

THE SUFFOLK BANK

A Study of a Free-enterprise Clearing System

George Trivoli

**The Adam Smith Institute
London**

Dr George Trivoli is Finance and Economics Coordinator at the College of Business Administration, Loyola University, New Orleans, Louisiana. He has been chairman of the Division of Economics and Business Administration at Hillsdale College, Michigan, and Associate Professor of Finance at the University of Texas at Arlington.

Dr Trivoli's publications include *Business Issues and the Environment* (University of Akron Press, 1972), and "A Modest Proposal for a Private International Monetary System", *Kredit und Kapital* 1977.

Bibliographical Information

© 1979 by the Adam Smith Institute, Leesburg, Virginia

Goron Pro-Print Co Ltd. 6 Marlborough Road, Churchill Industrial Estate, Lancing, West Sussex, England

All rights reserved. Apart from fair dealing for the purpose of private study, research, criticism, or review, no part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without the prior permission of the publishers.

ASI (Research) Ltd, 23 Great Smith Street, London SW1P 3BL (020 7222 4995).

The views expressed in this publication do not necessarily reflect those of the publisher or copyright owner. They have been selected for their independence and intellectual vigour and are presented as a contribution to public debate.

ISBN 0-906517-01-X

Contents	Page
Foreword	4
1. Boston Banking 1800–1819	5
Boston and the Country Banks	5
Gresham's Law and the Country Banks	6
2. The Suffolk System	10
The Creation of the Suffolk System	10
The Operation of the Suffolk System	11
The Criticisms of the Suffolk System	12
3. The Effects of the Suffolk System	13
Protection against Unsound Banks	13
Regulation of the Member Banks	14
Efficient Note Clearance	15
Strengthening of the Banking System	16
4. The End of the Suffolk System	18
The Growth of Opposition	18
5. An Appraisal of the Suffolk System	20

Foreword

The *Adam Smith Monographs* seek to provide valuable contributions to some of the long term issues under debate in Britain and the United States. In particular, the series will deploy innovative arguments and new information in an effort to encourage the exploration of interesting alternatives to more orthodox lines of argument.

In this first monograph, Dr. George Trivoli gives an account of the history of the Suffolk Bank System, showing that a free enterprise bank clearing system did operate with great success during a period of American banking history often characterized as “chaotic”. The system also operated as a regulator of banking in the Boston area, acting as a check on the overexpansion of bank notes and requiring small country banks to keep reserves with it in return for the honouring of their bank notes. Though guided primarily by the profit motive, the Suffolk system carried out many of the basic functions of a central bank, and enabled the population of the area to handle the notes of competing banks with safety.

As Dr. Trivoli indicates:

- The Suffolk System, operating in Massachusetts during the mid–nineteenth century, shows that a free enterprise central bank and clearing system can operate with great success.
- The Suffolk System brought stability to an area where competing banks issued their own notes, by acting as a clearing agent for banks.
- Member banks kept interest–free deposits at the Suffolk Bank, which cleared the members' notes. This system was an effective protection against unsoundness, and allowed the notes of small country banks to circulate at par.
- Careful management was required of the member banks as a condition of membership of the system.
- Even the U.S. Comptroller of Currency had to admit that the Suffolk System showed that “private enterprise could be entrusted with the work of redeeming the circulating notes of the banks, and it could thus be done as safely and much more economically than the same services can be performed by the government.”

Dr Trivoli's analysis of the Suffolk System is timely, in view of the revival of interest in the concept of non–governmental competitive monies. Important work in this field has been completed by Professor Friedrich Hayek; in particular his study *Denationalisation of Money* (Institute of Economic Affairs, 2nd edition, 1978). Dr. Trivoli's account of the operation of a free enterprise bank clearing system provides important additional evidence.

STUART BUTLER

1. Boston Banking 1800–1819

Boston and the Country Banks

From the beginning of the nineteenth century, banks in Boston were confronted with notes of country banks from all over New England circulating along with Boston bank currency. The money supply of Boston during these years consisted of coins, redeemable notes of State banks in Boston, and redeemable notes of State banks outside of Boston and throughout New England. The notes of all banks outside of Boston were dubbed “country” or “foreign” by contemporary Bostonians. These notes circulated at a discount that varied with the costs of redemption and the financial standing of the issuing institutions.

D. R. Whitney in his book, *The Suffolk Bank* describes the situation of the Boston merchant of the time.

“Receiving payment in bank notes, he assorted them into two parcels, current and uncurrent. In the first he placed the notes issued by the solvent banks of his own city; in the other the bills of all other banks. Upon these others there was a discount varying in amounts according to the location and credit of the bank issuing them. How great the discount he could learn only by consulting his “Sank Note Reporter” or by inquiring at his nearest exchange office. The discount on them varied from 1% upwards, according to the distance the bills had to be sent for redemption and the financial standing of the bank by which they were issued.”¹

Many of the country banks were established in remote places in order to delay redemption of their outstanding notes, thus increasing their ability to expand their note issue. The more distant they were from the business centers, the more expensive it was to send their bills home for redemption and the more difficult it was for the general public to know the true financial condition of the issuing bank.

Owing to the fact that Boston served as the *entrepot* for all of New England, substantial quantities of country bank notes converged on Boston, directed there by the favorable intra-regional balance of trade. These country notes were detained in that city's circulation by agents of country banks who loaned them to persons in Boston. Through their agents in Boston, country banks of New England could loan their bills to borrowers in that city, offering lower interest rates and easier terms than, the city banks.²

In the early 1800's Boston banks had accepted the notes of country banks at par or at a small discount, and had returned then to the issuing banks for redemption, rather

¹ D. R. Whitney, *The Suffolk Bank* (Cambridge, Mass, 1978) p. 10, This is the official history of the Suffolk Bank. D. R. Whitney, later president of the bank, based his account almost entirely on the records of the bank, This source is invaluable and will be quoted in order to give the views of the bank on various matters of the time.

² *Ibid.*, pp. 11-13

than placing them back into circulation in Boston in competition with Boston bank notes. This policy was later abandoned due to the inability of some country banks to redeem their excessive note issues and the various methods adopted by other banks to avoid or delay redemption of their notes. In addition, there was always the risk facing Boston banks that a country bank might fail before its notes could be presented for redemption.³

Boston banks finally refused to accept country bank notes, which gave rise to money brokers who exchanged "Boston money" for country bank notes at a commission of one-fourth of 1 per cent. The discount on country bank notes ranged from 1 to 5 per cent, based on the expense of returning them to the issuing bank for redemption and the financial position of the issuing bank. As the volume of country bank notes in Boston increased, the expense and risk of redemption increased, causing the discount on country bank notes to increase. Throughout this entire period notes of the city banks circulated at par.

This situation of discounted notes circulating side by side with notes at par, and the refusal of Boston banks to accept country bank notes, was disruptive to commerce and worked great hardship on Boston merchants. Since the merchants had to accept country notes from their customers and also had to make deposits in Boston banks, they were forced to assume the full burden of this discount when they exchanged country bank notes for Boston bank notes through the brokers. Similar so-called double currency existed in New York, Philadelphia, and other important commercial centers of the time.

Gresham's Law and the Country Banks

This dual-currency condition led some historians and economists to conclude that "bad" notes of the country bank in New England drove out of circulation the "good" notes of banks in Boston. Recent investigation, especially by Professor J. Clayburn La Force, has tended to dispel this belief.⁴ A typical statement that Gresham's Law was in operation in Boston prior to the establishment of the Suffolk System appears in Horace White's *Money and Banking*:

*"The country banks discounted commercial paper in Boston as well as at home, paying out their own circulating notes therefore. As these notes were below par in Boston, but were generally accepted by merchants, Gresham's Law came into play; that is, the worse drove out the better."*⁵

This interpretation is incorrect in two major respects. In the first place, the notes of Boston's banks did not disappear though they diminished relative to those of country banks in response to the growing reliance on demand deposits by city banks and to the increasing competition of country bank agents in Boston. Secondly, conditions were not right for the operation of Gresham's Law. The values at which the allegedly "worse" country bills circulated were constantly changing and the "better" city notes invariably were passed at par. Although both notes were redeemable in silver or

³ Nathan Appleton, *An Examination of the Banking System of Massachusetts* (Boston 1831) pp. 10.12.

⁴ J. Clayburn La Force, "Gresham's Law and the Suffolk System: A Misapplied Epigram," *Business History Review* (Harvard Graduate School of Business Administration) Vol. XL, No. 2, Summer, 1966.

⁵ Horace White, *Money and Banking* (Boston, Mass. p. 293-294 4th ed., 1911).

gold coin in the New England of pre-Suffolk System days, the country dollars were worth less than a dollar in specie in Boston. This is because receivers of country notes obtained a discount on country bills as compensation for the costs of redemption and for the risk of holding them. Consequently, a dollar of country currency, valued at less than a dollar in specie in Boston, would purchase less than a dollar's worth of goods from Boston merchants.⁶ When the specie or commodity value of a country note rose or fell in Boston, the purchasing power of this bill varied in like fashion. On the other hand, a dollar of city money consistently remained at par, i.e., they were worth 100 cents in gold coin and commodities. Under these conditions there existed no incentives for arbitragists to profit by taking the "good" city notes out of circulation.⁷

The phenomenon alluded to by Gresham's Law occurs when there are two or more currencies circulating together, both or all of which have the same nominal value; the currency with the higher intrinsic worth will tend to disappear from circulation. It might be said that the necessary condition for the workings of Gresham's Law, the existence of two currencies side by side with different values, did exist in Boston at this time. But, the sufficient condition, that the values at which both currencies pass (nominal or stamped values) when employed to purchase commodities must remain constant, fixed either by force of law or by mutual consent of the users, did not exist. The country bank notes' value was discounted according to redemptive costs and risks so as to always bring it in line with the city bank notes.

There still remains to be explained the fact that although city notes remained in circulation prior to the Suffolk System, they represented a small and perhaps declining proportion of New England's money supply. Table 1 shows that city bank notes remained in circulation in Boston at all times; however, despite the growth of the number of banks in Boston and total notes in circulation, the notes in circulation per bank declined markedly. The temporary increase in city notes per bank from 1825 to 1828 is due to the issuance of interest bearing notes, which Boston banks issued for this four year period in an attempt to reduce the competition of country banks. It is probable that banks in Boston used interest bearing notes in an attempt to wean away those individuals who were borrowing country notes from agents of country banks in Boston.

⁶ Appleton, p. 10,

⁷ La Force, p. 166.

TABLE 1
Number of Banks In Boston, Note in Circulation Per Bank, and
Total Notes In Circulation In Boston from 1810 to 1830

Year	Number of Banks in Boston	Total Notes in Circulation	Notes in Circulation per Bank
1810	3	906,578	302,193
1811	3	1,059,313	353,104
1812	4	1,079,748	269,937
1813	4	1,375,380	343,845
1814	6	1,745,754	290,959
1815	6	1,548,193	258,032
1816	6	1,142,307	190,384
1817	6	1,220,151	203,358
1818	7	1,142,116	163,159
1819	7	1,167,682	152,526
1820	7	1,272,226	181,746
1821	7	1,329,411	189,916
1822	10	1,191,971	119,197
1823	10	1,353,892	135,389
1824	12	1,796,601	149,717
1825	14	3,770,536	269,324
1826	15	3,942,651	262,843
1827	15	3,681,665	254,444
1828	16	4,445,600	277,850
1829	17	2,077,691	122,217
1830	17	2,171,417	127,730

Source: Compiled from Hunt's Merchants' Magazine, II (Feb., 1840), 137., p. 159.

Boston banks had a lesser amount of notes in circulation in proportion to their capital than did country banks. This, however, rather than being evidence that country notes were driving city notes out, was a consequence of the fundamental dissimilarities between city and country banking, and due to these differences Boston's banks had more deposits relative to circulation than did rural banks. Since country banks specialized in lending relatively small amounts to artisans, shopkeepers, and individuals in Boston, while the Boston banks did business generally with industrialist and merchants who operated on relatively large scales, the notes of country banks would necessarily be more in evidence in the channels of retail trade.

Moreover, merchants who needed specie frequently for international remittance or for other purposes kept deposits in Boston; country banks themselves often kept specie in city banks, and, in addition, some members of Boston's business community held part of their wealth in the form of deposits for use in discharging their debts. Finally, customers of the metropolitan banks generally followed the practice of taking the proceeds of their loans in the form of bank deposits, whereas patrons of

country banks took cash.⁸ As Boston merchants and industrialists substituted deposits for notes when making remittances and when taking proceeds of loans, the relative importance of notes for the city banks would tend to decline.

The actual existence of extensive deposit banking in Boston during the years 1800 to 1825 is unknown, but since wealthy merchants owned stock in and did business with Boston banks, it would be expected that they would frequently settle relatively large debts by transferring deposits to their creditors. The only evidence of the use of checks for transferring of deposits at this time is the number of court decisions which resulted from disputes and legal action arising from their use. Court decisions regarding use of checks in Massachusetts date from 1800 and became more frequent thereafter.

A rising preference for deposit banking would tend to diminish the importance of notes of city banks. In addition, the existence of large deposits in city banks restricted the ability of these institutions to increase their issues of notes. Banks kept a reserve of coin for their combined note issue and deposits.

⁸ Walter B. Smith and Arthur H. Cole, *Fluctuations In American Business, 1790–1860* (Cambridge, Mass. 1935) p, 5.

2. The Suffolk System

The Creation of the Suffolk System

In 1814 the New England Bank of Boston entered into competition with the brokers and began to accept the notes of country banks at a discount to return them to the country banks for redemption at par unless the country bank maintained a deposit with the New England Bank. Those country banks maintaining deposits were permitted to redeem their notes at the same discount charged by the New England Bank since their deposits compensated the New England Bank for its services while eliminating the risk of loss due to failure of a country bank. As a result of the activities of the New England Bank, the average discount in Boston for country notes declined from 3 per cent in 1814 to 1 per cent in 1818; however, the cost was still borne by the country-note holders.⁹

This was the currency situation in Boston in 1818 when a group of prominent merchants organized the Suffolk Bank. Within a year some of the bank's directors saw a profitable opportunity of entering into competition with the New England Bank. Within 8 months the Board of Directors of the Suffolk Bank approved a plan not unlike that of the New England Bank. They would accept notes of country banks at the same rate of discount as the New England Bank provided these banks kept a permanent deposit of \$5000 plus an additional deposit to constitute a redemption fund; twenty-three that were already depositors of the Suffolk were exempted from this requirement provided they kept all their Boston deposits at the Suffolk; all depositor banks would have the privilege of receiving their own bank notes at the same discount charged by the Suffolk Bank; the notes of institutions that refused to make such deposits were to be sent home for redemption at par.

As a result of the lively competition for exchange of country notes with the New England Bank and the various brokers, the basic rate of discount was reduced to one half of 1 per cent. But the early efforts of the Suffolk Bank to obtain new depositors met with little success; by mid-1820 only two new country bank deposits had been added. By the end of 1820 both the Suffolk and New England Bank suspended all purchases and return of notes of non-depositor banks since the business had become unprofitable.

By 1824, following a rise in country note circulation in Boston, both banks began purchasing again but the purpose was not to make a profit on the redemption but to reduce the circulation of country notes in Boston and so permit a wider circulation of the notes of the Boston Banks. This they hoped would increase the potential for their own loans and profits. Despite heavy purchases of the Suffolk Bank, the directors found that some of the notes which had been removed from circulation were being replaced by an influx of a worse type, particularly from Maine banks. To buy these notes involved some risk, so the Suffolk Bank proposed to the other Boston banks benefiting from the purchases that a joint fund be raised for the purpose of purchasing and sending back for redemption in specie the country bank notes.

⁹ J. B. Felt, *An Historical Account of Massachusetts Currency* (Boston 1839) p. 218.

An agreement was made by six other Boston banks and the Suffolk, known as the Associated Banks, and they contributed jointly \$300,000 to carry the plan into effect. The Suffolk Bank, starting May 24, 1824, began acting as agent for the group, buying country notes from the other Associated Banks first at a discount and later at par. With the support of the Associated Banks the volume of country bank notes received by the Suffolk rose from about \$330,000 per month in 1824 to over \$2 million per month by the end of 1825.¹⁰ This gave the Suffolk Bank the needed leverage to exert great pressure upon the country banks to establish deposits for redemption of their notes in Boston. With the discontinuation of the agreement of the Associated Banks in 1826 the Suffolk bank was strong enough to assume the entire responsibility for the system. By 1838 over 300 banks, practically all the banks in New England, redeemed their notes in Boston through the Suffolk Bank.

The Operation of the Suffolk System

The fundamental plan of the Suffolk System from 1825 to 1858 was as follows:

- (i) each country bank was required to maintain a permanent deposit at the Suffolk Bank of \$2000 or more depending upon its size, plus an added deposit sufficient to redeem all of its notes that were received by the Suffolk Bank,
- (ii) Boston banks were required to maintain only permanent deposits, which were gradually reduced from the \$30,000 under the Associated Banks' plan to \$5000 in 1835,
- (iii) no interest was paid on any of these deposits,
- (iv) in return the Suffolk Bank agreed to accept at par from depositor banks all the bank notes they received from other New England banks in good standing and to credit such deposits to the account of the depositor bank on the day following receipt.

From 1825 on, the Suffolk System was in operation receiving and collecting country notes at par. This meant banks all over New England could send in for deposit notes received from any other banks; thus, the Suffolk Bank acted as a clearing agency, i.e., the Suffolk received notes from all banks, sorted them, and made charges or credits to the accounts of the banks maintaining deposits with it.

The banks of New England were thus divided into two groups (a) those keeping a deposit with the Suffolk Bank and redeeming their notes at its counter, and (b) those which kept an account with some other Boston bank with which an arrangement was made for the redemption of their notes. The Suffolk Bank did not require the New England banks to keep a deposit with it as a condition precedent to receiving their notes at par, as long as the banks redeemed their own notes at some convenient place on penalty of having them sent home for specie. For the notes of the former group of banks the Suffolk had security in the form of deposits and collections. For the other banks it had no security except the good faith of the banks acting as the agents of the issuing bank. Bank notes were sent home for redemption by the Suffolk only when the country bank failed to arrange for redemption in Boston.¹¹

¹⁰ Wilfred S. Lake, "The End of the Suffolk System," *The Journal of Economic History*, vol. VII, No. 2., Nov. 1947, pp. 183–86.

¹¹ Whitney, p. 19.

The Criticisms of the Suffolk System

Country banks were opposed to the Suffolk System from the very beginning; to them nothing more exasperating than this plan could have been imagined. They objected to it at first because it seemed likely to curtail their circulation and the profits derived therefrom.¹² Opposition intensified with the inauguration of par redemption in 1825. Many country banks had been making loans in their bank notes in Boston and subsequently buying back these notes at a discount from brokers. Par redemption put an abrupt end to this practice. The country bank, furthermore, was furious over the Suffolk's policy of systematic redemption at home in specie, since the system apparently prevented the country bank from expanding its note circulation as much as it wanted.

In a defense against the country bank criticisms of the Suffolk System, D. R Whitney argued that the Suffolk Bank,

"...found the currency of New England in a chaotic state; but by putting this principle (redemption) into practice it had brought order out of confusion, and had compelled the banks to keep themselves stronger than they otherwise would, and live up to a principle the justice of which they could not deny."¹³

Following a Massachusetts Supreme Court decision upholding the right of the Suffolk Bank to demand redemption of country bank notes in specie in 1827, and the refusal of the State legislature to charter a new bank owned by the country banks to perform services similar to those rendered by the Suffolk System, organized efforts to supplant the Suffolk System by country banks subsided, to be revived only seventeen years later. The opposition remained, awaiting an opportunity to express itself against the control which the Suffolk System exercised over country banks. Nevertheless, the business and power of the Suffolk Bank continued to increase throughout this period. From 1841 to 1850 the annual volume of redemptions of the Suffolk rose from \$109 million to \$220 million.

¹² Horace White, *Money and Banking* p. 294.

¹³ Whitney, p. 20.

3. The Effects of the Suffolk System

Protection against Unsound Banks

In appraising the effects of the Suffolk System upon the banking scene of New England, it must be recalled that the principal motive for establishing the system was the desire of Boston banks to increase their bank note circulation. Once the Suffolk System was firmly established, one would have expected the city banks to experience a rise in circulation of their notes. This did not occur nor is there reason for it to have occurred.

Following our earlier analysis, there is every reason to have expected the country bank notes to have remained a significant portion of the currency of New England. If anything, the Suffolk System increased the acceptability of the country notes by making them acceptable at par. While the Suffolk System failed to increase the quantity of any bank notes in circulation, it was apparently not without its impact on country banks. Banks in Maine saw their aggregate as well as individual note issue drop precipitously in 1826. Banks in the countryside of Massachusetts experienced a fall of more than 20 per cent in notes in circulation per bank, while there was a rise of 10 per cent in aggregate note issue in 1826.

Yet there were other factors operating during this period, which tend to cast doubt on whether this was due solely to the Suffolk System. For instance, the Second United States Bank was in operation at this time; also the number of banks in Massachusetts increased 48 per cent in 1826. Not to be forgotten is the probably negative effect on country banks' notes of the issue of interest bearing notes by Boston banks between 1825 and 1828. Table 2 indicates that while the circulation of notes in Boston banks rose as a percentage of all notes of Massachusetts banks to a high of 48.5 per cent by 1826, it declined thereafter.

TABLE 2
Circulation of the Notes of Massachusetts Banks (In Thousands)

Date	All Banks	Boston Banks	Boston Percentage
1823	\$3,129	\$1,354	43.3
1824	3843	1797	46.8
1825	4091	1918	46.9
1826	4550	2206	48.5
1827	4936	2103	42.6
1828	4885	2067	42.3
1829	4748	2078	43.8
1830	5124	2171	42.3
1831	7139	3464	44.8
1832	7123	3060	43.0
1833	7889	2824	35.8

Source: Wilfred S. Lake, The End of the Suffolk System. p. 188.

The most striking achievement of the Suffolk System for Boston was the ultimate elimination of the discount on country banknotes. The citizens of Boston were relieved of a burden which was borne by the people in New York, Philadelphia, and other commercial centers up until the establishment of the national banking system. The Suffolk System worked as an effective protection of the public against unsound banks, despite its apparent ineffectiveness at increasing the circulation of Boston notes at the expense of country notes.

Even with its stabilizing influence on the banking system of New England, it should not be inferred that the Suffolk Bank was operating purely as a public benefactor. There was great opportunity for profit-making by the Suffolk in the handling of huge quantities of bank notes. The redemption of country notes by the Suffolk Bank increased steadily until the annual receipts reached a total of over \$400 million in 1858. This tremendous volume of business was handled with a total salary cost of \$40,000 against income from the lending of interest-free deposits of over \$1 million and income from the interest charged on overdrafts.¹⁴ D. R. Whitney refers to the business of handling these deposits and redemption as “very remunerative” by 1850 when the regular dividends on the Bank's stock were 10 per cent. Throughout the period the stock of the Suffolk Bank was usually the highest priced bank stock in Boston.¹⁵

Regulation of the Member Banks

The Suffolk System has been characterized by some as a “good regulator of a bad system”, by acting in some limited respects as a central bank for New England prior to the advent of the Bank of Mutual Redemption in 1858. Membership in the Suffolk System was restricted to banks whose notes could be accepted safely by the public. By looking after its own best interests it could withhold membership in the Suffolk System from new bank whose poor banking practices might tend to over-expand its note issue. Although the Suffolk could not prevent the undesirable newcomer from issuing notes, it could prevent the wayward bank notes from getting extensive circulation, by withholding membership in the Suffolk System.¹⁶ This acted as an effective safeguard when State legislatures were extremely lenient in granting bank charters and when State banking legislation was inadequate.

By requiring that members' deposits represent reserves against their notes in circulation, the Suffolk Bank centralized the reserves of the system. These reserves of banks on deposit at the Suffolk Bank could be utilized through overdrafts by individual member banks in need of excess reserves. This ability to sanction overdrafts gave the Suffolk Bank considerable indirect power over the volume of loans of country banks at a time when the borrower commonly took his loan in banknotes. By controlling overdrafts through the possibility of insisting upon immediate payment of notes sent home for specie redemption, the Suffolk Bank could exert great pressures on a bank's loan policy and note issue. Although the Suffolk Bank earned extra interest income from these overdrafts, there is no evidence that it encouraged this practice; in fact, the overdrafts were frequently used to force member banks to adopt more conservative loan policies that would keep their assets more liquid.¹⁷

¹⁴ Whitney, p. 53.

¹⁵ Martin's Boston Stock Market. (Boston, Mass. 1857.)

¹⁶ Whitney, p. 297.

¹⁷ Whitney, p. 25.

As a final resort in cases of what the Suffolk Bank felt was gross mismanagement, it possessed the power to remove the name of the offending bank from its list of New England banks in good standing. This action was greatly feared by country banks since it would immediately force the affected bank's notes to a discount even though still redeemable in specie at the counter of the bank.¹⁸

Efficient Note Clearance

The Suffolk System provided New England with an efficient clearing system for bank notes which effectively controlled the circulation of New England banks. The total volume of redemptions reached a high of over \$400 million in 1858; with an average circulation of \$40 million by New England banks during that period, the entire amount was redeemed about ten times each year, or about once every five weeks.¹⁹ In a comparison of redemptions under the Suffolk System and the National banking system, U.S. Comptroller of Currency, John J. Knox pointed out that:

“...in 1857 the redemption of notes by the Suffolk Bank was almost \$400,000,000 as against \$137,697,696 in 1875, the highest amount ever reported under the National banking system. The redemptions in 1898 were only \$66,683,467, at a cost of \$129 per thousand. The cost of redemption under the Suffolk system was ten cents per \$1,000, which does not appear to include transportation. If this item is deducted from the cost of redeeming National bank notes, it would reduce it to about ninety-four cents. This difference is accounted for by the relatively small amount of redemptions by the Treasury, and the increased expense incident to the necessity of official checks by the Government, and by the higher salaries paid. But allowing for these differences, *the fact is established that private enterprise could be entrusted with the work of redeeming the circulating notes of the banks, and it could thus be done as safely and much more economically than the same services can be performed by the Government.*”²⁰

Table 3 shows the growth in the amount of New England bank notes redeemed at the Suffolk Bank from 1841 to 1858. Mr. Knox indicated that redemptions under the National banking system (1863 to about 1898) averaged about \$54 million annually, whereas under the Suffolk they were \$229 million. Knox's glowing praise of the Suffolk redemption system indicates that it tended to contribute to sound banking by limiting the issues of notes by New England banks. Amasa Walker, on the other hand, insisted that the total volume of bank notes was increased by the system, which made the notes of the Suffolk System banks more widely acceptable.²¹ This point seems to be corroborated by a statement of Horace White that the Suffolk System gave wide credit acceptability to New England banks, and “in consequence their notes gained an extensive circulation in remote parts of the country and in Canada.”²²

¹⁸ William G. Sumner, *History of Banking In the United States*, (New York 1896), p. 422.

¹⁹ White, p. 297.

²⁰ John Jay Knox, *A History of Banking in the United States*, (New York 1903), pp. 368–69 [Italics added].

²¹ Amasa Walker, *Nature and Uses of Money and Mixed Currency* (Boston 1857), p. 64.

²² White, p. 296.

TABLE 3
Annual Bank Note Redemptions by the Suffolk Bank, 1841.1858

Date	Millions	Date	Millions	Date	Millions	Date	Millions
1841	\$109	1846	\$141	1830	\$220	1854	\$231
1842	105	1847	165	1831	243	1855	341
1844	126	1848	178	1832	245	1856	397
1845	137	1849	199	1853	288	1857	376
						(1858	400)*

*Source: J. J. Knox, A History of Banking In the United States, p. 369. *The 1858 figure is based upon an estimate contained in Horace White, Money and Banking, p. 297.*

It can be safely said, however, that the Suffolk System did accomplish through its clearing operations the equalization of note issue among the banks in the system, thus protecting the public against over-issue by individual banks, but not against expansion of notes by the entire system. To the extent that the American economy was growing at a rapid pace in the second half of the 19th century, a growth in bank credit may have been beneficial rather than inflationary as Amasa Walker feared.

Strengthening of the Banking System

A. Barton Hepburn has estimated what he terms the "banking power" in the four regions of the nation for the years 1830, 1840 and 1850. Banking power is a composite figure composed of bank capital stock, circulation of notes, and deposits of reporting institutions. By dividing these figures by population in the four areas, one arrives at the relative banking power per capita (excluding slaves in the Southern States) shown in Table 4. New England is the only region which more than doubled its total banking power between 1830 and 1850, aside from the Western region which was growing from a much smaller base. In addition, the per capita banking power of New England remained superior to other regions, with the exception of 1840 when the Southern region was highest. By 1850, the per capita banking power of the New England area was almost twice as high as the other regions. Certainly the Suffolk System did not hamper this overall growth in banking power in New England; if anything, it probably encouraged it by making all bank notes circulate at par.

TABLE 4
Banking Power (Bank capital, note circulation, and deposits)
of Reporting Banks of Four Regions of U.S., Years 1830, 1840, 1850

Regions	Banking Power (in millions)			Per Capita		
	1830	1840	1850	1830	1840	1850
New England	\$54	\$89	\$114	\$27.66	\$39.98	\$41.89
Middle	107	131	185	25.87	25.64	27.95
Southern	80	196	117	15.54	48.75	22.28
Western	7	38	35	4.47	1129	6.34
Total	248	454	451	19.33	26.64	19.47

Source: A. Barton Hepburn, A History of Currency In the U.S., (New York: Macmillan Co., 1915), p. 158.

There is some evidence that the Suffolk System contributed to banking stability; at least it served to avert greater disaster to New England banks during economic panics. In Connecticut in the years following the crisis of 1837 not one bank failure occurred, nor was there a suspension of specie payments. All banks were able to continue to redeem their bills at the Suffolk Bank.²³ A report of 1848 by the Bank Commission of Maine stated that only two banks in the State had not entered the Suffolk System. In September 1857, specie payment was suspended temporarily in Maine, and the report of the Bank Commission noted that all but three of the banks sustained themselves in credit. The report stated,

“The Suffolk system, though not recognized in banking law, has proved to be a great safeguard to the public; whatever objections may exist to the system in theory, its practical operation into keep the circulation of our banks within the bounds of safety.”²⁴

²³ Knox, p. 381.

²⁴ *Ibid.*, p. 333.

4. The End of the Suffolk System

The Growth of Opposition

Almost from its inception the Suffolk System had to defend itself against opposition from the country banks throughout New England. Not only was there a feeling of ill-will among the country banks which had been compelled to keep their note issues less than they would have liked, but there was an impression that the business of clearing was very profitable to the Suffolk Bank. Some country banks continually pressed to establish an institution in Boston, in which they were the stockholders, so that they might secure this profit for themselves.

Resentment of some of the alleged misuses of power by the Suffolk Bank dating from 1852 grew, culminating in a petition for a Bank of Mutual Redemption and the action of the Massachusetts legislature in granting a charter in 1855. The incorporators of the new bank included the president of the Exchange Bank which had earlier precipitated a dispute with the Suffolk Bank. This altercation arose when the Exchange Bank, acting as the redemption agent for several country banks which did not have deposits at the Suffolk Bank, refused to redeem for the Suffolk Bank the notes of two of its client banks that had gotten into financial difficulty in 1853. Consequently, the Suffolk Bank had caused a great furore by sending a circular to all agent banks stating that the notes of country banks would be received only on condition that all their notes would be redeemed by agent banks.

The Bank for Mutual Redemption was met with less than enthusiastic response by the country banks. Some banks questioned the motives of the incorporators, and so only a small minority of country banks, after a great deal of persuasion, took stock in the new bank. The Bank of Mutual Redemption at last began functioning in 1858, but only after the legislature had reduced the capital requirement (to \$500,000).

The battle between the two banks began when the Suffolk Bank refused to honor notes of banks having deposits with the new bank and stated that banks withdrawing deposits might expect the Suffolk to send their bills home for payment "at such times and in such manner as to us may seem best."²⁵ After October 9, 1858, the Suffolk Bank received bills as before, except that it sent bills from banks having deposits with the Bank of Mutual Redemption to that institution and received from that bank the bills of those banks which had an account with the Suffolk. But, on October 16, the Suffolk notified Boston banks that it would discontinue its service of assorting country bank notes.

Boston banks soon took action to establish a New England Sorting House in the order of one operating in Albany, New York. In addition, noting the seriousness of the dispute between the Suffolk Bank and the Bank of Mutual Redemption, 24 Boston banks sent all New England banks a circular in which they pointed out the need for an adequate system of redemption to protect the banks and the public against depreciated currency. The circular expressed grave doubt that the Bank of Mutual

²⁵ Lake, p. 197

Redemption would live up to expectations since “it linked borrowers and lenders between whom a certain antagonism was deemed necessary.” Country banks were urged to take immediate steps to assure the continuance of a sound system of redemption.²⁶

The Bank of Mutual Redemption was successful in gaining about half of the banks of New England as depositors, but it soon became evident that the restraint formerly maintained by the Suffolk System upon undue bank note issue no longer existed. The circulation of the notes of country banks immediately increased while the circulation of the Boston Banks decreased. In Massachusetts the total circulation of country bank notes rose from \$13,697,000 in 1858 to \$15,074,000 in 1859, while the circulation of Boston bank notes fell from \$7,142,000 to \$7,013,000. This expansion of the circulation of country bank notes was a direct result of the lax policy of the Bank of Mutual Redemption toward overdrafts by their depositors.²⁷

The Suffolk System had operated with great power and efficiency from 1825 to 1858, yet the only major legal support for it came in 1843 after the system was well established; this legislation allowed banks to pay out only their own bank notes, thereby forcing clearing through the Suffolk System. How, then, did a system that seemed so entrenched in 1851, collapse seven years later? This end was, to a considerable extent, due to the populous desire of country banks for over-expansion of their notes. Over the years the balance of power in the State legislature shifted to the country voters, thus making such expansion possible.

Furthermore, the country banks had always objected to being forced to redeem their notes in Boston through the maintenance of deposits at the Suffolk Bank even though they enjoyed the advantage derived from the wide circulation of their notes at par. They had also objected to the restriction of the circulation of individual banks and the control over theft activities possessed by the Suffolk Bank. The immediate reason for the final collapse of the system lay in the autocratic attitude of the Suffolk Bank toward the country banks, which was a natural but regrettable result of the unprecedented success of the system.

It seems likely that if the Suffolk Bank had been more conciliatory in its attitude toward both the country banks and Boston banks in the period from 1851 to 1857, especially toward the Exchange Bank, and had sought cooperation from Boston banks in the establishment of new regulations while reducing the cost of the system to the country banks, the Bank of Mutual Redemption would never have been formulated. But, all would have come to an end regardless with the total suspension of specie payments in 1861, the National Banking System Act in 1863, and the subsequent elimination of note issue by the State banks by a 10 per cent tax imposed upon bank notes.

²⁶ *Ibid.*, p. 202.

²⁷ *Ibid.*, p. 204.

5. An Appraisal of the Suffolk System

The Suffolk System was a partial failure after its inception, because of its inability to achieve its initial objective of increasing the circulation of the Boston banks at the expense of the country banks, and also at its termination because of its inability to defend itself against the Bank of Mutual Redemption. Nevertheless, these failures appear insignificant in the light of the invaluable services rendered not only to the city of Boston but to Massachusetts and all of New England. Even though the bank notes of New England were secured, for the most part, only by the general assets of the issuing bank, the Suffolk System made these notes as safe as the bond or bond-and-mortgage-secured bank notes of New York and Louisiana, and other states with effective banking systems at the time. And it was able to accomplish this without resort to the police power of the State to enforce the system. In addition, the System kept the bank notes of New England at par, prevented excessive note issue by individual banks, and established and maintained for over thirty-three years the principle of immediate specie redemption.²⁸

Within a banking system where every bank possesses the ability to issue notes which circulate as money there is a tendency for over-issue by many individual banks, leading to discounting of bank notes and a general deterioration of sound credit Systems of bank note clearing and redemption are a necessity for the smooth operation of relatively free banking with a gold coin standard, whether the system is privately operated as with the Suffolk System or governmentally operated as the Safety Fund System in New York.

There were two features which were essential for the effective operation of the Suffolk System — (1) constant clearing and redemption of a major portion of all the notes in circulation through the Suffolk; and (2) existence of the specie reserves of gold and silver, which could always be called upon by the Suffolk. The Suffolk System, in effect, forced every bank to maintain an adequate balance between notes outstanding and specie reserve backing. Horace White indicated that,

“It was the underlying principle of the Suffolk Bank system, that any bank issuing circulation should keep itself at all times in a condition to be able to redeem it; that it should measure the amount by its ability so to do; and that the exercise at any time of the right to demand specie of a bank for its bills was something of which the issuing bank had no right to complain.”²⁹

The Suffolk Bank, acting basically for profit-seeking reasons, engineered a bank note clearing and redemption system which made New England's banking system a sea of monetary tranquillity in the midst of a national monetary situation that is generally regarded as chaotic. Yet this relatively stable monetary system, within which all of New England's different bank notes circulated at par, seemed to provide New England with a generally expanding money supply (as indicated in Table 4) to meet

²⁸ Whitney, p. 31.

²⁹ White, p. 296.

rapidly rising needs of industry and commerce during this period. If the growth in banking power (bank capital, note circulation, and deposits) from 1830 to 1850 in percentage terms of New England is compared with like figures for the banking system of the entire United States, it is found that New England banking power increased 111 per cent while the American banking system's banking power as a whole rose about 25 per cent.³⁰

In summary, the Suffolk System was a free enterprise regional bank clearing system which operated with great success from 1825 until 1858, and which created lasting benefits for New England's economy. Furthermore, the system's requirement that reserves be deposited in a central depository, and its effective provision for clearing and redemption, demonstrate the feasibility of a private gold-related banking system which might well eliminate the necessity for a government-operated central bank.

³⁰ U.S. Department of Commerce, *Historical Statistics of the U.S. 1789-1945* (Washington, D.C. 1949) p. 263. The years 1834 and 1850 were compared for all U.S. banks. "Banking Power" included capital, surplus and net undivided profits, note circulation, and total deposits in those years.