<u>History of Banking in the U.S. (9/30/2010)</u> Econ 310-004

Definitions

- ***independent treasury*** – separation of bank and state
- ***laissez faire*** – transactions between private parties are free from state intervention, including restrictive regulations, taxes, tariffs and enforced monopolies
- ***mercantilism*** – alliance between government and certain privileged merchants
- ***interstate branch banking*** – the ability of a bank to have branches in more than one state
- ***intrastate branch banking*** – the ability of a bank to have multiple branches in the same state
- ***unit banking*** – no interstate or intrastate branching
- ***fractional currency*** – currency in denominations less than a dollar (e.g., 5¢, 10¢, 25¢, etc.)
- ***bond collateral requirement*** – dollar for dollar banknote to state bond ratio
- ***wildcat banking*** – fraudulent banks setup in wilderness that made it very hard to redeem notes
- ***inelastic currency*** – inability of the system to convert deposits into banknotes

Principles

- Banking has always been one of the most regulated industries.
- Branching allows diversification.
    - *Assets*: Without branching banks only loan locally, so when the local economy goes bad, many loans default at once.
    - *Liabilities*: Without branching banks only get deposits locally, so when the local economy goes bad, many customers withdraw at once.
- The stability of the bank system effects the reserve rate, not the other way around.
- Bond collateral requirement led to more bank panics due to inelastic currency.

Alexander Hamilton

- Secretary of the Treasury (Washington)
- formed United States Mint
- got Morris to form Bank of North America
- started Bank of New York
- architect of 1st bank of the United States
- killed by Aaron Burr (VP) in a duel

Andrew Jackson

- President of U.S. (1829-1837)
- advocated hard money
    - gold or silver
    - 100% reserves
- vetoed 2nd Bank re-charter
- “the bank is trying to kill me, but I will kill it”
- pulled government deposits from 2nd Bank
- paid off national debt (tarriffs & land sales)

early state banks

- 1776-1837
- regulation at state level
- no general incorporation for banks
- 9/31 states outlawed banking
- some states setup monopoly banks
- some still chartered banks
- 6 states tried deposit/note insurance

“free banking” era

- 1837-1863
- not really free banking
- similarities
    - complete federal deregulation
    - general incorporation of banks
- deviations
    - no inter-/intrastate branch banking
    - prohibition on small bank notes
    - bond collateral requirement

Bank of North America

- 1781-1785
- chartered by the Continental Congress
- Robert Morris was architect
- needed congress charter (mercantilism)
- first commercial bank in the U.S.
- helped finance Revolutionary War
- interstate branching (3 states)
- never became real central bank

First Bank of United States

- 1791-1811 (20 year charter)
- Alexander Hamilton was architect
- first U.S. central bank
- no monopoly on issue of banknotes
- interstate branching
- held government deposits
- public legal tender
- $10 million capital (1/5 government)
- 38% reserve ratio

Second Bank of United States

- 1816-1836 (20 year charter)
- founded due to War of 1812
- $35 million capital
- mostly same as 1st bank, more capital
- state bank reserves were 2nd bank notes
- bank panic in 1819 fueled opposition
- Andrew Jackson vetoed re-charter
- 16% reserve ratio

Federal Reserve Act of 1913

- Federal Reserve System (12 regional banks)
- real central bank for U.S.
- lender of last resort
- nationally chartered banks must join
- state chartered banks may join
- imposed reserve requirement for deposits
- federal reserve notes could be reserves
- check clearing services offered
- coincided with World War I

National Currency Act of 1863

- AKA National Bank Act
- quickly amended in 1864
- created Comptroller of the Currency
- created national bank charters
- Comptroller of Currency approval needed
- banks could issue banknotes
- federal bond collateral requirement
- 2% tax on state banknotes
- unit banking (no branching)
- dual banking system (state/federal)

Act of March 3, 1865

- raised state banknote tax from 2% to 10%
- with 2% tax, banks had kept issuing notes
- 10% tax shut them down

Glass-Steagall Act

- AKA Banking Act of 1933
- created federal deposit insurance
    - Federal Deposit Insurance Corporation
    - state and national banks could join
- divided commercial banks from securities
    - repealed by Gramm-Leach-Bliley
- imposed Regulation-Q
    - no interest on checkable deposits
    - capped interest on other deposits