History of The U.S. Federal Banking System

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Question

• Does anyone know what the first commercial bank on the U.S. was?
Bank of Pennsylvania

• First commercial bank in the U.S.
• Founded in 1780
• Founded in order to cover the debts incurred as a result of the Revolutionary War
• Stockholders and directors were politically, financially, and socially prominent men
A Lift of the Stockholders

IN THE

BANK of PENNSYLVANIA.
Alexander Hamilton

- Noted as a founding father of the U.S. banking system
- Supported the colonies’ fight for independence from Britain
- Served as an aide to the colonies’ lead general, George Washington
- As president, George Washington named him the first Secretary of Treasury
Financial Issues after the Revolutionary War

- War left the United States in heavy debt
- Money was essentially worthless
- Hamilton researched central banking systems in other countries, specifically Great Britain
- Analyzed how Great Britain banking system supported a country at war
Question

• Does anyone know what the first bank of the United States was called?
Creation of The First Bank of the US

- Founded by Alexander Hamilton in 1791
- Opened in Philadelphia with a 20 year charter
- Began with capitalization of $10 million
- Government owned 20% of the stock and private investors owned the remaining 80%
- Became the largest financial institution in the country
Functions of the First Bank

- Accepted deposits from the public
- Made loans to private businesses and the government
- Circulated notes which became an important form of currency
- Collected tax revenues
- Made loans to and paid the bills of the government
- Unlike central banks, it did not officially control the monetary policy or state banks
- International Trade improved with new currency
Scrip Bubble of 1791

• What is a bank scrip?
Scrip Bubble of 1791

• What is a bank scrip?

• Bank scrips represented the right to purchase stock in the First Bank and were initially sold for $25 in 1791

• To complete ownership, investors had to later pay $100 bi-annually in 1792 and $75 in 1793

• One quarter of payment had to be in the form of gold, but the remaining three-quarters could be in the form of bonds

• Because \( \frac{3}{4} \) of the payment could be made using bonds, the price of bonds increased as investors’ demand for bonds increased
Scrip Bubble of 1791

- Began with the bubble of bank scrips in July 1791
- One quarter of payment had to be in the form of gold, but the remaining three-quarters could be in the form of bonds
- Bonds increase in price
- The desire for scrips increased their price, raising the price dramatically
- Prices eventually crashed by mid-September and stabilized
Panic of 1792

- “The Six Percent Club”
- Bank share prices went on a roller coaster, increasing and decreasing from October to March of 1792
- George Clinton and his followers withdrew large amounts from the First Bank in March 1792
- Resulted in a credit shortage
Panic of 1792

- Six percent club fail to make payments on their loans
- Without these bankers to purchase shares of the First Bank, the price of the stock declines
- April 1792: Defaulting of the six percent club and the price of the First Bank stock collapsing produces the panic
- Response: bank’s tighten credit, reduce cash reserves, bank’s decline renewal of loans
Closing of the First Bank

• Charter expired in 1811
• In 1811, Congress vetoed the renewal by one vote
• There was a second vote, in which it was also vetoed
• Therefore, First Bank of the United States closed in 1811
War of 1812
Economic Consequences of the War of 1812

- Impeded trade, caused many prices to skyrocket
- Custom duties on imports dropped due to reduced trading, decrease government revenue
- Inflation
- Severe debt
The Second Bank of the U.S.

- President James Madison signed a bill establishing the Second Bank of the U.S. in 1816
- Opened in Philadelphia in January 1817
- 20 year charter
- $35 Million in capital
- 20% Government, 80% Private Investors
- 25 Branches
- Functioned similarly to the First Bank
Financial Panic of 1819

• Precursors...
• Imports and Exports after the War of 1812
• Bank expansion
  – Physically
  – Loans
• Land Expansion
• Reduction in exports
Financial Panic of 1819

• Contractionary Policy

• Consequences
  – Foreclosures
  – Mass debt
  – Wage ratings declined
  – Unemployment

• Responses: land debt relief, specie reserve increase, note circulation decrease
The End of the Second Bank

- Request to renew the charter of the Second Bank was sent to Congress in January 1832
- This bill passed both the House and Senate
- President Jackson eventually vetoed the renewal
- Economic Consequences:
  - BUS bank notes withdrawn, land transferred
Financial Panic of 1837

• Economic Boom:
  – Increase in business corporations
  – Increase in exports and imports
  – Canals, roads, railroads
  – Land speculation
  – Credit expansion
  – Banks expansion
Financial Panic of 1837

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Financial Panic of 1837

- Specie Circular of 1836
- Specie Shortage
- 1836-1837: Cotton Prices Fall
- May 1837: NY banks refuse to trade specie for notes
- British exports to the US decrease by 60%
- Panic ensues...
  - Businesses failed
  - Bank runs occur
  - Unemployment rises
  - Farmers lose land
  - Paper fortunes wiped away
  - Behaviorally, people severely panicked and snowballed the collapsing economy
The National Bank Act

• 1863: Abraham Lincoln proposed a new national bank system

• 1864: The National Bank Act is approved by Congress
  – Develop a national bank system
  – Create national currency
  – Establish a secondary market for Treasury securities
Prelude to the Federal Reserve Act

• Usually linked to the panic of 1907
  – “Bankers’ Panic” or “Knickerbocker Crisis”
  – New York Stock Exchange fell 50% YOY
  – Bank runs and lack of liquidity

• The need for a central banking system

• Jacob Schiff Chamber of Commerce speech
Aldrich-Vreeland Act

- Led by Senator Nelson Aldrich after the panic
- Provided emergency currency during crises
- Formed the National Monetary Commission
- Conference at Jekyll Island Club
- Final report published on January 11, 1911
- Recommendation for National Reserve Bank
Glass-Willis Proposal

- Establish regional Federal Reserve banks
- Create a national, elastic currency
- Reserve the right to rediscount paper money
- Institute supervision over the banking system
- Improve the national payment system
- Criticism
Federal Reserve Act

- Introduced in the House on August 29th, 1913 and passed on September 18th (287-85)
- Passed the Senate on December 18th, 1913 (54-34)
- Signed into law by President Woodrow Wilson on December 23rd, 1913
Building the Fed

• Reserve Bank Organization Committee:
  – Secretary of the Treasury: William G. McAdoo
  – Secretary of Agriculture: David F. Houston
  – Controller of the Currency: John S. Williams

• Designated a max of 12 Regional Fed Banks

• Divided the nation into districts

• Required participation from all chartered commercial banks
Structure of the Central Bank

• Each had its own branches, directors, and boundaries
• Federal Reserve Board
• Regional Reserve Bank locations:
  – Boston   – Chicago
  – New York – St. Louis
  – Philadelphia – Minneapolis
  – Cleveland – Kansas City
  – Richmond – Dallas
  – Atlanta  – San Francisco
Great Depression

- Banking Panics of 1930-1931
- Stock market crash on October 29, 1929
- Commercial bank crisis
  - “Floating” checks created false reserves
  - Immobility in bank reserves
- ~8,000 Fed members, ~16,000 non-members
- Bank of Tennessee collapse on November 7th
- Ensuing bank failures and runs
Federal Reserve Reaction

- Response varied throughout each district
  - Sixth District in Atlanta
  - Eight District in St. Louis
  - Crisis in Chicago
- Deflation and cash hoarding
- Banking Holiday of 1933
- Emergency Banking Act of 1933
Banking Act of 1933

• “Glass-Steagall Act”
• Signed into law on June 16, 1933
• Main Provisions:
  1. Creation of Federal Deposit Insurance Corporation
  2. Creation of the Federal Open Market Committee
  3. Outlaw and regulation of interests payments
  4. Regulated “speculation” of bank credit
Banking Act of 1935

• Signed into law on August 19, 1935
• Title I:
  – FDIC amendments
• Title II:
  – Amendments to “Board of Governors” and FOMC
  – Loans to member banks
• Title III:
  – Technical amendments
Humphrey-Hawkins Act of 1978

- Full Employment and Balanced Growth Act
- Establishment of Federal Reserve policy goals
  - Dual Mandate
  - Unemployment & Inflation
- Scrutiny of the Fed and Chairman Volcker
- The period of "Great Moderation"
Recession of 1981-82

- Federal Reserve interest rate hike
- High inflation and unemployment
- Failure of S&L association in ’80s
- Paul Volcker and the Fed policy
- Persisting threat of increasing inflation
Stock Market Crash of 1987

- Causes and catalysts
  - Rapid growth of economy caused asset bubble
  - Government reported trade deficit
  - Financial derivatives
- Global financial panic on “Black Monday”
  - Sharp 22% decrease in the DJIA
- Federal Reserve Response
  - Chairman Alan Greenspan
  - Source of liquidity and support
2007-09 Financial Crisis

• Subprime mortgage and housing crisis
• Effects on the financial sector
• Federal Bailouts
• Bear Stearns acquired by JPMorgan in 2008
• Lehman Brothers bankruptcy
• Bank of America acquired Merrill Lynch
Fed Response to “Great Recession”

• Fed Chairman Ben Bernanke
• “Too Big To Fail”
• Fed’s support of specific institutions
  – AIG, Citigroup, Bank of America
• Primary Dealer Credit Facility
• Dodd-Frank signed into effect on July 21, 2010
  – Stability of the US financial system
  – Increased transparency of derivatives
  – Financial Stability Oversight Council
Modern Duties of the Fed

• Conduct the nation’s monetary policy
  – Influencing monetary and credit conditions
  – Dual Mandate

• Supervise and regulate banking institutions

• Maintain the stability of the financial system

• Provide financial services and play role in operating the nation’s payments system
Fed Board of Governors

1. Janet Yellen (Chair)
2. Stanley Fischer (Vice-Chair)
3. Daniel Tarullo
4. Jerome H. Powell
5. Lael Brainard
6. Vacant
7. Vacant
The Fed Today

• Federal Funds Target Rate: 0.25% - 0.50%
• Next FOMC Meeting on November 1-2, 2016
  – Last increase: 25 basis points in December of 2015
• Potential rate hike?


Bibliography Continued


