Chapter 112 -- America Suffers An Economic Depression

Dates:
1837

Sections:
- Banks Panic As Western Land Price Inflation Becomes Evident
- Panic Spreads To The General Public
- An Economic Depression Ensues
- Van Buren Proposes The Creation Of An Independent US Treasury

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Time: April 1837

Banks Panic As Western Land Price Inflation Becomes Evident

The financial collapse that begins in April 1837 strikes a blow at the American economy that will be unmatched until the Great Depression of 1929. It will also crush Van Buren's hopes for his presidency and threaten the entire Democratic Party he has so cleverly assembled.

The collapse originates with speculative greed on the part of bankers.

In this case, their scheme focuses on buying up new public land west of the Appalachians from the government at low prices -- and then re-selling it to eventual settlers at much higher prices.

When Andrew Jackson spots this "get rich quick" move in 1835, it strikes him as one more instance where the few privileged bankers profit mightily at the expense of the many common citizens – and he will have none of that.

Jackson senses that the banks are paying for the public land by printing many more soft money notes than they can "back up" through the gold and silver in their vaults. To bring this practice, and the accompanying speculation, to a fast halt, Jackson's 1835 Specie Circular Order requires that all new public land purchased by "non-settlers" be paid for in gold or silver, not banknotes. This executive order quickly triggers two outcomes:

- Recognition among the bankers that the "real value" of the western land they purchased "to make a killing" is artificially inflated, and that settlers will refuse to pay the higher prices they had expected. What previously looked to the bankers like a parcel of land capable of commanding a $100 price and yielding a $25 profit, now looks like a $50 price and a $25 loss.

- As western land prices plummet – which was Jackson's intent – the bankers calculate the extent of their looming losses, and retreat into panic mode by trying to build enough cash on hand to stay solvent. To accomplish this, they start selling off the western land at ever decreasing prices ("something is better than nothing") and also "calling in existing loans" made to businesses and the general public.

At this point, the situation begins to spin out of control.

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Time: May 10, 1837

Panic Spreads To The General Public


Too Young to Understand the Hard Times

hat begins as a panic among bankers, now threatens America's entire financial system -- premised on a stable value for the dollar and an orderly system whereby everyday citizens can make deposits and loans with confidence

This confidence begins to disappear early in 1837.

The small farmer who has borrowed $100 to plant his crops expecting to pay back the loan in six months after growing and selling them, is suddenly required by his banker to repay the loan now or lose his land. City merchants and manufacturers suffer a similar fate.

Foreclosures follow for those who cannot comply. These, however, often fail to solve the banker's dilemma. They need cash to cover immediate operating expenses, not long-term assets like farms or shop which they can neither run nor sell off.

As conditions spiral downward, pressures from abroad add to the crisis – with fellow bankers in England and Ireland demanding repayment of their prior U.S. loans.

The Specie Circular order also causes many citizens to conclude that the banknotes in their wallets or in deposited savings may not be worth the paper it is printed on. To be safe, they head to their local bank to exchange their soft dollars for the gold or silver that the certificates promise them.

Those who arrive early may leave with minted coins. But the principle of "fractional banking" means that covering all demands for hard money will be impossible, if it arrives all at once.

When the Bank of New York announces on May 10, 1837 that it will no longer convert soft money into the promised gold or silver, depositors across the country begin to close out their accounts. As reported:

> *Distrust(of banks) seized upon the public mind like fires in the great prairies.*

The dreaded "run on the banks" is under way.

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Time: 1837-1843

An Economic Depression Ensues

Once their deposits are withdrawn, the banks themselves go under.

Out of some 850 banks operating across the country in 1837, 343 are forced to close entirely and another 62 are classified as partially failed.

With amazing suddenness, Hamilton's American economy – built on easy access to capital to support profitable investments – is left devoid of available capital. What money there is has been locked up tight in the reserves of the surviving banks, many of whom fueled the crisis in the first place.

In turn, the videotape of America's economic expansion plays out in reverse.

Absent the bank loans they need to operate, even more farmers are thrown off their land and more businesses shut their doors.

Unemployment also spikes, with more than 20,000 out of work in New York city alone.

As the supply of goods and services decreases, prices inflate, further strapping the citizenry.

Public confidence is lost as quickly as it was once found.

Instead of the "prosperity perfectly secured" envisioned by Van Buren in his March inaugural, the nation slips into a severe depression.

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Time: September 5, 1837

Van Buren Proposes The Creation Of An Independent US Treasury

Advice on what to do about the dilemma flows into the White House from all sides – with his own party divided on the issue.

The Jacksonians want him to hold the line on bringing the supply of banknotes back in line with the supply of gold and silver.

Others argue that the banks have been sufficiently punished; that Jackson's order should be repealed; and that Van Buren needs to restore confidence in the system. The public must regain trust in the value of the dollar and in the banks so they are willing to again make deposits. The banks must feel secure enough about their own assets to resume making the loans needed to revitalize the economy.

Van Buren is sufficiently alarmed to call for a special session of congress, an action reserved to date only in times of war. The session meets on September 5, 1837, and it hears the President's proposals. Characteristically he attempts to play it down the middle, with something for all sides.

He is not about to exhibit confidence in the motives or the disciplines of private bankers. The time has come, he says, to stop funneling surplus federal money into state banks that are liable to misuse it. Instead he proposes the creation of a US Treasury, functioning apart from the private banking system.

The US Treasury would exist to meet the needs of the federal government rather than those of corporate stockholders. It would deposit federal revenue collected in taxes, land sales and other sources, and disburse the money to pay off federal expenses. It would also make loans to various state banks, after first verifying they have the proper gold/silver reserves to "back the value of the dollar."

US Treasury funds loaned to these "reliable banks" could then be used for more loans to farmers, manufacturers and other businesses, thus revitalizing the capitalist economy. To back up this approach, Van Buren proposes to place $10 million in US Treasury money into the state banks.

The Senate approves this approach, but it is tabled in the House – where the fear is that a US Treasury would put too much power in the hands of the President.

This stalemate continues until June 1840 when a third attempt to win House support succeeds by a 17 vote majority.

Over time, this US Treasury will help stabilize the value of the dollar and tamp down the speculative expansion of credit. But its effects are imperfect, especially during boom or bust periods where plugging the right amount of money into circulation becomes especially important.

On July 4, 1840, Van Buren finally signs his Independent Treasury into law. He hopes that it will turn the economy around and win him a second term in office. But neither wish will come to pass.

What the Bank Panic of 1837 reveals is the profound change that has occurred in America's financial systems and economy. The much simpler and more transparent agricultural vision espoused by Jefferson has morphed into Hamilton's multi-faceted industrial economy, dependent upon capitalism and corporations whose interests may not always correspond with the good of the commonwealth.