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A History of Public Sector Pensions in the United States

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The Wharton School of the University of Pennsylvania

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Chapter 6
Financial Markets and the Management of the Navy Pension Portfolio

At the beginning of the nineteenth century, financial markets in America were not well developed even by contemporary European standards. Investment capital was in short supply, and information moved slowly in the United States, generally moving up and down the east coast from port to port. Financial information moved even more slowly from the eastern ports to the inland cities and settlements. In this period, before telegraph, railroad, or steamship, transatlantic travel to Europe took approximately one month from America and because of prevailing winds and currents even longer coming west from Europe. Economic growth, improvements in transportation and the flow of information, and the emergence of a national economy stimulated a rapid development of financial markets, at least in the leading coastal cities.

A variety of U.S. government securities were available to purchase when the navy pension fund entered into the financial markets in 1800. The bonds that had been issued by the treasury as part of Alexander Hamilton's effort to consolidate the American debt were widely held. They were traded in all American markets, and were also held by British and Dutch investors. Shares in the First Bank of the United States were available over the period 1791 through 1811, as were shares in the leading banks of New York, Boston, and Philadelphia. Shares of the Second Bank of the United States became available in 1817 and were actively traded in America and in Europe through 1835. Although there was a considerable quantity of high-quality U.S. bonds, stock in the First and Second Bank of the United States, and widely traded private bank and insurance stock being traded in U.S. asset markets, the navy pension fund "invested" a large portion of its assets in three Washington-area banks over the period 1809–25. This history of the pension fund's management of its portfolio provides a unique assessment of a government pension fund allocating a portion of its assets to private equities. This chapter describes the operation of early American

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securities markets that were developing in coastal cities, with special emphasis on the returns and risks on debt instruments of the U.S. government.

Economic Conditions and U.S. Financial Markets, 1800–1845

In order to understand and evaluate the management of the navy pension fund, we must understand the investment alternatives and opportunities available to the Commissioners of the fund. The period 1800–1845 was one of growth and general prosperity in the United States, with some brief periods of economic crisis, particularly in the late 1830s. In short, the first half of the nineteenth century provided a good investment environment at least until around 1835. From 1799 through 1845, gross domestic product of the new nation more than quadrupled, increasing from $380 million in 1799 to $1.75 billion in 1842, for an average annual compounded rate of 3.4 percent (Berry 1978, 1988; Sylla and Wilson 1999). The population of the United States grew from 5.2 million in 1799 to 20.2 million in 1845 (3.0 percent per annum); thus, per capita income increased by about 16 percent from $75 to $90 per annum (0.4 percent per annum). The federal debt declined from $83 million in 1799 to $45 million in 1811, before increasing to $127 million by 1815, during the war with Britain. Subsequently, the federal government began to retire its debt, and the national debt was virtually eliminated by 1834–35. The subsequent financial crises and recessions of 1837 and 1839 prevented the complete retirement of the debt and led to new deficits. As a result, the debt had risen back to $16 million by 1845 (Sylla and Wilson 1999). Revenue of the federal government increased from $3.7 million in 1792 to $10.8 million in 1800, with the vast majority ($9.1 million) of those revenues coming from customs.

There were attempts to increase taxes at the beginning of the War of 1812, as government expenditures had begun to exceed revenues, producing an increase in the national debt. However, the increase in taxes was delayed by Congress, and even when the tax increases were actually imposed, they did not take place immediately because of the lack of an effective system of collection beyond the customs house, and with international trade damaged by the war (and the British conquest of Washington), the public finances were in their worst condition since the Revolution. After war, trade recovered, though there was a downturn in the early 1820s, and once again the majority of federal revenues came from customs. By 1844, total U.S. government revenues were $26.2 million, and while customs revenues composed the largest share of that figure, federal land sales also contributed a considerable amount of revenue. Interestingly, income from the government's investment in the stock in the Second Bank of the United States ranked third. To get a feel for the size of the federal government at that time, consider that expenditures in 1844 totaled $24.7 million.

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Components of expenditures were "Civil" $2.5 million, "Foreign" $0.6 million, "Navy" $6.5 million, "War" $5.2 million, "Indians" $1.3 million, "Interest on the Debt" $1.9 million, and "Miscellaneous" $2.6 million, with "Pensions" totaling $2.0 million (or 8.1 percent of total outlays). In 1844, there was a budgetary surplus of $6.4 million that went toward the repayment of the federal debt (Studenski and Kroos 1963).

"Civil" expenditures included "internal" improvements in transportation, the development of "post roads," and further development of the postal service—what later policymakers would call "infrastructure." Between 1790 and 1840, the population per post office had decreased from 52,400 to 1,300, and the miles of post road had increased from 1,875 to 155,176 (Pred 1973). Over this same period, the transatlantic journey from America to Europe had decreased from five to six weeks to an average of about 23 days. With the introduction of the steamship around 1840, the one-way travel times were cut to an average of about 14 days (Albion 1938, 1939). Over the period 1821–38, New York was becoming the dominant port, increasing its percentage of foreign trade from about 25 percent to around 45 percent of the U.S. total (Pred 1973). The communication improvements over the period set the stage for a more efficient financial market for American securities, both public and private.

Newspapers developed rapidly following the Revolution, and financial newspapers in particular became an important source of day-to-day financial information. Many of the papers were related to shipping news and prices of goods being imported and exported, and they became *the* source for price quotations on stocks and bonds. Examples of this journalism were the *Boston Price-Current and Marine Intellingencer,* which began in 1795, the *New York Price-Current,* founded in 1796, followed in 1803 by the *Baltimore Price Current* and *Hope's Philadelphia Price Current,* in 1804 (Pred 1973). From January 1804 through January 1807, the *New York Commercial Advertiser* listed "Prices of stocks this day at One O'Clock" (Werner and Smith 1991). These newspapers were similar to their British forerunner, the *Course of the Exchange.*

In 1817 the newly formed New York Stock and Exchange Board began making their daily closing prices available exclusively to the *New York Price-Current.* Initially, these papers were weekly or twice-weekly and were readily available in coffeehouses and taverns. The newspaper market was competitive, and other important financial newspapers developed in New York. These papers included the *American Minerva*, *New York Daily Advertiser*, and *New York Journal of Commerce,* among others. Similarly, in Philadelphia, important financial papers were *Scott's Philadelphia Price Current*, *Grotjans's Public-Sale Report*, *Niles Weekly Register*, and the *Gazette of the United States.*

By 1815, the New York financial newspapers were also quoting the prices of the nationally traded securities in Boston, Philadelphia, Baltimore, and even London with time lags due to the delay in information flows. This

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information flowed in both directions from New York to other American markets, to European markets, and back. Much of the data used in this study on asset prices has been gathered from these original sources (Sylla, Wilson, and Wright 1997). Even the prices of U.S. securities in London were published in American papers, albeit with a lag of a month or more, as the U.S. prices of those securities were carried in London papers. The development of the flow of this financial information had much to do with the development of a more efficient financial market in America.

Although there were periods of inflation in 1811–15, largely associated with the war, the general price level declined over the period, as measured by either consumer or wholesale prices (Appendix A to this volume; David and Solar 1977; McCusker 1992; Smith and Cole 1935). Typically, price levels increased in times of war or international uncertainty, then settled back down to their original level once the crisis had passed. Currency exchange rates between Boston and London fluctuated, with the extreme lows occurring during the War of 1812, when the dollar traded at a discount of up to 20 percent. The extreme highs occurred either in years of financial panics, such as 1831 and 1837, when the dollar traded at a premium of up to 14 percent, or during periods of economic stress, for example, 1819 through 1823, when trading was at a premium of from 10 percent to 12 percent (Martin 1898).

One of the difficulties faced by traders in the financial markets in the various port cities of the United States was the lack of a national currency. Boston remained on specie throughout the period—that is to say, its banks maintained convertibility—but there were different currencies in New York, Pennsylvania, Maryland, and South Carolina, and inland exchange rates varied from place to place. Over most of this period, these differences in rates across cities stayed within plus or minus 1 percent. However, there were periods, such as the end of the War of 1812, when inland exchange rates were volatile, and discounts between cities and states exceeded 20 percent (Sylla, Wilson, and Wright 1997). This variance in exchange rates between cities was a barrier in the development of an integrated capital market in the United States. The financial markets in the various cities traded mostly in local stocks of banks and insurance companies, though U.S. debt instruments and the stock of the First and Second Banks of the United States were also actively traded.

The earliest incorporations in America were in banks and insurance companies. The Bank of North America was chartered in Philadelphia in 1782 with an authorized capital of $400,000; a revised charter in 1787 increased the firm's capital to $2.0 million. The Bank of Massachusetts was chartered in Boston in February 1784. The Bank of New York, originally a joint stock company founded in 1784, received a free bank charter in March 1791, with an authorized capital of $1.0 million. Ten years later in 1801, there were 32 banks in the United States, with a total authorized capitalization

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of $19.2 million, and by 1818 there were 338 banks with capitalization of $160.3 million (Fenstermaker 1965).

The earliest insurance companies were maritime and fire insurance companies, and their growth in numbers was similar to that of banks, though the insurance companies typically had a lower average authorized capitalization. By 1794, there were four incorporated insurance companies with a total capitalization of $1.2 million whose shares were being traded in at least some markets. By 1800, there were 15 firms with a combined capitalization of $5.0 million, and by 1806 there were 50 insurance firms with a combined capital of $15.0 million (Perkins 1994).

There is some controversy among scholars about the efficiency of American financial markets over the period 1790–1840. It has been suggested that "Trade in securities was unimportant in the United States from 1785 to 1820—unimportant quantitatively, and without much significance as a means of forecasting the state of business" (Smith and Cole 1935). However, this same study provides some unique monthly data for Boston on the history of prices of Hamilton's Threes, Boston bank prices, and exchange on *London*, suggesting some degree of integration at any rate. In addition to these data, complete monthly and/or weekly prices exist for a plethora of U.S. securities. These include federal bonds, First and Second Bank stock prices, state and municipal bonds, state chartered corporations, and all other actively traded securities in Boston, New York, Philadelphia for the period 1791 through 1845. In addition, there are prices of U.S. securities trading in London for the years 1810–45 (Sylla, Wilson and Wright 1997). The tentative conclusion from an analysis of these data is that there seems to have been a considerable degree of financial market integration at least a decade prior to 1820.

With respect to the volatility of these assets, the prices of securities in the United States were relatively stable over the period 1800–1839 but fell sharply between 1839 and 1845. An overview of the behavior of financial markets is provided in several graphs that display monthly data for the prices of selected securities over the period 1800–1845. Figure 6.1 shows the prices of bank stocks over the period. It also includes the Smith and Cole monthly index of financial stocks over the period 1802 through 1842 (Cole and Smith 1935).

The price of stock in the First Bank of the United States and the price of the Second Bank are plotted over the life of each in Figure 6.1. The Smith-Cole index of bank stocks is relatively stable, not exceeding a 20 percent premium, nor falling below a 20 percent discount from par, and the maximum deviation occurred over a few months during the Panic of 1837.[1] By the beginning of 1800, the price of stock in the First Bank of the United States was at a premium of 25 percent, reaching a 50 percent premium in 1802 before declining to slightly below par when its charter was not renewed in 1811. As noted above, the stockholders were paid off in an

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orderly fashion when the bank was sold to Stephen Girard and the bank became an unincorporated concern named Girard's Bank. By 1815, the stockholders in the First Bank had been compensated with 109 percent of par value (Hammond 1957). Ultimately the price of the Second Bank rose to a premium of 50 percent when the bank opened for business in 1817. Shortly thereafter, it dropped to slightly below par in 1818; subsequently, it recovered and then was relatively stable through 1831, trading at premiums of 20 percent to 25 percent.

This period of stability was followed by a period of somewhat greater volatility from 1832 through 1836, when prices began falling sharply as the prospects for recharter began to dim (Smith 1953). The dissolution of the Second Bank was neither smooth nor particularly orderly, and it took the U.S. government almost five years to be reimbursed by the new corporation, which took over from the government's management. The dissolution of the Second Bank is a complex story, but it is concisely and well explained by Catterall (1903): "The Bank ceased doing business on 3d of March, 1835. . . . [T]he corporation continued business under a state charter, without opening

Figure 6.1. Prices, as percent of par value, of stock of the First Bank of the United States, the Second Bank of the United States, and the Smith-Cole Index of New York Bank Stocks, 1800–1841. The figure ends with December 1840, because the price of the Second Bank declined to 4.00 percent of par in 1842 and to 1.75 in 1843, which, if included, would distort the representation of prices graphed on the logarithmic scale. The data for these bank prices are unpublished. The stock prices of the First Bank are from data collected by Wilson and Sylla in New York. The stock prices of the Second Bank are from those underlying the chart by Smith (1953) and which are currently being collected by Sylla and Wilson from the papers of Arthur Cole in the Baker Library at Harvard.

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a new set of books, thus making it impossible to disentangle the accounts of the old bank from that of the new."

The government still owned 68,752 shares, but the value of the stock per share at the time of the closing was in dispute between the new bank, who claimed that the shares were worth $113.44, and the Secretary of the Treasury, who calculated the value at $115.58 per share. The difference of $2.14 per share on the government's total shares amounted to slightly over $147,000. The dispute was finally settled at a price calculated to be $114.413. The government was to be paid off in four equal annual installments in September of each year 1837 through 1840 with an added interest amount of 6 percent per annum. The navy pension fund was not involved in this settlement, their stock in the Second Bank having been liquidated by the end of 1837. Investors who continued holding the stock in this new corporation, the Bank of the United States in Philadelphia, through the transition period continued to earn interest. The share price remained above par until the bank faced insolvency during the subsequent economic and financial crises, and the price fell quickly thereafter, falling to a price of between $1.50 and $2.00 per share. The bank ultimately failed altogether.

Turning to the bond market, Figure 6.2 provides some representative U.S. and state bond prices for various periods between 1800 and 1842. The U.S. bond prices are for the original Sixes and Threes as priced in New York (Sylla, Wilson, and Wright 1997). The price of the Sixes is slightly less than twice as high as the Threes. As noted above, the names of these original issues of Hamilton's debt referred to the annual coupon rate. The quotations were in percent-of-par prices, as opposed to today's practice of yield-to-maturity quotes. As originally issued, the bonds were repayable at the pleasure of the treasury and were priced as perpetuities. However, when the Sixes were converted to 8 percent annuities with a certain ultimate redemption date, the discounted value of expected revenue flows caused the market value of the Threes to be more than one-half the value of the Sixes, which were now Eights in the annuity sense; that is, 3 percent perpetuities were more than half as valuable as 6 percent annuities. The price series of the Sixes ended at final redemption in 1818. As the U.S. debt was paid off in the 1820s and 1830s, the Threes were the last series to be redeemed due to their low coupon cost to the Treasury relative to all other issues. Part of the increase in the price of the Threes over the period is due to the shortened expectation of a redemption date relative to their original expectation of perpetuity or outright default in the very early years. The Threes were redeemed in 1832, at which point that series ends on the chart.

With the retirement of the Threes, the entire U.S. debt had been nearly paid off. We say "nearly" because roughly $50,000 of the original debt issued by Alexander Hamilton in the 1790s remained "unredeemed" and in fact remained on the Treasury's balance sheet as "old debt" into the twentieth

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century. Still, this remained a small amount, and it was not being traded in the bond market. For the portfolio managers of the navy pension fund, or for any other investor for that matter, there were simply no U.S. bonds available. At this time, the fund turned to the municipal debt of Washington, D.C. and Cincinnati, and to the state bonds from Maryland and Pennsylvania. It was also about this time that the Congress directed the fund to invest only in the Second Bank of the U.S., which failed to be rechartered in 1836. Combined with the problems the states had in making coupon payments regularly, this was an extremely difficult time for managing a portfolio, whether governmental, institutional, or personal.

Figure 6.2 also contains data reflecting state bond prices. Ayres constructed a monthly series of state bond prices of Ohio, Kentucky, and New York state bond issues from January 1831 through the 1850s (Ayres 1939). Ayres's price index of those bond prices is plotted from 1831 through 1842, since there is very little in the record of the prices of U.S. securities, for those few in existence, over this period. State bond prices increased from 1831 through 1832, dipped, then began a rather steady decline to almost one-half of par value by the end of the period, as states began to defer on interest payments or default outright (English, 1996; Sylla and Wallis 1998).

Bond yields are summarized in Figure 6.3 for the period 1800 through 1842. The series is based on the yields of the price of the Threes, as reflected in New York. These prices are spliced into the yield estimates of

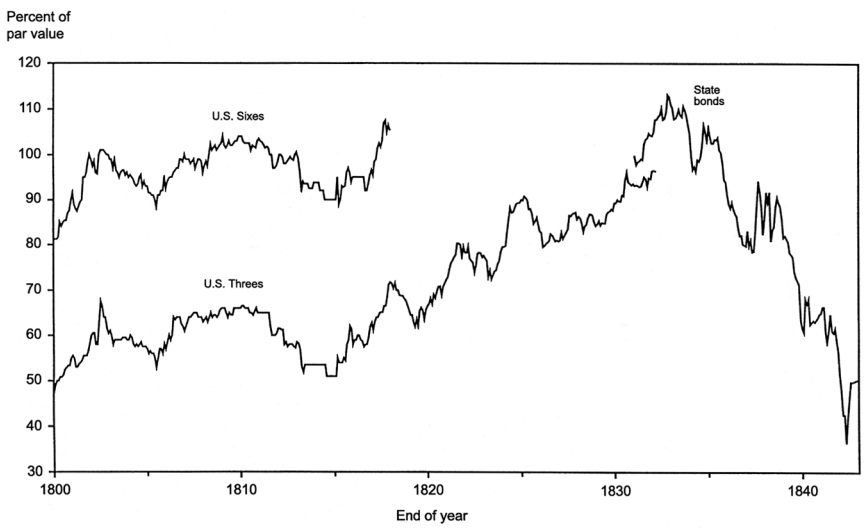

Figure 6.2. Prices, as percent of par value, for U.S. Sixes, U.S. Threes, and Ayres's Index of State Bonds, 1800–1842.

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Ayres's state bond index, with those prices shown in Figure 6.2. From 1800 through 1839, the yields vary between 5 and 10 percent, but rose rapidly in 1841 and 1842 to over 20 percent. These charts are provided as a background for any attempt to understand the purchases and/or sales of the navy pension fund over the period of their management of the portfolio. Of course, these price and yield data reflect the markets in which these securities were traded. Prior to Alexander Hamilton's consolidation of the federal debt and the issue of the Sixes, Deferred Sixes, and Threes, there were only fledgling securities markets in various American port cities. These debt issues quickly began to be actively traded in Boston, New York, Philadelphia, Baltimore, and Charleston—with significant interest from exchanges in London and Amsterdam. The national market was further enhanced by stock in the First Bank of the United States, which was chartered (at Hamilton's instigation) in 1792 and which was very actively traded. Prices differed slightly between markets, because in the era before telegraph, rail, and canal, information was transmitted either over land or by sea. About one-half of the U.S. government debt was owned by foreign investors by 1803, and this share was roughly divided equally between the London and Amsterdam markets, which were the most highly developed in the world (Blodget 1806).

U.S. government securities were actively traded in all of these markets, as were the stocks of the First Bank of the United States and the Second Bank of the United States over their chartered lives. Trading in private

Figure 6.3. Yields of U.S. Threes, 1800–1833, spliced to the yields of Ayres's Index of State Bonds, 1830–42.

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corporate stock, primarily banks and insurance companies, was also active, as documented above, but transactions in these securities were generally confined to local markets. For example, there was little trading in private corporate stock of Boston companies in the New York, Philadelphia, and Baltimore markets. In that sense, local bank and insurance stocks were less liquid than U.S. securities that were traded between markets. New York soon became the dominant market among these cities, due primarily to its becoming the principal seaport for the new nation. New York also gained an advantage with information flows from Europe as well as within the United States with the establishment of the New York Stock Exchange in 1815. In 1815, there were six different bonds and 17 stocks publicly quoted in New York. By 1837, there were nine bond issues and 87 stock issues quoted, and daily volume averaged over 3,000 shares on the New York exchange. By comparison, in 1837 daily volume averaged 937 shares in Philadelphia. Early in the nineteenth century, Philadelphia became the second largest financial market, followed by Boston, then Baltimore (Sylla, Wilson, and Wright 1997).

This brief review of financial markets in the early republic illustrates several key features of those markets, and these features are relevant for understanding the management of the U.S. navy's pension fund. First, throughout much of the period in which the fund existed, a wide variety of U.S. securities was available. The fund did in fact invest in many of these assets. Second, there also existed a variety of "seasoned" and widely traded private assets issued by bank and insurance firms that the fund conspicuously did not invest in. Third, prior to 1832 the fund invested in neither the First nor the Second Bank of the United States. In short, if the fund was merely attempting to diversify its portfolio by investing in private equities, or any other non-U.S. government securities, the fund chose to forego any number of promising, broadly traded investments with good track records. This choice proved costly for the taxpayers.

Acquisition of Commercial Bank Stock for the Portfolio

A central question concerning the investment decisions of the trustees of the navy pension fund is why they chose to buy stock in three local (that is, District of Columbia) banks instead of purchasing shares in the First and Second Bank of the United States or other more "mature" bank stocks in the financial markets of New York or Philadelphia. The existence of many other investment opportunities available to the fund managers makes their decision to purchase shares in these seemingly risky local institutions questionable. Ultimately all three banks failed, imposing a significant loss of capital on the fund. The opportunity cost associated with these investments made the economic loss even greater, since the managers could have earned substantially higher returns from other investment choices.

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In 1809, the navy pension fund began to acquire stock in Columbia Bank, a Washington, D.C. (actually Georgetown) institution. Additional stock in this bank, along with stock in two other local banks, Washington Bank and Union Bank, was added to the portfolio over the decade 1809–19. It seems that all these stocks were narrowly held, and not actively traded even in the local financial markets, like Baltimore or Philadelphia, let alone those of New York or Boston. From the few quotations that we can find in these markets, it appears that these stocks lacked liquidity and were seldom traded. When they were traded they were exchanged at prices that most likely reflected a wide spread between "bid" and "asked" prices.

Stock in the First Bank of the United States in 1800, when it could have been acquired by the fund, was relatively seasoned, having been on the markets since 1791, and the Bank's stock was nationally and internationally traded. Specifically, a large quantity of the stock of the Bank was held in London and Amsterdam. In 1803 the English held $6.0 million of the First Bank stock and the Dutch held $2.0 million out of a total capitalization of $10.0 million (Blodget 1806). For a comparison, consider that, of the total U.S. debt of $81 million in 1803, the British held $25 million and the Dutch $15 million. Of the Second Bank stock, it has been estimated that of the 350,000 total shares of the bank, almost 10 percent was foreign owned in 1820, and by 1830 over 20 percent was foreign owned (Catterall 1903). Compare this with the market in U.S. bonds in 1818; foreign investers held about 25 percent of the roughly $100 million outstanding (Seybert 1818). Given the international standing of these assets, it would be difficult to argue that they were merely overlooked by the trustees of the navy pension fund.

As for the Washington, D.C. banks, from information in the *Baltimore Price Current,* it is not possible to ascertain what the market prices were for the shares, especially for shares of Columbia Bank, nor can it be determined whether the market value was ever as high as par value. Our best assessment is that these shares simply did not have the same kind of liquidity as the shares in the First and Second Bank over the period and involved a much greater investment risk. Indeed, seasoned stock in the large banks of New York, Boston, or Philadelphia would have been much safer investments, with dividends that were competitive with the D.C. banks and a much greater potential for capital gains.

The details of the acquisition of Columbia Bank stock, as well as the purchases of stock in the other two D.C. banks, are presented in Table 6.1. The data in Table 6.1 are based only on the materials presented in the annual reports of the navy pension fund and the existence of these stocks in the portfolio are noted in those tables. However, attached to some annual reports is a list of vouchers from various transactions. With this additional information, we have attempted to provide as much detail as possible concerning the acquisition of these private bank stocks.

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Available records indicate that all of the purchases of stock in these banks were made by George Macdaniel, an agent of the navy pension fund. Table 6.1 includes the names of the individuals who sold the stock to Macdaniel. In addition, the table reports the amount of stock purchased and the price of the stock with a recapitulation of the value of the stock accumulated into the fund, based on par value and at cost to the fund. We are unable to provide the net asset value of the stock due to the absence of market prices. We can identify at least one individual who sold Columbia Bank stock to Macdaniel. This was one Joseph Nourse, who at the time of the transaction in 1809 was the Register of the United States Treasury. The price was $112.00 per share for 80 whole shares at a premium of 12 percent. Whether Nourse was an intermediary in a transaction with the Treasury or whether the shares were personally owned cannot be determined from available information. A review of the value of the stocks at par compared to the acquisition cost shows that practically all of these shares were purchased at a price greater than or equal to par. There were only a few instances where the cost and par value were the same. A final accounting of these purchases shows that the par value of the accumulated stock in Columbia Bank was $92,600. The trustees had paid a total of $99,503 to acquire these shares. Thus, the fund paid a net premium over par of 7.9 percent. The Union Bank stock had a total par value of $15,000, which was bought at a cost of $15,450, or a net premium of 3.0 percent. The fund paid $14,260 for shares in the Washington Bank that had a par value of $14,000, or a premium of 1.86 percent. Given the initial offering of this stock, it is highly doubtful that the price paid by the fund reflected a fair market value, and, at least with respect to Columbia Bank, this was because this was no ordinary bank.

Columbia Bank was among the first dozen banks chartered in America (Fenstermaker 1965; Gallatin 1832). It was chartered with an authorized capitalization of $1 million, which over the period 1800–1820 it came close to realizing. At the beginning of the nineteenth century, Columbia Bank began handling government accounts, such as disbursing interest on the national debt. With the demise of the First Bank of the United States, Columbia Bank began playing a more important role in the public finance of the United States. Within two weeks after the First Bank ceased doing business, Secretary of the Treasury Albert Gallatin informed several banks of the conditions under which the Treasury would do business with them. It seems Columbia Bank was singled out for special treatment. Specifically, Gallatin directed John Mason, president of the bank and son of George Mason, to establish a branch office in the U.S. Treasury building. A few years later, as General Andrew Jackson prepared his army for the protection of New Orleans, the Treasury had no funds with which to finance the campaign. Secretary of State, and future president, James Monroe mounted his

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TABLE 6.1. Details on the Acquisition of the Shares of Columbia Bank, Union Bank, and Washington Bank, Purchased by George Macdaniel, 1809–19.

		Number of shares			*Value*	
Date	*From whom purchased*	*Whole*	*Short*	*Price*	*At cost*	*At par*
Columbia Bank						
July 29, 1809	Walter S. Chandler	—	77	$ 50	$ 3,850	—
August 16, 1809	Joseph Nourse	80	—	112	8,960	$8,000
August 16, 1809	Walter S. Chandler	22	—	112	2,464	2,200
August 23, 1809	Clement Smith	88	—	110	9,680	8,800
August 23, 1809	Clement Smith	—	258	50	12,900	—
August 29, 1809	Charles Hill	93	—	110	10,230	9,300
September 1, 1809	Steven Pleasonton	—	8	48	384	—
June 30, 1810	Cash at Bank of Columbia	—	100	60	6,000	—
July 30, 1810	Cash at Bank of Columbia	—	93	60	5,580	—
December 9, 1815	unknown	—	150	60	9,000	9,000
December 4, 1818	unknown	200	—	102	20,400	20,000
unknown, 1819	unknown	64	—	106.25	6,800	6,400
unknown, 1819	unknown	—	90	40	3,600	3,600

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Recapitulation at the end of:						
1810		476	150	—	$60,103	$53,600
1811		476	150	—	60,103	53,600
1812		476	150	—	60,103	53,600
1813		476	150	—	60,103	53,600
1814		476	150	—	60,103	53,600
1815		476	150	—	60,103	53,600
1816		626	—	—	69,103	62,600
1817		626	—	—	69,103	62,600
1818		826	—	—	89,503	82,600
1819		890	90	—	99,503	92,600
1820		890	90	—	99,503	92,600
Union Bank						
unknown 1811	unknown	300	200	$25.45/$15.27	$10,690	$10,500
unknown 1812	unknown	100	200	25.83/ 10.33	4,650	4,500
Recapitulation at end of:						
1812		600	—	—	$15,450	$15,00
Washington Bank						
unknown, 1811	unknown	300	200	$20.50/$10.25	$8,200	$8,000
unknown, 1812	unknown	200	200	20.20/ 10.10	6,060	6,000
Recapitulation at end of:						
1812		700	—	—	$14,260	$14,000

Source: *ASP-NA,* 1; various Annual Reports on the U.S. Navy Pension Fund, 1809–20.
Note: There is a considerable degree of calculation and estimation involved in the reconstruction of the detail. The detailed vouchers are available for some years, but not for others.

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horse and rode to Georgetown to persuade the cashier of Columbia Bank to loan the government the requisite funds, which he did, and with those funds Jackson went on to win the Battle of New Orleans (Cole 1959).

The unique position enjoyed by Columbia Bank is perhaps more easily understood when one realizes that the ownership and control of the bank reads like a Who's Who of the early republic. George Washington was a stockholder, and in his will he bequeathed his stock in the bank to found a national university.[2] Henry "Light Horse Harry" Lee—a hero of the Revolution and the father of Robert E. Lee—was also a stockholder. A dashing cavalry officer, Lee was an abysmal manager of his own personal accounts. Twice imprisoned for failure to pay his debts, he ultimately died in exile after supposedly fleeing the country to avoid his creditors. Interestingly, on one occasion Lee tried to discharge a $2,800 personal debt to Washington by offering him Columbia stock. Washington, perhaps foreshadowing the institution's ultimate fate, appraised the asset well below $2,800 (Walsh 1940). Among the early directors of the bank were William Marbury, the plaintiff in the landmark Supreme Court case *Marbury v. Madison*, and Francis Scott Key. A founder and the second president of the bank, Benjamin Stoddert, was the first Secretary of the Navy. The first president of the bank was Samuel Blodget, who chronicled the statistics of the nation and was the architect of the building that housed the First Bank of the United States.[3]

The exact nature of the ultimate failure of the Bank of Columbia remains something of a mystery, but evidence suggests that there were at least three reasons. First, the bank was poorly managed even by the standards of the day. On more than one occasion, the bank failed to pursue or otherwise follow up judgments against bad creditors, even when those judgments were relatively large. Second, the bank was heavily invested in Georgetown real estate, which at that time was a very speculative market. The bank either lent to the wrong parties or at the wrong times, and many of its mortgage assets ultimately proved worthless. Finally, the bank became engaged in a misguided effort to serve as a collection agent for the Second Bank of the United States. Apparently, the Columbia Bank assumed or purchased some of the outstanding loans of the Second Bank, and ultimately the interest and principal on these loans proved uncollectable (Cole 1959; Walsh 1940).

It appears that the bank was largely a financial intermediary for its officers and stockholders and that its government business and real estate loans were its primary source of revenues. The possibility that the bank defrauded its stockholders and depositors cannot be eliminated. When it failed in the 1820s, the navy pension fund received nothing for its stock. Overall, the operation of the bank reeks of either misfeasance or malfeasance. The process by which it did this would not be unfamiliar to modern students of bank fraud. Essentially the bank may have been funneling loans to trustees or others,

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and for one reason or another these loans ultimately proved uncollectable. However, these were difficult times for Washington banks in general, and it is worth noting that of the 13 banks that had ever been chartered in the District of Columbia by 1830, four had failed (Gallatin 1832).

Summary and Conclusions

For most of the period 1800–1842, the U.S. navy pension fund had ample opportunities to invest in U.S. bonds yielding around 5 percent. Investments in the First or Second Bank of the United States would have yielded more. Yet in 1809 the pension fund began investing in private bank stock of Columbia Bank, Union Bank, and Washington Bank. Eventually the fund owned 10 percent of Columbia Bank, which accounted for between 40 percent and 15 percent of the total fund portfolio, depending on the flow of prize monies into the fund, which were much enhanced by the War of 1812 and which ultimately reached a value of over one million dollars. The failure of Columbia Bank in 1824 cost the fund $99,502.60 or roughly 10 percent of the value at the time. After extensive correspondence from the navy pleading for the relief of veterans, widows, and orphans, Congress reimbursed the fund in 1834 for $167,164.40, which included a nominal amount for foregone interest.

The macroeconomic situation in the United States during the period 1800–1842 was one of growth of aggregate output and population with relatively stable prices of commodities and a declining national debt due to the strict adherence to the Sinking Fund. As the U.S. debt was being retired between 1816 and 1834, investment opportunities decreased accordingly. Initially, the internationally-traded stock of the Second Bank of the United States was ignored by the Commissioners as an investment opportunity. Instead, the fund began to invest in the debt of the District of Columbia and Cincinnati, and state bond issues of Maryland, Pennsylvania, and Illinois, all at the rate of 5 or 6 percent interest on par value.

After Congress bailed the fund out of the Columbia Bank fiasco, the fund was directed to invest only in stock of the Second Bank of the United States. The fund used this restriction to its advantage, since it was able to purchase stock from the Treasury at the $100 par value. When in need of cash to pay pensioners, the fund was able to sell this stock on the open market at a premium of between 12 percent to 15 percent. In essence, the fund was being subsidized by its ability to purchase the Bank stock at a price that was below fair market value; however, this practice could not continue indefinitely because Jackson eventually vetoed the bill to recharter the Second Bank. From that date its days were numbered.

In 1841 and 1842, investment opportunities in the type of assets the fund would have held diminished. The U.S. government debt remained low by historical comparison. The Second Bank had not been rechartered, and the

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value of that stock became almost worthless. At the same time, many states had begun to default or defer interest payments on their debts, and the prices of state and municipal bonds fell to below one-half of their par value. This decline combined with the arrears payments on pensions after the addition to the rolls of widows and orphans overwhelmed the ability of the fund to continue operations. At this point, Congress assumed the pension liabilities of the fund. The navy pension fund died a quiet death, though from the taxpayers' perspective not a painless one. The fund would be resurrected a generation later, during the Civil War, and its colorful history would continue.

Notes

1. The Smith-Cole index included six banks in Boston, New York, and Philadelphia for 1802–20 and five New York banks and one insurance company through 1845.

2. See Blodget (1806, App. pp. ix, x) for details of Washington's will.

3. Blodget humbly describes his involvement with the First Bank: "The seat of the bank is in Philadelphia, where a superb building has been erected," to which he added the footnote, "The plan was by the author of this book, but its brick sides are an injurious deviation" (Blodget 1806).