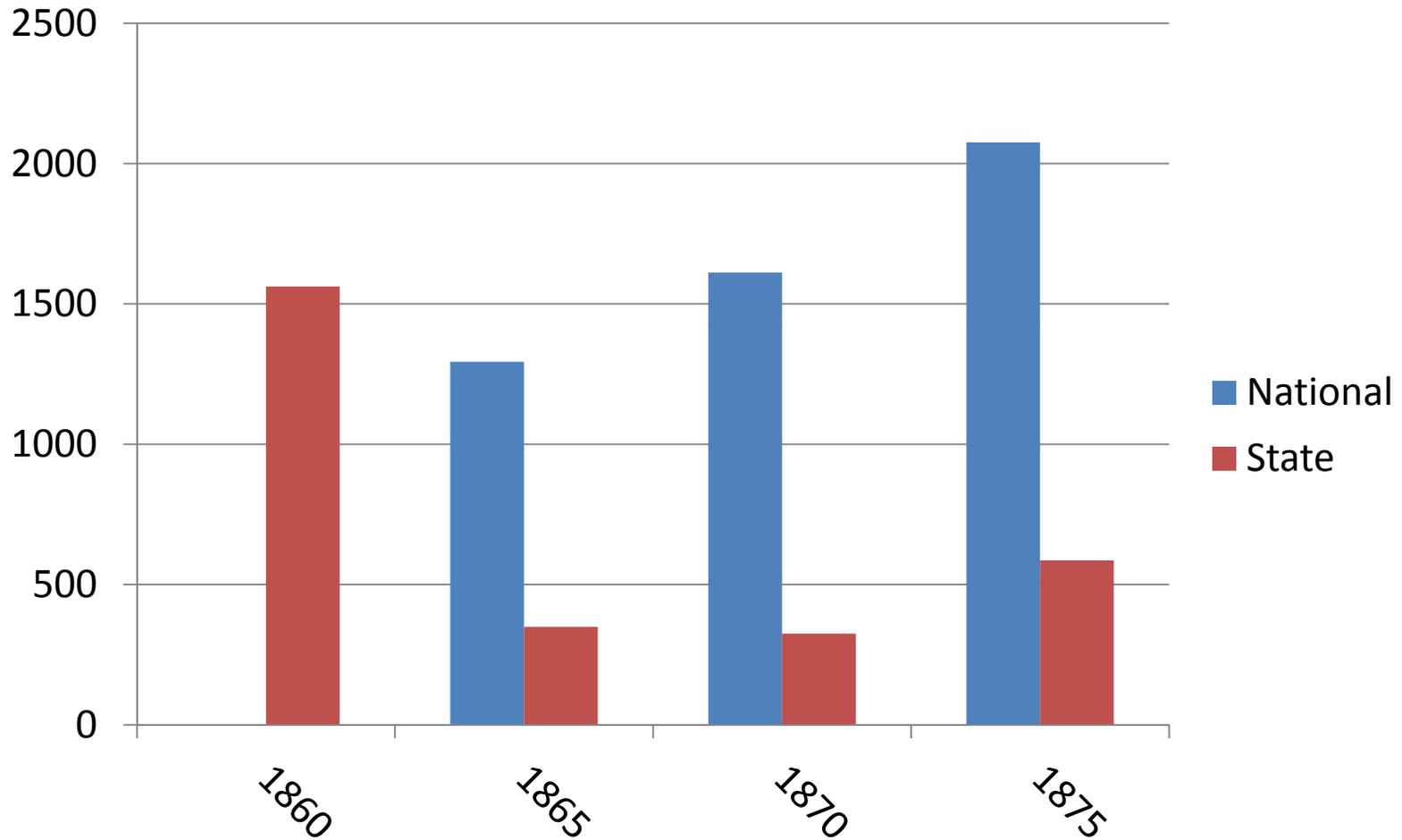
- Almost 1,600 in 1860, only 350 in 1865
- 10% tax placed on state bank notes – upheld by Supreme Court
  - Chief Justice Salmon P. Chase
- State banks introduce demand deposits
- Dual banking system still exists today



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# State and National Banks



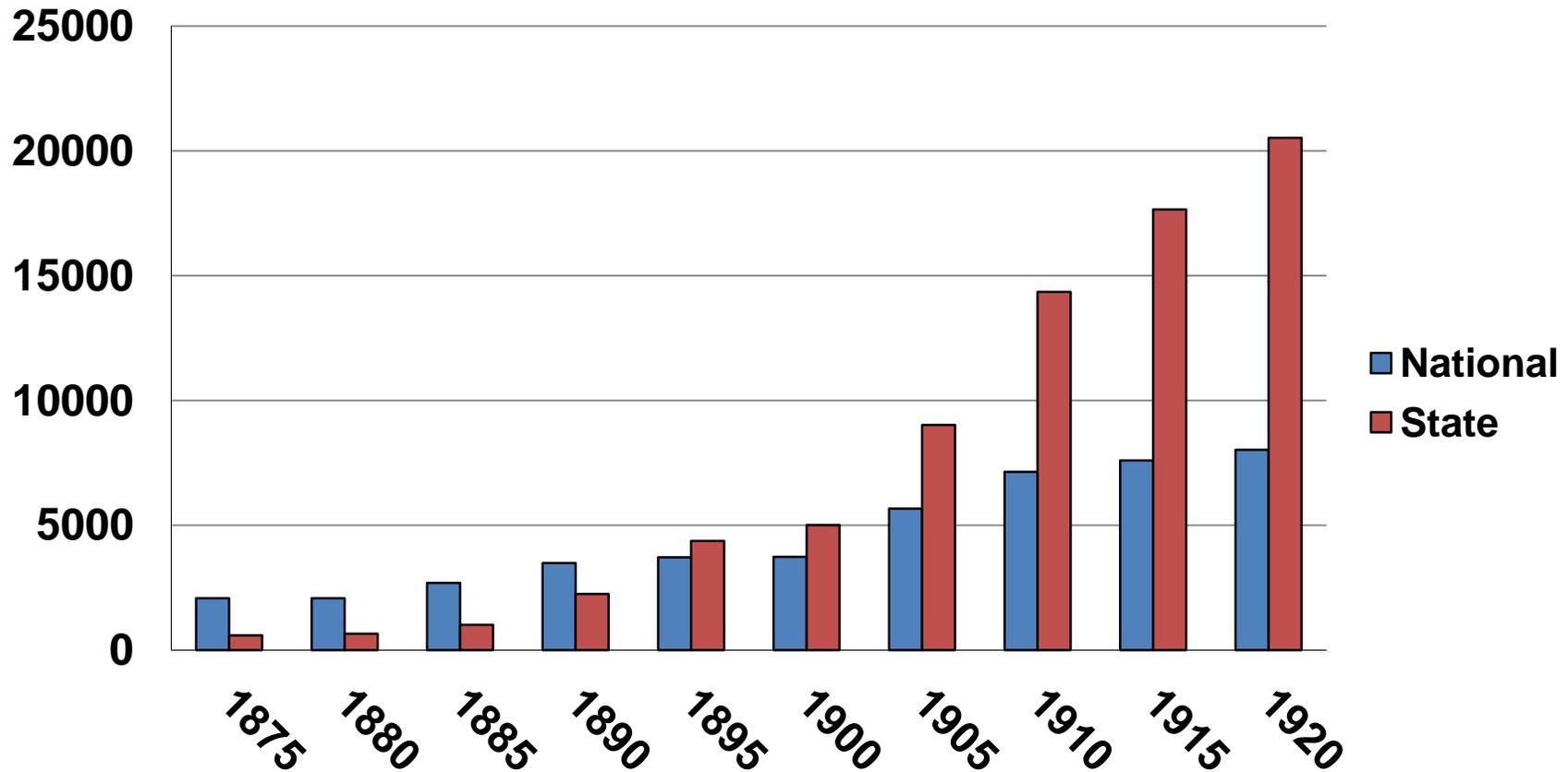
Source: *Banking and Monetary Statistics*, Federal Reserve System, 1914-1941, p. 6



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# State and National Banks



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



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# New Forms of Paper Currency

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- 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

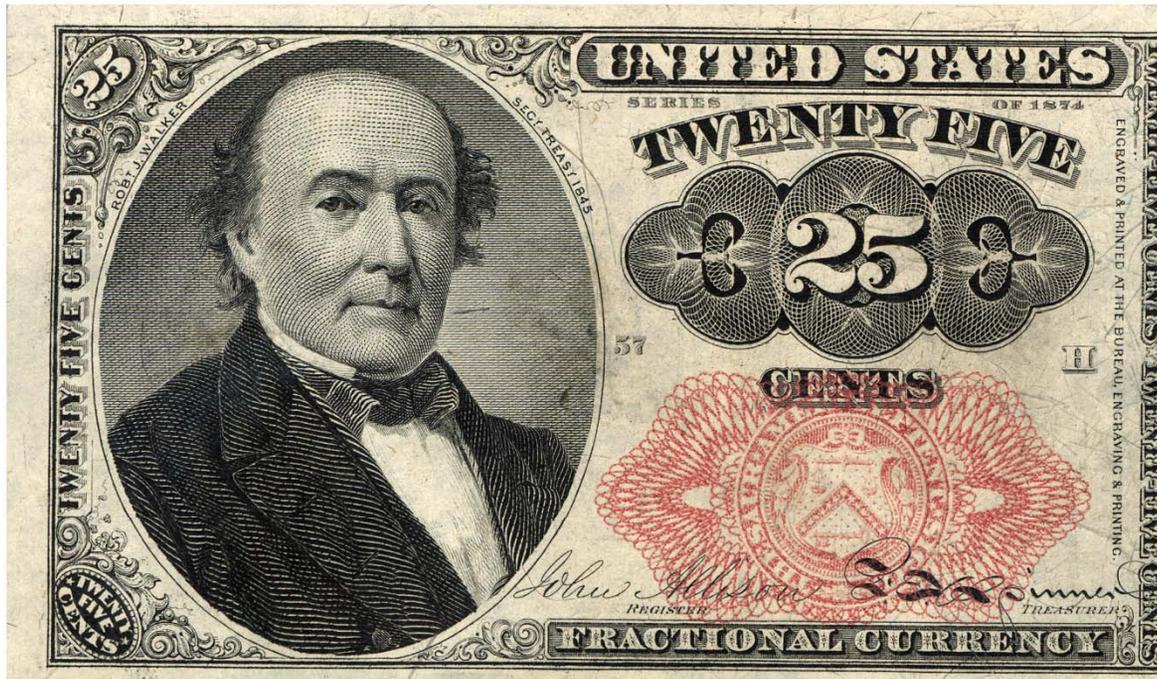


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# Fractional Currency

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# National Bank Notes

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- 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



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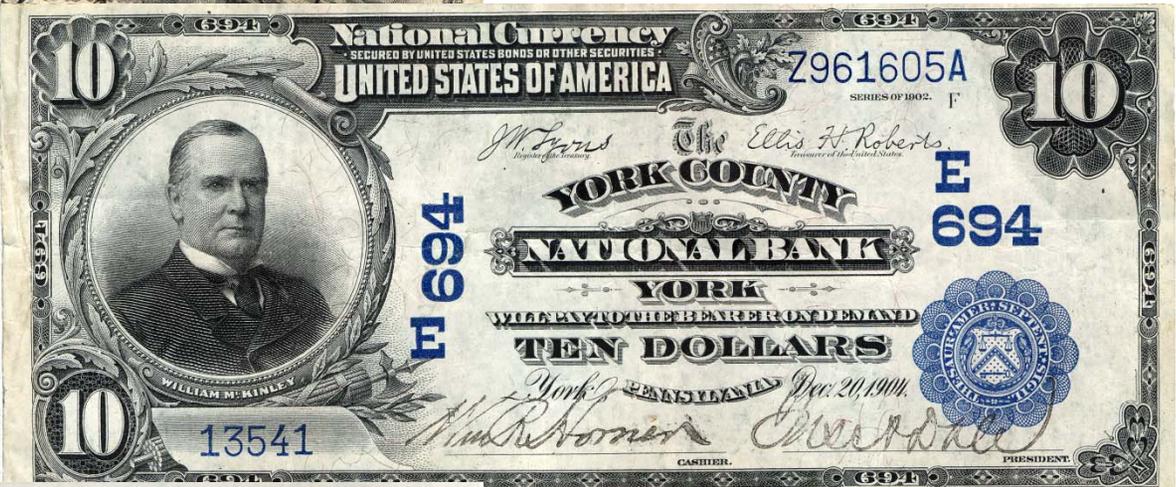
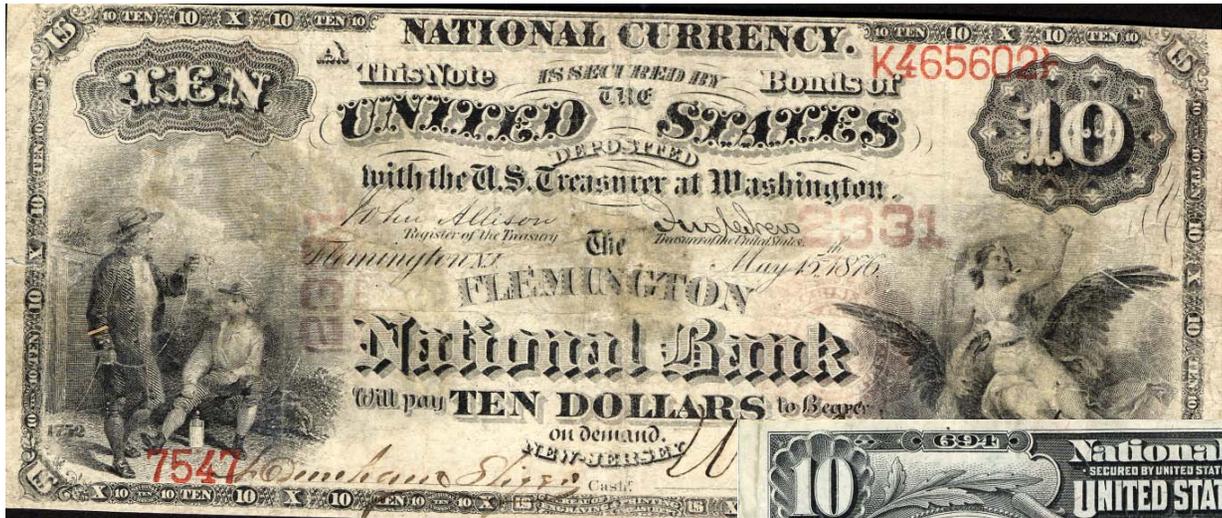
# National Bank Notes

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# Panic of 1873

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- 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



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# Gold Standard

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- 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



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20 (THIS CERTIFIES THAT) 20

Under Chap. 290, Sec. 12,  
ACT OF JULY 12, 1892

*There have been deposited in the*  
**Treasury of the United States,**  
**Twenty Dollars**  
 IN  
**GOLD COIN**  
*repayable to the bearer on demand.*

C52612125

**GOLD CERTIFICATE**

**20**

**WASHINGTON**

[DEPARTMENT SERIES.] **WASHINGTON, D.C.**

C52612125

*J. M. Lusk* *Ellis H. Roberts*



**20**

**RED GOLD**

**CERTIFICATE**

**20**

**RED GOLD**





# Panics

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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



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# Panic of 1893

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- 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

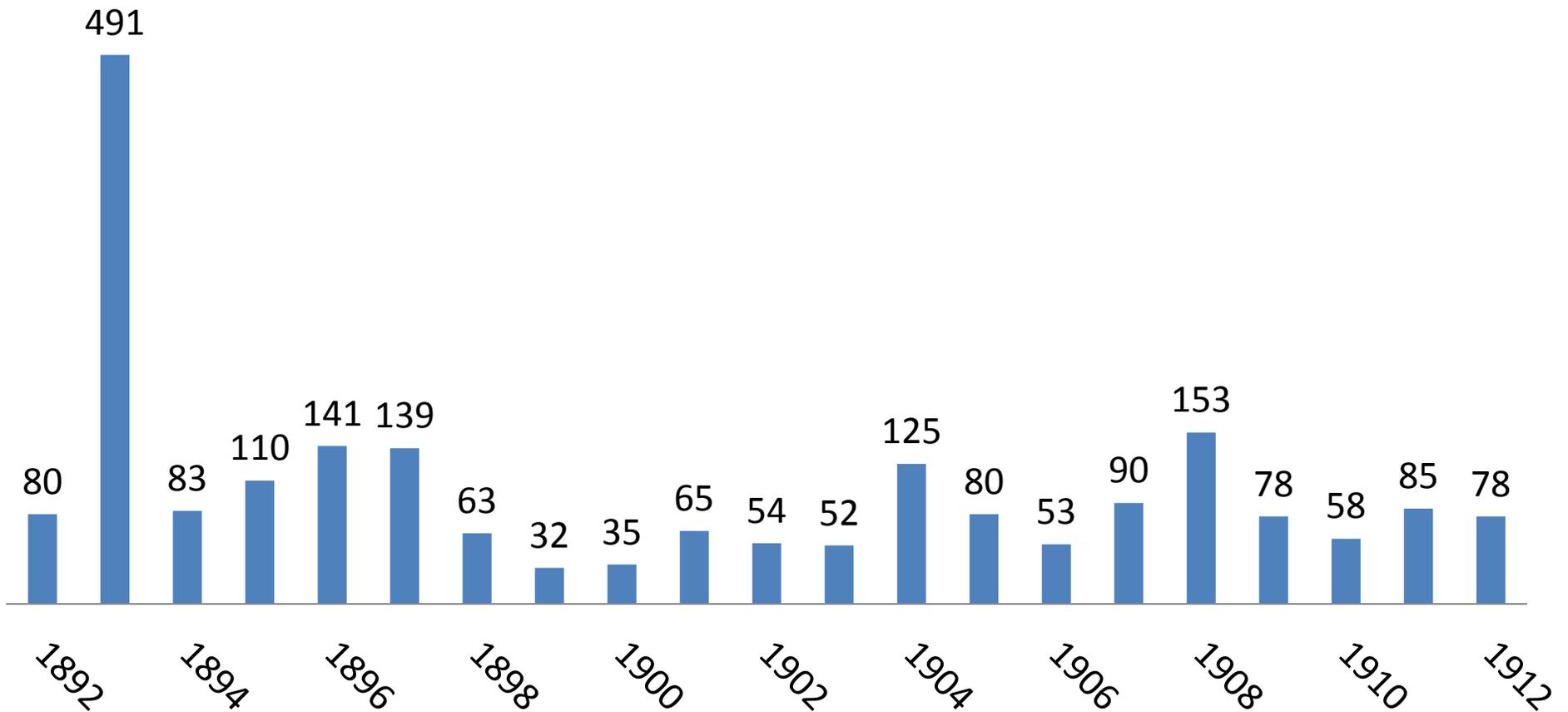


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# Bank Suspensions

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



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# Gold Standard vs. Bimetallic Standard

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- 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.*”



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# Panic of 1907

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- 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



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# Federal Reserve Act of 1913

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- “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)



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# Questions?



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