

BOOM AND BUST IN THE 1830s

INTRODUCTION

History President Andrew Jackson distrusted banks, especially the Second Bank of the United States. He blamed banks for printing worthless paper money that contributed only to inflation and economic panics. Eventually, he destroyed the Second Bank.

Mystery An expanding money supply was an important cause of the inflation of the mid-1830s, but Andrew Jackson's "war" on the Second Bank of the United States had little to do with the inflation or the Panic of 1837 that followed it. How could such distant events as the opium trade in China and the health of the economy in Great Britain cause big trouble for the U.S. economy?

Economic History The money creating rules of the economic system permitted the supply of money to change as the quantity of gold and silver changed. Silver from Mexico and gold from Great Britain accounted for the increase in specie in American banks in 1834-1837. More specie allowed banks to increase their lending. Economic problems in Great Britain reduced British demand for U.S. cotton. Problems in the cotton industry caused banks to fail. Bank failures caused the quantity of money to fall and produced an economic depression.

CONCEPTS

Money Supply
Specie
Reserves
Inflation
Depression

OBJECTIVE

◆ Use contemporary money supply data as the basis for evaluating theories about inflation and recession in the 1830s.

◆ Identify alternative explanations for the changes in the economy of the 1830s.

LESSON DESCRIPTION

Students read Activity 1 and use the Tables in Activity 1 to answer questions. Following the discovery that the increase in the money supply, 1834-1837, was caused primarily by increases in specie, students read Activity 2, which describes the causes of that specie increase and the causes of the Panic of 1837.

TIME REQUIRED

◆ One class period

MATERIALS

One copy for each student of Activities 1 and 2.

PROCEDURE

1. Tell the class that Americans have a long history of distrusting banks. President Andrew Jackson was one such American. He believed that banks in the western states printed worthless paper money. As president, he took steps to destroy one such bank. How clearly did President Jackson understand the role of money in the economy? Did his actions cause a new wave of inflation and finally the Panic of 1837? We will explore these questions in this lesson.

2. Distribute Activity 1, which should be read and completed in class. Review the answers to questions in Activity 1:

- A. What do the figures in Table 1 show about the effects of Nicholas Biddle's contraction of the money supply after President Jackson began to remove funds from the Second Bank of the United States? (The figures from 1833 and 1834 show that specie was increasing but that the money supply increased much less in 1834 than it had in 1833.)
- B. What happened to the money supply between 1832 and 1836? (The money supply almost doubled, going from \$150 million to \$276 million.)
- C. Using information in Tables 1 and 2, decide whether the inflation of the mid-1830s was caused primarily by an increase in specie or by banks (particularly western

banks) increasing the number of bank notes they issued on the basis of a given amount of specie. (Table 1 shows that reserve ratios [column 5] did not change dramatically over the period 1834–1837. Table 2 shows that reserves in the Middle Atlantic states were approximately the same as those in the Southwest and much lower than those in the Northwest. This does not support the charge that the western banks began to lend wildly when they were no longer under the influence of the Second Bank of the United States.)

3. Distribute Activity 2, which explains the rise in specie after 1832.
4. After students have read Activity 2, *ask*.
 - A. What factors contributed to inflation in the 1830s? (The inflow of specie encouraged banks to increase the amount of bank notes available.)
 - B. What factors contributed to the Panic of

1837? (Demand for cotton and for American canal bonds fell. The Bank of England attempted to reduce the amount of gold leaving Great Britain. Thus, less specie entered the U.S. economy, reducing the quantity of money, and bringing on panic and depression.)

CLOSURE

Tell students that after gold was discovered in California in 1848, prices in the mining areas skyrocketed. For example, one miner wrote about paying \$16 for eight ounces of sardines, \$6 for a pound of butter, and \$8 for a bottle of ale. Why did this happen? The amount of money (new gold dug out of the ground) was increasing rapidly, while the number of products available to buy with it was not. Over a longer period of time, high prices were an incentive for unsuccessful gold seekers to go into business to produce goods and services that were desired, and California quickly developed a thriving economy.

Name _____

ACTIVITY 1

ANDREW JACKSON
AND THE BANK WAR

THE MID-1830s WAS A PERIOD OF HIGH inflation in the United States. There was a general upward movement in the prices of most products and services in the economy. This inflation was accompanied by economic expansion. Both inflation and expansion ended with the Panic of 1837 when banks failed and factories closed. Why did the economy take this turn in the 1830s?

One theory is that Andrew Jackson's destruction of the Second Bank of the United States caused the inflation of the 1830s and the Panic of 1837. The accompanying tables will help you to decide on the truth of this claim.

Table 1 shows the supply of money in the United States from the end of 1830 through the end of 1839. The quantity of money in the United States (column 2) was made up of two elements: reserves and the additional money created on the basis of those reserves. In the United States in the 1830s, gold and silver (called *specie*) both circulated as money. When deposited in banks, specie served as the reserves that backed bank notes. People deposited specie in banks and received bank notes, which were easier to carry and to do business with. Banks also made loans on the basis of specie, usually in the form of bank notes. The total value of bank notes circulating was usually several times the value of the specie that banks held in reserve.

The Second Bank of the United States was a private bank that also served many government functions, including holding federal funds for the United States Treasury. Because it was so much larger than other banks, the Second Bank could also limit the number of bank notes that the other banks could create. When the Second Bank presented its bank notes for redemption in gold, the state banks had to pay out some of their gold, and this reduced their ability to make loans.

JACKSON DESTROYS THE SEC-

OND BANK OF THE UNITED
STATES

Although the charter of the Second Bank was not due to expire until 1836, in 1832 Henry Clay submitted a bill to Congress to recharter the bank. President Jackson vetoed the bill. Then he began removing government funds from the Second Bank, depositing them in state banks instead. In retaliation, the president of the Second Bank, Nicholas Biddle, began calling in loans and increasing redemption of state bank notes. Since this action reduced the amount of money available to buy goods and services, many businesses began to fail and jobs were lost. However, after Jackson won reelection by a sweeping majority at the end of 1832, Biddle gave in and the money supply increased. The Second Bank then was able to obtain a state charter for Pennsylvania and operated until 1841, when it went bankrupt.

According to many history books, the removal of the Second Bank's threat to withdraw specie held as reserves encouraged the state banks, particularly those in the West, to issue many more bank notes and to lend money recklessly. A great business boom followed, accompanied by severe inflation. From 1835 to 1837 prices rose by one-third. In 1837 the boom collapsed and the nation experienced the Panic of 1837. This contraction of the economy lasted until 1843.

QUESTIONS FOR DISCUSSION

Did the destruction of the Second Bank cause inflation and the Panic of 1837? Let's look at the evidence.

1. What do the figures in Table 1 show about the effects of Nicholas Biddle's contraction of the money supply after President Jackson began to remove funds from the Second Bank of the United States? Compare the amount of increase in money supply (columns 1 and 2) to the increase in specie (column 4) for 1833 and 1834.

2. What happened to the money supply between 1832 and 1836?

3. Using information in Table 1 and Table 2, decide whether the inflation of the mid-1830s was caused primarily by an increase in specie or by banks (particularly banks in the West) increasing the amount of bank notes they issued on the basis of a given amount of specie.

TABLE 1
QUANTITY OF MONEY IN THE UNITED STATES, 1830—1839

(1) END OF YEAR	(2) MONEY (MILLIONS)	(3) ANNUAL RATE OF CHANGE IN MONEY SUPPLY	(4) SPECIE (MILLIONS)	(5) RESERVE RATIO
1830	\$114	7.9%	\$32	23%
1831	155	36.0	30	15
1832	150	-3.2	31	16
1833	168	12.0	41	18
1834	172	2.4	51	27
1835	246	43.0	65	18
1836	276	12.2	73	16
1837	232	-19.0	88	20
1838	240	3.4	87	23
1839	215	-10.4	83	20

TABLE 2
RESERVE RATIOS OF STATE BANKS BY REGION 1834—1837

END-OF-YEAR TREASURY DATA	NEW ENGLAND	MIDDLE ATLANTIC	SOUTHEAST	SOUTHWEST	NORTHWEST
1834	.10	.21	.26	.21	.39
1835	.11	.16	.25	.17	.27
1836	.10	.16	.20	.13	.31
1837	.12	.26	.24	.13	.36

Sources of Tables 1 and 2: P. Temin, *The Jacksonian Economy* (New York: Norton, 1969) pp. 71, 75

Name _____

ACTIVITY 2**CAUSES OF 1830s****INFLATION AND PANIC**

You have examined some evidence which suggests that inflation and panic in the 1830s had little to do with careless lending by western banks. What are some alternative explanations?

OPIUM: CONTRIBUTOR TO INFLATION?

Opium was one reason that the stock of specie in the United States began to increase in the mid-1830s. By the 1830s the United States was exporting many products to Mexico and receiving in exchange silver from the vast mines of Mexico. The United States imported many goods from China and paid for them with silver. However, by the early 1830s, many Chinese had learned to smoke opium, which they acquired from the British and other European traders. Instead of trading with U.S. merchants for silver, the Chinese now wanted drafts on London banks so that they could buy opium.

United States traders had a large quantity of London bank drafts, and also British gold, as a result of their cotton exports to Great Britain and because the British had invested in American canal bonds. The silver from Mexico and the gold from Great Britain accounted for the great increase in specie in American banks over the years 1834-1837. And, with more specie in their vaults, American banks could greatly increase their lending without changing the ratio of specie

to bank notes.

WHAT CAUSED THE PANIC OF 1837?

What brought on the Panic of 1837 in the United States and the subsequent depression? British gold began to leave the United States, for three reasons. First, many states defaulted on their canal bonds, discouraging British investment. Second, the Bank of England attempted to reduce the amount of gold leaving Great Britain. Third, British demand for cotton from the United States fell because of a depression in Great Britain which idled many British textile mills. In other words, the British willingness and ability to buy U.S. cotton declined. American cotton producers and cotton brokers were unable to pay back bank loans, and many banks went broke.

Over the period 1837-1843, 23 percent of American banks failed, and the quantity of money fell by 34 percent (bank notes from failed banks were worthless). The economy showed some signs of recovery in 1838, but it worsened again in 1839. It continued in a depressed state until 1843.

QUESTIONS FOR DISCUSSION

1. What factors contributed to inflation in the 1830s?
2. What factors contributed to the Panic of 1837?