

The Life and Legacy of the Second Bank of the United States

Peter L. Rousseau

Vanderbilt University

Federal Reserve Bank of Philadelphia's Policy Forum on the History of Central Banking in the United States, December 6, 2013.

Overview

- Early in its history, Congress twice granted charters for quasi-public yet privately operated banks. The first time was in 1791, shortly after ratification of the U.S. Constitution, and the second in 1816, following the War of 1812. Both received 20-year charters, and both went un-renewed.
- The “First” and “Second” Banks of the U.S. were fiscal agents to the Treasury, and established branches around the country to hold government deposits and to make payments. In this sense they were private banks serving the public interest. Whether private or public objectives took priority, however, was at the center of controversies surrounding their existence.
- The 1st and 2nd BUS made commercial and private loans with the government’s surplus balances and regularly paid large dividends to private shareholders. In this sense they were very “private” banks.

But were they central banks?

- Not in the modern sense. Central banking involves some attempt to regulate the supply of money, monitor banks, and serve as a lender of last resort. Both early federal banks engaged in these activities to a limited degree, yet private interests created tensions, especially within the Second Bank, that limited their ability to engage in these activities fully. Of course, the leaders of these institutions knew less about central banking than is possible today.
- At the same time, the Second Bank did exercise some control over excessive note issues by state banks, and there is evidence that state banks may have treated the Bank's notes as base money. These features would have important economic implications for its dissolution in 1836.

The First BUS

- By most accounts, including even its early opponent Thomas Jefferson, the Bank served the Treasury well, and funded projects, both private and public, that helped the nation build much of its early infrastructure (Rousseau and Sylla 2005).
- Opposition usually focused on questions of constitutionality. Alexander Hamilton, the first Treasury Secretary, broadly interpreted Article 1, Section 8 of the Constitution, which reserves to Congress the right to “coin money and regulate the value thereof” through any means “necessary and proper,” as justification for creating a mint and federal bank.
- Congress approved the charter, but it was not until after the Second Bank was formed that the Supreme Court confirmed its constitutionality in 1819 and again in 1824.
- The Bank regularly paid annual dividends of eight percent to its shareholders, which critics viewed as excessive and used to fan the flames of its failed recharter in 1811.

The Second BUS: Early Days

- The Second Bank was intended to remedy financial problems faced during the War of 1812, when there was no federal bank, but quickly deteriorated into making large loans to insiders, coming close to bankruptcy within two years under its first President, William Jones.
- Successor Langdon Cheves was more able, yet contracted loans sharply when a financial panic took hold in 1819. Some claimed that the Bank had saved its shareholders at the expense of the public.
- When Nicholas Biddle takes over as the Bank's President in 1823, the situation seems to turn around. Biddle took pride in conducting the government's business efficiently and monitoring banks' note issues, while still lending out the public surplus to provide robust returns to shareholders.

The Election of 1832

- The election of Andrew Jackson in 1828 was a sea change. Almost immediately, Jackson questions the constitutionality of the Bank's and its privileged position in lending public monies at the end of annual addresses to Congress, tempering it with conciliatory yet firm language.
- *"In the spirit of improvement and compromise which distinguishes our country and its institutions it becomes us to inquire whether it not be possible to secure the advantages afforded by the present bank through the agency of a Bank of the United States so modified in its principles and structure as to obviate constitutional and other objections"* (Second Annual Message, December 6, 1830).
- Biddle erred in believing that Jackson would take a kinder view of the Bank with time. As Jackson held firm, Speaker Henry Clay steered an act to re-charter the bank through both chambers in 1832 and in the midst of Jackson's re-election bid.

- Designed to force the President's hand or make him look foolish, Clay miscalculated the strength of populist support for Jackson, and lost the general election to him in a landslide defeat.

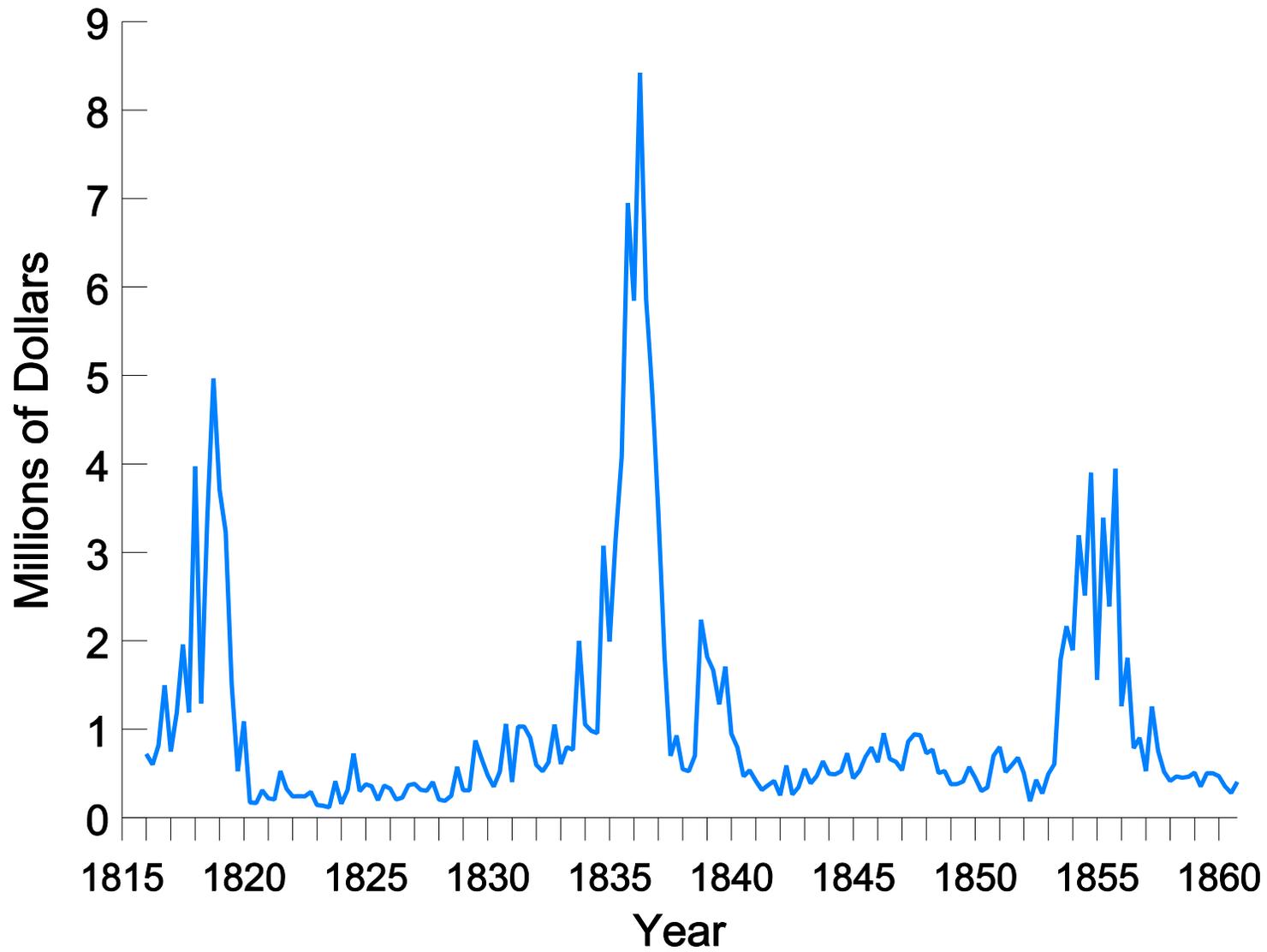
The “Bank War”

- Upon re-election, Jackson escalated the campaign against the Bank, citing the degree of private control wielded by the nation’s fiscal agent and charging it with failing to provide a “sound and stable currency.”
- Sec. 20 of the Act of Incorporation: *“The deposits of the money of the United States in places in which the said Bank and Branches thereof may be established, shall be made in said Bank, unless the Secretary of the Treasury shall otherwise order and direct; in which case the Secretary of the Treasury shall immediately lay before Congress, if in session, and if not, immediately after the commencement of the session, the reasons of such order and direction.”*
- Biddle interprets Sec. 20 as authorizing the Secretary to remove public monies if mismanagement presented a threat to their safety, which he did not believe, yet the Secretary and Congress form a committee in 1832 to investigate exactly this.

- The inquiry concludes that the deposits were safe, but Jackson proceeds to fire two Treasury Secretaries until Roger Taney orders the removal of the deposits in 1834, citing “reason to believe that the charter had been violated.”

The Executive in the Saddle

- The Secretary distributes the deposits among “pet banks” throughout the country, hastily selected by Jackson democrats. These bankers multiply their new base money, which along with specie flows from Mexico and points south intensify a mounting inflation.
- A boom in sales of public lands in the new “west” and “southwest” leads Jackson to issue an executive order (the “Specie Circular”) in June 1836 requiring all public lands be paid for with gold or silver coins. This does not slow land sales, but rather drains gold and silver reserves from eastern banks to the west.
- With the nation’s federal debt paid off in 1835, surpluses from customs and land sales accumulate in the pet banks, especially in New York City. This leads the Jackson Democrats to pass a “Deposit Act” in 1836, which called for a “Distribution of the Surplus” back to the states in accordance with their population beginning in 1837. This further drains eastern reserves.



Quarterly Public Land Sales, 1816-1861

The Executive in the Saddle (cont.)

- These measures combine with balance of payments deficits to bring public fear and launch bank runs in New York on May 10, 1837. In a weakened condition, the banks there suspend convertibility of their notes into coin, and this propagates into the nation's first general suspension. A recession ensues for the next six years, and the nation goes without a federally-chartered bank until December 1913, when the Federal Reserve Act is passed.



Wherefore hast thou smitten these
As? Behold I went out to Protest
thee, because thy way is perverse before
me.

Because thou hast mocked me, I would
there were a sword in mine hand, for
now would I veto thee.

Am not I thine Assaye
which thou hast ridden
ever since I was thine
unto this day?

I shall tread in the footsteps
of my illustrious predecessor

Protest \$ 20,000,000

Bankrupts
of 1857
The Treasury
Savings Fund
Deposit Receipts
'Old History'
Credit System
\$ 20,000,000.

Specie
Currency
Circulating
Medium

PHENIX BANK
MECHANICS B...
BANK OF NEWYORK
MANHATTAN BANK
BANK OF AMERICA
No Specie
Farewell Address
Specie Suspended
Gold or Silver required for Merchants' Bonds inquire at the Custom House

THE MODERN BALAAM AND HIS ASS.

What can be learned from the Second Bank?

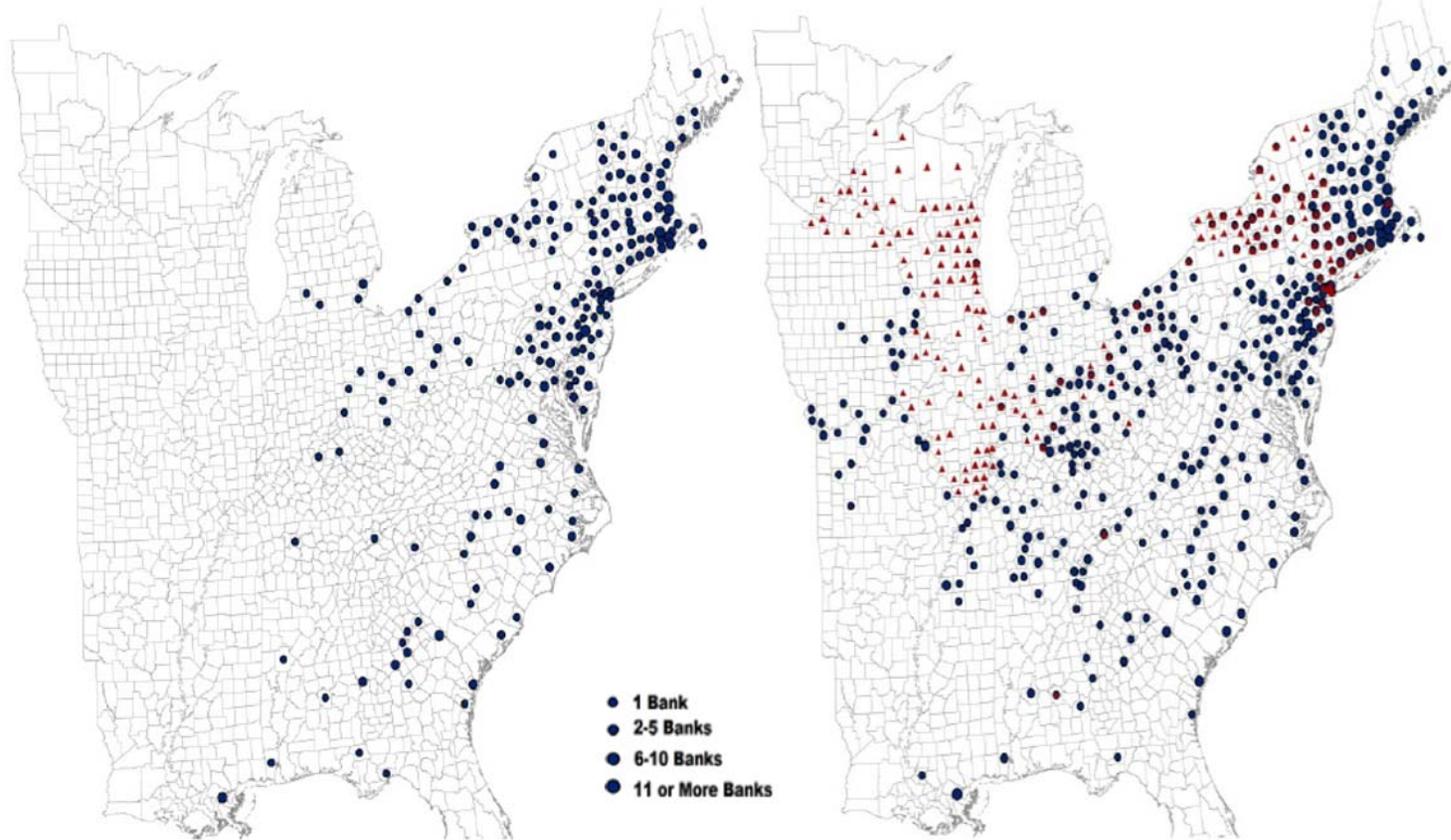
- What Jackson really sought was greater public accountability and oversight for the privately-controlled federal bank. The Secretary could provide some, but was not directly involved in the Bank's governance. Biddle seemed benevolently at the helm of the nation's monetary affairs, yet shareholder distributions seemed to have priority. Even if this were acceptable, would every Bank President take the public role as responsibly as Biddle?
- Jackson was not the first to notice the deficiency, but the one who acted most strongly upon it.
- On the other hand, Jackson represents an extreme case of what is possible when monetary policy is left in the hands of the Executive. Measured against the panic and recession of 1837-43, an independent central bank seems a good choice.

- Though short term effects of the Bank War were severe, it is possible to take a more positive view of Jackson's moves in the long-run. The free banking movement allowed the system of banks to expand, and the National Banking System furthered this, while also demonstrating the dangers of an inelastic currency.
- Even Bray Hammond (1936, 184), a sharp critic of Jackson policies, concedes that:

“Free banking is a direct heritage from Jacksonian democracy. The interest of Jackson himself in banking was mainly destructive, but the people who gave him his following – the mass of rugged individualists imbued with what Gallatin called with dismay the fierce spirit of enterprise – wanted not to stop with the destruction of the Bank of the United States, but beginning with that to erect thousands of local banks owned by local capitalists. They wanted to destroy the monopoly and make banking open to all.”

Panel A: 1832

Panel B: 1859



The Distribution of Free and Charter Banks, 1832 and 1859.

- The Second Bank showed that concentration of monetary interests in the hands of a few tended to constrict the banking system. Though banks would likely have expanded in any case, we cannot know how quickly had the Second Bank survived. Yet the expansion did round out the banking map, leaving a footprint that the Federal Reserve inherited upon its founding.
- What if Jackson had not ended the Bank? Bordo (2012) studies the counterfactual and suggests that continued renewal might have left the U.S. with a more European-like central bank today. Given that the next re-charter would have occurred under the watch of Millard Fillmore, the final Whig President, the Bank's survival into at least the 1870s would certainly have been likely.
- The framers of the Federal Reserve Act and the National Monetary Commission are to be credited for absorbing lessons from the past in striking the balance that we see enacted today.