




7-24-2017

A House of Cards: Free Banking in Antebellum Chicago

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Recommended Citation

Holtzman, Miles J., "A House of Cards: Free Banking in Antebellum Chicago" (2017). *Business and Economics Summer Fellows*. 5.
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A HOUSE OF CARDS

Free Banking in Antebellum Chicago

Miles Holtzman & Andrew Economopoulos

Abstract

The Chicago free banking market of the antebellum period has more than once aroused the interest of historians and economists alike. Implemented in the state of Illinois in 1851, free banking was a common, though not universal occurrence in the United States at the time. The city of Chicago's experience with free banking was anything but common, however. Within the first 18 months after the Illinois legislature enacted the Illinois Free Banking Law, 9 free banks had begun operation in Chicago and between them had an aggregate note issue of over \$800,000. But by 1860, Chicago was home to but a single free bank with less than \$50,000 in circulation. Free banks in cities of comparable size had around \$40 per person in note issue while Chicago had just \$3.85.¹ Those who have explored the subject have tended to focus on the bank wars or on the nature of free banking as a whole in their explanations, but neither of these explanations are entirely sufficient to explain the almost total lack of free banks in Chicago. Rather, a close examination of free banking in Chicago within the broader framework of Illinois free banking suggests that Chicago had what economist Andrew Economopoulos described as a shadow banking system.²

¹ Andrew Economopoulos, *A Reappraisal of the Chicago Free Banking Market: Why so few Free Banks?* (Collegeville: Ursinus College, 2016), pg. 1.

² Ibid.

Out of the Ashes: Free banking as a system and an era

In American economic history, the years 1837 to 1864 have come to be known as the free banking era. This period was preceded by central banking via the Second Bank of the United States, and succeeded by the national banking era. It is useful to keep in mind that during this time the United States dollar was valued in terms of specie – gold or silver – and that while paper notes were used extensively throughout the hard-money period, specie was still paramount in the conduct of business. During this period there were no federal banknotes and each state had a banknote of its own, meaning that interstate trade effectively required an exchange of two different currencies which did not necessarily have the same nominal value.

The term “free banking” itself refers to a specific system of banking which was characterized primarily by two aspects which were new to banking at the time: free-entry to the market; and bond-backed note issue. Prior to the free banking era (but after the demise of the Second Bank of the United States), a potential banker had to secure a special grant from the state legislature to be permitted to open a bank. Free banking laws, by contrast, gave potential bankers free-entry into the banking market in the sense that any private individual who requested to charter a bank from their state was granted a charter, provided that they met a certain capital requirement which was set by the state.

These chartered banks, also known free banks, were then allowed to circulate currency through a system of bond-backed note issue, in which the owner of the bank would deposit bonds, whose value had to be equal to or greater than the capital requirement set by the state, with a state authority in exchange for a certain number of state notes equal to the market value of the bonds that had been deposited. If, at some later date, the market value of the bonds

dropped below the value of the notes that had been issued, the owner of the bank would be called upon to deposit more bonds with the state in order to bring the value of the bonds and the value of the notes back into equilibrium.

The function of the bond-backed system was to protect the noteholders of banks. As long as a bank remained able to redeem its notes into specie upon demand, the bank retained legal ownership of the bonds that it had deposited with the state, and was entitled to the interest they accrued. But if a bank proved unable to redeem its notes into specie upon the request of the noteholder, the state would assume ownership of the bonds and sell them in order to provide the noteholder with the specie that had been requested.

In its entirety, however, the free banking system was not conceived to protect noteholders, nor to increase the accessibility of the banking market. Rather, the free banking system was born out of necessity, or more specifically, the need for capital.

In the middle decades of the nineteenth-century, the United States experienced an incredible transformation. The financial and monetary forces of the entire world seemed to concentrate on American industry, as capital (not to mention labor) migrated from Europe to America in astonishing quantities. In a 25-year period the national wealth increased twelve times over, from roughly \$380,000,000 in 1830 to \$4,500,000,000 in 1856. By 1850, industrial production had managed to overtake agricultural production and became the most economically productive sector of the U.S. economy.³ But this rapid expansion was by no means

³ F. Cyril James, *The Growth of Chicago Banks* (New York: Harper & Brothers, 1938), pgs. 247-248.

self-propellant. Such a prolific industrialization required vast amounts of capital to sustain itself, and as a consequence, capital was in perennially short supply.⁴

Exacerbating this shortage of capital was the fact that in July 1832 Andrew Jackson, then President of the United States, vetoed a bill that would have extended the charter of the Bank of the United States for another 20 years. Later that same year when Jackson was re-elected, he took it as a sign that he was essentially free to totally dismantle central banking in America.⁵ When the charter of the Bank of the United States expired in 1836, the nation was newly absent a reliable system to act as a reservoir for and a distributor of capital. It was out of the ashes of the Second Bank of the United States that free banking was born to meet the financial needs of the nation.⁶

Delineating the entire period from 1837 to 1864 as the free banking era is somewhat misleading, however. While the first free banking law was passed in 1837 by the state of Michigan, free banking was enacted on a state-by-state basis rather than on a federal level. Some states enacted free banking laws within a few years after the expiration of central banking, New York and Georgia, for example, enacted free banking laws in 1838, but others waited considerably longer. The state of Pennsylvania by contrast did not pass a free banking law until 1860, almost a quarter of a century after the charter of the Second Bank of the United States expired.⁷ Regardless of when a state enacted a free banking law, there was inevitably some disparity in time between the end of central banking and the enactment of free banking.

⁴ James, *The Growth of Chicago Banks*, pg. 195.

⁵ Richard Temin, *The Jacksonian Economy* (New York: W.W. Norton & co. 1969), pg. 22.

⁶ Hugh Rockoff, *The Free Banking Era: A Re-Examination* (Chicago: The University of Chicago, 1972), pg. 142.

⁷ Rockoff, *The Free Banking Era*, pg. 142.

During this time, the banking needs of a state were met either by banks that had been chartered by the state under a special legislative grant, or by banks who had no state charter, known as private banks. In general, private banks differed from chartered banks in a number of key ways: private banks were not permitted to issue notes; they assumed unlimited liability for all of their debts (as opposed to the limited liability assumed by free banks through the bond-backed system); and there was no minimum capital requirement to open a private bank.

When a state passed a free banking law, it did away with the old system of chartering banks through special charter and introduced the new charter system as well as the bond-backed system of note issuing to secure its banks; but private banks remained. To be sure, some private bankers chartered their banks and became free bankers, but throughout the free banking era, private banks functioned alongside free banks in providing the financial services requested by citizens alike.

Just as free banking differed from state to state in terms of when it was adopted, so too did free banking differ from state to state in its exact nature and function. Generally, the nature of free banking varied according to the exact provisions of its free banking law (or laws), and according to the particular financial needs of the businesses and citizens within its boundaries. But the state of Illinois, in particular the city of Chicago, stray outside the range of other free banking experiences and merit a careful examination as a unique occurrence.

The Formative Years

The story of Chicago's experience with free banking begins long before the state legislature of Illinois passed the Illinois Free Banking Law into effect in 1851. Until the early 1840s, Illinois was but another western state recently incorporated into the union, and Chicago was little more than a village on a river. It had no paved streets nor any significant commerce.⁸ When the State Bank of Illinois was chartered, under the old charter system, it was so small that its officers included the value of its office furniture in its capital reserves.⁹ When the crash of 1839 hit, most chartered banks, including the State Bank of Illinois, failed. And in response to the crash, the state of Illinois all but halted the chartering of banks.¹⁰

But early in the 1840s began a period of serious and uninterrupted growth in Chicago, and in Illinois in general, that extended well into the 1850s.¹¹ In the almost total absence of chartered banks, private bankers arose to greater prominence to provide the financial services needed to fuel the growth of the city and the state. But private bankers could not issue state currency, and given this constraint they had two options: they could circulate and redeem the banknotes of other states at a discounted rate; or they could issue their own illegal currency, known colloquially as shinplasters, the value of which depended on the public's willingness to use them. Neither of these options were ideal, but both were common. By 1845, there were 15 major private banks in Illinois, 7 of which were located in Chicago and between them handled

⁸ James, *The Growth of Chicago Banks*, pg. 191.

⁹ *The Banker's Magazine*. Vol. 11. July 1856-June 1857, pg. 338

¹⁰ Jane Knodell, *Private Banking and Economic Growth in the Middle West, 1840-1860*, (Burlington: University of Vermont, 2006), pg. 3.

¹¹ James, *The Growth of Chicago Banks*, pg. 190.

over half of the banking business conducted in Illinois.¹² In 1851, well-known private banker George Smith by himself had almost \$1,500,000 of his own banknotes in circulation, despite the chagrin of other Illinois bankers. Notes from St. Louis banks totaled around \$500,000 and even a few remaining notes of the defunct state banks of Illinois still circulated, albeit at a steep discount.¹³ Of course, none of these notes circulated at full value given their instability and the lengths an individual would have to go to in order to redeem them at full price, and the lack of any sound currency in Illinois drove investors to other states and made the conduct of business in Illinois unnecessarily difficult.

Chicago's transformation from riverside town to economic powerhouse was by no means complete by this time, however. In 1849 the total value of Illinois's foreign exports was just \$5 and in 1850 the newly formed Chicago Board of Trade almost inadvertently bankrupted itself by attempting to provide free lunches for its members.¹⁴ While it had come a long way, the economic development of Illinois had outgrown the financial capabilities that private bankers and their institutions could provide; the constraints of a predominantly private banking system had become all too apparent. To continue its progress, Illinois needed to change its financial system lest it continue to lag behind others that already had.

Free banking was the obvious choice, if even they had any other. Merchants and industrialists alike had been campaigning for free banking legislation in Illinois by the mid- to late-1840s, but bringing about action was not a simple matter. Chicago was controlled by

¹² James, *The Growth of Chicago Banks*, pg. 199.

¹³ James, *The Growth of Chicago Banks*, pg. 207.

¹⁴ *The Banker's Magazine*. Vol. 11. July 1856-June 1857, pg. 704; James, *The Growth of Chicago Banks*, pg. 255.

Jacksonian democrats whom still clutched to their demagogue's abhorrence for central banking. Having adopted a plank of open hostility toward any government bank – be it of state or national character – the Democratic party of Illinois could be counted on to heavily resist any free banking legislation. In light of this, the Illinois business community, spearheaded by the “Chicago money oligarchy,” moved hell and earth to elect Whigs and “bank-democrats” to power and rout Jacksonian democrats in the election cycle of 1850.¹⁵ In this they succeeded, and the free banking bill was introduced as soon as the legislature convened in 1851. Despite the opposition of downstate democrats and the veto of Governor Augustus C. French, the business elite of Chicago marshalled the support needed to get the bill through both houses and pass over Governor French's veto. Under the Illinois Constitution, however, any banking legislation had to be approved by a popular vote at the next general election, which was not until November, 1852. Time being money, and having already demonstrated their political power, the business community used their legislative dominance to pass a bill ejecting all Illinois county treasurers from their seats and calling for a special general election in November, 1851.¹⁶

After the votes were counted, the bill was approved by a small majority of 37,578 to 31,321. More telling, however, was the geographic distribution of votes. The issue of banking had split the state in two with the northern counties of Illinois voting overwhelmingly in favor of the law while the southern counties were overwhelmingly opposed. Nonetheless, a majority

¹⁵ James, *The Growth of Chicago Banks*, pg. 209.

¹⁶ *ibid.*

was a majority and so the Illinois Free Banking Law, modelled after the system adopted in New York in 1838, was signed into law in November 1851.¹⁷

The provisions of the law declared that banks would be chartered with no less than \$50,000 in capital investment and that the charter would last no more than 25 years. As long as the capital requirement was met, no requests for charters were denied.¹⁸ The notes issued legally by a bank were redeemable in specie on demand when presented at that bank, and any bank that failed to redeem its notes into specie upon request was heavily penalized. If a bank failed to exchange notes presented at the bank for specie, the noteholder was entitled to 12.5% interest per year for the period between the time at which the note was presented to the bank and the time at which the bank delivered the requested specie. If the noteholder did not want to wait, however, they could “protest” the bank and force the bank into immediate liquidation, at which point the State Auditor would sell the bonds that the bank had deposited with him in order to pay the noteholder.¹⁹ It is interesting that, given the harsh penalties for failing to redeem notes, banks were not required by the law to maintain any specific amount of specie in reserve, and the amount of specie kept by the bank was ultimately up to the owners. The law also set the interest rate on loans and discounts at a maximum of 7% per year, and appointed three Bank Commissioners to supervise the activities of the chartered banks. These commissioners would examine the banks annually, receive quarterly reports from the banks

¹⁷ James, *The Growth of Chicago Banks*, pg. 211.

¹⁸ James, *The Growth of Chicago Banks*, pg. 212.

¹⁹ James, *The Growth of Chicago Banks*, pg. 213.

and periodically inspect the bonds that the banks had deposited to ensure that they had not dropped in value.²⁰

You Can't Always Get What You Want

The *Banker's Magazine*, a nationally issued magazine for all things finance, declared that the Illinois Free Banking Law was safe and reasonable, and should be welcomed by the people of Illinois with open arms.²¹ The people of Illinois felt differently, however. Despite the need for capital, the abundance of bonds and the ease at which charters could be obtained, there seems to have been considerable hesitation to charter a bank in Illinois. Most potential bankers felt that the provisions were too stringent to be successful and legislature soon began discussing the advisability of repealing the law entirely. Nonetheless, a renowned lawyer by the name of J. Young Scammon led the charge and chartered the Marine Bank of Chicago on 13 January, 1852. After just a few months of operation, Scammon enthusiastically increased his investment from the minimum \$50,000 up to \$500,000, and began issuing notes which featured an eccentric design of Emanuel Swedenborg arm-in-arm with two voluptuous women.²²

By the spring of 1854, Chicago had ten incorporated banks which had already issued over \$800,000 in banknotes and some 31 other incorporated banks existed across Illinois.²³ Illegal currency had all but disappeared. In 1855, Chicago was recognized as *the* premier wheat

²⁰ James, *The Growth of Chicago Banks*, pg. 214.

²¹ *The Banker's Magazine*. Vol. 5. July 1850-June 1851, pg. 513.

²² James, *The Growth of Chicago Banks*, pg. 216.

²³ Economopoulos *A Reappraisal of the Chicago Free Banking Market: Why so few Free Banks?* (Collegetown: Ursinus College, 2016), pg. 1; James, *The Growth of Chicago Banks*, pg. 225.

market in the world and in 1857 the state was meeting its interest payments in full for the first time in over a decade. Later that year, while the rest of the country was embroiled in a financial panic, Chicago newspapers urged noteholders to maintain their confidence in their banks – and the public listened.²⁴ But Illinois did not ride off into the sunset after the implementation of free banking, and these facts, while all entirely accurate, paint only one-side of free banking in Illinois.

To begin with, the success in eliminating illegal currency in Illinois came only after a second banking law was passed in response to a shrewd but nonetheless dastardly scheme of private banker turned free banker George Smith. Smith, who as mentioned previously had in excess of a million notes of illegal currency in circulation, purchased the ownership of the Bank of America²⁵ in Chicago and immediately chartered it as a free bank. After depositing his capital in bonds with the state authority and becoming able to legally issue currency, he printed his legal currency with a design virtually identical to that of his illegal currency so that he could circulate a huge number of banknotes that appeared to be sound while in reality securing only a small portion of them with the bond-backed system.²⁶

Outraged at the exploitation of the law, or jealous that they hadn't thought to do it themselves, a group of Chicago bankers gathered and stockpiled Smith's banknotes and presented them *en bloc* at Smith's Bank of America in an attempt to break the bank. To their dismay, however, Smith was able to honor all of his notes, dipping into his personal fortune to

²⁴ James, *The Growth of Chicago Banks*, pgs. 263-264.

²⁵ Aside from an unimaginative name, Smith's Bank of America has no connection with the modern, multinational bank of the same name.

²⁶ James, *The Growth of Chicago Banks*, pgs. 226-227.

preserve his personal reputation and the reputation of his banknotes. Adding insult to injury, Smith payed so many of the notes in small coins that the bankers left his offices with their tails between their legs and a heavy burden on their backs. Outraged at their failure, the bankers petitioned the state for convictions of an enumerated list of fraudulent bankers, which they themselves provided. While there are no records of any of convictions, it was in response to this that the state of Illinois passed a law making the circulation of any illegal notes punishable by a \$50 fine and up to a year in prison *per illegal banknote*, and also introduced a tax on the revenue that free banks earned from loans and discounts.²⁷ In response to the legislation, Smith sold all of his banks across the United States, and returned home to Scotland with a sizeable fortune.²⁸

Even without the instability of illegal currency, evidence shows that bank capacity, defined as the amount of capital per 100,000 inhabitants, did not increase in Chicago, nor in the other urban areas of Illinois, as a result of the implementation of free banking. Of the ten free banks that were operating in Chicago by the spring of 1854, five would fail by the end of that summer, unable to survive the panic sparked by fraudulent railroad securities.²⁹ The Illinois legislative assembly of 1855 did nothing to help the banks and by 1856 there were just three free banks in the city supplemented by over 25 private firms.³⁰

When the panic of 1857 hit, it demonstrated to the people the house of cards that was Illinois's free banking system. Over half of the bonds that Illinois free bankers had deposited to

²⁷James, *The Growth of Chicago Banks*, pgs. 229-230.

²⁸ James, *The Growth of Chicago Banks*, pg. 231.

²⁹ James, *The Growth of Chicago Banks*, pg. 237.

³⁰ James, *The Growth of Chicago Banks*, pg. 255.

secure their charters were bonds of the State of Missouri. When the price of Missouri bonds crashed during the panic, noteholders of Illinois free banks began making bank runs out of fear that their banks would fail. It was at this moment that it became apparent that Illinois free banks did not have enough specie to redeem their notes. At the time, the free banks of Illinois had over \$6,000,000 of notes in circulation but between them had barely \$600,000 worth of specie on hand.³¹ To make matters worse, Illinois free banks had no real capital outside of the notes they had in circulation; every dollar they had was put into note issue, and they had few, if any assets that could be used in an emergency.³² As a result, the value of Illinois currency plummeted, and in an ironic turn of events, the *Chicago Democrat* wrote "...if George Smith were here, and had the privilege of throwing a million, or a million and a half...into circulation, a great deal of distress, and perhaps, a very severe financial revulsion, would be prevented."³³ As it were, Smith was by this time living in London and would never return to Chicago.³⁴ In Smith's absence, and given the apparent insolvency of Illinois's free banks, the *Democrat* went so far as to write an open invitation for Canadian banks of Toronto, Hamilton and Montreal to open branches in Chicago.³⁵

As a result of the collapse, Chicago was once again at the whim of private bankers. The crash in the price of Illinois notes brought back all kinds of illegal currency, despite the potential repercussions, and the unsound banking practices that had all but previously disappeared,

³¹ *The Banker's Magazine*. Vol. 12. July 1857-June 1858, pg. 995.

³² *ibid.*

³³ *The Chicago Democrat*. September 18, 1857.

³⁴ John Jay Knox, *A History of Banking in the United States*, (New York: Bradford Rhodes & co, 1900), pg. 740.

³⁵ *The Chicago Democrat*, Sept. 23 1857.

returned to provide an arguably more reliable medium of exchange to the people of Illinois. By 1860, 80% of all incorporated bank capital in Illinois was invested outside of Chicago and 89% of bank capacity in Chicago was provided by private banks.³⁶ For reference, private banks accounted for 7% of bank capacity in New England and 15-16% in the mid-Atlantic and South.³⁷ Furthermore, specie reserves in Illinois were the lowest in the country, at just over 4% of note liabilities.³⁸ By 1861, the situation had become so bad that businessmen were threatening to leave the state of Illinois altogether. The *Chicago Democrat* urged readers to “avoid all Illinois currency,”³⁹ and even the pro-bank *Tribune* was no less pessimistic, writing “We wash our hands of the whole business...We have endeavored to show that *all* banks of issue are a curse to the community.”⁴⁰ While a substantial banking reform act was passed in 1861, the relief came too late, and the total collapse of free banking in Illinois ensued.⁴¹

The Hunt for a Smoking Gun

Given that the Illinois Free Banking Law was initially declared to be so sound and so desperately needed, it is puzzling as to why it seems to have failed so spectacularly. Even more confounding is the fact that Chicago and the state of Illinois experienced so much growth while the system that was designed to fuel that growth appeared to be failing. Many have attempted

³⁶ Knodell, *Private Banking and Economic Growth in the Middle West*, pg. 6.

³⁷ Jane Knodell, *The Role of Private Bankers in the US Payments System, 1835-1865* (Burlington: University of Vermont 2010), pg. 239

³⁸ James, *The Growth of Chicago Banks*, pg. 275.

³⁹ *The Chicago Democrat*. May 13, 1861.

⁴⁰ *The Chicago Tribune*. August 8. 1861.

⁴¹ James, *The Growth of Chicago Banks*, pg. 275.

to find the answer as to what went wrong in Chicago, but no real consensus exists on exactly what the underlying problem was.

American economist and Nobel Memorial Prize winner Milton Friedman contended that the failure of free banking was due to instability that was inherent in *laissez-faire* banking systems, such as free banking. Friedman argued that the inherent instability of free banking resulted in numerous failures, unstable notes, and considerable losses to noteholders.

Economists Arthur Rolnick and Warren Weber, however, contended that Friedman's view was overstated. They argued that just because free banks experienced instability did not mean that the instability was *inherent*. They furthermore contended that the failure of free banking was not as severe as it was made out to be. In their research, they found that while a majority of free banks closed prematurely, only about a third of those banks closed because they had "failed," meaning that only a third of them were unable to redeem their notes at par and thus forced into liquidation. The rest of these banks closed as a result of what was known as voluntary liquidation, meaning that the owners paid off their notes in circulation, and voluntarily ceased their actions as a chartered bank.⁴² Because so many free banks went into voluntary liquidation, noteholders of the banks did not incur the great losses that Friedman pointed to, because the banks redeemed their notes before ceasing operations. Rolnick and Weber were by no means contending that free banking was a success, of course, but they had demonstrated the problems with the underlying assumption that the failure of free banking was a result of forces inherent to free banking.⁴³

⁴² Arthur J. Rolnick & Warren E. Weber. "New Evidence on the Free Banking Era" In *The American Economic Review* 73, no. 5, 1983, pgs. 1084-1085.

⁴³ Rolnick and Weber, "New Evidence on the Free Banking Era," pg. 1090.

If not for an inherent defect then, what caused the apparent failure of the Illinois free banking system? Historian Alfred T. Andreas argued that the coexistence of free banks and private banks made it difficult for free banks to survive in Illinois. Because private bankers and merchants were still willing to accept and use illegal banknotes from private banks, free banks earned less profit from note circulation because their notes were more likely to be redeemed in specie at full value than the notes of private bankers.⁴⁴ Holders of private banknotes would exchange them for the notes of free banks before redeeming them in specie because of the safeguard that the bond-backed system afforded them. But this explanation is lacking as well. For starters, many owners of free banks had other sources of income aside from note circulation. They drew interest on their bonds that had been deposited with the state and also often maintained the ownership of other private banks. Furthermore, if Andreas's argument were true, why were Illinois free banks holding so little specie if their notes were more likely to be redeemed?

Where the Wildcats Roamed

To explain the dearth of free banks in Chicago, and the growth of Chicago during the apparent failure of free banking, evidence suggests that private banks and free banks maintained relationships with each other to maximize the benefits that came with each institution, while minimizing the risks. Free banks, of course, held an advantage over private banks in the area of note issue and circulation because free banks could legally issue currency

⁴⁴ Alfred T. Andreas, *History of Chicago* (Chicago: A.T. Andreas, 1884), pg. 547.

through the bond-backed system, whereas private banks could not legally issue currency and faced potentially serious repercussions if they did so. Private banks, however, held the advantage in almost all other aspects of the banking business because private banks were not legally restricted to the 7% maximum on loans and discounts set by the state on chartered banks, nor did they have to pay taxes on their profits from loans and discounts the way free banks did.⁴⁵ Furthermore, private banks could not be forced into liquidation by the state if they failed to redeem their notes into specie upon demand.

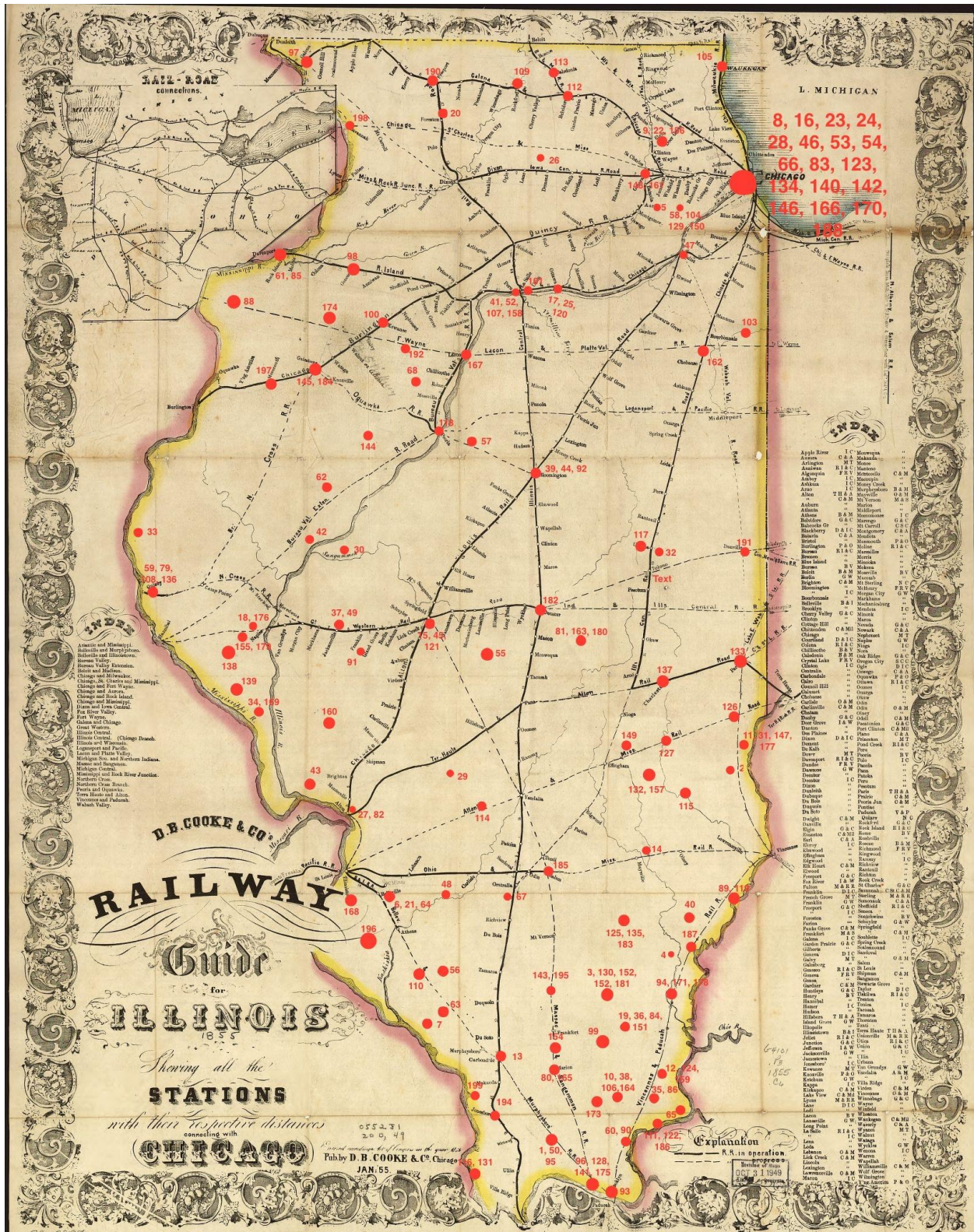
To maximize their efficiency and mitigate their risks, private bankers would open free banks, or establish relationships with free banks, in distant and inaccessible areas so that they could legally circulate Illinois currency while minimizing the likelihood that noteholders would request to exchange their notes for specie because it was so difficult to access the bank in the first place. By way of this, these bankers also minimized the risk that their bank would be unable to redeem their notes for specie and forced into liquidation by the state. This meant that these banks could maintain very low specie reserves with relatively low-risk. Such banks were colloquially known as wildcat banks because they were located “where the wildcats roamed.”⁴⁶ Meanwhile, the majority of these bankers’ banking business was conducted through the offices of their private banks which were located in urban centers, like Chicago.

The following map depicts the locations of the Illinois free banks of which there are records for. Of particular interest is the number of banks in the southeastern portion of the state which do not appear to be along any railroad lines, roads or waterways, indicating that

⁴⁵ Economopoulos, *A Reappraisal of the Chicago Free Banking Market*, pg. 7.

⁴⁶ Economopoulos, *A Reappraisal of the Chicago Free Banking Market*, pg. 4 Rockoff, *The Free Banking Era*, pg. 5.

these banks were wildcat banks.



There is also further evidence to suggest, though not prove, the validity of this theory, and the existence of these relationships. In December, 1852, when the embittered group of Chicago bankers (after their failure to break George Smith's bank) presented a list of wildcat banks to be indicted by the state, they conveniently left out those banks with which they themselves owned or were aligned with.⁴⁷ In 1853 after the reform law had been passed, which taxed the revenue that free banks earned from loans and discounts, the number of free banks providing loans and discounts dropped by over half, and yet no shortage of the availability of loans or discounts seems to have occurred.⁴⁸ Even the specie reserves themselves implicate the existence of such a relationship. The specie reserves of Illinois free banks were so low that any noteholder could have walked into the bank and forced it into liquidation. It is difficult, if not impossible to believe that this precarious situation would have been acceptable to either the bankers or the noteholders if the system was not functioning in some other capacity. Furthermore, bank capacity, defined as capital per 100,000 inhabitants, increased in rural areas but not in urban areas as a result of free banking.⁴⁹ In 1860, Chicago private bankers were listed as the officers of 38 down-state free banks while there was but a single free bank operating within the city of Chicago.

In an attempt to remedy the state's financial woes, Illinois passed a banking reform act in 1861 which made it virtually impossible operate a wildcat bank. Ironically, the reform act likely destroyed the last vestige of free banking in Illinois that was actually functioning in terms of supplying currency to the state.

⁴⁷ James, *The Growth of Chicago Banks*, pg. 230.

⁴⁸ Economopoulos, *A Reappraisal of the Chicago Free Banking Market*, pg. 7.

⁴⁹ Knodell, *Private Banking and Economic Growth in the Middle West*, pg. 6.

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