American Central Bank History

Joseph Dashevsky, Nicole Davessar, Sarah Nicholson, and Scott Symons

Early American Central Banking

What is a Bank?

- A bank is a financial establishment that accepts deposits and extends credit, facilitates the transmission of funds, and allows for the loan, exchange, or issuance of money.
- Some of its primary functions are
    - To serve as a secure place to store wealth.
    - To provide credit and debit cards, check-writing privileges, and cashier's checks.
    - To act as an intermediary between savers and borrowers.

Central Banks

- A central bank is an institution that determines the monetary and fiscal policies and controls the money supply and interest rate for a nation or group of nations.
- It monopolizes the monetary base and prints the national currency.
- They act as “lenders of last resort,” providing liquidity in times of financial difficulty.

The Bank of England

- The Bank originated in 1694 during a period of political stability.
- Founded as a commercial operation, its functions included
    - Accepting deposits.
    - Issuing banknotes that were redeemable for gold or coins.
- It also secured large government accounts thereby serving as “the Government’s banker and debt manager.”
- The Bank serves as a model upon which many modern central banks are based.

The Bank of North America

- Robert Morris, the U.S. Superintendent of Finance from 1781 to 1784, proposed the creation of the Bank of North America, which was chartered in 1781.
- It was organized as a corporate enterprise with a number of stockholders, and overseeing its administration were twelve directors.
- The charter sanctioned a moderate initial capitalization of $400,000.
- BNA bank notes were recognized as legal tender in the payment of debts and taxes to the federal government.
- It continuously supported the convertibility of its currency issue to specie.
- The BNA did limited business with the federal government, issuing it small, short-term loans during wartime.

The Legacy of the BNA

- The BNA’s ability to issue its own paper currency stimulated the spread of currency-issuing banking institutions chartered throughout the states.
- The Bank introduced the practice of settling accounts through the transfer of checks.
- It also led to the emergence of the market for commercial paper.
- Morris lent credibility to the American financial system and chartered commercial banking.
- Little progress was made in the way of alleviating the nation’s long-term financial burdens.

Hamilton vs Jefferson

Breaking Away from Washington

- Washington warned against forming of political parties and entangling foreign alliances
- Two main parties formed:
    - Federalists
    - Democratic Republicans
- Difffered on beliefs of finances, representation in government, and the future of the economy

Party Division: Federalist or Democratic Republican?

1. Led by Alexander Hamilton
2. Led by Thomas Jefferson
3. Believed in keeping power decentralized amongst the people and the states
4. Believed the U.S. could only grow through a strong national government
5. Wanted to align with the British government
6. Supported the French Revolution
7. Wanted a National Bank
8. Believed the states should pay off their own debts
9. Believed agriculture and the yeoman farmer should be at the center of the American economy
10. Favored a loose construction of the Constitution

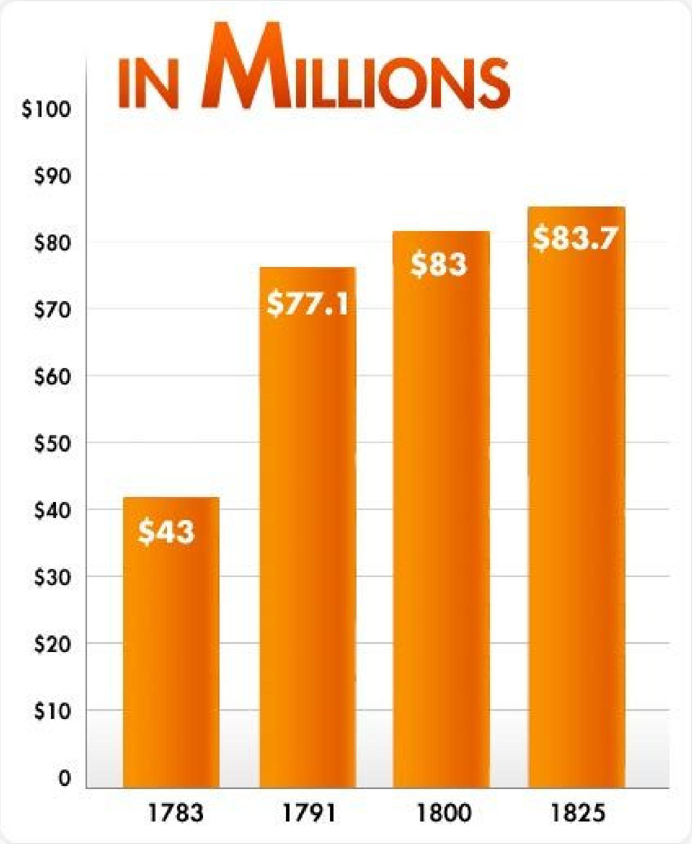
Two Political Parties Emerge

	Federalist Beliefs	Democratic-Republicans
Leader	Alexander Hamilton	Thomas Jefferson James Madison
Appealed to	Merchants, wealthy and educated, and city folk	Farmers , favored the South and West
Ideas of Government	Strong government over states Loose Construction of Constitution •Implied powers	State's rights over National Govt. Strict construction of Constitution
Domestic Policy	Supported National Bank Supported excise tax National debt good for country National govt. assume state debts Tariffs should be high	Against National Bank Against excise tax Against National debt States pay their own debts Tariffs should be low
Foreign Policy	Favored the British	Supported French Revolution

Source: https://www.slideshare.net/kmilkowich/federalist-v-democratic-republican-parties

Dealing with National Debt

- Huge debt following American Revolution
  - $43 million dollars in 1783
- Articles of Confederation did not give central government power to tax states
  - No source of revenue to pay back debt



Source:https://www.treasurydirect.gov/kids/history/history.htm

Reports on Public Credit

- Three reports by Hamilton regarding the fiscal and economic policies of the U.S. central government.
- New Constitution allows for the central government to levy taxes on the states
- First Report on Public Credit
  - January 9, 1790
  - Recommendations on reorganizing the national debt and establishing a public credit

Redemption

- “Credit, private or public, is of greatest consequence to every country. Of this, it might be called the invigorating principle.”- Hamilton
- Pay off foreign and domestic debts in full
- Issue new long-term federal bonds to replace the many forms of bonds issued during the American Revolution
- Maintaining a national debt is important for establishing a national credit
  - Foreign nations with stakes in the U.S. debt would want U.S. to succeed so that debts could be repaid
  - Promote investment
- Set up a “sinking fund” to repay debt periodically through post office revenues and new European loans
  - To be managed by a national bank

Assumption

- National government to assume all of states' debts
- Would improve U.S. financial reputation, stock of capital, and financial power of the federal government
- Issues:
  - Some states had already payed off their debts like Virginia and Maryland, while others, such as Massachusetts and South Carolina, had paid off little
  - Policy would benefit the sluggish debt payers much more

Compromise of 1790: A Solution

- Division between Federalists and Hamilton versus Democratic Republicans and Jefferson and Madison
- Compromise:
  - Hamilton’s financial plan passed in Congress
  - Permanent Federal government capitol in Washington D.C.

Establishment of the Bank of the United States

Alexander Hamilton's Proposal

- In December 1790, Alexander Hamilton submitted his proposal for the First Bank of the United States to Congress, outlining a plan that closely resembled the chartering of the Bank of England.
- Met by opposition from politicians representing Agrarian interests who feared the banks predisposition for favoring industry and manufacturing, the proposal passed through the house and the senate, signed into action by Washington in February 1791.

Location

- The First Bank of the United States was established in Philadelphia in 1791
- Branches were established in 1792 in Boston, New York, Charleston, and Baltimore
- Further branches were added: Norfolk (1800), Savannah (1802), Washington, D.C. (1802), and New Orleans (1805)

The First Bank’s IPO

- Hamilton’s proposal had certain stipulations on the bank's Initial Public Offering which included:
  - Total Stock of $10 million would be offered
  - $2 million would have to be purchased by the United States Government
  - Each Stock would be sold at $400 dollars each, and no person could own more than 30 stocks.
  - Foreign Investors could purchase stock but would not receive the voting rights associated with ownership

Function of the First Bank

- Operated as a the federal government’s fiscal agent
  - Collected tax revenues
  - Payed government bills
  - Made loans to the government
  - Transferred government deposits between branches
- Also operated as a commercial bank
  - Accepted deposits from the public
  - Made loans to private citizens and businesses

The First Bank as a Regulator

- When the Bank wanted to slow the growth of money and credit, it would present the notes to banks for collection in gold or silver, thereby reducing state banks' reserves and putting the brakes on their ability to circulate new banknotes.
- To speed up the growth of money and credit, the Bank would hold onto the state banks' notes, thereby increasing state banks' reserves and allowing those banks to issue more banknotes by making loans.

The First Bank vs. Modern Central Banks

- The First Bank did not regulate other banks (state, private, or otherwise)
- It did not provide insurance or support for other banks in times of crisis
- The first bank was run by a board of 25 governors, with all executive decisions devolving from Philadelphia Branch

Andrew Jackson vs the Central Bank

Andrew Jackson: President of the People

- War of 1812 hero at Battle of New Orleans
- Lost presidential election of 1824 due to “corrupt bargain” and John Quincy Adams
- Won 1828 election running a campaign of fighting for the “common man” and against the “corrupt aristocracy”

Bank War

- Jackson viewed the Second Bank of the U.S. as a symbol of the power of rich privileged classes and businessmen
  - Jackson favored agriculture and the frontier over industry and manufacturing
- Launched an investigation into the bank once he came into office in 1829.
- Congress determined that the bank was indeed constitutional.

GENERAL JACKSON SLAYING THE MANY HEADED MONSTER.

Biddle vs Jackson

- Nicholas Biddle, Director of the National Bank
  - Uses connections in Congress (Henry Clay) and wealthy businessmen to protect the bank.
- Election of 1832
  - Future of the bank is a divisive issue in election between Jackson and Clay
  - Jackson wins
  - Biddle promised to fight Jackson, “just because he has scalped Indians and imprisoned Judges [does not mean] he is to have his way with the bank.”

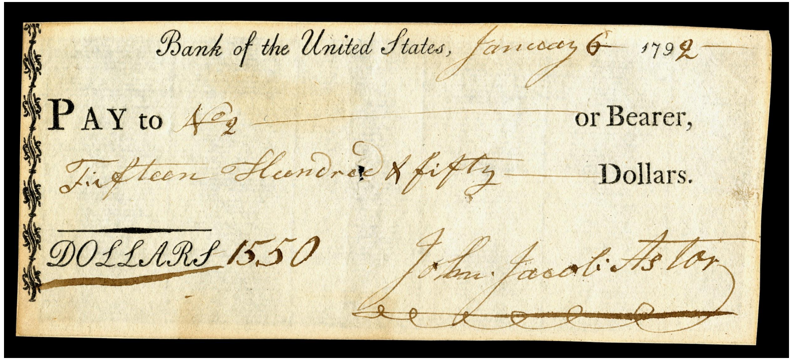
Closing the Bank

- Jackson vetoes bill for early renewal of Bank's charter in 1832
- Jackson removes all funds from the Second Bank of the U.S. and redistributes them to several state banks on September 10, 1883
- These state banks become known as "pet banks."
- Announces that effective October 1, 1833 no more federal funds would be deposited in the Second Bank of the U.S.
- Charter of the bank expires in 1836.

Success and Failures of the Central Bank

The First Bank of the United States

- Worked well to keep lending rates low, collect taxes, and work with the mint to establish federal currency
- Had the right to ask for status reports from local and state banks up to once a week
- Federal taxes had to be paid in federal currency



Rechartering of the First National Bank

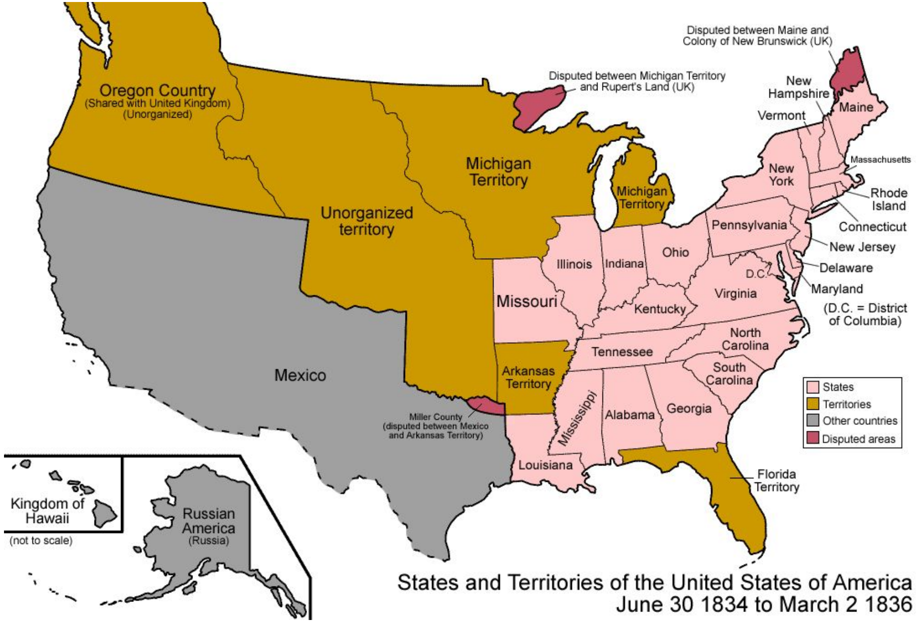
- A vote for recharting came through the Senate 20 years after its original chartering in 1811.
- Fear of overly strong central bank pushed agrarian politicians to be anxious about rechartering the central bank
- After a vote of 50-50, Vice President George Clinton voted against the rechartering of the First National Bank.
- From 1811 to 1816, the number of state banks increased from 117 to 232, creating instability in state based currency and exchange rates

The Second National Bank

- After 5 years without a central bank, Congress voted to charter a central bank which became known as the Second Bank of the United States.
- Similar to the First National Bank, the Bank was chartered with a capital limit of $35 million, with 20% pertaining to the government of the United States
- The structure of the bank’s responsibilities and powers mirrored that of the First Central Bank

The Fall of the Last Central Bank

- The Second Bank lead to Biddle vs Jackson.
- Tensions grew about an overly powerful central bank as the size of the United States continued to grow.
  - 1837-1862 was the “Free Banking” Era
  - 1863-1913 was the “National Banks” Era
  - In 1913, the Federal Reserve was chartered

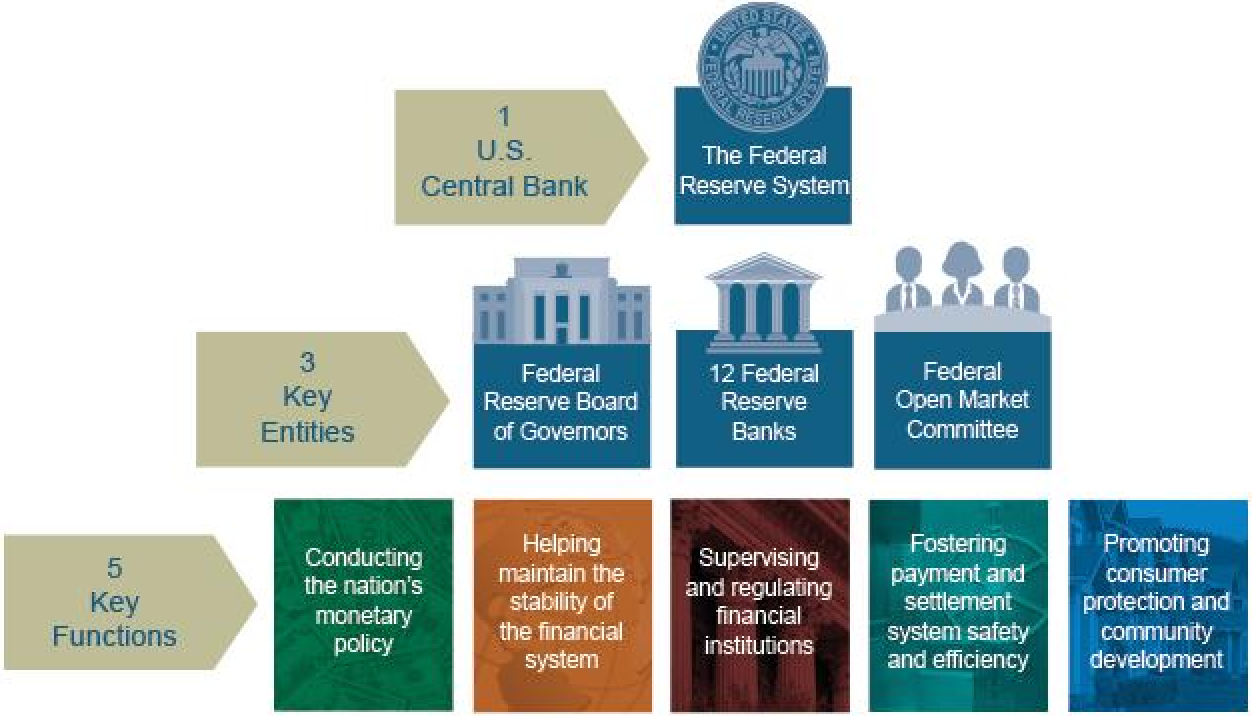


The Federal Reserve System

Origination of the Federal Reserve System

- The Federal Reserve System was established by the Federal Reserve Act in 1913 following a number of financial panics.
- Among other reasons, this entity was created to
    - Address banking panics.
    - Furnish an elastic currency.
    - Establish a means of rediscounting commercial paper.
    - Enact a more effective supervision of banking in the U.S.

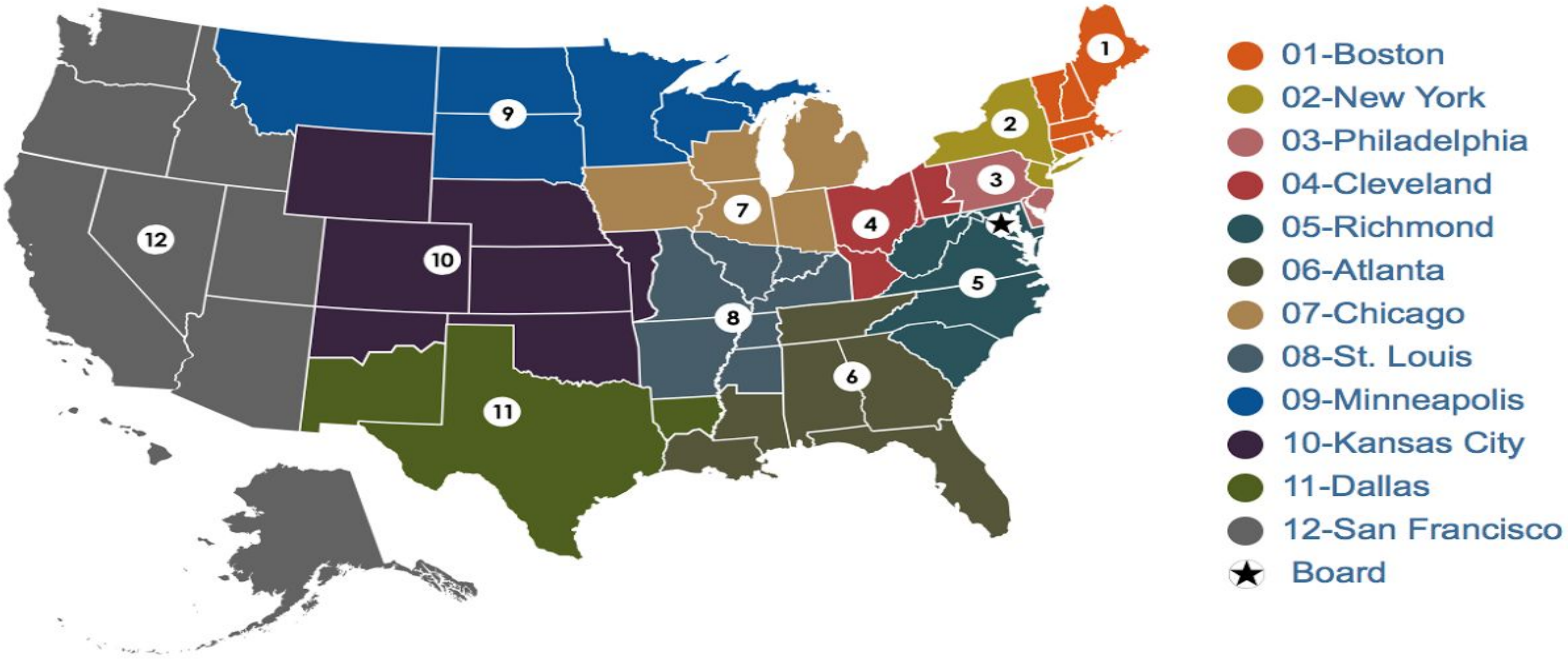
Structure of the Fed



The Fed Board of Governors

- The Board comprises seven members, whom the U.S. President appoints to serve fourteen-year terms.
- The current Chair is Janet Yellen, and the Vice Chair is Stanley Fischer.
- The Federal Advisory Council, the Consumer Advisory Council, and the Thrift Institutions Advisory Council consult with the Board on issues currently of interest three to four times annually.

The Fed Banks



The Federal Open Market Committee

- By establishing a target for the federal funds rate, the Federal Open Market Committee sets monetary policy.
- FOMC meetings are attended by the members of the Board as well as the presidents of the Reserve Banks, but voting rights rotate.

Functions of the Fed

1. The Fed conducts monetary policy to achieve the goals of maximum employment, stable prices, and moderate long-term interest rates.
2. The Fed examines and regulates financial institutions to assist in ensuring the safety and soundness of the financial system, promote stability in financial markets, and encourage compliance with applicable laws.
3. The Fed keeps cash reserves and processes check and electronic payments for depository institutions.
4. The Fed, as a fiscal agent for the federal government, issues currency and coin and provides banking and securities services to the U.S. Treasury.
5. The Fed creates and enforces regulations that provide consumer protection from fraud and unjust lending practices, promotes fair access to credit, and educates people about the institution’s economic role.

Fed in the News/Implications

The Dual Mandate of the Fed

1. Maximizing employment
2. Price stability
3. Moderating long term interest rates (not included in "dual mandate")

The Fed in the News

1. New Fed Chair after Janet Yellen's term ends in February 2018
2. Softer than expected inflation released on Friday
3. Expectation of an interest rate hike in December
4. Quantitative tightening → selling off securities

Next Fed Chair

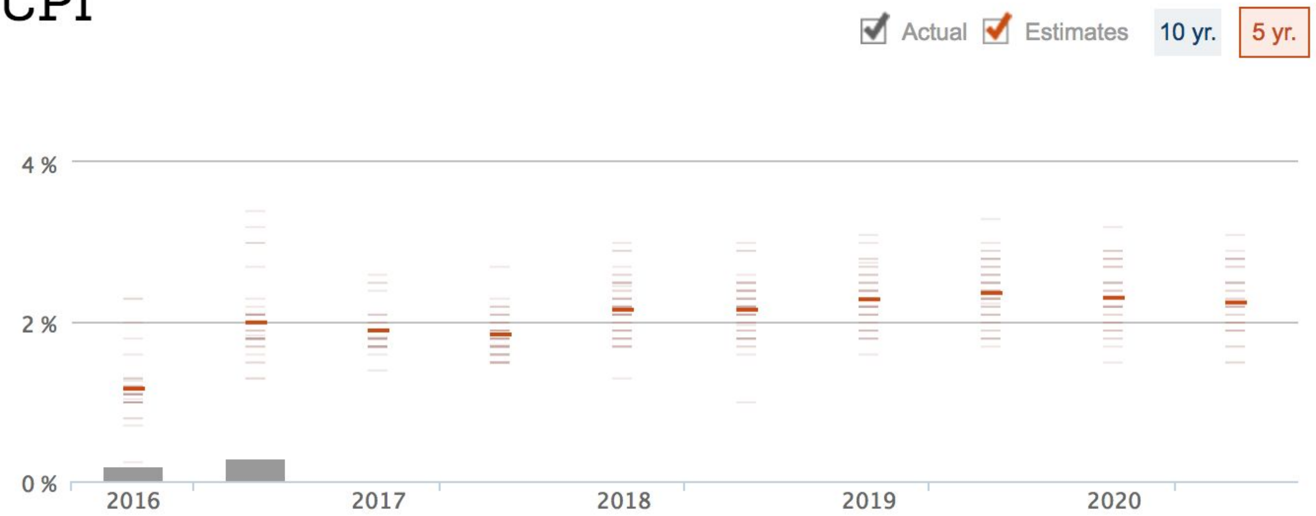
Considerations:

1. Janet Yellen (again)
2. Jerome Powell - current Fed Governor
3. Kevin Warsh - former Fed Governor
4. John Taylor - Stanford Economist

Softer-Than-Expected Inflation

- Edged up 0.5% in September from the month earlier (Labor Department reported Friday)
- Economists surveyed by The Wall Street Journal had expected a 0.6% gain
- Treasuries typically rally on soft inflation data because inflation is a main threat to government bonds → eroding the purchasing power of their fixed payments

CPI



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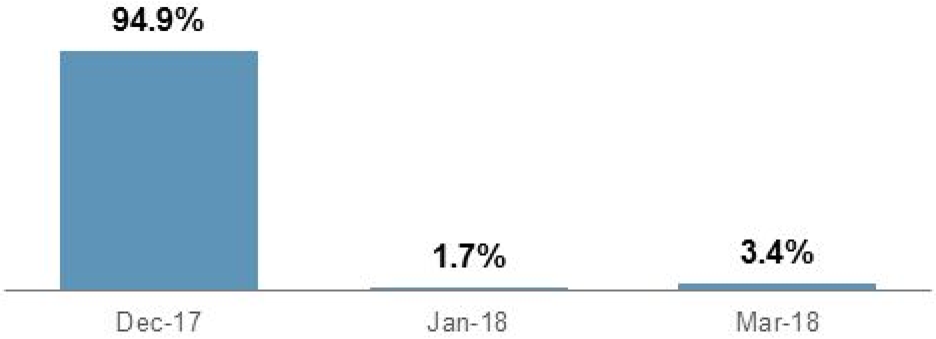
CPI

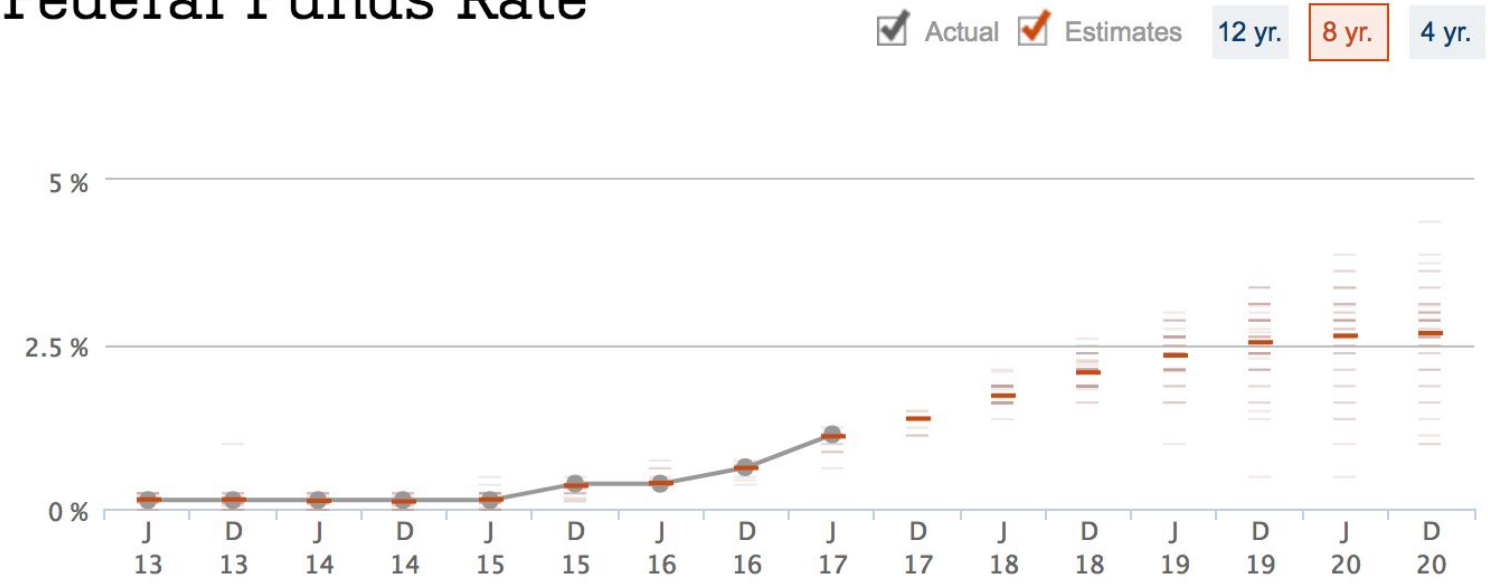
Actual (Jun. 2017)	Projected: Dec. 2017	Projected: Jun. 2018	Projected: Dec. 2018
0.0%	1.8% ▲	2.1%	2.1%

Interest Rate Hikes?

- Q&A: Christmas Rate Hike (wsj)
- At which FOMC meeting will the Fed make its next increase in the federal funds rate?



Federal Funds Rate



Federal Funds Rate

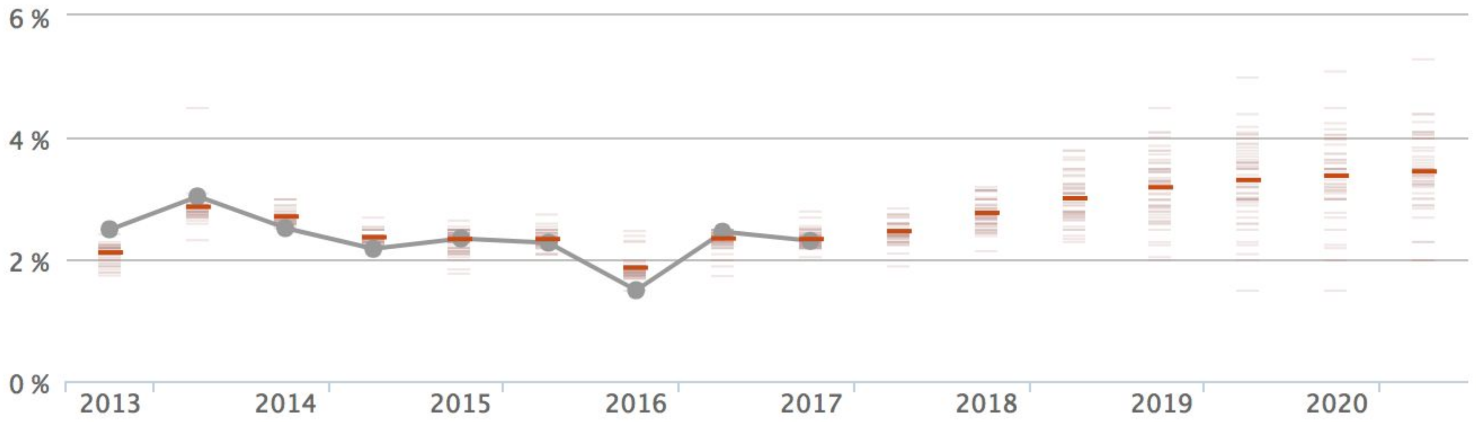
Actual (Jun. 2017)	Projected: Dec. 2017	Projected: Jun. 2018	Projected: Dec. 2018
1.13%	1.37% ▲	1.72%	2.07%

Quantitative Tightening

- Not going to happen all at once → Fed isn't going to "dump" stuff on the market
- With QE (post-recession), Fed has brought forward expected returns, repressed volatility, and completely changed the correlation
- With QT, market is going to evolve into going back to something more neutral

10 Year Note

Actual Estimates 12 yr. 8 yr. 4 yr.



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10 Year Note

Actual (Jun. 2017)	Projected: Dec. 2017	Projected: Jun. 2018	Projected: Dec. 2018
2.30%	2.46% ▲	2.76%	3.00%

Discussion and Questions

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