
National Bank Act

The **National Banking Acts of 1863 and 1864** were two United States federal banking acts that established a system of national banks for banks, and created the United States National Banking System. They encouraged development of a national currency backed by bank holdings of U.S. Treasury securities and established the Office of the Comptroller of the Currency as part of the United States Department of the Treasury and authorized the Comptroller to examine and regulate nationally chartered banks. The legacy of the Act is its impact on the national banking system as it stands today and its support of a uniform U.S. banking policy.

Background

For most of the nineteenth century, the American banking system consisted of state chartered banks. The paper currency issued by state chartered banks had to be redeemable. Depending on the state, the capital requirements for banks, set forth in the bank charter, differed. If a bank could not redeem its bank notes for money (gold or silver), the bank had committed fraud and was subject to prosecution. Most of the state chartered banks in the North and East created redeemable currency against Bills of Exchange (Real Bills) under the Real Bills Doctrine set forth by Adam Smith. (See "The Wealth of Nations", 1776 by Adam Smith). Real Bills were negotiable instruments, payable in 90 days, which banks discounted. Real Bills were a means of financing production of consumer items moving to market. Banks created uniformly denominated redeemable bank notes against the value of the Real Bills in their inventory.

If redemption demands exhausted their gold or silver reserves, these banks could rediscount the Real Bills to obtain gold or silver. The discounting of Real Bills by banks was particularly suited to the banking business in the industrial states of the North and the East of the country. As to the state-chartered banks, predominantly located in the West and South, many practiced fractional reserve lending for lack of availability of Real Bills to discount. Fractional reserve lending depended on low demand to redeem the paper currency. Fractional reserve lending amounted to the issuance of multiple demand receipts for the same amount of gold and silver held by the banks. Holders of this kind of paper currency could redeem it only at the bank's branch office.

Though each and every state chartered bank issued its own redeemable currency, because of its denomination in US dollars, each bank's currency was nominally the same as any other banks currency. The difficulty lay in judging the ability of an issuing bank to be able to promptly redeem their currency for gold or silver. It was therefore extremely difficult for currency to serve as a means of exchange for inter-regional parties. ^[1] In 1816, the Second Bank of the United States was chartered by the U.S. Congress for a twenty year period to create irredeemable currency with which to pay for the costs of the War of 1812. The creation of congressionally authorized irredeemable currency by the Second Bank of the United States amounted to taxation by inflation. The Congress did not want state chartered banks as competition in the inflation of currency.

Because fractional reserve banking does amount to inflating a currency, the states agreed to curtail fractional reserve banking engaged in by the "wildcat" banks by tying the amount of currency these banks could issue to the amount of gold and silver coin they held. When the charter for the Second Bank of the United States expired in 1836, "wildcat" banks resumed unsound and unregulated lending. As Americans began to head West, these institutions began to issue more and more currency as a means of facilitating land speculation. This at-will adjustment of the money supply caused all forms of currency to fluctuate wildly in value. The issuance of currency by multiple banks also led to a nationwide counterfeiting problem that left the public wondering not only how much their money was worth but whether it was real. To solve the problem, the Jackson administration passed an order that voided paper currency in the eyes of the national government, agents of the government were allowed to accept gold or silver only as a means of payment for land. Note holders ran to banks to redeem their currency only to find that banks' stocks of gold and silver were depleted and banks were no longer extending credit.

Currency notes could be redeemed for only a fraction of their nominal value and land investors began to rely on loans from abroad. A wave of bank failures ensued, eventually leading to the Financial Panic of 1837 which included a six year depression. Some banks remained open and continued to issue notes, signaling no distinct end to the paper currency problem.^[1] Notes issued by solvent institutions circulated along with currency of insolvent institutions and notes of some smaller, unknown banks even traded at a discount. The currency problem eventually became so bad that a magazine was issued that included photos and descriptions of the various bank notes and information about whether the issuing bank was sound.^[1]

Creation

In 1846 the Polk Administration created a United States Treasury system that moved public funds from private banks to Treasury branches in an effort to stabilize the economy. However, there remained no national currency. One of the first attempts of the nation to issue a national currency came in the early days of the Civil War when Congress approved the issue of \$150 million in national notes known as greenbacks. The government spent a significant amount of money on the war effort which, in turn, drew down its supply of coin. In response, the Legal Tender Act of 1862 was passed. This act mandated that paper money be issued and accepted in lieu of gold and silver coins. The bills were backed only by the national government's promise to redeem them and their value was dependent on public confidence in the government as well as the ability of the government to give out specie in exchange for the bills in the future. Many thought this promise backing the bills was about as good as the green ink printed on one side, hence the name "greenbacks."^[1]

The original National Banking Act (ch. 58, 12 Stat. 665; February 25, 1863) was originally known as the National Currency Act and was passed in the Senate by a narrow 23-21 vote. The main goal of this act was to create a single national currency and to eradicate the problem of notes from multiple banks circulating all at once. The Act established national banks that could issue notes which were backed by the United States Treasury and printed by the government itself. The quantity of notes that a bank was allowed to issue was proportional to the bank's



A "greenback" note issued by the U.S. during the Civil War

level of capital deposited with the Comptroller of the Currency at the Treasury. To further control the currency, the Act taxed notes issued by state and local banks, essentially pushing non-federally issued paper out of circulation.^[2]

The National Banking Act of 1863 was superseded by the National Banking Act of 1864 (ch. 106, 13 Stat. 99; June 3, 1864) just one year later.^[1] The new Act also established federally issued bank charters, which took banking out of the hands of state governments. Prior to the Act, charters were granted by state legislatures who were under an immense amount of political pressure and could be influenced by bribes. This problem was resolved to some degree by free banking laws in some states but it was not until this Act was passed that free banking was established on a uniform, national level and charter issuance was taken out of the hands of discriminating and corrupt state legislatures.^[2] The first bank to receive a national charter was the First National Bank of Philadelphia, Pennsylvania (Charter #1). The first new national bank to open was The First National Bank of Davenport, Iowa (Charter #15). Additionally, the new Act converted more than 1,500 state banks to national banks.



First National Bank of Philadelphia

Resurgence of State Banks

The granting of charters led to the creation of many national banks and a national banking system which grew at a fast pace. The number of national banks rose from 66 immediately after the Act to 7473 in 1913. Initially, this rise in national banking came at the expense of state banking—the number of state banks dwindled from a 1466 in 1863 to 247 in 1868. Though state banks were no longer allowed to issue notes, local bankers took advantage of less strict capital requirements (\$10,000 for state banks vs. \$50,000-200,000 for national banks) and opened new branches en masse. These new state banks then served as competition for national banks, growing to 15,526 in number by 1913.

A later act, passed on March 3, 1865, imposed a tax of 10 percent on the notes of state banks to take effect on July 1, 1866. Similar to previous taxes, this effectively forced all non-federal currency from circulation. It also resulted in the creation of demand deposit accounts, and encouraged banks to join the national system, increasing the number of national banks substantially. ^[1]

Legacy

The National Banking acts served to create the (federal-state) dual structure that is now a defining characteristic of the U.S. banking system and economy. The Comptroller of the Currency continues to have significance in the U.S. economy and is responsible for administration and supervision of national banks as well as certain activities of bank subsidiaries (per the Gramm-Leach-Bliley Act of 1999). ^[1] In 2004 the Act was used by John D. Hawke, Jr., Comptroller of the Currency's to effectively bar states attorney generals' offices from national bank oversight and regulatory roles. Many blame the resulting lack of oversight and regulation for the Late-2000s recession, the Bailout of U.S. financial system (2008) and the Subprime mortgage crisis. ^[3]

Notes

[1] Gale Encyclopedia of U.S. Economic History. Detroit: Gale, 2000.

[2] Grossman, Richard S. "U.S. Banking History, Civil War to WWII." EH.net. Economic History Services. 2010. <<http://eh.net/encyclopedia/article/grossman.banking.history.us.civil.war.wwii>>

[3] http://www.businessweek.com/magazine/content/08_42/b4104036827981.htm. "They Warned Us About the Mortgage Crisis," by Robert Berner and Brian Grow, Business Week, Oct. 9, 2008.

External links

- National-Bank Act as Amended, the Federal Reserve Act and Other Laws Relating to National Banks. February, 1920 (<http://fraser.stlouisfed.org/publication-series/?id=432>): Document compiled under the direction of the Comptroller of the Currency for the use of the Senate, providing dates of acts relating to national banks, 1863-1920, text of the acts and amendments, and indexes.
- The Library of Congress (<http://lcweb2.loc.gov/ammem/amlaw/>)
- History of the Office of the Comptroller of the Currency (<http://www.occ.treas.gov/aboutocc.htm>)
- History of banking at About.com (<http://usgovinfo.about.com/library/weekly/aa081599.htm/>)

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