

THE PANIC OF 1837

Lesson by

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Subject

Economic and Financial History of America and the United States

Academic Level

Secondary/Collegiate

Bloom Level

Knowledge

Comprehension

Analysis

Synthesis

Evaluation

Unit

The Art of Political Finance, Volume I, Part I—Chapter 8

Lesson Number within Unit: 7**Lesson Description**

This lesson regarding the Panic of 1837 and subsequent depression of nearly six years, takes place during what was known as the Free Banking Era. It will identify the political climate of the era, causes of the initial panic and what sustained the depression throughout the 1830s into the 1840s. In addition to domestic events and policies, it will also identify one international event that contributed to the depression.

Time Required

Two 60-minute classes

Objectives

Students will be able to:

1. Cite at least three causes of the Panic of 1837
2. Analyze the steps taken by President Jackson and determine whether his actions were a bane or boon to America; explain and support
3. Understand the effects of a bank failure
4. Explain the difference between hard money and soft or loose money
5. Define the period after the 2nd Bank of the United States Bank to the National Banking Era (1837 to 1865) as the “Free Banking Era.”
6. Develop a plan to offset eras of contraction and deflation

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Concepts & Terms

Pet Bank

Pet bank is a pejorative term for state banks selected by the U.S. Department of Treasury to receive surplus government funds from the Second Bank of the United States. The term implied that the state banks were controlled by Andrew Jackson.

State Bank

State Chartered banks that issued their own currency and were unregulated by federal banking law. They had no reserve requirement.

Bank Failure

A bank failure occurs when a bank is unable to meet its obligations to its depositors or other creditors because it has become insolvent or too illiquid to meet its liabilities.

Deflation

A fall in the general price level or a contraction of credit and available money (opposed to inflation).

Contraction

A type of policy that is used as a macroeconomic tool by the country's central bank or finance ministry to slow down an economy. Contraction policies are enacted by a government to reduce the money supply and ultimately the spending in a country.

Recession

A period of reduced economic activity over the course of a normal business cycle. Typical aspects are bankruptcies, business profits, reductions in salaries or income, spending and investment and a rise in unemployment.

Depression

A sustained, long-term downturn in economic activity in one or more economies. It is a more severe downturn than an economic recession and possibly unusual. Depressions are characterized by their length, by abnormally large increases in unemployment, falls in the availability of credit (often due to some form of banking or financial crisis), shrinking output as buyers dry up and suppliers cut back on production and investment, large number of bankruptcies including sovereign debt defaults, significantly reduced amounts of trade and commerce (especially international trade), as well as highly volatile relative currency value fluctuations (often due to currency devaluations). Price deflation, financial crises and bank failures are also common elements of a depression that do not normally occur during a recession.

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Materials & Equipment

Computer, Video Projector, Copy of Debt Tables Spreadsheet – Below

Date	Dollar Amount	Percent Increase from Previous Year	Events
1800	\$82,976,294.35	5.83%	Lousiana Purchase
1801	\$83,038,050.80	0.07%	
1802	\$80,712,632.25	-2.80%	
1803	\$77,054,686.40	-4.53%	
1804	\$86,427,120.88	12.16%	
1805	\$82,312,150.50	-4.76%	
1806	\$75,723,270.66	-8.00%	
1807	\$69,218,398.64	-8.59%	
1808	\$65,196,317.97	-5.81%	
1809	\$57,023,192.09	-12.54%	
1810	\$53,173,217.52	-6.75%	War of 1812
1811	\$48,005,587.76	-9.72%	
1812	\$45,209,737.90	-5.82%	
1813	\$55,962,827.57	23.78%	
1814	\$81,487,846.24	45.61%	
1815	\$99,833,660.15	22.51%	
1816	\$127,334,933.74	27.55%	
1817	\$123,491,965.16	-3.02%	
1818	\$103,466,633.83	-16.22%	
1819	\$95,529,648.28	-7.67%	
1820	\$91,015,566.15	-4.73%	
1821	\$89,987,427.66	-1.13%	
1822	\$93,546,676.98	3.96%	
1823	\$90,875,877.28	-2.86%	
1824	\$90,269,777.77	-0.67%	
1825	\$83,788,432.71	-7.18%	
1826	\$81,054,059.99	-3.26%	
1827	\$73,987,357.20	-8.72%	

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Date	Dollar Amount	Percent Increase from Previous Year	Events
1828	\$67,475,043.87	-8.80%	
1829	\$58,421,413.67	-13.42%	Andrew Jackson
1830	\$48,565,406.50	-16.87%	Andrew Jackson
1831	\$39,123,191.68	-19.44%	Andrew Jackson
1832	\$24,322,235.18	-37.83%	Andrew Jackson
1833	\$7,001,698.83	-71.21%	Andrew Jackson
1834	\$4,760,082.08	-32.02%	Andrew Jackson
1835	\$33,733.05	-99.29%	Andrew Jackson
1836	\$37,513.05	11.21%	Andrew Jackson
1837	\$336,957.83	798.24%	
1838	\$3,308,124.07	881.76%	
1839	\$10,434,221.14	215.41%	
1840	\$3,573,343.82	-65.75%	
1841	\$5,250,875.54	46.95%	
1842	\$13,594,480.73	158.90%	
1843	\$20,201,226.27	48.60%	
1843	\$32,742,922.00	62.08%	
1844	\$23,461,652.50	-28.35%	
1845	\$15,925,303.01	-32.12%	
1846	\$15,550,202.97	-2.36%	
1847	\$38,826,534.77	149.69%	Mexican War
1848	\$47,044,862.23	21.17%	
1849	\$63,061,858.69	34.05%	

Motivational Techniques

- A) Questions – Another Panic? Who Panicked? What set off the panic? Why did they panic?
- B) Other Methods - Political Climate - Still in the Age of Jackson and beginning the Free Banking Era

C) Show components of political climate:

1837	President	Party
	Martin Van Buren	Democrat
Senate Majority		Democrat
House Majority		Democrat
Senate Minority		Whig
House Minority		Whig
House Minority		Anti-Masonic
Conflicts	War of Texas Independence * 1830-36	

* <http://americanhistory.about.com/library/timelines/bltimelinetexasind.htm>

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Teacher Introduction

Irish & German immigration was taking place from approximately 1820 to 1870.

The steam engine was changing the landscape and the economy.

It was during what is called the Free Banking Era from 1836 – 1865 in which the Panic of 1837 took place. The period was characterized by the unrestrained entry of banks into the economy after the central bank's charter was not renewed by way of executive veto. Banks were not subject to any special regulations beyond those applicable to any other enterprise.

Procedures and Pupil Activity

Reading Activity

There were three major factors that contributed to the Panic of 1837 and subsequent depression.

- First, English banks—responding to financial troubles in England—stopped pumping money into the American economy, an important reversal since those funds had financed much of the nation's economic growth over the preceding two decades.
- Second, U.S. banks, which had overextended credit to their clients, began to call in loans after British banks cut their money supply.
- Third, President Andrew Jackson's "hard" money policies, especially the 1836 Specie Circular that aimed to stabilize what Jacksonians saw as an out-of-control economy by requiring that all purchases of federal land be made with precious metal (i.e. "hard" money) rather than paper ("soft") money, only exacerbated the credit crunch.ⁱ

The credit crunch was due to inflation which began long before the panic of 1837. (*Typical in the business cycle; boom before bust*).The reason for the price rise was:

- The total money supply had risen from \$109 million in 1830 to \$159 million in 1833 - an increase of 45.9 percent.ⁱⁱ What is the term for this? (*Money Inflation*)
- The total money supply rose from \$150 million at the beginning of 1833 to \$267 million at the beginning of 1837, an astonishing rise of 84 percent, or 21 percent per annum.ⁱⁱⁱ

In addition to the above, Congress enacted the Coinage Act of 1834 that redefined the amount of gold in a dollar, making coins minted prior to July 31, 1834 worth 5.2 percent less than their stated value.^{iv}

This led to its near disappearance from circulation after 1834, what's known as Gresham's Law. This devaluation and indirect exportation of silver is not intuitively congruent with Jackson's statements about the plight of the common people since silver is historically more prolific and circulated than gold. It's often referred to as a "poor man's currency" vs. gold, a "rich man's currency." Essentially what the Coinage Act did was apply further contraction on the money supply which is usually a main cause of recession or depression. Paul M. O'Leary, an author in the Journal of Political Economy, attributes this change to the animosity Jackson had toward the Bank of the United States and his penchant for hard

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currency and gold to the bank notes and paper currency. He and his administration felt that by making gold more valuable it would devalue the bank notes.^v

Question: What do you think happened to the price of gold during this period of inflation? *According to the World Gold Council it increased in 1834 but then remained relatively stable. From 1833 it was about \$19.75 and increased to \$20.67 a year later. Globally it stayed near the \$18.93 mark until 1913.*

Have students calculate the value of the difference in today's terms. Was it worth it to exchange paper for gold? Go to: <https://westegg.com/inflation/> to get the current values. Bookmark link.

With the national debt paid off and the government running large surpluses (government revenues increased by 150 percent between 1834 and 1836, in part due to the great increased land sales), the question of what to do with the money was increasingly urgent. Jackson convinced Congress to give it to the state governments, beginning January 1, 1837.^{vi}

In June of 1836 Congress passed the Distribution Act which called for the distribution of the accumulated treasury surplus to be distributed to the (Pet Banks) states on January 1 of 1837. The surplus was to be transferred to state banks which were to make payment to the State governments in specie (gold and silver).

After Congress adjourned President Andrew Jackson issued his Specie Circular which required that after August 15, 1836 that only specie would be accepted in payment for government land sales. Jackson's purpose in issuing the Specie Circular was to curb speculation in land. The effect was to reduce the money supply by depreciating the value of banknotes which constituted a major part of the money supply.

The Specie Circular did not make the bank notes worthless, it simply made their value relative to specie substantially less than it had been before. This effective reduction in the money supply brought about a deflation which in turn resulted in the failure of many enterprises, including farmers, who had paid high prices for resources such as land with borrowed funds expecting to pay off the loans with production selling at the higher prices that prevailed when they borrowed the money.^{vii}

Writing Activity

Question: What could have been done with the loans to alleviate or remedy this dynamic between the period of value differential of currency? *Adjust the loans according to the value of currency after the devaluation occurred. This would put people in debt on a par with prices; the deflated or hard money value.*

Similar to the HARP program – Home Affordable Modification Program – of 2011

The state banks suspended specie payments.

Despite a brief recovery in 1838, the recession persisted for approximately seven years. Banks collapsed, businesses failed, prices declined, and thousands of workers lost their jobs. Unemployment may have been as high as 25% in some locales. The years 1837 to 1844 were, generally speaking, years of deflation in wages and prices.^{viii}

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The Jacksonians had no intention of leaving a permanent system of pet banks, and so Jackson's chosen successor Martin Van Buren fought to establish the **Independent Treasury System**. **This system would confer no special privilege or inflationary prop on any bank. Instead of central or state banks, the government would keep its funds solely in specie, in its own Treasury vaults or "subtreasury" branches.** The Act was passed in 1840 and took the federal government out of the nation's banking system.^{ix}

President Martin Van Buren proposed the Act in 1837, partly in response to the panic which had caused many people to lose their money during that period as well as public funds being lost. **Under the Act, bank notes were phased out for payments to and from the government and only hard money was to be accepted--gold or silver coin.**

Although Van Buren signed the Independent Treasury Act into law on the Fourth of July 1840, it lasted only a year; the Whigs, who won a congressional majority in the 1840 elections, repealed the act in 1841. Four years later, President James K. Polk, a hard-core Jeffersonian Democrat from Tennessee, revived the idea. He made it and a reduction of the tariff the two pillars of his domestic economic program.^x Polk had secured the Independent Treasury System in 1846, lasting until the Civil War. At long last, the Jacksonians had achieved their dream of severing the federal government totally from the banking system, and placing its finances on a purely hard money, specie basis.^{xi}

From now on, the battle over money would shift to the arena of the states.

Closure

Discussion Activity

1. Was the depression caused by Andrew Jackson or Nicholas Biddle or others? Explain.

Inflationary monetary policy by both the 2nd Bank and the free banks was the precursor to Jackson's contraction and deflationary policy which then made money scarce and more valuable. Since debts were incurred before the contraction it made it more difficult to pay off loans.

2. How do you think the people saw Jackson after this?

Recommended Reading and Research

Bible Riots of 1844

Texas Independence Timeline
1830-1836

<http://americanhistory.about.com/library/timelines/bltimelinetexasind.htm>

<https://westegg.com/inflation/>

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Exercise

Number each incident in the order of a typical bank failure occurrence

Bank Failure Process

- _____ Claims on specie by customers reduce reserves.
- _____ Creditors and the government still want their money but people cannot pay.
- _____ Crime increases when jobs cannot be found. (More relative in an industrial society than an agrarian one).
- _____ Depositor places currency or specie with the bank and leaves with a receipt or note for specie.
- _____ Depositors and customers get wind of shortfall and "run" to the bank to get their money.
- _____ Land is foreclosed on or assets seized.
- _____ People go bankrupt or worse, "broke."
- _____ Some people may find jobs for less pay thereby reducing their overall standard or living.
- _____ Bank prints too much paper money which reduces the value due to price increases.
- _____ The bank closes its doors (fails) due to illiquidity leaving customers short or with no money.

Answer

1. *Depositor places currency or specie with the bank and leaves with a receipt or note for specie.*
2. *Bank prints too much paper money which reduces the value due to price increases.*
3. *Claims on specie by customers reduce reserves.*
4. *Depositors and customers get wind of shortfall and "run" to the bank to get their money.*
5. *The bank closes its doors (fails) due to illiquidity leaving customers short or with no money.*
6. *Creditors and the government still want their money but people cannot pay.*
7. *Land is foreclosed on or assets seized.*
8. *People go bankrupt or worse, "broke."*
9. *Some people may find jobs for less pay thereby reducing their overall standard or living.*
10. *Crime increases when jobs cannot be found. (More relative in an industrial society than an agrarian one).*

ⁱ <http://millercenter.org/president/vanburen/essays/biography/4>

ⁱⁱ History of Money and Banking in the United States – The Colonial Era to WW II pg 95.

ⁱⁱⁱ History of Money and Banking in the United States – The Colonial Era to WW II pg 96.

^{iv} <http://www.treasury.gov/about/history/Pages/1800-1899.aspx>

^v O'Leary, Paul M. "Journal of Political Economy." The Coinage Legislation of 1834: : Vol 45, No 1. N.p., Feb. 1937. Volume 45, Number 1

^{vi} <http://abrahamlincolnclassroom.org/abraham-lincoln-in-depth/abraham-lincoln-banking-and-the-panic-of-1837-in-illinois/>

^{vii} <http://www.sjsu.edu/faculty/watkins/dep1837.htm> San José State University Department of Economics

^{viii} "Measuring Worth – measures of worth, prices, inflation, purchasing power, etc". Retrieved 27 December 2012.

^{ix} Rothbard, Murray N. *The Mystery of Banking*. New York, NY: Richardson & Snyder, 1983. Page 214.

^x The Independent Treasury: Origins, Rationale, and Record, 1846-1861 By H.A. Scott Trask, Ph.D.

Von Mises Institute, Presented at the Austrian Scholars Conference, March 2002

^{xi} Rothbard, Murray N. *The Mystery of Banking*. New York, NY: Richardson & Snyder, 1983. Page 214.