MONETARY AND BANKING THEORIES OF ALBERT GALLATIN

by

LESTER B. McALLISTER, JR.

A THESIS

Presented to the Department of Economics
and the Graduate School of the University of Oregon
in partial fulfillment
of the requirements for the degree of
Doctor of Philosophy

June 1953

APPROVED:

[redacted]

(Adviser for the Thesis)

Gift (#9.12) bd. 1.35

TABLE OF CONTENTS

Chapter		Page
I.	THE NATURE OF THE STUDY.	1
II.	BIOGRAPHICAL SKETCH.	8
	The Genevan Period: 1761-1780	8
	From Emigration to America to Election to the House of Representatives: 1780-1795 .	11
	As a Jeffersonian: 1795-1813.	16
	In the Diplomatic Service: 1813-1827. . . .	38
	As Bank President and Essayist: 1828-1849 .	42
III.	A BIMETALLIC STANDARD.	54
IV.	INCONVERTIBLE PAPER SYSTEMS.	76
	Gallatin's Position	76
	Criticism: Comparison with Bollmann	102
V.	THE NATURE AND SUPPLY OF MONEY	115
	Commodity Theory *vs.* Nominalist Theory. . .	115
	Functions of Money.	122
	Components of the Money Supply.	127
	Specie *vs.* Bank Notes	135
	Modifications of the Currency School Principle	145
VI.	COMMERCIAL BANKING	160
	Functions of Banks: Nature of Their Assets and Liabilities	160
	Deposits and the Money Supply	172
	Free Banking.	181
	Banks and Capital Formation	197

Page

VII. COMMERCIAL BANKING, CONTINUED. 206

Advantages of Banks 206
Notes of Small Denomination 215
Further Restrictions on Note Issues 220
Safety Fund System. 230

VIII. BANK OF THE UNITED STATES. 234

First and Second Banks as Public Institutions. 234
First and Second Banks as Regulators of the Currency. 248
Charter Modifications 260

IX. MONETARY THEORY. 266

Rate of Interest. 266
Quantity Theory of Money. 274
Conclusion. 287

BIBLIOGRAPHY. 290

CHAPTER I

THE NATURE OF THE STUDY

Albert Gallatin (1761-1849) believed that a stable and secure money was both an economic necessity and a moral obligation of the monetary authority. He would have preferred that the supply of money be limited to that furnished by a purely specie system. His proposal to bring about the elimination of paper money anticipated by thirty-five years the prohibitive tax on state bank notes in the United States. If a purely metallic system was impractical, and there was to be paper money, Gallatin insisted that it must be payable in specie upon demand. A national bank, in addition to serving as a fiscal agent for the federal government, also would check the note issues of state banks and enforce convertibility.

On the issue of "free banking," Gallatin made the wise observation that competition in the business of money-creation, instead of serving a salutary purpose, merely depreciates the currency. He pointed out that the burden of a depreciated and insecure currency fell most heavily on creditors and low income groups. Gallatin understood the

dangers in long-term lending by banks whose obligations were payable on demand. Furthermore, he saw that the popular demand for long-term bank credit in the United States often mistook a lack of capital for a shortage of money.

Gallatin's "hard money" ideas were excessively conservative for an undeveloped country with great investment opportunities; but his evaluation of the role of a national bank was ahead of his times. Especially advanced was his belief that a central bank not only should curtail inflations but, in certain cases, should counteract deflations. His "cash balance" version of the quantity theory of money anticipated twentieth century developments, and he saw that the pure quantity theory was applicable to some problems but not to all.

The principal weakness of Gallatin's monetary theories was that, although he saw that deposits could arise as a result of bank loans, he failed to recognize that this process was a means to the creation of money by the banking system as a whole. Another weakness in his ideas was his inconsistent explanations of the nature of money. Fundamentally, however, he adhered to the nominalist theory. His distrust of inconvertible paper money was reasonably well justified by experience, but it demonstrated inadequate appreciation of the possibilities for improving the performance of the

economy with the aid of an intelligently managed inconvertible money. Despite such shortcomings, Gallatin's ideas on money and banking were among the soundest treatments of the subject in the first half of the nineteenth century, and in several notable instances anticipated later developments.

Gallatin was pre-eminently a practical man. Late in life, he said that his writings were chiefly concerned with pressing problems of his day, although one could find in them a few substantial and general views.[1] His economic theories are to be learned not only from his essays on currency and banking, and other topics of political economy, but also from his activities as Secretary of the Treasury, as advocate of a national bank, and as bank president.

The present study has as its justification not only the fact that Gallatin wrote on matters of monetary policy which are frequently highly interesting today, but also that he was a man of great ability and vast achievements in many, diverse fields. To illuminate his thinking on money and banking should contribute to a fuller understanding of the man. He was a tutor at Harvard, land speculator, legislator,

---

[1]The actual passage follows: "A l'exception près des recherches sur les Indiens, tous mes écrits ne sont que des ouvrages de circonstance dans lesquels on peut trouver quelques vues saines et générales. . . ." Albert Gallatin, letter to Simonde de Sismondi of June 10, 1842, The Writings of Albert Gallatin, ed. Henry Adams (Philadelphia: J. B. Lippincott & Co., 1879), II, 598. This source will hence-forth be referred to as Writings.

public administrator, financier, key American negotiator at the Treaty of Ghent, diplomat, bank president, ethnologist, political economist, and elder statesman. He was a Jeffersonian Republican, democrat, libertarian, moralist, and intellectual.[1]

Some appreciation of Gallatin's eminence and ability can be obtained from the comments of Henry Adams and Leonard White. Adams, discussing the decline in Gallatin's usefulness as Secretary of the Treasury after the defeat of the Gallatin-supported bill to renew the First Bank of the United States, summarizes Gallatin's role:

> To Mr. Madison the loss would of course be extremely embarrassing; for ten years Gallatin had taken from the President's shoulders the main burden of internal administration and a large part of the responsibilities of foreign relations; his immense knowledge, his long practical experience, his

---

[1]At the present time, the most useful biography of Gallatin is that by Henry Adams, The Life of Albert Gallatin (New York: Peter Smith, 1943, reprint of the work originally published in 1879 by J. B. Lippincott). Less useful is that by John Austin Stevens, Albert Gallatin ("American Statesmen Series"; Boston: Houghton Mifflin, 1898). For briefer, less professional studies, see Henry Cabot Lodge, "Albert Gallatin," The International Review, VII (September, 1879), 250-66; and [William Beach Lawrence], "Political Portraits with Pen and Pencil--Albert Gallatin," The United States Magazine and Democratic Review, XII (June, 1843), 641-53. It should be noted that Gallatin contributed personally to the writing of parts of the latter biographical sketch. Both Lawrence's authorship of this unsigned article, and Gallatin's participation by making suggestions and corrections, are indicated on the original manuscript, described by Wayne Andrews, "A Supplementary Calendar of The Gallatin Papers" (New York: The New-York Historical Society, 1951), p. 65.

> tact, his fertility of resource, his patience, his courage, his unselfishness, his personal attachment, his retentive memory, even his reticence, were each and all impossible to replace.[1]

Leonard White incorporates his appraisal of Gallatin in a comparison with another great Secretary of the Treasury, Alexander Hamilton.

> Gallatin, like his first predecessor, had the qualities of a great administrator. Both men had a national point of view and could work without the limitations of state loyalties that influenced most of their contemporaries. Both men had a taste and capacity for planning, and a skill in administrative invention.[2]

White then shows that Gallatin was "endowed with exceptional energy and drive," and became a leader of the Republicans and a financial expert because of his capacity for work and his consequent command of facts." White concludes by citing two of Gallatin's contemporaries:

> John Quincy Adams declared that Gallatin had "in his character one of the most extraordinary combinations of stubbornness and flexibility that I ever met in a man." Pennsylvania Senator Jonathan Roberts wrote that he was "truly a great man, in quickness, versatility, & clearness, & profundity of conception." While Gallatin's reputation rests on his eminence as a financier, he deserves also to be remembered as one of the great American administrators.[3]

---

[1] Adams, op. cit., p. 432. Cf. ibid., p. 491. Gallatin was Secretary of the Treasury throughout Jefferson's administrations and until 1813 in Madison's.

[2] Leonard White, The Jeffersonians: A Study in Administrative History, 1801-1829 (New York: The Macmillan Co., 1951), p. 135.

[3] Ibid., p. 136. References omitted.

Economists are also free with their praise of Gallatin. A writer on public finance says, "Given such a record of Gallatin's fiscal achievements, perhaps many would echo Professor E. R. A. Seligman's opinion that, as a technical financier, Gallatin was even abler than Hamilton."[1]

Finally, two opinions may be mentioned with regard to Gallatin's importance in the first half of the nineteenth century in matters of monetary theory and policy. One is by a contemporary, the other by a recent monetary writer. William Beach Lawrence, the contemporary, asserted that Gallatin's 1831 essay, "Considerations on the Currency and Banking System of the United States,"[2] was not only highly influential in the United States, but also was frequently cited in the House of Commons, and was accepted by "the statesmen and bankers of Europe, as the highest authority on currency extant."[3] Benjamin Franklin Brooks, in his

---

[1]Chien Tseng Mai, The Fiscal Policies of Albert Gallatin (New York: Columbia University, 1930), p. 148. Mai's reference is to Seligman's "Lectures on the Industrial and Fiscal History of the United States," given at Columbia University.

[2]Writings, III, 231-364. Hereafter, this essay will be referred to as "Considerations on the Currency."

[3][William Beach Lawrence], "The Public Distress," American Quarterly Review, XV (June, 1834), 530. This unsigned article is identified as Lawrence's by Joseph Dorfman, The Economic Mind in American Civilization, 1606-1865 (New York: The Viking Press, 1946), II, 726; also p. xi, n. 14. Dorfman offers an unsympathetic view of Lawrence.

exhaustive study of monetary literature before 1860, states that Erick Bollmann, William Gouge, Condy Raguet, and James Cox were the ablest writers on currency in the United States, with Gallatin "of equal or nearly equal ability"; and that the most cited Americans were Gallatin, Hamilton, Gouge, Benjamin Franklin and William Crawford, "with Gallatin relatively far in the lead."[1] It is interesting that the reason Brooks is not willing to rate Gallatin any higher in ability as a monetary writer is his criticism of Gallatin's use of the quantity theory of money--a criticism which the present writer believes to be unwarranted.[2]

---

[1]Benjamin Franklin Brooks, "A History of Monetary Theory in the United States Before 1860" (Unpublished Ph. D. dissertation, University of Chicago, 1939), p. 9.

Still another opinion, that of Mai, is more difficult to support, in the opinion of the present writer. Mai states: "And it is remarkable that, after so many years of hard banking experience, the United States, finally though not knowingly, adopted the fundamental points of Gallatin's banking policy when it established the Federal Reserve System in 1913." Mai, op. cit., p. 147. Although American banking legislation has adopted certain measures which, in essence, Gallatin anticipated, the above seems an overstatement.

[2]See below, pp. 283-86.

CHAPTER II

BIOGRAPHICAL SKETCH

A partial account of the career and social philosophy of Albert Gallatin will serve as an introduction to his monetary theories and policies.[1]

The Genevan Period: 1761-1780

Gallatin was born in the city-state of Geneva, into one of the most distinguished families. He received a classical education, and developed strong republican and democratic ideas. He became imbued with a strong aversion to debt, whether private or public. Raymond Walters, Jr., after pointing out that one of John Calvin's gifts to Geneva was its peculiar moral climate, adds:

> When he was a very old man, Albert Gallatin described this phenomenon in a letter to a friend: "During the sixteenth and the greater part of the seventeenth century the Genevese were the counterpart of the Puritans of the Old and the Pilgrims

---

[1] Where not otherwise indicated, the biographical material in the following account was drawn principally from Adams, op. cit., passim.

> of New England." . . . By the time Gallatin was growing up in Geneva this Puritanism was somewhat relaxed but the traditions lingered on.[1]

One of the manifestations of this moral climate was a severe attitude toward debt.

> There must be a payment in good faith and without exception, of all the public engagements. The influence of his Genevan education was apparent in his whole public course on this subject, as well as in the religious care with which he has always, in his private affairs, abhorred any form of debt. . . .[2]

Gallatin here developed the idea that a public debt tended to increase inequality in the distribution of income; and if the debt becomes permanent," the payment of interest, however just, becomes a permanent tax on industry in favor of idleness."[3] Gallatin approved of the Genevan law which provided for the disqualification from holding public office of children of a bankrupt person, "so long as any of their father's debts were left unpaid."[4] By creating confidence

---

[1]Raymond Walters, Jr., "Gentleman from Geneva: Albert Gallatin: Jeffersonian Democrat," The New-York Historical Society Quarterly, XXXVI (July, 1952), 291-92. Walters is at present engaged in (what it is hoped will be) the definitive biography of Gallatin.

[2][William Beach Lawrence], "Political Portraits with Pen and Pencil--Albert Gallatin," op. cit., p. 647.

[3]Ibid.

[4]Ibid. p. 648.

in the credit of the individual, this was supposed also to enhance the public credit, since "public and private credit are intimately connected."[1]

Another aspect of the Genevan period in Gallatin's life that should be mentioned was the close friendship between the Gallatin family and that of Jacques Necker. Necker was a Genevan, twenty-nine years older than Gallatin, who was Comptroller General for Louis XVI. It is perhaps no accident that Gallatin's career closely paralleled that of Necker, in view of their common background and the fact that Necker was among those whose discussions Gallatin remembered from his childhood. Necker's financial policies emphasized the same things as Gallatin's: sound finance, executive responsibility, and elimination of debt and privilege.[2] Also, Necker vigorously attacked the use of government paper money and of bank notes.[3]

---

[1]Gallatin, "Suggestions on the Banks and Currency of the Several United States, in Reference Principally to the Suspension of Specie Payments," Writings, III, 408. Hereafter, this essay will be referred to as "Suggestions on the Banks."

[2]Charles Gomel, Les Causes Financières de la Révolution Française: Les Ministères de Turgot et de Necker (Paris: Libraire Guillaumin et Cie, 1892), pp. 490-95, summarized, and pp. 234-333, passim.

[3]Ibid., p. 496.

For additional biographical material on the Genevan period in Gallatin's career, see Adams, op. cit., pp. 1-24.

From Emigration to America to Election to the House of Representatives: 1780-1795

In 1780, at the age of nineteen, Gallatin emigrated to the United States, in part, at least, in rebellion against aristocracy and privilege in Geneva. His first few years in the United States were not noteworthy except, possibly, for land purchases which he made on the western frontier. As a speculation these eventually proved to be a failure. But Gallatin, for much of his life, established residence in western Pennsylvania. If the following interpretation is at all correct, Gallatin's democratic inclinations were strengthened by his experiences and residence on the frontier:

> If it may be presumed that Alexander Hamilton learned some of his aristocratic federalism in the financial circles of New York, why is it not equally reasonable to suppose that Gallatin acquired his passion for democracy not only from the attenuated tradition of Geneva and the emotional sermons of Rousseau, but also from his contacts with backwoods America, the best school of them all?[1]

Gallatin's democratic principles cannot be attributed entirely, or even largely, to his experiences on the frontier. But the above application of Frederick Jackson Turner's frontier thesis is lent some credence by the following excerpt, pertaining to conditions in western

---

[1]Henry M. Dater, "Albert Gallatin, Land Speculator," Mississippi Valley Historical Review, XXVI (June, 1939), 38. Dater interprets Gallatin as a disciple of Rousseau, especially in his seeking contentment in the wilderness.

Pennsylvania, from a Gallatin letter to his wife: "An equal distribution of property has rendered every individual independent, and there is amongst us true and real equality."[1] An interesting application of his belief in democracy was his suggestion for a referendum to the people of Pennsylvania of an amendment to the State constitution.[2]

In 1789, Gallatin was elected to the Pennsylvania House of Representatives, where he developed a growing reputation as an Anti-Federalist and as an expert on financial matters. Also, he worked for improvement of roads and rivers, and for a better system of public education. Gallatin himself described his role in the Pennsylvania House of Representatives (note his Genevan financial conscience):

> I acquired an extraordinary influence in that body,--the more remarkable, as I was always in a party minority. I was indebted for it to my great industry and to the facility with which I could understand and carry on the current business. The laboring oar was left almost exclusively to me. In the session of 1791-1792 I was put on thirty-five committees, prepared all their reports, and drew all their bills. . . .
>
> The report of the Committee of Ways and Means of the session 1790-1791 (presented by Gurney, chairman) was entirely prepared by me, known to be so, and laid the foundation of my reputation. . . . The principles assumed, and which were carried into effect, were the immediate reimbursement and extinction of the State

---

[1] Adams, op. cit., p. 147, letter of April 22, 1795.

[2] Letter to Alexander J. Dallas, March 30, 1805, in George Mifflin Dallas, Life and Writings of Alexander James Dallas (Philadelphia: J. B. Lippincott & Co., 1871), p. 116.

> paper money, the immediate payment in specie of all the current expenses or warrants on the treasury (the postponement and uncertainty of which had given rise to shameful and corrupt speculations), and provision for discharging without defalcation every debt and engagement previously recognized by the State. In conformity with this the State paid to its creditors the difference between the nominal amount of the State debt assumed by the United States and the rate at which it was funded by the Act of Congress.
>
> The proceeds of the public lands, together with the arrears, were the fund which not only discharged all the public debts but left a large surplus. The apprehension that this would be squandered by the Legislature was the principal inducement for chartering the Bank of Pennsylvania with a capital of two millions of dollars, of which the State subscribed one-half. This and similar subsequent investments enabled Pennsylvania to defray out of the dividends all the expenses of government without any direct tax during the forty ensuing years, and till the adoption of the system of internal improvement, which required new resources.
>
> It was my constant assiduity to business and the assistance derived from it by many members which enabled the Republican party in the Legislature, then a minority on a joint ballot, to elect me, and no other but me of that party, Senator of the United States.[1]

Gallatin was one of the sponsors of the bill to charter the Bank of Pennsylvania. The sponsors intended that this bank would enjoy a relationship to the state government akin to that existing between the Bank of the United States and the federal government. The Anti-Federalists inserted two provisions intended to meet

---

[1]Adams, op. cit., pp. 84-86. Biographer John Austin Stevens twice quotes, at great length, the above and more of the same quotation; Albert Gallatin, op. cit., pp. 45-47 and 183-84.

certain economic grievances. One provision required the bank to lend to the state funds which would enable the latter to establish a loan office in each county--loan offices which were to accommodate the farmers, who had long declared that the only two banks in Pennsylvania, the Bank of North America and that of the United States, were of no use because they did not extend mortgages on rural property. The other provision permitted the Bank of North America to subscribe to stock of the new Bank of Pennsylvania only on the condition that it would give up its own charter. This was a sop to the concerted campaign by the Anti-Federalists against the Bank of North America, from which the members of the Federalist party were the chief beneficiaries. The eastern Federalists, led by Robert Hare, objected to the Bank of Pennsylvania on the grounds that the state should use the existing banking facilities. With two banks already operating in the state, Hare argued, Pennsylvania had no need for another. According to Raymond Walters, Jr.,

> Gallatin replied that it would lower the dignity of the state to have to continue to do business with a private institution such as the Bank of North America. He recalled the "humiliating terms" imposed by that bank when the state negotiated a loan two years earlier. The Bank of North America had demonstrated at that time, he added, that it was unwilling to trust the state government as far as it would an individual. Further, Gallatin flatly denied Hare's claim that the state already possessed ample banking facilities. As things now stood, he said, because of their "want of capital" banks gave fair discounts at some times and none at all at others. Even the

> friends of the Bank of North America recognized this, for they were seeking an increase in the capital of their institution. A third bank was desirable because it would increase the banking capital within the state.[1]

The Bank of Pennsylvania was chartered and proved to be highly successful, in spite of the fact that the loan offices were of little use to the farmers, and that the Bank of North America, of course, did not exercise its option of relinquishing its charter in favor of stock in the new bank.

Gallatin had only a brief stay in the Senate of the United States, from December, 1793 to February, 1794. At the end of this period, the Senate, in a strictly partisan vote, rejected his right to a seat on grounds that he had not been a citizen of the United States for the required nine years.[2]

He went back to Pennsylvania, played the role of a compromiser in the Whiskey Rebellion, and then was returned in 1794 to the Congress of the United States, this time in

---

[1]Raymond Walters, Jr., "The Making of a Financier: Albert Gallatin in the Pennsylvania Assembly," The Pennsylvania Magazine of History and Biography, LXX (July, 1946), 265.

[2]Debates of January 10, 1794, Annals of Congress (Washington: Gales and Seaton, 1849-55), 3rd Cong., Senate Proceedings, IV, 28-29; debates resumed January 13, 1794, ibid., p. 29, and intermittently between February 10-28, 1794, ibid., pp. 42-62, passim.

the House of Representatives. He served in the House until he became Secretary of the Treasury under Jefferson, in the year 1801.[1]

As a Jeffersonian: 1795-1813

In the Congress, Gallatin aligned himself with such Republicans as James Madison, James Monroe, John Randolph, William B. Giles, and Nathaniel Macon. He led the Republicans on the following major topics of debate: the responsibility of the executive to the Congress, together with reduction of administration discretion;[2] the protection

---

[1]For further biographical material on the fifteen year period in Gallatin's life from his arrival in the United States until his taking a seat in the House of Representatives of the United States, see Adams, op. cit., pp. 24-154.

[2]Gallatin, speech of January 8, 1794, Annals of Congress, 3rd Cong., IV, pp. 26-27; here Gallatin presented a motion, later carried, calling upon the Secretary of Treasury to furnish detailed information with regard to the application of Congressional appropriations and to the current status of the federal debt. Speech of January 31, 1797, Annals of Congress, 4th Cong., 2d sess., VI, 2039-40; here Gallatin pleaded for a favorite idea of his, that of "specific appropriations."

Finally, reference is made to his most important speech during his entire membership in Congress, that of March 1, 1798, Annals of Congress, 5th Cong. 2d sess., VIII, 1118-43. Gallatin spoke at length on the separation of powers and the principle of checks and balances, against the transference of legislative power to the executive, on the fact that the monetary powers were vested in Congress, on the "ruinous burden" imposed by increasing government expenditures, and on other topics covering almost the entirety of his political creed.

of the individual against arbitrary official action;[1] the necessity for rigid economizing, especially by strict limitation of military and naval expenditures;[2] and the preference for property taxes to an indirect tax on salt or other excises.[3]

A series of other speeches concerned the relationship of the Federal Government to the First Bank of the United States, principally in connection with the public debt. Hamilton was popularly, although not quite accurately, reported as having said that "a public debt is a public blessing," by way of justifying the funding and continued

---

[1]The following speeches on the bill concerning "Alien Enemies," ibid., May 22, 1798, pp. 1788-89, 1792; May 23, 1798, pp. 1793-96; June 19, 1798, pp. 1973-83, 1996-97; June 21, 1798, pp. 2002, 2026-28. The speech on the bill concerning "Seditious Practices," ibid., June 16, 1798, pp. 1954-57. The following speeches on the subject of "Punishment of Crime," ibid., July 5, 1798, pp. 2107-11; July 9, 1798, pp. 2136-37; July 10, 1798, pp. 2156-64.

[2]Speech of April 1, 1796, Annals of Congress, 4th Cong., 1st sess., V, 846-49; and numerous other speeches on the same topic in the 4th, 5th, and 6th Congresses.

[3]Ibid., speech of January 13, 1797, pp. 1862-63: January 16, 1797, pp. 1891-95; January 31, 1797, pp. 2033-34; February 14, 1797, pp. 2157-59; February 16, 1797, pp. 2172-75; and February 24, 1797, pp. 2273-76, 2278-79. Gallatin favored stamp taxes, including a revenue tax on bank notes, on the grounds that these would not hit the poor the hardest. See his speech of June 27, 1797, Annals of Congress, 5th Cong., 1st sess., VII, 395-96, 399; June 28, 1797, pp. 402, 407; June 29, 1797, pp. 422-23, 427-29.

increase of the federal debt, while building up a strong central government.[1] Gallatin, a decentralist, replied that "a public debt is a public curse"; however, he quickly added that this was not to attack the Bank of the United States, to which he felt the United States was obligated for accommodations it had extended.[2] On another occasion he discussed the entire topic of funding of the debt due to the First Bank. Gallatin favored both assumption and funding, but advocated a mode of paying the public debt in four or five years instead of over twenty-three years (as in Hamilton's scheme); i. e., he favored paying instead of "perpetuating" the debt. Gallatin pointed out that the Bank believed that it had extended the maximum possible advances to the government, and wished to contract them if possible, always with the understanding "that they would continue their loans to a certain amount, and not withdraw abruptly and unexpectedly the assistance they had heretofore given."[3]

Gallatin made his support of the Bank of the United States more explicit, though rather incidental, in his 1796

---

[1]Fritz Redlich, Essays in American Economic History: Eric Bollman and Studies in Banking (New York: G. E. Steckert, 1944), pp. 177-79.

[2]Speech of April 4, 1796, Annals of Congress, 4th Cong., 1st sess., V, 856.

[3]Speech of April 12, 1796, Annals of Congress, 4th Cong., 1st sess., V, 933-34, and 921-36, passim.

pamphlet, A Sketch of the Finances of the United States.[1] In this essay, in addition to favoring the national bank, he supported a direct tax on property, a balanced budget, and public land sales, while opposing excise taxes and a continued public debt. In 1800 and 1801, Gallatin had published Views of the Public Debt, Receipts & Expenditures of the United States,[2] culminating a running fight of several years duration[3] over the complex issue of the extent of the true increase in the national debt under the Federalist Administrations. Hamilton contended that it had decreased $1,100,000, while Gallatin argued that it had actually increased $7,200,000.

As Secretary of the Treasury, Gallatin continued both in print and in practice his attack on the public debt of the United States and on large-scale government expenditures, particularly in the military and naval establishments, and on those taxes that he considered to be discriminatory. Virtually all of his annual reports to the Congress from 1801 to 1809, and particularly a special report to the Congress submitted in the year 1802, emphasized the necessity

---

[1] Writings, III, 73-168.

[2] (2d ed.; Philadelphia: Mathew Carey, 1801).

[3] Gallatin speech of June 1, 1796, Annals of Congress, 4th Cong., 1st sess., V, 1506-14.

for economizing on public expenditures and at the same time for a revenue sufficient to reduce the public debt.[1] Gallatin also insisted on the principle that the public debt could not be reduced merely by making appropriations to a Sinking Fund, but rather only by an excess of revenues over expenditures.[2] Gallatin's constant battle for reduction of expenditures, for limitation of the army and navy, and for direct taxes while minimizing excises is set forth in detail by Chien Tseng Mai,[3] and need not be discussed here. The following from an 1809 letter to Jefferson, however, is too revealing to be omitted:

---

[1]Gallatin, letter to the Honorable John Randolph, Jr., Chairman of the Committee on Ways and Means, March 31, 1802, American State Papers: Documents of the Congress of the United States (Washington: Gales and Seaton, 1832-34), Finance I, 746-49. Gallatin's annual reports appear in their entirety in the American State Papers, ibid., Finance I and II, and they also appear in Reports of the Secretary of the Treasury of the United States, on the State of Finances (Washington: Blair & Rives, 1837). These two reprints differ only in minor matters of typography, use of abbreviations, etc. However, the American State Papers contain special reports on many topics as well as the annual reports of the Secretary on the state of the finances.

[2]"Annual Report of the Commissioners of the Sinking Fund," for each of the years 1801-1813, transmitting Gallatin's report to the commissioners, American State Papers, Finance I and II. Cf. Gallatin's report of June 20, 1809, "Powers of the Commissioners of the Sinking Fund," ibid., II, 369-73.

[3]Op. cit., pp. 59-69 (on public expenditures), 73-95 (on public revenues, including war finance), and 43-58, 142-45 (on national debt).

> The reduction of the public debt was certainly the principal object in bringing me into office, and our success in that respect has been due both to the joint and continued efforts of the several branches of government and to the prosperous situation of the country. I am sensible that the work cannot progress under adverse circumstances. If the United States shall be forced into a state of actual war, all the resources of the country must be called forth to make it efficient, and new loans will undoubtedly be wanted. But whilst peace is preserved, the revenue will, at all events, be sufficient to pay the interest and to defray necessary expenses. I do not ask that in the present situation of our foreign relations the debt be reduced, but only that it shall not be increased so long as we are not at war. I do not pretend to step out of my own sphere and to control the internal management of the other Departments. But it seems to me that as Secretary of the Treasury I may ask that, whilst peace continues, the aggregate of the expenditures of those Departments be kept within bounds such as will preserve the equilibrium between the national revenue and expenditure without recurrence to loans. I cannot, my dear sir, consent to act the part of a mere financier, to become a contriver of taxes, a dealer of loans, a seeker of resources for the purpose of supporting useless baubles, of increasing the number of idle and dissipated members of the community, of fattening contractors, pursers, and agents, and of introducing in all its ramifications that system of patronage, corruption, and rottenness which you so justly execrate.[1]

Note especially Gallatin's antipathy to what he considered to be unnecessary and unproductive governmental expenditures, and especially to profiteering on government contracts.

In all this Gallatin was a thorough-going Jeffersonian. He was also Jeffersonian in his insistence on protection of

---

[1]Gallatin letter of November 8, 1809, Writings, I, 465-66.

contracts and the defense of property rights. Although men like Jefferson, Madison, and Gallatin did not manipulate property rights for the benefit of a particular class, as the Hamiltonians may have done, they were, nevertheless, sufficiently imbued with the philosophy of John Locke to defend the sanctity of property and of contract. As Irving Brant shows in his biography of James Madison, Madison was a staunch defender of property rights;[1] the entire Virginia delegation to the Constitutional Convention were "a unit" on "devotion to government founded on the people, and a belief in the need to check state assaults on property rights."[2] In fact, with two or three exceptions "the whole convention desired to protect property rights . . . and to strike down state laws designed to wipe out debt or impair financial contracts."[3] Or, as Joseph Dorfman puts it, "Solid citizen that he was, Jefferson believed in the importance of a sound public credit, the sanctity of contracts, and of course the right of property."[4] Gallatin did not take exception to

---

[1] James Madison (Indianapolis: The Bobbs-Merrill Co., 1948-50), III, 44.

[2] Ibid., p. 23.

[3] Ibid., p. 61. It should be carefully noted that Brant shows that although Madison did not want property rights violated, neither did he want concentration and abuse of power through ownership of property.

[4] Dorfman, op. cit., I, 434.

this attitude on contracts and properties.[1] And on the matter of the scope of government activities, Gallatin was very much like other Jeffersonians. For example, he wrote in 1833: "No legislation is better than . . . bad, and, on most subjects connected with economy, than any legislation."[2] This is not much different than Gallatin was writing in 1807: "Governmental prohibitions do always more mischief than had been calculated; and it is not without much hesitation that a statesman should hazard to regulate the concerns of individuals as if he could do it better than themselves."[3] This last was in connection with Gallatin's objection to a permanent embargo. Nevertheless, in practice, Gallatin, like the other Jeffersonians, frequently modified his strict laissez-faire pronouncements, most of all, in the case of the enforcement of the embargo and non-intercourse acts of the second Jefferson administration. Gallatin, faced with the monumental task of enforcing the embargo against the wishes of the greater part of the commercial community, came to the conclusion that either he would have to have

---

[1] [Lawrence], "Political Portraits with Pen and Pencil--Albert Gallatin," op. cit., p. 647; Gallatin, letter to Nathaniel Macon, April 23, 1816, Writings, I, 697; letter to John A. Dix, March 30, 1842, ibid., II, 589.

[2] Letter to J. Horsley Palmer, May 1, 1833, Writings, II, 462.

[3] Letter to Jefferson, December 18, 1807, ibid., I, 368.

more power of enforcement or the whole system should be abandoned.[1] Also, he asserted that judicial review of the actions of customs collectors was making enforcement of the law all the more difficult. Such complaints were symptomatic of Gallatin's "doctrinal disorder" as he and Jefferson tried to enforce the embargo acts. Their libertarianism was severely abused, and they suffered keenly from the knowledge of that fact.[2]

Gallatin, however, was not typical of the Jeffersonians in certain other respects. He gave his support to internal improvements, not begrudgingly but willingly. Leonard White, in lauding Gallatin's state paper on internal improvements, points out that Gallatin was not worried about their constitutionality. White concludes:

> It was the first great plan for the physical development of the country, as Hamilton's report on manufacturers was the first plan for its economic development. It was bold, shrewd, farseeing, and thoroughly national in its scope and design. It was, moreover, practical, and easily within the technical and financial resources of the time, had those resources not been drained by war with Great Britain. Its major outlines remained valid until, just as the Republican period came to a close, they were rendered in large part out of date by the invention of the steam railroad.[3]

---

[1]December, 1809, Reports of the Secretary of the Treasury of the United States on the State of the Finances, I, 402.

[2]Leonard White, op. cit., p. 461.

[3]Ibid., pp. 476-77.

In this state paper, entitled "Roads and Canals," Gallatin noted the productivity of the proposed east-west, north-south network of roads and canals, and argued that the plan was of such scope that the federal government had to undertake it.[1]

Gallatin's report on manufacturers is important in that it indicates another direction in which he was trying to urge his party. This was an industry study, submitted in the year 1810, of the growth of American manufacturers. In it, Gallatin emphasized that capital had grown greatly in some twenty years in the United States, but still progress in manufacturing was impeded by a relative shortage of capital. He asserted, however, that the absence of "internal restrictions and monopoly" and of oppressive taxes was the principal cause of the growth and prosperity of the United States.[2]

When the opportunity to acquire the Louisiana Territory presented itself to the Jefferson Administration, in 1803, Gallatin took the view that the acquisition was at that time constitutional, whereas Jefferson, Madison, and the Attorney-General all believed that a constitutional amendment was

---

[1]April 4, 1808, American State Papers, Miscellaneous I, 724-921, including supporting papers.

[2]April 17, 1810, "Partial Report on the Subject of American Manufactures," ibid., Finance II, 430; for the entire report, pp. 425-39.

necessary to legalize the act. In the course of events, Gallatin's view became the accepted principle of the party and the grounds on which the territory was acquired.[1]

Again on the matter of the constitutionality of the Bank of the United States, as well as on the advisability and utility of banks in general, Gallatin and Jefferson stood on opposite sides. Jefferson's view follows:

> We are undone, my dear Sir, if this banking mania be not suppressed. . . . The war, had it proceeded, would have upset our government; and a new one, whenever tried, will do it. And so it must be while our money, the nerve of war, is much or little, real or imaginary, as our bitterest enemies chose to make it. Put down the banks, and if this country could not be carried through the longest war against her most powerful enemy, without ever knowing the want of a dollar, without dependence on the traitorous classes of her citizens, without bearing hard on the resources of the people, or loading the public with an indefinite debt, I know nothing of my countrymen.[2]

Jefferson strongly opposed a national bank, chiefly on the grounds of fear for the safety of any government "which is under the vassalage of any self-constituted authorities. . . ."[3]

---

[1]Adams, op. cit., pp. 319-21.

[2]Jefferson letter to Gallatin, October 16, 1815, The Writings of Thomas Jefferson (Washington: Thomas Jefferson Memorial Association, 1903), XIV, 356.

[3]Jefferson letter to Gallatin, December 13, 1803, The Works of Thomas Jefferson, ed. Paul L. Ford (Federal ed.; New York: G. P. Putnam's Sons, 1905), X, 57.

The immediate occasion for this letter was a proposed New Orleans branch of the Bank of the United States.

Gallatin replied with a positive statement of the advantages of a national bank.[1] He concluded by taking a viewpoint precisely opposite to Jefferson's:

> Against this there are none but political objections, and those will lose much of their force when the little injury they can do us and the dependence in which they are on government are duly estimated. They may vote as they please and take their own papers, but they are formidable only as individuals and as merchants, and not as bankers. Whenever they shall appear to be really dangerous, they are completely in our power and may be crushed.[2]

Gallatin elaborated upon the usefulness of the Bank to the government in a series of special reports to the Congress in 1809-1811 on the renewal of the charter of the First Bank.[3] In the first of these reports, Gallatin mentioned the advantage to the United States of acquiring loans from the National Bank, a point which he had been making for many years.[4] Gallatin also made a point of the

---

[1]Letter to Jefferson, December 13, 1803, Writings, I, 171. See below, p. 237.

[2]Ibid.

[3]March 2, 1809, American State Papers, Finance II, 351-53; January 30, 1811, ibid., p. 481.

[4]In a speech in the House on January 26, 1797, in opposition to an increase in the compensation of public officers, Gallatin pointed out that the First Bank had carried the United States when the government was unable to pay part of its indebtedness to the Bank on request:

income derived by the United States from dividends on bank stock held by the Government.[1] In four other reports, Gallatin replied to Congressional inquiries regarding details of the relations between the Treasury and the Bank.[2] In spite of Gallatin's active support of the First Bank, the Congress did not renew the charter. The Bank expired in 1811, and the Secretary of the Treasury had to place the federal deposits in various state banks.[3]

Annals of Congress, 4th Cong. 2d sess., VI, 1992, 1996-98. In a report of March 1, 1802, submitted to the Honorable Joseph H. Nicholson, Chairman of the Committee of Investigation (of the State of the Treasury Department) on the "Application of Public Money," Gallatin mentioned advances from the Bank of the United States to the Government to meet expenses, where appropriations were not forthcoming until later. American State Papers, Finance I, 755-57. This entire report, pp. 755-821, illustrates how Gallatin as Secretary adhered rigidly to the principle of responsibility to the Congress on the part of administrative and executive officials upon which he had insisted as a Congressman. Cf. above, p. 16.

[1]Reported in each of Gallatin's "Annual Reports on the State of the Finances," ibid., Finance I and II, and especially the report on "Public Debt," of March 31, 1802, submitted to the Honorable John Randolph, Jr. Chairman of the Committee of Ways and Means, ibid., I, 746-49.

[2]Report of December 3, 1806, "Public Deposites in Banks," American State Papers, Finance II, 216-18. Report of April 3, 1810, "Bank of the United States," ibid., pp. 417-18. Report of January 9, 1811, "Bank of the United States," ibid., pp. 460-63. Report of January 23, 1811, "Bank of the United States," ibid., pp. 468-70.

[3]Gallatin, report of January 8, 1812, "Public Deposites in Banks," ibid., pp. 516-17.

Further discussion of Gallatin's position on the constitutionality of a national bank, his detailed plans for recharter of both the First and the Second Bank, and additional information on his concept of the role of a national bank, especially as a controlling factor over the state banking system, is included in Chapter VIII, below.

Gallatin's support of a national bank was atypical of the Jeffersonians. Also, in his positive support of internal improvements and of manufacturing, and in his departures from a strict construction of the Constitution, Gallatin was more like the New Republicans than the Old.[1] If it is true that in certain respects the Republicans, by the end of Madison's administrations, had "out-Federalized Federalism,"[2] then, in several respects, Gallatin had led them there.

However, Gallatin differed from the New Republicans--Henry Clay, John C. Calhoun, John Quincy Adams, William H. Crawford, et al.--in that he did not favor a strong army and naval establishment, "a foreign policy that looks toward the further acquisition of territory,"[3] or the protective

---

[1]The terms "New" and "Old Republicans" are Leonard White's; op. cit., pp. 13-14.

[2]Richard Hofstadter, The American Political Tradition and the Men Who Made It (New York: Alfred A. Knopf, 1948), p. 41.

[3]White, op. cit., p. 14.

tariff. In the last twenty years of his life, Gallatin was not associated with any political party.[1]

By way of conclusion on Gallatin's political and economic philosophy, it may be stated that he was an Old Republican, yet not essentially an agrarian; that is, he differed from Jefferson chiefly in that he saw economic progress through growing application of capital to both commerce and manufacturing, and that he did not regret this prospect.[2] Contrast Gallatin's position with that aspect of Jefferson's philosophy which is emphasized by Vernon L. Parrington:

> To a mind imbued with such conceptions the appeal of the Physiocratic theory of social economics would be irresistible. The ground was prepared for the sowing of the seeds of the liberal French thought. With its emphasis laid upon agriculture, its doctrine of the produit net, its principle of laissez-faire, and its social concern, the Physiocratic theory accorded exactly with his familiar experience, and it must have seemed to Jefferson that it was little other than a deduction from the open facts of American life. . . . The sharp struggle between Jefferson and Hamilton must be reckoned, in part at least, a conflict between the rival principles of Quesnay and Adam Smith, between an agrarian and a capitalistic economy. Much as Jefferson feared

---

[1] On Gallatin's nonpartisanship, and his bemoaning the tendency to settle national issues on the basis of party spirit, see the appendix, "War Expenses," to his pamphlet, The Oregon Question (New York: Bartlett & Welford, 1846), pp. 74-75. The entire pamphlet pleads for moderation and peace in the territorial dispute with England.

[2] Bray Hammond, "Banking in the Early West: Monopoly, Prohibition, and Laissez-Faire," Journal of Economic History, VIII (May, 1948), 4.

> the ambitions of an aristocracy, he feared quite as much the creation of a proletariat. . . . A free yeomanry he regarded as the backbone of every great people, the producers of the real wealth, the guardians of manly independence; and the number of factory workers measured for him the extent of social disease. It is this Physiocratic conception that explains his bitter hostility to protective tariffs, national banks, funding manipulations, the machinery of credit, and all the agencies of capitalism which Hamilton was skillfully erecting in America.[1]

Gallatin, on the other hand, like his counterpart in France, Jacques Necker, was not a Physiocrat.[2]

The Jeffersonians claimed that the Hamiltonians used the central government to build up the position of a special privileged class.[3] It should not be inferred from Gallatin's advocacy of the growth of capital, however, that he similarly wanted to promote a privileged class. On the contrary, Gallatin was strongly and consistently opposed to privilege, especially those privileges acquired by virtue of governmental action. The remainder of this section is intended to prove that point. Gallatin departed

---

[1] Main Currents in American Thought (New York: Harcourt, Brace & Co., 1927), I, 346-47.

[2] Gallatin's position on capital accumulation is developed further below, pp. 197-205.

[3] The Jeffersonian indictment of the Federalists' financial measures is effectively summed up by Charles Beard's presentation of the argument of John Taylor. Beard, The Economic Origins of Jeffersonian Democracy (New York: The Macmillan Co., 1915), p. 205.

from Geneva because he disliked the prevalence there of aristocratic privilege. In his fiscal policies he worked for the principle of executive responsibility, and specific appropriation by Congress from which the Secretary of the Treasury could not depart to accomplish his ends. One of Gallatin's objections to the public debt was that the payment of interest charges on it required taxing the industrious members of the community in favor of the "idle." He favored taxes on slaves, land, and houses, and a mild revenue tariff, in preference to internal excise duties, especially those on salt and distilled spirits, each of which he believed to be unequal and oppressive on the poorer segments of the community.[1]

As Secretary of the Treasury, his policy for the disposal of the public lands was in all respects to minimize the activities of the speculators and to encourage purchase by the poor and by actual settlers.[2] He strenuously opposed profiteering on government contracts. On political patronage, Gallatin was for a nonpartisan public service; he would have submitted the following memorandum with regard to

---

[1]Mai, op. cit., pp. 73-76.

[2]Letter of January 2, 1804, to Honorable Joseph H. Nicholson, Chairman of the Committee on Sale of Public Lands, American State Papers, Public Lands I, 183. See also Mai, op. cit., pp. 96-106.

appointments in the Treasury Department had he not been discouraged by Jefferson:

> The law having given to the collectors the appointment of a number of inferior officers subject to my approbation, there is on that subject, on which we must act in concert, but one sentiment that I wish to communicate; it is, that the door of office be no longer shut against any man merely on account of his political opinions, but that whether he shall differ or not from those avowed either by you or by myself, integrity and capacity suitable to the station be the only qualifications that shall direct our choice.[1]

Similarly, Jefferson had urged Gallatin to use his position as Secretary of the Treasury to promote support for the Republican Party, as shown in the following letters to Gallatin:

> It is certainly for the public good to keep all the banks competitors for our favors by a judicious distribution of them, and thus to engage the individuals who belong to them in the support of the reformed order of things, or at least in an acquiescence under it.[2]

> As to the patronage of the Republican Bank at Providence, I am decidely in favor of making all the banks Republican, by sharing deposits among them in proportion to the dispositions they show; if the law now forbids it, we should not permit another session of Congress to pass without amending it. It is material to the safety of

---

[1]Enclosure with letter to Jefferson of July 25, 1801, Writings, I, 28-29. For further information with regard to Gallatin's position on political patronage, see the excellent article by Jay C. Heinlein, "Albert Gallatin: A Pioneer in Public Administration," The William and Mary Quarterly, Third Series, VII (January, 1950), 65-66.

[2]The Works of Thomas Jefferson, IX, 395-96, letter of October 7, 1802.

> Republicanism to detach the mercantile interests from its enemies and incorporate them into the body of its friends. A merchant is naturally a Republican, and can be otherwise only from a vitiated state of things.[1]

Gallatin rejected these suggestions, however,[2] thus indicating again that he would not use a position of power to promote the interests of any group, and that he did not want finance and politics mixed. As Jefferson wrote to William Wirt, "I often press[ed] him [Gallatin] to divide the public deposits among all the respectable banks . . . but his repugnance to it prevented my persisting."[3]

Opposition to privilege is also demonstrated by the fact that Gallatin was not an uncritical advocate of a national bank. He frequently suggested restrictions on its behavior and modifications of its charter designed to make it an instrument for promoting the social welfare.

---

[1] Ibid., X, 15-16, letter of July 12, 1803.

[2] See Adams, op. cit., p. 309.

[3] Op. cit., XI, 200, letter of May 3, 1811. Charles Beard seized upon the two letters from Jefferson to Gallatin, above, in support of the thesis that, despite the Jeffersonian opposition to the use by the Federalists of the central government to promote their financial ends, "Jefferson and his advisors deliberately adopted a policy of manipulating the government funds in such a way as to build up local Republican moneyed machines in order to resist the force of the Federalist interests and provide competitors that would give the Republicans the power in the economic world which they so earnestly desired." Beard, op. cit., p. 446. But Beard missed the essential point: that, in this matter, Gallatin did not act on the basis of his chief's suggestions.

For example, he would have modified the charter of the First Bank in the direction of increased ownership by citizens of the United States, provision for the payment of interest on public deposits over three million dollars in the Bank, requirements that the Bank stand ready to lend to the United States up to a specified amount, and provision that both states and federal government appoint a "few" of its directors.[1] And he would have chartered a new national bank in 1841 with the following, among other, provisions: that its capital be limited, since the danger of abuse "is increased in proportion to the magnitude of the capital"; that the quantity and quality of its loans be regulated; that it sustain other banks and "lessen the commercial distress" in critical times; that it be rigorously and regularly inspected by federal officials; and that it "have a truly national character, and not degenerate into a local institution."[2]

Again, Gallatin opposed privilege in his attitude on protective tariffs. Generally speaking, Gallatin supported a revenue tariff, but opposed protection, quite as "an

---

[1]Report of March 2, 1809, "Bank of the United States," American State Papers, Finance II, 352-53.

[2]"Suggestions on the Banks," op. cit., pp. 454-56.

early disciple of Adam Smith"[1] might have been expected to do. His argument was based essentially on the law of comparative advantages, the effect of a protective tariff being to misallocate resources (Gallatin even recognized that this assumed full employment).[2] More important, for immediate purposes, is Gallatin's argument that protection was not only injurious to the country as a whole, but that it enriched one section at the expense of another; only the protected manufacturers gained; all others lost, and this was unjust. He rebutted the argument that the farmer benefited from a tariff, and denied that free trade pulled down domestic wages, since wages were regulated by "supply and demand and the state of society."[3] That Gallatin acknowledged the validity only of the "infant industries" argument is relevant to the thesis that he, unlike Jefferson, saw the United States as progressing through the growth of manufactures; yet Gallatin denied that a protective tariff

---

[1][William Beach Lawrence], "Political Portraits with Pen and Pencil--Albert Gallatin," op. cit., p. 652.

[2]Memorial of the Committee Appointed by the Free Trade Convention (New York: William A. Mercein, 1832), p. 1. Gallatin was chairman of the committee, and wrote the Memorial. The plea was not for free trade, but only for lower tariffs.

[3]Ibid., pp. 6-10.

was an important cause of industrial growth. More important were the growth of capital and the enterprise of the American people, unobstructed by governmental restrictions, taxes or monopoly.[1]

To conclude the argument that Gallatin did not want to promote a privileged class of capitalists, Gallatin's attitude toward labor should be mentioned. Unlike Jefferson, Gallatin did not fear the growth of an urban proletariat; in fact, he was quite sympathetic toward the common laborer. In 1846, as part of a strong argument against war, Gallatin said:

> In this, and other large cities, for every thousand merchants, or men of capital who may be injured or thrown out of business [by war], there are ten thousand men living on wages, whose employment depends directly or indirectly on the commerce of those cities. The number of common laborers is proportionately less in the purely agricultural districts. But it is evident that in both, a considerable number must be thrown out of employment either by the destruction of commerce, or in consequence of the lessened value and quantity of the agricultural products. And it seems impossible that this should take place without affecting the rate of wages, than which a more afflicting evil could not fall on the community. There is no man of pure and elevated feelings who does

---

[1] Ibid., p. 41; letter of March 19, 1816, to T. R. Gold, Writings, I, 690; "Partial Report on the Subject of American Manufactures," American State Papers, II, 430. In a letter of March 25, 1846, to J. R. Ingersoll, Gallatin further discussed tariffs, favoring specific over ad valorem duties. Writings, II, 628-35.

> not ardently wish, that means could be devised to ameliorate the state of society in that respect, so as that those who live by manual labor should receive a more just portion of the profits, which are now very unequally divided between them and their employers.[1]

In the Diplomatic Service: 1813-1827

Gallatin left active control of the Treasury Department in 1813, in order to serve abroad as a Minister of the United States. From 1813 to 1827, with only short interruptions, he performed diplomatic functions in the countries of Russia, The Netherlands, France, and England, the chief of these being as key American negotiator at the Treaty of Ghent. This period is relevant to the present topic principally because of his acute observation of various foreign monetary systems and experiences.

Gallatin's brief stint in Russia in 1813 served to give him the basis for his later description of the Russian monetary system and of exchange rates of the ruble.[2] In 1817, Gallatin implemented his theories on freer trade,

---

[1] "War Expenses," appendix to The Oregon Question, p. 72. Underlining added.
For additional biographical material on the period in his life from 1795 to the end of his Secretary of the Treasuryship in 1813, see Adams, op. cit., pp. 146-492.

[2] Letter to Alexander J. Dallas of September 25, 1815, Writings, I, 654-57.

when he and William Eustis negotiated a commercial treaty with The Netherlands.[1] In 1818, with Richard Rush, Gallatin negotiated a convention with the British on commercial and boundary problems.[2] Gallatin's despatches from France in 1819 and 1820 commented extensively on commercial relations between France and the United States. Gallatin objected to discriminatory duties of the United States on French products; but where France discriminated, Gallatin recommended amending the Constitution in order to tax certain exports to France, by way of retaliation. His general principle, however, was to work for lower duties.[3] Many more such despatches might be cited, but the above will suffice to show this aspect of Gallatin's diplomacy abroad.

Of considerable importance was the influence of the French and British monetary experiences on Gallatin's later

---

[1]United States, State Department, Diplomatic Despatches, The Netherlands, VI (October 30, 1815-August 20, 1819), unnumbered despatch of September 22, 1817; File Microcopy 42, Roll 7 (Washington: The National Archives, 1943). See also the Gallatin and Eustis despatch of September 7, 1817, ibid.; and Gallatin's letter to Eustis of October 9, 1817, ibid.

[2]United States, State Department, Diplomatic Despatches, Great Britain, XXIII (November 10, 1817-June 18, 1819), unnumbered despatch of October 20, 1818; File Microcopy 30, Roll 19 (Washington: The National Archives, 1942).

[3]United States, State Department, Diplomatic Despatches, France, XIX (June 4, 1819-July 31, 1820), despatch 149, July 5, 1820; File Microcopy 34, Roll 22 (Washington: The National Archives, 1942).

thinking. In 1829, he wrote to S. D. Ingham, then Secretary of the Treasury, a description of the monetary system of France, with its bimetallism, issuance of paper money only by the Bank of France, "and none of a denomination less than 500 francs."[1] Gallatin argued for comparable monetary provisions in the United States, because he was very favorably impressed by the operation of the French system. As Henry Adams says, "Mr. Gallatin had, during his residence in France, become prepossessed in its favor."[2] In a letter to Nicholas Biddle in 1830, Gallatin expressed his opinion that even skillfully administered banks could meet only "ordinary commercial fluctuations," and that, lacking very large specie reserves, severe crises were their downfall. A case in point was the suspension of specie payments by the Bank of England in 1797.

> On the other hand, the example of France, under the united pressure of a double invasion, a failure of crops, large indemnities to foreign countries,--a vast portion of which was paid by the exportation of specie,--an unsettled government, and wild stock

---

[1]December 31, 1829, Writings, II, 416. For a concise discussion of the French monetary system, see Charles Rist, History of Monetary and Credit Theory from John Law to the Present Day (London: George Allen & Unwin, Ltd., 1940), pp. 229-38.

[2]Op. cit., p. 637.

> speculations, is decisive to prove with what facility a crisis is met with an abundant circulating metallic currency.[1]

Gallatin noted that he and Alexander Baring were witnesses to these events, and that they came to the same conclusions.

Gallatin was in England during part of the "Period of the Restriction" of specie payments of bank notes, which lasted from 1797 to 1821. Until 1819, but not thereafter, Gallatin carefully read the literature on the controversy between the bullionists--who opposed the Restriction and the policy of the Government--and the anti-bullionists--who thought that restriction of specie payments was at times necessary and who, in general, were supporters of the Government.[2] Gallatin's sympathies were all with the bullionists. In an important 1831 essay, he cited Thomas Tooke, who in turn quoted Baring's testimony of 1819 before the Lords' Committee on the Resumption of Cash Payments.[3]

---

[1]Gallatin, Writings, II, 433.

[2]"It is so long since my mind was made up on the subject, that I have not lately collected any facts. The evidence reported by the committees of both Houses of Parliament previous to the resuming of specie payments in Great Britain is the last document of any importance which I read with attention." Gallatin letter to Robert Walsh, Jr., April 27, 1830, Writings, II, 427.

[3]Tooke was an exponent of the banking school, which succeeded to the theories of the anti-bullionists; however, on policy matters, the banking school was quite closely in agreement with the bullionists. See Lloyd Mints, A History

Gallatin, Tooke, and Baring were all in agreement that in France, a nation which had sufficient specie, a bank that had over-extended by issuing too much paper relative to its specie reserves could still replenish its coffers merely by shifting to a more conservative lending policy; whereas in countries lacking enough specie, additions would have to come from abroad, and over-extension was more apt to be fatal.[1] In short, Gallatin's experiences in France and England increased his conviction that a strong specie base and convertibility of paper notes into specie were vital to the success of any monetary system.[2]

As Bank President and Essayist: 1828-1849

After 1828, Gallatin occupied himself with research, writing, and service as a bank president. He wrote on

---

of Banking Theory in Great Britain and the United States (Chicago: University of Chicago Press, 1945) p. 100. See also E. Victor Morgan, The Theory and Practice of Central Banking, 1797-1913 (Cambridge, England: The University Press, 1943), pp. 121-22ff.

[1]Gallatin, "Considerations on the Currency and Banking System of the United States," Writings, III, 299-300.

[2]For further biographical material on the period during which Gallatin served as a diplomat abroad, see Adams, op. cit., pp. 493-634. See also James Gallatin, The Dairy of James Gallatin, Secretary to Albert Gallatin, a Great Peace Maker, 1813-1827, ed. Count Gallatin (New York: Charles Scribner's Sons, 1920).

currency and banking, on Indian vocabularies, and in opposition to war over Texas and Oregon.

In 1822, Gallatin had turned down the opportunity to become President of the Second Bank of the United States; but in 1829, he accepted the presidency of the small National Bank of New York. The promoters of this bank had secured a charter from the State of New York but had been unable to dispose of the stock; hence they had applied to John Jacob Astor for assistance. Astor, a close friend of Gallatin, offered to purchase the remaining stock on the condition that Gallatin should be the bank president. It was on these terms that Gallatin became head of the National (afterwards the Gallatin) Bank, capitalized at only seven hundred fifty thousand dollars. "Mr. Gallatin drew from it the very modest compensation of $2,000 a year, that being the sum which he considered necessary, in addition to his own income, to enable him to live in New York."[1]

In December, 1830, Gallatin contributed an article entitled "Banks and Currency" to the American Quarterly Review,[2] which was expanded with statistical material and

---

[1]Adams, op. cit., p. 643.

[2]VIII (December, 1830), 441-528. This periodical was edited by Robert Walsh, Jr., and printed by Carey and Lea of Philadelphia. The article, like all appearing in Walsh's Review, was unsigned, but can be identified as Gallatin's by correspondence in Writings, II, 425-27, 429-31, 441, 443-44, 447. See also below, p. 44, n. 1.

modified by several verbal transpositions into his popular essay of 1831, "Considerations on the Currency and Banking System of the United States."[1] This is a detailed treatment of the theory of money and of banks, but also a policy proposal: the renewal, with modifications, of the charter of the Second Bank of the United States, for the principal purpose of controlling the currency. This essay will be referred to extensively below. It should be mentioned that Robert Walsh, a pro-Bank man, asked Gallatin to write the essay for Walsh's Review; that Gallatin corresponded with Nicholas Biddle, President of the Second Bank, drawing statistical material from him, during the writing of this essay; and that Gallatin's article was printed at the expense of the Bank, to assist in Biddle's effort to get the charter renewed before its expiration in 1836.[2] However, it should also be pointed out that Gallatin not only turned down Biddle's offer to remunerate Gallatin for his contribution, as indicated in the following letter to Biddle, but

---

[1] Ibid., III, 231-364. Hereafter this essay will be referred to as "Considerations on the Currency." An initial note to this article, entitled "Advertisement," identifies it as first prepared for the American Quarterly Review of December, 1830.

[2] Writings, II, 429-40, 443-44. Cf. R. C. H. Catterall, The Second Bank of the United States (Chicago: University of Chicago Press, 1903), p. 200.

also refused the ordinary pay of contributors to the periodical:[1]

> Yours of the 6th instant is received. I would not in ordinary cases feel the slightest reluctance to receive compensation for my labor. This would indeed be convenient at this time, as I must withdraw to the country unless I can make some addition to my income. But the article on banks and currency makes an exception. On this I had made up my mind from the beginning. I did not write, and would not have written, and do not wish it to be supposed that I have written, for the Bank of the United States; and I necessarily must accordingly decline any compensation. So far as I am concerned, I did write, on Mr. Walsh's invitation, on a subject of great importance, and am quite satisfied provided the bank will at its expense print and publish my corrected copy. I am confident that a moment's reflection will satisfy you that my decision is correct as respects myself, public utility, or the bank itself. Under existing circumstances, he who happens to have drawn conclusions favorable to the renewal of the charter must have no personal interest for having come to that result, if he wishes to produce any effect.[2]

It is also relevant that Gallatin, unlike some of those who were supporting the Second Bank in the early 1830's,[3] had long and consistently favored a national bank, or a bank performing certain of the functions of a central bank. It was indicated above that Gallatin sponsored the

---

[1]Gallatin letter to Walsh, February 6, 1831, Writings, II, 447.

[2]Ibid., pp. 443-44.

[3]E. g., see Joseph Dorfman, op. cit., II, 606. On loans by the Bank to Congressmen, see Walter B. Smith, Economic Aspects of the Second Bank of the United States (Cambridge: Harvard University Press, 1953), p. 249.

Bank of Pennsylvania, to serve within the state in a capacity akin to that of the First Bank, nationally.[1] His speeches in the Congress, in 1796 and 1797, although directly concerned with federal indebtedness and only indirectly with the role of the Bank of the United States, nevertheless showed a certain sympathy toward that institution.[2] His "Sketch of the Finances of the United States" saw clearly the objections to the First Bank, as raised by its enemies, and recognized that the power of the Bank might be abused, yet argued that the Bank had had several beneficial effects, chiefly its assistance in the fiscal affairs of the federal government.[3] As Secretary of the Treasury, Gallatin vigorously supported the Bank from at least 1803 until its demise.[4] And every time thereafter that he expressed himself on the issue, right up to the period under review, he favored a bank that would act as a fiscal agent for the government and a regulator of the currency. These pro-bank positions assumed before he became Secretary of the Treasury do not

---

[1]Pp. 13-15.

[2]See above, pp. 18, 27-28.

[3]Writings, III, 135-36.

[4]See above, pp. 27-28.

seem to support Theodore J. Grayson's assertion that, before 1801, Gallatin was no better than "indifferent" to a national bank.[1]

Although Gallatin preferred to argue the question of a national bank on the economic factors involved, and although he had, in a naive moment in 1803, said that "against this there are none but political objections,"[2] nevertheless, the whole issue of a national bank had, by this time, become "intricately interwoven with the all-pervading political issues of State sovereignty, constitutional interpretation, scope of judicial authority," and measures for the relief of debtors in times of contraction.[3] The Bank expired in

---

[1] Leaders and Periods of American Finance (New York: Wiley & Sons, 1932), p. 110. Nor is the interpretation by Arthur M. Schlesinger, Jr., very apt, when he wrote with regard to the era of the Second Bank, ". . . conservative Jeffersonians, led by Madison and Gallatin, had come to accept Hamilton's Bank as necessary . . ."; The Age of Jackson (Boston: Little, Brown, & Co., 1945), p. 76. To suggest that Gallatin belatedly and reluctantly came to accept a national bank, and to couple Madison and Gallatin as to their views on a Bank of the United States is highly misleading. See Brant, op. cit., III, 328-33 for Madison's views on the First Bank at the time of its chartering; Adams, op. cit., pp. 427-28, for Madison's passive role during Gallatin's efforts to achieve recharter in 1811; and Stevens, op. cit., p. 296, for the least tolerant view of Madison's behavior in 1811.

[2] See above, p. 27.

[3] Sister M. Grace Madeleine, Monetary and Banking Theories of Jacksonian Democracy (Philadelphia: The Dolphin Press, 1943), p. 34.

Andrew Jackson's attack on privilege, allegedly exemplified by this "hydra of corruption."[1]

Because Gallatin, in later years, was not optimistic that the bank issue could be disassociated from political interests, and because he was shocked by the irresponsibility of the directors of the Second Bank after, say, 1836, Gallatin said in 1841 that the cause of a national bank "is really not worth dying for."[2] Although his views "respecting the constitutional powers of Congress, the great utility of a national bank as the fiscal agent of government, and the aid which may be derived from it to regulate the general currency of the country," were the same as theretofore, he did not believe that under the circumstances a national bank was as important as its latest advocates thought; and the "catastrophe" of the Second Bank showed that the great power of such an institution, if not properly safeguarded against, was apt to be abused.[3]

---

[1]For an excellent account from the economic standpoint, and a balanced over-all treatment of the Bank War, see Walter B. Smith, op. cit., pp. 147-78, 233-54. For a politically-oriented account, see Arthur M. Schlesinger, Jr., op. cit., pp. 74-114, especially pp. 88-102.

[2]Letter to John M. Botts, June 14, 1841, Writings, II, 552.

[3]"Suggestions on the Banks," op. cit., pp. 449-50. His "Suggestions," then, included a discussion of the restrictions which should be imposed on any new national bank which might overcome "the obstacles of conflicting opinions and interests." Ibid., pp. 453-56.

The suspension of specie payments by American banks in 1837, partial resumption in 1838, and final resumption in 1841, were the occasions for Gallatin's most noteworthy role as a New York banker. Because of a drain of specie to England, and to other sections of the United States consequent upon the distribution of the Treasury surplus, the New York banks, Gallatin's included, suspended specie payments on their demand obligations, in May, 1837.[1] Banks in the rest of the country followed. Gallatin, having made every effort to prevent the suspension, now did everything he could to bring about resumption. New York State law provided that a suspending bank that did not resume within one year had to forfeit its charter. This provision Gallatin used as a basis for persuading the other banks of New York City to join with him in urging rapid resumption.[2]

As a result of a general meeting in August of the officers of the several city banks, letters were sent to other banks in the country, stating the case for immediate

---

[1]See the section on "Causes and Incidents of the Bank Suspensions," in Gallatin's "Suggestions on the Banks," ibid., pp. 385-406.

[2]Gallatin's letter to Jonathan Goodhue, at Albany, April 5, 1838, indicated that the threat of withdrawal of bank charters was used, as far as Gallatin was concerned, as a lever to secure resumption; avoidance of loss to depositors and noteholders, and accomodation of the business community, were superior objectives. Writings, II, 537.

resumption, and urging cooperation toward that end with the New York banks. Chief resistance formed around the Bank of the United States, of Philadelphia, now with a Pennsylvania charter. Gallatin wrote of this bank as follows:

> . . . its loans and profits, under a wise and cautious administration, should have been reduced to the amount corresponding with the actual means.
>
> Instead of pursuing that course, a bold attempt was made, as soon as the suspension of May, 1837, had taken place, to take advantage of that state of things for commencing a system, of operations foreign to the ordinary and legitimate transactions of any bank.[1]

The Bank of the United States made reckless loans to its directors, who speculated in cotton, and to others. These actions brought it to a state of virtual failure in 1839, and to total, ignominious collapse in 1841.[2]

The New York banks sponsored a bank convention in October, 1837, with Gallatin leading the drive for an early

---

[1]"Suggestions on the Banks," op. cit., pp. 402-3. See also, "Documents Respecting the Resumption of Specie Payments in the Year 1838," appendix to ibid., pp. 462-86; for papers concerning the defections of the Philadelphia banks, pp. 464-66 and 480-84; for 1837 and 1838 "Reports of the Committee," headed by Gallatin, "appointed by the Convention in New York to secure resumption generally," pp. 471-80.

[2]See Grace Madeleine, op. cit., pp. 96-111; and, for a more extended account, Walter B. Smith, op. cit., pp. 180-230. Both are very temperate, objective accounts of a subject which has seldom received nonpartisan treatment, pro or con.

resumption of specie payments. He based his case largely on moral and legal grounds.[1] Gallatin recommended assistance from the State of New York only to the extent of its lending its credit and moral assistance.[2] When the New York banks received support only from banks in the South and Northwest, and could agree with no one on a date for general resumption, the convention adjourned. The bank

---

[1]For a view of Gallatin's public and behind-the-scenes efforts to force resumption, see the following: letter to Willis Hall, Chairman of the Committee on Banks of the New York Legislature, February 20, 1838, Writings, II, 520-22; letter to Hall, March 3, 1838, ibid., pp. 524-25; letter to A. C. Flagg, Comptroller, March 6, 1838, ibid., pp. 525-26; letters to William L. Marcy, Governor, March 20 and 27, 1838, ibid., pp. 526-30; letters to Hall, March 28 and April 3, 1835, ibid., pp. 531-35; letter to Jonathan Goodhue, State Legislator, April 5, 1838, ibid., pp. 535-37; letter to Marcy, April 9, 1838, ibid., p. 538; letter to Samuel B. Ruggles, State Legislator, April 9, 1838, ibid., p. 539; and letter to B. C. Howard, Member of Congress, May 7, 1838, ibid., pp. 539-40. Additional letters of the same sort are in the unpublished residue of The Gallatin Collection. Wayne Andrews, "A Calender of The Albert Gallatin Collection" (New York: The New-York Historical Society, 1950), pp. 323-26.

[2]Of the references in the previous footnote, the February 20 and the March 28 letters to Hall, and the letters to Marcy, Goodhue, and Ruggles, recommended that the State of New York assist only by authorizing a loan of State stock to strengthen certain banks, and by indicating the determination to have forfeited the charters of banks that failed to resume within the year. These things were done. The March 3 letter to Hall, and the letters to Flagg and Howard argued that the Specie Circular and the sub-treasury plan made resumption by the Western banks more difficult, and that legislation permitting free banking or the use of post-notes (i. e., payable not on demand but at a future date) would only make the task harder.

heads met again in April, 1838. Even then, banks outside New York could not be persuaded to resume when the New York banks resumed in May, 1838.[1] Many banks in other sections of the country followed later in the year, but abortively; suspension was widespread again in 1839. The second wave of suspensions, according to Gallatin, was "caused, exclusively in all but some of the South-Western States, by the inconceivable and unparalleled mismanagement of the United States Bank of Pennsylvania."[2] Resumption was not generally successful until 1841.

Evaluating the early resumption by the New York banks, Walter B. Smith says:

> The policy was resolute: it undoubtedly contributed to the subsequent growth in importance of New York as a financial center. Resumption cemented the ties between London and New York, a matter of importance. Both bankers and merchants gained because of the tight rein which the New York banks placed on credit. New York merchants collected bills due them while

---

[1]In a letter to J. Abbot, Jr., October 14, 1841, Gallatin claimed that "the resumption was effected with great ease, and without being attended with any of the fatal consequences which had been predicted." Writings, II, 559.

For additional material on the activities of the New York banks in 1837 and 1838, see Fritz Redlich, History of American Business Leaders: A Series of Studies, II, Part II, The Molding of American Banking: Men and Ideas (New York: Hafner Publishing Co., 1951), 258-65. Redlich interprets these events as an early phase in a trend toward increasing cooperation among American banks.

[2]Writings, II, 559.

> their Philadelphia competitors continued to accumulate additional accounts receivable which turned out to be of questionable value.[1]

Resigning his bank presidency in 1839, Gallatin devoted himself to research and writing. His "Suggestions on the Banks" appeared in 1841.[2] This improved upon Gallatin's banking theories, in certain respects, but generally is less comprehensive and analytical than his "Considerations on the Currency." The 1841 essay is oriented around the suspension and resumption of specie payments, and proposed remedies for the banking system, especially to insure convertibility of bank notes.

Gallatin lived out his years in New York City. An 1845 social register, entitled "Wealth and Biography of the Wealthy Citizens of New York City," listed Gallatin as being worth one hundred fifty thousand dollars and his two sons, one hundred thousand dollars each.[3] But the principal achievement of Gallatin's life was not the amassing of wealth, but rather service to his adopted country.[4]

---

[1] Op. cit., p. 205.

[2] Op. cit., pp. 365-488.

[3] Reprinted in Henry W. Lanier, A Century of Banking in New York, 1822-1922 (New York: The Gilliss Press, 1922), [p. 163].

[4] For further biographical material on Gallatin after the period of diplomacy abroad, see Adams, op. cit., pp. 635-78.

CHAPTER III

A BIMETALLIC STANDARD

Following the recommendation of Alexander Hamilton, the United States adopted a bimetallic standard in 1792. A bimetallic standard is one in which the monetary unit of the country--in the United States, the dollar--is legally defined as being either a certain number of grains of gold or a certain number of grains of silver. Holders of the precious metals have the alternatives of turning them in for currency in unlimited quantities, or of selling them for their bullion uses.

Albert Gallatin favored a bimetallic standard. He contended that it would enlarge the specie base, and thereby increase the stability of the standard of value. Gallatin wrote to Secretary of the Treasury S. D. Ingham: "There is, indeed, no permanent standard of value in nature; but, as applied to periods of twenty or thirty years, within which time all ordinary contracts are executed, gold and silver are, for that purpose, far preferable to any other commodity. . . ."[1]

---

[1]Letter of December 31, 1829, Writings, II, 417. The letter is reprinted as an appendix to Ingham's Report to the

Note that Gallatin was concerned with the problem of monetary stability for the execution of long-term contracts. By long-term he meant those which expire within two or three decades.

Many writers assert that it is not sufficient for it to be merely legally permissible for both metals to circulate as a medium of exchange, or for either or both to be freely coined. These writers say that it is further necessary that the following equilibrating condition be satisfied: When an appreciable quantity of either metal, for example, gold, moves out of circulation because it is undervalued at the mint, its market value falls. When the market value equals the mint value, gold ceases to flow out of circulation.[1]

As these writers demonstrate, the condition that both metals must circulate was not satisfied in the United States.

Senate, Senate Documents, 21st Cong., 1st sess., II, No. 135, 32-38. Cf. "Considerations on the Currency," op. cit., pp. 305-6, 311.

[1]The following references are to writers who (1) assert that the criteria for the successful operation of bimetallism is that both metals circulate concurrently; and (2) describe the compensatory action which, in theory, was supposed to accomplish this objective: A. E. Feavearyear, The Pound Sterling (London: Oxford University Press, 1932), p. 19; J. Lawrence Laughlin, The History of Bimetallism in the United States (4th ed.; New York: D. Appleton & Co., 1898), pp. 4-5, 13-15, 51; Karl H. Niebyl, Studies in the Classical Theory of Money (New York: Columbia University Press, 1946), p. 7-12.

The definition of the monetary unit in terms of two metals of unequal value necessarily requires the establishment of some ratio between them. In the United States in 1792, this mint ratio was 15-1, which undervalued gold. That is, holders of gold bullion found that their gold was worth more on the free market than at the mint. As a consequence, less and less gold was coined, with the amount falling to nothing in 1816 and 1817. Small amounts of half- and quarter-eagles were coined intermittently between 1818 and 1834.[1] Therefore, these writers conclude that the attempt to remedy the prevailing "scarcity of specie" in the United States, by the establishment of a bimetallic standard, was unsuccessful.[2]

To condemn bimetallism as a failure, however, for the sole reason that both metals did not circulate in the same country at the same time, is inadequate. The assumption

---

[1]Gold coins struck at the mint in 1814 were 15,454 pieces; in 1815, 635 pieces, and in 1816-17, no gold coins were struck. United States, Treasury Department, "A Statement of Coins struck at the Mint of the United States," for the years 1814, 1815, and 1816, Correspondence of the Mint at Philadelphia, I (November 2, 1795-December 29, 1817), 432, 452, 479, and 504, respectively; File Microcopy 64, No. 1 (Washington: The National Archives, 1943).

For gold coinage between 1817 and 1834, see Illustrated History of the United States Mint (Philadelphia: George G. Evans, ed. and pub., 1888), pp. 81-83. Cf. Davis R. Dewey, Financial History of the United States (8th ed.; New York: Longmans, Green & Co., 1922), p. 211.

[2]Laughlin, op. cit., pp. 14, 23, 51, 57, 68; Niebyl, op. cit., pp. 12-13. Nor did both gold and silver circulate after revision of the mint ratio in 1834. See below, p. 64-65.

behind the argument of the writers who would make this the criterion of the success of bimetallism is that the specie base would be large only if both metals circulate. If only one metal is circulating, however, it is at least possible that it would provide as much specie as if both metals were circulating simultaneously. Such might be the case if, of two countries on bimetallism, one overvalued gold and the other overvalued silver, so that both countries had more specie than they would have been able to command if they were both on the same monometallic standard. At any rate, it is sufficient for present purposes to indicate that the criterion that both metals must circulate is deficient.[1]

Since Gallatin thought that bimetallism would enlarge the specie base, it is legitimate to ask what was happening to the monetary supplies of gold and silver in the United States. The fact that gold was driven out of circulation before 1834 has been established. Curiously enough, silver dollars of the United States also were leaving the country.

During Gallatin's period as Secretary of the Treasury, the American silver dollar was slightly under the weight of Spanish silver dollars, which came from the Spanish-American colonies. Nevertheless, the American dollars were accepted

---

[1]For other criteria for the success of bimetallism, see below, pp. 61, 65-66.

at par with the Spanish dollars in the West Indies, because they were shiny and new whereas the Spanish coins were dull. Money-brokers in the United States, more economically-minded than the natives of the West Indies, shipped American dollars to the West Indies, and exchanged them for heavier Spanish coins. The money-brokers then imported the Spanish coins, melted them down, and sent the silver to the United States Mint, from which it emerged as an increased number of American dollars. The arbitragers could then repeat the process. Laughlin says:

> This process kept the Mint busy, but without the effect of filling the circulation with our own coins. The Mint, therefore, was a useless expense to the nation, but a source of profit to the money-brokers. The coinage of dollar pieces was consequently suspended in 1805 by the President, and none were coined until 1836.[1]

Even after President Jefferson's action, the same arbitrage was carried out with pairs of silver half-dollars, each of which contained half the silver that was in the old dollar. With gold undervalued and driven out of circulation, and American silver coins flowing to the West Indies, the United

---

[1]Laughlin, op. cit., p. 53. Cf. Niebyl, op. cit., p. 12; Dewey, op. cit., p. 211; United States, Treasury Department, Correspondence of the Mint at Philadelphia, pp. 312-13, 329, and passim.

It is a moot question why the supply of Spanish silver dollars did not dry up and bring this process to a halt, by foreign holders of silver bullion shipping it to the United States for minting, rather than having it made into Spanish coins.

States was largely dependent upon the continued circulation of foreign coins.[1]

Gallatin, when a member of the United States House of Representatives, favored the continued circulation of these foreign coins in order to meet the pressing needs.[2] In 1805, he wrote to Jefferson to the effect that Congress had, in the last year, neglected to renew the temporary laws by which foreign gold or silver was permitted to continue to circulate as legal tender.

> It followed that foreign gold ceased on 1st May last to be a legal tender. At that time nine-tenths of the circulating specie, or of that in the vaults of the several banks, consisted of such gold. . . . It must be observed that the omission of Congress, which was accidental, has done as yet no injury; for, as there was no other specie, everyone by tacit consent has received and paid it as if it had been a legal tender.[3]

Congress soon restored legal tender status to foreign coins.

Even with foreign coins substituted for American coins, however, it appears that the specie base for the currency

---

[1]By 1830, the Mint had coined $34,000,000 of silver coins, of which only $14,000,000 had stayed in the United States. In 1831, of $11,000,000 in specie in the vaults of the Bank of the United States, only $2,000,000 was in United States' coin. Laughlin, op. cit., pp. 54-55; H. Gordon Hayes, "Bimetallism Before and After 1834," American Economic Review, XXIII (December, 1933), 678.

[2]Gallatin speech of December 13, 1797, Annals of Congress, 5th Cong., 2d sess., VII, 718, 722-23. Cf. his speech of December 14, 1797, ibid., pp. 732-34.

[3]Gallatin, Writings, I, 255-56.

was not enlarged as the bimetallists hoped. Full-weight Spanish coins tended to be diverted from the currency to the arbitrage process. Clipped and worn Spanish coins were the ones in circulation. The legislation that gave foreign coins legal tender status also specified the official rating of those coins. The Spanish coins were legally valued at a premium over the American dollar, as, indeed, they should have been when full-weight. Gallatin's periodic assays of foreign coins, however, revealed the fact that the circulating Spanish coins were underweight.[1] In his reports of 1808 and thereafter, he recommended revaluing foreign coins, especially the Spanish, to equal their assayed value. In 1810, for example, he pointed out that rating the Spanish specie higher than its intrinsic worth tended

> to invite its importation and increased circulation, and to drive out of circulation the other species. Every bank, if called on to pay its notes in specie, will, in that case, pay with that species of coin; and the whole paper circulating medium must, after a while, be depreciated in the same proportion. The only guard against the abuse, and consequent

---

[1]Report submitted to the President of the Senate, January 16, 1808, American State Papers, Finance II, 265-66. It was followed by similar reports on "Assays on Foreign Coins," usually submitted in December of each year.

In turn, Gallatin was extremely insistent that United States coins, as turned out by the Mint, should be full weight. See letters from the Director of the Mint to Gallatin, of December 24, 1807 and June 29, 1809, United States, Treasury Department, Correspondence of the Mint at Philadelphia, pp. 344-46, 359-61.

> depreciation of bank paper, is a strict adherence to the principle, that payment may at any time, be demanded in specie, rated at its intrinsic value.[1]

This, of course, is a statement of Gresham's Law.

Gallatin looked to France for an example of the successful operation of bimetallism.[2] He calculated that the relative value of gold to silver bullion, according to the French mint ratio, was nearly 15.69-1. Gallatin then added that the consequences for France were as follows:

> Each metal is brought to the mint in greater or less quantities respectively, according to the fluctuations in their relative market value. But what proves that this ratio does not essentially differ from the true average market relative value is, that the mint has been abundantly supplied with both for the last twenty-five years, the coinage of France being far greater than that of any other country. I hardly need observe that it is due to the almost total expulsion of paper as currency.[3]

In his "Considerations on the Currency," Gallatin made other calculations of the market rate between gold and silver,

---

[1]Gallatin, letter on "Currency of Foreign Coins," to the Honorable Josiah Quincy, December 17, 1810, American State Papers, Finance II, 457. By way of illustrating Gallatin's extremely moral position on matters of money and debt, it may be added that Gallatin suggested in this letter that holders of Spanish coins, who would be hurt by the proposed revised rating of those coins, might be reimbursed for their loss by the government.

[2]On the operation of bimetallism in France, see, e. g., Joseph French Johnson, Money and Currency (Boston: Ginn & Co., 1921), pp. 224-27.

[3]Gallatin, letter to S. D. Ingham, December 31, 1829, Writings, II, 416. The last sentence is a non sequitur.

for example, in England during the immediately preceding years. He concluded that the mint ratio in the United States should have been between 15.60-1 and 15.69-1,[1] instead of 15-1.

In 1830, Gallatin offered the discovery of extensive deposits of gold, extending from Virginia to Alabama, as another reason for changing the mint ratio. By increasing the price of gold, it again would circulate, and thus "afford to those employed in collecting that natural product a certain and the highest home market of which it is susceptible."[2]

It might be well, at this point, to introduce Gallatin's mention of the "upper gold point." After showing that $4.56 in gold coin of the United States contained, when the United States was on the 15-1 ratio, a quantity of pure gold equal to that contained in the English sovereign, Gallatin added the following: "Allowing 1 per cent. for charges and transportation, our gold coins may commence to be exported to England as soon as the exchange rises to $4.61 per pound

---

[1]"Considerations on the Currency," op. cit., pp. 303-4; letter to Ingham, Writings, II, 421. Specifically, Gallatin recommended redefining the dollar so as to contain 259.5 grains of pure gold as compared to the previous 270 grains. He would have left the silver dollar as it was. This would have helped bring gold into circulation, but would not have stopped any remaining tendency to export shiny silver coins to the West Indies for heavier Spanish coins.

[2]Gallatin, "Considerations on the Currency," op. cit., p. 310.

sterling; which rate corresponds with . . . 3 per cent. below the true par, calculating this at the ratio of near 15.6 to 1, or $4.75 per pound sterling."[1] He then went on to show that, except for the year of the embargo, the exchange on London from 1795 to 1821 never rose to $4.62 per pound sterling. "This is the reason why our gold coins, though underrated, were not exported till the year 1821, when the exchange rose from $4.60 to $4.98 per pound sterling."[2] Thus it was, according to Gallatin, that gold was exported during the years 1821 to 1830 due to "unfavorable" exchanges, with few short exceptions. His analysis was quite sound.

During the late 1820's and early 1830's, the idea of revaluing the mint ratio so that silver would no longer be overvalued was very popular. It had supporters among both Jacksonians and non-Jacksonians. In addition to Gallatin, Condy Raguet, Thomas Hart Benton and William H. Crawford might be mentioned.[3] There was considerable disagreement, however, as to the appropriate ratio. Gallatin and others opposed the effort of the pro-gold forces, led by "old Bullion" Benton,

---

[1] Ibid., p. 304.

[2] Ibid.; see also pp. 269-71. Cf. Writings, II, 418.

[3] Laughlin, op. cit., pp. 28-29.

to raise the value of gold to 16-1.[1] William Gouge, for example, joined Gallatin in his opposition to the proposed 16-1 ratio, not because Gouge wished both metals to circulate, but rather because he frankly preferred a silver system.[2] Whatever the motives for opposing the 16-1 ratio, the arguments were unavailing against those of the Administration forces, such as expressed by the Washington Globe. According to Dorfman, the Globe declared that, since the break of Latin America from Spain and with the proposed 16-1 ratio, nearly all Latin American gold would come to the United States as the "natural and best market," and spread into the West, so that:

> In a few months "every substantial citizen will have a long silken purse, of fine open network through the interstices of which the yellow gold will shine and glisten." Every substantial man and his family will travel upon gold. The satellites of the bank alone, to show their servile subjection to their leige monarch, will repine at the loss of paper.[3]

The coinage Act of 1834 made the mint ratio 16-1. This Act was slightly amended in 1837, when the proportion of alloys to pure metals in all coins of the United States was changed such that the mint ratio became 15.98-1. Gold was

---

[1]On Benton's position, see Schlesinger, op. cit., pp. 126-27.

[2]Dorfman, op. cit., II, 609-10.

[3]Ibid. Reference omitted.

overvalued, resulting in a movement of silver out of, and gold into, circulation, since the market ratio was about 15.6-1.[1] Even if a mint ratio which was in accord with the 1834 market ratio had been chosen, however, it would soon have been out of accord with the changing market ratio. World gold discoveries in the 1840's made that metal relatively cheaper still.[2] Hence, in 1841, Gallatin was again advocating a change in the mint ratio to conform to the market ratio, to correct the overvaluation of gold.[3]

To conclude, Gallatin wanted a bimetallic monetary standard, despite recognized difficulties caused by fluctuation in the relative values of the two metals, on the grounds that bimetallism offered the possibility of a larger specie base, with greater stability of the monetary standard consequent upon that. His reasons follow:

1. Fluctuations in the values of the precious metals were said to be less than changes in values of other commodities.

2. Bimetallism offered greater protection against

---

[1]Laughlin, op. cit., p. 68. Note how closely the ratio accepted by Laughlin, who has done the definitive work on the history of bimetallism in the United States, corresponds to that calculated by Gallatin.

[2]Ibid., pp. 68, 288. This trend was again decisively reversed after the 1860's.

[3]"Suggestions on the Banks," op. cit., pp. 426-27.

certain changes in the relative values of the two metals. Gallatin assumed for purposes of illustrating this second point a country on a silver standard, with the value of silver alone rising. Debtors would have to pay in relatively dear money, that is, "to pay a greater value than according to the original contract." Assuming, on the other hand, the same rise in the price of silver in a country on a bimetallic standard, Gallatin showed that debtors would pay in gold, "in perfect conformity with the original contract," without being penalized by the changed value of one of the monetary metals.[1]

3. Bimetallism offered greater protection against the export of specie. Again assuming a rise in the value of silver relative to other commodities, with silver the sole legal tender, "it will be exported, and diminish in a most inconvenient way the whole amount of specie, a diminution which in that case cannot be remedied by resorting to the other metal which is not a legal tender."[2]

It should be noted that the remedy of "resorting to the other metal" would not be invoked until it was no longer undervalued at the mint. Assume a bimetallic standard, in

---

[1]Gallatin, "Considerations on the Currency," op. cit., p. 306. That "preserving a permanent standard of value" was crucial to his thinking, see ibid., p. 308. See also Writings, II, 422.

[2]Writings, II, 423.

which the mint ratio is set at 15.5-1, whereas the market ratio is 15.7-1. Gold is undervalued at the mint; hence is driven out of circulation. Assume the value of silver rises until it takes only 15.3 units of silver to get one of gold on the commercial market. Holders of silver would then sell on the market, while holders of gold would now go to the mint. Whereas under a silver system, the volume of specie currency would have been reduced, under bimetallism gold tends to replace silver. Even if, in practice, the relative prices of gold and silver do not behave in this way, bimetallism has provided "stand-by" protection against such contingencies. Note that the protection against loss of specie does not become effective until the market ratio reaches the mint ratio. If the latter were chosen highly unrealistically, say, 15-1 in the above example, then the value of silver would have to fall further, and greater export of specie risked, before gold tended to flow into circulation as a replacement.

Therefore, the 15.6 ratio suggested by Gallatin would have served this function of affording stand-by protection much better than did the actual 15-1 ratio in the United States. Moreover, the more realistic ratio would have been more likely to bring in gold.

Replying to the objection that with two metals "the fluctuation in their relative price increases the uncertainty

of the standard," Gallatin argued that this was only true to a slight extent, and again cited the case of France, where, with nearly correct mint ratios of silver to gold, both metals were coined and circulated for several decades up to the time he was writing, "and by always giving the same regular price for each, government has to a certain degree prevented any great fall in the price of either."[1]

Gallatin's reasoning with regard to the stabilizing effects of bimetallism was quite sound. The mint ratio that he proposed, in 1829 and 1830, would have greatly enhanced the possibility of both gold and silver circulating. He underestimated, however, the difficulties in getting the American Congress to adjust the legal ratio to a changing market ratio. Also, he failed to give sufficient consideration to the occasional uneconomic behavior (such as that of the West Indians who overvalued shiny American coins) which prevented the size of the specie stock from increasing as it otherwise might have.

If a monometallic system was desired, Gallatin had a slight preference for the use of silver, on two grounds: (1) the supply of it in the United States was greater than that of gold, and (2) it required a "greater premium on

---

[1]"Considerations on the Currency," op. cit., p. 307.

the exchanges" before it could be exported.[1] His reasoning was consistent: if one metal were to be chosen, it should be that which would have provided the larger specie base.

Gallatin, like most writers of his time, discussed the value of gold and silver in terms of demand and supply. When he said that the demand for gold and silver arose out of their use in the arts,[2] he was merely saying what William Gouge and others were also saying; and when Gallatin added that the demand for gold and silver arose also out of their use as money,[3] this was no different from that which Erick Bollmann was also stating.[4] Gallatin, however, went on to

---

[1] Writings, II, 424. Cf. Gallatin's letter to J. Horsley Palmer, May 1, 1833, ibid., 464. Gallatin acknowledged that, "at present, whenever the relative value of gold is greatly increased in the rest of Europe, the demand for it presses with great inconvenience on England. Silver being our standard, we are immediately affected by a contrary state of things and whenever there happens to be an extraordinary demand for that metal." Ibid. In a letter to Alexander J. Dallas, September 25, 1815, discussing the circulating medium of Russia, Writings, I, 656, he argued that silver was the best common denominator between various foreign currencies.

Gallatin did not explain his point that silver required a "greater premium on the exchanges" before it would be exported.

[2] Gallatin, "Considerations on the Currency," op. cit., pp. 242-43.

[3] Ibid., pp. 307-8.

[4] For the views of Gouge and Bollmann as to the factors affecting the demand for gold and silver, see Brooks, op. cit., pp. 378-79.

add several rather penetrating comments. One of the factors contributing to the stability of the value of the precious metals was the fact that the demand for them, he believed, could increase only gradually. He said that this was due to the fact that demand for the precious metals was "always proportionate to the wealth and prosperity of the civilized world."[1] Unlike the demand for corn, for example, which he thought was based largely on the quantity needed, the demand for gold and silver was for a certain value. Gallatin's succeeding discussion amounts to saying, in modern parlance, that the demand for corn was income inelastic whereas the demand for the precious metals was income elastic. Gallatin did not distinguish clearly, however, between the concepts of income and wealth. The relevant quotation follows:

> The demand for an increased value of plate, jewels, and other articles manufactured, in whole or in part, of gold or silver, with the exception, perhaps, of a few articles in general use amongst all classes, will everywhere be nearly in proportion to the wealth of each country respectively. And what is nearly correct as regards the demand for manufactures of gold and silver, is strictly true as applied to the demand for those metals for currency.[2]

Gallatin then suggested that the non-monetary demand for the precious metals did not increase appreciably with

---

[1]Gallatin, "Considerations on the Currency," op. cit., p. 242.

[2]Ibid., p. 243.

decreases in price, that is, the demand was price inelastic.[1] Gallatin summed up this point by saying that there was some proportion "of the average value of the various objects purchased" within a given time, say a year, which was needed in the form of money.[2] In other words, the demand for money, including gold and silver in its monetary uses, was a function "of the average value of the various objects purchased" over a period of time and of the level of wealth of the community. These ideas bear a striking resemblance to some of those of the great economist, Alfred Marshall, as in the following examples:

> A country's demand is not for a certain amount of metallic (or other) currency; but for an amount of currency which has a certain purchasing power. Her stock of gold at any time tends to be equal to the amount, which (at that value) equals the purchasing power that the people care to keep in the form of gold either in their own custody or in their banks; together with the amount that the industrial arts of the country will absorb at that value.[3]
>
> . . . . . .
>
> Let us suppose that the inhabitants of a country. . . find it just worth their while to keep by them on the average ready purchasing power to the extent of a tenth part of their annual income, together with a fiftieth part of their property . . .[4]

---

[1] Ibid., p. 243.

[2] Ibid., p. 244.

[3] Money Credit & Commerce (London: Macmillan & Co., 1923), p. 39.

[4] Ibid., p. 44. Gallatin's treatment of the demand for money will be dealt with in the discussion of the quantity theory of money, below, pp. 275-80.

Turning now to supply as it acts upon price, most writers of the time said that scarcity of gold and silver was the principal reason for their being more valuable than other metals. On account of their durability and small annual output relative to the size of the existing stocks of gold and silver, the supply was fairly constant (in the short run). Therefore, many writers at that time were saying that changes in value came about chiefly through changes in demand, although it is true that many commented upon the decrease in the value of the precious metals that followed the influx of these metals from America into Europe.

Some writers adopted a pure cost of production theory of the value of the precious metals, but others, including Gallatin, said that cost of production was only a single, though important, determinant of their value.[1] Gallatin thought that the discovery of America had brought the value of the precious metals down to one-quarter of their previous value relative to other commodities. "This great revolution was due to a simultaneous vast increase of the supply and corresponding reduction in cost of production of the metals."[2] This was said to be due to the size and accessibility of the new silver beds, and consequently to the greater quantity

---

[1]"Considerations on the Currency," op. cit., pp. 238 ff.; Brooks, op. cit., pp. 378-79.

[2]Ibid.

of ore which could be dug out with no more labor. The same was said to be true of gold. The depreciation in the value of gold, he thought, had been 3-1, and of silver, 4-1, so that the relative value of gold to silver, once 11-1 or 12-1, was at the time he was writing between 15-1 and 16-1.[1] Gallatin added that "the relative value of gold to silver does not depend on any supposed similarity or connection between the two metals, but is the result of their respective prime cost, which determines the value of each in relation to that of all other commodities."[2] Presumably Gallatin was here suggesting that, in the short run, the value of the precious metals fluctuated about the cost of production, because he previously has stated that, over a long period, demand factors also influence the value of the metals.

Gallatin estimated the amount of gold and silver in Europe and America in 1830 at $4,100,000,000, of which one-quarter he thought to be gold. Therefore, to produce another revolution in the value of specie comparable to that brought about after the discovery of America,

---

[1] Ibid., p. 239. J. Laurence Laughlin, A New Exposition of Money, Credit and Prices (Chicago: The University of Chicago Press, 1931) I, 96-97, roughly confirms Gallatin's view as to the relative degrees of depreciation of gold and silver, for the period 1500 to 1800.

[2] "Considerations on the Currency," op. cit., p. 239.

"mines must be discovered which in thirty or forty years should produce, in addition to the supply required by the increasing demand, thirteen or fourteen thousand millions of dollars, or three times the quantity now existing; and this increased supply must be accompanied with a corresponding reduction in the cost of production."[1] Since he doubted this possibility, he therefore doubted any revolutionary change in the relative value of the precious metals. The expense of extracting silver from the ore, he asserted, was small relative to the cost of mining, so that no technological change in the extraction process would make much difference. Large changes in labor costs would make a difference, but he thought that these changed quite slowly. While expecting progressive discoveries of new gold and silver mines, he thought that the increasing annual supply would be matched by the increasing annual demand attributable to the rising state of wealth of society. All in all, Gallatin thought that precious metals would change in value only gradually, thus making them the best monetary standard. He was proved wrong by the world wide leap in output of gold and silver after the year 1850.

> As much new gold ($3,174 million) was poured forth in twenty-five years (1851-75) as had been produced in all the previous three hundred and fifty-seven

---

[1] Ibid., p. 241.

> years since the discovery of America ($3,158 million). . . . Enormous as was this new upheaval, it was . . . only the beginning.[1]

Thus, Gallatin discussed fairly extensively the factors acting upon the value of the precious metals and hence influencing the value of the currency in a country, and he made laborious studies to determine precisely the relative market values of gold and silver. He suggested some of the conditions under which the specie base would be consistently larger with a bimetallic standard than with a monometallic standard. In the final analysis, however, his chief concern was not whether a bimetallic system was much preferable to a monometallic one, but rather that either was vastly superior to an inconvertible paper system. This position he summed up in his letter to Ingham, as follows: "As the defect of our currency consists in our wretched paper system the contemplated regulation [revision of the mint ratio to 15.6-1] relating to gold may not be very important; but its effect, though not great, cannot be but beneficial."[2] His great aversion to an inconvertible paper standard will be discussed in the next chapter.

---

[1]Laughlin, A New Exposition of Money, Credit and Prices, p. 111.

[2]Writings, II, 411.

CHAPTER IV

INCONVERTIBLE PAPER SYSTEMS

Gallatin's Position

Gallatin was strongly opposed to the issue of inconvertible paper money. His role in the attempts to resume specie payment by banks, in 1837 and 1838, has been described above.[1] The violence of his feelings against a state of suspension of specie payments must now be shown. The following letter to Jefferson, written after the end of the War of 1812, summarizes his position:

> On the lamentable state to which the banks have reduced the circulating medium of the country there ought to be but one opinion. Yet I fear with you that there will be no legislative effectual interference. . . . Specie, for which there is no use but for exportation, is hoarded up or exported. The number of borrowers and of pretended lenders, equally interested in continuing and extending the present system at the expense of the community, daily increases. . . . I have no patience on that subject. The war has been successfully and honorably terminated; a debt of no more than 80 millions incurred, which, as we had paid more than 40 during your Administration and until the war began, makes that debt only 40 millions or 50 per cent. more than it was in March, 1801; . . . our

---

[1] Pp. 49-53.

> population increased in the same, and our resources in a much greater proportion; our revenue greater than ever; and yet we are guilty of a continued breach of faith towards our creditors, our soldiers, our seamen, our civil officers; public credit, heretofore supported simply by common honesty, declining at home and abroad; private credit placed on a still more uncertain basis; the value of property and the nature of every person's engagements equally uncertain; a baseless currency varying every fifty miles and fluctuating everywhere,--all this done, or at least continued, contrary to common sense and to common integrity, not only without necessity or law, but in the face of positive laws and of the provisions of the Constitution itself. Yet a majority of the Republican papers already leans to that system. The seat of government is the worst focus of the evil, there not being less than 14 banks already organized in the District of Columbia, and some more preparing. The language of several of the bank directors is similar to that of Peter to his brothers in the Tale of the Tub. They insist that their bread (God grant it was even bread!) is good, substantial mutton, that their rags are true solid silver; and some of them do already damn to all eternity every unbeliever.[1]

Great antipathy to an inconvertible paper system is perhaps the most constantly recurring theme throughout Gallatin's monetary writings. In 1796, Gallatin discussed the issuance of paper money by the Continental Congress during the Revolutionary War, which issue he said was for one of two purposes: discharging contracts, or purchasing supplies. If for the latter, the continental paper could not get more than it was worth. "But whenever it was issued in order to pay debts contracted before, and had depreciated

---

[1]Gallatin, letter to Jefferson, November 27, 1815, Writings, I, 667-68.

in its value from the time when the contract was entered into, the difference was lost by the creditor and gained by the Union."[1] Among the creditors hurt were officers and soldiers of the army and navy. In their case, "the several States, on the recommendation of the Congress, made up the difference to the officers and soldiers according to a certain scale of depreciation."[2] In such instances the taxpayer ultimately bore the loss from which the Union gained; but in any event, the debtor nation gained while the others--creditors or taxpayers--lost due to the badly managed paper. This inequity, Gallatin believed, could be justified only by the great necessity of the case.[3]

During the suspension of specie payments from 1814 to 1817, Gallatin wrote: "Although I have nothing to do with it, the continued suspension of specie payments, which I consider as a continued unnecessary violation of the public faith, occupies my thoughts more than any other subject. I feel as a passenger in a storm, vexed that I cannot assist."[4]

---

[1]Gallatin, "Sketch of the Finances of the United States," op. cit., p. 122.

[2]Ibid.

[3]Ibid., p. 123. Cf. "Considerations on the Currency," op. cit., pp. 338-39.

[4]Letter to Monroe, December 26, 1815, Writings, I, 677.

In a similar state of mind, Gallatin bemoaned the continued suspension during the year 1816, on the grounds that it did harm by depreciating the currency, "in other words, by raising a tax on the community for the benefit of the banks and borrowers, and, what is more, by impairing the sanctity of contracts."[1] Paying public creditors in a depreciated currency, "instead of the gold and silver promised to them," was a violation of faith; it had driven public stocks below 85 per cent, and impaired public confidence. Gallatin referred to the "strong sense of justice" on which his argument rested.[2]

In 1830, Gallatin still had not changed his mind as to the magnitude of the evil of the suspension of specie payments from 1814 to 1817, nor of the great undesirability of any inconvertible paper system.[3] In 1841, Gallatin was writing that suspension was "the great and natural disease" of the state banking system,[4] that payment of obligations in specie

---

[1]Letter to Nathaniel Macon, April 23, 1816, Writings, I, 697.

[2]Ibid., p. 698. See also, ibid., p. 707.

[3]"Considerations on the Currency," op. cit., pp. 236, 258-59.

[4]Letter to M. T. Hunter, July 12, 1841, Writings, II, 554; cf. "Suggestions on the Banks," op. cit., p. 381.

was the "paramount and most sacred duty" of commercial banks,[1] and that the general public, and finally even legislatures, had grown indifferent to the suspension. "It would be painful to pursue the subject any farther, and to advert to the recklessness, gross neglect, inconceivable mismanagement, amounting to a breach of trust, to the disgraceful and heretofore unheard-of frauds which have occasionally occurred, or to that which is perhaps still worse, the apathy or lenity with which those enormities are viewed."[2]

---

[1] "Suggestions on the Banks," op. cit., p. 462. Gallatin argued that commercial banks have two duties: (1) to stand ready at all times to pay their notes and deposits in specie, "so as to preserve the constitutional standard of value"; (2) to extend loans for productive purposes. "But the first duty is positive and absolute; they are bound, in the first instance, to fulfil their engagements; it is the express condition on which the banks were permitted to issue paper; they have no right whatever to issue a depreciated currency. The second duty is discretionary, and subordinate to the first; it can be exercised rightfully only so far as can be done without running the risk of placing themselves in a situation that would put it out of their power to fulfil their engagements." Ibid., pp. 379-80. Gallatin raised the question whether, in view of the above, the two duties should not be separated; but in 1841 he no longer cared to argue this point, saying that was impractical for the United States. Cf. below, pp. 136-37, 139.

[2] Ibid., p. 384. Henry W. Lanier describes banking practices of those times, as follows: "One gets an illuminating glimpse of some of the financial practices of those days in DeVoe's record that some of these institutions 'were every few weeks or months stopping specie payments or closing for a period; then, with their agents, buying up their bills for 25 or 50 cents on a dollar, while others stopped entirely, defrauding thousands of poor mechanics and others.'" Op. cit., p. 52.

Most government officials in responsible positions, and many writers on currency, such as Raguet, Gouge, and Charles Francis Adams, were in agreement with Gallatin on the evils of an inconvertible system. By far the most frequently mentioned advantage of a mixed currency of specie and paper, according to Brooks, was its relative stability of value.[1] In contrast to the beneficial limitations on the issuance of a convertible currency, the great ease of increasing the issue of inconvertible paper and the lack of limitations on it were emphasized by many writers, from Alexander Hamilton to Charles Francis Adams. Also, numerous writers, among them President Tyler, pointed out that an inconvertible system was unsafe and insecure in view of the losses to the holders of depreciated and defaulted paper notes. Finally, the relative uniformity of a mixed currency and the non-uniformity of the value of an inconvertible paper one were emphasized by Secretary of the Treasury Dallas, Presidents Madison, Van Buren and Tyler, Lawrence, Benton, and others. These writers usually mentioned that this non-uniformity was peculiar to the United States on account of its multiple bank note system.[2]

---

[1]Brooks, op. cit., pp. 166-70.

[2]On all the above, see ibid., pp. 166-78.

An inconvertible paper system, however, had numerous advocates in the colonial period, and one outstanding proponent during Gallatin's public career, Erick Bollmann. Brooks says that many of the advocates of a paper currency during the colonial period believed that it would increase the capital of the nation, an argument based on a confusion of money and wealth. Bollmann's argument, however, was more sophisticated. Freely acknowledging that a depreciating inconvertible currency was a great evil, he nevertheless argued that a managed inconvertible currency could be so operated as to afford great stability.[1] Whereas Gallatin emphasized the gradualness of the increases in the output of specie, with the major exception of the large increases after the discovery and exploitation of the Americas, Bollman pointed out that the supply of specie was subject to numerous, often capricious, external and internal influences and hence was beyond the control of any government. Brooks mentions miscellaneous other arguments put forward by the advocates of a paper currency system, but none reached the acumen of Bollmann's.[2]

---

[1] [Bollmann], "A letter to Alexander Baring, Esq., on the present state of the Currency of Great Britain," American Review of History and Politics, II (October, 1811), 274, 288-89. This is identified as Bollmann's by Mints, op. cit., p. 297, and Fritz Redlich, Essays in American Economic History: Eric Bollmann and Studies in Banking, pp. 40-41, 99.

[2] Brooks, op. cit., pp. 294-315.

In spite of what many of the writers on currency were saying, however, the rigid insistence on the payment of paper notes in specie upon demand was anathema in many sections of the country. The opposition to specie payments on paper currency was based essentially on the fact that state banks were in the difficult position of having liabilities payable on demand, while the bulk of their assets with which they were supposed to meet these liabilities had distant maturities and little marketability. Banks on the Atlantic seaboard furnished, for the most part, short-term mercantile credit; but in the inland towns and smaller cities there were different credit needs, frequently long-term, for farmers, mechanics, speculators, and, during the period of internal improvements, local governments.[1] This combination

---

[1]Guy S. Callender describes the compelling urges to expand the commercial banking system in the west, (1) to finance internal improvements, (2) to enable the states to profit by their ownership of bank stock, and (3) in the southwest states especially, to furnish long-term agricultural credit. "The Early Transportation and Banking Enterprises of the States in Relation to the Growth of Corporations," Quarterly Journal of Economics, XVII (November, 1902), 158-62. According to Gallatin, the reason the Southwest needed more agricultural credit than the Northwest was that slavery required greater capital. Whereas the northern farmer advanced at most twelve months' wages to his labor, the southern planter advanced the price of the slave himself, "which amounts perhaps to 5 or 6 times the net product of his annual labor." Consequently, banking credit to agriculture was greater in the Southwest, and "much more fatal." "Suggestions on the Banks," op. cit., p. 388.

It would be a mistake to infer that agrarians always favored cheap money. For evidence that the contrary was

in American commercial banking of short-term and long-term credit led to the "fatal hybridization of function" referred to by Bray Hammond, "consisting on the one hand in the issuance of evidences of liability which constituted the country's means of monetary exchange and which the banks were expected to redeem on demand, and on the other hand in the provision, simultaneously and by the same token, of capital for fixed investment in farms, mills, opera houses, and what not."[1]

Gallatin observed the prevalence of lending on the basis of real security and the extension of more or less permanent accommodations, and argued that this was an unsound departure from "the true banking principle," being an important factor forcing banks to default on their demand obligations.[2] He wisely recognized the cause of the trouble as a lack of real saving that could be lent out on a long-term basis,

---

often true in the three decades before the Civil War, see Bray Hammond, "Banking in the Early West: Monopoly, Prohibition, and Laissez-Faire," op. cit., pp. 2-6, 8-12, 18-23; Thomas P. Abernethy, "The Early Development of Commerce and Banking in Tennessee," Mississippi Valley Historical Review, XIV (December, 1927), 323, 325.

[1]"Long and Short Term Credit in Early American Banking," Quarterly Journal of Economics, XLIX (November, 1934), 93-94. Fritz Redlich finds both the element of long-term credit, and its combination with note issue accompanying short-term credit, as being rooted in mercantilist thought; Redlich, Essays in American Economic History: Eric Bollmann and Studies in Banking, pp. 108-18.

[2]"Considerations on the Currency," op. cit., p. 279.

whereas contemporary opinion confused this with a simple lack of money, hence clamored for more banks. As Gallatin pointed out, "Where, as in the United States, the currency itself rests on credit, and the same institutions which issue that currency are those from which accommodations are expected, want of credit is most liable to be mistaken for a want of currency."[1]

Elsewhere, Gallatin anticipated Bray Hammond's conclusion of a century later, that the function of long-term lending should have been divorced from banks which also issued monetary notes payable on demand. But Hammond in 1934 emphasized the pressing need in the 1830's for specialized agencies which might have furnished such credit, whereas Gallatin, writing at the time, relegated such lending to private bankers who would, presumably, not lend anything but their own capital or funds actually deposited with them. Gallatin preferred to emphasize the need for a movement toward "hard money," or at least strictly regulated convertible currency.[2]

Gallatin noted that the banks of his day were what the borrowers made them; hence the bank which extended the desired

---

[1] Ibid., p. 268. Underlining added.

[2] Hammond, "Long and Short Term Credit in Early American Banking," op. cit., pp. 93-95. Gallatin, "Suggestions on the Banks," op. cit., p. 376; Writings, II, 442.
On the fact that the private bankers of the 1830's and

accommodations, whether long or short term, was popularly supported when it did not pay in specie upon demand. Yet he was deeply resentful of this.[1] Popular opinion in support of such banks sometimes was manifested in violent forms. Brooks gives the following example:

> The Louisville Courier for January 30, 1855, for example, reported that the citizens of Versailles, Kentucky, had denounced and hung in effigy Barclay, a banker from Lexington, for presenting the notes of the Versailles bank for redemption. These indignant people, the article said, "promised to make summary work with Barclay, or his clerk, if either ever again molested the vault of their bank."[2]

1840's did not, for the most part, create credit, but merely lent their own capital or acted "as brokers, or middlemen, with other people's money," see Bray Hammond, "Banking in the Early West: Monopoly, Prohibition, and Laissez Faire," op. cit., p. 16; Redlich, History of American Business Leaders: A Series of Studies, II, Part II, The Molding of American Banking: Men and Ideas, 63-66, 73. For a description of private banking in this era, see Henrietta M. Larson, Jay Cooke, Private Banker (Cambridge: Harvard University Press, 1936), pp. 48-63.

[1]"Banks, though money-lenders, are in fact governed rather by the borrowers than by the lenders"; "Suggestions on the Banks," op. cit., p. 381. In the same year he wrote A. C. Flagg, with regard to the times in which the New York banks were paying in specie when other banks were not: "The fact to which I call your attention is that whilst the banks in other States, which have persisted in a continued violation of their engagements, have been and continue to be specially favored, those of this city have been more vehemently attacked and appear to be more unpopular than anywhere else. . . . taking the country at large, those banks have been treated with most indulgence which least deserved it." Writings, II, 569. Gallatin neglected to mention the considerable anti-bank sentiment in the West. See above, p. 83, n. 1.

[2]Brooks, op. cit., pp. 221-22.

There were many ways in which banks evaded redemption even when their notes were nominally convertible: they might make their notes payable at some place other than where their home office was located; banks might require borrowers to agree not to present borrowed notes for redemption within a certain time; and "saddle-bag banks" might carry their notes about the country in order to put them into circulation at a great distance from the place of redemption, possibly so remote that it was "inhabited only by a den of wildcats."[1]

As a result of observing such practices, many writers, including Gallatin, made suggestions designed to maintain real convertibility. Gallatin offered the following alternative remedies: the revocation of the charter of banks not redeeming their notes upon demand, the application of a national bankruptcy law to such offending banks, or the levy of a tax or interest payment against notes not redeemed upon demand.[2]

---

[1]On these and other methods of evading redemption, see Davis R. Dewey, State Banking Before the Civil War, Senate Documents, No. 581, 61st Cong., 2d sess. (1910), pp. 100-7. See also William H. Dillistin's excellent study of Bank Note Reporters and Counterfeit Detectors, 1826-1866 (New York: American Numismatic Society, 1949), pp. 59-65.

[2]On these points, see, respectively, above, p. 49; "Suggestions on the Banks," op. cit., pp. 456-61 (when suspending banks pay in a depreciated paper, they are not paying in money the equivalent to that which, according to the

Gallatin's arguments in opposition to an inconvertible paper currency were, essentially, three in number. These were, (1) that it is immoral; (2) that it involves lack of uniformity among various bank notes, with resulting problems of constitutionality; (3) that it involves excessive issue.

1. The morality issue was raised in two different ways: inconvertibility brought an unjust redistribution of income, and, more than that, it was inherently immoral and disgraceful. Gallatin pointed out that, when contracts are paid off in depreciated paper money, those persons who are net creditors, or creditors at home and debtors abroad, are hurt relatively. Creditors of the government (for example, veterans of the Revolutionary War) who were paid in depreciated Continental paper money were thereby discriminated against.[1]

Constitution, is the only legal tender in payment of debts, Gallatin argued, so he advocated a law applied uniformly among all states declaring this to be an act of bankruptcy); "Consideration on the Currency," op. cit., p. 318, and Writings, II, 449. Some states adopted a penalty tax, and the charter of the Second Bank contained a provision for interest of 12 per cent a year on all its bank notes upon which payment was refused. See "Suggestions on the Banks," op. cit., pp. 417-18, 435.

[1]See above, pp. 76-77. Dewey quotes another writer, Breck, to the effect that "'the sailors, on returning from their cruise, being paid off in bundles of this worthless money, had suits of clothes made of it, and with characteristic light-heartedness turned their loss into a frolic by parading through the streets in decayed finery which in its better days had passed for thousands of dollars.'" Dewey, Financial History of the United States, p. 41.

Whether it is the result of government or private bank issue, depreciated inconvertible paper money "is a violation of existing contracts, renders all subsequent engagements uncertain, destroys confidence, and impairs private and public credit."[1] A debased coinage or a depreciated currency makes "the ignorant and the weak dupes of the shrewd and the wary."[2]

Furthermore, the depreciation of the currency is unjust to consumers who must pay higher prices. "The loss falls heavily and most unjustly on those who live on wages, which do not advance with the enhanced prices of articles of consumption, but which, on the contrary, generally fall during a period of universal derangement."[3]

In view of Gallatin's intensely ethical attitude, it is readily seen how deeply he must have felt such injustice.

---

[1]"Considerations on the Currency," op. cit., p. 379.

[2]Gallatin, letter to Robert Potter, December 3, 1830, Writings, II, 442.

The use of paper money that was at a discount relative to specie sometimes reacted against creditors even in periods of declining prices. Creditors lost when their "purchasing power" profit was more than offset by their "money" loss, as described by Thomas Senior Berry: "Payments of debts to broken banks were commonly made in their own notes, which could be bought in the market at a heavy discount. A substantial number of debtors profited in this way during a period of major price decline, because the obligations of their creditors depreciated more rapidly than commodities or real estate." Western Prices Before 1861: A Study of the Cincinnati Market (Cambridge: Harvard University Press, 1943), p. 404; see also p. 396. It should not be inferred that creditors were always "the ignorant and the weak," and debtors, "the shrewd and the wary."

[3]Gallatin, "Suggestions on the Banks," op. cit., p. 383.

Moreover, Gallatin believed that payment in specie, per se, was a moral and legal obligation, apart from any effects on prices or distribution of income. "Independent of every temporary party consideration, there are questions of right and wrong, of what is just or unjust, which must be settled on that principle alone. Such is the question of the currency."[1]

Brief comments are in order with regard to Gallatin's position on the moral aspects of inconvertible paper. Present-day value judgments may accord with Gallatin's dislike of discrimination against public and private creditors, wage-earners, and consumers. Few people today, however, would agree with his insistence that specie payments, for their own sake, are a basic ethical obligation. Times have changed, and so have our values. The prevalence of managed, fiat money today has left us, not with the belief that governments have a duty to pay in specie on their paper notes, but rather that they furnish a safe and reasonably stable money.

---

[1]Gallatin, Writings, II, 442. Cf. "Suggestions on the Banks," op. cit., pp. 412-13, in which he condemns the continued suspension of specie payments by Philadelphia banks, and the sanctioning of it by the State of Pennsylvania, even though they had succeeded in keeping their demand liabilities at a discount compared with specie of less than 5 per cent. He called it "immoral."

Thus, one must appeal to Gallatin's Genevan education and his early political career to understand his attitude toward debts and obligations. This was discussed in Chapter II, above. Gallatin took a more puristic attitude than did most of his contemporaries. Possibly it was true that, as Lanier says, when bankruptcy occurred "to a reputable man, he not only felt his honor deeply involved, but it was a matter of deep concern in his community."[1] Yet this sense of honor did not extend often to the obligations of impersonal banking corporations. As Gallatin himself said, there was too little "moral responsibility" on the part of directors of joint stock companies, who did not feel disgraced if the banking company failed, as they would have if they had failed in their own businesses.[2]

2. With regard to non-uniformity, Gallatin said of the period 1814 to 1817 that "we had fifty and more species of local currencies, varying in value in different States or districts of the country, and from time to time in the same district."[3] The situation was not much better in the suspension of 1837 to 1841. He also might have added, as did

---

[1]Lanier, op. cit., p. 199.

[2]"Suggestions on the Banks," op. cit., p. 380.

[3]"War Expenses," appendix to The Oregon Question, p. 63.

Raguet, that even during the period of nominal convertibility, different state banks notes were discounted at varying degrees, since real redemption was frequently evaded.[1]

The extent to which state bank notes depreciated tended to vary directly with the distance between the place in which they were circulating and the place of supposed redemption, as illustrated in the following account of the experiences of a French traveler with notes of a Georgia bank, in 1815:

> It seems the little man had arrived from Cuba, with about eight thousand dollars in gold, which by way of security he lodged in one of the banks of Savannah.--When he came to demand his money, he was told that they did not pay specie, and he must therefore take bank notes or nothing. Being an entire stranger, and ignorant of the depreciation of paper money, arising from the refusal to pay specie, and from the erection of such an infinite number of petty banks in every obscure village without capital or character, he took the worthless rags and began his Journey northward. Every step he proceeded his money grew worse and worse, and he was now travelling on to Boston with the full conviction that by the time he got there he should be a beggar.[2]

---

[1] Raguet is quoted in Walter B. Smith, op. cit., pp. 114-15.

[2] From The History of the Little Frenchman and His Bank Notes (Philadelphia, 1815), quoted in Dillistin, op. cit., pp. 3-4. On the extent of non-uniformity, see ibid., pp. 5-9, 44-46: Berry, op. cit., pp. 358-64, 389-404, 443-46. See Gallatin's comments, above, pp. 76-77. For several other interesting accounts of the problems which the multiplicity of non-uniform and insecure bank notes raised for business men, bankers, and money handlers of all kinds during the state bank note era, see Dillistin, op. cit., pp. 55-57, 74-75.

After the colonial period, non-uniformity was probably worst during the suspension of specie payments accompanying the War of 1812. As compared with the value of specie, bank paper was at par in New England, where specie payments were maintained, but at a discount of 7 per cent at Charleston and New York, 15 per cent at Philadelphia, and 20 or 25 per cent at Baltimore and Washington, "with every other possible variation in other places . . ."[1] Gallatin contrasted the chaos of the American currency with the situation in England during the Period of the Restriction of specie payments, in which

> All the country bankers were compelled to pay their own notes, if not in specie at least in notes of the Bank of England. These notes were, as a standard of value, substituted for gold; and if the currency of the country was depreciated and fluctuating in value from time to time, it was at the same time uniform throughout the country.[2]

Applying the fact of non-uniformity of the inconvertible paper in the United States, Gallatin argued that it was unconstitutional:

> Independent of all the other clauses in the Constitution which relate to that subject, it is specially provided, 1st, that all duties, imposts, and excises shall be uniform throughout

---

[1] "Considerations on the Currency," op. cit., pp. 331-32.

[2] Ibid., p. 331. Gallatin uses this as a powerful argument in support of a national bank as a regulator of the currency. Cf. "Suggestions on the Banks," op. cit., p. 382.

> the United States; 2d, that representative [sic] and direct taxes shall be apportioned among the several States according to their respective numbers, to be determined by the rule therein specified; and that no capitation or other direct tax shall be laid, unless in proportion to the enumeration. Both these provisions were violated whilst the suspension of specie payments continued. It is clear that after the quota of the direct tax of each State has been determined according to the rule prescribed by the Constitution, it was substantially changed by being collected in currencies differing in value in the several States. It is not less clear that the clause which prescribes a uniformity of duties, imposts, and excises was equally violated by collecting every description of indirect duties and taxes in currencies of different value.[1]

As a matter of fact, according to Dewey, the problems raised for the Treasury by these currency disorders were great, even though the unconstitutionality argument was not accepted.

> The direct loss to the government from poor or worthless bank-notes received during the four years, 1814-1817, amounted to over $5,000,000. The monetary derangement was so acute that the treasury department was obliged to keep four accounts with its depositories in four standards of value: cash or local currency; treasury notes bearing interest; treasury notes not bearing interest; and special deposits.[2]

In the following argument, Gallatin referred to the Constitutional prohibition on the states of making anything but gold and silver legal tender:

---

[1] Ibid., p. 332.

[2] Dewey, Financial History of the United States, p. 145. Gallatin estimated the loss to the government at over four million dollars. "Considerations on the Currency," op. cit., p. 293.

> The Constitution of the United States, without absolutely excluding every other circulating medium, has imperatively rendered the precious metals the only standard of value. The substitution of a paper for a gold or silver currency is therefore admissable only on the express condition that it shall always be equal in value to the legal coin of which it is the representative; and that equality cannot be maintained unless the paper be at all times convertible, on demand, into such coin at its nominal value. Any deviation from that principle is unjust in itself and an evasion of the constitutional provision.[1]

It should be noted that all of Gallatin's arguments regarding a uniform currency, except the last-mentioned one of unconstitutionality, would still not preclude an irredeemable paper currency, provided that it was everywhere uniform. A currency of uniform value might be achieved by several methods, among them redemption in central bank notes or government paper money, even though the latter were fiat money.[2] Thus, it would seem that Gallatin has defined a once-pressing problem, and has proposed a scheme to solve it; but that he has not yet successfully attacked another possible solution, that of an inconvertible, but managed and universal, paper money. His argument that such a currency was unconstitutional made little impression. His

---

[1] "Suggestions on the Banks," op. cit., p. 379.

[2] [Erick Bollmann], "Outlines of a Plan for the Regulation of the Circulating Medium of the United States," American Review of History and Politics, III (April, 1812), 280-87. This essay is identified as Bollmann's in the sources cited above, p. 82, n. 1.

attack on inconvertible paper rested more strongly on the moral argument, already discussed, and the claim of excessive issue, which will now be considered.

3. Gallatin showed how the volume of note issues by state banks increased greatly during the suspension of 1814 to 1817. With the dissolution of the First Bank of the United States, the number of state banks increased from eighty-eight on January 1, 1811, to two hundred and eight on January 1, 1815. Without the restraining influence of the First Bank, note issues by these banks increased "much beyond" what was necessary to prevent "commercial distress" by taking up the accommodations previously extended by the First Bank. Omitting deposits, for which data were fragmentary, note issues doubled during the same period.[1] Specie payments on the increased note issue became impossible, especially in view of three other factors which Gallatin listed as being at work: (a) Specie drained away to pay for imports, when exports fell off greatly because of the war blockade. (b) Specie was unequally distributed within the country. Since the war was unpopular in New England, and because "circulating capital" was small in the southern and western states, the principal burden of the loans which largely financed the war fell on individuals and banks in

---

[1] "Considerations on the Currency," op. cit., pp. 285-86.

the middle states. This drained specie from them toward whatever places the government spent the proceeds of the loans, especially to New England. (c) Foreign stockholders of the First Bank withdrew their capital from this country upon the dissolution of that institution, further aggravating the loss of specie.[1] In view of the fact that the war ended within six months after the suspension began, Gallatin believed that the Bank of the United States, had it been continued, could have prevented the suspension. It might have done so by limiting the issues of the banks, through the device of frequent presentation of their notes for payment in specie.[2]

Within the first fifteen months after the suspension, bank notes in circulation increased by almost 50 per cent, while total specie in the greatly increased number of banks rose only from seventeen to nineteen millions. Gallatin wrote in 1830, with regard to the almost seventy million dollars of notes in circulation in 1816:

---

[1] Ibid., pp. 282-85. Gallatin reported that about $35,000,000 of the total of $41,000,000 advanced to the United States during the War of 1812, was loaned by persons and banks in the cities of New York, Philadelphia, Baltimore, and Washington. The reasons Gallatin assigns for the suspension are the same as those advanced by Dewey, in a briefer discussion. Financial History of the United States, pp. 144-45. Cf. Walter B. Smith and Arthur H. Cole, Fluctuations in American Business, 1790-1860 (Cambridge: Harvard University Press, 1935), p. 28.

[2] "Considerations on the Currency," op. cit., p. 287.

> It is equal to the present amount of the currency; and as the increase of wealth during the last fourteen years has at least been in the same proportion as that of the population, the amount which could have been wanted at that time may be estimated at about forty-six millions, including both paper and specie.[1]

Next, Gallatin mentioned the test by which it could be determined whether there had been an excessive issue of paper money. He asserted that a premium on specie was proof of overissue.

> The wisest government, with the purest views, never has any other means of ascertaining whether the amount of a paper money is too limited or excessive than the price of the precious metals in such paper, because these metals are, of all others, the commodity least liable to variations in its value.[2]

In other words, the appropriate amount of money is that which can be sustained at par with, for example, gold. This, of course, is guaranteed when the monetary unit is defined as so much gold,[3] and redemption or conversion of currency into

---

[1] Ibid., p. 286. Since the amount of bank-note money in circulation in 1830 is here taken as a referent, it is relevant to inquire as to the state of prices and of business activity in that year. Smith and Cole indicate that an index of wholesale commodity prices was at the low point in a cycle of slight amplitude, but that an index of the volume of trade was at a moderately high level; this was a period of relative stability, especially as compared to the years 1834-1843; op. cit., pp. 60-61, 73. For the construction and limitations of these indices, see ibid., pp. 59-60, 70-72.

[2] "Considerations on the Currency," op. cit., p. 259.

[3] I. e., the government will pay a specified number of dollars for an ounce of gold.

specie is possible. Hence, said Gallatin, it was best to have a metallic standard in the first place.

After roundly expressing a good Jeffersonian, laissez-faire doubt that governments could ever manage properly a currency, he added:

> But supposing government to be endowed with such skills as to be able always to adjust the proper amount of currency,--an amount which, if this is metallic, adjusts itself, and which, by banks properly conducted, may be tolerably well regulated,--there is still an ingredient inherent to paper not convertible on demand in specie which no human skill can control. This is public opinion with respect to future contingencies, and therefore purely conjectural.[1]

In discussing the value of inconvertible paper money, Gallatin made much of the necessity for public confidence, especially confidence in its ultimate redemption. This depended a great deal on the discretion and skill of the issuing authority, whether government or bank, and Gallatin saw no hope of either showing the necessary restraint. Banks will overissue if not checked by the necessity of paying specie on demand, since they profit by the accompanying large numbers of discounts. And governments are to be trusted even less, "experience having but too well proved the natural disposition of every government which ever did issue paper to resort, whenever pressed by its exigencies,

---

[1] Ibid., p. 260.

to that resource, without regard to amount or consequences."[1] The belief that governments could not be trusted to issue paper money with restraint was widely and strongly held among Gallatin's contemporaries. Lawrence and Charles Francis Adams made particularly strong statements to this effect.[2]

After studying a number of case histories, Gallatin suggested that there might be under- or overissue without immediately affecting commodity prices; that the degree of depreciation does not depend solely on excess issue; and that the size or even existence of the premium on gold is unpredictable and may depend on fortunes of war. He concluded: "It is believed that no doubt can remain that a paper currency liable to fluctuations like those, and originating in causes that baffle all calculation, never can, by any skill whatever, be made a stable standard of value."[3]

---

[1] Ibid. Cf., ibid., p. 338; Writings, II, 428, 440, 442, 511-12.

[2] Brooks, op. cit., pp. 183-84.

[3] "Considerations on the Currency," op. cit., p. 263. In the original version of this essay, in the December, 1830, American Quarterly Review, this quotation (p. 470) was followed immediately by a discussion of the effects of an external drain of specie on purely metallic, convertible, and inconvertible systems. In the 1831 edition, "Considerations on the Currency," the latter discussion does not appear until twelve pages later. Over-all, however, the identical textual matter is included in both versions; merely the arrangement is changed. This is the major difference, apart from the expanded statistical material, between the two appearances of this essay.

The belief that the currency should vary precisely as would a purely specie currency, and that there should be no discretionary departure from such manner of variation, was typical after 1821 of the Currency School in England, successors to the pro-bullionists of the Period of the Restriction. In addition to the test of a premium on specie, the Currency School emphasized a rise in the exchange rates as evidence of excessive issue. Gallatin mentioned the latter only briefly, and in other respects either did not discuss the identical problems that they did, or departed in practice from their theories.[1] In the United States, James Cox and Daniel Raymond were, according to Brooks, the most consistent exponents of Currency School ideas, and Crawford also cited a premium on specie as evidence of over-issue. Finally, among those refuting, on quantity theory grounds, the notion that an inconvertible paper money was a direct means of creating capital, were Raymond, Adams, Raguet, and Gouge.[2]

---

[1]See below, pp. 145-52. On the Currency vs. Banking School controversy, see Lloyd Mints, op. cit., pp. 75-77. Cf. E. Victor Morgan, op. cit., p. 141 for summary, and pp. 121-41, generally. Currency School writers apparently believed that parity with specie was the equivalent of the volume of paper varying in a direct and constant proportion with specie. These are not necessarily equivalents, however.

[2]Brooks, op. cit., pp. 239-40, 182.

Criticism: Comparison with Bollmann

The ideas of Albert Gallatin with regard to overissue of inconvertible paper money have been set forth, and compared briefly to those of some of his contemporaries. It has been shown that his case rested largely on the belief that the appropriate amount of money for a society was that which would be furnished under a purely metallic system, or, at least, that which could be kept at par with specie. Tying the money supply to specie, however, makes the rate at which the system furnished new money depend on accidental circumstances, as pointed out by Bollmann, in 1811, as well as by recent writers.[1]

Bollmann argued that convertibility into gold or silver, so that parity of paper with metallic money was maintained, prevented neither rising nor falling prices, with attendant evils. If the business community was demanding more credit, he pointed out, and not demanding gold or silver, the quantity of bank money could increase greatly without jeopardizing specie payments and without paper money exchanging at a discount. Whether or not this was desirable depended upon a criterion other than parity with specie. The criterion

---

[1] E. g., Dennis H. Robertson, "Theories of Banking Policy," Essays in Monetary Theory (London: Staples Press, 1940), pp. 51-52. On Bollmann, see above, p. 82.

that Bollmann suggested for the proper amount of money was that quantity "convenient" to the economy without disruptive price changes.[1]

On the other hand, according to Bollmann, if the demand for gold and silver increased, for any one of a number of possible reasons, then banks would find it much more difficult to maintain convertibility. Gold would tend to sell at a premium in terms of paper money, and it would be said that the money was "overissued." Bollmann disagreed that there was excessive issue in such a case; the only real change was in the demand for gold, not in the amount of money convenient to the economy without disruptive price changes. Yet the Currency School principle would dictate that the money supply be contracted, even if that meant "distress" to business. It would be better, Bollmann thought, to relinquish convertibility, as England did in 1797.

> From these considerations it seems to follow, that a currency, entirely unconnected with the precious metals, peculiar to the country in which it should be established, and confinable within certain limits, would be an important improvement in political economy.[2]

---

[1] [Bollmann], "A letter to Alexander Baring, Esq. on the present state of the Currency of Great Britain," op. cit., pp. 259-63, 274, 289.

[2] [Bollmann], ibid., p. 274. On price stability as a goal of monetary policy, see Robertson, Essays in Monetary Theory, pp. 56-57; Board of Governors of the Federal Reserve System, "Objectives of Monetary Policy," Federal Reserve Bulletin, XXIII (September, 1937), 827-28. On other goals

Bollmann also criticized the assumption of the proponents of a metallic standard that a change in domestic prices would bring about international movements of gold or silver such as would restore the former price level. Gallatin apparently believed that a metallic standard would afford stability by such a process. Specifically, "the orthodox theory of the gold standard" assumes that a temporary rise in prices, for example, will decrease commodity exports relative to imports, and cause an outflow of gold. In turn, according to the theory, prices would fall until they were in equilibrium with the new level of output. The temporary rise in prices would have been corrected; there would be internal stability.[1]

Bollmann argued, in rebuttal, that foreign commerce did not depend on a "nominal cheapness" but rather on "intrinsic cheapness." Even if prices of export goods were to rise, if their labor cost abroad were still comparatively greater,

---

for monetary policy, and criticism of the gold standard, see Robertson, Essays in Monetary Theory, pp. 51-52, and Kenneth Boulding, The Economics of Peace (New York: Prentice-Hall, Inc., 1945), p. 208.

[1]H. L. Puxley, A Critique of the Gold Standard (London: George Allen & Urwin, Ltd., 1933), pp. 16-18; Ragnar Nurkse, International Currency Experience (League of Nations, 1944; reprint, New York: United Nations, 1947), pp. 66-67.

they would continue to be exported.[1] Compare Bollmann's ideas to the modern analysis which shows that, if a country's demand for imports were highly unresponsive to changes in price, and especially if foreign demand for the country's exports were also "inelastic," then a rise in domestic prices relative to foreign would tend toward a more, not less, favorable balance of trade.[2]

To recommend the adoption of inconvertible or fiat money requires considerable confidence in the strength, discretion, and knowledge of the monetary authority. Bollmann may have had greater confidence in the governments of his time than was warranted. Nevertheless, Bollmann recognized shortcomings in a rigid adherence to a metallic standard which Gallatin, writing twenty to thirty years later, did not see. And Bollmann anticipated the needs of the future far better than did Gallatin. The gold standard has been discarded because of its failure to provide sufficient stability of prices and incomes, and to permit management

---

[1][Bollmann], "A letter to Alexander Baring, Esq. on the present state of the Currency of Great Britain," op. cit., pp. 285-88.

[2]Nurkse, op. cit., p. 119; Howard S. Ellis, "The Dollar Shortage in Theory and Fact," Canadian Journal of Economics and Political Science, XIV (August, 1948), pp. 358-72.
Nurkse also shows that, even if the rise in domestic prices brought about an unfavorable balance of trade, gold might not flow out, as the theory requires; op. cit., pp. 15, 98-102. Neither Gallatin nor Bollmann consider this possibility.

of the currency toward the improvement of the performance of the economy.[1] Gallatin attributed a certain generality to some of his own views; and the principle that he would have insisted was most universal was the advisability of a metallic standard.[2] Hence, it is fair to say that Gallatin offered an inadequate monetary prescription for the future. How well did inconvertible paper systems work in America? Brief inquiry will be made into the colonial experiences with the issue of inconvertible paper money, and the evaluation of these experiences by certain orthodox gold standard theorists.

Many critics of inconvertible paper money, Gallatin included, pointed to the alleged disastrous experiences with such systems during the colonial period. They described the real abuses of fiat monies in Massachusetts, Rhode Island, and certain other colonies, and the extreme depreciation of the Continental currency of the Revolutionary War; they mentioned the use of paper money in the remaining colonies; then they concluded that the entire history of inconvertible paper

---

[1]R. G. Hawtrey, The Gold Standard in Theory and Practice (4th ed.; London: Longmans, Green & Co., 1939), p. 215; Dennis H. Robertson, Money (New York: Pitman Publishing Corp., 1948), pp. 140-44, 178-79; Ragnar Nurkse, op. cit., pp. 68-88.

[2]See above, p. 3; Gallatin, Writings, II, 426-27; ibid., pp. 460-61.

money in America has been a dismal record of overissue.[1] For the issues in those colonies, such as Connecticut and Pennsylvania, where the results were not so drastic a depreciation of the currency nor disruption of business (if any), these critics admitted that the issues retained a good reputation and may have been reasonably well managed. But their conclusion was nevertheless the same: the issues must have been bad, because there was a premium on gold--the paper had undesirably depreciated.[2] The question was rarely even asked whether or not this made any difference in the performance of the economy, whether price and income

---

[1]Francis A. Walker, Money (New York: Henry Holt & Co., 1878), pp. 305-35. William G. Sumner, A History of American Currency (New York: Henry Holt & Co., 1874), pp. 14-49. For Gallatin's views, see the references in p. 100, n. 1, above.

[2]Walker, op. cit., pp. 309-16. Joseph French Johnson, op. cit., pp. 291-92, 313, concludes that it is practically impossible to manage properly a fiat money, notwithstanding his evidence that Bank of England notes during the Restriction were "apparently" liked better than gold and that "nobody ever questioned their value or their prospects." His reason? The notes depreciated relative to gold, and prices rose. Thomas Tooke and the Banking School disputed this latter contention when first advanced by the Bullionists; Mints, op. cit., pp. 42 ff. Morgan disputes the quantity theory idea that changes in the money supply caused this price rise, arguing that all the major changes were associated with non-monetary factors; Morgan, op. cit., pp. 46-47. Gallatin thought that the inflationary effects of the Bank of England's policies were "slow and progressive," but that a 20 per cent depreciation in English bank paper during a three month period from "the last entrance of Bonaparte in Paris . . . till its capitulation to the allies" had not had "any material effect on the prices of English manufactures." Letter to Dallas, September 25, 1815, Writings, I, 655.

stability was or was not fostered. To condemn inconvertible paper because it falls in value relative to gold is to attempt to prove one's case for a gold standard by assuming the truth of that which one is trying to prove.[1]

At least one modern advocate of managed currency who investigated these colonial currencies, and who was careful to inquire into the effect of the fiat money on prices and incomes, has concluded that the results were not always bad. Richard A. Lester found, first, that in several important instances the issue of inconvertible paper was subsequent, rather than prior, to the drain of specie from the colonies. That is, the drain of specie made convertibility impossible, rather than that overissue raised prices and thereby drove out the precious metals.[2]

Second, Lester demonstrates that the issues of the New England colonies may have been inflationary and contributed to an export of gold and silver, but in the middle colonies paper was used in depressions in an effort to revive domestic trade and to stop falling prices. The results were generally

---

[1]Cf. [Bollmann], "A letter to Alexander Baring, Esq., on the present state of the Currency of Great Britain," op. cit., p. 258.

[2]Gallatin's own analysis showed that this was largely true of the suspension of specie payments during the War of 1812. See above, pp. 96-97; Smith and Cole, op. cit., p. 28.

salutary, and prices were more stable as a consequence of the use of fiat money.[1]

Since Gallatin used the period of suspension of specie payments in the United States, from 1814 to 1817, to illustrate the worst evils of inconvertible paper, that period will be examined below in order to make some tentative comments on whether or not inconvertibility was associated with unstable economic conditions, and, if so, the extent to which it was causal.

Smith and Cole, in the definitive work on business cycles of this period, argue that "the impulses that disturbed the business of America came from abroad; and that fluctuations in foreign demand and supply are attributable directly to the state of war and politics."[2] During the War of 1812 (hostilities lasted from the middle of 1812 to the first quarter of 1815), commodity prices rose greatly, with those of imported goods rising the more rapidly, as might be expected. Suspension of specie payments may have had some tendency to raise prices, but, "generally speaking there was a fair degree of correlation between prices on this side of the Atlantic and those in England. . . . the

---

[1]Richard A. Lester, Monetary Experiments, Early American and Recent Scandinavian (Princeton: Princeton University Press, 1939), pp. 56 ff.

[2]Op. cit., p. 31.

activities of banks were no more than contributing factors."[1] The principal effect of the suspension was to create price differentials between New England, which did not suspend specie payments, and the middle and southern states, which did. Bank notes were unreliable and of widely varying value, as has been shown.[2]

High prices meant only spotty prosperity during the war. Newly-created manufacturing industries, the product of war demand and the absence of foreign competition, gave New England a measure of prosperity despite the temporary ruin of the shipping industry. Producers of cotton and flour in the South and West were at a considerable disadvantage. The higher prices of imported goods as compared to most domestic goods were not conducive to general prosperity.[3] Whereas wholesale prices had begun rising in the East before the outbreak of the war, the upswing did not begin in the West until late 1812. The price rise in the West was no less precipitous, however: an index of agricultural prices was 75 per cent greater in 1814 than in 1811.[4] Specie payments were not

---

[1]Ibid., p. 32.

[2]Above, pp. 91-93. Once again, this evil can be attributed as readily to the absence of convertibility into the uniform notes of a national bank as to absence of convertibility into specie.

[3]Smith and Cole, op. cit., pp. 19, 148.

[4]Berry, op. cit., pp. 96, 372.

suspended in the Ohio Valley until 1815, one year later than in the East. In general, interruptions in trade which figured so strongly in fluctuations on the eastern seaboard had much less effect in the interior.

With the end of the war, the advantages to New England manufacturing were lost. Europe at peace was a strong competitor. Prices fell rapidly, unemployment rose, and manufacturing suffered hard times for some years to come. But the rest of the economy, both in New England and elsewhere, recovered, and enjoyed years of moderate prosperity from 1816 to 1818. There was again a foreign market for American agricultural products, and prices of domestic goods were above prices of imports. American shipping recovered from its low war-time state. The major effect of the general resumption of specie payments in 1817, according to Smith and Cole, was the disappearance of any price divergences between the various Atlantic ports, except those explained by differences in transportation costs. "The Atlantic seacoast was once more a unified market for staple products."[1] Despite complaints, in 1817, that there was considerable distress caused by the contraction of bank loans in anticipation of resumption, Smith and Cole conclude that "business was not very seriously embarrassed at this time, however, for

---

[1]Smith and Cole, op. cit., p. 20.

foreign demand for American produce was strong. Resumption of specie payments in February 1817 was accompanied by no embarrassing outflow of precious metals."[1]

Gallatin did not discuss the state of business during the suspension, but devoted considerable effort to measuring the extent of the contraction of demand liabilities necessary to resume specie payments. He made a point not mentioned by Smith and Cole, whose indices largely reflect conditions in eastern cities: resumption was hardest on western banks and their patrons, because of the pressure on unusually large debts of cash drains to the east. These debts had been a product of "an excited spirit of enterprise."[2] Gallatin's contemporary view agrees with Smith and Cole's modern analysis, that the speculative expansion of 1818 was enhanced by too liberal credit, and was followed by a severe depression, including financial crisis, from late 1818 to 1820. Gallatin, however, did not mention the fall in export prices as a major cause of the contraction by the banks, a factor which Smith and Cole emphasize.[3]

---

[1] Ibid., p. 29.

[2] Gallatin, "Considerations on the Currency," op. cit., pp. 290-91.

[3] Smith and Cole, op. cit., pp. 20-21, 29. For a brief description of business fluctuations from 1813 to 1818, based not on business statistics but on the business literature of the period, see Willard L. and Hildegarde E. Thorp, Business Annals (New York: National Bureau of Economic

To conclude the discussion of economic activity during this period, it appears that the suspension of specie payments was caused by exogenous factors, and played no more than a contributory role in business fluctuations from 1814 to 1817. Gallatin overemphasized the monetary forces at work. It is true, however, that the absence of a national bank between 1812 and 1816 precluded any responsible central banking, and contributed to the overly-rapid increase in numbers of banks and in bank money. Gallatin was very much aware of that fact.[1] He placed too much faith in the resumption of specie payments, in view of the failure of resumption to prevent a sharp inflation in 1817 and 1818. Excessive bank credit stimulated speculation in common stocks and public lands.[2] The new Bank of the United States facilitated rather than restrained this process.

Research, 1926), pp. 17-18. The picture presented by the Thorps differs from the above in that it emphasizes more the prevalent theme of business annals of the period, that is, depression in many branches of manufacturing.

For a detailed study of prices and business activity in the Ohio valley during the period 1813 to 1823, see Berry, op. cit., pp. 371-405.

[1]Smith and Cole, op. cit., p. 28; Gallatin, "Considerations on the Currency," op. cit., p. 287.

[2]Smith and Cole, op. cit., pp. 22, 46, 53. Gallatin was not in the United States in 1817-18, and in his writings did not comment on the role of the Bank during this period. It is probable that he would have been highly critical.

Neither the metallic standard nor the policies of the National Bank prevented or moderated the depression of 1818 to 1820. Yet it remains true that, whereas an unregulated metallic standard offers no opportunity for fighting contractions and inflationary expansions, a central bank, especially one that is unhampered by rigid ties to a metallic standard, at least has the opportunity to adopt a monetary policy designed to offset undesired deflations and inflations.[1] That it may fail to do so, through ignorance, lack of will or foresight, or conflicting objectives, has also been proven true.[2] The Bank of the United States eventually justified Gallatin's support by its performance during the next twelve or fourteen years, but the metallic standard proved to be a handicap in times of future crises.[3]

---

[1]For an excellent discussion of the possibilities, and yet limitations, of monetary measures, see William J. Fellner, Monetary Policies and Full Employment (2d ed.; Berkeley: University of California Press, 1947), pp. 174-209.

[2]On the early mistakes and failures of the Second Bank, see Walter B. Smith, op. cit., pp. 99-116, 123-24.

[3]See below, pp. 248-50, 256-58.

CHAPTER V

THE NATURE AND SUPPLY OF MONEY

Commodity Theory vs. Nominalist Theory

> Whatever commodity or species of paper may, by law or general consent, be universally received in any country in exchange of every other commodity and in payment of all debts, is the circulating medium or currency of such country, or, in other words, its common standard of the value of all commodities whatever, and that which regulates the performance of all contracts not specially excepted.[1]

Gallatin thus introduced a discussion of the nature and functions of money. The quotation cites two basic functions of money: (1) medium of exchange, and (2) standard of value. It mentions general acceptability as a requisite for any commodity which is to serve as money, and suggests that this general acceptability may be the product of general consent of the society or of legislation by the state. By giving money physical embodiment as a thing which could be spent and received, Gallatin adopted a sounder position than that taken more recently by the "idealistic nominalists," a school of German writers of the early twentieth century. To this group,

---

[1]Gallatin, "Considerations on the Currency," op. cit., p. 237.

money was merely an abstract concept. Hence, they were unable to talk about scarcity or plenty of a thing serving as money. Gallatin, on the other hand, in adopting a more orthodox description of money, was in a position to attribute the value of money to its relative scarcity.

At the opposite extreme from the position of the idealistic nominalists is the view of certain writers who hold to the commodity theory of money. To the commodity theorists, money is merely one commodity among many, distinguished only by its wide acceptance as a medium of exchange. By describing money as something more than a widely accepted medium of exchange, in that it was also distinctive as a unit of value, Gallatin avoided the extreme position of a few commodity school adherents.[1] Thus Gallatin could probably be classified as a "materialistic nominalist," whose ideas agree with those of a great many modern writers, such as Dennis H. Robertson. Robertson says: "Money then is anything which is widely acceptable in discharge of obligations: but a thing will not as a rule be widely acceptable for this purpose unless it is expressed as a multiple of some unit which is regarded as a measure or standard of the value

---

[1]On these schools, see Howard S. Ellis, German Monetary Theory, 1905-1933 (Cambridge: Harvard University Press, 1937), pp. 104-5.

of things in general."[1]

The commodity theorists, in the first half of the nineteenth century, held that the value of metallic money was determined by the value of the bullion out of which the money was made, while the value of paper money, when used, was explained by its prospects for redemption. Some extreme commodity theorists, such as George Bancroft, Daniel Raymond, and Amasa Walker, refused to call bank notes "money." Whereas the commodity theorists emphasized the necessity of money having intrinsic value, or being exchangeable into bullion with intrinsic value, the larger group of Gallatin's contemporaries argued that intrinsic value was merely desirable. In this group were William Gouge, John McVickar, Henry Vethake, Ferris Pell, and others. Finally, a small group argued that intrinsic value was not, or not necessarily, desirable; Erick Bollmann was an exponent of this point of view.[2]

Gallatin, at times, made statements typical of a commodity theorist. For example, he stated that "paper, having no intrinsic value, must, however used as currency, be always estimated in reference to those precious metals."[3]

---

[1]Dennis H. Robertson, Money, p. 4. The phrase "materialistic nominalist" is Ellis's.

[2]Brooks, op. cit., pp. 16-18. See above, pp. 82, 102-5.

[3]Writings, II, 417.

He sometimes asserted that the value of an inconvertible paper money depended upon the prospect for its redemption in bullion.[1] Thus, when Gallatin was preoccupied with a discussion of a purely specie currency, he came close to adopting that branch of the commodity theory called "metallism." Metallists emphasize that money circulates only because of the utility of the money-stuff, as distinguished from the argument that money circulates because it is generally acceptable, or because it is legal tender.

As opposed to the commodity theory, with its offshoot, metallism, the nominalist theory of money says that money is a claim or ticket, the purchasing power of which depends on the quantity of tickets in existence. As Howard Ellis suggests, the "natural predilection" of nominalists is toward the quantity theory of prices and a monetary theory of business cycles.[2] When Gallatin was preoccupied with a discussion of inconvertible paper money, he tended to adopt the nominalist theory of money. In the following, Gallatin combines the two ideas several times in one passage:

> Where gold and silver are the only currency, any great and permanent increase in the quantity of those metals used as currency (the aggregate value of the objects annually paid for in currency remaining the same) must be due to a corresponding reduction in the cost of

---

[1] "Considerations on the Currency," op. cit., p. 260.

[2] Ellis, op. cit., pp. 4-6.

> production of gold and silver; which cost, leaving to the owners of mines a greater or less rent according to their fertility, determines the value of those metals as compared with that of all other commodities. Where a paper has been substituted to a metallic currency, any similar considerable increase in its amount must cause a corresponding depreciation in its value, if the aggregate value of the objects, annually paid for in currency, remains the same. . . . But whenever the precious metals used as currency exceed in any country the value wanted to effect the necessary payments, . . . [the excess] will accordingly be either converted into manufactured articles of those metals, or be exported to other countries. If, on the contrary, the currency should consist of an irredeemable paper, having only an artificial and local value, and none whatever either in other countries or for any other purpose, it is evident that any excess in the nominal value of such currency, beyond the actual value sufficient to make the necessary payments, must cause a corresponding depreciation in that nominal value.[1]

The commodity theory and the nominalist theory, here combined by Gallatin, give contradictory explanations of the value of money. The value of a specie currency, the former says, is intrinsic; specie, in addition to the "proper amount," instead of driving up prices, is withdrawn from circulation. On the other hand, the value of a paper money, according to the nominalist view, consists in its purchasing power; additional units of paper money tend to raise prices.[2]

---

[1]Gallatin, "Considerations on the Currency," op. cit., pp. 245-46. Brooks says that the idea of a "proper amount of money," additional amounts being redundant, was associated with the commodity theory. Brooks, op. cit., p. 330.

[2]Brooks says that a number of writers were similarly inconsistent, for example, Raymond, Lawrence, and Crawford. For a discussion of the comparative ideas of nominalists and the commodity theorists, see Ellis, op. cit., pp. 4-6.

Gallatin never developed a single theory of the value of money. When he discussed the specie system, he argued that comparison of the intrinsic value of the money-stuff with the intrinsic value of particular commodities established price ratios. But when he discussed an inconvertible paper system, he argued that the price ratios were established by a comparison of the amount of goods to be bought and sold with the number of units of money being exchanged. An outstanding example occurs in a discussion of John Law's system, in which Gallatin argued that the doubling of the irredeemable paper currency had caused a doubling of the price level.[1]

Even in his treatment of irredeemable paper, Gallatin was not consistently nominalist or commodity theorist. It has been indicated above that Gallatin, at one time, stated that the value of inconvertible paper depended upon its future prospects of redemption. But it was also indicated that Gallatin, on another occasion, cited historical experience as proving that there was no consistent explanation of the value of irredeemable paper money.[2] And on still other occasions, as in the discussion of John Law's system, he was definitely of the opinion that excessive issues tended to depreciate the paper money relative to the value of commodities. One final

---

[1]Gallatin, "Considerations on the Currency," op. cit., pp. 257-58. Cf., ibid., pp. 243-45.

[2]See above, pp. 99-100.

contradiction: until a certain point was reached, Gallatin believed, the supply of irredeemable paper money could increase without tending to increase prices; but after that point, additional money became excessive and tended to depreciate.[1]

Gallatin never discussed the reasons why there should be one type of behavior up to a certain point, and another after that point, except to say that every society demanded only "a certain amount of money" depending upon its wealth, population, confidence in government, etc.[2] It is clear that he believed that additions to the money supply over some proper amount tended to increase prices; but it is not clear whether he believed that decreases in the money supply below the proper amount would decrease prices. Is not the quantity theory always applicable? J. M. Keynes, in 1935, answered "no" to this question. He also supplied the reasons for different price behavior before and after a certain point, which Gallatin, as well as virtually all other writers preceding Keynes, omitted. According to Keynes, increased spending of money tends to raise incomes and employment, without raising prices generally, until full employment is reached. After resources are fully employed, further increases in the

---

[1] "Considerations on the Currency," op. cit., pp. 245-46.

[2] Ibid., pp. 246-48.

money supply, when spent, merely tend to push up prices. This will be true as long as the technological relations between input (of fully employed resources) and output remain the same.[1]

To conclude, Gallatin was principally worried about the problem of excessive issues of paper money. This reflected nominalist tendencies. Even when he recognized that the demand for money might not be constant, he always was insistent that the causal sequence ran from changes in the rate of spending money to changes in the price level, and not vice versa. This is a modified version of the quantity theory, far removed from the commodity theory. Further evidence that, in the final analysis, Gallatin leaned towards nominalism, is the fact that he argued that law as well as general consent gave rise to money.

Functions of Money

The functions served by money, according to Gallatin, including the two basic ones mentioned above, were as follows:

1. Money serves as a medium of exchange. As a "substitute" for an inconvenient barter system, "it enables every individual to dispose at all times, and with facility, of

---

[1]John Maynard Keynes, The General Theory of Employment Interest and Money (New York: Harcourt, Brace & Co., 1935), pp. 289-91.

the whole surplus of the products of his industry, and to purchase with the proceeds any of the products of the industry of others which he may want."[1]

2. Money serves as a standard of value. Gallatin was one of the many writers who emphasized that money performs the useful function of a common denominator in terms of which the value of all commodities can be measured.[2]

3. Money serves as a standard for fulfillment of contracts. Although this can be treated as merely one aspect of the function of a standard of value, Gallatin attached so much importance to it that he made a separate point of it. He referred to money as "that which regulates the performance of all contracts not specially excepted," and as "the standard that regulates the payment of debts and the performance of contracts."[3] To most writers, this function was implicit in their discussion of money as a standard of value, but a few spoke of money serving as a standard of

---

[1]"Considerations on the Currency," op. cit., p. 246. Most writers of Gallatin's period discussed this function of money, drawing analogies to oil which lubricates a mechanical system, to wheels or canals or roads which facilitate transportation, etc. Brooks, op. cit., p. 34. Comments in the following sections on the functions of money, according to Gallatin's contemporaries, are drawn from Brooks, ibid., pp. 34-51.

[2]"Considerations on the Currency," op. cit., pp. 237-38.

[3]Ibid.

deferred payment and a storehouse of value. Gallatin too, made passing statements which might be interpreted to mean that money served as a means of storing up value.[1]

4. Money facilitates production and aids in the division of labor. While many writers indicated that division of labor necessitates the use of money, only a few were able to recognize that the reverse was also true. Gallatin wrote, on the one hand, that "with respect to the state of society, the want and demand for currency increase in proportion to the density of the population, the consequent multiplication and growth of towns, and the division of labor." But, on the other hand, money "promotes the division of labor, and vivifies the industry of the whole country."[2] Others who made similar statements were Ferris Pell and William Gouge.

It is interesting to note the parallel between Gallatin's statement that money facilitates production and aids the division of labor, and a recent statement by Dennis Robertson. Having said that the first great achievement of money is that it generalizes purchasing power, Robertson states:

> The second great achievement of money is that it enables man as producer to concentrate his attention on his own job, and so to add more effectively to the general flow of goods and services which constitute the real income of society. . . . The specialisation and division of labour on which our economic structure is

---

[1] Ibid., p. 251.

[2] Ibid., pp. 246-47.

> founded would be impossible if every man had to spend a large part of his time and energies in bartering his products for the materials of his industry and the goods which he requires for his own consumption.[1]

Brooks mentions that, among the miscellaneous other functions of money cited by various writers, there were some who looked upon money as a direct creation of capital. This group included Alexander Hamilton, Oliver Wolcott, William Crawford, and Daniel Raymond. Although Gallatin did not elaborate upon what he meant when he said that money "vivifies the industry of the whole country," these writers were quite clear in their statements to the effect that an abundance of money not only stimulated business but also meant more capital and lower interest rates. High interest rates, in fact, were considered a proof of the scarcity of money. The most naive statements regarding the creation of real wealth through the printing of money were made in the colonial period. The minority of writers in the post-colonial period, who stated that paper money was capital, were usually enthusiastic advocates of banks. They considered only the excess of bank paper money over the cash held by banks to be a creation of capital. This group included Hamilton, Alexander Johnson, Stephen Simpson, and Thomas Cooper.[2]

---

[1]Robertson, Money, pp. 6-7.

[2]Brooks, op. cit., pp. 40-42.

Post-colonial writers who refuted such notions used the quantity theory, arguing that increasing the number of units circulating as money merely decreased the value of each unit. Some thought that the decrease in the value of each unit was strictly proportionate to the number of additional units. Gallatin suggested that the writers who complained about a scarcity of money were really complaining about a scarcity of capital.[1]

When discussing the desirable attributes of the thing that serves as money, Gallatin, as may be expected, emphasized permanence or stability of value. Having mentioned that money serves as the standard of value of commodities and for the performance of contracts, he added that it was "therefore of primary importance that the commodity or substitute which may be selected for that purpose should be of a value as permanent as practicable."[2] Another desirable attribute of the thing serving as money was that it should be

> the same in every part of the same country; and it is also highly desirable that the same circulating medium should be common to all countries connected by commerce. Gold and silver are the only substances which have been, and continue to be, the

---

[1]Gallatin, Writings, I, 697; "Considerations on the Currency," op. cit., pp. 255-58; Brooks, op. cit., p. 42.

[2]Gallatin, "Considerations on the Currency," op. cit., p. 237.

> universal currency of civilized nations. . . . They have also been found superior to any other substance in that permanency of value which is the most necessary attribute of a circulating medium, in its character of the standard that regulates the payment of debts and the performance of contracts.[1]

Other writers mentioned, in addition to stability of value, many of the attributes of gold and silver as traditionally stated in money and banking textbooks; namely, portability, divisibility, durability, homogeneity, and cognizability. Gallatin, however, merely mentioned durability, and the importance which he attached to that attribute of the money-stuff was that it meant continued large stocks, to which annual additions were small. That is, durability was said to be a factor enhancing permanence of value.[2]

Components of the Money Supply

Gallatin carefully considered what things should be counted in the money supply. He did not carry his "hard money" views so far as to deny that bank notes were money. In fact, he argued that bank deposits (subject to transfer by check, and payable on demand) were the equivalent of money. In 1809, he made a very explicit statement that deposits arose both from the deposit of money "for safe-

---

[1] Ibid., pp. 237-38.

[2] Ibid., p. 251. Brooks, op. cit., pp. 20-34.

keeping," and from loans. Alternatively, he indicated, the proceeds of the loans might be taken in bank notes. But both the deposit credits in the bank books and the notes "constitute the circulating medium substituted by the banking operations to money; for payments from one individual to another are made equally by drafts on the bank or by delivery of bank notes."[1]

In 1830 and 1831, Gallatin stated, without qualification, that deposits were to be counted as an important part of the money supply.[2] Notes held by one bank on other banks formed no part of the circulation, however, and ought to be deducted in calculations of the total money supply. For the same reason, "inasmuch as the balances due to other banks are included in the deposits, the balances due by such other banks also ought to be deducted from that item . . ."[3]

Here is Gallatin's statement of the money supply as of January 1, 1830:

---

[1]Gallatin's report to the Senate of March 2, 1809, "Bank of the United States," American State Papers, Finance II, 351. Note the idea of bank notes and deposits being "substitutes" for money. In 1809, Gallatin held to vestiges of the commodity theory of money.

[2]"Considerations on the Currency," op. cit., pp. 266-67, 281.

[3]Ibid., p. 281. The elimination of inter-bank liabilities from calculations of the money supply is standard procedure today; see Edward S. Shaw, Money, Income, and Monetary Policy (Chicago: Richard D. Irwin, Inc., 1950), p. 37.

Gross amount of notes issued	$ 62,500,000
Silver coins	10,000,000
Usual mode of computing	$ 72,500,000
And if deposits are included	55,500,000
. . . . .	$128,000,000
But if the bank-notes of other banks on hand are deducted, the notes in circulation will be	$ 53,500,000
Silver	10,000,000
	$ 63,500,000
And if deposits are included	55,500,000
	$119,000,000

Which last appears to us the most correct mode of computation.[1]

In 1841, Gallatin not only repeated that money included demand deposits, but added that the bulk of commercial payments in cities was accomplished by "the transfer of credits accumulated for that purpose." Of all payments in commercial transactions, "by far" the greater part was effected by foreign and domestic bills of exchange; in all large transactions, "even not of a commercial nature, such as the purchase of land," transfers of credits instead of bank notes were the means of settlement; and in the cities these transfers took the form of checks against demand deposits. Deposits were, said Gallatin, a great benefit as a substitute for currency, and were far more convenient than specie. He believed that in New York City, the turnover of twelve million dollars of deposits, "together with one or two millions of notes of large denomination which pass daily from bank to bank

---

[1] "Considerations on the Currency," op. cit., p. 298.

and make no part of the general circulation, are sufficient to effect annually payments amounting to about twelve hundred millions."[1] Note the attempt to calculate the velocity of circulation of certain kinds of money in the city.

Regarding demand deposits, only a small part arose through the payment of specie, Gallatin said. "They generally consist of transfers of credit from banks, or arise from a note owned by the party and discounted in his favor."[2] Demand deposits differed from bank notes, however, in that they were not received, as bank notes were, "as a full payment of a debt." Also, if checks against demand deposits were not honored by the bank, the drawer was still responsible. "The bank-note is taken in payment solely from the general confidence reposed in the bank; the check, from the special confidence placed in the drawer."[3] This is a good statement of the relationship between demand deposits subject to check, and other kinds of money. Although Gallatin described deposits arising out of the expansion of loans, by and large he failed to recognize that such deposits were a means to the creation of money by banks. Chapter VI considers further Gallatin's treatment of such loan deposits.

---

[1]Gallatin, "Suggestions on the Banks," op. cit., pp. 372-73. Cf. Writings, II, 553.

[2]"Suggestions on the Banks," op. cit., p. 372.

[3]Ibid., p. 373.

In considering what instruments of debt to count as part of the money supply, in addition to bank notes and deposits, Gallatin refused to include bills of exchange, promissory notes, and bonds. Although he called a bill of exchange a substitute for money, he thought it clearly distinguishable from a bank note. "The essential distinction is, that the bills of exchange are only a promise to pay in currency, and that the failure of the drawers, drawees, and endorsers does not in the slightest degree affect the value of the currency itself, or impair that permanent standard of value by which the performance of all contracts is regulated."[1]

Certain drafts of the Second Bank of the United States, however, were a different case. The various branches of the Bank were issuing drafts upon the parent bank, to overcome a requirement which strictly limited the issue of bank notes by the Second Bank. The requirement was that only notes could be issued that were personally signed by the president and the cashier of the parent bank. Because of the physical limitations of those officers, this unduly limited the issues of the Second Bank, which had been unsuccessful in its petitions to the Congress to have this requirement removed. Hence, the Bank of the United States resorted to the device

---

[1]Gallatin, "Considerations on the Currency," op. cit., p. 265.

of branch drafts. These were sold at a premium of about 1/2 of 1 per cent.[1] Gallatin recognized the branch drafts as money, despite his refusal to classify as money other bills of exchange, on the reasonable grounds that the branch drafts circulated in common with other bank notes:

> Those bills are of the same character, depend on the same security, and in case of failure would share the same fate with bank-notes. Though not usually included in the amount of the circulation of the bank, we cannot but consider the average amount in actual circulation as making part of the currency of the country.[2]

Finally, with regard to bills of exchange, Gallatin said that, although those issued by non-banks were not to be considered as money, they lessened the amount of currency which would otherwise be required. In other words, extensive use of certain credit instruments which were not money nevertheless lowered the demand for money for transactions purposes.[3]

In 1810, in a letter to the Chairman of the Committee of Ways and Means of the House of Representatives, Gallatin proposed the issuance, in moderate amounts, of Treasury notes, bearing interest, and maturing in one year. These were to be receivable in payments for public lands.[4] Gallatin

---

[1]Walter B. Smith, op. cit., pp. 52, 146.

[2]Gallatin, "Considerations on the Currency," op. cit., pp. 265-66.

[3]Ibid., p. 265.

[4]Gallatin, Writings, I, 467-68. The suggestion was repeated in 1812, ibid., p. 514.

expressed the belief that such Treasury notes would, "to a certain degree," become a part of the circulating medium, taking the place of bank notes. For this reason, however, the issue must be moderate, and limited to the amount that could be kept at par.

Treasury notes were acceptable to Gallatin, although a government paper currency was not, because there was a definite plan for redeeming the former. If war required new methods of government finance, he much preferred Treasury notes to government paper money.[1] He objected even to convertible government paper, on the ground that it was too new an experiment. In 1841, he declared that, with rare exceptions, no government had "ever attempted to issue on its own responsibility a paper currency redeemable on demand."[2]

The Congress authorized, in 1812, an issue of five million dollars of Treasury notes. Initially, these were well received, and exchanged at par.[3] They were used as means of payment in certain transactions, and they may have enabled holders to reduce the size of their average cash balances. If the Treasury notes served in this fashion, as "near money," then they tended to reduce the demand for money.

---

[1]Letter to Monroe, October 26, 1814, ibid., p. 643.

[2]Writings, II, 574. Convertible government paper money differed from Treasury Notes in that it was non-interest-bearing and had no fixed maturity.

[3]Stevens, op. cit., p. 210.

However, the volume of Treasury notes was increased after 1813. And with falling revenues relative to war-swollen expenditures, the notes were not paid when due, in 1814. They rapidly fell below par. Gallatin's remedy was to increase taxes and to reduce the amount of Treasury notes in circulation, by funding them at their market price.[1] This was not done, and in 1815 and 1816 both the currency and government finances were in chaos.[2] Taxes were paid everywhere in the cheapest local currency, usually the inconvertible bank notes of that locality. But if the latter were near par, then taxes were paid with the depreciated Treasury notes. In later years, Gallatin reflected on these notes:

> They never can become a general currency, on account of their varying value, so long as they bear an interest and are made payable at some future day. In order to give them that character, they should assume that of bank notes, bearing no interest and payable on demand. It does not require the gift of prophecy to be able to assert that, as the wants of government increased, such notes would degenerate into paper money to the utter ruin of the public credit.[3]

As a matter of fact, the conditions suggested by Gallatin for preventing Treasury notes from becoming part of the

---

[1] Writings, I, 697.

[2] Dewey, Financial History of the United States, pp. 144-45.

[3] Gallatin, "War Expenses," appendix to The Oregon Question, p. 64.

currency were violated, and successive issues during the War of 1812 "progressed" toward inconvertible paper money. Although the first four series were payable in one year, the last had no fixed maturity date. Successive issues gradually lowered the minimum denomination from one hundred dollars to three dollars. The earlier issues had all been interest bearing, but in later series, the small denominations were non-interest bearing.[1]

Specie vs. Bank Notes

Gallatin insisted that the issuance of money was the prerogative solely of the federal government. He made much of the constitutional provision that no state shall coin money, emit bills of credit, make anything but gold and silver coins legal tender, or pass laws impairing contracts. This provision vested in Congress the exclusive power to coin money, and to regulate its value as well as that of foreign coins. Therefore, Gallatin argued, the Constitution required control of the currency by the federal government, in order to assure uniformity and prevent overissue of paper money. He noted that the debasing of coins by the issuing authority had long been frowned on, and that overissued,

---

[1]For these and other characteristics of the Treasury notes, see Dewey, Financial History of the United States, p. 137.

inconvertible paper money did the same thing. Governments have a positive duty to guard against this.[1]

In the constitutional prohibition against issue of bills of credit by the states, Gallatin found an argument for the prohibition of note issue by state banks. "I would, indeed, be inclined . . . to insist that the term 'bills of credit,' in the Constitution, embraces every species of paper currency, and therefore precludes the issuing of bank-notes under State authority."[2] The Supreme Court of the United States, six years after Gallatin wrote the above, came to the opposite conclusion, in the case of Briscoe vs. Bank of the Commonwealth of Kentucky. Despite the fact that the bank was owned and controlled by the state, the Court ruled that the notes of this bank were not "issued by the state on the faith of the state," hence were not bills of credit subject to the constitutional prohibition. Justice Story's vigorous dissent, however, agreed with Gallatin's view.[3]

---

[1]Gallatin, "Considerations on the Currency," op. cit., pp. 319-20; "Suggestions on the Banks," op. cit., pp. 429, 431.

[2]Gallatin, letter to G. C. Verplanck, May 22, 1831, Writings, II, 428.

[3]11 Peters, 237 (1837); for Story's dissent, pp. 328-50. For a discussion of the case, see A. Barton Hepburn, History of Coinage and Currency in the United States, and the Perennial Contest for Sound Money (New York: The Macmillan Co.,

It already has been shown that Gallatin opposed the use of government paper money.[1] He also advocated the abolition of bank paper money. He argued that notes of state banks were unconstitutional, and that they were unsafe, non-uniform, and typically issued to excess.[2] Thus, Gallatin's ideal was a currency consisting only of specie. He referred to himself as "an ultra-bullionist."[3]

Gallatin's arguments in favor of a purely specie currency supported it as against both convertible and inconvertible paper. His views on the latter were discussed at length in the previous chapter. It will suffice to add here that Gallatin believed that, even with the best of intentions on the part of the issuer, there was an "irresistible tendency" for paper money to degenerate into irredeemable and depreciated currency, "and the lamentable effects this produces, not as a mere matter of dollars and cents, but on the moral feeling

---

1903) pp. 130-31. For a description of the Bank of the Commonwealth of Kentucky as a "huge paper money machine" created to relieve debtors in Kentucky, see Grace Madeleine, op. cit., pp. 32-34.

[1]See above, pp. 98-100.

[2]Writings, II, 428, 442-43. For a statement that paper currancies are unsafe in addition to their other faults, see ibid., pp. 416-17.

[3]Ibid., p. 512.

and habits of the whole community, are such that I am quite convinced that it is far preferable to do without it."[1]

Gallatin also favored a purely metallic currency over a mixed currency of coin and convertible paper. In addition to his basic prejudice against all debt instruments, of which paper money was an example, he pointed out that drains of specie from the monetary system were more deflationary under a convertible paper system than under a purely specie system.

> It is equally clear that extraordinary drains of specie, occasionally inconvenient when the currency is purely or principally metallic, may be fatal to one which consists of bank-notes convertible at will into specie. Supposing the currency of a country to consist of one hundred millions, a drain of twenty millions from abroad would produce great inconvenience, but not beyond that of contracting the metallic currency to that extent, until commerce had supplied the deficiency. But, if consisting of bank-notes, sustained by twenty millions of specie in the vaults of banks, the basis being withdrawn, the whole fabric is at once overthrown, and specie payments must be suspended.[2]

The above statement by Gallatin was based on the premise that banks kept only a partial specie reserve against their outstanding notes. That reserves were, in fact, fractional was frequently indicated in the data used by Gallatin on the balance sheets of banks.[3]

---

[1]Letter to Jonathan Roberts of June 3, 1841, quoted in Adams, op. cit., p. 664.

[2]Gallatin, "Considerations on the Currency," op. cit., pp. 275-76.

[3]Gallatin's report to the Senate, March 2, 1809, "Bank of the United States," American State Papers, Finance II, 357-59: "Suggestions on the Banks," op. cit., p. 487.

Not only did a convertible system with partial reserves accentuate contractions, according to Gallatin, but it also permitted and encouraged "overtrading" in the upswing of a business cycle. A purely specie monetary system would not, he believed, similarly aggravate business cycles.[1]

In order to bring about a specie currency, Gallatin would have levied a prohibitive stamp tax on the notes of state banks. Such a tax, he argued, was necessary to carry out the constitutional provisions vesting in Congress exclusive control over the monetary system of the United States, and, more particularly, those provisions which implied the necessity for a uniform currency.[2] It should be noted that the National Banking Act of 1863, thirty-two years later, was intended to remedy two principal defects of the state banking system which Gallatin had observed: (1) the lack of uniformity in the currency, and (2) the tendency to excessive issue of bank notes. Also, the federal law of 1865 provided for a 10 per cent annual tax on state bank notes, much as recommended earlier by Gallatin. The tax effectively forced state bank notes out of circulation.[3]

---

[1]Gallatin, "Suggestions on the Banks," op. cit., p. 385; "Considerations on the Currency," op. cit., pp. 272-73. See below, pp. 143-44.

[2]Gallatin, "Considerations on the Currency," op. cit., pp. 323-24. See above, pp. 93-95.

[3]Dewey, Financial History of the United States, pp. 320-28.

The prohibitive tax on state bank note issues, proposed by Gallatin and enacted into law more than three decades later, should be distinguished from another proposal of Gallatin's. This second proposal was that the federal government should levy a revenue tax on the interest income derived as a consequence of the issuance of state bank notes.[1] That is, borrowers often took the proceeds of a new loan in the paper notes of the bank, and on such loans the bank profited by drawing interest. Gallatin here apparently neglected the fact that borrowers could, alternatively, have the proceeds of the loan deposited to their account in the banks. It seems altogether likely that, had a revenue tax been levied on income derived from the issuance of bank notes, it would have encouraged greatly the use of demand deposits in place of notes. In other words, since demand deposits were in the process of replacing bank notes anyway,[2] it is probable that even a small tax would actually have been prohibitory, or at least would have retarded greatly the use of these bank notes.

In this second proposal, Gallatin was merely advocating that the society as a whole share in the profits derived from

---

[1]Gallatin, "Considerations on the Currency," op. cit., p. 337.

[2]See Board of Governors of the Federal Reserve System, Banking Studies (Washington, 1941), pp. 13, 417.

the process of lending and issuing bank notes. His justification was that banks issued notes only at the sufferance of the state, that money issue was a social function, and, therefore, that it was only just that the society participate in the profits derived from such issue. More specifically, Gallatin believed that the gain attributable to paper money was a result of substituting a cheap for an expensive means of payment, that is, substituting paper for specie.[1] He thought that the banks should not be the sole beneficiary of this economy. Hence, he proposed the above-mentioned revenue tax. It should be pointed out that all the above arguments for the society to share in the gains of substituting a cheap for an expensive means of payment would apply equally to loan deposits.[2] That being the case, the above-mentioned difficulty with Gallatin's proposed tax would have been avoided if the revenue tax were applied to interest income on loan deposits as well as on loan-created bank notes. There would have been little tendency for even a small tax to be prohibitory had it been applied to both.

Writing to Nicholas Biddle in 1830, Gallatin proposed the revenue tax, and suggested that it offered at least one

---

[1] See below, pp. 207-9.

[2] As, indeed, Gallatin tacitly acknowledged, in "Considerations on the Currency," op. cit., p. 254. Cf. "Suggestions on the Banks," op. cit., pp. 372-73.

advantage to the Bank of the United States. That is, it would forestall the anti-Bank argument which asserted that the government had a right and ought to issue paper money, in order to derive the "profit" itself.[1]

Harry E. Miller points out that, although several writers advocated a revenue tax on note issue, Gallatin was the only one who reconciled the following ideas: (1) interest must be paid to banks for the use of their currency; but (2) the social advantage of paper money is that it substitutes a cheap for an expensive means of payment. The other writers merely advocated the tax on note issues on the grounds that it would make for more conservative banking.[2] Gallatin however, saw that the banks derived all the gain, except for the convenience of the circulating paper, unless they paid a tax in return for the privilege of note issue.

Although the advocates of a purely specie currency were probably in the minority during Gallatin's lifetime, nevertheless there were a number of prominent supporters of hard money. Jefferson, Jackson, Benton, and Gouge were perhaps

---

[1]Gallatin, Writings, II, 436-37.

[2]Harry E. Miller, Banking Theories in the United States Before 1860 (Cambridge: Harvard University Press, 1927), p. 46.

the most noteworthy.[1] The Loco-Focos (Equal Rights Party) were staunch advocates of hard money.[2]

With the possible exception of Gallatin, Gouge had the most penetrating criticisms of a paper system. Banks were inclined to overissue their notes, he asserted. The paper currency expanded and speculation took place before the necessity of making redemptions out of a limited amount of specie occurred. Periods of speculative inflation were followed by panic, suspension of specie payments, and contraction. Not only Gouge, but all writers stating the case for a purely specie currency, emphasized the greater stability of value that would characterize such a monetary system.[3]

Gallatin wanted to avoid the sudden expansions and contractions of the money supply, characteristic of the state bank note system. He thought that readily-available bank money excited business activity and facilitated over-rapid economic growth, only to be followed by panics. Hence,

---

[1]See above, pp. 26, 63-64; St. George L. Sioussat, "Some Phases of Tennessee Politics in the Jackson Period," American Historical Review, XIV (October, 1908), 60-61; Brooks, op. cit., pp. 101-46; Schlesinger, op. cit., pp. 115-22; Grace Madeleine, op. cit., pp. 115-16.

[2]Redlich, Essays in American Economic History: Eric Bollmann and Studies in Banking, pp. 135-37; Grace Madeleine, op. cit., p. 115.

[3]Schlesinger, op. cit., pp. 119-22; Brooks, op. cit., pp. 105-7, 114-23.

Gallatin preferred a specie system that would afford greater security and stability.[1]

The demand on the part of hard money people, like Jefferson and Jackson, for a purely specie currency, has been characterized by Bray Hammond as "hopelessly Spartan and primitive for a rising democracy having a rich continent to exploit."[2] In 1834, Gallatin tacitly acknowledged that the total exclusion of paper money would have been too "Spartan" for the United States. He authored a report that stated that the condition necessary for the adoption of a metallic currency in the United States was that there should be enough specie to make the money supply equal to that which it was under the mixed currency system.[3]

---

[1]"I am myself an ultra-bullionist, and prefer security to rapid growth. I would wish, though the progress of the country should be slower, that the use of paper would be confined to transactions between dealers and dealers, and that it did not take the place of currency proper. But this does not accord with the extraordinary and irresistible energy of this nation. Nothing more is, I think, practicable than a proper regulation of the system, both as to the amount of issues and as to the persons or bodies by whom it shall be issued." Gallatin, letter to Frederick Beasley, September 3, 1836, Writings, II, 512. Cf. Gallatin's letter to Michel Chevalier, September 14, 1841, Writings, II, 556-57.

[2]"Long and Short Term Credit in Early American Banking," op. cit., p. 93.

[3]Union Committee of New York, "Report of the Union Committee appointed by the meeting of the signers of the memorial to congress, held on the 11th day of February, 1834, at the Merchants' Exchange, in the city of New York," Niles' Weekly

Recognizing, then, that a purely specie currency was impractical for the United States, Gallatin recommended a series of proposals designed to improve the operation of the mixed currency system.[1]

Modifications of the Currency School Principle

As has been shown, Gallatin believed that paper money generally tended to be overissued. Even in depression years, when popular opinion thought that there was "a scarcity of money," he sometimes was saying that the paper money was depreciated and issued excessively. For example, 1834 was a year of financial stringency and mild depression. Yet the report of the Union Committee, headed by Gallatin, inquiring into the causes of the contraction of that year, concluded by arguing that some banks, at least, were overissuing and that restrictions on their lending and note-issue activity were required.[2] The theory was that the money supply was being expanded too much as compared to the specie base.

Register, XLVI (March 29, 1834), 78. Gallatin was the chairman of the Union Committee and chief author of the report. The report, after acknowledging that there was not enough specie to replace the paper element in the currency, continued by advocating control and restriction of the volume of paper currency.

[1]See below, pp. 194-96, 215-16, 220-26, 248-50.

[2]Union Committee, op. cit., pp. 79-80. For a description of the business contraction of 1834, see Smith and Cole, op. cit., p. 61.

It should be recalled that Gallatin had many affinities with the Currency School. He agreed, in general, that the proper amount of money depended on the specie stock, and that a government could not properly manage the money supply.[1]

In practice, however, Gallatin departed from the Currency School principle in several important instances. The following are cases in which there was a drain of specie out of the monetary system, of such a nature that the Currency School principle, had it been applied, would have contracted bank loans and discounts. In these instances, however, Gallatin thought that the banks should operate so as to offset the incipient contractions.

1. In his "Considerations on the Currency," Gallatin described the business depression in England in 1793, in which banks were failing and credit contracting. Commonly-accepted banking principles dictated further effort on the part of the Bank of England to increase its liquidity and curtail its outstanding obligations. Gallatin pointed to the fact that the British Government stopped the panic, in spite of banking theory, by offering to lend exchequer bills to "solvent dealers." He would have preferred, however, that the Bank of England rather than the government had undertaken this remedy. If the Bank of England, Gallatin

---

[1]See above, pp. 98-101.

said, had been "more sparing of its resources during the preceding period of prosperity and incautious enterprise," it could have lent its credit to solvent businesses when the "revulsion" took place. Thus, Gallatin would have had the Bank of England increase its discounts and issues of paper currency in the face of a financial contraction.[1]

2. Gallatin approved of the action of the American state banks after 1811, when they took up the commercial paper that the First Bank of the United States dropped upon its loss of charter. Here, Gallatin approved some fifteen million dollars of additional bank lending, in order to prevent the great business distress which otherwise might have occurred, even though it meant that the state banks had to extend greatly their loans, relative to their specie reserve.[2] Gallatin also showed, however, that the state banks did not stop with the above-mentioned increased lending. In fact, the number of banks, together with their circulation increased to an unhealthy degree. This was a factor contributing to the suspension of specie payments from 1814 to 1817.[3]

---

[1] "Considerations on the Currency," op. cit., pp. 273-74.

[2] Ibid., pp. 284-85.

[3] Gallatin gave the following estimates: On January 1, 1811, the Bank of the United States and 88 state banks, had $28,100,000 notes in circulation, against $15,400,000 specie reserve. On January 1, 1815, the number of banks had increased to 208; these had $45,500,000 notes in circulation, against $17,000,000 specie. On January 1, 1816, the number

3. In 1834, the Union Committee, with Gallatin chairman, put pressure upon the Bank of the United States to increase its accommodations to banks and businesses. The report of the committee attempted to prove that both the parent office of the Bank of the United States, in Philadelphia, and its branch in New York City had not been as liberal in their accommodations as they might have been, even in view of their loss of specie reserve. The report indicated that the New York City banks, far from curtailing loans and discounts, had increased their accommodations by $5,000,000 in order to relieve the "financial stringency." The specie in these banks amounted to $1,652,000, while the sum of their demand liabilities was $15,500,000. "This proportion is known from experience to be sufficient in ordinary times, and will prove so now, so long as the amount of public deposites shall not be materially diminished."[1] In short, to alleviate commercial distress, Gallatin's committee advocated

---

of banks had increased to 246; these had $89,800,000 notes in circulation, against $19,000,000 specie. On the latter date the specie was very unevenly divided, so much so that banks in the New England states had, on the average, a ratio of specie reserve to notes in circulation of 154 per cent; banks of Pennsylvania, Maryland, and the District of Columbia, 21.7 per cent; and banks in all other states, 22.6 per cent. Ibid., p. 286. Cf. Berry, op. cit., pp. 366-67. Data on deposits were inadequate at that early date.

Gallatin's data are used by Dewey, Financial History of the United States, pp. 127, 154, and by Mints, op. cit., p. 61.

[1]Union Committee, op. cit., p. 73.

that the banks should extend discounts to the maximum of their ability, as long as they could sustain specie payments.[1]

4. During his efforts to secure resumption of specie payments in March, 1838, Gallatin stated his belief that the New York banks would have no difficulty sustaining specie payments and "at the same time continuing to give banking facilities to the community at least equal to the present amount of their loans and discounts, and freely though discreetly issuing their circulation."[2] Here, too, Gallatin asserted that the banks should accommodate the community as much as possible, as long as they paid in specie their demand obligations. He recommended to Governor Marcy of New York that the state lend its credit to the resuming banks, not so much with a view to the safety of the banks,

---

[1]The entire report by the Union Committee examined the effects, direct and indirect, of the withdrawal of federal deposits from the Bank of the United States, the causes of the depression of 1833-34, and possible remedies. The report criticized President Jackson's removal of the public deposits from the Bank of the United States, on the grounds that it helped to cause the contraction. Cf. Gallatin, "Suggestions on the Banks," op. cit., p. 391. For a pro-Jacksonian account of the removal of the government deposits, and the "vindictive" contraction by the Second Bank, see Schlesinger, op. cit., pp. 97-113. Another view which is critical of the Bank of the United States in this matter is that of Catterall, op. cit., pp. 329, 343. Grace Madeleine, op. cit., pp. 114-15, distributes the blame for the contraction on both Jackson and the Bank. Walter B. Smith, op. cit., pp. 149-50, 160-67, 237, explains the actions of both the Bank and the President, rather than places blame, and shows the effects of their actions.

[2]Gallatin, Writings, II, 526-29.

but rather in order that they would not have to curtail their discounts.[1]

Next to be examined is the limited extent to which Gallatin used his position as Secretary of the Treasury to alleviate depressions. In 1802, Gallatin raised with Jefferson the problem of how to help the Bank of Pennsylvania, which was experiencing a regular drain of specie to the Bank of the United States on account of government fiscal operations. Gallatin and Jefferson decided to give considerable help to the Bank of Pennsylvania, by increasing federal deposits with that institution.[2]

In 1804, Gallatin strongly urged Jefferson to seek a reduction of governmental expenses, on the grounds that these expenditures were one of the causes of a large export of specie. At the same time, no specie was entering the United States from the British or Spanish-American colonies. Hence, the reserves of the First Bank were falling. "Under those circumstances, it is highly desirable to leave as large deposits with the bank as the public service will

---

[1] Ibid., pp. 528-29. See above, p. 51.

[2] Gallatin, Writings, I, 80; Jefferson, The Writings of Thomas Jefferson, IV, 439. See Esther Rogoff Taus, Central Banking Functions of the United States Treasury, 1789-1941 (New York: Columbia University Press, 1943), p. 23.

permit. If we press them hard, they must curtail their discounts suddenly to an extent equally injurious to commerce and our revenue."[1]

A final instance of consideration given by the executive to moving government deposits between banks, in order to enhance the reserve position of needy ones, began when President Madison wrote Gallatin in 1810. In view of the fact that measures taken by the First Bank to wind up its affairs, pending dissolution, were likely to bear hard on certain other banks, Madison inquired whether some remedy could not be found. He suggested transferring some of the public money from its present vault to those of state banks. Madison believed that this would enable them to discount for persons whose accommodations were curtailed elsewhere. Gallatin was only moderately receptive to this idea, but acknowledged that some relief could be afforded.

> It is extremely difficult to make, at this moment, any general alteration in the deposits of public money; for as we grow poorer we are, on the contrary, obliged to concentrate what is left by

---

[1]Gallatin, Writings, I, 191. The largest drain of specie, according to Gallatin, was attributable to the payment in Great Britain of installments on the public debt. Since Gallatin, above all, would insist on meeting faithfully this obligation, it is not clear from this letter how he hoped that a reduction of federal expenditures would decrease the drain of specie out of the country. Internal expenditures would merely redistribute funds within the United States. But the point that is relevant to the present argument remains, that is, Gallatin would alleviate distress attributable to drains of reserve from the banking system.

> drawing from the other banks, such as the Manhattan, &c., and by the end of the year we will probably be reduced so low as to make the deposits of no importance to any bank. I believe also that the lessening of discounts by the Bank of the United States has not produced the effect you apprehend, as it is but trifling, and is far exceeded by the new discounts made by the new banks created since spring in New York, Baltimore, &c. But there is a general diminution of specie; and there may be partial inconveniences to State banks resulting from that source. If instead of a general observation the place or places whence the complaint has arisen are made known to me, a temporary remedy may perhaps be administered. I have already been applied to by the Bank of Columbia, where the evil arose from Davidson's harshness and littleness, and have acted upon it.[1]

Note that, in each of these cases in which Gallatin gave consideration to manipulating public deposits in banks, the purpose was merely to offset the depressing effects of certain government policies.

Moreover, Gallatin was extremely fearful, in general, of the central government misusing its powers. In an 1830 letter, after stating his distrust of note issue by state banks, Gallatin said:

> But I am equally adverse to any issues of paper money by government, and still more so to its converting the Treasury into a banking, trading company. This I think the very worst plan, in every view of the subject, that could be devised. . . .[2]

---

[1]Madison's letter to Gallatin appears in Gallatin's Writings, I, 481. Gallatin's reply appears in ibid., pp. 482-83.

[2]Letter to Robert Potter, December 3, 1830, Writings, II, 442.

Similarly, he objected to a proposal by the Secretary of the Treasury, in 1842, for the government to issue paper money, deal in bills of exchange,[1] and hold its own funds for safe-keeping. His opposition to government paper money has been discussed, above.[2]

On exchange dealings, Gallatin objected strenuously to the government buying and selling bills with any purpose in mind other than merely transmitting government funds as necessary to make its payments. For one thing, he believed it to be unconstitutional for the government to become "a trading company." For another, it was "undignified" for the government to compete with individuals in any commercial pursuit. But more compelling than either of these arguments against the government dealing unnecessarily in exchange was the danger of mismanagement and corruption.[3] Gallatin thought that the suspicion of favoritism was difficult to avoid.[4]

---

[1]Letter to Caleb Cushing, January 7, 1842, Writings, II, 572-80.

[2]Pp. 99-100.

[3]Gallatin, Writings, II, 576-77.

[4]Thus, Jackson's withdrawal of the public deposits from the Bank of the United States, in 1833, and their transfer to selected state banks, was accompanied by accusations of favoritism toward "pet banks." Dewey, Financial History of the United States, pp. 209-10. Modern studies of the event, however, give no evidence to substantiate the accusations; e. g., Grace Madeleine, op. cit., pp. 56-68. Walter B. Smith, op. cit., pp. 184-85, and Schlesinger, op. cit., p. 98, do

Rates of exchange should be regulated, he said, by "the natural laws of trade," and in these the Treasury should not deliberately interfere. The necessary transmission of public funds to places where they are used for immediate payments will have an effect on the equilibrium level of exchange rates on domestic bills, "but this has been and must always be done by the Treasury, without regard to the effect it may produce."[1]

Thus, Gallatin opposed the plan to have the federal government issue its own paper, and to deal in bills of exchange. He also opposed the proposal to have the government hold its own funds for safe-keeping. His antagonism to the sub-treasury, as an alternative to the government placing its deposits in banks, was of long standing, and was based on three grounds: First, "the capital of the bank is a better security than the bonds of any private person; and the banks are answerable for contingent losses, such as fire or robbery,

---

not even mention the problem of protecting the public interest against favoritism. Gallatin questioned Jackson's wisdom in this, and other matters concerning banking, but not his integrity. See "Suggestions on the Currency," op. cit., pp. 390-93.

Cf. Gallatin's rejection of Jefferson's proposal to use the disposition of the federal deposits to promote Republicanism; above, pp. 33-34.

[1]Gallatin, Writings, II, 577. Note that Gallatin recognized that Treasury transactions did have an effect on the private sector of the economy, even though he rejected, in the above passage, any thought of doing something about it.

for which a public officer cannot be made responsible."[1] That the banks would provide the greater security, Gallatin thought, was true only as long as they maintained specie payments.

Second, the plan would not restore a sound currency, because it made no provision for control over the issues of the state banks. The sub-treasury, or Independent Treasury, enacted by Congress in 1840, was necessary only because of the fact that the Bank of the United States had been destroyed. It would not have been necessary for the Treasury to protect itself against defaulting banks if the Bank of the United States had been retained to preserve general specie payments and a uniform currency.[2]

Third, the public funds accumulated in the Independent Treasury were unproductive. The evil consisted in taking "active capital" from the people because of a federal surplus of income over outgo, and allowing it to lie idle. The remedy consisted in reducing federal revenues as long as they exceeded expenditures.[3] Note that the last statement

---

[1]"Suggestions on the Banks," op. cit., p. 447; report on the "Bank of the United States," January 30, 1811, American State Papers, Finance II, 481. By "private person," in the above quote, Gallatin meant any governmental official who would collect and hold the public funds.

[2]"Suggestions on the Banks," op. cit., p. 449; letter to M. T. Hunter, July 12, 1841, Writings, II, 553.

[3]"Suggestions on the Banks," op. cit., p. 449; cf. Gallatin's annual report of 1807, Reports of the Secretary

indicates that the basic evil, to Gallatin, was not so much the Independent Treasury as an unbalance between federal receipts and expenditures.

To conclude, Gallatin acted in a less deflationary manner than his "ultra-bullionist" theories would have indicated. In practice, he departed considerably from the Currency School principles. He by no means thought of systematically managing the currency, but he gave some consideration to elementary "central banking" policies designed to counteract business contractions.[1] In the case of expansions, there was no difficulty reconciling his bullionism with his desire to avoid inflation and deflation. The principle of restricting the money supply to that which could be sustained at par with specie and

---

of the Treasury on the State of the Finances, I, 359. On the effects of the distribution of the Treasury surplus, in 1836, see Reginald C. McGrane, The Panic of 1837 (Chicago: University of Chicago Press, 1924), pp. 91-94. For a discussion of the Independent Treasury and its effects on the banking system, see Grace Madeleine, op. cit., pp. 114-36.

[1]Mints says that neither Gallatin nor his contemporaries "thought in terms of a central bank as a monetary agency which might deliberately manage the currency in accordance with some stipulated goal." Mints, op. cit., p. 152.

Taus shows that the Treasury performed certain central banking functions between 1791 and 1846. "Some secretaries of the Treasury seemed conscious of the fact that the Treasury Department because of its unique position as the largest disburser and receiver of funds would be able intentionally and unintentionally to affect the reserves of commercial banks." Taus, op. cit., p. 48. To her, the very essence of central banking is "the coordination of the money and banking system with other economic activities so that economic stability is promoted." Ibid., p. 4.

the policy of dampening inflationary upswings of business activity coincided. An automatically functioning specie standard accomplished both aims.

In contractions, however, the desire to restrict the money supply to that which could be converted at all times into scarce specie and the desire to minimize governmental interference in the economy conflicted with the desire to alleviate economic distress. Gallatin was reluctant to have the government attempt discretionary management of the currency. In a few instances, as Secretary of the Treasury, he undertook merely to neutralize certain undesired effects of government fiscal operations.

Gallatin much preferred that strong and responsible private banks undertake compensatory monetary policies, as in the above-mentioned cases regarding the Bank of England, the Bank of the United States, and the New York banks. Such a proposal was a logical outgrowth of his Jeffersonianism. The report of his Union Committee stated that it was not for profit "but for the public good that banks are instituted." Even though they were tempted to increase their discounts in order to earn 9 and 1/2 per cent returns on their capital, as some banks had done, they should restrain themselves to a reasonable 6 per cent return. They would not then overextend

their issues and endanger specie payments.[1] And in time of contraction, the banks should alleviate business distress in so far as compatible with the continued payment in specie of their obligations. The latter qualification was all-important to Gallatin. In commenting upon the fact that banks outside of New York were forced to suspend specie payments again in 1839, after having temporarily resumed in 1838, Gallatin said that the difficulty was that they had failed to reduce their discounts during the two years from the time they first suspended to an amount compatible with their specie reserves. Had they done so gradually, they could have minimized the inconvenience to the business community. As it was,

> The continued suspension of specie payments and circulation of a depreciated currency are the general evil and the true injury to the community at large. The reduction in the amount of discounts is a partial evil which falls precisely on those who ought to bear it, since it was the excess of the loans which was the cause of the suspension.[2]

The Bank of the United States, although a private institution, was in several respects a service agency to the gov-

---

[1]Union Committee, op. cit., p. 79. Cf. Edward S. Shaw, who says, "Private commercial banks are recipients of a public trust. . . ." Op. cit., p. 86.

[2]Gallatin, letter to J. Abbot, Jr., October 14, 1841, Writings, II, 558. Cf. ibid., p. 581; above, p. 80, n. 1. The belief that the reduction of discounts fell on those who ought to bear it may have been based on his idea that the loan policies of banks were what the borrowers made them. See above, p. 86.

ernment, and was charged with responsibilities over the monetary system. It was a central bank.[1] It was not, therefore, illogical to expect that the Bank of the United States should adopt a countercyclical monetary policy, and Gallatin deserves credit for recognizing this. But it was expecting too much of the state banks. It is an unfortunate fact that such private institutions, operated for profit, would not have been following their own best interests had they failed to expand in times of rising profits and prices, or failed to contract in times of falling prices and profits.[2] Gallatin's Jeffersonian "solution" to the problem of monetary policy, when the central bank was weak or non-existent, was totally inadequate.

---

[1]Bray Hammond, "Public Policy and National Banks," review of Arthur M. Schlesinger, Jr.'s, The Age of Jackson, in Journal of Economic History, VI (May, 1946), 80; Hammond, "Jackson, Biddle, and the Bank of the United States," Journal of Economic History, VII (May, 1947), 1-2.

[2]Cf. George L. Bach, Federal Reserve Policy-Making; A Study in Government Economic Policy Formation (New York: Alfred A. Knopf, 1950), pp. 41-42.

CHAPTER VI

COMMERCIAL BANKING

Functions of Banks; Nature of Their Assets and Liabilities

The functions of banks, Gallatin showed, include discounting, receiving deposits, and issuing bank notes. In more detail, American banks "discount negotiable paper, purchase and sell domestic and occasionally foreign bills of exchange, receive deposits, or open cash credits to individuals, and issue bank notes, always, nominally at least, payable on demand in specie. . . . Banking in America always implies the right and the practice of issuing paper money as a substitute for a specie currency."[1]

The essential difference between banking and commercial enterprises, according to Gallatin, was that merchants rely "for the fulfilment of their engagements on their resources, and not on the forbearance of their creditors," while banks

---

[1]Gallatin, "Suggestions on the Banks," op. cit., p. 369. Cf. letter to Leonard Maison, December 20, 1836, Writings, II, 515; "Considerations on the Currency," op. cit., p. 79.

rely not only on their resources, "but also on the probability that their creditors will not require payments of their demands."[1] Gallatin added, typically, that the probability of the creditors demanding payment was greatly increased in proportion to the excessive issues of the banks. Since the "primary duty of banks is to maintain specie payments,"[2] Gallatin believed it incumbent upon banks to keep their issues of notes moderate in amount, in order to give confidence to their creditors and to maintain specie payments at all times. Logically, Gallatin should have added that banks should also keep their deposits moderate for the same reason, but he did not always include deposits when he discussed limitations on bank liabilities.[3] The insistence on the necessity of maintaining specie payment on demand obligations is a recurrent theme throughout Gallatin's monetary writings.

As early as 1809, Gallatin described the principal assets and liabilities of commercial banks. Bank "property"

---

[1]"Considerations on the Currency," op. cit., p. 298.

[2]New York Bank Presidents to Michael Hoffman, Chairman of the Committee of Ways and Means of the New York Assembly, February, 1842, Gallatin, Writings, II, 581.

[3]In his 1831 essay he was more likely to neglect deposits (e. g., "Considerations on the Currency," op. cit., p. 299), whereas in his 1841 essay he generally included deposits in his discussion (e. g., "Suggestions on the Banks," op. cit., pp. 378-80).

consists of "debts outstanding," specie, and the "building necessary for the institution." Bank liabilities are those to stockholders, in the form of capital and undivided profits, to government, and to individuals. The latter two are evidenced by deposits and notes.[1] In the same discussion, Gallatin noted that banks were operated for profits, and that these profits were derived largely from lending at interest. Large dividends to the stockholders, he thought, were indicative of a low ratio of specie to liabilities. Therefore, moderate dividends indicated safe and conservative banking.[2] For example, since the dividends of the Bank of the United States had been averaging only 8 3/8 per cent a year, he thought it "proves that the Bank has not, in any considerable degree, used the public deposites for the purpose of extending its discounts."[3]

Gallatin developed further the nature of the assets and liabilities of banks, in his "Considerations on the Currency." As he put it, "a portion of the capital is sometimes vested in public stocks," but this was not obligatory. Frequently

---

[1]Gallatin, Report of March 2, 1809 on "Bank of the United States," American State Papers, Finance II, 351. By "debts outstanding" he meant "loans and discounts."

[2]Ibid. This unqualified conclusion is made somewhat plausible by the fact that usury laws limited the rates that could be charged, hence the principal method left to banks for increasing their profits was to stretch their loans and their liabilities relative to their specie.

[3]Ibid.

all the assets of American banks took the form of loans and discounts to individuals and businesses; in this respect the American banks differed essentially from the Bank of England. "The capital of this institution, being loaned to government, and not depending on the solidity of the paper discounted, affords a stable guarantee to the holders of notes and to the depositors."[1] Gallatin saw one difficulty with proposed legislation in New York requiring banks to invest certain portions of their funds in government securities. There was not enough capital in the United States, he thought, to tie up much of it in government securities. With so many loanable funds already in mortgages, the proposed requirement would force banks to curtail too much their accommodations to business. If it were not for that difficulty, he believed, the result of the proposal would be to inspire confidence in banks that they otherwise lacked.[2]

In attempting to show that the creditors of the Bank of England were better protected than the creditors of American banks, Gallatin reasoned as follows:

> The bank can loan to individuals, or advance to government (beyond its capital as above mentioned),

---

[1]Gallatin, "Considerations on the Currency," op. cit., p. 279. Note that this is strictly true only if these loans to government are a true "secondary reserve," that is, they are highly liquid without loss of face value, while drawing interest.

[2]Ibid., p. 319.

> nothing but the difference between the aggregate of its notes in circulation, and of the credits in account current on its books, and the amount of specie in its vaults. But the American banks lend to individuals not only that difference, but also the whole amount of their capital, with the exception only of such portion as they may find it convenient but are not obliged to vest in public stocks. It follows that the security of the holders of notes, and of the depositors generally, rests exclusively on the solidity of the paper they have discounted.[1]

This quotation requires some explanation and comments.

It might seem that the capital of the Bank of England was in part "tied up," whereas that of the American banks was not. This was not so, according to Gallatin, because the American banks frequently extended accommodation loans, which were renewed continually, and loans based on real property. "This departure from what has been generally deemed the true banking principle must, it is believed, be ascribed to the original disposition of the capital."[2]

In analyzing Gallatin's comments on the greater restrictions on Bank of England lending than on lending by American banks, it must be noted first that, unless the loans to government replace loans to individuals, then the fact that the capital of a bank was invested in government securities would not necessarily give greater protection to creditors.

---

[1] "Considerations on the Currency," ibid., p. 279.

[2] Ibid. Accommodation loans were those secured by paper other than short term commercial paper or mortgages.

In fact, if the loans to government took the form of derivative deposits,[1] the ratio of specie reserve to demand liabilities would be decreased. It is reasonably clear from the context, however, that Gallatin had in mind loans to government replacing loans to individuals.

The quotation comparing lending by the Bank of England with lending by American banks is somewhat ambiguous in that it may seem that Gallatin was implying some kind of a quantitative limitation on Bank of England lending, as well as a qualitative limitation in so far as part of its loans had to be made to government. Furthermore, Gallatin said that the real difficulty with American banking was that state banks extended "permanent accommodations" rather than short-term commercial paper, implying that there would be no problem of the quantity of note issues if only they were issued on the basis of genuine commercial paper.[2] He failed to point out that the restriction of loans to those based on government securities and commercial paper will not prevent expansion of the money supply.[3]

---

[1]Deposits stemming not from the in-payment of cash or the transfer of credits from other banks but rather from the extension of new loans.

[2]Ibid.

[3]This shortcoming of Gallatin's views was shared by many British and American monetary writers of his day. Mints, op. cit., pp. 26-38, 48-50, 129-36, 156-59, 166.

As a matter of fact, Gallatin has stated merely a truism in the quotation comparing the Bank of England with American banks. For purposes of analysis, he assumed that all bank assets consist of specie, loans to individuals, and loans to government, and that all bank liabilities consist of notes, demand deposits, and capital. Thus he omitted those balance sheet items that were of minor importance. In the case of the Bank of England, he showed that the amount of loans to government equals the capital. Then, specie plus loans to individuals must equal notes plus demand deposits, since the total assets must equal the total claims against the assets. Gallatin merely said the same thing in a different form when he stated that the Bank of England could lend to individuals "nothing but the difference between the aggregate of its notes in circulation" and demand deposits, on the one hand, and its specie, on the other. This is so by definition, and no special significance for credit expansion should be attached to the statement.

The following illustrations will show that the "requirement" that the private loans of banks be limited to the difference between their demand liabilities and their specie is no limit at all on the quantity of such loans, or of the resultant demand liabilities. In each of the following abbreviated balance sheets, all entries are hypothetical. Assets are placed on the left-hand side of the balance sheet,

and liabilities on the right. As in Gallatin's discussion, some accounts are omitted on the grounds that they are not of strategic importance. In Figures 1 and 2, loans to government just equal the capital. In Figure 2, it is assumed that the bank extended additional accommodations either by issuing notes or by increasing demand deposits. In the case of the American banks, Figures 3 and 4, it is assumed that none of the loans is to government.

Fig. 1.--Bank of England, Balance Sheet

Specie	$100	Notes plus demand deposits	$200
Loans to government	100	Capital	100
Loans to individuals	100		
	$300		$300

Fig. 2.--Bank of England, Balance Sheet

Specie	$100	Notes plus demand deposits	$900
Loans to government	100	Capital	100
Loans to individuals	800		
	$1,000		$1,000

The Bank of England in both Figures 1 and 2 meets the "requirement" that nothing is lent to individuals except the difference between demand liabilities and specie; yet the Bank in Figure 2 has greatly extended its discounts. Its specie on hand to meet demand liabilities is only one-ninth of those liabilities; that is, its "reserve ratio" is 11.1

per cent. This ratio should be contrasted to the 50 per cent reserve ratio of the Bank depicted in Figure 1.

Fig. 3.--An American Bank, Balance Sheet

Specie	$100	Notes plus demand deposits	$200
Loans to individuals	200	Capital	100
	$300		$300

Fig. 4.--An American Bank, Balance Sheet

Specie	$100	Notes plus demand deposits	$900
Loans to individuals	900	Capital	100
	$1,000		$1,000

The American Bank, in both Figures 3 and 4, fails by one hundred dollars to keep its loans to individuals down to the difference between demand liabilities and specie. But in Figure 3, it has a 50 per cent reserve ratio, whereas in Figure 4, it has a ratio of only 11.1 per cent. Moreover, this does not take into account the probability of a drain of reserves to other banks as checks are written against the newly-created deposits.

To sum up, it is true that the Bank of England not only had immediate recourse to specie, but presumably could convert quickly its secondary reserve into cash. The American banks were dependent upon maturing discounts for extra cash. They were in an even less liquid and secure position when

their assets were long-term.[1] It would be a mistake to assume, however, that the secondary reserve requirement, or, for that matter, the limitation of loans to short-term, "self-liquidating" commercial paper, would limit the quantity of money in circulation. Figures 2 and 4 are examples to the contrary. Yet Gallatin sometimes seemed to overlook that fact, especially in these passages from "Considerations on the Currency."

One has to look elsewhere in Gallatin's writings to find indications that he did not believe that limitations on the quality of bank loans (for example, loans only to government or on commercial paper) were sufficient to prevent significant increases in the money supply. On November 17, 1831, in a letter to R. M. Sherman, Gallatin showed greater insight into the process of credit expansion than in "Considerations on the Currency." He was discussing a plan whereby the State of Connecticut would permit banks to issue notes to an amount no greater "than they shall have secured by a deposit of mortgages or public securities of certain descriptions."[2] He argued that the provision would secure the note-holders against ultimate loss, provided that the land mortgaged was worth more than the amount of the mortgage, and that the public securities

---

[1]See above, pp. 83-85.

[2]Gallatin, Writings, II, 448-49.

were valued sufficiently below the market price to cover any loss attributable to a fall in their price. There were other difficulties, however, with the proposal. If there were two million dollars of Connecticut bank notes in circulation, then in order to place an equal amount of their funds in mortgages or public securities, the banks would have to do one of two things: decrease their ordinary loans drastically, to the detriment of the business community, or increase the aggregate of their loans by two million dollars. The latter sum "may be more in proportion to their capital than would consist with good management. . . ."[1] Here, then, Gallatin recognized a factor that he did not contemplate in much of his "Considerations on the Currency," the creation of loan deposits to finance such assets. Thus, although the proposal might protect the note-holders against ultimate loss, it would protect "neither them nor the public at large against a suspension of specie payments and the consequent temporary depreciation of the notes."[2]

As a result of such reasoning, Gallatin in his later writings departed greatly from the "Banking School" principle. This theory asserts that a sufficient limitation on the lending activities of banks was that they discount only

---

[1] Ibid., p. 448.

[2] Ibid., pp. 448-49.

short-term, commercial paper. Gallatin advocated legislation limiting the loans to stated proportions of the capital of banks.[1] As Brooks shows, some of the American writers who wanted bank notes to arise solely in the process of discounting short-term, business paper believed that such notes could not long be issued in excess of "the needs of business." Any temporary overissue of notes would be returned quickly to the banks, hence the currency would be both safe and protected against overissue. Bancroft, Raguet, and Charles Francis Adams held to this view, generally characteristic of the Banking School in England.[2]

In the United States, many writers attacked the commercial-loan, Banking School theory, but Gouge was among the few who saw that "by discounting business paper as much bank paper might be set afloat as by discounting accommodation notes. The same lot of goods might be sold to a dozen persons and each might give a note, and each of these twelve notes might be discounted at a bank."[3] Gallatin nowhere

---

[1] See below, pp. 220-22.

[2] Brooks, op. cit., pp. 225-30; Mints, op. cit., pp. 9-11, 46-47, 86-89.

[3] Cited in Brooks, op. cit., p. 233. See also Figures 2 and 4, above, pp. 167-68. For further criticism of the commercial loan theory, see Bollmann, op. cit., pp. 268-74; Mints, op. cit., p. 94, and passim; Robertson, Essays in Monetary Theory, pp. 54-55.

made as clear a criticism as Gouge's.

Deposits and the Money Supply

Demand deposits in commercial banks could be converted at any time into bank notes, and they commonly performed the majority of payments in commercial transactions. Accordingly, Gallatin recognized demand deposits as money.[1] In order to analyze the role of demand deposits, Gallatin discussed the history of banks of deposit. He first described the bank of Hamburg, which was essentially a warehouse for deposits of silver. Credits were issued for deposits, and these credits could then be transferred from person to person. The credits were merely warehouse receipts for the silver; hence the bank created no new money by note issues. Nor did the bank of Hamburg extend discounts and thereby increase deposits. It was purely a bank of deposit.

Next, Gallatin showed that the Bank of Amsterdam developed on the basis of partial, instead of 100 per cent, specie reserves. The Bank of Amsterdam, finding that it had a certain minimum amount of specie in its vaults at all times, decided to lend part of the idle specie. Again, payments were effected by transfers of credits, and these credits, Gallatin insisted, were like bank notes in every respect. "The bank-notes and the deposits rest precisely on the same basis: for

---

[1]See above, pp. 127-29.

immediate payment on the amount of specie in the vaults; for ultimate security on the solidity of the debtors of the banks."[1]

In discussing the creation of a system of partial reserves, Gallatin thought in terms of specie being withdrawn from the vaults of the banks, as loans were extended, the total amount of money (now including deposits) staying the same. He further thought that the specie released by this lending process then would be productively used.[2] The fact that Gallatin conceived of a system of partial reserves as originating from the withdrawal of specie was probably one reason for his failure to understand the creation of money through the extension of loans that result in derivative deposits. As the following quotation shows, he was quite explicit in his belief that new money had not been created:

> In this case, the amount of credit on the books of the bank would remain the same as if that sum in silver had not been withdrawn from its vaults; and all the payments effected by the transfers of those credits would continue to be made precisely as theretofore. The amount of those credits would therefore continue to be, in every respect, the currency of Hamburg, differing from what it was formerly only in being sustained by a less amount in specie, and depending for its ultimate security on the solidity of those to whom the silver withdrawn from the vaults had been loaned.[3]

---

[1] "Considerations on the Currency," op. cit., p. 267.

[2] See below, pp. 207-9.

[3] "Considerations on the Currency," op. cit., p. 267.

In 1836, Gallatin clearly recognized that deposits might arise through the extension of loans,[1] whereas in March, 1831, he specifically stated that banks can afford relief in times of depression by lending their credit to "solvent dealers," "which cannot be done without enlarging their issues."[2]

Assuming with Gallatin, for the moment, that the bank loans occur without extending derivative deposits, and without printing new paper money, it is not true even then that the money supply is unaffected. In the balance sheets for "A Commercial Bank" and "All Non-Banks," in Figures 5 and 6, it is assumed that non-banks deposit specie in the bank. The money supply then consists of the amount of the

Fig. 5.--A Commercial Bank, Balance Sheet

Specie	$100	Deposits	$100

Fig. 6.--All Non-Banks, Balance Sheet

Deposits in banks	$100	Capital	$100

---

[1]Letter to Leonard Maison, December 20, 1836, Writings, II, 516. See also his 1841 "Suggestions on the Banks," pp. 372, 420-21. Even here, however, Gallatin did not see the full implication of the creation of loan deposits for the money supply. See below pp. 177-79. Cf. Redlich, History of American Business Leaders: A Series of Studies, II, Part I, The Molding of American Banking: Men and Ideas, 236, n. 101.

[2]"Considerations on the Currency," op. cit., p. 274. Cf. above, pp. 127-28.

demand deposits, counted either as a liability of the bank or as an asset of the non-banks. There is no money circulating from hand to hand, so the money supply equals $100. In Figures 7 and 8, it is assumed that the bank grants loans to the extent of $80 to non-banks, which loans are

Fig. 7.--A Commercial Bank, Balance Sheet

Specie	$20	Deposits	$100
Loans	80		
	$100		$100

Fig. 8.--All Non-Banks, Balance Sheet

Deposits in banks	$100	Debt	$80
Specie	80	Capital	100
	$180		$180

withdrawn in specie from the banks. Thus an additional sum of $80 is put into circulation. It should be recalled that this is the way in which Gallatin described the origin of partial reserve banking. The money supply has not remained at $100, however, as Gallatin apparently thought. It now consists of $100 of deposits plus $80 of specie outside of banks. Gallatin treated this not as an increase in the money supply but as a release of specie for export--the least probable eventuality.[1]

---

[1]See below, pp. 208-14.

Gallatin's limited understanding of the nature of loan deposits was typical of his time. Many writers, including Gallatin, knew that bank discounts could be taken either in the form of deposits or of bank notes. Likewise, many of them must have known that, in the larger cities, the volume of demand deposits began to exceed the amount of bank notes in circulation in the 1830's.[1] When it came to recommendations for monetary reform, however, most of these writers ignored bank deposits. Gallatin argued that depositors acquired their status voluntarily, and were well-informed with regard to their bank. Holders of notes, on the other hand, did not have as much discretion, and were frequently the less well-informed members of the community. Therefore, Gallatin thought, regulation was more necessary for notes than deposits.[2]

As a general rule, most American and English writers prior to the middle of the nineteenth century either failed to recognize that new money could be created by loan deposits, or else minimized the importance of this fact. Alexander

---

[1]See above, pp. 129-30, 140.

[2]Gallatin, Writings, II, 516-17; "Suggestions on the Banks," op. cit., p. 428. The view was widely held that depositors could take care of their own interests, but note-holders could not; see Brooks, op. cit., p. 145; John T. Holdsworth, "Lessons of State Banking Before the Civil War," Academy of Political Science, Proceedings, I (1910-11), 219.

Hamilton and Erick Bollmann were among the few exceptions to this general rule.[1] Although Thomas Joplin had described accurately, in 1826, the process of expansion of the money supply by the banking system on the basis of a new primary deposit,[2] most monetary writers in the nineteenth century had little understanding of the process.

As a first approach to an explanation, assume that the increase in loans, in Figures 2 and 4, above,[3] took the form of increased demand deposits. If that were the end of the matter, then the banks in question each would have increased the money supply by $700, as compared to the situations in Figures 1 and 3. It is quite likely, however, that the recipients of the loans soon will write checks against their deposits. To the extent that these checks transfer credits to other banks, it will be a drain upon the reserve of the banks that have extended their loans so improvidently. Consequently, no single bank in a system of many banks can extend new loan deposits of much more than the amount of any new

---

[1]Brooks, op. cit., pp. 145-46, 292-93; Mints, op. cit., pp. 42-43, 80-81; Miller, op. cit., pp. 6, 115-20; Grace Madeleine, op. cit., p. 151.

[2]Joplin's work is described in Mints, op. cit., pp. 104-7. In 1920, Chester A. Phillips formulated algebraically the theory of deposit expansion, in his Bank Credit (New York: The Macmillan Co., 1920), pp. 32-44.

[3]Pp. 167-68.

primary deposits that they might receive.[1] Other banks in the system, however, as recipients of new primary deposits, are now in a position to extend new loan deposits, even though they previously were "loaned up."

The process of loan expansion is described, for example, by the Board of Governors of the Federal Reserve System. Assume a uniform reserve requirement of 15 per cent against demand deposits of all banks. Assume also that there is no drain of funds to hand-to-hand currency; that all banks, upon receiving new deposits, keep only 15 per cent of them in additional reserves and lend out the remaining 85 per cent; and, finally, that some one bank receives new deposits of $100. The banking system as a whole will then do what no single bank could have done safely, and that is to expand the total of deposits to 6.66[2] times the original deposit of $100. Stated as a series of transactions, the process is shown in Figure 9.

Gallatin occasionally made decided errors through his failure to recognize that banks create the money with which they buy assets. He was especially prone to make such mistakes before 1830, as in an 1816 letter to Nathaniel Macon.[3]

---

[1] Assuming that the bank was previously "loaned up," that is, keeping only the minimum ratio of reserves to demand liabilities, which it permits itself.

[2] One hundred divided by fifteen.

[3] Writings, I, 697.

Fig. 9.--The Multiplying Capacity of Money in Bank . . . Transactions.

		Amount... deposited	Amount... lent	Amount set aside
Transaction	1	$100.00	$ 85.00	$ 15.00
	2	85.00	72.25	12.75
	3	72.25	61.41	10.84
	4	61.41	52.20	9.21
	5	51.20	44.37	7.83
	6	44.37	37.71	6.66
	7	37.71	32.05	5.66
	8	32.05	27.24	4.81
	9	27.24	23.15	4.09
	10	23.15	19.68	3.47
	11	19.68	16.73	2.95
	12	16.73	14.22	2.51
	13	14.22	12.09	2.13
	14	12.09	10.28	1.81
	15	10.28	8.74	1.54
	16	8.74	7.43	1.31
	17	7.43	6.32	1.11
	18	6.32	5.37	.95
	19	5.37	4.56	.81
	20	4.56	3.88	.68
Total for	20	$640.80	$544.68	$ 96.12
Additional transactions		25.86	21.98	3.88
Grand Total		$666.66	$566.66	$100.00

[1]Board of Governors of the Federal Reserve System, The Federal Reserve System: Its Purposes and Functions (Washington, 1947), p. 18. Errors in addition appearing in the right-hand column of the original have been corrected.

The principal concerns of the letter were with a "redundancy of the currency," and with the sale of government bonds to the banks. He stated that, in the event of the sale to banks of United States securities, banks that were in an insecure position could resell the securities, and thereby bolster their reserves relative to their liabilities. He conceived of this as a boon to the economy, in that it would raise reserve ratios and not add to the money supply. He preferred it to an alternative method of enlarging the proportion of specie reserve to monetary liabilities of banks, that is, the curtailment of discounts to the distress of business.

The process as described, however, would permit an inflationary expansion of the money supply, undesired and unforeseen by Gallatin, provided that the banks purchased the securities by giving new deposits (or issuing bank notes). If the banks that originally purchased the government securities resold them to other banks, then the tendency would be to enlarge the money supply and lower, not raise, the proportion of specie reserve to monetary liabilities.[1] In fact, the only way in

---

[1]Additional reserves acquired by the banks which resold the securities would soon be drained to other banks as the Treasury wrote checks against its new deposits. These other banks, as a whole, would have given up reserves to purchase the securities, then had those reserves restored as checks written by the Treasury were deposited with them. Total reserves for the banking system would have stayed the same;

which the sale of government securities to the banking system would not defeat the purposes Gallatin had in mind would be for the bank to resell the securities to individuals, who would pay for them by transferring deposits from other banks; and, in addition, for the banks which gained new reserves, as the Treasury wrote checks against its new deposits, to refrain from extending new loans. Only if these conditions were met would no new money have been created by the sale of government securities. Gallatin's analysis in this particular was seriously deficient.

Free Banking

Gallatin distinguished clearly the principal functions of banks: discounting, issuing notes, and accepting deposits. Not all of his contemporaries, however, were able to see that the function of issuing notes was separable from the functions of discounting and accepting deposits. In the eyes of many proponents of hard money, banking was synonymous with note issue. Therefore, they believed, in order to abolish, state

---

total monetary liabilities would have increased by the amount of the government securities.

The exact effects would depend on whether there was a drain from deposits to hand-to-hand currency, whether there were originally reserves in excess of the minimum bankers wished to keep, and whether the banks expanded their discounts upon receiving new reserves. Consideration of possible effects on income and output has been omitted.

bank notes, legislatures would have to prohibit all banking.[1] Consequently, legislation in several of the states of the upper Mississippi Valley in the 1840's abolished commercial banking altogether.[2] Gallatin noted this tendency to identify banking with note issue, but showed that, historically speaking, banks had seldom had the privilege of note issue.

> We have, from the general practice in the United States, contracted the habit of considering the issuing of a paper currency as an essential attribute of banking. The opinion is erroneous. Banks and bankers had been in existence long before any paper currency was issued by any private individuals or associations. . . . The right of issuing either a metallic or a paper currency has always been considered on the Continent of Europe as an attribute of sovereignity, and it has but very rarely been delegated even to corporate bodies. . . . The business of exchange and banking has for centuries been carried on throughout the whole European Continent, and in the most important seat of commerce of Great Britain, by capitalists who issued no paper currency.[3]

Gallatin went on to add that

> the proper banking business consists not in making currency, but in dealing in existing currency and in credit, or, as both are generally expressed, bankers are money-dealers. They borrow and lend money, discount notes, buy and sell bills of exchange. They are, in all those respects, necessary intermediaries in every commercial country.[4]

---

[1]Miller, op. cit., p. 12; Brooks, op. cit., p. 134.

[2]Hammond, "Banking in the Early West: Monopoly, Prohibition, and Laissez-Faire," op. cit., p. 2, and passim.

[3]Gallatin, letter to Leonard Maison, December 20, 1836, Writings, II, 514-15.

[4]Ibid., p. 515.

Thus, Gallatin concluded, such banking operations, when separated from the privilege of issuing notes, should be unrestricted by government and open to anybody with the necessary capital. But the privilege of note issue should be drastically restricted, or, if possible, prohibited to all but the Bank of the United States.[1]

Gallatin urged that banking functions, other than note issue,

> be left as free and open to every person or association of persons as any other branch of commerce whatever, but not that it should be placed on a better or different footing. There is no reason why persons or associations of persons should not be permitted to apply their capital and credit as freely to the dealing in promissory notes and bills of exchange as to the purchase and sale of merchandise, of land, or of any commodity whatever. Nor is there any reason why any special provision should be made in favor of that particular branch.[2]

The key to Gallatin's argument is that free competition should prevail in money-dealings, but not in money-creating. He acknowledged that "great capitalists will ever have an influence on the money market," and asserted that "no other

---

[1] Ibid., pp. 515-16; letter to Robert Walsh, Jr., April 27, 1830, Writings, II, 426; letter to Robert Potter, December 3, 1830, ibid., p. 442; letter to J. Horsley Palmer, May 1, 1833, ibid., pp. 461-62; letter to A. C. Flagg, December 31, 1841, ibid., p. 564.

Ideally, Gallatin desired a purely metallic currency, but he admitted this was impracticable; letter to Frederick Beasley, quoted above, p. 144, n. 1.

[2] Gallatin, letter to Leonard Maison, December 20, 1836, Writings, II, 519.

remedy can be found than in the freest competition."[1] Although he believed that capital was not dangerously concentrated, in his time, he suggested that state legislatures might limit the extent to which capitalists could form voluntary associations, so as to prevent a monopoly of the money market. But the greater problem in the United States was the "great disproportion between the demand for capital and the supply," so that "concentration of small capitals for the purpose of banking" was useful, and should not be prohibited.[2]

Because he believed that the business of money-dealing should be left free, Gallatin opposed the Restraining Act of the State of New York, which preceded the Free Banking Law of 1838.[3] The New York Restraining Act, passed in its earliest form in 1804, was copied widely in the early 1830's by many other states. These acts were intended to protect the monopoly of the chartered banks by prohibiting persons and non-chartered associations from engaging in various

---

[1] Ibid., p. 516.

[2] Ibid., p. 517.

[3] Ibid., pp. 514-20; letter to Frederick Beasley, ibid., p. 512; letter to J. Horsley Palmer, ibid., p. 462; letter to A. C. Flagg, ibid., p. 563; "Considerations on the Currency," op. cit., Note C, "Restrictions on Private Banking," pp. 350-51; "Report of the Union Committee appointed by the meeting of the signers of the memorial to Congress, held on the 11th day of February, 1834, at the Merchants' Exchange, in the city of New York," op. cit., p. 79.

banking operations. The acts were seldom enforceable, and were finally swept aside in the attack against privilege and monopoly, exemplified by the "free banking" movement.[1]

The opposition which Gallatin expressed toward the Restraining Act, and his espousal of free competition in money-dealing, may be the source of an error made by Fritz Redlich. He stated that "Albert Gallatin . . . was a friend of Free Banking as early as 1834."[2] But Gallatin was never a friend of free banking in the sense in which the term was used before the Civil War. As has been mentioned, banking was typically associated with note issue, and free banking was taken to include that privilege. As Gallatin said,

> I use the term banking in that sense in which it is universally understood in the United States; that is to say, as implying the permission to issue a paper currency.

---

[1]Hammond, "Free Banks and Corporations: The New York Free Banking Act of 1838," Journal of Political Economy, XLIV (April, 1936), 186-94; "Banking in the Early West: Monopoly, Prohibition, and Laissez-Faire," op. cit., pp. 2-6, 8-12. Oscar and Mary Handlin point out that the unique characteristic of chartered corporations, in the early history of the colonies and of the United States, was that they were conceived of as "an agency of government, endowed with public attributes, exclusive privileges, and political powers"; hence they were used, for the most part, in turnpikes and banks, not trading companies and land speculations. "Origins of the American Business Corporation," Journal of Economic History, V (May, 1945), 22.

[2]Redlich, Essays in American Economic History: Eric Bollmann and Studies in Banking, p. 165. Redlich's source is a diary entry of an impressionable woman who reported, on the basis of a conversation with Gallatin, that he "would have free banking"; Adams, op. cit., p. 651.

> By free banking, in its genuine sense, I understand the extension of that permission to all persons or associations of persons, free of all restraints, but on his or their personal responsibility.[1]

Far from being a friend of free banking in this sense, Gallatin believed, as early as 1804, that "of all acts of government none perhaps was more delicate, none required greater discretion and caution to guard it against improper speculations, than the granting of a bank charter."[2] This statement is contrary to the philosophy of free banking. Moreover, Gallatin was consistently and strongly opposed to the unrestricted grant of the privilege of note issue. He insisted that the issuance of notes was not a private right but a prerogative of the federal government. Fixing the standard of value, he thought, was as important as setting standards of weights and measures. Consequently, he strongly disapproved of unrestricted note issue by state banks.[3]

Much as he opposed "governmental interference" in the economy, Gallatin said, with regard to the issue of paper money, since "the poor and the ignorant would be incapable of judging between sound and bad paper, that they would be exposed to perpetual impositions and losses, and that it is

---

[1]Letter to A. C. Flagg, December 31, 1841, Writings, II, 563-64. See also above, p. 160.

[2]Letter to Jefferson, April 12, 1804, Writings, I, 184.

[3]"Suggestions on the Banks," op. cit., pp. 429, 431.

one of the cases in which, for their protection, legislative interference is legitimate and necessary."[1] Acknowledging "that no restrictions should be imposed on the acts of individuals or associations but such as are necessary to secure the rights of others or to protect the whole community," Gallatin nevertheless argued that restriction on note issue is "proper and necessary."[2]

Gallatin cited the numerous bank failures in England during an era of free banking before establishment of joint-stock banking associations. Annually from 1814 to 1825, Gallatin asserted, there had been a 16 per cent average ratio of bank failures to the number of chartered banks. This figure he contrasted to the 2 1/4 per cent of bank failures in the state of New York during the same period. He compared "personally responsible private bankers" with banks chartered by the legislature, "in which the capital actually paid has been the guarantee substituted for personal responsibility, and which have been regulated by efficient restrictions." Either system was acceptable to Gallatin, and far preferable to a plan of unrestricted, free banking.

> The assertions that the community will be better protected, and individuals of all classes less likely to be imposed upon, under a system in which there is neither personal responsibility, nor any assurance of

---

[1] Gallatin, Writings, II, 564.

[2] "Suggestions on the Banks," op. cit., p. 431.

> a sufficient and real capital actually paid, nor any legal restrictions that may prevent the dilapidation of that capital, is a pure theoretical opinion wholly unsustained by experience.[1]

The Loco-Focos and certain other elements among the Jacksonian Domocrats were the groups that wanted "sound money" and, at the same time, wanted to democratize banking and destroy the privileged "moneyed machines."[2] Gallatin observed that this opposition to the state banking system was originally, in many states, as much against paper currency, "by whomsoever issued," as against monopolistic privileges of banks chartered by the legislatures. Then he added the following caustic but penetrating observation: "The opponents seem to have lost sight of the principal object, and to have remained satisfied that there should be a dangerous excess of paper money, provided everybody should be permitted to issue it."[3]

---

[1] Ibid., p. 443.

[2] Hammond, "Free Banks and Corporations: The New York Free Banking Act of 1838," op. cit., pp. 184, 192 ff.; Redlich, Essays in American Economic History: Eric Bollmann and Studies in Banking, op. cit., pp. 139-66. Jackson, himself, according to Redlich, was highly inconsistent in his position toward banks other than the Bank of the United States. At various times, Jackson seems to have (1) argued for free banking, (2) approved state-chartered monopoly banking, and (3) opposed all banks. Ibid., pp. 165-66.

[3] "Suggestions on the Banks," op. cit., p. 430. For documentation of the view, here being attacked by Gallatin, that free banking would be non-inflationary, see Brooks, op. cit., p. 263. Also, Bray Hammond cites the report of

There had been some assertions by the proponents of free banking that the principle of free competition required that no restrictions be placed upon private banking, including issuance of notes. Gallatin observed, rightly enough, that unrestricted note issue was an "erroneous application of the principle of free trade." Free competition in producing any commodity tends to bring about a reduction in its cost or an improvement in the quality of the commodity. In money dealings, the same competition "procures discounts of negotiable paper on the cheapest possible terms. But issuing a paper currency is not dealing in money, but making money."[1] Competition, Gallatin argued, cannot make a currency cheaper except in that it makes it "worse than the legal coin of which it is the representative."[2] That is, competition in note issue merely depreciates the currency. With free banking, Gallatin said, "We would then be inundated with insecure

---

a committee of the New York legislature in support of the 1838 bill to provide free banking in that state. The report attributed inflation to the existing system of restricted charter banking, and argued that free banking would prevent inflation! Hammond ridicules the committee report, pointing out that one justification for monopoly in banking was that it kept down the number of banks and minimized inflation. "Free Banks and Corporations: The New York Free Banking Act of 1838," op. cit., pp. 194-95.

[1] "Suggestions on the Banks," op. cit., p. 431.

[2] Ibid.

paper."[1] This is a shrewd appraisal of competition in banking.[2] Only if the power to create money is divorced from the operations of banks would competition in banking be safe.

Bray Hammond points out that free banking, despite the arguments of men like Gallatin, became deep-rooted in the American banking system. Hammond speaks of it as an outgrowth of the "destruction of centralization and untrammeled exploitation of the continent under individualism and laissez-faire."[3] Free banking spread rapidly after its adoption in Michigan and New York in 1837 and 1838. Hammond asserts that free banking, without the privilege of note issue but with the power to create loan deposits, was accepted by the federal government in the National Banking Act of 1863. Moreover, "the Federal Reserve banks, the Reconstruction

---

[1]Letter to Frederick Beasley, September 3, 1836, Writings, II, 512. For evidence that Gallatin's prediction proved to be accurate and that free banking brought numerous banking abuses and failures, see the following: Hammond, "Banking in the Early West: Monopoly, Prohibition, and Laissez-Faire," op. cit., pp. 6-8, 12-15, 25; Andrew McFarland Davis, The Origin of the National Banking System, Senate Documents, No. 582, 61st Cong., 2d sess., (1910), pp. 13-26; John Jay Knox, A History of Banking in the United States (Bradford Rhodes & Co., 1903), pp. 306-28 and passim. Cf. above, pp. 86-87.

[2]Cf. Mints, op. cit., p. 140.

[3]Hammond, "Free Banks and Corporations: The New York Free Banking Act of 1838," op. cit., p. 184.

Finance Corporation, and the Federal Deposit Insurance Corporation are evidence that free banking, too firmly vested to have its defects remedied from within, has had to have them compensated from without."[1]

Gallatin's proposed solution to the defects of American banking, however, went to the heart of the problem. He would have separated the privilege of money creation from the other functions of money-dealers.[2] That he did not include a prohibition of loan deposits is undeniable, but it is equally clear that if he had seen the possibilities of credit expansion through loan deposits, he would have argued for their prohibition.[3] It has been stated above that the private bankers, in the three decades before the Civil War, extended discounts only out of their own capital; they probably did not create deposits over and above the amount of money already in their possession.[4]

---

[1] Ibid. See also, Hammond, "Long and Short Term Credit in Early American Banking," op. cit., pp. 95-97; Lauchlin B. Currie, The Supply and Control of Money in the United States (Cambridge: Harvard University Press, 1934), pp. 126-28, 131, 142-43, 158.

[2] Cf. the modern proponents of "100 per cent reserves": e. g., Irvin Fisher, 100% Money (New York: Adelphi Co., 1935). Currie, op. cit., pp. 151-52.

[3] See the quotation in which Gallatin expands upon the principle that "the proper banking business consists not in making currency, but in dealing in existing currency. . . ." Above, p. 182.

[4] See above, p. 85, n. 2.

One of Gallatin's reasons for distinguishing between notes and deposits, prohibiting the former only, was mentioned above. Depositors were better informed and more wary than note-holders, hence were able better to protect their own interests.[1] For another reason, if banks were prohibited from issuing notes, their failures would hurt only depositors.

> It would derange the beneficial system of transfers of credit, but would not affect the standard of value, which, since no paper currency had been put in circulation, would, for the community, continue to be legal coin of the country, and nothing else.[2]

Gallatin went on to add that the danger of suspension of specie payments was greater when banks had two kinds of demand liabilities, notes and deposits, than if they had only deposits. In the above quotation, Gallatin apparently overlooked the fact that the deposits in banks served the purpose of money, and that the failure of the banks would cause the contraction of that part of the money supply represented by the deposits. Far from not affecting the "standard of value," prices could very well be collapsing, business calculations upset, and profits falling. The harm done by such a sequence of events would be as great as in

---

[1] See above, p. 176.

[2] "Suggestions on the Banks," op. cit., p. 374.

the case of the loss of money represented by notes. Again Gallatin's understanding of the role of bank deposits was deficient.

One qualification should be noted to Gallatin's recommendation that the state banks be prohibited from issuing notes. While in the process of writing his "Considerations on the Currency," Gallatin wrote to Nicholas Biddle as follows:

> There is a . . . point on which I do not feel myself sufficiently informed: it is the real utility of country banks to the districts in which they are situated. I have only general and vague notions on that subject. That the local currencies they issue are anomalous and insecure I am satisfied; but independent of the selfish motives of speculators in those institutions, there is a general feeling even now in their favor, which must have its foundation in some real utility. . . . To distinguish in that case between use and abuse is important, and to me difficult.[1]

Whatever information he received from Biddle, he inserted in his essay an acknowledgement that, in rural districts, the system of deposits could not exist to the same extent as in cities, and that "banks soberly and skilfully administered stimulate industry by the facility which their loans afford to men of enterprise, and that the ability of those banks to make those advances would be much curtailed if altogether

---

[1]Letter of August 14, 1830, Writings, II, 439.

precluded from issuing notes."[1] Although Gallatin said no more on the subject in this passage, elsewhere he insisted that if state banks were to be allowed to continue to issue notes, their powers should be circumscribed.[2]

Gallatin not only opposed the general idea of extending indiscriminately the right to issue notes, but he also opposed the New York Free Banking Law on the grounds that it had several serious omissions.[3] The law contained no requirement that capital actually be paid in, either in specie or its equivalent. The capital of the free banks "may be nominal or real, consisting, at the will of the parties, of specie, mortgages, or stocks of any description, of nominal debts, or of nothing at all."[4] Nor did the law

---

[1]"Considerations on the Currency," op. cit., p. 277.

[2]See below, pp. 215-29.

[3]For Gallatin's summary of the provisions of this law, see "Suggestions on the Banks," op. cit., pp. 433-37.

[4]Ibid., p. 437. The consequences of the failure to require that capital be contributed in specie, or in the failure to enforce such a requirement, are described in Dewey, State Banking Before the Civil War, pp. 5-22; Dewey cites William Gouge's illuminating account of the practices of that era: "The first installment, which we shall suppose to be $5 on a share, enables the banks to purchase desks and the counter and to pay for engraving and printing its notes. It has, then, the necessary apparatus for commencing its operations, and it has, perhaps, a specie fund in reserve, of three or four dollars for each share of stock, to meet contingencies. It then begins to discount notes and circulate paper. As the bank notes will serve the purpose of trade in the neighborhood, the specie is sent to distant

limit the duration of the charters, restrict note issues relative to capital, or provide for the forfeiture of banking rights one year after a suspension of specie payments. In these respects, Gallatin objected that the free banks were not subject to the same restrictions already applied to the banks chartered by the legislature. He wanted the free banks restricted in these matters just as the other banks were.[1]

Next, Gallatin objected to a provision in the law concerning the note issues of the free banks. They were required to deposit with the state certain kinds of bonds to the full extent of their note issue. Although this regulation might provide ultimate protection for the note-holders, Gallatin thought, it did nothing to prevent the immediate evils of a suspension of specie payments. In fact, the provision was actually harmful, "inasmuch as it gives an

---

places to procure commodities. Then comes the time for paying the second, third, or fourth installment. The bank makes a call on the stockholders. Some of them hypothecate their stock; that is, pledge it to the bank and with the means obtained from the bank itself pay in their proportion. Others have obtained the means by discounts of accomodation notes. . . . Thus, bank capitals are formed by exchanging one kind of promises to pay for another kind of promises to pay." Quoted in Dewey, ibid., pp. 7-8. Cf. Lanier, op. cit., p. 196.

[1] "Suggestions on the Banks," op. cit., pp. 434-35, 440-46; Writings, II, 566-68.

unmerited credit to institutions which do not deserve it, and inspires a general unfounded confidence on the part of those who from their situation cannot have the information necessary to discriminate between a good and a doubtful bank-note."[1]

Thus, in 1841, Gallatin saw certain dangers in the extension of credit to the states by banks taking up state securities. He recommended that the Free Banking Law be amended so as to define more precisely the kinds of business that the banks might lawfully carry on. Among the activities that he would have prohibited to the banks was dealing in long-term securities of all kinds.

> It is notorious that, independent of the fraudulent institutions to which the general law gave rise, there is hardly one which has not been induced, compelled, or invited to deal more or less in public stocks, and which has not been injured by it. Examples might be quoted where the law was, contrary to the intention of the Legislature, used for the sole purpose of creating associations of irresponsible stock-jobbers. . . . It appears . . . essential to prohibit the dealing in stock of any description on the part of those institutions. The example of a neighboring State has clearly proved the danger, both to the State and to the banks, of resorting to them, even for the purpose of supplying temporary wants, but still more so when the object is to sustain

---

[1] "Suggestions on the Banks," op. cit., p. 441. Cf. his 1831 discussion of a similar provision in Connecticut, above, pp. 169-70.

by artificial means the credit of the State and the market price of its stocks.[1]

Banks and Capital Formation

A principal purpose for which many states sought bank credit was to finance internal improvements. Between 1831 and 1841, Gallatin had become disillusioned with this and other methods of state financing. In some cases, the states had undertaken the public works themselves, pledging their securities to banks in return for credit. In other instances, the states chartered corporations to carry out the improvements, assisting these corporations by lending the credit of the state. Foreign investors, in particular, were most willing to purchase the public securities.[2] Real

---

[1]Letter to Flagg, December 31, 1841, Writings, II, 566. Presumably, Gallatin would have relied in 1841 upon a national bank and private bankers to purchase public securities, especially those of the federal government.

In connection with Gallatin's recommendation that commercial banks be prevented from becoming "associations of irresponsible stock-jobbers," it should be noted that the Banking Act of 1933, almost one hundred years later, provided for "the prohibition against the receipt of deposits by any person who is engaged in the business of underwriting, selling, or distributing securities. . ." Board of Governors of the Federal Reserve System, Banking Studies, p. 57.

[2]Callender, op. cit., pp. 112-14, 153-59; on the stimulus afforded by British capital to bank expansion and public works in the United States, see Leland H. Jenks, The Migration of British Capital to 1875 (New York: Alfred A. Knopf, 1927), pp. 73-77, 85-95.

capital was scarce relative to the demand for it, however, even with the import of British capital into this country and increased savings and investment within the United States.[1] The relative scarcity of capital retarded the growth of both internal improvements and manufacturing. Gallatin described the situation as follows: "The increase of our population and the unparalleled spirit of enterprise of this nation have always been far in advance of the accumulation of capital."[2] In the absence of sufficient capital, then, the states frequently resorted to bank credit to finance the internal improvements. When returns were long delayed, and the Panic of 1837 struck, several states defaulted on their debts and ruined both their credit and that of the other states. The United States were referred to in England as a "nation of swindlers," and "those perfidious United States."[3]

---

[1]Callender, op. cit., pp. 136-43.

[2]Letter to J. Horsley Palmer, May 1, 1833, Writings, II, 460. For a comparison with the shortage of capital in the first decade of the century, see Gallatin, "Partial Report on the subject of American Manufactures," op. cit., p. 430; report on "Roads and Canals," op. cit., p. 724; and his letter to Sir Francis Baring & Co., June 6, 1811, in United States, Treasury Department, "Letters to Foreign Bankers, April 28, 1803 to March 20, 1833," ZM Series, No. 1 (Microfilm copy; Washington: The National Archives, 1953), p. 175.

[3]Jenks, op. cit., pp. 86-88, 99-108; Ralph W. Hidy, The House of Baring in American Trade and Finance: English Merchant Bankers at Work, 1763-1861 (Cambridge: Harvard

One can imagine Gallatin's reaction. He spoke of the great error committed by those states which advanced their credit for the establishment of banks when banking capital was lacking. Other states, he said, undertook "premature and far too extensive internal improvements," which, when they were unproductive for a long initial period, ruined the credit of the states.[1]

> The honor and interest of every state require, and justice demands, that its credit should be restored. Public and private credit are intimately connected. That of individuals is impaired when public faith is not preserved. A resumption of specie payments on the part of banks and of individuals will at once inspire a greater confidence in the stocks of the states where it may take place.[2]

Some of the clamor, in the 1830's, for bank credit to finance internal improvements reflected the naive popular

---

University Press, 1949), pp. 303-41. The latter shows that the Barings tried to persuade English investors that not all American states had proven to be poor risks, but with little immediate success.

For a discussion of internal improvements in the various states, their financing, and their relation to the Panic of 1837, see McGrane, op. cit., pp. 9-38, 103-30.

[1]"Suggestions on the Banks," op. cit., p. 408. Cf. letter to Michel Chevalier, September 14, 1841, Writings, II, 556-57.

[2]"Suggestions on the Banks," op. cit., p. 408. Note how Gallatin took the occasion to argue for resumption of specie payments.

notion that banks directly created capital.[1] Gallatin, however, saw clearly that capital accumulation was a slow process when a nation had to rely on its own resources, and that to attract capital from abroad required reasonable security in addition to attractive returns. On the latter point, he wrote to Willis Hall, chairman of the Committee on Banks of the New York legislature:

> The power to repeal a charter at the will of the Legislature should be exercised with the greatest discretion. You may by legislative enactments divert capital from one employment to another, and substitute, to a certain extent, credit for capital, but you cannot create capital. If you want more capital, it must be invited from abroad; and you cannot expect that foreign capital will be invested in the stock of institutions that may be annihilated by the simple fiat of a popular assembly.[2]

In 1841, in a shrewd letter to Michel Chevalier, Gallatin said that there was more energy than prudence in the United States. In trying to progress too rapidly, he asserted, the United States actually had been retarded. Some states, not yet having had sufficient time to accumulate capital, began

---

[1] See above, pp. 125-26; Redlich, Essays in American Economic History: Eric Bollmann and Studies in Banking, pp. 117-18.

[2] Letter of April 3, 1838, Writings, II, 534-35. For a similar statement of the necessity of protecting domestic creditors and capitalists, in order to encourage them to furnish their resources, see Gallatin's letter to John A. Dix, March 30, 1842, ibid., pp. 589-90.

For the indirect role that credit may play in capital formation by means of forced savings, see below, pp. 201-4.

public works on no other resources than credit, whereas they could have executed the projects seven or eight years later without difficulty. As it was, not wanting to impose any tax, they borrowed annually the sum necessary both for the improvements and for the always-growing interest on the debt. Then they tried to remedy their falling credit by establishing banks in excess of the needs of the country. The destruction of their credit standing followed. But the country would recover and progress again, Gallatin believed, more slowly but more surely.[1]

At the risk of repetition, it should be made clear that Gallatin did not oppose internal improvements or believe them unproductive, but merely that he feared initiating them more rapidly than existing stocks of capital would permit.[2] There are two or three indications, described below, that Gallatin realized that the monetization of private or public credit, although it did not create real capital directly,[3] may have brought about "forced savings,"

---

[1]Letter of September 14, 1841, Writings, II, 556.

[2]See above, pp. 12, 24-25; Writings, II, 570-71; ibid., pp. 460-61.

[3]Alexander Hamilton, and others, had argued that a funded debt was "a species of capital," that it extended "the active capital of a country," etc. See his "Report on Manufactures," December, 1791, Reports of the Secretary of the Treasury of the United States, on the State of the

and thus released resources for investment. By forced savings is meant "involuntarily" reduced real consumption because of higher prices.[1] Moreover, Gallatin would have preferred that other methods be found of financing investment or government expenditures.

In 1816, while bemoaning the evils of the suspension of specie payments, Gallatin said that it depreciates the currency, "in other words, . . . [it raises] a tax on the community for the benefit of the banks and the borrowers. . . ."[2] Fifteen years later, he stated that the paper

---

Finances, I, 97, 98, 99; cf. Redlich, Essays in American Economic History: Eric Bollmann and Studies in Banking, pp. 174-89; Burnham Putnam Beckwith, Contemporary English and American Theories concerning the effect of commercial banking on the supply of physical capital (Los Angeles: University of Southern California Press, 1935), pp. 2-6.

Gallatin, on the other hand, took pains to refute the idea that the issuance of instruments of debt thereby added to the real capital of a nation, as in the following passage: "A public debt does not increase the existing amount of cultivated lands, of houses, of consumable commodities; it makes not the smallest addition either to the wealth or to the annual labor of a nation. It does not appear that it can in any way be an additional national capital. . . ." "A Sketch of the Finances of the United States," op. cit., pp. 145 ff. See also "Considerations on the Currency," op. cit., pp. 254-57.

[1]For a careful study of the various forms in which saving may appear, see Robertson, "Saving and Hoarding," Essays in Monetary Theory, pp. 65-82.

[2]Letter to Nathaniel Macon, April 23, 1816, Writings, I, 697.

money of the Continental Congress was necessary to carry us through the war, "though operating as a most unequal tax. . . ."[1] Gallatin disliked the extraction of forced savings from the consumers, as a method of financing expansions, both on the grounds that it was inequitable, and that it tended to bring about speculative booms followed by inevitable panic and depression.[2]

There is a striking similarity between Gallatin's ideas on the expansion of the money supply as a means of financing capitalistic expansion, and a modern view held by Dennis H. Robertson. Replying to the argument that the stream of money demand should be enlarged as long as there is unemployment, Robertson wrote as follows about the capital equipment engendered in such an expansion:

> But we still think that to press on so rapidly with its formation is a mistake, because it sets before the economic system problems in digestion and readjustment which it cannot possibly solve. And we still think that the process by which you propose to achieve your ends, namely the unreasonable enrichment of the entrepreneur class, is fairly and illuminatingly described as the infliction of a system of forced levies on the rest of the community, including

---

[1] "Considerations on the Currency," op. cit., p. 338. See also ibid., p. 311, where he states that a depreciated currency "operates as a tax," affecting particularly the consumer. Cf. Paul A. Samuelson, who says, "Inflation is a mighty tax collector." Economics (2d ed.; New York: McGraw-Hill Book Co., 1951), p. 163.

[2] "Considerations on the Currency," op. cit., pp. 272-73.

> the working class as a whole, and that sooner or later their effort to react against this system will play its part in inducing crisis and collapse.[1]

Gallatin did not make so explicit a statement of the concept of forced savings as did Jeremy Bentham and Thomas Malthus, in earlier decades in England. Bentham even used the phrase "forced frugality." Also, the concept of inflation acting like "indirect taxation" had been used occasionally in England by other writers. Hence, Gallatin was making brief, but good, use of a concept that was not entirely novel. The theory languished after the first few decades of the nineteenth century, and was not revived again until the twentieth century.[2]

To summarize, Gallatin believed in the necessity for limiting expansion of the money supply. His proposed restrictions on the quality of bank assets would not have accomplished the desired quantity control, however. He saw that deposits should be counted as money, but, like most of his contemporaries, he failed to see the possibilities of

---

[1] "The Snake and the Worm," Essays in Monetary Theory, p. 110. Cf. Robertson's "Theories of Banking Policy," ibid., pp. 43-44, 50-51, 56-57.

[2] The above information with regard to the early uses of the idea of forced savings is derived from Beckwith, op. cit., pp. 7-18; and F. A. Hayek, "A Note on the Development of the Doctrine of 'Forced Saving,'" Quarterly Journal of Economics, XLVII (November, 1932), 123-33.

multiple expansion of deposits by means of the extension of loans.

On free banking, Gallatin made several penetrating observations. Competition in money-creation, he indicated, tended merely to depreciate the value of that money. Any sympathies that he might have had with the effort to democratize the incorporation process were offset by his dislike of uncontrolled money issue by state banks. If note issue were divorced from other banking functions, Gallatin preferred that those remaining functions be performed by private bankers.

Gallatin feared the excessive use of credit by the states to finance internal improvements. The country was trying to progress without the troublesome preliminary of accumulating capital. Occasional statements indicate, however, that he was aware of the phenomenon of forced savings. On this point, his ideas were quite modern.

CHAPTER VII

COMMERCIAL BANKING, CONTINUED

Advantages of Banks

Commercial banks offered certain advantages to the nation, Gallatin thought, in addition to those associated with the several bank functions previously enumerated. He stated that banks fostered "commercial punctuality," and that they economized on specie, thereby releasing it for export.[1] These unfamiliar ideas require some explanation.

Credit, at least to a certain extent, was necessary to commerce, Gallatin thought, and punctual settlement of obligations was vital to credit. On a credit system, "Every merchant must for the fulfillment of his own engagements depend principally on the punctual payment of the debts due to him."[2] Accordingly, "punctuality in fulfilling engagements" was an

---

[1] "Suggestions on the Banks," op. cit., pp. 370-78; "Considerations on the Currency," op. cit., pp. 253-54; Writings, II, 512.

[2] "Suggestions on the Banks," op. cit., p. 370. Part of Irving Fisher's relatively recent theory of business contractions was built on the fact of credit interdependence. See, e. g., "The Debt-Deflation Theory of Great Depressions," Econometrica, I (October, 1933), 341.

absolutely necessary commercial virtue, as well as a desirable attribute of everyone. Gallatin then suggested that punctuality had become so commonplace that its origin had been forgotten. Speaking of "commercial punctuality," Gallatin wrote as follows:

> It was indubitably due to the establishment of banks. At the close of the war of Independence, Philadelphia was the only place in the United States where commercial punctuality was general, and that city was indebted for it to the Bank of North America. The same effect was successively produced, as banks were established, in New York, Boston, Baltimore, and the other commercial cities; and finally almost universally, or wherever country banking has penetrated.[1]

Gallatin explained that the merchant who did not pay his discounted note would be denied further accommodations at the banks; "and the protest of a note, either discounted or placed in the bank for collection, became soon sufficient to prostrate his credit."[2] Banks, then, had fostered the desirable attribute of punctuality in fulfilling engagements. Other writers of Gallatin's time made the same point.[3]

Banks of issue offered an additional advantage to the nation, according to Gallatin, and that was the substitution of a cheap medium of exchange for an expensive one. He thought that this economy could be calculated nicely, and

---

[1]"Suggestions on the Banks," op. cit., pp. 370-71.

[2]Ibid., p. 371.

[3]Miller, op. cit., pp. 21-22.

thereby permit a comparison of the advantages of paper money with its considerable disadvantages. He reasoned as follows:

> If in a country which wants and does possess a metallic currency of seventy millions of dollars a paper currency to the same amount should be substituted, the seventy millions in gold and silver, being no longer wanted for that purpose, will be exported, and the returns may be converted into a productive capital, and add an equal amount to the wealth of the country.[1]

Now, if notes of a very low denomination were excluded, Gallatin estimated that the circulation would consist of sixty million dollars in notes and ten million dollars in specie. The banking system, if it were meeting specie payments upon demand, would keep about twenty million dollars in specie on reserve, judging by experience. The net economy of specie would then be forty million dollars. "This, at the rate of 5 per cent. a year, may be considered as equal to an additional annual national profit of two millions of dollars."[2]

---

[1] "Considerations on the Currency," op. cit., p. 253. In "Suggestions on the Banks," Gallatin assumed a certain amount of specie for the country "when in a healthy situation," then assumed a substitution of paper for part of the metal. Op. cit., p. 372.

[2] "Considerations on the Currency," op. cit., p. 253. Gallatin was explicit both in the above passages and elsewhere that his conclusions with regard to the utility of paper money depended upon the assumption of a constant money supply, and that "the suppression of notes of inferior denomination" was "the most simple and efficient mode" of assuring that there would not be a net increase in paper money; letter to Biddle, August 14, 1830, Writings, II, 432.

The banking system gave rise to a still greater gain, Gallatin asserted, because of the economy arising from the use of deposits. In "Suggestions on the Banks," however, Gallatin was intent on comparing the benefits with the dangers of paper money; hence he eliminated deposits from his calculations. Gallatin never indicated that deposits could be a means to inflationary expansion of the money supply, too.[1]

Gallatin acknowledged that such economies were an important advantage attributable to banks, but he added immediately that it was achieved only at the cost of considerable insecurity. He offered the following analogy:

> Barns are certainly a very expensive implement of agriculture. The capital expended on those buildings in the Middle and Northern States is more than the value of one year's crop of the farms, and causes therefore a deduction of more than 5 per cent. on the annual gross produce of the earth. To dispense with barns would be a greater annual saving than that which arises from the substitution of a paper to a metallic currency. Some favorable seasons occur when the farmer might thresh his wheat on a temporary floor exposed to the weather, and dispense with a barn. Yet, in our climate, every prudent farmer prefers security to a precarious advantage, and would consider it a most wretched economy not to incur the expense necessary for that object. Similar is the economy of that expensive instrument, the precious metals, if the substituted paper is insecure.[2]

---

[1] "Suggestions on the Banks," op. cit., pp. 374-76. Cf. "Considerations on the Currency," op. cit., p. 254.

[2] "Considerations on the Currency," op. cit., p. 254. See also "Suggestions on the Banks," op. cit., pp. 378-79.

To Gallatin, then, the monetary problem was to achieve security in the form of stable and uniform money, and at the same time realize "the acknowledged and considerable saving" to be derived from the release of specie for export.

Adam Smith was one of the first to advance the idea that an advantage of bank notes was their economizing on specie. He was intent on refuting the mercantilistic idea that banks, by the process of issuing notes, thereby directly created capital; but he also was trying to explain the evident fact that bank loans enabled individual borrowers to add to their physical capital.[1] Smith said, "It is not by augmenting the capital of the country, but by rendering a greater part of that capital active and productive than would otherwise be so, that the most judicious operations of banking can increase the industry of the country."[2] Smith's ideas were repeated by writers in England and America; but the older, mercantilist doctrine that banks created capital, without export of specie and without forced savings, prevailed for a half

---

[1]David Hume merely made the former point, that of the confusion of money and capital by the mercantilists; Beckwith, op. cit., pp. 2-5.

[2]Adam Smith, An Inquiry into the Nature and Causes of the Wealth of Nations, Edwin Cannan, ed. (New York: G. P. Putnam's Sons, 1904), p. 303; see also ibid., pp. 275-79. Cf. Gallatin, "Suggestions on the Banks," op. cit., p. 371.

century more in America.[1]

Smith's statement of paper money economizing on specie is criticized by Charles Rist, on the grounds that the bank notes might not replace specie, but might be additions to the money supply. Rist adds, with regard to the use of paper money or of credit, "it is absurd to measure its usefulness by the economy which it permits in the use of the precious metals, since it is impossible to say what quantity of the precious metals would be necessary in the absence of credit."[2] Rist's criticism is less applicable to Gallatin's use of the idea that paper economizes on specie. Gallatin not only protected himself by assuming a constant money supply, but he also added the proposal that he believed would assure that the money supply would not be increased by the use of paper. That is, Gallatin's analysis was predicated upon the assumption that notes of small denomination would be prohibited, and that the remaining large denomination notes merely would be substituted for specie. If there is any difficulty with Gallatin's analysis, it is not that he neglected the problem of the size of the money supply in

---

[1]Beckwith, op. cit., p. 6; Brooks, op. cit., pp. 154-55; Miller, op. cit., pp. 41-42. William Gouge, like Gallatin, thought that the insecurity of a paper system was not compensated by its economies. Grace Madeleine, op. cit., p. 140.

[2]Rist, op. cit., pp. 86-87.

the absence of paper currency, but rather that his assumption with regard to notes of small denomination might not be reasonable.[1] Given Gallatin's assumption, his conclusions follow logically.

Assuming, however, that the new bank money is a net addition to the money supply, rather than a substitute for part of it, then different conclusions follow. First, there is the problem of whether the additional money would get spent, rather than be offset by an increased demand for money to hold idle. In view of the fact that the additions to the supply of bank money arose in the process of discounting business paper, or otherwise extending loans, in an industrially undeveloped but rapidly expanding economy, it is reasonable to suppose that the new money would get spent, rather than be "wasted" in a move toward increased liquidity.[2]

Second, there is the problem of whether the additional spending would draw upon previously unemployed resources, and, generally speaking, would increase incomes and employment without increasing prices, or whether it would merely draw resources away from previous employments, thereby tending to raise prices and money incomes, but not real income. The

---

[1]See below, pp. 217-20.

[2]Beckwith, op. cit., p. 20. Alvin H. Hansen, Monetary Theory and Fiscal Policy (New York: McGraw-Hill Book Co., 1949), pp. 169-70, 173.

former is the Keynesian case, the latter, forced savings.[1] The evidence shows that unemployment was not a major problem, and that there certainly was not chronic unemployment, during the period Gallatin was writing. The economy was dominated by agriculture, in which output and employment tended not to fall with declining prices or demand, but rather depended upon exogenous factors. Even in the growing industrial sector, expansion and plentiful investment opportunities were the rule, and not contraction, stagnation, and underemployment.[2]

The remaining question, then, is whether new money tended as a matter of fact, to release specie for export, or whether it enabled entrepreneurs to bid up the price of scarce resources, and increase the output of capital goods at the expense of consumer goods. Although Gallatin made passing comments showing an acquaintance with the forced savings case,[3]

---

[1]See above, pp. 121-22, 201-3. Jacob Viner cites two English writers of the 1820's, T. P. Thompson and Henry Burgess, who argued that the increased supply of money would result in increased employment in the production of consumers' goods, thus slowing up the rise in prices. Studies in the Theory of International Trade (New York: Harper & Bros., 1937), pp. 189-90.

[2]See the references cited, above, pp. 197-98. See also Gallatin, "Considerations on the Currency," op. cit., pp. 314-16; Statement of the Arts and Manufactures of the United States of America for the Year 1810 (Philadelphia: A. Cornman, Junr., 1814), pp. xxiv, xlix; Hammond, "Banking in the Early West: Monopoly, Prohibition, and Laissez-Faire," op. cit., p. 4; Smith and Cole, op. cit., p. 31.

[3]See above, pp. 201-3.

his emphasis was very much on the Adam Smith case, that is, the economy attributable to the export of specie.

In fact, Gallatin's assumptions did not hold, as will be shown in the following section. Notes of small denomination were not prohibited generally in the United States, but even in those instances in which they were prohibited, inferior substitutes took their place rather than specie. This is circumstantial evidence that the money supply, even if notes of small denomination were banned, would not have been the same as it would have been under a simple specie system. Since bank notes constituted a net addition to the money supply, and the extra money was spent domestically on fully employed resources and scarce goods,[1] the forced savings effect was much more important than any release of specie for export.[2]

---

[1]In a letter to J. Horsley Palmer of May 1, 1833, Gallatin indicated that available capital was most profitably employed domestically, not abroad: "That credit has in too many instances been far too much extended (particularly in the interior) is indubitable; but it is not less true that capital was drawn in that direction because it could not be employed as profitably in any other way; and that more is still wanted for the same purpose is proved by the fact that there is not enough to discount good short paper at 6 per cent." Writings, II, 460-61.

[2]Beckwith, using twentieth century data, concludes that "a dollar of new bank credit takes the place of only one or two cents in specie. Thus the great source of the new capital received by borrowers of new bank credit is compulsory social saving." Op. cit., p. 26. Beckwith does not even consider the Keynesian case.

Notes of Small Denomination

The suppression of notes of low denomination was a popular idea before the Civil War, and Gallatin accepted the usual arguments in its favor.[1] Basically, Gallatin, Gouge, Jackson, and others believed that notes of small denomination unduly increased the money supply,[2] with resultant evils of depreciated currencies, increased danger of bank runs, and suspension of specie payments. Gallatin was one of many who indicated that the small notes were received with less caution than larger ones, that they passed mainly into the hands of the "poorest class of the community," and that losses from bad notes fell mostly on this class.[3] Gallatin recommended that notes under ten dollars or, at least, five dollars, be suppressed by legislation. He cited

---

[1]Miller, op. cit., pp. 142-45; Brooks, op. cit., pp. 250-54; Dorfman, op. cit., pp. 608-9. There was much disagreement as to what constituted a small denomination note for purposes of prohibition; proposals ranged all the way from five dollar to one hundred dollar notes, according to these sources.

[2]The corollary was that notes of large denomination merely substituted for specie. From this followed Gallatin's argument that suppression of small notes would permit a society to realize the economies of paper money yet keep the money supply constant.

[3]Gallatin, Writings, II, 432; "Considerations on the Currency," op. cit., pp. 300-2; Union Committee, op. cit., p. 79; "Suggestions on the Banks," op. cit., pp. 425-27.

the prohibition of notes under five pounds in England, and under one hundred francs in France.[1] He emphasized that the supression of small notes in France was a cause of the large proportion of specie in the French currency.[2]

Before showing some of the shortcomings of the proposal to prohibit notes of small denomination, it must be admitted that losses because of counterfeited and other bad notes were serious, and that these losses fell heavily on the members of the community who had to handle paper money, yet who were not expert in money-dealings.[3] It is difficult to say whether the fact that it was legally permissible to issue small notes aggravated this evil.

---

[1]See the references in p. 215, n. 3, above. Several of the states, at one time or another in the first half of the nineteenth century, restricted notes of small denomination; Dewey, State Banking Before the Civil War, pp. 63-73.

[2]Gallatin, Writings, II, 426; "Considerations on the Currency," op. cit., p. 301. Information furnished by Rist suggests that Gallatin did not deal with basic causes, in so far as he attributed the great use of specie in France to this prohibition. Banking was relatively undeveloped in France before 1848; notes were not used as credit instruments but merely as a means of transporting large sums of money; the Bank of France, the chief issuer of what notes there were, redeemed them only in Paris; and most holders of money were accustomed to keeping large sums of silver in their coffers and making exchanges with specie. Summarily, Rist says, "In France the question was one not of restricting but of extending the use of notes, not of curbing credit but of developing it. . . ." Rist, op. cit., pp. 229-33.

[3]Dillistin, op. cit., pp. 13-17, 32-39, 41-58.

Gallatin thought that the suppression of notes of inferior denomination would, in some unexplained fashion, cause specie to flow into circulation in the same amounts as notes were withdrawn. On one occasion, he said that this replacement would take place "instantaneously,"[1] but for the most part he envisioned an influx of precious metals from abroad as a consequence of trade. For example, he cited from his own experience the fact that the western counties of Pennsylvania, for more than twenty years after their first settlement, did not have enough specie for internal transactions. He contended that this was attributable to the lack of trade and communications with outside markets. "The principle, almost universally true, that each country will be naturally supplied with the precious metals according to its wants, did not apply to their situation."[2] It should be noted that, if the suppression of small notes was to bring an influx of gold and silver, it would have to be through an effect on prices of a temporary change in the money supply, and a resultant change in the balance of trade. That these things would not necessarily take place was admitted by Gallatin in the case of the western counties of Pennsylvania

---

[1]"Considerations on the Currency," op. cit., p. 301. Presumably such an immediate increase would come from domestic hoards and non-monetary uses.

[2]"Considerations on the Currency," op. cit., p. 315.

(although he looked upon this as an exception), and was a key point in Erick Bollmann's criticism of the operation of a metallic standard.[1]

It is much more reasonable to say that notes of low denomination arose because of the shortage of specie than to argue that there was a shortage of specie because of the use of notes of small denomination. Dillistin shows that a great variety of small notes, including "shin-plasters" in amounts less than one dollar, were in quite general circulation during several periods before the Civil War. "They took the form of tickets, due bills, and promissory notes and were in many instances the private obligations of merchants, manufacturers, and others whose business required them to 'make change'. . . ."[2] They were necessary simply because there was no subsidiary silver or other coins for small transactions. The following story is very revealing. It concerns an English traveler in the United States, in 1819, who had made a half-dollar purchase in a store in Washington.

> I presented a Philadelphia one dollar note; it would not be taken without a discount of 2 1/2 per cent. I then tendered a Baltimore bank [note], of the same amount. This being one hundred miles nearer was accepted. The storekeeper had no change; to remedy which, he took a pair of scissors and divided the note between us: I enquired if the half would pass, and

---

[1]See above, pp. 104-5.

[2]Dillistin, op. cit., p. 66.

> being answered in the affirmative, took it without hesitation, knowing the want of specie throughout the country, and being previously familiarized with Spanish dollars cut into every variety of size. I now find that demi-notes are a common circulating medium.[1]

Finally, cases in which notes of small denomination were prohibited demonstrate that the actual effect was not the influx of specie, but rather for the community to seize upon any inferior substitute which it could find. A New York law of 1835 prohibited notes under five dollars, but its purpose was defeated as notes from neighboring states flowed into the circulation of New York. Consequently, the law was repealed in 1838.[2] Gallatin advocated that the law be reenacted, but admitted that all notes under twenty dollars would have to be prohibited to make the law more "efficient."[3] The Union Committee, in 1834, recommended banning notes of amounts under five dollars, but admitted that "no inconsiderable portion of this would be soon again supplied by five dollar notes."[4] In short, when there was a shortage of United States coins, then foreign coins, counterfeit pieces, merchants' notes, demi-notes, and a whole host of other expe-

---

[1]Quoted in Dillistin, ibid., p. 5-6.

[2]McGrane, op. cit., pp. 99-100.

[3]"Suggestions on the Banks," op. cit., p. 426. Cf. Gallatin's letter to Biddle, August 14, 1830, Writings, II, 432.

[4]Union Committee, op. cit., p. 79.

dients were, of necessity, used.[1] If some of these expedients had been banned, it seems entirely likely that recourse would have been had to still other media, for example, demand deposits. Where none of these was adequate, as in western Pennsylvania, there simply would have been a greater use of barter. Gallatin's assumption that specie would flow in to take the place of prohibited notes was not well founded on fact.[2]

Further Restriction on Note Issues

Gallatin strongly recommended two sorts of limitations on the lending activities of state banks: a restriction of note issue to two-thirds of the capital of a bank;[3] and a restriction of the volume of loans to twice the amount of the capital.[4] In focusing his attention on the relationships between notes and capital, or loans and capital, Gallatin was

---

[1]See above, pp. 59-60, 218-19; for evidence that the same process took place in England when there was a shortage of money of small denomination, see Niebyl, op. cit., p. 14.

[2]Catterall came to a different conclusion, namely that prohibition of small notes "would certainly have brought into circulation a larger amount of specie." Op. cit., p. 429. He assigns no reasons and offers no analysis in support of his conclusion.

[3]"Considerations on the Currency," op. cit., p. 312; Writings, II, 449.

[4]"Considerations on the Currency," op. cit., p. 312; Writings, II, 449, 512; "Suggestions on the Banks," op. cit., pp. 420-22, 454.

taking the view typical of the 1830's and 1840's. His recommendations, however, were more restrictive on bank lending than most. Laws providing that the circulation of a bank should not exceed two and one-half times capital, nor loans three times capital, were fairly frequent.[1] According to Gallatin, these legal provisions were so lenient as to be only nominal limitations. He wrote, in 1831, that "amongst more than three hundred banks, either now existing or which have failed, and of which we have returns, we have not found a single one the loans of which amounted, so long as specie payments were in force, to three times, or the issues to twice, the amount of their capital."[2]

The more lenient provisions, Gallatin thought, had permitted banks to extend excessively their loans in search of profits. Some country banks had paid dividends of 15 per cent, which Gallatin believed to be indicative of excessive lending. "Considered as a whole," he said, "the excessive and fatal expansions of the years 1836-1837 could not have taken place had the maximum been properly regulated."[3] Accordingly, in

---

[1]Hammond, "Banking in the Early West: Monopoly, Prohibition, and Laissez-Faire," op. cit., p. 17; Dewey, State Banking Before the Civil War, pp. 53-63.

[2]"Considerations on the Currency," op. cit., p. 312. "Suggestions on the Banks," op. cit., p. 487. Dewey's information confirms the fact that actual circulation was generally far less than that permitted in most states; State Banking Before the Civil War, p. 61.

[3]"Suggestions on the Banks," op. cit., p. 421.

the 1830's, Gallatin advocated a prohibition on loans over twice the capital of a bank. He drew upon his experience as bank president to conclude, as follows:

> I can now say, from actual experience, that this is amply sufficient, and will, after defraying expenses, taxes, and ordinary losses, allow of a dividend of 8 or 9 per cent. a year. The restrictions will take away the temptation of excessive credits, and necessarily limit the issue of paper and increase the specie basis.[1]

By 1841, Gallatin was inclined to be more restrictive; he advocated in "Suggestions on the Banks" a one and three-fifths limitation on loans relative to capital, to apply to all loans of all banks, with penalties for overissue.[2]

Applying the one and three-fifths limit on loans relative to capital, Gallatin gave the example shown in Figure 10, with slight revisions in form.[3] The bank has extended its

Fig. 10.--An American Bank, Balance Sheet (in thousands of dollars).

Specie	$ 300	Circulation and deposits	$1,000
Loans	1,600	Capital	1,000
Real estate	100		
	$2,000		$2,000

loans to the maximum permissible. Assuming that capital and

---

[1]Gallatin, letter to Frederick Beasley, September 3, 1836, Writings, II, 512; "Considerations on the Currency," op. cit., pp. 281, 312.

[2]Pp. 420-21.

[3]Ibid.

and real estate remain constant, Gallatin asserted that any increase in the circulation and deposits had to be accompanied by an increase in the "specie or available resources of the bank. And the effect of this would be to strengthen instead of weakening the bank; since the ratio of available resources to liabilities payable on demand would thereby be increased."[1] For example, a new deposit of specie amounting to $200,000 would leave the bank in the condition shown in Figure 11.

Fig. 11.--An American Bank, Balance Sheet (in thousands of dollars).

Specie	$ 500	Circulation and Deposits	$1,200
Loans	1,600	Capital	1,000
Real estate	100		
	$2,200		$2,200

Now, if the bank in question were to extend new loans of $100,000, creating loan deposits of the same amount, and if the borrowers rapidly transferred by check the entire sum to third parties having accounts in other banks, then the situation would be as depicted in Figure 12. The ratio of loans to capital in Figure 12 is 1.7-1, exceeding the permissible limit of 1.6-1. Yet the bank still has a "reserve ratio" of specie to demand liabilities of one-third, which seems quite

---

[1] Ibid., p. 421.

safe by modern standards.[1]

Fig. 12.--An American Bank, Balance Sheet (in thousands of dollars).

Specie	$ 400	Circulation and Deposits	$1,200
Loans	1,700	Capital	1,000
Real estate	100		
	$2,200		$2,200

Banking in the 1840's and banking in the mid-twentieth century are not comparable, however. Bray Hammond shows that the limitations of loans to three times capital and of notes to twice capital were rarely approached in early American banking. In 1948, by way of comparison, loans and investments of American banks were eleven times capital, and deposit liabilities, thirteen times capital. Hammond adds, "There was then more fictitious capital, but not enough to alter the fact that bankers counted much less upon their liabilities to the public than they do now." The limitation of loans relative to capital "was based evidently on the unsophisticated supposition that bank capital would be paid

---

[1]The minimum legal reserve ratios for member banks of the Federal Reserve System, on April 1, 1953, were 14 per cent, 20 per cent, and 24 per cent for country banks, reserve city banks, and central reserve city banks, respectively. Board of Governors of the Federal Reserve System, Federal Reserve Bulletin, XXXIX (April, 1953), 365.

In a speech in Congress on June 29, 1797, Gallatin indicated that a one-third ratio of specie to liabilities "was a general rule for regulating the quantity of cash kept to answer . . . current demands." Annals of Congress, 5th Cong., 1st sess., VII, 412-13.

in specie, and it was intended to insure convertibility."[1] George Tucker, in 1839, criticized Gallatin's proposed limitation of loans relative to capital on the grounds that the capital of the banks typically was not "real," and did not consist of specie.[2]

Gallatin was quite insistent, however, on provisions to insure that capital would be paid in specie,[3] and that the reserves of a bank be "tantamount to specie."[4] Thus, Gallatin approached the idea of a required specie reserve against liabilities only incidentally to his several discussions of other limitations on loans or note issue.[5] Nevertheless, he was in the vanguard in seeing that, for the purpose of maintaining convertibility, the relation between specie and liabilities was strategic.[6] It was not until after 1830, or

---

[1]Hammond, "Banking in the Early West: Monopoly, Prohibition, and Laissez-Faire," op. cit., p. 17.

[2]Cited by Brooks, op. cit., p. 240. See above, pp. 194-95.

[3]"The restrictions can only be made in reference to the capital actually paid in. . . ." "Considerations on the Currency," op. cit., p. 312.

[4]"Suggestions on the Banks," op. cit., p. 420. Hammond would be the first to recognize that Gallatin had thus protected himself against the criticism that capital was often not paid in specie.

[5]"Considerations on the Currency," op. cit., pp. 253, 281, 312, 313; "Suggestions on the Banks," op. cit., pp. 421, 455; Union Committee, op. cit., pp. 73, 77.

[6]Redlich, History of American Business Leaders: A Series of Studies, II, Part II, Molding of American Banking: Men and Ideas, p. 37.

perhaps after the Panic of 1837, that legal specie reserves were contemplated in America. The original New York Free Banking Act of 1838 required a 12 1/2 per cent reserve against bank notes, but this clause was repealed a year later. In 1842, Louisiana permanently adopted a 33 1/3 per cent required specie reserve against all cash liabilities.[1] Grace Madeleine suggests that, by about 1840, many writers acknowledged that a required specie reserve relative to liabilities was desirable, but "the practical difficulties in the way of such compulsion appeared to be insurmountable."[2] Dewey demonstrates the veil of secrecy which typically was drawn over all banking operations, and especially the jealousy with which information as to the state of the specie in a bank's vaults was guarded, even against state inspection.[3]

Gallatin saw clearly the need for bank inspections by public officials, and for publication of the condition of banks. He approved of a requirement in the banking laws of New York providing for inspections, at least once every four months, of the books, specie on hand, general ability to

---

[1]Redlich, ibid., p. 9; Hammond, "Banking in the Early West: Monopoly, Prohibition, and Laissez-Faire," op. cit., p. 17.

[2]Grace Madeleine, op. cit., p. 162.

[3]Dewey, State Banking Before the Civil War, pp. 126-36.

fulfill obligations, etc., of every bank in the state.[1]

As stated above, Gallatin approached the idea of a minimum specie reserve against demand liabilities only incidentally to discussions of other limitations on bank lending activities, so that in this respect his attack on the problem of maintaining convertibility was only indirect. The restriction on liabilities to one and three-fifths capital, however, would have limited effectively the expansion of the money supply by the banking system, as shown below. Thus, Gallatin was interested principally in maintaining specie payments, thinking only secondarily of preventing expansion of the money supply. Paradoxically, however, his proposal to limit loans to one and three-fifths capital would have assured convertibility only in so far as capital was paid and maintained in specie, but the proposal would have limited expansion of the money supply more effectively than do modern reserve requirements.

Assume that the bank in Figure 10[2] is just meeting a dual requirement of a 30 per cent specie reserve against

---

[1]"Suggestions on the Banks," op. cit., pp. 417, 419-20. Cf. "Considerations on the Currency," op. cit., p. 318; letter to R. M. T. Hunter, July 12, 1841, Writings, II, 554.

For Gallatin's description and approval of certain other details of the legal requirements imposed upon New York banks as of 1841, see "Suggestions on the Banks," op. cit., pp. 415-19.

[2]Above, p. 222.

demand liabilities, and of a one and three-fifths limit on loans relative to capital; the bank is "loaned up" in both respects. New deposits of $200,000 are received, bringing about the situation depicted in Figure 11.[1] Now, the 30 per cent reserve requirement would permit the bank to extend additional loans by creating derivative deposits, resulting, perhaps, after the new deposits are drained off to other banks, in the situation represented by Figure 12.[2] The other banks in the system would receive new primary deposits, enabling them to extend additional credit to some multiple of the original $200,000 primary deposit in "An American Bank," after the fashion of the expansion illustrated in Figure 9.[3] Gallatin's proposal, however, would have prevented such an expansion, as shown above. The specie reserve rule permits expansion of the money supply whenever there is an increase in primary reserves; the loans-to-capital rule permits an expansion of the money supply only

---

[1] Above, p. 223.

[2] Above, p. 224.

[3] Above, p. 179. The precise amount of the expansion would depend on further assumptions with regard to the proportion of new primary deposits which the banks saw fit to use as the basis for additional loans. In Figure 12, it is assumed that 50 per cent of the new specie is drained off to other banks; in Figure 9, it is assumed that 85 per cent is drained off in each transaction.

in the less-likely event of an increase in paid-in bank capital.[1]

In addition to the loans-to-capital rule, Gallatin proposed, less emphatically, that the note circulation of banks be limited to a maximum of two-thirds the amount of their capital.[2] In so far as there was any tendency to substitute deposits for notes, this requirement would not have prevented large expansions of credit by creating loan deposits. Loans taken in the form of deposits can jeopardize convertibility and expand excessively the money supply just as readily as can loans taken in the form of bank notes. For banks which had already extended their note issues greatly, and were not prone to use deposits, the limit on circulation to two-thirds of capital would have been restrictive. For example, calculations from Gallatin's data show that on January 1, 1830, country banks in Massachusetts had a ratio of notes to capital of 38 per cent, far below the two-thirds rule; but country banks in New York had a ratio of 93 per cent, and in Pennsylvania, of 104 per cent, and would have

---

[1] Assuming, in both cases, that the banks were previously "loaned up." Under the same assumption, the obverse of the above statement would be as follows: The specie reserve rule forces contraction of the money supply whenever there is a decrease in primary reserves; the loans-to-capital rule forces contraction of the money supply only in the less-likely event of a decrease in paid-in bank capital.

[2] "Considerations on the Currency," op. cit., pp. 312-14; Writings, II, 449.

had to contract their circulation in order to meet Gallatin's requirement.[1]

Safety Fund System

In 1829, New York enacted legislation designed to protect the holders of notes of banks chartered in that state. The Safety Fund Act required the banks to contribute to a fund which was to be used to redeem the notes of any bank that failed. Each bank was required to pay to the treasurer of the state a sum equal to 1/2 of 1 per cent of its capital stock, the payments being made annually until they totalled 3 per cent of capital. If the Fund were depleted by future redemptions of the notes of failed banks, additional payments could be required. The law contained other provisions relating to banks with New York charters, but these are not relevant to the main purpose of the Safety Fund, namely, to provide security to noteholders by a system analogous to modern deposit insurance. As a consequence of achieving

---

[1]Gallatin, "Considerations on the Currency," op. cit., pp. 313-14. The following calculations have been made from Gallatin's data to show the relative importance to country banks, of notes, and to city banks, of deposits, in the states for which information is available; in Massachusetts, country banks had deposits of only 31 per cent of their notes outstanding, whereas city banks had deposits of 93 per cent of their notes; in New York, country banks had deposits of 81 per cent of their notes, whereas city banks had 196 per cent; and in Pennsylvania, the ratios were, for country banks, 49 per cent, and for city banks, 138 per cent.

this main purpose, it was thought that other advantages would follow: prevention of runs on banks, and promotion of greater stability of the monetary system.[1]

Gallatin was extremely critical of the Safety Fund System. First, the law made "properly managed" banks responsible for the conduct of others "at a great distance, and over which they have no control."[2] The result was "a premium given to neglect of duty and to mismanagement, at the expense of the banks which have performed their duty and been cautiously administered."[3] Gallatin thought that the Fund would be less objectionable

> by applying it to each county, or other district of country prescribed by law, respectively. Thus the banks would each be made responsible to the extent of the tax for the banks only within the same county or district. They would all thereby be induced to watch and regulate those in their own vicinity.[4]

Second, the operation of the Act had a tendency to encourage excessive issues of paper. Referring to the promise

---

[1]Robert E. Chaddock, The Safety Fund Banking System in New York, 1829-1866, Senate Documents, No. 581, 61st Cong., 2d sess. (1910), pp. 259-63. For a detailed treatment of the operation of the Fund, see ibid., pp. 270-367.

[2]Gallatin, "Considerations on the Currency," op. cit., p. 318.

[3]"Suggestions on the Banks," op. cit., p. 423; letter to A. C. Flagg, December 31, 1841, Writings, II, 568; letter to John A. Dix, March 30, 1842, Writings, II, 591; Union Committee, op. cit., p. 79.

[4]"Suggestions on the Banks," op. cit., p. 424.

of redemption of the notes of failed banks out of the Fund, Gallatin stated:

> That provision gives a false credit to some institutions, which, not enjoying perfect confidence, would not otherwise be enabled to keep in circulation the same amount of notes; and it therefore has a tendency unnecessarily to increase the amount of paper money.[1]

Third, banks with the greatest capital had to pay in the most to the Fund, city banks paying in about twice as much as the country banks. By implication, Gallatin was saying that the banks that were in the soundest condition had to contribute the most. Yet the country banks were the ones that issued the most notes relatively to their capital. "This . . . does not accord with the principles of a government founded on the equal rights of all."[2]

Fourth, the Fund "provides at best only against ultimate loss, and not at all against the danger of a general suspension."[3] These objections by Gallatin to the Safety Fund System reflect his basic antagonisms toward discrimination, governmental interference, inflation of the currency, and suspension of specie payments. They also reflect the

---

[1] Ibid., p. 423; Writings, II, 591; Union Committee, op. cit., p. 79.

[2] "Considerations on the Currency," op. cit., p. 318; see also ibid., pp. 313-14; Chaddock, op. cit., pp. 238-42, 296-97.

[3] "Suggestions on the Banks," op. cit., p. 423; Writings, II, 591.

fact that he was president of the National Bank of New York, because it was the city banks that were undeniably discriminated against by the law.[1]

Although there was this uneven incidence of the burden of the law, and although it did not prevent the numerous bank failures of 1840 to 1842 which were its ultimate undoing,[2] the Safety Fund System was not a complete failure. It was partially successful in its minimum function, in that holders of the notes of insolvent "free banks," not subject to the Fund, suffered worse than holders of the notes of insolvent banks of the Safety Fund System.[3] More important is the fact that, in Bray Hammond's words, "the fund was a significant and influential experiment in banking control."[4]

---

[1]Grace Madeleine, op. cit., p. 156; Lanier, op. cit., p. 201. For evidence that the opposition to the Safety Fund Law came mostly from the city banks, see Gallatin, writing on behalf of the "Gentlemen connected with the banks" of New York City, letter to John A. Dix, March 30, 1842, Writings, II, 588-91; Chaddock, op. cit., pp. 267-70.

[2]Chaddock, op. cit., pp. 309-49.

[3]Ibid., p. 340.

[4]Board of Governors of the Federal Reserve System, Banking Studies, p. 9. Cf. Chaddock, op. cit., pp. 299, 324-25, 382-88.

CHAPTER VIII

BANK OF THE UNITED STATES

First and Second Banks as Public Institutions

The Bank of the United States, as it operated under each of its charters, was a central bank, and it was as such that Gallatin treated it.[1] He saw the Bank as performing the principal function of controlling the money supply in the country. This function is the distinguishing feature of a central bank.[2] Among other functions, that of acting as the fiscal agent of the government will be emphasized, because of its importance in Gallatin's time and in his monetary writings. Although a central bank may deal with individuals, it "directs a substantial part of its dealings through other banks," and it is concerned with certain "larger interests" than merely those of its

---

[1] Cf. above, pp. 158-59. See also James O. Wetterau, "New Light on the First Bank of the United States," Pennsylvania Magazine of History and Biography, LXI (July, 1937), 263, 270-72; and Walter B. Smith, Economic Aspects of the Second Bank of the United States, pp. 233-63.

[2] A central bank may be a single institution or a system of regional banks with a national governing body.

own stockholders.[1] These "larger interests" would depend upon the philosophy of the times as to the role of the government in the economy, and might vary from an effort to provide price stability and order in the money markets, to an effort "to do its share in creating conditions favorable to sustained high employment, stable values, and a rising level of consumption."[2] Some writers add that, ideally, the central bank should be the sole bank of issue, hold the reserves of other banks, and be the principal depository of the gold of the country.[3]

---

[1]Henry Parker Willis, The Theory and Practice of Central Banking (New York: Harper & Brothers, 1936), pp. 5-9, 21; Currie, op. cit., p. 34; Board of Governors of the Federal Reserve System, The Federal Reserve System--Its Purposes and Functions, p. ix.

[2]Board of Governors of the Federal Reserve System, ibid., p. 1. Cf. Taus, op. cit., pp. 3-4. Gallatin thought in terms of the more limited objectives of price stability and maintenance of convertibility.

[3]Henry Thornton, a contemporary of Gallatin, made these points. His thinking was influenced by the British experience during the Period of the Restriction, in which notes of country banks were inconvertible into gold, but were convertible into Bank of England notes. The Bank of England had become the principal holder of the gold reserves of the country. For Thornton's ideas on central banking, see Rist, op. cit., pp. 383-95; Mints, op. cit., pp. 53-56. Gallatin, on the other hand, preferred that all banks maintain convertibility into specie, hence, that they hold sufficient specie reserves in their own vaults to accomplish this purpose. See above, pp. 76-101.

For opinions of English bankers in the 1920's to the effect that a central bank should be the sole bank of issue, and should hold the reserves of the country, see the quotations in Taus, op. cit., pp. 3-4, and Willis, op. cit.,

Gallatin, in defending central banking by the First and Second Banks of the United States, felt obliged to reply to the argument that the Banks were unconstitutional. The Jeffersonians and Jacksonians, with few exceptions, declared that the creation of a national bank was not among the powers delegated to the federal government. They also feared the erection of a financial power allegedly independent of the government.[1]

With regard to the First Bank, Gallatin asserted its constitutionality as a corollary of the fact of its great utility to the government. He showed that banks were "necessary" to the government "for the punctual collection of the revenue,[2] and the safekeeping and transmission of public

---

pp. 21-22.

For miscellaneous other aims and functions of a central bank, see C. O. Hardy, Credit Policies of the Federal Reserve System (Washington: Brookings Institute, 1932), pp. 16-17; G. L. Bach, Federal Reserve Policy-Making (New York: Alfred A. Knopf, 1950), pp. 19-20; Willis, op. cit., pp. 9-20.

[1] See, e. g., The Works of Thomas Jefferson, X, 56-58; Beard, op. cit., pp. 154-59; Schlesinger, op. cit., pp. 90-91; and certain of Jackson's messages to the Congress, in James D. Richardson, ed., A Compilation of the Messages and Papers of the Presidents, 1789-1897 (Washington: Government Printing Office, 1896-99), II, 462, 576, 581; ibid., III, 302-4.

[2] Because customs duties were not payable immediately upon receipt of imported goods, the importers had to furnish "revenue bonds" or "customs bonds" to the government pending payment. The Bank of the United States frequently assumed these bonds, enabling the government to collect its revenues

moneys." For these purposes, the Bank of the United States was the "most convenient." As contrasted to the state banks, the Bank of the United States was more useful, and more secure by virtue of its greater capital.[1]

In 1803 when Gallatin was trying to convince Jefferson of the necessity to the Treasury of a branch in New Orleans of the Bank of the United States, he argued as follows:

> The great advantages we derive from banks, and especially from the Bank of the United States, are:
> 1st. A safe place of deposit for the public moneys.
> 2d. The instantaneous transmission of such moneys from any one part of the continent to another, the bank giving us immediate credit at New York, if we want it, for any sum we may have at Savannah, or at any other of their offices, or vice versa.
> 3d. The great facility which an increased circulation and discounts give to the collection of the revenue.[2]

In his reports to the Congress, Gallatin intended to show that the Bank was "necessary and proper" to the execution

---

immediately. "The punctuality of payments introduced by the banking system, and the facilities afforded by the bank of the United States to the importers indebted for revenue bonds, are among the causes which have enabled the United States to collect with so great facility and with so few losses, the large revenue derived from the impost." Gallatin, report to Congress on the "Bank of the United States," March 2, 1809, American State Papers, Finance II, 352. Cf. John T. Holdsworth, The First Bank of the United States, Senate Documents, No. 571, 61st Cong., 2d sess. (1910), pp. 63-66.

[1]Gallatin, "Bank of the United States," American State Papers, Finance II, 352; also, Gallatin's report to Congress of January 30, 1811, ibid., 481.

[2]Writings, I, 171.

of functions delegated by the Constitution to the federal government, hence, that the Bank was constitutional. To refute the argument that it was not "necessary" because state banks could be used as the fiscal agent of the government, Gallatin added that the "General Government" should not be "entirely dependent on institutions over which it has no control whatever." Unlike the state banks, the National Bank had both a greater interest and a greater sense of duty "to afford to the Union every assistance within its power."[1] Gallatin then referred directly to the issue of constitutionality. Because the Bank charter had, "for a number of years, been acted upon, or acquiesced in, as if constitutional," and because the Bank was "necessary" for the legitimate powers of the federal government, it did not seem to him that the Bank was unconstitutional.[2]

In his "Considerations on the Currency," some twenty years later, Gallatin gave greater attention to the issue of constitutionality. He refused to base his argument upon the clause in the Constitution empowering Congress to "provide for the . . . general welfare of the United States." Gallatin was a strict constructionist with regard to this

---

[1]Gallatin, "Bank of the United States," American State Papers, Finance II, 352.

[2]Ibid., p. 481.

clause.[1] Rather, he thought that the Bank was "sanctioned exclusively by that clause which gives to Congress power to make all laws which shall be necessary and proper for carrying into execution any of the powers vested in the government of the United States."[2]

In a long discussion, Gallatin indicated that, in his opinion, the "necessary and proper" clause did not mean "absolutely necessary." Since there are almost always alternative means of accomplishing a given purpose, no one means is "absolutely necessary." The question, then, was whether "some other equally efficient mode" besides his proposals for a prohibitive stamp tax on state bank notes,[3] or a regulatory Bank of the United States, could be found to carry out the constitutional powers of Congress to regulate the value of the currency, provide for uniform taxation, and prevent the impairment of contracts.

On the other hand, "means proposed for carrying into effect any special or expressed power vested in Congress should be highly useful and important, having clearly and bona fide that object in view which is the avowed purpose," and not some disguised motive. The chartering of the Bank

---

[1] "Considerations on the Currency," op. cit., pp. 321-25.

[2] Ibid., p. 325.

[3] See above, p. 139.

of the United States, in 1791, was opposed on the grounds that the real, although hidden, motives were "the consolidation of a moneyed aristocracy, and to further the views at that time ascribed to a certain party and to its presumed leader."[1]

In 1831, Gallatin did not believe that the Bank of the United States would further "a moneyed aristocracy."[2] Moreover, "Experience . . . has confirmed the great utility and importance of a bank of the United States in its connection with the Treasury." He recited the advantages to the government of the Bank, in much the same language as in his 1809 and 1811 reports on the "Bank of the United States." He emphasized that the Bank transmitted gratuitously and "at a moment's warning" government funds from place to place within the country.[3]

Having had experience with state bank notes varying greatly in value from place to place at any one time, Gallatin now added another argument designed to show the consti-

---

[1]"Considerations on the Currency," op. cit., pp. 327-28.

[2]He recommended certain modifications of the charter of the Bank, however, designed to assure that the Bank would further the public interest. See below, pp. 260-64.

[3]"Considerations on the Currency," op. cit., pp. 328-29. For an exceptional case, in 1818 and 1819, in which the Bank limited the places in which it would honor Treasury drafts, see the letter from William H. Crawford to Gallatin, July 24, 1819, in Gallatin's Writings, II, 112-15.

tutional necessity of a national bank. The Bank of the United States, by presenting for prompt redemption state bank notes that came into its hands, helped to assure convertibility into specie. A uniform currency was thereby promoted, thus meeting the minimum requirement for uniform taxation in that persons in different parts of the country would pay their taxes in currencies of equal value relative to specie.[1] Constitutionally, Congress was bound to assure a uniform currency, and Gallatin thought that this could be accomplished either by a prohibitive tax on state banks notes, in order to bring about a metallic currency, or by a regulatory national bank. Therefore, Congress had the right to establish a national bank under both the "necessary and proper" clause and the requirement that Congress should make provision for a uniform currency.[2]

---

[1]See above, pp. 93-94.

[2]The 1819 Supreme Court decision in the case of McCulloch vs. The State of Maryland had upheld the constitutionality of the Second Bank, in elaborating the doctrine of implied powers. "Let the end be legitimate," Chief Justice Marshall had said, "let it be within the scope of the constitution, and all means which are appropriate, which are plainly adapted to that end, which are not prohibited, but consistent with the letter and spirit of the constitution, are constitutional." McCulloch vs. The State of Maryland, 4 Wheaton 421. Marshall cited the public functions served by the Bank of the United States, and added that the state banks could not perform them as well.

In 1824, the Supreme Court reaffirmed its 1819 decision, making more explicit the fact that the Bank of the United

In the course of stating the advantages to the government, of the First Bank of the United States, Gallatin replied in part to the most telling argument against renewal of the charter, namely, that it was dominated by foreigners. It was true, he acknowledged, that the high percentage of foreign stockholders in the Bank necessitated an annual remittance abroad of the dividends, with a consequent drain of resources from the United States. He turned the tables on this argument, however, by showing that if the bank were liquidated the foreigners' proportion of the capital, $7,200,000, would have to be remitted abroad at once.[1] Thus, the renewal of the charter would act "as a foreign loan, bearing an interest of 8 1/2 per cent. a year."[2] In general, Gallatin believed that any disadvantages of foreign ownership of part of the stock of the Bank were more than offset by the services the Bank rendered the country.

There were other advantages of the Bank of the United States to the government. As has been stated, the Bank made

---

States was not a "mere private corporation"; it was created not principally for profit, but for "public and national purposes." Osborn vs. The Bank of the United States, 9 Wheaton 859-60.

[1]That this proved to be the case, and was a factor contributing to the suspension of specie payments in 1814, see above, p. 97.

[2]Gallatin's 1809 report on the "Bank of the United States," American State Papers, Finance II, 352. The 8 1/2 per cent a year was the average dividend rate of the Bank.

direct loans to the government, and assisted the Treasury to borrow from the public.[1] In 1831, Gallatin discussed the role of the Bank of the United States in assisting war financing by the government. With the outbreak of a war, the government needs additional funds, requiring the levy of new taxes.

> The utmost diligence and skill cannot render such new taxes productive before twelve or eighteen months. The estimated amount must be anticipated, and advances to that extent . . . may justly be expected from the Bank of the United States.[2]

In addition to such direct loans, the Bank would "powerfully assist" the process of Treasury borrowing in the money market. The Bank would do so "by affording facilities to the money-lenders," especially by making advances to them to meet installments on the government securities. This would prevent "glutting the market" with sales of the securities when new installments came due, and would thereby tend to support the market for the government stocks.[3]

Another advantage of the Bank of the United States to the fiscal affairs of the government was the profit derived by the federal government on its ownership of stock in the Bank. Gallatin presented this argument only in connection

---

[1] Above, p. 27. Cf. Writings, I, 228.

[2] "Considerations on the Currency," op. cit., p. 346.

[3] Ibid.

with the First Bank. As early as 1796, he pointed out that the government owned five thousand shares of stock in the Bank, and that these shares were purchased with the two million dollars lent by the Bank at 6 per cent interest. Therefore, the difference between the 6 per cent paid to the Bank and the 8 1/2 per cent average annual dividend was a source of profit to the government.[1]

To conclude the discussion of Gallatin's treatment of the Bank of the United States as a fiscal agent of the government, it is necessary merely to confirm his judgment as to its great utility. Both the First and Second Banks were the principal depositories for government funds, until President Jackson had the federal deposits removed from the Second Bank in 1833.[2] Both the First and Second Banks transmitted, with rare exceptions, government funds without cost to the government. This was a valuable service,[3] which the state banks could not have performed as well.

---

[1]"A Sketch of the Finances of the United States," op. cit., p. 97. Cf. Holdsworth, The First Bank of the United States, p. 73.

[2]Walter B. Smith, op. cit., pp. 160-77. For the extent of the government deposits in the Bank, see ibid., pp. 48-51; Gallatin, report on "Public Deposites in Banks," American State Papers, Finance II, 216-18; Wetterau, op. cit., p. 272; Holdsworth, The First Bank of the United States, pp. 53, 58.

[3]Catterall, op. cit., p. 467.

In fact, both the First and Second Banks got the "lion's share" of the foreign and domestic exchange business for the country as a whole by virtue of their superior resources, wide distribution of their funds, and universal recognition of drafts on their branches.[1] Whereas both the First and Second Banks transmitted government funds domestically without cost to the government, they levied a charge for the transmission of funds for all others; that is, they sold drafts at a slight premium. The size of the premium varied with the distance involved. This was the source of considerable profit to the Banks,[2] and was probably the basis for the assertion by Jackson that the Second Bank had failed to provide a uniform currency.[3] Gallatin's extended reply provides as good an answer as any to Jackson's argument. Although it was true that drafts of the Bank and its branches were received at par only at the place of issue, Gallatin showed that this was only because it involved an expense to transmit funds from one place to another.

---

[1]Holdsworth, The First Bank of the United States, pp. 54-55; Wetterau, op. cit., p. 271; Walter B. Smith, op. cit., pp. 42-46; Catterall, op. cit., pp. 140-63.

[2]Holdsworth, The First Bank of the United States, pp. 54-55; Grace Madeleine, op. cit., pp. 35-36; Walter B. Smith, op. cit., p. 44; Catterall, op. cit., pp. 141-42.

[3]Gallatin letter to Biddle, August 14, 1830, Writings, II, 438; Catterall, op. cit., pp. 194-95.

> The objection is reduced to the simple fact that individuals who may still hold such notes cannot always exchange them at par at a place distant from that where they are payable. . . . When this objection is made, what in fact is complained of is, that the bank will not, or cannot, transfer the funds of individuals, as well as those of the public, from place to place gratuitously,--an operation which has no connection with the uniformity of currency.[1]

In 1841 he restated the argument. A new Bank might "bring exchange nearer to par," that is, transmit funds more cheaply,

> But it is a great error to suppose that it can afford a generally uniform currency, or one which shall at the same time be of the same value in all places. This is to confound exchange and currency, and to suppose that paper money may not only be a true representative of gold and silver, but can perform that which gold and silver cannot accomplish.[2]

For all practical purposes, the Bank of the United States furnished a uniform currency, as Catterall says, because the discount "was always small, and did not affect the mass of the people, since the smallest denomination of the bank's paper was receivable at par wherever there was

---

[1] "Considerations on the Currency," op. cit., p. 342. See also "Suggestions on the Banks," op. cit., p. 452; Writings, II, 438.

[2] "Suggestions on the Banks," op. cit., p. 452. As a matter of fact, some of the obligations of the First and Second Banks were an even better currency than Gallatin gave them credit for being, since, in the Ohio valley, their notes "commonly carried a premium over coin because they could be used for interregional exchange"; Berry, op. cit., p. 540.

an office of the bank, and all the notes were receivable at par in payments to the government."[1] In the United States before the Civil War, internal communications and a clearing system for bank obligations were not yet so well developed that funds ordinarily could be transmitted at so negligible a cost that the bank could bear the expense.

The soundness of Gallatin's views that the central bank was extremely useful as a fiscal agent to the government is further attested to by the fact that the First Bank established certain of its branches solely because of the desires of the Secretary of the Treasury, thereby aiding the Treasury in its fiscal operations.[2] Wetterau adds the following points: The Bank of the United States acted as an agent for subscriptions to new government loans, and for paying the salaries of government officials. It cooperated with the Mint in holding government bullion and foreign coins, turning

---

[1]Ralph C. H. Catterall, "The Successes and Failures of the First and Second Banks of the United States," Academy of Political Science, Proceedings, I (1910-11), 208; Gallatin, "Considerations on the Currency," op. cit., pp. 341-43. Cf. Catterall, The Second Bank of the United States, pp. 137-40; Walter B. Smith, op. cit., pp. 236-37. Grace Madeleine points out that "Under freely competitive conditions the rate of premium or discount on bills would be settled by the forces of supply and demand operating at any given time, the remedy against undue exactions being the alternative of transmitting specie." Op. cit., p. 35.

[2]Wetterau, op. cit., p. 272; Holdsworth, The First Bank of the United States, p. 73.

them over to the Mint as necessary. Finally, as pointed out above, it aided the Treasury in the collection of customs bonds.[1] The Second Bank served equally well as a service agency for the government.[2]

First and Second Banks As Regulators of the Currency

More important, if anything, than service as a fiscal agent for the government is the task of regulating the currency. Both the First and Second Banks of the United States performed this central banking function by continually presenting for redemption in specie the state bank notes that came into their possession. It thus prevented them from extending their discounts so far that they had more notes in circulation than they were able to redeem in specie upon demand. The result was that bank notes tended toward par with specie, hence toward uniform value. In addition to being far safer for the noteholder, the money supply was to some degree prevented from rising unduly. Gallatin described this regulatory process and emphasized its importance.[3] He

---

[1]Wetterau, op. cit., pp. 271-72.

[2]Catterall, The Second Bank of the United States, pp. 453-77.

[3]"Considerations on the Currency," op. cit., pp. 334, 336; "Suggestions on the Banks," op. cit., p. 395. Cf. Catterall, The Second Bank of the United States, p. 435;

believed that the stability of the currency and "a just performance of contracts" depended almost entirely upon the actions of the Bank of the United States.[1]

If the Bank of the United States was to have more notes of the state banks to present for redemption than the state banks had notes of the National Bank, it required that the latter maintain a creditor status in relation to the state banks. That is, it was necessary for the Bank of the United States to keep its discounts moderate in amount as compared to those of the state banks in order to remain their creditor.[2] Gallatin thought that the actions of the Second Bank had been "irreproachable" in keeping its issues "extremely moderate and its treasure considerable" as late as November, 1830, when he was writing his essay for Walsh's Review.[3]

In "Considerations on the Currency," Gallatin presented the imperfect data from which he drew his conclusion that the Second Bank had restrained the state banks and had not

---

Hammond, "Jackson, Biddle, and the Bank of the United States," op. cit., pp. 2-3; Holdsworth, The First Bank of the United States, p. 51.

[1]Gallatin, letter to Robert Walsh, Jr., April 27, 1830, Writings, II, 426; "Considerations on the Currency," op. cit., p. 336.

[2]"Suggestions on the Banks," op. cit., p. 395; letter to Palmer, May 1, 1833, Writings, II, 461.

[3]Letter to Palmer, ibid. He cautioned Biddle, however, against further increases in his circulation relative to specie; letter of August 14, 1830, Writings, II, 434.

itself overissued. For all state banks, including those for which he had estimates only, circulation was reduced from $66,000,000 to less than $40,000,000 between 1816 and 1820. In the same period, the Bank of the United States began operations and issued $4,000,000 of notes. From 1820 to 1830, Gallatin calculated that "the whole amount of the paper currency has during those ten years increased about forty-five, and that portion which is issued by the State banks only twenty-two and a half per cent."[1]

The fact that the Bank of the United States had restricted the expansion of the state banks, while itself meeting the increased monetary needs of a nation growing in wealth and population, was proved, he thought, by the frequent complaints that the Bank "operates as a screw." Relative to capital and specie, however, Gallatin concluded that the state banks had been restrained no more than the Bank restrained itself; and the dividends of the former "certainly far exceeded" those of the Bank of the United States.[2] By 1832 or 1833, however, Gallatin believed that

---

[1]"Considerations on the Currency," op. cit., p. 334.

[2]Ibid., pp. 335-36. Calculations from Gallatin's data on reporting banks indicate that, on January 1, 1830, 281 state banks had a ratio of specie reserves to demand liabilities of 16.7 per cent, while the Bank of the United States had a reserve ratio of 25 per cent. The reserve ratio of the state banks certainly does not appear to be too conservative in view of the record of bank failures. See Appendix

the Bank had lost its power to regulate the currency, because its discounts and issues had become excessive.[1]

There were other reasons why the Bank of the United States was able to maintain a creditor relationship with the state banks. The Bank was the collector of all the revenues of the federal government, much of which came to the Bank in the notes of state banks. Moreover, by agreement with the Secretary of the Treasury, the Bank was to decide what notes it would accept as equivalent to specie in payments to the government. These factors, together with the refusal to receive its own branch paper at par, helped assure that the Bank of the United States received

---

IV, ibid., pp. 360-62. These figures should be accepted only as approximations. The data accepted by Smith and Cole indicate that the total money supply, including deposits, increased by 44.5 per cent during the 1820's. Op. cit., p. 39. Catterall states that the note issues of the state banks were never as large between 1817 and 1830 as they were in 1816. He thought that this was a wonderful improvement, and he cited Gallatin to the effect that it was attributable almost wholly to the Second Bank. Catterall, The Second Bank of the United States, p. 444.

[1] "Suggestions on the Banks," op. cit., p. 394. Catterall disagrees, pointing out that the state banks as a whole were in debt to the Bank of the United States "at almost every moment of its existence," and as late as the year 1834. Catterall, The Second Bank of the United States, pp. 435, 451. In Gallatin's defense, it should be pointed out that a relative increase in the amount of discounts by the Bank after 1830 might have caused it to lose its creditor status with particular banks, even if not with the state banks as a whole, and to that degree lose its regulatory power. See the data in Appendix V of Catterall, ibid., pp. 501-3.

more notes of the state banks than vice versa.[1] Similar considerations apply to the First Bank, which was very conservatively managed, and kept both its loans and its note issues lower than its ten million dollar capital.[2]

Gallatin believed that the Bank of the United States was instrumental in achieving and maintaining convertibility of notes into specie. He thought that the suspension of 1814-1817 would not have occurred if the original Bank of the United States had been rechartered, that the resumption in 1817 was attributable to the efforts of the new Bank, and that the decline sometime before 1836 of the latter as a socially-responsible central bank was a principal reason for the large increase in banks and note issues that contributed to the general suspension of 1837.[3]

---

[1]Catterall, ibid., pp. 434-37.

[2]Holdsworth, The First Bank of the United States, pp. 49-51; Wetterau, op. cit., pp. 271, 282-84.

[3]"Considerations on the Currency," op. cit., pp. 282-86; section entitled "Causes and Incidents of the Bank Suspensions," in "Suggestions on the Banks," op. cit., pp. 385-406, passim; Adams, op. cit., pp. 474-75. Dewey agrees that the rash of state banking after the demise of the First Bank contributed to the suspension of specie payments in 1814. Financial History of the United States, pp. 144-45. There were other powerful forces contributing to the suspension, however, and it is doubtful that the First Bank, had it been rechartered, could have prevented the general suspension. The evidence is much stronger that the Second Bank, by pledging its financial support to those banks that undertook to resume specie payments, was instrumental in bringing about general resumption in 1817. Catterall, The Second Bank of

The knowledge that particular banks could be restrained in their note issue by being called upon for frequent redemption in specie of their notes led Gallatin to advocate the widespread use of facilities for clearing balances due between banks. He knew that a system for frequent clearings and collections would facilitate the banking business in any given locality, and he saw that adequate provision for clearings would limit the expansion of any one bank to that which could be sustained by its specie reserve. More than that, however, Gallatin apparently believed that adequate clearing facilities would prevent excessive issues and consequent depreciation of the notes of the banking system as a whole.[1]

---

the United States, pp. 23-26; Hammond, "Jackson, Biddle and the Bank of the United States," op. cit., pp. 3-4; Walter B. Smith, op. cit., pp. 103-5.

McGrane argues that Jackson's removal of the public deposits and destruction of the Second Bank were first in time and importance as causes of the speculative bubble of 1836-37, the suspension of specie payments of 1837, and the panic of that year. Op. cit., pp. 91-92. Smith believes that the operations of the Bank under its state charter after 1836 contributed to the instability, but were not primary causes. Op. cit., pp. 255-61. The stimulus to the state banks by the receipt of federal deposits, and by other policies of the government, contributed to the 1836-37 speculation and instability, according to Smith. Ibid., pp. 184-85.

[1]Gallatin, Note B, "On Scotch Banks," appended to "Considerations on the Currency," op. cit., pp. 348-50; "Suggestions on the Banks," op. cit., pp. 424-25. Cf. Mints, op. cit., p. 136.

Gallatin was the first writer in America to suggest a clearing house for New York, according to Redlich.[1] Gallatin maintained that

> a general cash office might be established, in which each bank should place a sum in specie proportionate to its capital, which would be carried to its credit in the books of the office. Each bank would be daily debited or credited in those books for the balance of its account with all the other banks. Each bank might at any time draw for specie on the office for the excess of its credit beyond its quota, and each bank should be obliged to replenish its quota whenever it was diminished one-half, or in any other proportion agreed on.[2]

Similar arrangements might be made in other districts, Gallatin suggested, except that in order to obviate the necessity of establishing the cash office, "the balances due by the banks in each district might be paid by drafts on New York, or any other place agreed on."[3] For the country as a whole, however, Gallatin believed that an adequate clearing system was impractical.

Gallatin saw in such a system much more than convenience to the banking and business community. He thought it would prevent dangerous expansions of the money supply. Note his comments on the system of clearings and collections in Scotland:

---

[1]Redlich, A History of American Business Leaders: A Series of Studies, II, Part II, The Molding of American Banking: Men and Ideas, 47.

[2]"Suggestions on the Banks," op. cit., pp. 424-25.

[3]Ibid., p. 425.

> The great and efficient method of preventing the over-issuing of bank-notes and the depreciation of their value consists in the practice, rigorously adhered to by all the banks, of exchanging each other's notes twice a week, and paying immediately the balances. The state of those balances is looked at by the banks with the utmost jealousy and attention: . . . if anything in any degree wrong were to appear, the banks would instantly correct it, and force a bank acting improperly to alter its mode of conduct. This method is the same which, tho with less rigor and uniformity, is successfully used by the allied banks of Boston, and by the Bank of the United States, for preventing excessive issues of paper.[1]

Gallatin is correct in saying that adequate clearings would tend to prevent individual banks from incurring demand liabilities in excess of their ability to convert them into specie. This would tend to prevent depreciation of notes relative to specie. Moreover, the same banks that tended to grant excessive credit and issue excessive bank notes were also the ones that became net debtors in their relations with other banks.[2] Therefore, adequate provision for clearings or redemption certainly would have dampened inflationary increases in the money supply on the basis of a given amount of reserves.

As Mints points out, however, to prevent excessive issue by individual banks is not necessarily to prevent an

---

[1]"Considerations on the Currency," p. 350. Gallatin does not discuss further the Safety Fund System of the Boston and other Massachusetts banks.

[2]See above, p. 249.

increase in the money supply.[1] If, for example, there is an influx of specie into the banking system, providing additional reserves, the banks as a whole could expand by several times their fractional reserves.[2] Even though frequent clearings or the necessity for redemption in specie might prevent excessive issue relative to reserves, it may not have prevented inflationary increases in the money supply.

Some general conclusions are possible with regard to the role of the First and Second Banks of the United States in regulating the money supply. In the first half of the nineteenth century, the United States was expanding rapidly, and, as Hammond points out, the principal task of the central bank was to restrain the banking system from contributing to over-rapid expansion.[3] Both the First and Second Banks performed invaluable services to the economy in checking the loans and note issues of the state banks.[4] When Jackson and

---

[1]Mints, op. cit., pp. 105-7.

[2]See above, pp. 177-79.

[3]Hammond, "Jackson, Biddle, and the Bank of the United States," op. cit., pp. 3, 9. Cf. Gallatin's letter to Chevalier, September 14, 1841, Writings, II, 556.

[4]Wetterau, op. cit., pp. 283-84; Catterall, "The Successes and Failures of the First and Second Banks of the United States," p. 202; Walter B. Smith, op. cit., pp. 236-37; Berry, op. cit., pp. 125, 405, 417.

The one period during which the Bank did not exercise

his supporters destroyed the Second Bank as a public institution, they fomented the very evils they deplored.[1]

Although it is true that the general role of the Bank of the United States as a central bank was to check over-rapid expansions, it also consisted, to some extent, of affording relief by easy credit policies in times of contraction. Generally speaking, the First Bank and the state banks cooperated with each other, the Bank of the United States aiding the other banks when they were distressed.[2] Also, the Second Bank on occasion "afforded ease as holder of the ultimate reserves and lender of last resort."[3]

---

sufficient restraint, especially in its own discounting, was from 1817-18. Smith, op. cit., pp. 104-7, 252; Catterall, The Second Bank of the United States, p. 439.

[1]Hammond, "Jackson, Biddle, and the Bank of the United States," op. cit., p. 8; Gallatin, "Suggestions on the Banks," op. cit., pp. 390-92.

[2]Holdsworth, The First Bank of the United States, pp. 41, 125. Holdsworth mentions an exception to this policy of extending aid to banks when they were pressed: during a period of "financial stringency" in 1796, the New York branch of the Bank of the United States looked to its own interests and put undue pressure upon the Bank of New York; ibid., pp. 41-42. Wetterau says of the First Bank that "It acted to prevent excessive drains of specie from the United States. It cooperated with the Treasury in relieving occasional stresses and strains in the chief money markets"; op. cit., pp. 272, 273.

[3]Hammond, "Jackson, Biddle, and the Bank of the United States," op. cit., p. 3. See also Walter B. Smith, op. cit., p. 253. Again there are exceptions: the Bank may have aggravated the depressions of 1819 and 1834 by contracting excessively, even though the role of the Bank was a minor one. Smith, op. cit., pp. 118-25, 252.

To summarize, the two Banks of the United States were central banks, and Gallatin supported them on that account. He was keenly aware of the central bank function of regulating the money supply. He saw clearly the role of the Bank of the United States in checking inflationary expansions. Since the purposes of restraining the state banks and preserving specie payments were his overwhelming considerations, Gallatin's discussions of central banking as it operated in times of economic contractions were few and far between. Nevertheless, in several instances he did recommend that the central bank adopt counter-deflationary policies.[1] And in 1841 he made the following excellent statement of the role in contractions of a central bank adequately supplied with specie:

> In that case the bank would be the great reservoir which might, if applied properly, supply sudden demands, and at critical times sustain the other banks, protect the local currency, and lessen the commercial distress.[2]

The means of regulating the currency that Gallatin proposed and that the Bank of the United States exercised were simple and direct. The central bank, in a creditor relationship to the state banks, restrained them by frequently presenting their notes for redemption in specie. Control of

---

[1] See above, pp. 146-49, 156-57.

[2] "Suggestions on the Banks," op. cit., p. 455.

this sort was more efficient in some respects than that exercised by the Federal Reserve banks in the mid-twentieth century.[1]

The Federal Reserve banks are in a debtor relationship to the banks that are to be controlled, since they hold as deposit liabilities the reserves of the member banks. Control over the money supply depends on the ability of the central bank to influence the size of the earning assets of the member banks by acting upon their reserves. An effort to contract the money supply may be nullified, however, if the effect of higher legal reserve requirements or of "open-market" sales of securities is merely to utilize "excess reserves." Or, an effort to expand the money supply may be nullified if the effect of lower reserve requirements or of "open-market" purchases is merely to create or increase "excess reserves."[2] Moreover, according to Currie, the prevailing repugnance of the member banks to indebtedness to the Federal Reserve banks has made manipulation of the rediscount rate obsolete as a method of control. In short, the

---

[1]Cf. Hammond, "Jackson, Biddle, and the Bank of the United States," op. cit., p. 2.

[2]Federal Reserve Banks are empowered, within limits, to extend direct loans to non-banks, as did the Bank of the United States. These direct loans are used sparingly, however. Edwin W. Kemmerer, The ABC of the Federal Reserve System (11th ed.; Princeton: Princeton University Press, 1938), pp. 163-66.

regulatory powers of the central bank are weakened because so much initiative still lies with the commercial banks in determining what the size of their reserves and of their earning assets shall be.[1] In many respects, the technique of central banking of which Gallatin approved was the more effective. On the other hand, the Bank of the United States could not prevent expansion of the money supply, even if it were undesirable from the standpoint of stability of prices and incomes, when there was an increase in the specie reserves of the banking system. For Gallatin's day, however, the latter problem was the more remote.

Charter Modifications

Although Gallatin recognized that the two Banks of the United States were performing central banking functions, he thought that they could be made still more responsible. On several occasions, he recommended various changes in their charters. These changes were designed to make the Bank more

---

[1] On the methods and limitations of control over the money supply under the Federal Reserve System, see Currie, op. cit., pp. 65-68, 103, 124, 131-33, 136-37, and passim. Currie is optimistic that monetary weapons can be made more effective, however. See also Board of Governors of the Federal Reserve System, Federal Reserve Policy, No. 8 of Postwar Economic Studies (Washington, 1947). Karl R. Bopp contends that the "so-called tradition against rediscounting" has been exaggerated. "Three Decades of Federal Reserve Policy," ibid., pp. 5-7.

responsible and more efficient in its role as a semi-public institution.

In his 1809 report on the "Bank of the United States," Gallatin proposed the following modifications in the charter if it were to be renewed after 1811, in order "to give to the institution all the public utility of which it is susceptible":[1]

1. The Bank should pay interest on the public deposits whenever they exceed three million dollars.

2. The Bank should be required, if called upon, "to lend to the United States a sum not exceeding three-fifths of its capital, at a rate of interest not exceeding six per cent."[2]

3. The capital stock should be increased from ten million dollars to thirty million dollars. Of the capital, five million dollars were to be subscribed by citizens of the United States; fifteen million by such states as may desire it, with a branch of the Bank to be established in every such state; and the remainder by the federal government. Payments of capital were to be in specie or in securities of the federal government, and were spread out over ten installments.

4. The federal government should appoint a "few" of the

---

[1] American State Papers, Finance II, 352.

[2] Ibid., p. 353.

directors, and the subscribing states a "few" of the directors of the branch in their state.

The social utility of these proposals, Gallatin thought, would accrue from the interest on government deposits; the available loans up to eighteen million dollars; the gradual increase in capital, "not more rapid than may be required by the progressive state of the country";[1] and the fact "that the Bank itself would form an additional bond of common interest and union, amongst the several States."[2]

In his "Considerations on the Currency," Gallatin indicated the ways in which the Bank of the United States was held socially accountable:

> Placed under the control of the general government, relying for its existence on the correctness, prudence, and skill with which it shall be administered, perpetually watched and occasionally checked by both the Treasury Department and rival institutions and without a monopoly, yet with a capital and resources adequate to the object for which it was established, the bank . . . affords the strongest security which can be given with respect to paper not only for its ultimate solvency, but also for the uninterrupted soundness of its currency.[3]

Writing to Nicholas Biddle in 1830, Gallatin pointed out that the opposition to the First Bank had not been so

---

[1] Ibid.

[2] Ibid.

[3] "Considerations on the Currency," op. cit., pp. 333-34. Cf. Gallatin letter to Palmer, May 1, 1833, Writings, II, 462-63.

widespread as it then was to the Second, yet the First Bank had been defeated in its effort at recharter. Therefore, he advised Biddle to compromise with his opponents in order to enhance the possibilities of recharter. Gallatin made the following proposals:

1. Tax the interest revenues derived in the process of issuing the notes of the Bank of the United States. Such a tax would enable the public to participate in the economy realized by the substitution of paper money for specie.

2. Undertake at par transactions for the general public in inland drafts and bills of exchange. Admitting that parity of exchange and a uniform currency were not the same thing, nevertheless it would be well to propitiate the opposition to the Second Bank by transmitting gratuitously funds between branches of the Bank.[1]

3. Alternatively to the tax on the interest revenues from notes issues, provide for the public to share in the Bank's dividends over a certain rate. The Bank was entitled to "a reasonable profit" in addition to the usual interest on its capital, but the United States was "justly entitled to participate in the advantages which the bank derives from its charter, by being permitted to issue paper and to

---

[1]Gallatin, letter to Nicholas Biddle, August 14, 1830, Writings, II, 435-39.

extend its operations over the whole country."[1]

Biddle refused to compromise, however, and the battle between him and Jackson grew increasingly bitter after 1832.[2]

It is not inconceivable that the compromises and charter modifications that Gallatin suggested might have placated Jackson and made the Second Bank an even more socially useful instrument, if they had been adopted before the height of the "Bank War." As it was, the Jacksonians killed the Bank, and there was no centralized control over the monetary system of the United States for the next three-quarters of a century.[3]

---

[1] Ibid., p. 437. See also "Considerations on the Currency," op. cit., p. 340.
Note the similarity of Gallatin's proposal to that in the recent Report of the Subcommittee on Monetary, Credit, and Fiscal Policies of the Joint Committee on the Economic Report, in which it is proposed that a franchise tax be enacted on the net earnings of the Federal Reserve Banks in excess of dividend requirements, to replace the voluntary contributions now being made to the Treasury by the Board of Governors. Senate Documents, No. 129, 81st Cong., 2d sess. (1950), p. 51.

[2] Grace Madeleine, op. cit., pp. 52 ff.; Schlesinger, op. cit., pp. 74-114; Catterall, The Second Bank of the United States, pp. 195-214 and passim.

[3] Five years after the expiration of the charter of the Second Bank, Gallatin suggested that, if a bank could overcome political interests, a new Bank of the United States might be chartered subject to the following restrictions: its capital should be limited to fifteen million dollars; its earning assets should be restricted to one and one-half times its capital; it should be forbidden to deal in merchandise, real estate, or stocks; it should be regularly and rigorously inspected by federal officials; and precautions should be taken to prevent its degenerating into a local institution. "Suggestions on the Banks," op. cit., pp. 453-56.

Gallatin saw that the Bank of the United States served usefully as a fiscal agent for the government and as a regulator of the currency. He made several proposals designed to increase the social utility of the Bank. His counsel did not prevail, however; his ideas on the Bank were not a decisive influence on the policies pursued by the nation. Nevertheless, these ideas are significant as a contribution to the theory of central banking.

CHAPTER IX

MONETARY THEORY

The Rate of Interest

The rate of interest, Gallatin asserted, depended not on the quantity of money in circulation, "but on the proportion between the amount or supply of capital which may be loaned and the demand for that capital."[1] Gallatin was using the term "capital" to mean loanable funds. Hence he was saying that the interaction of the supply of loanable funds with the demand for loanable funds determined the rate of interest.[2]

Gallatin was attempting to rebut the prevalent notion that increases in the quantity of money lowered the rate of interest, and thereby stimulated industry.[3] In so doing, he merely was repeating David Hume's theory of the rate of interest and attack on mercantilist doctrines, of some

---

[1] "Considerations on the Currency," op. cit., p. 258.

[2] Miller, op. cit., p. 37.

[3] Ibid., pp. 35-38. Alexander Hamilton was one writer who believed that the rate of interest was a function of the supply of money.

eighty years before.[1] Gallatin's statements, however, were much sketchier than Hume's.

Banks tended to lower the rate of interest, according to Gallatin, not by increasing the supply of currency but by adding to the supply of loanable funds. "Their capital--that which they bring into action--and their credit have a tendency to reduce the rate of interest."[2] Gallatin ignored the troublesome fact that banks increased the supply of loanable funds by increasing the supply of money. His analysis applied best to the loans from the capital of private bankers. In that case, however, it is necessary to include the supply of new money as a determinant of the rate of interest.

Gallatin mentioned elsewhere some factors affecting the supply of loanable funds in connection with discussions of government borrowing. The availability and cost of funds, he indicated in his "Report on the State of the Finances" of November, 1811, depended on the degree of confidence in the government and on "the state of the credit."[3] In 1846,

---

[1]For a summary and analysis of Hume's interest and quantity theories, see Hansen, op. cit., Appendix A, pp. 215-18.

[2]Gallatin, letter to Leonard Maison, December 20, 1836, Writings, II, 515.

[3]Reports of the Secretary of the Treasury of the United States, on the State of the Finances, I, 449.

he cautioned that "men of property are perhaps more timid than others," and will not offer their funds to a government "so long as it is controlled by men whom they consider as reckless, and as entertaining rather lax opinions respecting public credit."[1] Under such circumstances, the government must borrow on much dearer terms than if public confidence was unimpaired. Referring to the loan thus obtained, he said:

> There will always be found bold speculators, who will advance it at a premium--enhanced by the want of competition, and proportionate to the risks they may be supposed to incur. Independent of this, it is most certain that the rate of interest at which loans may be obtained, will always be increased in proportion to their magnitude.[2]

That is, the "pure" rate of interest is increased by a risk premium; monopolistic elements in the supply of loanable funds tend to raise the rate of interest; and the price of loanable funds varies directly with the demand.

On several other occasions, Gallatin pointed out the simple fact that increased amounts of public securities put on the market tended to worsen the terms on which the government could borrow.[3] In addition to government borrowing, the

---

[1]Gallatin, "War Expenses," appendix to The Oregon Question, p. 66.

[2]Ibid.

[3]Reports of the Secretary of the Treasury of the United States, on the State of the Finances, I, 449; letter to Ezekiel Bacon, Chairman of the Committee of Ways and Means

demand for loanable funds, as a factor acting upon their price, depended on "the existing demand for other objects."[1] The combination of these demand and supply factors determined the rate of interest. "Whatever this may be, the money wanted by the public must be purchased at its market price."[2] The only "honest" way is for the government to borrow at the market rate; any other fiscal "contrivance is nothing but quackery, if not something worse."[3]

Gallatin's loanable funds theory of the rate of interest is the essence of modern interest theory. Present-day refinements distinguish, on the demand side, between the desire for funds for the purpose of increasing one's liquidity and the investment demand for funds for the purchase of real capital. The aggregate "supply of loanable funds" may be broken down into new gross savings (including depreciation) out of current income, dishoardings, and newly-created money.[4] Another

---

of the House of Representatives, January 10, 1812, Writings, I, 512-13; "Suggestions on the Banks," op. cit., p. 413.

[1]Reports of the Secretary of the Treasury of the United States, on the State of the Finances, I, 449. See also Writings, I, 467.

[2]Ibid.

[3]"Suggestions on the Banks," op. cit., p. 413.

[4]See e. g., Alvin H. Hansen, "Classical, Loanable-Fund, and Keynesian Interest Theories," Quarterly Journal of Economics, LXV (August, 1951), 429-32; Robertson, "Mr. Keynes and the Rate of Interest," Essays in Monetary Theory, pp. 1-38.

significant addition to the theory of interest has been the recognition that the volume of savings, and probably the volume of investment, depend on the level of income.[1] Therefore, a complex of schedules relating savings and the rate of interest, and a complex of schedules relating investment and the rate of interest, for different levels of income are necessary to a complete theory of the rate of interest.[2]

Even though Gallatin's theory of the rate of interest would not be adequate for problems that involve aggregate savings, investment, or income, nevertheless it was quite serviceable for his purposes. That is, he used the loanable funds analysis to demonstrate certain consequences of increased government borrowing, and to attack usury laws.

Examples from 1811, 1812, and 1846 have been given in which Gallatin warned his colleagues or contemporaries that increased government borrowing tended to increase the cost

---

[1]In the Keynesian view, savings depend on current income; in the Robertsonian view, savings depend on the income of an immediately preceding period, the period being defined in such a way that there has not been time to spend that income. See Robertson, ibid., pp. 4-5; Keynes, op. cit., pp. 77-84, 96-97, 166-73.

For a discussion of the determinants of investment, see Fellner, op. cit., pp. 21-42, 55-83, 95-97.

[2]Schedules of liquidity demand and of dishoarding, plus the money supply are also necessary, as mentioned above. J. R. Hicks, "Mr. Keynes and the 'Classics': A Suggested Interpretation," Econometrica, V (April, 1937), 147-59; Hansen, "Classical, Loanable-Fund, and Keynesian Interest Theories," op. cit., pp. 429-32.

of the funds to the government. Especially on the eve of the War of 1812, he argued that "In proportion to the amount wanted for the service of the year, and to the increase of stock of the public debt at market, the terms must naturally become less favorable."[1] For his purpose of insisting upon the difficulties in government borrowing and the consequent need for a balanced federal budget, his sketchy loanable funds theory of the rate of interest served well enough.

When he argued that the government should borrow at whatever terms it could get on the market, Gallatin also expressed his feelings against usury laws.

> If it becomes necessary to borrow, you must pay for the money according to its market-price and to the credit of the borrower. Indeed, in that respect the State has the advantage of not being trammelled by its own absurd usury laws, which may compel the individual to pay a dearer price for the loan than he otherwise would.[2]

Gallatin did not elaborate upon the above sentences, but it seems clear that he was expressing both his laissez-faire dislike of interferences with a competitive market, and also his recognition that usury laws may defeat their own purposes. He implied that usury laws forced borrowers and lenders to evade the law, if the supply of loanable funds were so short

---

[1] Letter to Ezekiel Bacon, January 10, 1812, Writings, I, 513.

[2] "Suggestions on the Banks," op. cit., p. 413. Underlining added. See also Writings, I, 513.

relative to the demand for them that the equilibrium rate of interest tended to exceed the legal maximum. When that occurred, the cost of borrowed funds was greater than in the absence of the usury laws, because of the additional risk involved in operating beyond the law.[1]

There were other difficulties with usury laws. With a typical 6 per cent maximum rate of interest that could be charged by the banks, the going rate tended to be pushed up to the maximum and to stay there. Then, if the "demand for capital" fell off, the banks tended to "lay on their oars," making no loans, or to "discount doubtful paper" in order to get the maximum rate. On the other hand, if the demand became great, the banks had to "reject good paper, or discount more than prudence would dictate."[2] If interest rates had been allowed to rise, the higher price of loanable funds would have rationed the scarce supply.

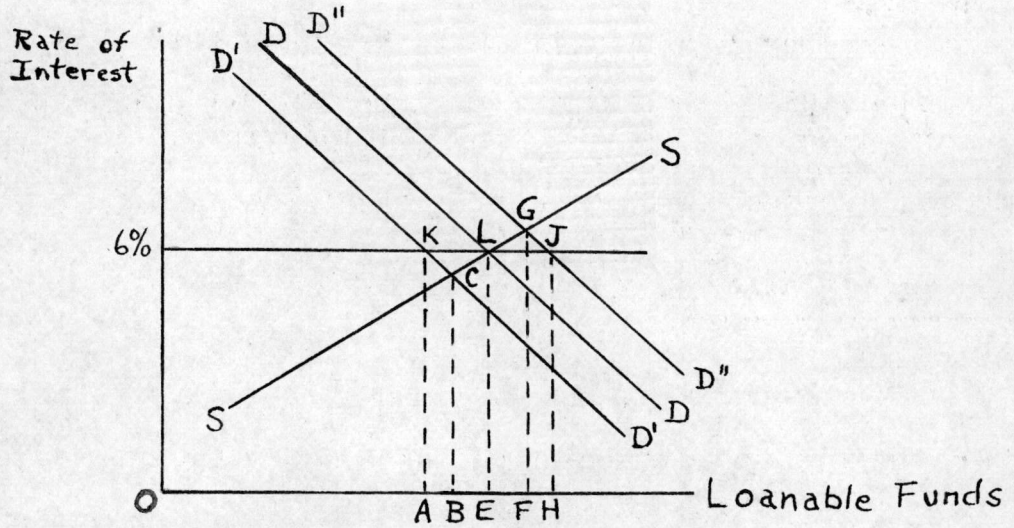
Precision may be given to Gallatin's argument by Figure 13. Line SS is the positively-sloped supply schedule of loanable funds at various rates of interest: DD is the

---

[1] Miller cites Richard Hildreth to the effect that only the banks refrained from evading the usury laws, for fear of losing their charters. Op. cit., p. 184. In addition to Gallatin and Hildreth, a few other writers attacked usury laws, but their protests were ineffective and largely unheeded during Gallatin's lifetime. Ibid., pp. 182-86.

[2] Gallatin, letter to Biddle, August 14, 1830, Writings, II, 437.

Fig. 13.--Effects of a 6 per cent usury law



negatively-sloped demand schedule. The market is cleared at 6 per cent, OE units of loanable funds exchanging hands. It is assumed that the demand schedule then falls, that is, shifts to D'D', and, in accordance with Gallatin's observation of actual practice, all loans still take place at the 6 per cent rate. Now, only OA units are lent, whereas at the equilibrium rate,[1] OB would have been exchanged.

---

[1] BC, as determined by the intersection of the supply curve with D'D'.

The situation in which funds continue to be lent at the maximum legal rate even after the fall in demand could be interpreted as evidence of a kink in the supply curve at the 6 per cent rate, so that the supply curve is KLS. Each lender refuses to sell below the 6 per cent rate for fear of spoiling the market.

The market is not cleared; the banks "lay on their oars."[1] Finally, assume that the demand schedule shifts upward and to the right, to D"D". At the maximum rate of 6 per cent, potential borrowers of OH exist, but the banks prefer to extend loans amounting only to OE. They "reject good paper" amounting to EH. OF units would have been lent at the equilibrium rate of FG, if there had been no usury law. Or, the other possibility suggested by Gallatin, the banks shift their supply schedule to the right (not shown) until it intersects D"D" at point J. If SS was based on the amount of their reserves, among other things, and they have been induced to increase the supply only because the usury law has limited the rate at which they can lend, then they may now be discounting "more than prudence would dictate."

In conclusion, Gallatin's antagonism toward usury laws was thoroughly consistent with his philosophy of political economy. Moreover, in so far as he analyzed the effects of such laws, his ideas were sound.

Quantity Theory of Money

Analyses of the relationships between the money supply and the price level, or between the rate of spending and the

---

[1]Or, alternatively, they "discount doubtful paper"; that is, the units measured along the horizontal axis are no longer equivalent to those in Fig. 13.

level of income, are a source of frequent dispute in economic literature. Certainly Gallatin found it difficult to explain these relationships. In the final analysis, his ideas contain the rudiments of the modern "cash balance" approach to the quantity theory, and, for certain problems, a recognition of the short-run variability of the rate of spending of a given amount of money. Genuine contributions such as these, however, must be sifted from much chaff.

As did many others of his time, Gallatin said that there was "a certain quantity" of money needed by the society at any one time.[1] According to Brooks, the prevailing belief in the first half of the nineteenth century, as in the colonial period, was the idea of "a proper amount of money," that each country needed "a certain amount," or an "adequate supply," or a "sufficient amount" of money for daily dealings.[2]

---

[1] "Considerations on the Currency," op. cit., pp. 246-47, 258-59, 299. See also the 1792 petition to Congress, drafted by Gallatin, expressing the opposition of western Pennsylvanians to the whiskey tax. Adams, op. cit., p. 88.

[2] Brooks, op. cit., pp. 328-29. The idea of a more or less fixed need for "a certain amount" of money was a corollary of the commodity theory, as Brooks points out. In the commodity theory, both money and other goods have absolute values, and prices are determined by a comparison of these values. With prices determined, it follows that "a certain amount" of money is needed to effect exchanges of the goods. Ibid., p. 330. Gallatin occasionally showed vestiges of the commodity theory.

Some of the difficulties with this concept were discussed above, in connection with a passage from "Considerations on the Currency," in which Gallatin said that additions to the specie stock beyond what is needed were taken out of circulation, whereas additions of irredeemable paper money beyond the proper amount depreciated the value of the money.[1]

Without further explanation (and Gallatin provides none), the concept of "a proper amount" of money combines poorly with the quantity theory explanation that an increase in the money supply raises prices. To the quantity theorist, prices adjust to changes in the quantity of money. Who, then, is to say what is the proper amount of money?

Gallatin's statements can be reconciled by use of the "equation of exchange." If M represents the average quantity of money in circulation during a given period, for example, a year; V the velocity of circulation of that money, or the number of times per year that the average unit of money is spent; P the average price level; and T the volume of all things sold for money during the year; then MV = PT. That is, the total value of the money that changes hands equals the total value of the things purchased with this money.[2] Now, if M increases and V stays the same, then there must be

---

[1]Above, pp. 118-22.

[2]Irving Fisher, The Purchasing Power of Money (New York: Macmillan, 1910), pp. 26-27 and passim.

an increase in the elements on the right-hand side of the equation. Gallatin's statement that additions to the specie stock beyond the proper amount are exchanged for manufactured goods or for imports might be taken to mean that only T rises.[1] On the other hand, his assertion that additions to the amount of irredeemable paper causes a corresponding rise in prices would be represented by a rise in P alone.

As the following quotation will indicate, Gallatin seemed to have in mind the relationships shown by the equation of exchange:

> It is obvious that the aggregate value of the annual payments made in currency,[2] which regulates the value of the currency wanted, must itself principally depend on the aggregate value of the land, labor, products of labor, and in short of all the objects which are or may be annually sold or exchanged.[3] The amount of the value of the currency wanted, or the demand for currency in every country, depends, therefore, principally on its wealth, but is modified in some degree by the state of society.[4]

Gallatin's statement, like the equation of exchange, does not indicate the direction in which cause and effect will run. They both are truisms. On the one hand, Gallatin states that MV, in effect, "regulates the value of the currency wanted," which would seem to make changes from the

---

[1] Cf. above, pp. 121-22.

[2] I. e., MV. Footnote added.

[3] I. e., PT. Footnote added.

[4] "Considerations on the Currency," op. cit., p. 247.

money side cause changes in PT. On the other hand, he also says that MV "must itself principally depend on the aggregate value of . . . all the objects which are or may be annually sold or exchanged," which would seem to make changes in PT cause changes in MV. So far, a framework for analysis of monetary phenomena has been presented, but no basis for determining causal relationships.

The demand for money, Gallatin indicated, depended on the wealth and "the state of society."[1] By the latter he meant institutional factors such as the development of commerce as compared to agriculture, and the presence or absence of a system of slavery. He added that the "want and demand for currency increase in proportion to the density of the population, the consequent multiplication and growth of towns, and the division of labor."[2] In other words, these institutional factors determine the proportion of people's "engagements" and wealth that they wish to hold command over in the form of money.

---

[1] Ibid., pp. 244, 247.

[2] Ibid., pp. 247, 286; "Suggestions on the Banks," op. cit., p. 371. Howard S. Ellis has analyzed the factors affecting "income velocity," that is, the turnover of money in exchange for the current output of goods and services. Principally these factors are the number of stages in the productive process, and the "degree of overlapping" between payments periods and income periods. "Some Fundamentals in the Theory of Velocity," Quarterly Journal of Economics, LII (May, 1938), 431-72.

Gallatin's analysis may be illustrated as follows. If W is the physical wealth of the society, and k is the fraction of the value of the wealth and of the things currently purchased for money that people wish to hold in the form of currency,[1] then $M = kP(T + W)$.[2]

Since k is the proportion of annual payments held, on the average, in cash, while V is the number of times per year that the cash turns over in order to effect those payments, then k is the reciprocal of V in the equation of exchange presented above. The followers of Marshall, in their "cash balance" version of the quantity theory, drop the W, while reinterpreting k as that proportion of real annual national income that "people wish to have enough money on hand to purchase."[3]

Gallatin, of course, did not anticipate all these developments, but he seems to have stated the relationship

---

[1]"Every merchant, every person who enjoys or earns a certain income, always keep on hand a certain amount of currency proportionate to his engagements, to his wealth, and to his wants." "Suggestions on the Banks," op. cit., p. 371. Cf. "Considerations on the Currency," op. cit., pp. 243-44.

[2]Cf. above, p. 71, in which Alfred Marshall is quoted as he relates the demand for money to income and to wealth or property. See Hansen's commentary on Marshall, op. cit., pp. 2-3.

[3]Robertson, Money, pp. 180-81. Robertson also reconciles the velocity approach with the cash balance approach. The Marshallian k is the reciprocal of Ellis' "income velocity."

between V and k. First, he pointed out that a dollar, "passing from hand to hand, effects in a given time, a year for instance, a great number of payments," so that the amount of money needed is much less than the "gross amount of payments made in currency" in that year.[1] With regard to that money supply, he then said, "Its value must always, therefore, bear a certain proportion to the aggregate value of the land, labor, and all objects whatever thus paid for with currency."[2] In other words, Gallatin apparently recognized the relationship between the more recent cash balance theory and the equation of exchange, both applying to total transactions. Although the quantity theory of money was "overwhelmingly predominant" among the monetary writers of Gallatin's day, few refined the theory as did Gallatin, once he got beyond the idea of "a proper amount" of money.[3]

Gallatin sometimes stated the quantity theory as involving a directly proportional relationship between the

---

[1]"Considerations on the Currency," op. cit., p. 243.

[2]Ibid., p. 244.

[3]Brooks, op. cit., pp. 339-56. Bollmann was another writer, in addition to Gallatin, who had the rudiments of the cash balance approach. A few other writers discussed determinants of velocity or of the demand for money. Ibid., pp. 345-46, 353-56.

Henry Thornton, in England, had views vary similar to Gallatin's. See M. W. Holtrop, "Theories of the Velocity of Circulation of Money in Earlier Economic Literature," Economic History, a supplement to the Economic Journal, I (January, 1929), 515.

quantity of money and the price level. In these cases, he was talking about large issues of inconvertible paper money, and was implying that V (or k) and T would stay the same, so that the increased money had the sole effect of pushing up prices.[1] Here, then, is not just a truism, but a statement of a functional relationship, subject to empirical verification, and, if established, useful for prediction.

Alvin Hansen asserts that the quantity theory is strictly applicable to "a country rich in natural resources, but industrially undeveloped and rapidly expanding."[2] His data show that the Marshallian k was remarkably stable over ten year intervals between 1800 and 1870.[3] Under these circumstances, additions to the money supply are spent at the same rate as previous dollars were circulating, thereby directly increasing the money value of consumption and investment expenditures. Moreover, the new money tends to lower interest rates, thereby further stimulating investment.[4]

---

[1] "Considerations on the Currency," op. cit., pp. 249, 256, 257; ibid., p. 246 is quoted above, p. 119.

[2] Monetary Theory and Fiscal Policy, p. 173. See also Niebyl, op. cit., pp. 46-51.

[3] Hansen, Monetary Theory and Fiscal Policy, pp. 3-5. This k applies to current output of goods, not to all transactions. Data are not available for the latter.

[4] In technical language, the liquidity function is completely interest inelastic, and the investment function is more or less interest elastic. New money is spent instead

Hansen's analysis of the effect of changes in M on the rate of interest throws some more light on Gallatin's interest theory. In so far as Gallatin argued that changes in M affected not the interest rate but only P, he was neglecting the fact that M is one, although only one, of the determinants of the interest rate. Yet he was correct in his belief that the net effect of new money was to raise prices, since the resultant increase in the rate of spending on a limited output of goods and services would be inflationary. This assumes full employment, which, by and large, was the case during Gallatin's lifetime.[1]

There is little doubt that the conditions necessary for the quantity theory to be generally valid accurately describe the United States of Gallatin's day. Additions to the money supply by the banking system most certainly were spent. The country was predominantly agricultural, but rich in investment opportunities. Manufacturing and internal communications were being developed rapidly. The philosophy of the times gave maximum scope to the efforts of the enterpriser.[2]

---

of going to satisfy a demand for liquidity. Investment increases. Income, or price times output, rises. Hansen, Monetary Theory and Fiscal Policy, pp. 169-73.

[1]Smith and Cole, op. cit., p. 31.

[2]Gallatin, Memorial of the Committee Appointed by the "Free Trade Convention," p. 41; and the references cited and the discussion above, pp. 197-98, 213, 214 n. 1.

It is under these circumstances that the quantity theory is most applicable.

When he was taking a less sweeping view, however, of the operation of monetary forces, Gallatin asserted that the demand for money was not constant, in other words, that the proportion k was subject to fluctuation.[1] "I also think," Gallatin stated in 1830, "that the depreciation of a paper currency does not exclusively depend on, or always correspond with, its excess. . . ."[2] The extent of depreciation also depends on the degree of confidence in the issuing government. The value of the paper varies with the assurance that the government will show restraint in future issues, and soon will redeem the inconvertible paper.[3]

Certain criticisms applicable to Gallatin's use of the quantity theory, and his departure from it in so far as he said that the velocity of money did not remain constant, are now in order. Brooks criticizes Gallatin for failing to understand clearly that the quantity theory applied to "long run causal relationships between the quantity of money

---

[1]"The proportion may vary, according to the rapidity of the circulation, and to the means used in order to economize the currency. . . ." "Considerations on the Currency," op. cit., pp. 245, 246, 252.

[2]Writings, II, 428.

[3]"Considerations on the Currency," op. cit., p. 261-62.

and the price level." Given sufficient time, the velocity of money would return to "normal" following a change in the quantity of money. Gallatin failed to realize this, according to Brooks, when he stated that changes in the quantity of money did not result in strictly proportional changes in its value.[1]

Gallatin was not unaware that the strictly proportional relationship between money and prices applied best over fairly long periods of time. In "Considerations on the Currency," for example, he indicated that there may be a considerable time lag before changes in the quantity of

---

[1]Brooks, op. cit., p. 354. For Irving Fisher's assertion that the quantity theory involves a long run period, see The Purchasing Power of Money, pp. 55, 159, 169-74. For Fisher's discussion of the institutional factors that tend to make V stable, ibid., pp. 74-111. Finally, for his discussion of the transitional effects of changes in V over shorter periods, for example, the business cycle, ibid., pp. 55-73.

Brooks, incidentally, attributes to Gallatin an unsigned essay on the "Bank of the United States," in the American Quarterly Review, IX (March, 1831), 246-82. Brooks, op. cit., pp. 349, 354-55. He gives no evidence to support his contention, however, and he is probably mistaken. The two calendars of the Gallatin collection in the New-York Historical Society give no indication that Gallatin might have written this essay. Andrews, op. cit. The style and some of the ideas in the essay are not characteristic of Gallatin, in the opinion of the present writer. Dorfman attributes the essay to George Tucker. Dorfman's conclusion is based upon evidence in correspondence between Nicholas Biddle and Tucker, in the Biddle Papers in the Library of Congress. Dorfman, op. cit., II, 882, and p. xx of the "Bibliographic Notes."

money affect price levels.[1] Gallatin's other use of the strict quantity theory was in situations in which increases in M overwhelmed any short-run disturbances of V, so that P rose rapidly and in rough proportion to the increase in M. This, Gallatin asserted, described the inflationary effects of the issues of irredeemable notes by John Law's bank, in France, from 1716-1720.[2]

As to Gallatin's qualifications to the strict quantity theory, his evidence is convincing that V (or k) might not be stable during short, cyclical fluctuations of economic activity.[3] It should not be inferred that Gallatin discussed,

---

[1] Op. cit., p. 259. The same passage argues that not all prices will be affected equally by changes in M. See also Gallatin's letter to A. J. Dallas, September 25, 1815, Writings, I, 654-55.

[2] "Considerations on the Currency," op. cit., pp. 257-58. Fisher's discussion of Law's scheme comes to the same conclusion. The Purchasing Power of Money, pp. 252-53.

[3] "Considerations on the Currency," op. cit., pp. 261-63. Modern studies of various velocity concepts give a mixed picture as to the stability, or lack of stability, of k or V. James W. Angell found that an index of the velocity of money in all transactions was quite unstable, both cyclically and secularly, for the period 1919-1934. The Behavior of Money (New York: McGraw-Hill Book Co., 1936), pp. 112-28. An index of velocity in transactions involving only currently produced goods and services, however, was remarkably stable from 1909-1930. Ibid., pp. 136-44, 153-55. James Tobin found that the "liquidity demand for money," as a factor acting upon k, varied yearly from 1919-45, especially with changing interest rates. "Monetary Velocity and Monetary Policy--A Rejoinder," Review of Economics and Statistics, XXX (November, 1948), 314-17.

except by inference, long-run and short-run concepts. The contention is simply that, first, Gallatin stated that there was a certain general relationship between increases in the quantity of money and eventual increases in prices; and, second, he recognized that there may be temporary situations in which the demand for money varied so that changes in the supply of money did not cause immediate and proportional changes in prices. Brooks's criticism would not seem to be entirely warranted.

Keynesians levy another sort of criticism at the quantity theory.[1] Walter S. Salant, for example, argues that the concept of k or V is a catch-all that fails to identify the basic forces at work. It is necessary to break down the aggregate figure into its active components, according to this view.[2]

---

[1]Despite his departure in some cases from the version of the quantity theory that restricts its use to a strictly proportional relationship between M and P, Gallatin still believed that changes in money flows were active, not passive. The belief that changes in money flows can cause changes in incomes is the essence of the quantity theory approach, broadly conceived. Cf. William J. Fellner, "Employment Theory and Business Cycles," Howard S. Ellis, ed., A Survey of Contemporary Economics (Philadelphia: The Blakiston Co., 1949), pp. 51-52. Robertson, Money, pp. 117-19.

[2]Salant, "The Demand for Money and the Concept of Income Velocity," Journal of Political Economy XLIX (June, 1941), 395-421. See also Henry M. Oliver, Jr., "A Note on Velocity," Review of Economics and Statistics, XXXI (May, 1949), 153-54.

As mentioned above, Gallatin acknowledged that the demand for money was variable in the short run, and that it required further investigation. His conclusion was that the value of money depended not only on its quantity but also on confidence in the discretion and good intent of the government to redeem inconvertible paper.[1] Although there were doubtless other factors involved besides confidence in the issuer, nevertheless it is true that Gallatin pressed the analysis beyond the aggregate, k, in trying to analyze the factors immediately affecting the value of money.

For other problems, Gallatin was content to deal with the aggregate rather than to break it down into its components. As far as price levels were concerned, he was interested primarily in the protection of the creditor as a party to long term contracts. He sought price stability over periods of twenty to thirty years.[2] For such problems, and for a country with plentiful investment opportunities, the quantity theory is an appropriate and useful tool.

Conclusion

It is fitting to conclude the present study with the above section on Gallatin's treatment of the quantity theory

---

[1] See above, p. 99.

[2] Gallatin, letter to Ingham, December 31, 1829, Writings, II, 417.

of money. His discussion of "the proper amount" of money, like his shifts between the nominalist theory and the commodity theory, demonstrates certain inconsistencies in his theories of money. His neglect of demand deposits in a discussion of the relationships between the money supply and the price level reflects his failure to see the signifi- of derivative deposits.

On the other hand, Gallatin's rudimentary cash balance version of the quantity theory, qualified by the recognition that there may be short-run fluctuations in the demand for money, serves as an example of ideas that anticipated later developments in theory and policy. He saw the incompatibility of long-term lending with short-term liabilities of banks. He advocated the prohibition of note issue as a function of state banks. He made passing references to the doctrine of forced savings. Finally, most important of several other contributions, Gallatin recognized the need for control of the money supply by a responsible central authority. He emphasized the useful functions that a central bank could perform.

The quantity theory also provides a final link in the chain of Gallatin's arguments for "sound money" and "sound finance." His attitude toward obligations and indebtedness of all kinds was intensely moralistic and legalistic. He deplored the insecurity of the system in which the money

supply was dominated by the volatile demand liabilities of state banks, expecially since losses arising from depreciation and default fell most heavily on the poorer members of the community. He argued and acted strenuously against inconvertible paper money. In addition, however, his belief that increases in the quantity of a paper money not tied to specie caused increases in prices and thereby discriminated against creditors offended his basic principles.

Avoidance of debt, elimination of privilege and unfair gain, and maintenance of slow but sure economic progress were fundamental to his thinking, and were intimately connected. "Sound money" was crucial to them all. Gallatin would have understood perfectly the following words of a recent Premier of France, Antoine Pinay: "Money reflects the image of the country. The first duty of a government is, therefore, to defend the currency, for by defending the currency it defends everything."[1]

---

[1]Quoted by Michael A. Heilperin, "The Pinay Phenomenon," Fortune, XLVI (August, 1952), p. 80.

BIBLIOGRAPHY

Books

Adams, Henry. The Life of Albert Gallatin. New York: Peter Smith, 1943, reprint of the work originally published by J. B. Lippincott & Co., 1879.

American Economic Association. Readings in Business Cycle Theory. Edited for the American Economic Association by a committee under the chairmanship of Gottfried Haberler. Philadelphia: The Blakiston Co., 1944.

_____. Readings in Monetary Theory. Edited for the American Economic Association by Friedrich A. Lutz and Lloyd W. Mints. New York: The Blakiston Co., 1951.

_____. Readings in the Theory of Income Distribution. Edited for the American Economic Association by William Fellner and Bernard F. Haley. Philadelphia: The Blakiston Co., 1949.

Angell, James W. The Behavior of Money. New York: McGraw-Hill, 1936.

Bach, George L. Federal Reserve Policy-Making; A Study in Government Economic Policy Formation. New York: Alfred A. Knopf, 1950.

Beard, Charles A. The Economic Origins of Jeffersonian Democracy. New York: The Macmillan Co., 1915.

Beckwith, Burnham Putnam. Contemporary English and American Theories concerning the effect of commercial banking on the supply of physical capital. Los Angeles: University of Southern California Press, 1935.

Berry, Thomas Senior. Western Prices Before 1861; A Study of the Cincinnati Market. Cambridge: Harvard University Press, 1943.

Blau, Joseph L. (ed.). Social Theories of Jacksonian Democracy: Representative Writings of the Period 1825-1850. New York: Hafner Publishing Co., 1947.

Board of Governors of the Federal Reserve System. Banking Studies. Edited for the Board of Governors of the Federal Reserve System by E. A. Goldenweiser, Elliott Thurston, and Bray Hammond. Washington: 1941.

_____. Federal Reserve Policy, No. 8 of Postwar Economic Studies. Washington: 1947.

_____. The Federal Reserve System: Its Purposes and Functions. Washington: 1947.

Boulding, Kenneth. The Economics of Peace. New York: Prentice-Hall, Inc., 1945.

Brant, Irving. James Madison. Vols. II-III. Indianapolis: The Bobbs-Merrill Co., 1948-50.

Catterall, Ralph C. H. The Second Bank of the United States. Chicago: University of Chicago Press, 1903.

Chandler, Lester V. An Introduction to Monetary Theory. New York: Harper & Bros., 1940.

Coxe, Tench. A Statement of the Arts and Manufactures of the United States of America for the Year 1810. Philadelphia: A. Cornman, Junr., 1814.

Crawford, William Harris. The Journal of William H. Crawford. Edited by Daniel C. Knowlton. Northampton: Smith College, 1925.

Currie, Lauchlin B. The Supply and Control of Money in the United States. Cambridge: Harvard University Press, 1934.

Dallas, George Mifflin. Life and Writings of Alexander James Dallas. Philadelphia: J. B. Lippincott & Co., 1871

Dewey, Davis R. Financial History of the United States. 8th ed. New York: Longmans, Green & Co., 1922.

Dillistin, William H. Bank Note Reporters and Counterfeit Detectors, 1826-1866. New York: American Numismatic Society, 1949.

_____. Historical Directory of the Banks of the State of New York. New York: New York State Bankers Association, 1946.

Dorfman, Joseph. The Economic Mind in American Civilization, 1606-1865. 2 vols. New York: The Viking Press, 1946.

Eliason, Adolph O. The Rise of Commercial Banking Institutions in the United States. Minneapolis: University Press of Minnesota, 1901.

Ellis, Howard S. German Monetary Theory, 1905-1933. Cambridge: Harvard University Press, 1937.

_____ (ed.). A Survey of Contemporary Economics. Philadelphia: The Blakiston Co., 1949.

Feavearyear, A. E. The Pound Sterling. London: Oxford University Press, 1932.

Fellner, William. Monetary Policies and Full Employment. 2d ed. Berkeley: University of California Press, 1947.

Fisher, Irving. 100% Money. New York: Adelphi Co., 1935.

_____. The Purchasing Power of Money. New York: The Macmillan Co., 1911.

Flagg, A. C. Banks and Banking in the State of New York from the Adoption of the Constitution in 1777 to 1864. Brooklyn: Rome Brothers, Printers, 1868.

Gallatin, Albert. Memorial of the Committee Appointed by the Free Trade Convention. New York: Wm. A. Mercein, 1832.

_____. The Oregon Question, with appendix, "War Expenses." New York: Bartlett & Welford, 1846.

_____. Views of the Public Debt, Receipts, & Expenditures of the United States. 2d ed. Philadelphia: Mathew Carey, 1801.

_____. The Writings of Albert Gallatin. Edited by Henry Adams. 3 vols. Philadelphia: J. B. Lippincott & Co., 1879.

Gallatin, James. The Diary of James Gallatin, Secretary to Albert Gallatin, a Great Peace Maker, 1813-1827. Edited by Count Gallatin. New York: Charles Scribner's Sons, 1920.

Gomel, Charles. Les Causes Financières de la Révolution Française: Les Ministères de Turgot et de Necker. Paris: Libraire Guillaumin et Cie, 1892.

Grace Madeleine, Sister M. Monetary and Banking Theories of Jacksonian Democracy. Philadelphia: The Dolphin Press, 1943.

Gras, N. S. B., and Larson, Henrietta M. Casebook in American Business History. New York: F. S. Crofts, 1939.

Grayson, Theodore J. Leaders and Periods of American Finance. New York: Wiley & Sons, 1932.

Haberler, Gottfried. Prosperity and Depression. 3rd ed. Lake Success: United Nations, 1946.

Hansen, Alvin H. Monetary Theory and Fiscal Policy. New York: McGraw-Hill Book Co., 1949.

Hansen, Bent. A Study in The Theory of Inflation. London: George Allen & Unwin, 1951.

Hardy, C. O. Credit Policies of the Federal Reserve System. Washington: Brookings Institute, 1932.

Hart, Albert G. Money, Debt and Economic Activity. New York: Prentice-Hall, Inc., 1948.

Hartz, Louis. Economic Policy and Democratic Thought: Pennsylvania, 1776-1860. Cambridge: Harvard University Press, 1948.

Hawtrey, R. G. The Gold Standard in Theory and Practice. 4th ed. London: Longmans, Green & Co., 1939.

Helderman, Leonard C. National and State Banks. Boston: Houghton-Mifflin Co., 1931.

Hepburn, A. Barton. History of Coinage and Currency in the United States and the Perennial Contest for Sound Money. New York: The Macmillan Co., 1903.

Hidy, Ralph W. The House of Baring in American Trade and Finance: English Merchant Bankers at Work, 1763-1861. Cambridge: Harvard University Press, 1949.

Hofstadter, Richard. The American Political Tradition and the Men Who Made It. New York: Alfred A. Knopf, 1948.

Holdsworth, John T. Financing an Empire: History of Banking in Pennsylvania. Chicago: S. J. Clarke Publishing Co., 1928.

Hollander, Jacob H. (ed.). A Reprint of Economic Tracts. Baltimore: The Johns Hopkins Press, 1906.

Illustrated History of the United States Mint. Philadelphia: George G. Evans, 1888.

Jacobson, J. Mark. The Development of American Political Thought: A Documentary History. New York: D. Appleton-Century Co., 1932.

Jefferson, Thomas. The Works of Thomas Jefferson. Edited by Paul L. Ford. Federal ed.; vols. IX-XII. New York: G. P. Putnam's Sons, 1905.

_____. The Writings of Thomas Jefferson. Vols. IX-XIX. Washington: Thomas Jefferson Memorial Association, 1903.

Jenks, Leland H. The Migration of British Capital to 1875. New York: Alfred A. Knopf, 1927.

Johnson, Joseph French. Money and Currency. Boston: Ginn & Co., 1921.

Kemmerer, Edwin W. The ABC of the Federal Reserve System. 11th ed. Princeton: Princeton University Press, 1938.

Keynes, John Maynard. The General Theory of Employment Interest and Money. New York: Harcourt, Brace & Co., 1935.

Knox, John Jay. A History of Banking in the United States. New York: Bradford Rhodes & Co., 1903.

Lanier, Henry W. A Century of Banking in New York, 1822-1922. New York: The Gilliss Press, 1922.

Larson, Henrietta M. Jay Cooke, Private Banker. Cambridge: Harvard University Press, 1936.

Laughlin, J. Laurence. The History of Bimetallism in the United States. 4th ed. New York: D. Appleton & Co., 1898.

_____. A New Exposition of Money, Credit and Prices. Chicago: The University of Chicago Press, 1931.

Lester, Richard A. Monetary Experiments, Early American and Recent Scandinavian. Princeton: Princeton University Press, 1939.

Madison, James. The Writings of James Madison. Edited by Gaillard Hunt. Vols. VI-VIII. New York: The Knickerbocker Press, 1906-8.

Mai, Chien Tseng. The Fiscal Policies of Albert Gallatin. New York: Columbia University Press, 1930.

Marshall, Alfred. Money Credit & Commerce. London: Macmillan & Co. Ltd., 1923.

McGrane, Reginald C. (ed.). The Correspondence of Nicholas Biddle dealing with National Affairs, 1807-1844. Boston: Houghton-Mifflin Co., 1919.

_____. The Panic of 1837. Chicago: University of Chicago Press, 1924.

Merk, Frederick. Albert Gallatin and the Oregon Problem: A Study in Anglo-American Diplomacy. Cambridge: Harvard University Press, 1950.

Miller, Harry E. Banking Theories in the United States Before 1860. Cambridge: Harvard University Press, 1927.

Mints, Lloyd. A History of Banking Theory in Great Britain and the United States. Chicago: University of Chicago Press, 1945.

Morgan, E. Victor. The Theory and Practice of Central Banking 1797-1913. Cambridge, Eng: The University Press, 1943.

Myrdal, Gunnar. Monetary Equilibrium. London: W. Hodge & Co. Ltd., 1939.

Niebyl, Karl H. Studies in the Classical Theory of Money. New York: Columbia University Press, 1946.

Nurkse, Ragnar. International Currency Experience. Geneva: League of Nations, 1944.

Parrington, Vernon L. Main Currents in American Thought. New York: Harcourt, Brace & Co., 1927.

Phillips, Chester A. Bank Credit. New York: The Macmillan Co., 1920.

Porter, Kenneth W. John Jacob Astor, Business Man. 2 vols. Cambridge: Harvard University Press, 1931.

Puxley, H. L. A Critique of the Gold Standard. London: George Allen & Unwin, Ltd., 1933.

Redlich, Fritz. Essays in American Economic History: Eric Bollmann and Studies in Banking. New York: G. E. Steckert & Co., 1944.

_____. History of American Business Leaders: A Series of Studies. II, 2 parts. The Molding of American Banking: Men and Ideas. New York: Hafner Publishing Co., 1947-51.

Rist, Charles. History of Monetary and Credit Theory from John Law to the Present Day. London: George Allen & Unwin, Ltd., 1940.

Robertson, Dennis H. Banking Policy and the Price Level. New York: Augustus M. Kelley, 1949.

_____. Essays in Monetary Theory. London: Staples Press, 1940.

_____. Money. New York: Pitman Publishing Corporation, 1948.

Schlesinger, Arthur M., Jr. The Age of Jackson. Boston: Little, Brown & Co., 1945.

Shaw, Edward S. Money, Income, and Monetary Policy. Chicago: Richard D. Irwin, Inc., 1950.

Smith, Adam. An Inquiry into the Nature and Causes of the Wealth of Nations. Edited by Edwin Cannan. 2 vols. New York: G. P. Putnam's Sons, 1904.

Smith, Walter B. Economic Aspects of the Second Bank of the United States. Cambridge: Harvard University Press, 1953.

Smith, Walter B., and Cole, Arthur H. Fluctuations in American Business 1790-1860. Cambridge: Harvard University Press, 1935.

Sowers, Don C. The Financial History of New York State, from 1789 to 1912. New York: Columbia University Press, 1914.

Stevens, John Austin. Albert Gallatin. "American Statesmen Series." Boston: Houghton-Mifflin, 1898.

Sumner, William G. A History of American Currency. New York: Henry Holt & Co., 1874.

Taus, Esther Rogoff. Central Banking Functions of the United States Treasury, 1789-1941. New York: Columbia University Press, 1943.

Thorp, Willard L. and Hildegarde E. Business Annals. New York: The National Bureau of Economic Research, 1926.

Viner, Jacob. Studies in the Theory of International Trade. New York: Harper & Bros., 1937.

Walker, Francis A. Money. New York: Henry Holt & Co., 1878.

Walters, Raymond, Jr. Alexander James Dallas, Lawyer, Politician, Financier, 1759-1817. Philadelphia: University of Pennsylvania Press, 1943.

White, Leonard D. The Jeffersonians: A Study in Administrative History, 1801-1829. New York: The Macmillan Co., 1951.

Willis, Henry Parker. The Theory and Practice of Central Banking. New York: Harper & Bros., 1936.

Wilson, Thomas. Fluctuations in Income and Employment. 3rd. ed. New York: Pitman Publishing Corp., 1948.

Wood, Elmer. English Theories of Central Banking Control 1819-1858. Cambridge: Harvard University Press, 1939.

Articles

Abernethy, Thomas P. "Andrew Jackson and the Rise of Southwestern Democracy," American Historical Review, XXXIII (October, 1927), 64-77.

_____. "The Early Development of Commerce and Banking in Tennessee," Mississippi Valley Historical Review, XIV (December, 1927), 311-25.

"Albert Gallatin," Fortune, XXVI (November, 1942), 128-29.

Andrews, Wayne. "Gallatin Revisited (concl.)," The New-York Historical Society Quarterly, XXXVI (July, 1952), 336-43.

_____. "Gallatin Revisited: John Jacob Astor," The New-York Historical Society Quarterly, XXXVI (April, 1952), 175-80.

Board of Governors of the Federal Reserve System, "Objectives of Monetary Policy," Federal Reserve Bulletin, XXIII (September, 1937), 827-28.

[Bollmann, Erick]. "A letter to Alexander Baring Esq. on the present state of the Currency of Great Britain," American Review of History and Politics, II (October, 1811), 243-95.

_____. "Outlines of a Plan for the Regulation of the Circulating Medium of the United States," American Review of History and Politics, III (April, 1812), 275-93.

Callender, Guy S. "The Early Transportation and Banking Enterprises of the States in Relation to the Growth of Corporations," Quarterly Journal of Economics, XVII (November, 1902), 111-62.

Catterall, Ralph C. H. "The Successes and Failures of the First and Second Banks of the United States," Academy of Political Science, Proceedings, I (1910-11), 199-209.

Dater, Henry M. "Albert Gallatin, Land Speculator," Mississippi Valley Historical Review, XXVI (June, 1939), 21-38.

Dempsey, Bernard W. "The Historical Emergence of Quantity Theory," Quarterly Journal of Economics, L (November, 1935), 174-84.

Dunbar, Charles F. "Accounts of the First Bank of the United States," Quarterly Journal of Economics, VI (July, 1892), 471-74.

Ellis, Howard S. "The Dollar Shortage in Theory and in Fact," Canadian Journal of Economics and Political Science, XIV (August, 1948), 358-72.

_____. "Monetary Policy and Investment," American Economic Review, Supplement, XXX (March, 1940), 27-38.

_____. "Some Fundamentals in the Theory of Velocity," Quarterly Journal of Economics, LII (May, 1938), 431-72.

Fay, C. R. "Adam Smith, America, and the Doctrinal Defeat of the Mercantile System," Quarterly Journal of Economics, XLVIII (February, 1934), 304-16.

Fisher, Irving. "The Debt-Deflation Theory of Great Depressions," Econometrica, I (October, 1933), 337-57.

[Gallatin, Albert]. "Banks and Currency," American Quarterly Review, VIII (December, 1830), 441-528.

_____. "Inaugural Address," The New-York Historical Society, Proceedings, (1843), pp. 1-18.

Hammond, Bray. "Banking in the Early West: Monopoly, Prohibition, and Laissez-Faire," Journal of Economic History, VIII (May, 1948), 1-25.

_____. "Free Banks and Corporations: The New York Free Banking Act of 1838," Journal of Political Economy, XLIV (April, 1936), 184-209.

_____. "Jackson, Biddle, and the Bank of the United States," Journal of Economic History, VII (May, 1947), 1-23.

_____. "Long and Short Term Credit in Early American Banking," Quarterly Journal of Economics, XLIX (November, 1934), 79-103.

_____. "Public Policy and National Banks," review of Arthur M. Schlesinger, Jr.'s The Age of Jackson, in Journal of Economic History, VI (May, 1946), 79-84.

Handlin, Oscar and Mary. "Origins of the American Business Corporation," Journal of Economic History, V (May, 1945), 1-23.

Hansen, Alvin H. "Classical, Loanable-Fund, and Keynesian Interest Theories," Quarterly Journal of Economics, LXV (August, 1951), 429-32.

_____. "Note on Savings and Investment," Review of Economics and Statistics, XXX (February, 1948), 30-33.

Hayek, F. A. "A Note on the Development of the Doctrine of 'Forced Saving,'" Quarterly Journal of Economics, XLVII (November, 1932), 123-33.

Hayes, H. Gordon. "Bimetallism Before and After 1834," American Economic Review, XXIII (December, 1933), 677-79.

Heilperin, Michael A. "The Pinay Phenomenon," Fortune, XLVI (August, 1952), 80, 184, 186.

Heinlein, Jay C. "Albert Gallatin: A Pioneer in Public Administration," The William and Mary Quarterly, Third Series, VII (January, 1950), 64-94.

Hicks, J. R. "Mr. Keynes and the 'Classics': A Suggested Interpretation," Econometrica, V (April, 1937), 147-59.

Holdsworth, John T. "Lessons of State Banking Before the Civil War," Academy of Political Science, Proceedings, I (1910-11), 210-24.

Hollander, J. H. "The Development of the Theory of Money from Adam Smith to David Ricardo," Quarterly Journal of Economics, XXV (May, 1911), 429-70.

Holtrop, M. W. "Theories of the Velocity of Circulation of Money in Earlier Economic Literature," Economic History, supplement to the Economic Journal, I (January, 1929), 503-24.

Kriz, M. A. "Central Banks and the State Today," American Economic Review, XXXVIII (September, 1948), 565-80.

[Lawrence, William Beach]. "Political Portraits with Pen and Pencil--Albert Gallatin," The United States Magazine and Democratic Review, XII (June, 1843), 641-53.

[Lawrence, William Beach]. "The Public Distress," American Quarterly Review, XV (June, 1834), 498-531.

Lodge, Henry Cabot. "Albert Gallatin," The International Review, VII (September, 1879), 250-66.

Oliver, Henry M., Jr. "A Note on Velocity," Review of Economics and Statistics, XXXII (May, 1949), 153-54.

Redlich, Fritz. "Bank Money in the United States in the First Half of the Nineteenth Century," Southern Economic Journal, X (January, 1944), 212-21.

Robinson, R. I. "Central Banks and the State: A Comment," American Economic Review, XXXIX (March, 1949), 494-96.

Salant, Walter S. "The Demand for Money and the Concept of Income Velocity," Journal of Political Economy, XLIX (June, 1941), 395-421.

Sayers, R. S. "Central Banking in the Light of Recent British and American Experience," Quarterly Journal of Economics, LXIII (May, 1949), 198-211.

Sioussat, St. George L. "Some Phases of Tennessee Politics in the Jackson Period," American Historical Review, XIV (October, 1908), 51-69.

Smith, Arthur A. "Bank Note Detecting in the Era of State Banks," Mississippi Valley Historical Review, XXIX (December, 1942), 371-86.

Tobin, James. "Monetary Velocity and Monetary Policy--a Rejoinder," Review of Economics and Statistics, XXX (November, 1948), 314-17.

Union Committee. "Report of the Union Committee appointed by the meeting of the signers of the memorial to congress, held on the 11th day of February, 1834, at the Merchants' Exchange, in the city of New York," Niles' Weekly Register, XLVI (March 29, 1834), 73-80.

Walters, Raymond, Jr. "Gentleman from Geneva: Albert Gallatin, Jeffersonian Democrat," The New-York Historical Society Quarterly, XXXVI (July, 1952), 289-300.

_____. "The Making of a Financier: Albert Gallatin in the Pennsylvania Assembly," Pennsylvania Magazine of History and Biography, LXX (July, 1946), 258-69.

Walters, Raymond, Jr. "The Origins of the Second Bank of the United States," Journal of Political Economy, LIII (June, 1945), 115-32.

Warburton, Clark. "Monetary Velocity and Monetary Policy," Review of Economics and Statistics, XXX (November, 1948), 304-14.

Wetterau, James O. "The Branches of the First Bank of the United States," The Tasks of Economic History, supplement to Journal of Economic History, II (December, 1942), 66-100.

_____. "New Light on the First Bank of the United States," Pennsylvania Magazine of History and Biography, LXI (July, 1937), 263-85.

Government Publications

Chaddock, Robert E. The Safety Fund Banking System in New York, 1829-1866. Senate Documents, No. 581, 61st Cong., 2d sess., 1910.

Dewey, Davis R. The Second United States Bank. Senate Documents, No. 571, 61st Cong., 2d sess., 1910.

_____. State Banking Before the Civil War, Senate Documents, No. 581, 61st Cong., 2d sess., 1910.

Holdsworth, John T. The First Bank of the United States. Senate Documents, No. 571, 61st Cong., 2d sess., 1910.

Richardson, James D. (ed.). A Compilation of the Messages and Papers of the Presidents, 1789-1897. Washington: 1896-1899.

U. S. Congress. American State Papers: Documents of the Congress of the United States. Finance I-II, Miscellaneous I, Public Lands I. Washington: Gales & Seaton, 1832-34.

_____. The Annals of the Congress of the United States. Vols. IV-X. Washington: Gales & Seaton, 1849-55.

_____. Report of the Subcommittee on Monetary, Credit, and Fiscal Policies of the Joint Committee on the Economic Report. Senate Documents, No. 129, 81st Cong., 2d sess., 1950.

U. S. State Department. Diplomatic Despatches: France. Vols. XVII-XXI (1816-23). Washington: The National Archives, 1942. (File microcopy 34, Rolls 20-24).

_____. Diplomatic Despatches: Great Britain. Vols. XXIII, XXXIII-XXXIV (1817-19, 1826-27). Washington: The National Archives, 1942-44. (File microcopy 30, Rolls 19, 29-30).

_____. Diplomatic Despatches: The Netherlands. Vols. V-VI (1814-19). Washington: The National Archives, 1943. (File microcopy 42, Rolls 6-7).

_____. Diplomatic Despatches: Russia. Vol IV (1813-14). Washington: The National Archives, 1943. (File microcopy 35, Roll 4).

U. S. Treasury Department. Correspondence of the Mint at Philadelphia. Vol. I (1795-1817). Washington: The National Archives, 1943. (File microcopy 64, Roll 1).

_____. Reports of the Secretary of the Treasury of the United States, on the State of the Finances. 2 vols. Washington: Blair & Rives reprint, 1837.

Unpublished Material

Andrews, Wayne. "A Calendar of The Albert Gallatin Collection." New York: The New-York Historical Society, 1950. (Microfilm copy).

_____. "A Supplementary Calendar of The Gallatin Papers." New York: The New-York Historical Society, 1951. (Microfilm copy).

Brooks, Benjamin F. "A History of Monetary Theory in the United States Before 1860." Unpublished Ph.D. dissertation, University of Chicago, 1939.

U. S. Treasury Department. "Letters to Foreign Bankers, April 28, 1803 to March 20, 1833." ZM Series, No. 1. Washington: The National Archives, 1953. (Microfilm copy).

_____. Selected Circulars from volume labelled "No. 0, April 21, 1795 to May 1, 1817, Circulars, etc., Set T." Washington: The National Archives, 1953. (Microfilm copy).

U. S. Treasury Department. Selected Letters from volume labelled "E, Vol. 5, Letters and Reports to Congress, December 22, 1806 to June 26, 1812, Treasury Department." Washington: The National Archives, 1953. (Microfilm copy).

Typed by
Elaine S. McAllister