A. The Clearinghouse Certificate as a Cash Substitute, 1857-1933

By Dr. Loren Gatch

University of Central Oklahoma

Prior to the creation of the Federal Reserve System in 1913, major aspects of banking regulation lay in the hands of private bank clearinghouse associations. Formed initially for the limited purpose of facilitating the clearing of checks and other offsetting liabilities, clearinghouses rapidly took on wider regulatory responsibilities including mutual protection against the contagion of bank runs. By the beginning of the twentieth century the New York Clearing House Association (NYCHA) in particular assumed central banking functions and responsibilities for the nation's financial system. Building upon early appreciations of the role clearinghouses played in ameliorating the financial crises of the National Banking Era *(Cannon 1910a; Sprague 1910; Spahr 1926)*, modern scholars have argued that the clearinghouse arrangement represented a viable private, market-oriented alternative to public regulation of the nation's monetary and financial systems *(Timberlake 1984, 1993; Gorton 1985; Gorton and Mullineaux 1987)*.

As an outgrowth of their clearing activities, clearinghouses introduced their own internal exchange media—large denomination certificates issued against gold and currency deposits—that enabled banks to settle without the bother of handling large amounts of coin and paper. In addition, to provide for mutual aid during financial stringencies, banks developed a distinctive financial instrument, the clearinghouse loan certificate. Also issued in large denominations ($1,000-$100,000) and circulated only amongst members of the clearinghouse, loan certificates enabled members to extend to each other credit during periods of financial stress. Settlements via certificates enabled member banks to pool their legal reserves when financial markets grew tight, effectively expanding these reserves by eliminating the need to settle their mutual balances in cash, which could then be employed to satisfy the increased liquidity demands of depositors. Their use, according to the financial historian Fritz Redlich, "was the specifically American solution to a problem which central banks in other great commercial nations of the world were faced at every crisis throughout the second half of the nineteenth century" *(Redlich 1951 Part II: 158)*.

Used successfully during periods of financial stress between 1860 and 1884, the clearinghouse loan certificate took on a new significance during the Panic of 1893 when small-denomination versions were issued by a few scattered bankers' associations to circulate amongst the general public. By the Panic of 1907, the clearinghouse certificate (the word "loan" was increasingly dropped) emerged as a cash substitute on a national scale, when upwards of 500 million dollars' worth of certificates, and variants thereof, were issued by dozens of clearinghouse associations across the country.

Of uncertain legality under federal law, these currency substitutes nonetheless met widespread public demand for liquidity, and their success in stemming the panic stimulated a policy debate about banking reform that led shortly to the Aldrich-Vreeland Act of 1908, which authorized the creation of National Currency Associations with the power to issue emergency notes. Invoked briefly at the

Dr. Gatch (PhD Cornell University) is a professor of political economy.

outbreak of World War I, the Aldrich-Vreeland arrangement was overtaken by the founding of the Federal Reserve, which replaced clearinghouse associations as a source of emergency liquidity with its own discount facilities.

Despite the existence of the Federal Reserve, the stock market crash of 1929 and its aftermath ushered in a contraction of prices and output that the Fed proved unable or unwilling to counteract. Culminating in the banking holidays of 1932-1933, the economic crisis provoked one last brief issue of clearinghouse certificates in March 1933. By this time, however, the clearinghouse certificate had been rendered obsolete as a currency substitute, and quickly disappeared from the financial scene.

This article traces the evolution of the clearinghouse certificate from a device for interbank settlements to an important source of emergency liquidity and even a cash substitute for hand-to-hand transactions. It argues that the rise of the clearinghouse certificate as a private adjunct to the national money supply was abetted by two factors. First, the treatment of money both in economic thought and law defined money in a narrow enough way to exempt the clearinghouse certificate from sustained hostile scrutiny. Second, the legal status of clearinghouses as private, unincorporated associations endowed them with a degree of flexibility and discretion that enabled them to mobilize their member banks' resources without fear of legal challenge. Indeed, recognizing these advantages, clearinghouses resisted proposals to formalize their cooperative arrangements by incorporating under federal auspices.

The Origins and Significance of Clearinghouse Certificates

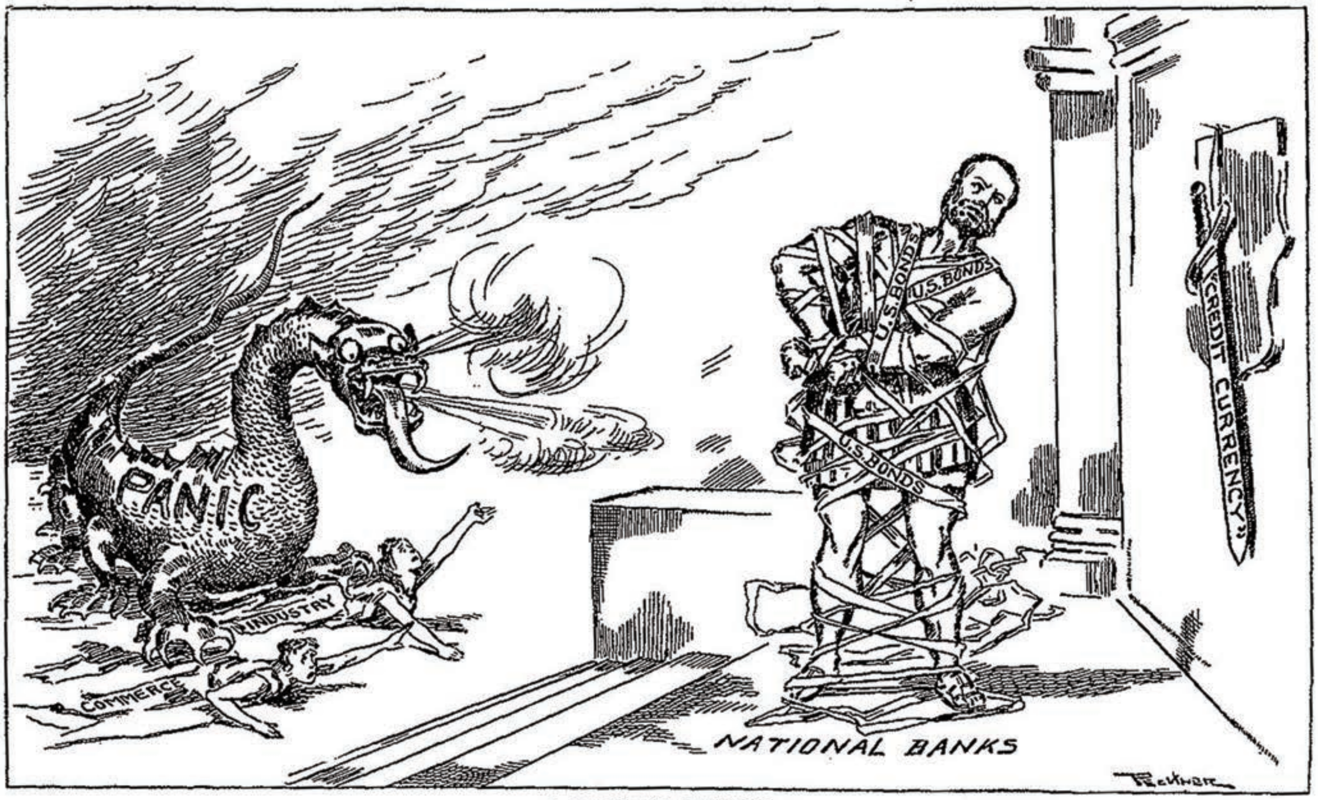
The NYCHA, founded in 1853, was the first bank clearinghouse in the nation, although the Suffolk System of New England had functioned for many years previously on analogous principles for clearing banknotes. Soon, banks in other major cities began establishing their own clearinghouse associations, including Boston (1856), Philadelphia (1858), Chicago (1865), and St. Louis (1868). By century's end, hundreds of cities, large and small, would feature similar associations of local banks *(Cannon 1910a: 75-116).*

Very early on, the NYCHA employed a device called the "clearing house certificate", issued against deposits of gold coin, which enabled banks to settle with each other on a routine basis without the effort and risk of transferring actual specie *(Gibbons 1868: 340-1; Cleaveland and Hutchinson 1980 [1864]: 274-5)*. This practice was subsequently copied by other clearinghouses. With the advent of the legal tender Greenback, certificates issued against deposits of legal tenders were also used in clearings. Federal legislation establishing the system of national banks in 1864 conferred official status upon these private clearinghouse certificates by deeming them "lawful money" for the purposes of calculating legal reserves. Further, the U.S. Government authorized the issue of its own gold certificates in 1863, and currency certificates in 1872. While not legal tender, these notes could also serve as part of national banks' reserves, and served to settle clearinghouse balances *(Knox 1885: 115-6; Dunbar 1969 [1897]: 209-10, 223)*. Up until 1888, the issue of coin and currency certificates for the NYCHA was managed by the Bank of America. In that year, the U.S. Treasury began issuing large-denomination gold coin certificates that supplanted these private certificates. In smaller clearinghouses, standards were less strict as to what settled balances. Settlements could be made in non-legal tender national bank notes or even in exchange on New York, Boston, or Chicago.

A second, but similar, instrument, the clearinghouse "loan" certificate, emerged at the same time as a way for clearinghouse members to lend reserves to each other. This device was far more significant as a policy instrument. When the money market tightened and concerned depositors withdrew their funds, member banks could settle with each other not with scarce cash, but with interest-bearing certificates issued by a clearinghouse committee against approved collateral (loans, bonds, bills of exchange) hypothecated by the bank needing the certificates. Negotiable only amongst member banks, clearinghouse loan certificates effectively enabled banks to expand temporarily the money supply by eliminating the need to settle with each other in lawful money, which could then be used to meet withdrawals. Since these certificates paid interest, banks that drew them from the clearinghouse had an obvious incentive to retire the notes as soon as conditions permitted.

The use of clearinghouse loan certificates was often (but not always) associated with the suspension of payments by banks during financial crises. "Suspension"meant different things at different times during the 19th century, reflecting the progressive change in the nation's circulating medium from banknotes to bank deposits. Before the Civil War, when banks suspended (as in 1819, 1837, and 1857) they no longer redeemed their banknotes and deposits in specie. With the introduction of Greenbacks, the advent of the National Banking System, and the growth of deposit banking, suspension after the 1860s meant that banks would cease to redeem freely their deposits in either legal tender—gold, Greenbacks, silver dollars and silver certificates—or in national banknotes.

In neither period did suspension necessarily mean that banks were about to go out of business, although many did. Whereas in antebellum America suspension of



A POWERLESS DEFENDER.

specie payments cast into question the value of state banknotes and implied a temporary departure from a metallic monetary standard, after the Civil War suspension increasingly cast into question the solvency of financial institutions, and implied an inability of banks to convert their deposits into hand-to-hand currency *(Myers 1931 Vol. I: 235)*.

The National Banking System established during the Civil War was intended to provide a uniform and secure currency, and to support the Union war debt. Yet several features of this system predisposed it to stringency and even crisis. National banknotes were widely criticized for being "inelastic," meaning that their supply neither adjusted easily to seasonal needs (like agricultural harvests), nor to the immediate demands of depositors. Because the supply of banknotes was determined by the supply and price of the government bonds which banks had to deposit as collateral, the amount of notes in circulation did not respond easily to shifts in the public's liquidity preferences. Indeed with the growth of deposit banking currency, inelasticity emerged as a fundamental element of instability within the nation's financial structure. Stipulated reserves for national banks took the form of specie and legal tenders (state banks could also make use of national bank notes), while checkable deposits during normal times provided a flexible and workable circulating medium in addition to the relative stagnant supplies of paper currency. Yet to the extent that such currency also formed the monetary reserves of the banking system, sudden shifts in the currency-deposit ratio caused by heightened liquidity demands would only aggravate tight credit conditions. Customers who demanded currency reduced the reserve base and thus restricted the supply of credit to a multiple of their currency withdrawals. Lacking any easy way of meeting currency demands without reducing the supply of deposits by an even greater amount, banks lacked the flexibility to prevent tight credit conditions from tipping over into financial panics *(Timberlake 1993: 210)*.

Other characteristics of the banking system compounded the instability caused by an inelastic currency. The lack of a national rediscount market made it difficult for individual banks to liquidate their portfolios at short notice. The increasing concentration of banking resources in a central reserve city like New York, and the practice of paying interest on bankers' balances, linked the nation's reserves to unstable and speculative money markets. As the nation's banks became increasingly interconnected, suspension disrupted the national payments system by making it hard for reserve cities to remit to outlying areas. Finally, the growth of correspondent banking relationships in the late 19th century increasingly knitted together three distinct types of institutions—state banks, national banks, and trust companies—that were regulated differently and which often viewed each other as commercial competitors *(Sprague 1910: 228-30; Myers 1931 Vol. I: 240-250)*. By the end of the 19th century, as these three groups all turned to clearinghouses during crises as a source of emergency liquidity and lender of last resort, their differences worsened the panic conditions that encouraged the use of clearinghouse certificates as a cash substitute.

The Clearinghouse Loan Certificate, 1860-1884

While a device similar to the clearinghouse loan certificate was employed by New York banks during the Panic of 1857, the instrument was first introduced during financial disturbances surrounding the election of 1860, when an issue of $10 million in certificates was authorized by the clearinghouse loan committee. Backed by deposits of federal and New York State debt, certificates paying seven percent interest were issued in amounts to seventy-five percent of the value the underlying collateral, a formula which became fairly widespread in the following decades. In addition to accepting these certificates in clearing, the NYCHA banks also agreed to pool their reserves so as to protect their weaker brethren. With the outbreak of the Civil War, three more issues of clearinghouse certificates on similar terms in 1861, 1863, and 1864 increased the total amount issued to some $59 million.

Following the precedent set by New York, other cities' clearinghouse associations adopted the same device during the financial disturbances of 1873. By September of that year financial conditions were so difficult that the New York Stock Exchange closed its doors for two weeks. Between then and January of 1874, New York banks issued more than $26 million in clearinghouse loan certificates on terms similar to those of the 1860s. The banks also took the precaution of not publishing the financial statements of banks that were in bad shape, so as to discourage bank runs. The clearinghouses of Boston, Philadelphia, Baltimore, St. Louis, Cincinnati, and New Orleans (but not Chicago) followed with their own issues. During this crisis, banks also began the practice of issuing certified checks, "payable through the clearing house," drawn on their balances. While these instruments could be deposited and checked against, banks would not pay out currency for them. This practice allowed banks to economize on the use of cash. Apart from a small issue of loan certificates in New Orleans in 1879, the next emission came in 1884, when the NYCHA put out nearly $25 million between May and September. In 1890, New York along with Boston and Philadelphia issued more than $30 million in clearinghouse loan certificates, much of which offset a drain of balances to smaller reserve cities and country banks *(Cannon 1910a: 80-95)*.

The Clearinghouse (Loan) Certificates of 1893

Up to this point clearinghouse loan certificates served only to enlarge member banks' reserves by removing the need to settle in cash. With the Panic of 1893, however, clearinghouse loan certificates assumed a new role. Poor crops, uncertainty over the nation's commitment to the gold standard, and some prominent business failures led New York and eight other large cities in June 1893 to issue about $70 million in certificates, following precedent. As in 1890, demand for these certificates was heightened by the withdrawal by interior banks of their reserve balances, thus hastening the panic by anticipating it. By August, withdrawals and hoarding produced such tight money conditions that a premium of up to five percent emerged on the sale of currency *(Lauck 1907: 102-3)*.

In the face of this demand for liquidity and the inelasticity of the national banknote circulation, private remedies burst forth. For the first time, clearinghouses particularly in the Southeast began issuing certificates not for interbank settlements, but for general circulation, as in Atlanta and Birmingham, Alabama. In the latter city, the use of small denomination notes produced such a need for a further medium with which to make change for the notes that the clearinghouse eventually issued scrip to denominations as small as twenty-five cents. To meet withdrawals, other banks in Georgia and South Carolina issued "clearinghouse certificates" against their own assets, outside of any clearinghouse arrangement, as an emergency currency. Hoarding of currency by the public also became a problem. Jacksonville, Florida banks refused to rent safe deposit boxes to customers who withdrew cash from the banks only to store it in the banks' own vaults *(Cannon 1910a: 98-116; Stevens 1894: 145-8; Warner 1895; Indianapolis Monetary Commission 1900: 221-2)*.

"Payable only through the clearinghouse" once again became a common caveat on bank checks. The Panic of 1893 also witnessed a variety of other temporary currency devices throughout the country, including certified checks, negotiable certificates of deposit, bond certificates, warrants, and payroll checks issued in round amounts. The use of unofficial media was hardly unusual in American financial history. However, the trend in 19th century financial crises towards ever-larger uses of such media as sources of emergency liquidity and circulation suggested structural flaws in the organization of American banking and finance. These flaws would become dramatically evident during the Panic of 1907.

The Clearinghouse Certificates of 1907

Prior to 1907, resort was again made, on a small scale, to clearinghouse loan certificates in Boston, Philadelphia, and New Orleans during 1895-1896. However, it was the Panic of 1907 that triggered the largest and most dramatic use of clearinghouse media, both for settlements and for general circulation. The defects in the nation's financial system illuminated by that crisis inaugurated a searching public debate over financial reform, leading to the Aldrich-Vreeland Act of 1908, and by 1913 to the establishment of the Federal Reserve System.

Unlike 1893, the Panic of 1907 emanated from New York outward. Unlike 1893, there was no political battle over the monetary standard to explain it. Brought on by badly-handled runs on major New York trust companies, the national rush to liquidity touched off a cascade of clearinghouse issues throughout the country. Even more so than in 1893, the events of late 1907 highlighted how the basic features of American finance—the network of correspondent banking; the uneven regulation of national banks, state banks, and trust companies; the pyramiding of reserves in New York City, and their investment in stock market loans—had produced a financial system that was highly sensitive to losses of public confidence, whatever the particular disturbance. As the NYCHA resorted in late October to clearinghouse certificates and restricted payments, banking associations in regional reserve cities and their outlying areas all hastened to adopt similar measures lest they too be confronted with currency drains. In effect, the Panic of 1907 expressed itself as much in the preemptive fears of bankers as it did in the behavior of depositors. Indeed, the rush to issue certificates was itself a stimulus to forming clearinghouse associations in the smallest locales. For example, in Oklahoma alone, where some two dozen emissions occurred, associations were formed with memberships as small as two banks simply to issue scrip *(Gatch 2009)*.

The volume of clearinghouse loan certificates in 1907 surpassed all previous crises. New York alone issued more than $100 million; other major clearinghouse associations together issued a comparable amount. These large-denomination certificates did not circulate amongst the general public. Although banks in most states did not shut their doors, restrictions upon cash withdrawals were common throughout the country. What made this crisis distinctive was the explosion of cash substitutes issued by banks and others in lieu of scarce legal tender, even compared to 1893. In his early survey of the crisis, the economist A. Piatt Andrew (1908) distinguished seven different sorts of emergency media:

1. Clearinghouse loan certificates, issued in large denominations for bank settlements. Their use dated back to 1860, and were not a cash substitute in the sense that they never circulated as hand-to-hand currency;

2. Clearinghouse (loan) certificates, issued in small denominations for general circulation. Some clearinghouses, such as Chicago's and Los Angeles's, used both large certificates for bank settlements and small certificates for circulation;

3. Clearinghouse Checks in round amounts. Similar to the small-denomination clearinghouse certificates in that they were issued against collateral deposited with the clearinghouse association, these were technically distinct in that they were a liability of the bank that drew them, and not of the association. In a few cases, the issue of clearinghouse checks in very small amounts for change making purposes (to $1 and less) complemented the use of circulating clearinghouse certificates of higher denominations;

4. Cashiers' Checks in round amounts. Unlike clearinghouse certificates and checks, cashiers' checks were not issued through, or in the name of, any association of banks. Favored by smaller institutions, they were instead circulated directly by individual banks, which sought to avoid overtly breaking the law against non-national banknotes by making the checks payable to fictitious persons, "or bearer."

5. Certificates of Deposit in round amounts. Less often, smaller banks styled their emergency circulations as unassigned evidences of deposit, with or without an interest feature, and payable at sight or within some specified period.

6. Bank Drafts on Eastern Exchange in round amounts. While correspondent balances may have been unavailable during the panic, interior banks circulated drafts on these balances in small denominations.

7. Payroll Checks in round amounts. Similar to cashiers' checks (no. 4 above), payroll checks enabled non-bank employers to effectively print their own currencies, subject to the tolerance and trust of their communities. This was done at the employer's own initiative, although bankers sometimes assisted, as in Philadelphia.

While the recent onset of the Panic made his survey incomplete, Andrew estimated that these various emergency media amounted to more than $500 million, half of which were clearly designed to circulate as cash substitutes. Andrew's estimates also show that the bulk of this emergency currency took the form of nos. 2-4: small denomination clearinghouse certificates, clearing house checks, and cashiers' checks.

James G. Cannon, a New York banker and a student of clearinghouses, examined the various means by which banks created cash substitutes in 1907. Cannon found that, as a mark of their scrupulous attention to form, banks typically took care to back up these currency substitutes with some sort of collateral, however redundant the arrangement may have been in practice. Thus, in most instances small denomination clearinghouse notes, checks or scrip were "backed" by large denomination clearinghouse loan certificates, even though these large denomination certificates in turn merely represented the banks' own loan and discount portfolios. This was the case in Chicago, Cleveland, Kansas City, and many other large towns. Whatever their precise character, circulating notes themselves tended to be more utilitarian and check-like in appearance, and generally lacked the ornamentation typical of currency. Manufacturing centers with large payrolls like Pittsburgh and Canton issued both small denomination certificates down to $5, and even smaller denominations of bearer checks put out at the fiat of individual banks so as to make change for the larger notes. Philadelphia banks issued certified "payroll checks" in small round amounts against the encumbered deposits of employers *(Cannon 1910a: 117-136; Cannon 1910b)*. In the parlance of the time, such cash substitutes were examples of "asset currency"—liabilities issued against the banks' portfolios of loans and discounts—as opposed to "bond-backed" currency, of which national banknotes were the major example. In effect, during disturbances like 1893 and 1907 banks were reverting to the issuing practices of the antebellum state banking era.

Given the vital service clearinghouse loan certificates provided during 1893 and 1907, it was understandable that their use would inform debate over reform of the nation's financial system. Beginning in the 1890s, a number of legislative proposals sought to formalize the clearinghouse role, including those of Senator Orville Platt (1903) and the New York Chamber of Commerce in 1906 *(Redlich 1951 Part I: 167; Timberlake 1993: 205-7; Wicker 2005: 80-83)*. Other plans prominent at the time included Theodore Gilman's scheme for a federal system of incorporated clearinghouses, and Cannon's own alternative that envisioned clearinghouses organized around the existing regional Sub-Treasuries *(Gilman 1896, 1903, 1904; Cannon 1910b: 25-31)*. Ultimately, though, the private bank clearinghouse and its certificates had no role in the arrangement provided by Federal Reserve Act of 1913. Richard Timberlake suggests that the questionable legal status of clearinghouse certificates (see below) imparted to them a "hucksterish quality;" moreover, the general idea of banks creating their own circulations without an identifiable reserve "smacked of Wall Street legerdemain" *(Timberlake 1993: 211-2)*. O.M.W. Sprague faulted the New York banks for suspending too early in 1907, out of a misplaced fear for their reserve levels; the coincidence of suspension and the issue of clearinghouse loan certificates tarred the latter as part of the problem, not the solution *(Sprague 1910: 273, 276)*.

In a more substantive sense, though, defining the solution also defined the problem. Advocating merely a more formal and preemptive version of clearinghouse certificate issuance presumed that the nation's financial problem lay primarily in its inelastic supply of currency, the (private) solution for which would require no fundamental reordering of the nation's financial system. Advocates of "asset" currency tended to cluster around this alternative, as did opponents of branch banking who (like Gilman) saw clearinghouse associations as a bulwark of unit banking. In contrast, advocating some kind of central bank with discount and note-issuing powers presumed that the problem lay not in the availability of currency during crises, but in the insufficient concentration of and control over reserves, the (public) solution for which would require institutional innovations of a Hamiltonian sort beyond what the Independent Treasury and National Banking Systems and yet achieved.

Were Clearinghouse Certificates and Other Emergency Monies Legal?

The legal status of emergency money, of which clearinghouse certificates were an example, must be appreciated in the context of the increasing standardization of American currency that occurred during the second half of the 19th century. If the state bank note reigned during the antebellum period, the Civil War imposed increased federal control over the provision and regulation of circulating media. Along with the issuance of government Greenbacks themselves—the nation's first legal tender fiat currency—the founding of the National Banking System standardized both the appearance and backing of bank notes. In response to the bane of "shinplasters" (fractional currency in paper form), a federal statute of 1862 proscribed the issue of currency notes in denominations less than one dollar. Shortly thereafter, state bank notes were driven out of existence by the so-called 'death tax' of ten percent upon their circulation. The constitutionality of this tax was upheld in *Veazie Bank v. Fenno* (1869), while federal legal tender powers sustaining the Greenback were upheld by the Legal Tender cases between 1871 and 1884 *(Dunbar 1969 [1897]: 170, 198; Dunne 1960: 49-50, 67-83)*.

Despite these measures, scrip payable in merchandise as well as forms of municipal debt with currency-like properties did survive, thanks to the permissive nature of 19th century court-based economic regulation. Without proactive enforcement of the law by agents of the state, complaints had to be made before the courts would take notice; otherwise, illegal monetary practices would persist with the consent of all parties. When disputes about the monetary quality of negotiable instruments did arise, 19th century federal courts looked to the intent of the issuer and even to the text on the notes themselves for interpretive guidance. If the presumed intent was to create exchange media for general use, then such media invited suppression. However, courts upheld the use of instruments if they had the character of an evidence of debt *(Poindexter v. Greenhow, 114 U.S. 270 [1885])*. If scrips promised redemption in goods and services and not in money, then they also passed muster *(United States v. Van*

Auken, *96 U.S. 366 [1877]; Hollister v. Zion's Co-operative Mercantile Institution*, *111 U.S. 62 [1884])*.

In their rulings, courts could employ a definition of money that was so strict as to grant pragmatic acceptance to a wide array of media with money-like properties. As one judge declared in a 1900 case examining the monetary status of warrants issued by the state of Texas, "it must not only be that they are capable of sometimes being used instead of money, but they must have a fitness for general circulation in the community as a representative and substitute for money in the common transactions of business." As a standard for ascertaining *moneyness*, "fitness for general circulation" left ample scope for exchange media of a more limited nature *(Houston and Texas Central Railroad Company v. Texas*, *177 U.S. 66 [1900]: 84)*. Likewise, the limited negotiability of private scrip meant that it posed no meaningful competition to national currency. "Congress", the U.S. Attorney General's Office opined in 1888, "did not intend to clog the business of the country by repressing the giving of negotiable promissory notes, nor impose an additional indebtedness of 10 per cent. upon a debtor who, in the ordinary course of business, gives his creditor a promissory note for the amount he owes" *(19 Op. Att'y Gen. 100 [1888])*.

Given the widespread forbearance shown quasi-monetary exchange media, it is understandable that large-denomination clearinghouse loan certificates were never the object of serious legal questioning. While even the casual observer could note that by the late 19th century the nation's business was increasingly being conducted via checkable deposits, specie and currency continued to occupy a separate, iconic status in policymaking and economic analysis.

Despite its functional identity with bank deposit credit, paper currency continued to be regarded with special solicitude, even as credits increasingly constituted the bulk of the nation's circulating medium. This policy distinction between notes and deposits was also justified in terms of the different responsibilities attributed to their users. It was incumbent upon those making use of bank deposits to be an informed consumer of a bank's services. For those using currency, however, the presumption was that its integrity was the responsibility of the state. In New York, whose free banking law was later to become the model for other states, public authorities characterized this responsibility by distinguishing between deposit banks and banks of issue:

> Of those which issue no paper to be circulated as money, no danger can be apprehended, unless to the depositors who may perhaps be tempted, by offers of interest or competition in some other way, to extend to them an unmerited credit. Indeed, it would seem to be an unnecessary interference with individual right, to prohibit the establishment of offices, either by associations or individuals, for the purpose of lending actual capital and receiving deposites [sic]; but we can perceive no substantial grounds for any claim of natural right in any individual, to furnish by his own notes, the whole or any part of the currency of the country *(Report of the Bank Commissioners 1837: 14-15)*.

While federalizing the provision of bank notes, the postbellum National Banking System still preserved the distinction between credit and currency, particularly insofar as the new system adopted the practices New York State's Safety Fund, which had protected state bank notes but not deposits. Accordingly, national bank notes were to be issued against the deposit of approved bonds, with an additional gold redemption fund held by the Treasury. In contrast, not only did deposits not enjoy such protection, but schemes for deposit guarantees were opposed both by political and financial authorities as morally-enervating, socialistic, and worse.

These political and policy predispositions to treat currency and deposits differently were reinforced by the dominant currents of late 19th century American monetary thought. Most authorities cleaved to a distinction, inherited from the British "Banking School" tradition, between money and deposit credits. As the standard of value, money measured the value of commodities, while deposit credit and currency (properly issued) merely facilitated their exchanges. Indeed, some writers went so far as to deny that deposit credits had any influence at all on the level of prices, arguing that they were an endogenous effect of real economic activity and that their supply was thus self-regulating. When connected to a commitment to a metallic monetary standard, this doctrine led to typical condemnations of inconvertible paper currencies like the Greenback *(see, e.g., Laughlin 1903; Scott 1910; Cleveland 1908; Conant 1906)*. Unfortunately for the contrary view, grounded upon the quantity theory of money, that the supply of specie, currency and deposit credits together did influence the price level, its contemporary associations with the radicalism of free-silver Populists tainted it too much to be taken seriously *(Fisher 1911: 15)*.

Against this legal and intellectual backdrop, the use of the large-denomination clearinghouse loan certificate was not perceived as a monetary phenomenon. Indeed, even though it was a powerful device for expanding the reserve capacity of clearing house member banks, playing the functionally equivalent role of additional supplies of specie or Greenbacks, its use solely within the restricted confines of the clearinghouse caused it to be regarded as evidence of a loan between private parties with no monetary significance. Arguing that such certificates were not subject to the ten-percent "death tax," the *Banking Law Journal* contended that the tax "is designed as a prohibitive tax upon notes issued by persons or state banks which circulate among the people at large, and cannot be extended to embrace certificates, issued upon deposit of collateral, and available in the settlement of balances, only among a limited number of banks consenting thereto" *(3 Banking Law Journal 451)*. According to another contemporary description,

> [loan certificates] are not in any sense to be considered as currency or as bank notes; they are not passed over the counter to bank depositors or checkholders; they do not pass between man and man as a medium of exchange. They do not in any way measure, determine, or express the value of commodities, nor is the value of anything quoted in their terms *(Curtis 1897: 253)*.

In contrast, in the case of the small-denomination emergency currencies issued by banks, their semblance to Greenbacks and bank notes seemed obvious and inescapable. Even their friends presumed they were illegal. According to John Dewitt Warner, the measures of 1893 worked by "overriding and evading restrictive law" *(Warner 1895)*. A. Barton Hepburn wrote of the 1893 issues that they were "clearly subject to the 10 percent tax enacted for the purpose of getting rid of state bank circulation. This temporary currency, however, performed so valuable a service…that the government, after due deliberation, wisely forbore to prosecute" *(Hepburn 1903: 374)*. As one South Carolinian newspaper defended its state's emissions, "we ask no more consideration for our clearing house certificates than has been given to those issued in New York. There they passed between the banks as money. Here they perforce passed between both the banks and the people" *(The State [Columbia, S.C.] 1893: 4)*. Of 1907, A. Piatt Andrew concluded, "it was an inconvertible paper money issued without the sanction of law" *(Andrew 1908: 516)*. *Bankers' Magazine* agreed: "without awaiting legal sanction—in fact, in the face of express statutory prohibitions—the country has lately been supplied with an abundance of 'checks' and 'clearing-house certificates', constituting a real emergency currency" *(Bankers' Magazine 1907: 888)*. While considering their issue to be of doubtful legality, Joseph Cannon *(1910b: 8)* contended that "no right thinking man would condemn either the purpose or the act" of issuing such currency. Cannon also noted that the Chicago Clearing House in 1907 took care to authorize the drawing of bearer checks only against national banks, since any state bank circulation would have been subject to the "death tax." It was widely assumed that, given their obvious value in meeting panics, the government simply chose not to prosecute issues of emergency monies.

Indirect evidence for this forbearance can be found in the federal government's own legal interpretations. Commenting on a twenty-dollar certificate of deposit issued in 1893 by the First National Bank of Albany (Georgia) against collateral deposited with the Albany Clearing House, U.S. Attorney General Richard Olney argued that, since the wording of the note did not express any specific promise to pay, it was not illegal currency subject to the ten percent tax. Olney pointed out further, "the paper is not signed anywhere by the First National Bank. It is plainly not an instrument upon which either that bank or the Clearing House Association could be sued in an action at common law and a money judgment recovered by introducing the paper alone" *(Op. Att'y Gen. 681 [1893])*. Richard Timberlake quotes Comptroller James H. Eckel's somewhat facetious defense of certificates of that year: "if they had been used as currency…the banks issuing them would have been fined" *(207)*. Given that there were numerous examples of emergency currency that did make such promises to pay, the opinion seems conveniently disingenuous. In contrast, federal authorities did look less kindly upon emissions backed up by the assets of a single bank alone *(23 Banking Law Journal 945, 1019)*. As for the issue of small-denomination certificates of deposit, as well as certified and cashiers' checks, case law on the applicability of the federal tax to these various devices was less than clear as to when they would be regarded as unauthorized currency *(9 Banking Law Journal 203)*.

A more hypothetical legal problem was the banks' own customers. Under the law, checks presented or deposited had to be paid in legal tender, unless otherwise agreed. Not to do so violated contract and exposed the banks to damage claims. During general panics like 1893 and 1907, it was countered that payment restrictions reflected "a temporary rule of the bank not to pay any checks in currency. A refusal so generally understood and so universal in its application can in no wise impair the drawer's credit" *(Angert 1908: 23)*. Given the widespread approval that state attorneys-general and governors gave to payment restrictions (including outright bank holidays during the Panic of 1907 in several states), banks could be confident that their actions would not give rise to suits for damage *(White 1911: 228)*.

Yet another potential legal threat to clearinghouse certificates, whether used for interbank clearings or general circulation, came not from public authority but from private challenges to the ability of banks to hypothecate collateral to clearinghouse associations in exchange for their certificates, without that collateral being subject to prior claims by other creditors. Claims upon the collateral behind these certificates would have compromised their utility precisely under those panic conditions when they would have been needed most. *(Yardley v. Philler 167 U.S. 334 [1897])*.

In any event, none of this emergency media circulated long enough to create the opportunities for legal challenges. Moreover, the fact that none of the hundreds of millions' worth was ever repudiated by its issuers took the fundamental legal cause of action off the table. Not everyone liked the ersatz money. Horace White's disdain for it was unsparing. "All were illegal. Some were engraved to resemble bank notes or government notes, and these were doubly illegal; some were as small as twenty-five cents, and these were trebly illegal…" *(White 1911: 229)*. Populists like Senators William A. Peffer of Kansas in 1894 and Benjamin R. Tillman of South Carolina in 1907 found it galling that banks were allowed this power to expand their circulation—what Tillman called "clearinghouse shinplasters"—while farmers could not issue notes against their stored crops *(Peffer 1894; Tilman 1908)*. Expressing the prevailing fear of concentrated private financial interests, the Money Trust Investigation of 1912 saw great hypothetical danger in the prospect of private clearinghouse associations issuing unregulated circulating media, and recommended the incorporation and regulation of such associations under federal law *(U.S. House of Representatives 1912: 24-7, 107-113)*.

Even more sympathetic observers who envisioned a significant role for clearinghouses in the nation's financial future urged that they incorporate and formalize their relationship with public authority. This unease captured an important part of the legal reality that made clearinghouses such successful adaptors to financial crises in the first place. Thanks to their legal status as private, unincorporated associations, they could bind their members individually to agreements while minimizing their exposure collectively to legal action from other parties. A clearinghouse existed solely to facilitate settlements. While it could issue clearinghouse loan certificates, the clearinghouse itself was not a bank. *(Philler v. Patterson, 168 Pa 468 [1895]; Crane v. Fourth Street National Bank 173 Pa 566 [1896])*.

While other activities of a regulatory or policy nature might evolve from this initial cooperation, at the core of the clearinghouse was a function—the offsetting of credits and debits—that had no legal or material implication for other parties who might otherwise have relations with the member banks. These other parties were, in the legal argot, "strangers" to the activities of the clearinghouse, being neither helped nor harmed by it. In particular, the routine act of sending a check through a clearinghouse did not in itself imply its payment, since this only occurred when bank ascertained that the check was good and that sufficient funds existed. This occurred not on the premises of the clearinghouse, but at the individual member bank, just as if the check had been presented directly over the counter *(Watson 1902: 22, 60, 67; Bryan 1915: 447-56)*. In addition to the flexibility and protection afforded by the unincorporated status of clearinghouses, James L. Laughlin argued that banks were reluctant to make formal arrangements which, if readily available to clearinghouse members, might encourage excessive lending: "What is good medicine for a sharp attack of disease…is not desirable as a regular diet" *(Laughlin 1912: 185)*. In sum, given the advantages of remaining unincorporated, it is not surprising that clearinghouse associations remained lukewarm about measures to increase their supervision by public authority *(8 Banking Law Journal 455; Redlich 1951: 167)*.

The Clearinghouse Certificates and Aldrich-Vreeland Notes of 1914

The Federal Reserve Act of 1913 was supposed to have solved the 19th century financial problems that had periodically given rise to clearinghouse emissions. Now that a national lender of last resort existed with powers to issue an elastic currency presumably at will and at need, clearinghouse loan certificates ought to have disappeared. The core function of clearinghouses, the clearing of checks, migrated to the regional Federal Reserve banks as those banks accumulated reserve deposits from their new members and endeavored to enforce par clearing for checks. It became inevitable that settlements through local clearinghouses would be replaced by the simple debiting and crediting of member banks' account with their Federal Reserve district bank *(Spahr 1926: 172, 196-7, 226; Andrews 1942: 595)*.

The banking reform movement sparked by the Panic of 1907 did produce legislation that temporarily legalized one version of emergency asset currency, the Aldrich-Vreeland notes. To issue such emergency notes, banks had to organize themselves into National Currency Associations under federal authority, an arrangement that merely wrote into law the existing informal arrangement for issuing clearinghouse certificates. Before the Federal Reserve was up and running the financial stresses accompanying the outbreak of World War I provoked the first and only issue of Aldrich-Vreeland emergency notes. Fortuitously, the act establishing the Federal Reserve had temporarily extended for one year the Aldrich-Vreeland provisions for emergency currency. Between August and October 1914, forty-five National Currency Associations hurriedly formed under the 1908 statute issued some $370 million in emergency notes, mostly against commercial paper and corporate bonds. These were rapidly retired as the Federal Reserve opened for business. During the same time, New York and eleven other clearinghouse associations briefly issued over $200 million in loan certificates for their own settlements. None of these circulated amongst the public. *(U.S. Comptroller of the Currency 1916: 99-100; Kemmerer 1914: 604-5)*. A few clearinghouses in areas lacking National Currency Associations did issue low denomination certificates for general circulation. Otherwise, the Aldrich-Vreeland issues eliminated the need for any widespread resort to scrip on the level of 1907 *(Commercial and Financial Chronicle 1915: 509)*.

Shortly thereafter, a brief issue of Federal Reserve Bank Notes to replace existing silver certificates was occasioned by the provisions of the Pittman Act of 1918, which authorized the sale of silver to Great Britain. While not emergency notes, they bear mentioning because the terms of their issue resembled the Aldrich-Vreeland currency, and they later reappeared in 1933 under more trying circumstances *(Nussbaum 1958: 166-7, 178, 200)*. In any event, with the Federal Reserve henceforth controlling the issue of currency, the role of clearinghouse certificates as a cash substitute seemed to be over.

The Clearing House Certificates of 1933

The stock market crash of September 1929 and the ensuing depression ushered in yet another episode of emergency currencies. Given the severity of the economic downturn, these currencies ranged from barter notes and tax warrants to the exotic fad of "stamp scrip." The increasing problem of insolvent banks led by early 1933 to the collapse of the nation's financial system, and to the declaration of a national banking holiday at the outset of the new Roosevelt Administration. Intended as a breathing space to prepare a program for the rescue of the banking system, the holiday of March 1933 was also the occasion for the last issue of clearinghouse certificates. Previous panics did not compare to the grinding liquidations of 1929-1932, although many country banks had already suffered through the agricultural depression of the early 1920s. Whereas a generation earlier, clearinghouse associations used certificates first for interbank clearings, and then as general-circulation currency, the advent of the Fed's discount window as well as its use of open-market operations meant that banks no longer looked to their clearinghouse associations for an emergency expansion of reserves. At the same time, so severe was the effect of price deflation upon banks' portfolios that, by 1932, banks were turning to the Reconstruction Finance Corporation to recapitalize their balance sheets. What banks needed at the height of the crisis was an emergency currency to counteract hoarding and meet the extraordinary demands of panicky depositors.

As state-level bank moratoria culminated in Roosevelt's decision to close all banks on March 4, 1933, the possibility of clearinghouse certificates once again arose. Despite the actual closure of banks, the president's declaration left open the use of certificates to meet immediate currency needs. It was symptomatic of the new situation that the NYCHA, which during previous crises through 1914 had never issued small-denomination scrip, now endeavored to produce an emergency circulation. After a few days' delay, Treasury Secretary William Woodin did give clearinghouses permission to issue certificates. According to Vernon L. Brown, who wrote the first study of Depression-era emergency currency, forty-six clearinghouses authorized nearly $650 million in such scrip, and many millions' worth were printed by the American Bank Note Company and other firms. Unlike their 1907 forbearers, the clearinghouse certificates of 1933 looked less like bank checks and more like currency. Yet before the use of certificates could gear up, the Federal Reserve used its new powers under the Emergency Banking Act of March 9th, 1933, to create sufficient Federal Reserve Bank notes—descendents of the Aldrich-Vreeland and Pittman Act currencies—to meet anticipated public demands for cash once the banks reopened. Of the original amount of clearinghouse scrip authorized, less than $30 million was actually issued by fifteen associations, and most of this circulated for no longer than one month. Otherwise, the bulk of the scrip printed sat unused in bank vaults *(Brown 1941: 129-147)*. Federal Reserve officials opposed the use of bank scrip, believing that it encouraged monetary radicals in Congress. In particular, the prospect of the New York Clearing House—the premier banking organization of the country—issuing scrip was too much for Washington, especially as the New York state legislature had also authorized the creation of an Emergency Certificate Corporation to issue a statewide scrip. Treasury Secretary Woodin forbade New York to undertake this, on the grounds that the emergency banking legislation represented a solution to the problem *(Kennedy 1973: 172-3)*.

As in 1907, the events of 1933 produced variants on the clearinghouse certificate form. Though closed by the various bank holidays or even insolvent, banks outside of clearinghouses sought some means of providing their depositors access to their funds. Banks did this by assigning some fraction of their assets as collateral for scrip, and using the notes to meet some of the demand for currency. The famous "wooden money" of Tenino, Washington was issued in this fashion, and other banks individually produced scrip (particularly in Tennessee) for circulation. In Wisconsin, the state legislature authorized the issue of "State of Wisconsin Bank Scrip" against frozen deposits, which was clearly illegal under federal law. In other cases, banks worked with other business organizations to issue currency. For example, the Springfield, Illinois "Credit Clearing Committee" issued notes in round amounts against the encumbered accounts of specific depositors. In New Bedford, Massachusetts numerous employers met their payrolls through small denomination checks issued through local banks, much like the earlier examples of 1907 *(Gatch 2008)*.

All of these currency expedients disappeared quickly as monetary conditions moved back from the precipice of March 1933, and stability (if not prosperity) returned to the credit markets. Clearinghouse certificates and their variants had been displaced by the issue of emergency Federal Reserve Bank notes under the provisions of the March 9th legislation. In any event, the returning flood of dishoarded currency meant that most of these emergency notes were never put into circulation. As for the clearinghouse certificate, the events of 1933 marked its retirement into financial history.

Conclusion

The rise and fall of the clearinghouse certificate as a cash substitute over some seventy years was symptomatic of a financial system that remained permeable to the introduction of private exchange media, even as federal law and policy sought to impose uniformity upon the nation's money. Motives for the use of clearinghouse certificates, large and small, were afforded by the distinctive shortcomings of the postbellum National Banking System, especially its failure to provide an adequate supply of paper currency flexible enough to meet seasonal and emergency needs. Opportunities to issue this particular form of private money were afforded by the prevailing ideas about what money and currency were (and were not); in particular, enduring conceptual and legal distinctions between the form and function of specie, paper currency, and deposit credit encouraged a permissive regulatory atmosphere in which local bank scrip flourished. As private unincorporated voluntary associations, clearinghouses enjoyed both flexibility and discretion in carrying out their monetary innovations within the interstices of the law.

The persistence of private clearinghouse certificates also illustrates nicely what the legal historian Arthur Nussbaum termed the "society theory of money;" namely that, despite the assumption by the modern state of monetary functions as an aspect of sovereignty, societal actors can and do provide private alternatives to legal tender when the state falls short *(Nussbaum 1950: 5-10)*. Even in their disagreements, contemporary observers of the clearinghouse were sophisticated about the larger financial system and its shortcomings. They understood that, even if clearinghouse certificates were technically illegal (or, as Redlich put it, "extra-legal"), they served a purpose that was more important than conformity to an imperfect law.

Present-day scholars have rediscovered in the 19th century bank clearinghouse a plausible alternative to monetary regulation via a central bank under public (or, as Richard Timberlake [1984] would have it, "political") control. As Gary Gorton and Donald J. Mullineaux (1987) have contended, clearinghouses solved information asymmetries peculiar to the dynamics of checkable deposits, especially as opposed to banknotes. Moreover, the episodic use of clearinghouse certificates represented "co-insurance" of members' bank deposits during panics. What the present article suggests is that such interpretations of the clearinghouse are best situated in the understandings and practices of late 19th century banking. In particular, a device like the clearinghouse certificate, which found function and purpose during this period, later lost its relevance as the mode and locus of financial regulation shifted from the private to the public sphere.

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