THE PANIC OF 1819

Lesson by
William Pacello

Subject
Economic and Financial History of America and the United States

Academic Level
Secondary/Collegiate

Bloom Level
Knowledge
Comprehension

Unit
The Art of Political Finance, Volume I, Part I—Chapter 6

Lesson Number in Unit: 5

Lesson Description

In this lesson in which most of the text is based on "The Panic of 1819, Reactions and Policies" written by Murray Rothbard, we will introduce events occurring during this era, additional economic terms, reinforce some of the opponents and proponents of central banking and cite this panic and depression as the first of many in the continuum of industrial business cycles.

Time Required
Two 60-minute classes

Objectives

Students will be able to:

1. Identify the Panic of 1819 as the first panic and depression of its kind in the United States
2. Explain three facets of The American System
3. Understand meaning of the phrase "time is money"
4. Name at least three statesmen opposed to central banking
5. Define the four characteristics of the business cycle

THE PANIC OF 1819

Concepts & Terms

Bank Panic
Occurs when banks suddenly lose a large amount of their real or perceived value or money stock, causing fear and widespread losses among their customers. Typically, depositors "run" to the bank to withdraw their money.

Henry Clay
Senator from Kentucky (1777-1852), closely associated with the "Golden Era" of the Senate (1801-1850), was one member of a "Great Triumvirate"--along with Daniel Webster and John C. Calhoun--that made an indelible mark on Senate history.

American System
This "System," championed by Henry Clay, consisted of three mutually re-enforcing parts: a tariff to protect and promote American industry; a national bank to foster commerce; and federal subsidies for roads, canals, and other "internal improvements" to develop profitable markets for agriculture.

Subsidies
A sum of money granted by the government or a public body to assist an industry or business so that the price of a commodity or service may remain low or competitive. (Early on typified by a farm subsidy).

Deflation(ists)
A proponent of a fall in the general price level (opposed to inflation).

Speculation
Conjectural consideration especially in regard to commercial ventures or undertakings.

Scarcity
Principle that states that at any given time and place economic goods, finished goods and resources, are rare enough not to satisfy all people's wants.

Wildcat Banking
Refers to the unusual practices of banks chartered under state law during the periods of non-federally regulated state banking between 1816 and 1863 in the United States.

The defining characteristic of free banking is that if the requirements of a given state's free banking law are met, any person or group of persons is permitted to open a bank.

Use of the word wildcat to mean "reckless" or "financially unsound" apparently arose in Michigan in the 1830s, when bankers supposedly established free banks in inaccessible locations "where the wildcats roamed."

Business Cycle
Economic cycle known for four periods; expansion or growth, recession, depression, recovery.

THE PANIC OF 1819

Materials/Equipment

Computer with internet connection, Video Projector, calculator

Money Supply Spreadsheet

Procedures and Pupil Activity

Motivational Techniques:

Day 1

A) Questions – Has anyone heard the phrase, "Time is Money"? *Elicit divergent/convergent responses.* What do you think it means?

B) Other Methods – Cite: "When a government is dependent upon bankers for money, they and not the leaders of the government control the situation, since the hand that gives is above the hand that takes... Money has no motherland; financiers are without patriotism and without decency; their sole object is gain."
Napoleon Bonaparte, 1815

Political Climate

It was the Era of Good Feelings until 1819 and the controversy over the admission of Missouri to the union. The Monroe Doctrine became a basis for westward expansion and dominion. Henry Clay's "American System" was devised in the Hamiltonian fashion, with protective tariffs, a central bank and subsidies to increase roads and canals. As early as 1817 on Wall Street, a group of New York brokers formally establish the New York Stock and Exchange Board, an organization that later will be renamed the New York Stock Exchange (N.Y.S.E.). The commercial banking and monetary system wasn't highly developed and most banks were in the port cities, but as we will see there are some very significant institutions that were spawned from this period.

1816-1824	President	Party
	James Monroe	Democrat-Republican
Senate Majority		Democrat-Republican
House Majority		Democrat-Republican
Senate Minority		Federalist
House Minority		Federalist

THE PANIC OF 1819

1. Reading Activity

The Panic of 1819 was the first major peacetime financial crisis in the United States followed by a general collapse of the American economy persisting through 1821. The panic and depression were a result of a monetary inflation. After the War of 1812, the economy flourished, as loosely chartered state banks issued redeemable notes far beyond specie. The quantity of money multiplied rapidly. In 1815 alone, bank notes increased from $46 million to $68 million. Banks throughout the country were unable to make good on customers' claims for specie and were forced to close their doors.[i]

At this time, the monetary system of the country was not highly developed. The banks, outside of New England at least, were confined almost exclusively to the cities.

Monetary expansion led to a boom in real estate prices and speculation, and rapidly growing indebtedness by farmers. The Second Bank of the United States was authorized by Congress to solve the monetary problems and provide a sound and uniform currency. Instead, it has continued and enhanced the expansion. The boom continued for a while, but the banks were soon having problems with the return to specie payments. The Second Bank started a painful contraction and a wave of bankruptcies followed, known as the Panic of 1819.[ii]

Creditors foreclosed on deeply indebted farmers, city dwellers, and speculators who had bought cheap public land. Wages as well as prices dropped precipitously. Interest rates climbed and people moaned over the "scarcity of money." Utmost in the minds of American leaders and influential journalists was the question, "Why did the boom die?"

Before the Panic, specie payments were suspended from August 1814 to February 1817. For two and a half years could [sic] banks expand while issuing what was in effect fiat paper and bank deposits. From then on, every time there was a banking crisis brought on by inflationary expansion and demands for redemption in specie, state and federal governments looked the other way and permitted general suspension of specie payments while bank operations continued to flourish. **It became clear to the banks that in a general crisis they would not be required to meet the ordinary obligations of contract law or of respect for property rights**, so their inflationary expansion was permanently encouraged by this massive failure of government to fulfill its obligation to enforce contracts and defend the rights of property.[iii]

THE PANIC OF 1819

Day 2

1. Review Day 1 salient issues

Clay argued that a vigorously maintained system of sectional economic interdependence would eliminate the chance of renewed subservience to the free-trade, laissez-faire "British System."[iv]

2. Reading Activity

Eventually, bank notes began selling at a discount, as foreigners and money brokers profitably claimed the notes for specie. In addition, the Bank of the United States' began to call on branches to redeem other bank obligations. The monetary expansion ended abruptly and a wave of bankruptcies ensued.[v]
It was during this period, for example, that General Andrew Jackson grew extremely suspicious of banks. There is little doubt that Jackson's vehement opposition to the Second Bank of the United States grew out of this experience. Other important contemporary figures, such as Martin Van Buren, William Henry Harrison, and Davy Crockett (who called the banking system a "swindling"), also gained prominence at this time as a consequence of their opposition to wildcat banking.[vi]

Wildcat Banking refers to banks chartered under state law during the periods of non-federally regulated state banking between 1816 and 1863 in the United States. The defining characteristic of free banking is that if the requirements of a given state's free banking laws are met, any person or group of persons is permitted to open a bank. Wildcat banks were established in the Midwest to circulate their notes, collect real resources and disappear with the gains. Use of the word wildcat to mean "reckless" or "financially unsound" apparently arose in Michigan in the 1830s, when bankers supposedly established free banks in inaccessible locations "where the wildcats roamed."[vii]

One of the most interesting parts of Murray Rothbard's history presents the views of the founding fathers who lived through the Panic of 1819. Thomas Jefferson is referred to as the "most thorough-going opponent of bank credit," favoring the "eternal suppression of bank paper." Jefferson believed that only specie should be allowed to circulate. Jefferson's son-in-law, Governor Thomas Randolph, was in support of a 100 percent specie standard. James Madison regarded banks as "harmful" institutions. And John Adams, whose views on banks were nearly identical with Jefferson's, regarded paper money beyond specie as "theft." Although such views as the 100 percent specie standard are considered repugnant and taboo to most economists today, it is interesting and significant that such views were generally held by the founding fathers.

The debate raged between the inflationists and the hard-money advocates during the depression. Some public figures spoke out for public works projects and relief for the poor. Some states enacted legislation to keep creditors from foreclosing on debtors (stay laws and minimum appraisal laws). Others blamed the depression on the contraction of the money supply and enacted laws to "prime the pump" in an effort to reduce interest rates and stimulate business. On the national level, vain efforts were made to issue a currency unbacked by gold or silver. [viii]

THE PANIC OF 1819

Web research/browsing activity.

1. Use Inflation calculators to check "value of money." Use dates from the Money Supply spreadsheet and see the values today or other years.

   http://www.bls.gov/data/inflation_calculator.htm

Closure

Unlike today, the deflationists and hard-money men had the upper hand. As a result, the depression ended rather quickly (by 1821) when confidence in currency was restored and currency once again was redeemable in specie.[ix]

Other Web Sites

Westegg Inflation Calculator

Shadow Stats Calculator

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[i] *Libertarian Review*, Vol. 4 (August 1975), pp. 8–9.
[ii] http://wiki.mises.org/wiki/Business_cycle
[iii] http://wiki.mises.org/wiki/Business_cycle
[iv] http://www.senate.gov/artandhistory/history/common/generic/Speeches_ClayAmericanSystem.htm
[v] *Libertarian Review*, Vol. 4 (August 1975), pp. 8–9.
[vi] Nashville Whig, October 13, 1823, quoted in Charles G. Sellers, Jr., James Polk, Jacksonian, 1795–1843 (Princeton, N.J.: Princeton University Press, 1957), pp. 79ff.
[vii] Dwyer, G. P. "Wildcat Banking, Banking Panics and Free Banking in the United States." Federal Reserve Bank of Atlanta Economic Review 81, pp. 1-20.
[viii] *Libertarian Review*, Vol. 4 (August 1975), pp. 8–9.
[ix] *Libertarian Review*, Vol. 4 (August 1975), pp. 8–9.