The Panic of 1837 and the Contraction of 1839-43: A Reassessment of its Causes from an Austrian Perspective and a Critique of the Free Banking Interpretation

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The standard interpretation of the Panic of 1837 and subsequent recession blamed state-bank monetary inflation abetted by President Jackson's removal of the federal deposits from the Bank of the United States. This interpretation was rooted in sound economic analysis by contemporary Jeffersonian and hard-money critics of Jackson such as Nathan Appleton (the Massachusetts' conservative textile manufacturer and banker), Albert Gallatin (Jefferson's treasury secretary and now a New York banker) and Condy Raguet (the Philadelphia political economist and free-trade leader). It was extended and refined in the late nineteenth century by William Graham Sumner, the Yale political economist, classical liberal, and economic historian.

In the twentieth century, advocates of the Federal Reserve System subtly but significantly modified this interpretation to support the supposed need for a government central bank to regulate the money supply and banking system. They blamed the Panic of 1837 on Jackson's policy of "destroying" the second B.U.S. by depriving it of its regulatory powers over the state banks and providing the latter with the public money as a speculating fund. To students and superficial observers the two interpretations appeared to be the same, or at least complementary; but the two were not the same, as we shall see below.

Peter Temin's *The Jacksonian Economy* (1969) has become the standard and definitive work on the causes of the Panic of 1837 for both libertarian free bankers and many Austrian 100 percent reservists. Temin absolved both the state banks and President Jackson of all blame for causing, or even contributing, to the Panic of 1837 and subsequent recession. To be sure, he acknowledges that a rapid expansion in the money supply in the 1830s resulted in rising prices and a business boom. However, he does *not* believe that that the increase in money made a contraction inevitable; nor does he believe that the banks were responsible for the inflation. Rather, he attributes the inflation to a sudden influx of silver coin from Mexico. The reason for this influx was a dramatic change in the China trade. Because the Chinese demand for opium suddenly increased, the British could pay their remittances with Indian opium rather than Mexican silver. Thus, as British demand slackened, more Mexican silver remained in the United States. Temin cited another factor tending to keep Mexican silver, as well as gold coin, in the United States. The British were willing to grant credit to American importers to sustain a chronic trade imbalance and to lend capital to help fund the American canal and railroad boom.[1] As a result of the increasing stock of specie in the United States due to the factors above, the banks could expand their loans and discounts without decreasing their proportion of specie reserves. Temin marshals statistics to prove both that the stock of specie increased in the 1830s and "the

[1] Peter Temin, *The Jacksonian Economy* (New York: W.W. Norton, 1969): "The American inflation was caused by the retention of Mexican silver . . . made possible by capital imports from Britain. The inflation was thus the product of two factors—the change in the Oriental trade and the capital imports from Britain—not just one," 86; "The capital imports resulted from the demands of the construction boom stimulated by the success of the Erie Canal and the changeable investing habits of the British. The cessation of silver exports resulted from the introduction of opium into China. Andrew Jackson had no control over these events," 88.

reserve ratio of the American banking system as whole did not fall below its 1831 level throughout the 1830s." His conclusion: "The factor leading to an expansion of the monetary stock . . . was the rise in the stock of specie"; "the money supply increased because the amount of specie in the country increased, not because banks expanded on the basis of fixed reserves."[2]

Temin also denies that the land boom of the 1830s fueled in any way the monetary or credit inflation of the period. On the contrary, by absorbing much of the new money being issued by the banks, "the land boom acted to *retard* the inflation." Temin argues that because the price of public land remained fixed, regardless of the demand, the increasing land sales were due to an enormous latent demand that was freed by the increasing availability of credit due to the rise in the specie stock.[3]

What then caused the Panic of 1837? According to Temin, there were two factors. First, beginning in late 1836, the British stopped exporting capital to the United States and demanded payment in hard currency for new exports. Second, in early 1837, the British demand for American cotton suddenly fell; and, as the demand fell, so did the price. "As this important price fell, the credit structure built with cotton as security collapsed." The banks suspended in the spring of 1837, credit suddenly dried up, money became dear, and prices collapsed. Thus, "a diminution in the capital flow from England to America was the force that led to the crisis."[4]

Libertarian free bankers and Austrians seem to have uncritically accepted Temin's interpretation. Temin gathers an impressive array of data to bolster his argument, and he obviously understands the banking and credit system of the period. Most importantly, by absolving the incorporated fractional-reserve banks of the states from any responsibility for the crisis, he bolsters the free-banking position that fiduciary media and free banks are not inflationary. Second, by denying that Jackson's "war" on the federal bank had anything to do with the subsequent inflation and panic, he reassures them that the B.U.S. could not have served to restrain inflation. The B.U.S. could either foster and protect, or restrain, the inflationary tendencies of the state banks. Although the B.U.S. as a quasi-government bank had its own powerful motives and tendencies to inflate, it could, and did, at times repress inflation. Its second president, Langdon Cheves of South Carolina, who directed the bank from 1819 through 1822, repressed inflation by the state banks. Even Nicholas Biddle for the first eight years of his presidency was only a moderate inflationist.

Evaluation

Temin's interpretation is not consistent with Austrian theory, nor does it refute the American hard-money or currency-school interpretation of the 1830s. Temin blames both the monetary inflation of the 1830s and the Panic of 1837 completely on changing market conditions, or real-world factors. He blames the inflation on the influx of specie from Mexico, the change in the China trade, and British investment, not money creation by the B.U.S., the state banks, or the policies of President Jackson. He blames the panic on the sudden drying up of British credit, the fall in cotton prices, and the rising British demand for specie, not on mal-investment caused by below market interest rates, unsustainable levels of debt and balance of payment deficits, or the excessive creation of new money.

According to Austrian monetary theory, when government and fractional-reserve banks of issue inflate the money supply and lower the natural interest rate they create an artificial

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[2] Temin, *Jacksonian Economy*, 73, 77, 90.
[3] Temin, *Jacksonian Economy*, 89-90.
[4] Temin, *Jacksonian Economy*, 174.

economic book marked by rising consumption, increasing indebtedness, and expanded capital investment (all funded by new money). The monetary inflation of the 1830s was not caused by the influx and then the retention of Mexican silver, but by the fractional reserve banking system, which used the silver as a fund on which to pyramid new discounts and loans. For every new Mexican silver dollar deposited in a bank by an American merchant or manufacturer, the bank created at least *five* new paper dollars or paper credits. The payment of a debt, or a purchase, by specie is not by itself inflationary, but to use the specie to build five times its amount in new money most certainly is inflationary. The statistical tables tell the story. The banks increased their holdings of specie, and they created new money on top of it (five times the amount).

Temin is wrong to conclude that the proportion of specie reserves did not drop during the 1830s. He organizes the reserve ratios of the banks by region. While this breakdown is useful for informing us that reserve ratios varied considerably from region to region—New England banks consistently kept a lower proportion of reserves relative to all other regions—it does not tell us whether the level of reserves was rising, falling, or staying the same for the country as a whole. When all the banks of the union are considered together, reserve ratios *did* fall from 18% in 1830 to 15.2% in 1833 (the year Jackson withdrew the government deposits from the federal bank). From 1833 to 1837 (the eve of the panic), reserve ratios fell again from 15.2% to 13.7%. Even Temin's own statistical tables reveals that reserve ratios were falling in certain regions. Temin uses two sets of statistics. According to one set, reserve ratios fell in the middle Atlantic and northwestern banks between 1834 and 1837; according to the other, they fell in the northwestern and Southern banks. Furthermore, there is evidence that the state-bank depositories did lend out at least part of the public deposits with which they were entrusted. Treasury Secretary Taney informed them that they were expected to increase their discounts after receiving the government funds; and when the government in 1837 called on the banks to pay out the remainder of the surplus funds deposited with them in previous years, the banks replied that the money was gone. Thus, it seems clear that by depositing the government's funds in the state banks, President Jackson did contribute to the inflation of the mid-1830s.

Temin completely ignores the expansion in banking after President Jackson hinted in his first annual message (December 1829) that he would oppose a renewal of the charter for the second Bank of the United States. From January 1830 to December 1833, the number of banks increased from 330 to 506, a 53% increase. Then, from 1833 to 1837, the number of banks increased from 506 to 788, a 56% increase. The chartering of so many new banks meant that the banking system as a whole could inflate the money supply significantly even while maintaining the same proportion of reserves. Contemporary political economists (Gallatin, Gouge, and Raguet) all cited Jackson's campaign against the federal bank as spurring a bank mania in the states. Bank projectors and state legislators rushed to organize and charter new banks in the hope not only of getting a share of the public deposits but a share in the bank business being forfeited by the Bank of the United States' loss of prestige, circulation, and deposits resulting from the loss of its privileged federal status.

Finally, Temin's contention that the land boom of the 1830s had a *deflationary* effect upon the economy is simply insane. The government accepted state bank paper in payment for the purchase of public lands. When the Bank of the United States was the fiscal agent of the federal government (from 1817 through mid-1833), this money was deposited in the federal bank or one of its branches. As the B.U.S. was a specie-paying bank, and as merchants and the public felt less compunction about withdrawing specie from it compared to their local bank, the federal bank had to keep a large stock of specie. If state bank notes began to accumulate due to an increase in land sales, the managers would have to return at least some of them for payment. This acted to check or restrain the state banks from inflating. However, after mid-1833, the B.U.S. was no

longer the fiscal agent of the federal government, so state-bank paper used to purchase public lands now ended up in a state bank. The state banks then lent it out again. The same money could now be used to purchase more land, or for other purposes. It could be lent out a third and fourth time. Federal land sales simply exploded after 1833. They went from $4.2 million in 1833 to $6.1 million in 1834, $16.2 million in 1835, and $24.9 million in 1836, and $6.9 million the first few months of 1837 before the panic. While the price of public land was fixed by law, its price could, and did, rise after it was sold to the first purchaser (often a land speculator who bought up large amounts only to sell it at a profit).

In summation, Temin was right to notice that the inflation of the 1830s began in 1830 not in 1833. However, he is wrong to absolve President Jackson and the state banks of all blame for the monetary and credit inflation of the decade. The incorporated, fractional-reserve banks of the states were the chief cause of the inflation previous to the panic, and Jackson's state-bank depository system was a secondary cause. Temin is also wrong to blame the Panic of 1837 merely on changing market conditions abroad. Had the United States had a sound banking and monetary system founded on 100 percent specie reserves, the fall in cotton prices and the drying up of British credit would have been a mere temporary inconvenience and certainly would not have led to a calamitous panic, followed by a brief recovery and then a second panic and a four year business contraction.

Statistical Tables for American Banking and Currency, 1820-1860[5]

Table I: Banking and Currency Statistics from 1820 to 1830

	1820	1830 (Jan.)	Increase
Number of Banks	307	330	7%
Bank Loans	$86m.	$201m.	133%
Bank Notes	$45m.	$61m.	35%
Bank Deposits	$38m.	$55m.	45%
Bank Specie	$21m.	$21m.	0%
Reserve Ratio	24%	18%	-25%
Specie in country (total)	$41m.	$39m.	-5%
Total Money Supply	$103m.	$134m.	30%
Inflation	$62	$95	53%
Population	9.6m.	12.8m	33%
Money per capita	$10.73	$10.46	-2.5%
Inflation per capital	$6.46	$7.42	15%
Commodity Prices	84.1	72.2	4%

Table II: The 1830s Inflation under the B.U.S.

	1830 (Jan.)	1833 (Dec.)	Increase
Number of Banks	330	506	53%
Bank Loans	$201m.	$324m.	61%
Bank Notes	$61m.	$95m.	56%
Bank Deposits	$55m.	$76m.	38%
Bank Specie	$21m.	$26m.	24%
Reserve Ratio	18%	15.2%	16%
Specie in country (total)	$39m.	$41m.	5%
Total Money Supply	$134m.	$186m.	39%
Inflation	$95	$145	53%
Population	12.8m.	14m	9%
Money per capita	$10.46	$13.21	26%
Inflation per capita	$7.42	$10.35	40%
Commodity Prices	72.2	75.3	4%

[5] All statistics are taken from A. Barton Hepburn, *A History of Currency in the United States* (New York, 1903; repr. NY: Augustus M. Kelley, 1967), 127-141; 159-160; and Davis R. Dewey, *Financial History of the United States* (New York, 1902).

Table III: The 1830s Inflation under the State-Bank Depository System

	1833 (Dec.)	1837 (Jan.)	Increase
Number of Banks	506	788	56%
Bank Loans	$324m.	$525m.	62%
Bank Notes	$95m.	$149m.	57%
Bank Deposits	$76m.	$127m.	67%
Bank Specie	$26m.	$38m.	46%
Reserve Ratio	15.2%	13.7%	-9%
Specie in country (total)	$41m.	$73m.	78%
Total Money Supply	$186m.	$311m.	67%
Inflation	$145	$238	64%
Population	14m.	15.7m	12%
Money per capita	$13.21	$19.80	50%
Inflation per capita	$10.35	$15.15	46%
Commodity Prices	75.3	90.4	20%

Table IV: The Panic and Contraction of 1837

	1837 (Jan.)	1838 (Jan.)	Decrease
Number of Banks	788	829	5%
Bank Loans	$525m.	$486m.	-7%
Bank Notes	$149m.	$116m.	-22%
Bank Deposits	$127m.	$85m.	-33%
Bank Specie	$38m.	$35m.	-8%
Reserve Ratio	13.7%	17.4%	27%
Specie in country (total)	$73m.	$88m.	21%
Total Money Supply	$311m.	$254m.	-18%
Inflation	$238	$166	-30%
Population	15.7m.	16.1m	2.5%
Money per capita	$19.80	$15.77	-20%
Inflation per capita	$15.16	$10.31	-32%
Commodity Prices	90.4	91.3	1%

Table V: The 1838 Recovery

	1838 (Jan.)	1839 (Jan.)	Increase
Number of Banks	829	840	1%
Bank Loans	$486m.	$492m.	1%
Bank Notes	$116m.	$135m.	16%
Bank Deposits	$85m.	$90m.	18%
Bank Specie	$35m.	$45m.	28.5%
Reserve Ratio	17.4%	20%	15%
Specie in country (total)	$88m.	$87m.	-1%
Total Money Supply	$254m.	$267m.	5%
Inflation	$166	$180	8%
Population	16.1m.	16.6m	3%
Money per capita	$15.77	$16.08	2%
Inflation per capita	$10.31	$10.84	5%
Commodity Prices	91.3	87.2	-4%

Table VI: The 1839-1843 Contraction

	1839 (Jan.)	1843 (Jan.)	Decrease
Number of Banks	840	691	-18%
Bank Loans	$492m.	$255m.	-48%
Bank Notes	$135m.	$59m.	-56%
Bank Deposits	$90m.	$56m.	-38%
Bank Specie	$45m.	$34m.	-24%
Reserve Ratio	20%	29%	45%
Specie in country (total)	$87m.	$90m.	3%
Total Money Supply	$267m.	$171m.	-36%
Inflation	$180	$81	-55%
Population	16.6m.	18.7m	13%
Money per capita	$16.08	$9.14	-43%
Inflation per capita	$10.84	$4.33	-60%
Commodity Prices	87.2	65	-25%

Table VII: Banking and Money Statistics Three Years Previous to the Panic of 1857
(Free Banking under the Specie Treasury System)

	1854 (Jan.)	1857 (Jan.)	Increase
Number of Banks	1208	1416	17%
Bank Loans	$557m.	$684m.	23%
Bank Notes	$205m.	$215m.	4%
Bank Deposits	$188m.	$230m.	22%
Bank Specie	$59m.	$58m.	-1%
Reserve Ratio	15%	13%	-13%
Specie in country	$241m.	$260m.	7%
Total Money Supply	$575m.	$647m.	12%
Inflation	$334m.	$387	16%
Population	27	29	7%
Money per capita	$21.29	$22.31	.04%
Inflation per capita	$12.37	$13.34	.07%
Commodity Prices	85.7	88.1	2.8%

Table VIII: Banking and Money Statistics from 1847 to 1860
(Free Banking under the Independent Treasury System)

	1847 (Jan.)	1860 (Jan.)	Increase
Number of Banks	715	1562	118%
Bank Loans	$310m.	$692m.	123%
Bank Notes	$106m.	$207m.	95%
Bank Deposits	$92m.	254m.	176%
Bank Specie	$35m.	84m.	142%
Reserve Ratio	17.6%	18.2%	3%
Specie in country	$120m.	$253m.	110%
Total Money Supply	$283m.	$630m.	123%
Inflation	$163m	$377	131%
Population	20.5	31	51%
Money per capita	$13.80	$20.32	53%
Inflation per capita	$7.95	$12.16	53%
Commodity Prices	65.9	73.8	4%