

# Monthly Review

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### *The Louisiana Banking Act of February 5, 1842*

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February 5, 1942, is the hundredth anniversary of the famous Louisiana Banking Act—one of the most significant documents in the history of American banking. The Act is notable as a legislative embodiment of the principle of short-term, self-liquidating, commercial credit; and under its provisions, the banks of New Orleans became famous for their liquidity. The Louisiana Bank, the Canal and Banking Company, the Louisiana State Bank, the Mechanics and Traders Bank, and the Union Bank—all located in New Orleans—were the only banks in Louisiana, the rest of the State being served by their branches. They weathered the crisis of 1857, in which banks elsewhere suspended almost universally, and they continued until interrupted by the military operations of the War Between the States.

► Important provisions of the act were as follows:

At least one-third of the amount of each bank's deposits and circulating notes had to be in specie; the balance had to be in paper maturing in less than ninety days and not renewable.

These quick assets and liabilities were denominated "Movement"; they were segregated sharply from slow assets and liabilities, including capital, which were denominated "Dead Weight."

Renewal of paper at maturity was forbidden, the penalty being that the debtor's account be closed at the creditor bank and notice thereof furnished other banks.

A condensed statement of condition of all the New Orleans banks had to be published weekly.

► The author of the Louisiana Banking Act of 1842 was Edmond J. Forstall. He was a representative of New Orleans in the Louisiana legislature for twenty years, a planter, a banker, and agent for Baring Brothers, the English banking firm long prominent in American financing. The law was drawn up during the crisis of 1842 when the banks of New Orleans along with those in most of the United States had suspended specie payments. It is remarkable for the directness and simplicity of its provisions.

Forstall based the provisions of the law on the peculiar situation of New Orleans, then the fourth largest commercial port in the world. There was no other place on the globe, he said, "possessing so many elements and sounder materials for banking." The produce of the vast territory drained by the Mississippi, its tributaries, and other streams flowing into the Gulf was exported mainly from New Orleans, and, accordingly, the New Orleans money market was supplied with a

great volume of short term, self-liquidating paper, based on merchandise transactions. At the same time New Orleans was the port through which gold and silver from Mexico found their way into the United States.

► One of the considerations behind the Forstall Act was cessation of the operations of the Bank of the United States under its Federal charter, which expired in 1836. The Bank of the United States had had considerable power to regulate the extension of credit by local banks and, in spite of mistakes and political interference, had performed with considerable success the functions of a central bank. Among the functions of such an institution is that of supplying additional reserves to the banking system when necessary and desirable in order that an expanding credit demand may be met; and, when necessary, restraining an inflationary over-expansion of bank credit.

Thus, the Bank of the United States had systematically made local banks redeem their circulating notes and by this pressure on their cash reserves had restrained their extensions of credit. On the other hand, when they had needed additional reserves, it had held their circulating notes and discounted for them. The discontinuance of this central banking function—essentially the same as that now performed by the Federal Reserve Banks—left individual local banks without support outside their own resources. They were forced to safeguard their own liquidity without the assistance of a central banking institution.

In the country as a whole, the period when the Forstall Act was written was one of revolutionary change and experimentation in banking. The Federal Government had abandoned jurisdiction over the field and, by establishing a system of sub-treasuries in various parts of the nation, was seeking to divorce Treasury and banking operations. In 1837 and 1842, bank suspensions had been practically universal. In Indiana, banking could be carried on only by the State Bank of Indiana and its branches. Going as far in another direction, New York in 1838 adopted a general law making banking a business "free to all"; then in 1845 its Supreme Court declared that this general banking law was unconstitutional and "utterly void" and that the banks organized under it—over one hundred in number—had "no legal existence." Going as far in still another direction, Texas and Iowa, in 1845 and 1846, included in their constitutions a flat prohibition of banks.

The Louisiana act of 1842, was, therefore, only one of several efforts being made by various States to solve the banking problem. One of its distinctions was that it put firm emphasis upon bank reserves for the first time in American legislation. Its requirements were directly imitated in the later banking laws of Massachusetts and New York and in-

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fluenced ultimately the reserve provisions of the National Banking Act and the Federal Reserve Act.

► An anonymous writer in *The Bankers Magazine*, November 1877—who said that the act of February 5, 1842, would “always remain among the most enlightened pieces of banking legislation to be found on the statute books of any country”—leaves the following record:

“We have been at pains to enquire of old bank officials in New Orleans as to the authorship of the law of 1842, and as to its practical working; whether, in fact, its stringent provisions were maintained and whether any set of bank officers had the nerve to enforce those provisions against their customers. We are assured that the provisions of the law were strictly carried out; that any renewal of three months' paper was regarded as equivalent to protest, and the maker of it publicly dishonored; that the reserve of specie and the proportion of short paper were rigidly adhered to; and that where the specie fell below 33 1/3 per cent discounting was stopped until the deficiency was made good. These practices continued until the Civil War (although the crisis of 1857 caused a general suspension of specie payments by banks in other parts of the United States), and until the Confederate Government required the banks of New Orleans to send their specie into the interior to prevent its falling into Federal hands. The bulk of the specie thus sent went to Columbus, Georgia, and Montgomery, Alabama, and amounted to about \$5,300,000. Two of the banks buried an amount equal to \$4,500,000, and another sent \$800,000 up the Red River for safety. When General Butler got possession of New Orleans he persuaded the banks to bring their specie back and they endeavored to do so, but the Confederate Government would not consent to send the portion under their control within the Federal lines. The Secretary of the Confederate Treasury gave his receipt for it, and it was for a long time sacredly kept; at last, however, the exigencies of the war led to its being used and the banks lost it altogether. The specie buried and that sent up the Red River was, however, brought back to New Orleans by the institutions to which it belonged.”

► The following excerpts from a report submitted to the Louisiana State Board of Currency on July 15, 1847, by the cashier of the Mechanics and Traders Bank indicate how the requirements of the law were administered:

Q. Is your dead weight composed and is the movement of the bank regulated in strict accordance with the fundamental rules laid down in the first section of the act to revive the several banks of New Orleans, Laws of 1842?

A. The dead weight and movement have been always regulated in accordance with the rules laid down in the act of February, 1842, as a reference to the weekly statements furnished the Board of Currency every Monday morning will show.

Q. Has any maker or endorser of any note, or acceptor of any bill of exchange offered and discounted as paper strictly payable at maturity ever applied for a renewal of said paper, or for an extension of time? In that case, did you close the account of the maker or endorser of said note, or of the acceptor of said bill of exchange? And did you give notice thereof to the other banks?

A. Since the acceptance of the act of 1842, no notes which

were discounted to be paid at maturity, nor bills of exchange, have been renewed.

Q. Have you ever, since February, 1842, bought or sold cotton or sugar, and have you ever bartered or traded in said produce, or in any other? And have you bought the stock of any incorporated company?

A. This bank has neither bought nor traded in produce of any description, nor purchased the stock of any company or incorporated institution.

The following is a consolidated statement of condition of the five banks in New Orleans, October 30, 1852, ten years after the law went into effect. (The statement is not in balance because surplus is not shown.)

## MOVEMENT OF THE BANKS

CASH ASSETS	
Specie	\$ 5,827,000
Loans payable in full at maturity	11,116,000
Due from banks	2,437,000
Other cash assets	1,649,000
	\$21,029,000
CASH LIABILITIES	
Circulating notes	\$ 4,397,000
Deposits	10,545,000
Due to Banks	810,000
Other cash liabilities	329,000
	\$16,081,000
DEAD WEIGHT ASSETS	
Capital of branches	\$ 1,405,000
Real estate	893,000
Public Improvements <sup>1</sup>	1,149,000
Mortgages, long loans, etc.	5,829,000
Other assets not available in 90 days	946,000
Protested paper	633,000
	\$10,855,000
LIABILITIES	
Capital	\$10,934,000

<sup>1</sup>This item was the canal operated by the Canal and Banking Company.

► The requirement of a 33 1/3 per cent reserve against demand liabilities is as high as any other statutory requirement to which banks have been subject in modern times. At a time when bank reserves consisted exclusively of cash, it was a higher requirement than banks in general could meet, simply because there was not enough cash in existence to go round. It is higher than could be instantly met today in cash (though the Federal Reserve Banks, under existing law, could promptly supply the currency needed), for it would mean cash in vault of \$16 billion for member banks of the Federal Reserve System alone, whereas the total money in circulation is \$11 billion.

Likewise, the requirement that the banks hold short-term, self-liquidating assets for as much as 66 2/3 per cent of their demand liabilities was also one that most banks outside of New Orleans would have found it impossible to meet. The majority of bank borrowers were not merchants and did not want short-term credit. They wanted long-term credit. As the country grew and its resources were developed, the demand for long-term capital grew also. The great majority of banks could not fill their portfolios with short-term paper. Only in a commercial center such as New Orleans was that possible.

The Louisiana Banking Act of 1842 stands by itself, therefore, and its characteristic provisions are not typical of

American banking legislation in general. Its requirements, while practicable for the New Orleans banks, both as to cash and as to short-term paper, were not generally practicable elsewhere. They are memorable, however, as a realistic and skilful adaptation of banking practice to the environment in which the banks concerned were then operating; and some of those requirements—in particular the ones dealing with bank reserves—influenced later developments profoundly and contributed to some of the most important features of present day banking legislation.

**T**HE Louisiana Banking Act of 1842 was adopted at a time when the banks of New Orleans were in suspension, and it laid down the conditions upon which they were to resume and conduct their business. The more important provisions of the Act were the following:

1. Each bank shall separate its loans on capital paid in from its loans on deposits; the loans on capital to be composed of accommodations on personal security, or on mortgage, loans on stock by the property banks, and of all other investments of whatever nature not realizable in ninety days.

The loans on deposits and specie, representing the paper money issued by the banks, shall be restricted to paper payable in full at maturity, and such paper shall form a component part of the specie basis intended to meet the circulation and deposits, and shall be restricted to ninety days, so as to effectually insure a rapid movement in the daily receipts.

The loans and investments on the capital shall be denominated the "dead weight."

The loans on deposits shall be denominated the "movement of the banks."

2. No bank shall increase the investment in its "dead weight" so long as the whole of its cash liabilities shall not be represented by one-third of the amount of such responsibilities in specie, and at least two-thirds in satisfactory paper, payable in full at maturity, and within ninety days; and each and every director shall be personally responsible for all loans and investments made in contravention of this rule, unless he shall show that he has voted against the same, if present.

*Provided*, That nothing herein contained shall be so construed as to relieve any bank from its obligation to lend the amount in the country required by its charter; provided further, that no bank shall be authorized to increase the amount of its present loans, in the city of New Orleans, until such bank shall have made the loans required by its charter in the different country parishes.

3. That the account of the maker or endorser of any note, or acceptor of any bill of exchange offered and discounted as paper strictly payable at maturity, who shall apply for a renewal of said paper, or for an extension of time, shall be closed in the bank where such transaction shall have originated, and notice thereof shall be immediately given by such bank to the other banks.

4. That every party to commercial paper, who shall suffer such paper to be protested, and if a drawer of a bill of exchange or indorser of a promissory note or bill, shall suffer it to remain unpaid during ten days, without any legal cause, shall be considered *de facto* discredited, and the fact shall be notified to the board of currency, and the other banks, and no discount shall be afterwards allowed him as drawer or acceptor until he has paid up the full amount.

5. That all paper offered for discount, and having no more than ninety days to run, shall be considered *de facto* as payable in full at maturity.

## District Summary of Business Conditions

In December department store sales in the Sixth District increased less than seasonally but, nevertheless, established a new high level for the month. Wholesale trade also increased, contrary to the usual seasonal trend. Life insurance sales recorded a substantial gain, construction contracts were awarded in larger volume, and pig iron production increased. Textile activity declined somewhat from the record November level, and residential contracts were lower.

► Sixth District department store sales increased in December, but the gain was smaller than might have been expected on the basis of past experience. Holiday business was seriously retarded following the entry of this country in the war. The daily average sales index for the month was up 45 per cent from November, but the adjusted index, which makes allowance for seasonal influences, declined 9 per cent. The December indexes, however, both adjusted and unadjusted, are well above those for December of any previous year.

Among reporting cities in the District Birmingham registered the largest increase over December 1940, a gain of 35 per cent; Chattanooga, Macon, and Jackson reported gains of more than 20 per cent; Jacksonville, Knoxville, Montgomery, and Baton Rouge had increases of between 15 and 20 per cent; New Orleans and Tampa reported increases of 14 per cent; Atlanta a gain of 13 per cent. For the year 1941 Birmingham experienced an increase of 26 per cent, Jacksonville 25 per cent, Chattanooga 23 per cent, Jackson 22 per cent, Knoxville and Tampa 20 per cent, Nashville 19 per cent, Atlanta 17 per cent, New Orleans 16 per cent, Montgomery 15 per cent, and Baton Rouge 10 per cent.

December reports of sales classified by departments from a smaller number of reporting firms show increases in sales of women's coats and suits of 38 per cent over December 1940, and in men's wear of 21 per cent. However, furniture sales increased only 6 per cent and sales of major household appliances were slightly less than they were a year ago.

In the first half of January weekly sales have averaged 24 per cent greater than in the corresponding period a year ago, indicating a much smaller than usual post-holiday decline.

Inventories of department stores declined some 8 per cent more than usual from November to December, but were 29 per cent larger in dollar value in the latter month than they were a year earlier. Wholesale trade increased 3 per cent in December, when there is usually a decline, and was 24 per cent greater than in December 1940. Declines in sales of shoes, dry goods, electrical goods, furniture, and hardware were slightly more than offset in the total by increases in groceries, drugs, tobacco products, and paper products.

► For the year, total wholesale sales in the District were 28 per cent greater than in 1940. It is probable that a substantial part of this increase may be attributed to the rise in prices. The "All Commodities" index of wholesale prices compiled by the United States Bureau of Labor Statistics averaged 11 per cent higher in 1941 than in 1940 and in early January the index was 18.5 per cent higher than it was a year earlier. December inventories held by wholesale firms were

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