

The Panic of 1819 – Document I

Synopsis: After the "Era of good feelings" American farmers and citizens borrowed many loans from the bank. They over speculated and backed bank notes with good intentions instead of a safe currency. In turn this led to panic and families lost their farms and establishments because they could not pay of their debt. (Jessica Levin)

Background: "First, the nation's rapid economic growth infected Americans with a get-rich-quick fever. Farmers and planters borrowed heavily to expand their farms and plantations. New England Merchants encouraged by the protective tariff, borrowed to build new factories. Citizens everywhere speculated in land and stocks. The recklessness spread to bankers, who issued bank notes (paper money) backed by optimism rather than by sound currency or deposits." (A Land of Promise)

The Event: "In 1819 the bubble temporarily but dramatically burst. The 2nd Bank of the United States, acting as a watchdog over American Financial affairs, challenged the local state banks to prove the soundness of their bank notes. The Bank called in all its loans to these banks. In turn, local bankers demanded that private citizens pay mortgages and loans. Panic struck. Families lost their farms and businesses because they could not meet their debts. Banks closed their doors. Life savings disappeared. Many Americans blamed the Bank of the United States for the Panic of 1819. But American overconfidence was surely a culprit too." (A Land of Promise)

Impact on the future: "There were also serious political problems that no "era of good feelings" could hide or solve. These problems were reawakened by the very westward expansion and growth of the Cotton Kingdom in which Americas took such pride. In part, the problems centered around who should control the federal government and set its policies. In the postwar (War of 1812) period, with the federal government growing stronger each day, the struggle for control between the commercial-industrial North and the plantation South increased. This rivalry was known by the shorthand: "Slave states vs. free states". Until 1819 political power in the federal government was roughly equal for the slave and free states." (A Land of Promise)

The Panic of 1819 – Document II

Two years into his presidency, Monroe faced an economic crisis that tested his experience and raised questions about his leadership. In the spring of 1819, a number of state banks suspended payment on their notes and claimed bankruptcy. Hundreds of employers all around the nation, unable to borrow money to pay their bills, went out of business. In urban centers like Philadelphia, unemployment reached 75 percent of the working force, and several thousand workers were imprisoned for their unpaid debts.

Known as the Panic of 1819, this economic collapse was the result of several events. First, European nations who were recovering from the Napoleonic wars reduced international demand for American foodstuffs. Second, war and revolution disrupted the Mexican and Peruvian economies, which in turn, decreased the flow of gold and silver

into the United States. Thirdly, frightened Europeans hoarded precious metals, further tightening the world supply of precious metals. Finally, American state and private bankers issued banknotes that were not backed by specie (gold or silver), which rapidly expanded the U.S. paper money supply. With so much paper money in circulation, speculators borrowed enormous sums and re-loaned the money to western farmers to buy lands and expand production—resulting in wild speculation in western lands purchased with nearly worthless banknotes. In 1819, the Second Bank of the United States abruptly shifted policy and demanded that any state banknotes that it had acquired as deposits (the holders of state banknotes routinely deposited them in the various regional branches of the Second Bank) or in payments for federal lands were to be redeemed at once in gold or silver. The state banks then called in their loans—in order to obtain gold or banknotes of the Second Bank—and the national economy collapsed.

Monroe did little to respond to the situation beyond supporting a policy by his secretary of the treasury, William Crawford, to relax payment terms on mortgages for lands purchased from the federal government. The Treasury allowed, as an alternative to foreclosure, up to eight years to complete payment on land purchases instead of three years. Or debtors could pay off the total amount still outstanding but at a greatly reduced price. This measure did little to prevent the default on mortgages.

As a result of the Panic, a cry arose to return to the solid Jeffersonian principles of 1800. To many old-time Republicans, Monroe's party-less "Era of Good Feelings" had been a disastrous betrayal of party principles to Federalism in disguise. The revolt never touched Monroe personally as much as it called for new leadership in Congress and a revived party discipline. Most victims of the depression blamed the Second Bank of the United States, providing the foundation for later attacks on the Bank and on paper currency by the supporters of Andrew Jackson in the late 1820s. The Second Bank had become a "monster bank" in the eyes of millions of Americans.

Agriculture, Cotton & Land and their Role in the Panic of 1819

The state banks that had risen up to financially support speculation and expansion had issued notes far in excess of what they could realistically redeem. In reaction to this situation, the 2nd Bank of the United States insisted that the state banks redeem all notes that had passed into the hands of the Bank of the US. In order to pay the Bank of the US, the state banks had to demand payment of debts by the farmers of the Midwest. The result was a vast restriction in the amount of circulating money, and a substantial cutback in the amount of credit offered farmers and speculators, dramatically slowing the economy. The Panic of 1819 punctured the land rush and the agricultural boom that had been underway since 1815, and alerted farmers to the need for more effective transportation to distant markets.

After the War of 1812, the sharply rising prices of agricultural commodities pulled settlers westward to find more arable land and become farmers. Between 1815 and 1819, commodity prices climbed steeply, driving up land prices as well. Farmers took advantage of the extensive river system of the West, shipping wheat and corn down the

Ohio River to the Mississippi and then down the Mississippi to the port of New Orleans where it was sold or shipped to distant ports. Due to the capabilities of the Eli Whitney's newly invented cotton gin, farmers rushed to claim lands in the southwest, hoping to cash in on cotton. "Alabama fever" gripped the South after the War of 1812, and settlers flowed into Alabama and Mississippi, driving land prices to unprecedented levels. By 1820, Mississippi and Alabama produced half of the nation's cotton. The United States' total cotton output tripled between 1816 and 1826. Cotton continued to rise in value as the nation's primary export, and by 1836, would make up two-thirds of all American exports in terms of value. High prices tempted many former subsistence farmers to enter the market economy.

However, the agriculture and land boom collapsed temporarily in the Panic of 1819. The state banks that had risen up to support speculation and expansion financially had long issued notes guaranteeing redemption for specie or gold. These notes had then been widely circulated as a method of exchange throughout the West. The state banks governed the issuance of these notes very loosely, and thus issued notes far in excess of what they could realistically redeem. In reaction to this situation, the Bank of the United States began to insist that the state banks redeem all notes that had passed into the hands of the Bank of the US, branches of which had been in the practice of redeeming the notes themselves and amassing large numbers of state bank notes which they assumed would be redeemed by the state banks. In order to pay the Bank of the US, the state banks had to demand payment of debts by the farmers of the Midwest. The result was a vast restriction in the amount of circulating money, and a substantial cutback in the amount of credit offered farmers and speculators, dramatically slowing the economy.

The credit squeeze coincided with increased foreign production and thus falling export demand for US crops. Agricultural prices, which had sparked the boom, dropped off sharply, bringing the value of land down. Farmers could not afford to pay their debts, and since speculators could not collect payment for lands they had sold, the value of land plummeted even further. Eventually, through maintained production, innovation, and economic measures by the federal government, prices stabilized and progress continued in settling the West, but at a slower rate than the boom of 1815 to 1819.

The paralleling meteoric rises in agricultural prices and land values fed off of each other to define the character of the western economy. Despite the Republicans' efforts to create a West filled with small subsistence farmers, high land prices and high-interest loans from state banks forced many settlers to focus on cash crops and enter the agricultural market, with which few had previous experience.

Commercial agriculture exposed these inexperienced farmers to many new risks they had not counted on, and had not been warned about by the speculators who had encouraged them to grow cash crops. Cash crops such as wheat and corn were sold far from where they were grown, to strangers of whom the farmers had no knowledge. The farmers had no control over these distant markets and their fickle fluctuations. Additionally, due to the inevitable time gap between the harvesting period and the sale of cash crops, farmers often found themselves borrowing money to sustain their families during these periods of

zero-income. These short-term debts were often much larger than expected, and usually cut into long-term profits.

The West was very vulnerable to a crash like the Panic of 1819 because of the overextension of credit and the heightened dependence on agricultural exports to repay loans. Even a slight decrease in foreign demand for agricultural commodities would set off a downward spiral in which farmers could not pay their debts and banks could not issue gold or specie to holders of their notes. The added decline in the value of land capped off the severe restriction of capital in the economy. The biggest losers in the Panic of 1819 were the speculators, who owned huge tracts of land that they had bought at exorbitant prices and now could not sell. Land that had sold for up to \$69 an acre dropped in value to only \$2 an acre.

The Panic of 1819 had a profound effect on the American psyche. Many grew distrustful of banks, and especially the Bank of the United States, which took the blame for beginning the economic collapse. Also, the Panic accentuated the vulnerability of American agriculture and factories to foreign competition, leading to calls for protective economic policies. Though the Republicans in power generally objected to high import duties, higher tariffs were passed in 1824 and 1828. Additionally, falling crop prices highlighted farmers' dependence on cash crops and unstable agricultural markets. This provoked a search for more efficient methods of transportation to reach distant markets. If the cost of transportation could be cut, farmers could keep a larger portion of the value of their crops as profit, easing the effects of variations in the markets.

Economics & Politics – The American System

Although Monroe personally supported the idea of internal improvements, he balked at the federal government's role in the American System being proposed by Congressmen Henry Clay and John C. Calhoun. They wanted a series of federally financed projects designed to improve and update the nation's roads, bridges, and canals. Monroe worried, however, that federal payments for such internal improvements would expand even further the power of the federal government at the sake of state power. Where would the limits be drawn? A Jeffersonian at heart, Monroe feared that the day might come when an all-powerful federal government would try to abolish slavery and thus trigger the secession of southern states from the Union. On the other hand, he also shared with John Quincy Adams the belief that a system of national roads would better tie the country together and strengthen the bonds of national union. The issue came to a head when Congress passed a bill in 1822 to extend the Cumberland Road, or National Road. This great national road ran from Cumberland, Maryland, to the town of Wheeling in western Virginia. At Wheeling, settlers could board steamships that would take them further west along the Ohio River. Monroe, in the one exercise of his presidential veto, refused to sign the new bill, arguing that the road's completion should be undertaken by the states through which it passed—present day Pennsylvania, Virginia, Ohio, Indiana, and Illinois. This was one of his most controversial actions. Some historians claim that Monroe vetoed the measure specifically because of its local pork-barrel features that benefited specific states rather than regions.

1816-1860: The United States and the Tariff

Following the crises with France and Britain, the federal government came to rely almost exclusively on the tariff as a source of funding. As the nation's economic and political systems began to mature and diversify, however, the consensus on the tariff's role gradually broke down. Particularly within the context of sectional and partisan conflict, the tariff assumed a political significance beyond its putative revenue-generating function.

1816

The 14th Congress passed the Tariff Act of 1816 levying a series of 25% duties designed to encourage domestic manufacturing. In the wake of the conflict with Britain, nationalist war hawks like Henry Clay and John Calhoun sought to nurture independent industry that had sprung up during the Embargo era, while reducing reliance on British manufactures. Even so, the Tariff Act of 1816 was only mildly protectionist, more in keeping with those enacted since 1789 than with those that would follow after 1820. Manufacturing interests in the United States (particularly in the West and New England) did not yet carry the political clout in Congress that mercantile and shipping interests (who tended to oppose tariffs) did. In fact, no sustained popular support for protection developed much before 1819.

1819

In the wake of the Panic of 1819, a credit crisis sparked by a sharp drop in world agricultural prices, numerous economic interests pushed for protective tariffs to minimize the threat of cheap imported goods from Europe, setting the stage for the later tariffs of 1824 and 1828.

In the landmark case *McCulloch v. Maryland*, the Supreme Court struck down a Maryland state tax on notes issued by the Baltimore branch of the Second National Bank of the United States. The Maryland legislature had designed the tax to preserve the competitive advantage of state-chartered banks and to reign in the Second Bank's powers to monitor reserves and regulate credit. Speaking for the Court, Chief Justice John Marshall rejected the defendants' claims that 1) Congress had no constitutional authority to charter a Bank 2) Maryland had a right to tax activities within its borders. He rebutted the first argument with an expansive reading of the "necessary and proper" clause. Favoring the Federalists' "loose construction" of the Constitution, he determined control of currency and credit well within the purview of Congressional authority. In rejecting the second point, Marshall concurred with Daniel Webster, legal counsel for the bank, who insisted that a tax employed in this manner would render the national government dependent on the states. "The power to tax is the power to destroy," Marshall asserted, and in so doing he proclaimed the dominance of national statutes over state legislation.

1820

A House bill to increase the entire tariff schedule by 5% – with even higher duties on cotton and wool cloth, finished clothing, iron, and hemp – passed the House but was not enacted. Nevertheless, the failed measure reflected important trends that would influence

the course of tariff policy in the future. Middle and Western states provided the bulk of support for the tariff. New England, with its mix of powerful mercantile interests and budding manufacturers, split evenly over the bill, while the South, lacking any real industrial base, voted solidly against it. But the South was swimming against the demographic tide, on its way to becoming a regional minority in Congress. In the decade from 1810 to 1820, the South's rate of growth peaked at 28%, as compared with 38% for the rest of the nation. The states below the Mason-Dixon line and the Ohio River comprised 47% of the population in 1810, but only 45% just ten years later. Congressional reapportionment based on the Census of 1820 redounded to the advantage of the West and Middle Atlantic regions, where support for a protective tariff grew enthusiastically. Similarly, 8 of the 12 Senate seats added since 1816 tended to represent pro-tariff states.

1824

Henry Clay, a champion of federally sponsored internal economic development (articulated in a set of policies, including protective tariffs, known collectively as the American System) served as Speaker of the House. He controlled the selection of committee chairman, and installed John Tod of Pennsylvania, an ardent protectionist, to head the Committee on Manufactures. Tod wasted little time reporting out a bill that levied a 35% duty on imported iron, wool, cotton, and hemp. Since the Federal Treasury reported a surplus, the rate increases had little to do with revenue needs.

Congressional reapportionment reflecting population increases in the Ohio Valley and the North enabled the protective tariff to pass over southern opposition. More unified support for the tariff among New England legislators bespoke of the expansion of manufacturing in the region. Representatives like Daniel Webster of Massachusetts who previously opposed protection now advocated it unconditionally. Without protective duties, which accounted for an estimated three-fourths of textile manufacturing's value added, half the New England industrial sector would have gone bankrupt, since European technology produced cloth much more cheaply than American mills could.

1828

During the administration of John Quincy Adams, Jackson supporters lobbied to raise tariffs on hemp, wool, fur, flax, liquor, and imported textiles, a package catered to the benefit of states in the Mid-Atlantic, Ohio Valley, and New England. In fact, the tariff elevated the rate on manufactured goods to about 50% of their value, resulting in significantly greater protection for New England cloth manufacturers. The South, by contrast, did not benefit at all from this scheme, and stood to get soaked by higher prices on goods the region did not produce. The tariff also threatened to reduce the flow of British goods, making it difficult for the British to pay for the cotton they imported from the south.

Jackson supporters, with a strong southern base, normally opposed the protective tariffs advanced by the Adams faction. The 1828 bill represented a blatant appeal to sections where the Jacksonians were weaker politically. Congressional supporters of Jackson felt they had little to lose, figuring their rivals would shoulder the blame in the upcoming

election anyway. The marked upward revision of the tariff rates enacted by the Tariff of 1828, dubbed the Tariff of Abominations by its southern opponents, formed the basis for the nullification Crisis

John Calhoun and South Carolina's Nullification Strategy

Calhoun was one of the most fervent War Hawks during the 1812 crisis with Britain, and a sponsor of the tariff enacted in 1816. Constitutionally speaking, his early career seemed to mark him as a loose constructionist. During the late 1820s, however, his views began to undergo significant revision. The South Carolina Senator ultimately emerged as the era's leading states' rights sectionalist.

Calhoun had based his earlier support for the tariff on the perceived need to assist fledgling, defense-related industries – part of a broader strategy to overcome the nation's commercial dependence on Britain. By 1826, defense was no longer a salient issue. The infant industries of 1816 were now querulous adolescents, clamoring for an extension of the protective tariff system. The economy of Calhoun's South Carolina was exclusively a slave economy, producing agricultural products like cotton, rice and indigo. Having no manufacturing concerns of its own, South Carolina depended upon imports from the North and abroad; tariffs made both more expensive. The so-called "40 bales theory" articulated southern economic reservations. The theory attempted to explain how tariffs on manufactured goods reduced demand for the South's raw cotton: a 40% tariff on cotton finished goods led to 40% higher consumer prices, which translated to 40% fewer sales, since consumers had less money to spend following the Panic of 1819. And 40% fewer sales meant cotton manufacturers purchased 40% less cotton. Calhoun's rise to prominence as a national figure led him to take up the fight against economic policies that hurt the South.

Calhoun's opposition to tariffs, or more accurately the federal powers they implied, cannot be separated from his pressing desire to preserve the slave system. He feared that as border-south states gravitated to northern economic orbits, slavery in those states would grow less economically viable, their percentage of black slaves would diminish, and anti-slavery factions would succeed in eliminating slavery there (the percentage of slaves in states like Maryland had dropped precipitously since 1790). If slavery evaporated at the periphery, Calhoun believed, southern slave interests would face perpetual political perils. The same geographic coalitions that enacted the tariff laws in Congress could succeed in limiting slavery's expansion into western territories, and might even threaten the institution in the Deep South. Kentucky's Henry Clay, one of the congressional champions of the tariff, actually proposed that some of the revenue collected be used to fund state colonization societies dedicated to relocating African Americans overseas. By diffusing the American black population abroad, such organizations effectively sought to phase out slavery in the United States. In this context, Calhoun and his supporters targeted the tariff issue to test the limits of federal power, since the south had continually lost tariff-related battles.

From Calhoun's perspective, tariffs redistributed wealth from the South to Northern manufacturers, which meant that federal power was being routinely employed to benefit one section over another. The fear that certain factions would capture federal powers to repress minorities had resonated since the Constitution had first been debated. The Virginia and Kentucky Resolves of 1798, drafted in reaction to Alien and Sedition Act, hypothesized a limited compact among states authorizing a federal government of limited powers. Under this scheme, Congress could pass only those acts that served a common purpose – protective tariffs didn't fit those requirements.

Calhoun believed a measure's constitutionality turned on whether it provided equal benefits to all interests. In his South Carolina Exposition and Protest (1828) he argued that the Tariff of 1828 was unconstitutional, and that the states had the right to nullify such laws within their borders by calling nullification conventions. Following this act of interposition, if a number of the rest of the states affirmed Congress's power to enforce the law, the dissident state had the option of seceding from Union. Implicit in this scheme was the concept of the concurrent majority: if each state possessed a veto, then every conceivable interest would theoretically be represented. Calhoun trusted such a system to ensure a truly disinterested government where all interests had to be in accord. The threat of a state veto would prevent federal taxes not fair to all, which, in fact, meant most taxes. An institutionalized paucity of funds would discourage patronage-minded office seekers. For Calhoun, the concurrent majority would foster both disinterested laws and disinterested representatives, tempering the excesses of a corrupt democratic spoils system.

CGI Economic History of the United States Assignment

All Students are to read the following documents and then follow the instructions below.

Honors

1. List and explain the causes and results of the Panic of 1819.
2. List the tariffs and the effects they had on the United States between the years of 1816 – 1860.

AP (Create a thesis and outline for an essay for both questions)

1. In the eyes of many historians and economists, the Panic of 1819 is our nation's first experience with the "boom-bust" cycle. Support or refute this statement. (This may require research into what a "boom-bust" cycle is.)
2. In his decision in *McCulloch v. Maryland*, Chief Justice John Marshall asserted, "the power to tax is the power to destroy." Based upon the United States' tariff policies between the years 1816 to 1860 assess the validity of his assertion?