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NOTE

The Role of Private Banks in the Early Economy of the United States

Students of American banking history have tended to concentrate on chartered banks, not because they fail to recognize the importance of private bankers in the early economic development of the United States, but because of the problems that surround research on this subject. One of the best recent statements of the importance of private bankers is nevertheless far from convincing — judging from comments of others in the field — as a result of the lack of hard evidence on this point. I therefore offer this note to draw attention to possibilities for placing such reviews on more solid ground.[1]

Let us distinguish between two kinds of banking functions; one is essentially of economic character, namely the creation of purchasing power, while the second is primarily of business character and thus only indirectly influences the economy as a whole. To begin with the first, in the late eighteenth and early nineteenth centuries the main instruments for creating purchasing power were bills of exchange and promissory notes, of which the latter came to play a particular role in the early United States. Originally, many of the American colonies and states when coming into existence were reluctant to legalize the promissory note as a business instrument. Only in the second stage of the country's development did the attitude slowly change. But then the issuance of promissory notes was often restricted to chartered banks. They issued promissory notes in the form of banknotes, this being actually the basis of their business. Rather late in the nineteenth century everywhere in this country the issue of promissory notes was legalized and their use

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1 Richard Scylla, "Forgotten Men of Money: Private Bankers in Early U. S. History," and Discussion by Lance E. Davis. Papers Presented at the Thirty-fifth Annual Meeting of the Economic History Association, published in *The Journal of Economic History, XXXVI* (March, 1976), 173–197.

became common practice in every line of business. For details I refer to my paper, "The Promissory Note as a Financial and Business Instrument in the Anglo-Saxon World; A Historical Sketch" in *Revue Internationale d'Histoire de la Banque*, III (1970). It is obvious that early reluctance of the American legislatures to permit the general use of promissory notes was a severe handicap to businessmen who wanted to do a banking business without taking out a charter.

Students of banking have long been aware, of course, of the fact that purchasing power can also be created in the form of deposits, as is generally done today; but at least in the Anglo-Saxon world this practice demanded the general acceptability of checks. Nothing kept the private bankers from creating purchasing power except the difficulty of introducing the check into the back country. Thus before we can hope to portray their roles, a preparatory step is necessary. We must investigate when and by which method deposits were first created by banks (chartered, "free," and private alike) in the various American states. A number of years ago Professor Fredrick C. Merk found a Massachusetts document describing in all detail the creation of deposits in the Commonwealth. He left the presentation and analysis of the document to the author of this note.[2] To my knowledge, nothing is known about the beginning of the creation of deposits in other American states.

One early step toward the solution of this problem would be the search for similar documents indicating when and how deposits were first created in the various American states and to ascertain if and when private bankers saw their chance thereby to worm their way into a more complete banking business. The search for surviving checks of private banks, as I know from experience, would not be an easy job. There are only very few collections of old checks as such. Most of them are to be found in surviving papers of businessmen and of companies collected by state or local historical societies. The mere quantity of extant samples of checks drawn on private bankers might permit some conclusions. Simultaneously one might also guess the relative importance of private banks as compared with chartered and "free" banks as payees of checks and creators of deposits.

For a long time it has been known that some individual businessmen got around the legal prohibition, usually by stealth, and built up a private banking business on the basis of note issue. But these

[2] See Fritz Redlich, "On the Origin of Created Deposits in the Commonwealth of Massachusetts" in *Business History Review*, XLIII (Summer, 1969), 204–208.

were exceptions, and of the several hundred private bankers accounted for in the 1850's in the *Bankers Almanac*, no more than a very few, if any, issued banknotes illegally. It is well known that some private bankers had their hands in chartered or "free" banks and issued the latter's notes in their (the private bankers') business. Undoubtedly that was an opportunity for increasing their concerns and gaining greater importance for them. Perhaps one should start a special study of that very combination of private and chartered or "free" banking to find proof of the former's importance. Up to now there are no such studies. Of course, a businessman does not *ipso facto* become a private banker when he owns a more or less large share in a legally recognized bank.

There remains one other approach to this subject. One may start from a paper by Erling A. Erickson "Money and Banking in a 'Bankless' State; 1846–1857".[3] It seems to me that the importance of Erickson's work rests on the fact that its author found a particular American type of banker, the real-estate-agency banker, who added to his main business of real estate deals some financial transactions common to banks. This specific type of American private banker is homologous to the merchant banker as we know him as working all over the Western world in commercial centers and ports, a man or firm doing a mercantile business first of all but engrafting financial transactions thereon. Erickson discovered this type of real-estate-agency banker for Iowa, and I suspect one might find this type everywhere in the American back-country. If this hunch is correct and if these typical American businessmen are counted as private bankers, as I think they should be, then the importance of the category becomes significantly greater.

This type of businessman, whom I certainly would classify as a private banker, even though he was not listed in the *Almanac,* would preferably issue bills of exchange. Thereby he would draw capital from the capital-rich areas into the underdeveloped ones to make capital available for both real estate speculations and investments by would-be farmers.

To sum up: if one wants to show that private bankers played a greater role in the U.S. than has been accorded them so far, one could consider several approaches: (1) investigate when and how the creation of deposits became possible and actually took place in the various American states; (2) ascertain when and how the check became a common means of payment in the various American states;

[3] *Business History Review,* XLIII, (Summer, 1969), 171–191.

(3) search for the real-estate-agency bankers in all American states in the Middle West and West; and (4) search for surviving checks issued prior to the Civil War and for surviving bills of exchange drawn in the American interior on financial centers and then analyze the items as to the drawer or issuers, respectively, and their presumable purpose.