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ABSTRACT

This thesis corrects some fairly prevalent misunderstandings about the impact on the economic development of Texas of the anti-banking provisions of the 1845 Texas constitution. The Texas constitution provided that no corporate body could be created with banking priveleges, nor could any individual issue checks, promissory note or paper to circulate as money. This anti-banking sentiment prevailed until 1905 when Texas began chartering banks.

Some economic historians have incorrectly concluded that the Texas economy suffered from inadequate credit facilities because of these articles in the Texas constitiution. My research reveals that, in reality, the anti- banking legislation, was, for the most part, inconsequential. It did not prevent the creation of thousands of small, private, unincorporated banks. These private banks blanketed the state from 1836 to 1905, and performed all the customary banking functions. They made loans, accepted deposits, cleared checks, created money, and were able to accumulate large amounts of capital. These banks represented the only viable form of banking in the frontier economy and they adequately provided for the credit needs of the developing Texas economy.

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COUNTRY STORE TO COMMERCIAL BANKER:

THE EVOLUTION OF THE TEXAS

BANKING INDUSTRY

APPROVED:

Supervisor: David C. Wheelock

David C. Wheelock

Stephen L. McDonald

Stephen L. McDonald

COUNTRY STORE TO COMMERCIAL BANKER:
THE EVOLUTION OF THE TEXAS
BANKING INDUSTRY

by

THOMAS P. KERINS

THESIS

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TABLE OF CONTENTS

PREFACE

One of the most enduring legacies of Andrew Jackson resulted from his vehement opposition to formal banking institutions. His views on this matter strongly influenced the opinions of many of the early settlers of America, including Samuel B. Houston, freedom fighter and first governor of Texas. In 1836, when Texas established itself as an independent republic, Sam Houston was instrumental in preventing banking legislation from being written into the Texas constitution. In 1845, when Texas joined the United States and its constitution was rewritten, he insured that very detailed anti-banking provisions were included in it. Thus, Texas entered the Union with its constitution providing that:

> No corporate body shall hereafter be created, renewed, or extended with banking or discounting privileges. No private corporation shall be created unless the bill creating it shall be passed by two-thirds of both Houses of the Legislature, and two-thirds of the Legislature shall have power to revoke and repeal all private corporations...The Legislature shall prohibit by law individuals from issuing bills, checks,

promissory notes, or other paper to circulate as money.

From 1836 until 1905, this anti-banking sentiment prevailed in the Texas Legislature. For only a brief period during the reconstruction era (1865-1875), under an amendment to the state constitution, were bank charters granted by the state of Texas. At that time, however, as a result of the National Banking Act of 1863, National banks also began to open in Texas. Four opened in 1865 and, along with private banks, national banks grew in number through the 1920's. Throughout the late 1800's and early 1900's, legislative records show there was continual agitation for the repeal of the anti-banking provision. Finally, in 1904 the Texas Legislature passed a bill authorizing the chartering of state banks beginning in August, 1905. This brought a veritable flood of requests for charters and state-chartered banks began to appear throughout Texas. Within 10 years there were 840 state banks in operation as opposed to just 529 national banks.

It is generally accepted in the current literature on the history of banking in Texas that the Texas economy suffered in the early years of its development because of the articles in the Texas constitution which prohibited banking. Avery Carlson, in his book *A Monetary and Banking History of Texas* (p.52), called the anti-banking clause " a grave political error whose ill effects became more apparent every day", and Joseph Grant and Lawrence Crum in their book *The Development of State-Chartered Banking in Texas* (p.48) blame this legislation for the apparent lack of banking facilities in smaller towns. Supposedly, because of the provisions preventing the development of an indigenous banking system there was an insufficient supply of credit to meet the needs of a developing agricultural economy. It was not until the creation of the state banking system that adequate banking facilities became available to serve the rural economy.

THESIS STATEMENT

Despite these generally unsupported assertions to the contrary, my research reveals that the development of the Texas banking industry was not adversely affected by the Anti-banking Legislation of 1845. Throughout the course of its economic development, Texas rural credit needs were amply served by a well-developed financial infrastructure of private banks. They performed all customary banking functions of making loans, accepting deposits, clearing checks, and creating money and existed in the only form that allowed them to operate profitably in the frontier economy. The fantastic rate of growth in the number of banks with state charters after 1905 was simply a result of private banks converting to the state system and a confirmation of the profitability of banking in a booming Texas economy at the turn of the century.

Chapter One describes how private merchant banks were able to overcome the problems of rural lending and serve the credit needs of the frontier agricultural economy while incorporated commercial banks could not.

Chapter Two describes the development of the banking systems of the Antebellum South. The economies of these states were very similar to that of Texas, and the analysis illustrates the insurmountable problems facing commercial banks in a frontier economy.

Chapter Three describes the course of development of the Texas banking industry from 1836 to 1910, showing how it was well developed and exactly typical of a frontier banking industry.

Chapter Four provides evidence against the view that the boom in state chartered banks after 1905 was indicative of an economy that was starved for banking institutions, and that only the commissioning of the state banking system brought credit facilities to rural Texas.

CHAPTER I

MEETING THE NEED FOR RURAL CREDIT

The role of banking in meeting the credit needs of rural Texas was largely unaffected by Sam Houston's anti-banking provisions in the Texas State Constitution of 1845. The banking needs of the developing economy were supplied primarily by a large number of small private unincorporated banks, in the only form of banking viable in a frontier economy. In the absence of the constitutional restrictions there would not have been an abundance of large, incorporated "commercial" banks - those that specialized in providing only traditional banking services. The frontier economy presented many obstacles to profitable banking which commercial banks could not overcome. Their specialized nature required that they operate on too large of a scale for most frontier areas. Also, they could not have prevented the ruinously high default rates that were common in rural lending nor mitigate their effects by charging high interest rates.

The small private banker, however, was ideally suited to operate in this environment and to provide the credit needed by the rural economy. Private banks held an absolute advantage over chartered commercial banks because of flexibility in the scale of their operations, their familiarity with the local economy, and their ability to charge interest rates commensurate with the riskiness of agricultural loans.

Early money-lenders in Texas were typically merchants or professionals whose lending was but a small portion of their business activities. Businesses that specialized in banking were not a viable entity in frontier areas because there was not enough local demand to support them. Although the entire frontier region had thousands of settlers, they were scattered over miles of countryside. The distance between farms and banks would have prevented a commercial bank from servicing the numbers of farmers it needed to remain viable. Until the local area had attracted a sufficient population, a business could not specialize in banking successfully.

Although there existed a demand for credit in rural areas due to the seasonal nature of agricultural income, the local demand was not very large. The total amount of money required to satisfy the credit needs of a typical frontier community in 1840 was probably no more than $5800 annually.[1] Given a minimum capital requirement in Texas of at least $10,000, this amount was likely not enough to make a commercial banking establishment viable. If $5800 was loaned at eight percent (the maximum allowable in Texas), with only a five percent default rate, for example, a bank would have earned an annual gross profit of only $174. This was a paltry amount. A clerk working in a dry goods store earned more than that in a year.[2] Overhead and operating expenses would likely have reduced this amount to below the breakeven point.

In order to survive in this economic hinterland a business had to operate on a small enough scale to

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1 FRONTIER MERCHANTS SOLD APPROXIMATELY $11,000 WORTH OF GOODS ANNUALLY (ATHERTON, *THE FRONTIER MERCHANT*, P.57). SEVENTY PERCENT WERE CREDIT SALES WITH A TWENTY-FIVE PERCENT MARKUP FOR CREDIT PURCHASES. IE - $11,000 X .70 = $7700 X (1 - .25) = 5775.

2 GERALD CARSON, *THE OLD COUNTRY STORE* (NEW YORK: OXFORD UNIVERSITY PRESS, 1954), P. 32.

provide just the amount of credit needed, yet be a large enough operation to earn a living for the proprietor. The solution to this dilemma was to create a diversified business that simultaneously accommodated several of the small demands for particular service. Private bankers had this ability to diversify their operations, and typically operated as an adjunct to another business, often a dry goods store.

It was only logical that these merchants should act as a town's first banker. Since the credit needed by farmers was to be used to purchase goods from the store, it was very easy for storekeepers to be merchandisers and bankers at the same time. Storekeepers could make loans simply by extending credit on sales of merchandise. Thus, credit was extended in flexible amounts to provide just the amount of banking services needed to accommodate the small and fluctuating demand of the frontier population.

This flexibility gave the private bank an absolute advantage over a commercial bank in beginning their operations. Unlike a commercial banker, a merchant banker could begin offering his services whenever he perceived a need for them. He could operate his bank right at the margin. As the economy grew the merchant banker had the ability to increase or decrease the scale of his banking operations as the situation warranted. In good years he could extend credit more liberally, and in bad years he could use his capital to add to his stock of merchandise or make internal improvements. But, overall, the amount of credit granted by a country store was no greater than what would have been borrowed from a regular bank, so a merchant bank had to have a minimum scale of operation that was much smaller than would be feasible for an independent banking operation. A merchant banker could do this because the proprietor's livelihood was supported more by the income from his mercantile operations than from his banking business.

The mercantile business in the frontier economy could be a very profitable endeavor. If the merchant could overcome the many hazards of ferrying his goods to the frontier market he could sell each item with a substantial markup over what he paid for them. The typical retail markup ranged from seventy-five to one hundred percent, though on some items it was even more.[3] A saddle which sold for five dollars in Charleston might cost fifteen or seventeen in the interior of Georgia. Coffee bought wholesale at five cents per pound sold for twenty, and bacon was always sold retail for twice the wholesale price.[4] Undoubtedly, merchants in remote areas exercised some monopoly power over their customers as often a good's final price depended on the merchant's perception of his customer's ability to pay and on his unwillingness to haggle over prices.[5] But, the substantial retail markups were largely a reflection of the great risks inherent in frontier merchandising operations.

Merchandisers faced many hazards in procuring and transporting the goods demanded in frontier areas. On their buying trips to Eastern cities the merchants often encountered unscrupulous wholesalers who might

3 *IBID.*, P.93.
4 *IBID.*, P.43.
5 ATHERTON, *THE FRONTIER MERCHANT*, P.54.

attempt to swindle the unsophisticated frontiersman. Sometimes wholesalers would employ "phantom bidders" who would continuously bid against the unsuspecting merchant at auctions. Other times a wholesaler would purposefully leave out an obvious item from the order which the buyer would easily catch and have corrected. But, this only served to distract him from the absence of another, much larger, item from the order. Transporting the goods to the frontier was also wrought with uncertainty. Treacherous river currents, rain that turned roads into oceans of mud, or marauding Indians could easily wipe out an entire year's stock of goods.[6]

However, if all went well in a given year, a storekeeper could expect to earn about $4200 on only a $6000 investment in his dry goods operation.[7] Hence, the few hundred dollars made annually from his banking operations were negligible to the overall profitability of his enterprise. Granted, credit and sales were

6 *IBID.*, P.69.

7 *IBID.*, PP.115,143. MERCHANTS REALIZED A PROFIT OF APPROXIMATELY SEVENTY PERCENT ON EVERY ITEM. (ATHERTON, SOUTHERN COUNTRY STORE, P. 209.)

linked, with more credit leading to more sales. But, the mercantile business could have survived without extending large amounts of credit, and there were "cash only" stores[8], whereas the banking business would not have survived without the mercantile operation. It was the private banker's retail business that made his banking operations possible, not the interest received from extending credit.

The second critical area where a merchant banker held an advantage over a commercial banker was in dealing with the problem of high default rates. Unlike merchant banks, commercial banks could not economically gather the information necessary about their debtors to keep default rates at a minimum. They were also unable to charge high interest rates to compensate for the level of risk because of usury laws.

High default rates on loans were not uncommon in the developing agricultural economy. Baton Rouge merchants reportedly calculated an average annual loss

[8] CARSON, P. 110.

of twenty percent on credit sales,[9] and William B. Johnson, a Charleston, S.C. cotton factor and private banker, reported that on loans of less than $100, the ratio of defaults to loans , at times, reached forty percent.[10] Farmers seemed to have little compunction about departing to some other frontier community and leaving their obligations in default when times were hard. During the Antebellum period merchants continually put notices in Southern newspapers requesting payment of overdue accounts, often citing delinquent creditors by name. Merchants were sometimes compelled to travel great distances and threaten the debtor with legal action to collect on accounts.[11]

The key to minimizing default rates was the ability to economically collect personal and financial information about those farmers seeking credit. Because farmers had little to offer as collateral, bankers made loans to them based on their character.

9 LEWIS ATHERTON, *THE SOUTHERN COUNTRY STORE* (BATON ROUGE: LOUISIANA STATE UNIVERSITY PRESS, 1949),P.53.

10 LARRY SCHWEIKART, *BANKING IN THE AMERICAN SOUTH* (BATON ROUGE: LOUISIANA STATE UNIVERSITY PRESS, 1987), P. 200.

11 ATHERTON, *THE SOUTHERN COUNTRY STORE*, P. 13.

Hence, detailed information about the farmer and his operation was absolutely essential to minimize default rates.

Commercial banks were at a disadvantage in collecting this type of information. Because a commercial bank needed a fairly large concentration of people to provide sufficient demand for its services, they either had to locate far from the countryside or begin operations only after a frontier town had sufficiently developed. Either way, the information they needed about their debtors was not readily available. Consumer credit bureaus did not exist so the banks had to do all of their own research. Thus, information was expensive to gather relative to the potential revenues generated by loans made to farmers.

The demand for credit in the frontier areas took the form of a large number of small loans. Farmers required a series of loans throughout the year to purchase supplies, but the total amount of credit needed by a fifty acre farm rarely exceeded one hundred dollars a year.[12] Thus, a bank would probably have made four or five $20 loans to a farmer over the course of a year. This would generate less than eight dollars in revenue (at eight percent interest) while the cost of gathering the necessary information to make the loan would likely have consumed much of this.

The initial loan to a farmer would require at least a survey of the farmer's assets, and interviews with reliable people who were familiar with his character and business practices. Since the population was dispersed over the countryside this could take a considerable amount of time. In fact, to discover which farmers were good credit risks would require years of monitoring each farmer's business practices.[13] The cost of gathering the necessary information alone would have made most farm loans unprofitable for a commercial bank.

Merchant bankers were able to overcome this information problem by minimizing the cost of

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12 ROGER L. RANSOM AND RICHARD SUTCH, "DEBT PEONAGE IN THE COTTON SOUTH AFTER THE CIVIL WAR", *JOURNAL OF ECONOMIC HISTORY* (SEPTEMBER, 1972), P.653.
13 ATHERTON, *THE SOUTHERN COUNTRY STORE*, P. 13.

collection. Detailed personal information about the farmers was available to the merchant banker as an incidental byproduct of his dry goods operations.

The country store was almost always one of the first commercial establishments to open and operate in the newly-settled areas.[14] Farmers would patronize the store to purchase items not easily produced on the farm. As the local population grew, the storekeeper would expand his operation and eventually serve three hundred or so farmers. Over time storekeepers became well acquainted with the farmers through frequent social and business contact. Not only was the country store a place to buy supplies, but also served as a gathering place for farmers during their idle time. Therefore, the storekeeper actually came in contact with individual farmers much more frequently than did the lawyer, doctor, or even the preacher. Through his proximity to the farmer's operations and his constant contact with the farmer, the merchant could accumulate a great deal of information about his customers.

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[14] ATHERTON, *THE FRONTIER MERCHANT*, P. 46.

Recorded in the pages of his little black book were remarks concerning almost every aspect of the farmer's life. This information included: the productivity of his farmland, his business and drinking habits, honesty, livestock, other debts, and his crop mixture.[15] The collection of this detailed information was a fairly long and tedious process. But, the merchant banker's station in the community allowed him to collect it inexpensively. Because of this unique ability, the private merchant banker was able to service the credit needs of farmers profitably, where a commercial bank would not have been able to do so.

Between 1800 and the beginning of the twentieth century, most Southern states enacted usury laws to protect borrowers from exceedingly high interest rates. While well-intended, their effect was to further emasculate the ability of banks to service smal˙-scale rural borrowers. The maximum interest rate allowed in any Southern state was eight percent, and most were lower.[16] Eight percent could not begin to cover the

15 *IBID.*, P.14.
16 SCHWEIKART, P.140.

administrative costs, much less the potential default risks, inherent in rural lending. For example, a default rate of only ten percent would have required an interest rate of over eleven percent just to break even.[17] Since default rates regularly exceeded twenty percent a much higher rate was needed for a bank to remain viable.

While usury laws applied to all money-lenders, merchant bankers could easily circumvent them and charge whatever rate of interest they deemed appropriate given the size, duration and other terms of the loan. Since most loans were made for the purchase of goods from the store, merchandisers could simply charge higher prices on the goods purchased on credit. This also had the effect of minimizing transactions costs as no mortgages were drawn up, and the only paperwork was an entry in the merchant's ledger. Accounts vary as to just how much of an additional markup accompanied credit purchases, but it was likely

[17] A DEFAULT RATE OF TEN PERCENT ON $1000 IN LOANS LEAVES A LENDER WITH $900 IN CAPITAL. HE MUST EARN A RETURN OF 11.11 PERCENT ON THIS AMOUNT TO RETURN HIM TO THE $1000 LEVEL HE BEGAN WITH.

on the order of twenty to thirty percent.[18] Despite the implicit higher rates charged by merchant bankers, agricultural lending was not an overly profitable venture because of the high default rates. A business that specialized in lending money would have struggled to remain viable even if it was able to make as much as $10,000 in loans.[19] With a twenty percent default rate a bank would have had to charge an interest rate of over seventy-five in order to earn the same $4200 return a merchant banker earned on only $6000 worth of capital. Higher interest rates alone would not have made lending a profitable venture. They would have only helped to lessen the damage caused by high default rates.

18 ATHERTON, *THE FRONTIER MERCHANT*, P.144. THE ISSUE REMAINS UNRESOLVED AS TO WHETHER OR NOT THESE RATES WERE MONOPOLISTIC. RANSOM AND SUTCH (1972) CONTEND THAT THESE RATES ARE AN INDICATION OF MONOPOLY POWER. BROWN AND REYNOLDS (1973) REJECT THIS ARGUING THAT MONOPOLY POWER IMPLIES BARRIERS TO ENTRY AND THEY FOUND NONE TO EXIST. FISHBACK'S RESEARCH (1989) SHOWS THAT GEORGIA'S FARMERS ACTUALLY DECREASED THEIR DEBT LOAD OVER TIME. MY RESEARCH SUPPORTS THE LATTER ARGUMENTS. WHILE IT APPEARS THAT MERCHANTS IN REMOTE AREAS HAD THE OPPORTUNITY TO EXACT MONOPOLY PROFITS IN THE SHORT RUN, IN REALITY, THEY DID NOT. THEIR HIGH RATES WERE ONLY A REFLECTION OF HIGH DEFAULT RATES.

19 $10,000 WAS THE MINIMUM CAPITALIZATION ALLOWED UNDER A TEXAS STATE BANK CHARTER.

The paucity of independent commercial banks in Texas from 1845 to 1905 was not simply the result of the anti-banking provisions of the 1845 constitution. The problems of banking in the frontier economy prevented commercial banks from operating viably in Texas. The nature of the demand for credit - small, uncollateralized loans - combined with high default rates and usury laws, precluded profitable commercial banking. The small private banker prevailed in this environment because of the advantages of flexible scale, a unique knowledge of the customer and his operation, and an ability to avoid usury laws. In the developing frontier economy of Texas the private merchant bank was indeed the only viable form of banking.

CHAPTER II

THE BANKING SYSTEMS OF THE OLD COTTON SOUTH

This chapter analyzes the state banking systems of Georgia, Alabama, Arkansas, Mississippi, and Louisiana during the Antebellum period. The economies of these states were most like those of Texas in the nineteenth century. This study demonstrates the failure of state-chartered banking to meet the credit needs of agriculture in these states and strongly suggests that the absence of state chartered banking in Texas did not significantly affect the supply of credit to rural borrowers.

Although the economies of the Old Cotton South were primarily agricultural, commercial banks had very few outlets to serve the rural economy. The banking systems of Georgia, Alabama, Louisiana and the rest of the Old Cotton South were marked by a relatively few very large banks and a high degree of concentration in the major cities and commercial centers. Commercial banks were ill-suited to operate in the rural economy. Despite innovations such as branch banking, rural lending requirements, and agricultural banks designed specifically to service the rural economy, commercial banks remained primarily an urban phenomenon.

Georgia's commercial banking system was typical. Banks were highly concentrated in a few cities, and all of its banks were fairly heavily capitalized. Georgia's banking system grew at a fairly constant rate for its first fifty years, but banks were not dispersed evenly throughout the state. From 1807 to 1850 the state of Georgia chartered nearly thirty banks, with most located in the large commercial centers. Savannah, for instance, the trading hub of Georgia, had twenty-four banking offices in 1848.[1] That was nearly one office for every three hundred people. Other large cities also had a number of banks. Macon had six separate commercial banks, Augusta had four, and Columbus had three. Other banks were located

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1 JOHN J. KNOX, *A HISTORY OF BANKING IN THE UNITED STATES* (NEW YORK:BRADFORD RHODES AND CO., 1903), P. 576.

in Athens and Milledgeville, the state capital.[2] Initial capitalization of these banks ranged from $300,000 to $1 million. From 1850 to 1856, during Georgia's "Free Banking Era", an additional twenty-four banks were chartered. However, one third of these new banks were located in Savannah, Augusta, or Columbus.[3]

The economy of Antebellum Louisiana developed along two complementary but distinct lines. Like other Southern states Louisiana was heavily agricultural, but unlike the rest of the South (especially Alabama, Mississippi, Arkansas, and Texas), Louisiana also developed a prosperous and powerful urban economy in the great commercial center of New Orleans.[4] This dynamic urban center greatly exaggerated the tendency of banks to locate in cities and service urban customers. The Louisiana legislature issued its first bank charter in 1804 to a group of businessmen who opened the Louisiana Bank in New Orleans. From then until 1857, Louisiana chartered 26 banks, all of which

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2 GOVAN, PP. 313-315.

3 *IBID.*, P.314.

4 GEORGE D. GREEN, *FINANCE AND ECONOMIC DEVELOPMENT IN THE OLD SOUTH* (STANFORD: STANFORD UNIVERSITY PRESS, 1972), P.13.

established their home offices in New Orleans. Even the Free Banking Campaign of the 1850's did little to change this situation. Despite strong support from many planters, farmers, rural political spokesmen, and the New Orleans business community, only five new banks were chartered and none were located outside of New Orleans.[5]

Lawmakers in Alabama decided early on that there should be only one Bank of the State of Alabama. But, recognizing that a single bank located in the capital, Tuscaloosa, would be insufficient to service the entire state, they authorized the opening of branches. Between 1832 and 1845, despite Alabama's bustling rural economy, only four branches of the state bank were opened, and the sites chosen were all relatively large cities (Mobile, Montgomery, Decatur and Huntsville). And, all four branches had between $300,000 and $1.5 million of capital. After a series of scandals, all of the branches were closed by the legislature in 1845. This left only a few private banks to service the

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5 *IBID.*, P.27.

state's economy until 1850 when Alabama adopted a free banking law in the hope of enticing banks to open throughout the state. However, only six new banks opened in the decade before the outbreak of the Civil War and, not surprisingly, most located in the large cities like Tuscaloosa and Montgomery. Often banks opened for business where other banks were already operating. Montgomery and Mobile each had three banks and Selma had two. Other cities with banks included· Huntsville, Eulala, and Gainesville.[6]

The remaining two states of the Old Cotton South, Mississippi and Arkansas, were at each end of the spectrum of banking systems. Arkansas' formal banking system was tiny, with only three commercial banks. The Bank of Arkansas was located in Little Rock and had branch offices in Fayetteville and Batesville.[7] Mississippi, at the other extreme, granted banking privileges to a large number of companies that were spread throughout the state. However, most of them were not commercial banks in the true sense. Usually

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6 KNOX, P.600.

7 *IBID.*,P.655.

they were commercial enterprises engaged in some other business such as railroading. The strictly commercial banks that were chartered were large and did have some degree of geographic concentration. Of the fourteen commercial banks that opened between 1810 and 1837, four were located in Natchez. The remaining ten were located in the large commercial centers like Vicksburg, Port Gibson, Colombus, and Holly Springs. All of the banks were large with capitalization ranging from $500,000 to $3 million.[8]

In concentrating in the large cities and commercial centers bankers located in places best suited for their businesses. While large cities offered ample opportunities for banks to conduct profitable lending operations, banking in frontier areas was risky and unprofitable because of the peculiar credit needs of agriculture and the high costs of servicing those needs.

The continual unfulfilled need for credit, and the unwillingness of state-chartered banks to accommodate

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[8] WILLIAM G. SUMNER, *A HISTORY OF BANKING IN ALL THE LEADING NATIONS* (NEW YORK: AUGUSTUS M. KELLEY PUBLISHERS, 1971), P.248.

that need provoked a constant struggle between farmers and bankers. Reconciliation between the two sides could never really be achieved as the fundamental problems of agricultural lending remained unchanged. Much legislation was enacted, aimed at increasing the rural credit supply, but the nature of rural credit needs repelled all attempts to transplant commercial banking operations into the countryside.

To encourage mortgage lending the states enacted liberal branch banking laws and mortgage lending requirements. Of all the Southern states that authorized branch banking, only Louisiana had what could legitimately be called "branch banks". Alabama, Georgia, and Arkansas all authorized branch banking, but in reality the branches were nothing more than independent operations which shared the same name with the parent bank. Each had its own board of directors and the relations between the banks and their branches were reported to be, in many ways, analogous to the relations between different banks. For instance, the Bank of Georgia refused to redeem for specie bank notes and checks issued by some of its branches.[9] The branches also tended to open in the larger cities, increasing the concentration of banks rather than lessening it. The Bank of Georgia is a good example. It opened branches in Augusta, Macon, and Milledgeville, all locations where the Bank of Darien already had branch offices.

Louisiana's experience with branching was different, but also illustrates the difficulty of establishing any type of rural commercial banking operation. Of the fifteen banks chartered by the Louisiana state legislature, several were authorized to establish branch banks. Hoping to blanket the state with credit facilities, forty-six branches were authorized for twenty-six different towns.[10] However, the tremendous demand for farm credit and the limited supply of credit facilities lead to an intense political struggle. The chartering of each new bank involved a massive tug-of-war in the legislature, with each rural representative seeking a branch for his

9 GOVAN, P. 194.
10 GREEN, P.24.

district. The sites were finally chosen and numerous branches began to open. However, existence of a nearby branch bank did not guarantee the local farmer an increase in credit.

In 1818 the legislature created the Louisiana State Bank with a $2 million capital stock and provisions for five branch offices outside of New Orleans. Each branch office was authorized a $100,000 capital stock of its own. But, within a few years of its opening, the state bank was sharply criticized for dramatically reducing the number of agricultural loans from its branch offices. Angry legislators sought to replace all of the bank's officers and enforce more liberal lending policies. But, this was to no avail. Although the 1820's were a decade of substantial growth for Louisiana's cotton and sugar growers, by 1825 the Louisiana State Bank had closed four of its five branch offices.[11]

The effort to expand agricultural credit through branch banks was a failure. Of the forty-six branches

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[11] *IBID.*, P.21.

authorized in Louisiana, only thirty-six actually opened, and these were heavily concentrated in the richest cotton and sugar areas along the Mississippi and Red Rivers.[12] Less than $6.8 million of the $13.4 million authorized capital for branches in the various bank charters was actually allocated by the parent banks. In addition, not all loans went to meet agricultural needs. Only about one-third of all branch loans were mortgages, and some of which went to small-town businessmen and cotton factors. Most of the credit which did reach purely agricultural concerns apparently went to the larger planters who owned most of the valuable fields and slaves that were preferred as loan collateral.[13]

In Louisiana, there is evidence that once established, branch banks pressed their headquarters for greater lending capacity and sought greater freedom in extending liberal terms to rural borrowers.[14] However, the home office never shared their enthusiasm.

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12 *IBID.*, P.22.
13 *IBID.*, P.24.
14 *IBID.*, P.26.

Though happy to have their bank notes circulate more widely in rural areas, the parent banks consistently sought to channel their loans into the more liquid commercial loans, and avoided risky long-term operations like mortgages.[15] Thus, while branch banking did offer some advantages over unit banking, it failed to overcome the problems which made commercial banking inviable as a source of agricultural credit.

Because a branch bank has recourse to head-office services, a branch bank's minimum viable scale is much smaller than that of an independent bank. Branch banks could also begin as a very small operation, like a merchant banker, to accommodate even a small demand. However, branch banks were no better equipped to deal with certain facets of agricultural lending than an independent bank. For example, relative to merchant bankers, branches suffered the same disadvantages as independent banks in the gathering of information about the credit worthiness of borrowers. And, branches remained subject to the same usury ceilings as their

[15] *IBID.*, P.27.

parent banks. Unable to earn a rate of return commensurate with risk levels, it is understandable that parent banks preferred to restrict the lending of their rural branches to only the larger agricultural operators. Capital was too scarce and the uses for it too many to tie it up in ventures of questionable outcome.

In addition to the granting of branching privileges to banks, lawmakers of the various states enacted other legislation aimed at increasing rural credit. Written into the charters of many banks were strict provisions mandating how much of its authorized capital must be made available for agricultural loans. The Union Bank of Mississippi, for example, with a prodigious $15.5 million capital stock was required to loan fully two-thirds of its capital on real estate, with the other one-third on promissory notes.[16] In Louisiana, such requirements were equally common. Often, banks were granted branching privileges only in exchange for a promise to make their branch's capital

[16] WILLIAM G. SUMNER, *A HISTORY OF BANKING IN ALL THE LEADING NATIONS* (NEW YORK:AUGUSTUS M. KELLEY PUBLISHERS, 1971), P. 248.

available for farm loans. Of the six banks chartered in Louisiana between 1824 and 1832, five of them had mortgage loan requirements written into their charters. Between one-half and two-thirds of the capital of most banks was earmarked for this type of lending. In 1838, Louisiana enacted sweeping legislation requiring that at least forty percent of all loans by all banks must be made to rural borrowers.[17]

This type of legislation is a clear reflection of just how reluctant bankers were about becoming entangled in the rural credit market. If mortgage loans were a profitable use of capital, bankers would naturally have rushed to accommodate this demand for credit. But, farm loans were not good business for commercial banks, and the experiences of a few banks in Louisiana that did purvey solely to farmers is testimony to the hazard of doing so.

All banks in Louisiana were created by one of three legal routes. A chartered bank was established by a separate, special act of the state legislature;

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17 GREEN, P.21.

its charter spelled out the particular rules and restrictions which were to guide its operations. Free banks were also creatures of the legislature, but they were regulated by the general free banking law of 1853 rather than by separate acts. Besides these two types of incorporated banks, there were unincorporated "private banks", which operated as partnerships or single proprietorships.[18]

Chartered banks were further identified as one of three types: Commercial, Improvement, and Property Banks. Their charters specified the range of economic activities that each was to finance. Commercial banks were conventional banking operations, providing merchants with short-term credit to finance inventories or shipments of cotton, sugar, and other commodities. Improvement banks financed, constructed, and managed internal improvements such as canals, railroads, waterworks, and hotels. Property banks made mortgage loans to planters, farmers, and urban property owners.[19] It was through the chartering of property

18 *IBID.*, P.15.
19 *IBID.*, P.17.

banks that legislators also hoped to increase rural credit. From the outset, however, all ran into difficulties.

The Planter's Bank, the first of the property banks, was chartered in 1811. It was set up specifically to provide credit to Louisiana's rural sector, with half of its directors being planters. Despite the best of intentions of its directors and a rapidly expanding agricultural economy, the bank sustained losses year after year. It finally suspended its operations for good in 1820.[20]

The late 1820's and early 1830's were years of substantial growth for Louisiana's cotton and sugar plantations.[21] The value of all agricultural production doubled between 1825 and 1835, as did the population. Along with this growth came strong demands for the expansion of banking facilities. To mollify these pressing demands, the Louisiana legislature chartered three additional property banks between 1828

20 *Ibid.*, p.25.

21 George D. Green, *Finance and Economic Development in the Old South* (Stanford: Stanford University Press, 1972), p. 22.

and 1833. Hoping to increase rural credit and replace the New Orleans branch of the Second Bank of the United States, which was soon to close, two of the banks were granted massive capitalization. But, like their predecessor, they struggled to operate profitably over the long run, and demonstrated that agricultural lending was not a viable proposition for commercial banks.

The Consolidated Association of the Planters of Louisiana was chartered in 1828 with an initial capitalization of $2.5 million. It was probably the most successful of the three property banks, as it was in business for the longest time. However,this was only fifteen years. In 1832 and 1833 Louisiana chartered the Union Bank and the Citizen's Bank of Louisiana, with initial capitalization authorized at $7 million and $12 million respectively. These were, by far, the largest banks ever chartered in Louisiana, and caused much debate in the legislature. Many lawmakers felt that these banks were far larger than anything

Louisiana's economy needed. They were not the only doubters either.

Like the Planter's Bank, both the Union Bank and the Citizen's Bank were property banks and their assets were to be comprised mainly of mortgages and crop liens. Investors were understandably reluctant to invest in such a risky operation, and so shyed away from purchasing the bank's bonds. Both banks were forced to delay their opening until investors could be found. The Citizen's Bank searched for three years before an Amsterdam firm finally purchased its securities. Ultimately, however, all three of the property banks were unable to arouse sufficient interest in their bonds. It was not until the state of Louisiana completely guaranteed the bonds that investors were willing to purchase them.[22]

The fears of investors proved well-founded as none of the property banks had particularly long or prosperous lives. The longest period of service for a property bank was only fifteen years, while the

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[22] *IBID.*, P.27.

shortest, that of the Citizen's Bank, with its many branches and huge capital stock, was only seven years. By contrast the shortest lifetime of a commercial bank in New Orleans was thirty years and the longest, that of the Louisiana State Bank, was over ninety.[23]

What lawmakers could not accomplish with legislation, bankers and businessmen attempted to achieve with innovation. The agricultural economy was not conducive to formal commercial banking, but, because of the constant demand for credit, a business offering some type of banking services could be very profitable. Bankers and businessmen knew that diversification was an important bridge between risk and profitability. Consequently, there developed a plethora of quasi-merchants and semi-bankers to service the rural economy.

Many of the banks in Georgia, Alabama, Arkansas, and Mississippi attempted to overcome the problems of rural lending by imitating their competitors in the countryside, the merchant bankers. Although most banks

[23] *IBID.*, P.32.

were strictly prohibited from merchandizing, many banks actively engaged in the buying and selling of tobacco, cotton, sugar, and other commodities. This practice was widespread throughout the South despite cries of outrage from cotton merchants, legislators, and newspapers.[24] The Agricultural Bank of Mississippi traded in both cotton and pork, and all the branches of the Bank of the State of Alabama were heavily involved in cotton merchandising.[25] Likewise, the Bank of Arkansas saw an opportunity to expand its operations by issuing bills in return for cotton and tobacco, and then marketing these commodities on its own. Banks in Georgia were a bit more subtle in their involvement. Instead of transacting the business through their offices, they appointed someone in each town to serve as their agent. This individual would purchase and market cotton with money advanced to him by the bank. He would then return the money and receive a commission on what he sold.[26] Sometimes these banks' activities

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24 SCHWEIKART, P. 205.

25 *IBID.*, P.206.

26 *IBID.*, P. 229.

were so flagrantly in violation of their charters that they were closed down by state officials. Such was the case with state banks in Alabama and Arkansas where banks made loans to their own directors for the purpose of engaging in the commodities trade.[27]

The experiences of these Southern banks demonstrates the desirability of diversification when operating in a rural environment. The banker could not only be the provider of credit, but also the purchasing and marketing agent of crops as well. The economy was not developed sufficiently to allow for specialization of the three operations. They had to be combined for any to be viable. Some of the most successful banks in the South were those that were granted the authority to engage in more than one business at a time.

Many legislators recognized the advantages of diversification and so granted banking privileges on a very regular basis to companies that were in heavily-capitalized industries. Railroads and municipal utilities were most often the recipients of these

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[27] SCHWEIKART, P. 229.

privileges, which were valuable for many reasons. Railroads, with their huge capital subscriptions were able to employ their capital profitably through their banking operations, which allowed the payment of dividends to their stockholders while the railroad was still under construction. The privilege of note issue also helped ease the problem of financing by providing a ready source of liquidity.[28]

The banking business of the railroads also benefitted from this blurring of occupational lines after the rail lines were built. The various banking offices throughout the state ensured wide circulation of their bank notes, lessening specie redemption. Also, the financing of bridge building or purchases of rolling stock provided the banks with additional outlets for their capital.

The Georgia Railroad and Banking Company was probably one of the most diversified banking operations in the South. Besides conducting railroad and banking operations, it was also heavily involved in cotton and

[28] KNOX, PP. 600, 206.

tobacco merchandising and continually sought new sources of trade and revenue.[29] Not coincidentally, this bank, along with the Central Railroad and Banking Company of Savannah, was one of the strongest banks in Georgia. And, both companies survived until well after the Civil War and financed much of the state's reconstruction in the Postbellum period.[30]

Mississippi was probably the most liberal in granting banking privileges to railroads and other industrial firms. Between 1830 and 1836, Mississippi chartered twenty-one banks. Over fifty percent of the charters were granted to railroads or municipal utilities.[31] Likewise, during this same period Louisiana granted banking powers to a number of railroads and municipal utilities. Over forty percent of the banks chartered in Louisiana between 1830 and 1836 were engaged in another business besides banking.[32] Neither Alabama nor Arkansas extended banking privileges to railroads. Their networks of

29 *Ibid.*, p.575.
30 *Ibid.*, p.576.
31 Sumner, p.240.
32 Green, p.20.

chartered banks were quite small and dominated by the state-run institutions. Interestingly enough, this appears to have affected both their railroad and banking industries, as development of both networks lagged behind their sister states that did extend such privileges.[33]

The lawmakers and innovative commercial bankers were never particularly successful in creating a vehicle that would meet the credit demands of the rural economy and do it profitably. Ultimately it was the indigenous country store system whose operations were small and flexible that provided the credit that was needed in the rural areas. Any economy, such as that of nineteenth century Texas, which developed along predominantly agricultural lines would not naturally have had an abundance of rural commercial banks during its early development.

33 Schweikart, p.232.

CHAPTER III

THE EVOLUTION OF BANKS IN TEXAS

Texas was the last of the Southern cotton states to be settled and experience economic development. It lagged behind its eastern neighbors by some twenty-five to thirty years. The Texas economy of 1850 was comparable to the economies of Louisiana or Georgia in 1820.[1]

In 1836, when Texas won her independence from Mexico she had only 30,000 settlers. By 1845 her population had quadrupled to 125,000, but the population density in the state was still only one person for every three square miles. As late as 1850, Texas was still very much a frontier area. Less than 10 percent of the population lived in urban areas, and settlements extended to only seventy-five miles west of present-day Dallas.

It was in this environment that the banking industry of Texas began. Despite the anti-banking

1 SCHWEIKERT, P. 257.

legislation of 1845 Texas had thousands of private bankers. The legislation did not disrupt the fundamental evolutionary process of frontier banking nor did it prevent these banks from accomodating every banking need of the rural Texas economy.

Virtually every bank which existed in the early days of the Texas republic began as a mercantile operation or other business. It is nearly impossible to find a county whose first bank was an independent operation. Typical of frontier areas, Texas' first banks were tiny diversified operations which grew and evolved with the surrounding economy until the banking business was mature and profitable enough to stand on its own. Often it was the dry goods store that evolved to become the town's first independent bank. This evolutionary process was repeated in virtually every county with every bank in frontier Texas.

One of the earliest banking operations on record was that of Ball, Hutching and Company of Brazoria, Texas. It opened as a mercantile establishment in 1854 and dealt in boots, shoes, hairpins, scissors, dry goods and other merchandise, according to their advertisement. In 1858 it began private banking operations, and just after the Civil War banking became its sole line of business.[2]

The firm of T.W. House in Houston was also a private banker which had begun as a dry goods store. It also produced and sold ice cream, and dealt in the retail and wholesale marketing of groceries.[3]

The history of the Frost Bank is an excellent example of the evolution of a Texas bank. Beginning as a small frontier store that made loans to farmers and wool producers, this business evolved into a bank that continues to operate over one hundred years later.[4]

John and Thomas Frost opened a mercantile and auction business in San Antonio in 1867. They built and stocked their store with $3000 that Thomas Frost had received for his service in the Civil War. The Frost brothers sold general merchandise and also did

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2 JOE E. ERICSON, *BANKS AND BANKERS IN EARLY TEXAS 1835-1875* (NEW ORLEANS:POLYANTHOS, INC., 1976), P. 17.

3 *IBID.*, P. 17.

4 HERBERT M. MASON, JR., *A CENTURY ON MAIN PLAZA; A HISTORY OF THE FROST NATIONAL BANK* (SAN ANTONIO: THE NAYLOR CO., 1968) *ET AL.*

some wool commission work. In the course of their mercantile operations they began advancing credit to customers, and soon discovered that this was very beneficial to their business. Banking transactions and sales of merchandise increased as new settlers in need of credits and loans discovered where such help was available. The Frost brothers learned a great deal about the banking business through the banking transactions they made at their store. They continued to expand both operations and in 1880 they separated the banking account records from the mercantile records. The banking operations were relocated to the rear of the store, and the bookkeeper was made into a part-time bank cashier. By the mid-1880's the Frosts were making sizable loans to wool and cotton shippers, although the bank remained just a small room in the back of the store. In 1888, the Frosts announced that they were becoming full-fledged bankers and phased out the mercantile part of their business. Their building was remodeled to present an image more conducive to banking, and a new sign was hung which read "THE FROST BANK Private Bankers".

The histories of many of the counties of Texas reveal a similar process of bank development. All confirm that the Texas banking industry developed exactly as one would expect given the frontier nature of Texas.

Bell County

In 1867 the mercantile houses of Miller, Chamberlain and Co. and H.C. Denny and Co. began to do a small banking business in Belton. In 1874 Chamberlain and Miller split to form their own businesses, but both firms continued in the banking business which, by this time, was expanding into an appreciable amount of small deposits and loans. In 1880 L. Burr and Co. opened a wholesale grocery store in Belton with a banking department. Two years later H.C. Denny took over the banking interests of Burr and opened the first exclusive banking house in Belton. About the same time, the Miller brothers ceased their mercantile business and began to operate an exclusive banking business, also in Belton.[5]

Ellis County

In 1860 J.W. Ferris of Waxahachie opened an exchange office in connection with his law business. This was the first and only business of its kind in north Texas outside of Dallas. His operations were interrupted by the war, but in 1868 he formed a partnership with another attorney, W.H. Getzendaner. Shortly thereafter they opened an exchange and banking office in connection with their law business. In the same year, the firm of Burford, Good and Jordan set up a banking and exchange office in conjunction with their law business. By the mid-1880's both firms had evolved into independent banking operations.[6]

Hamilton County

Hamilton County defined the very edge of the frontier just after the Civil War. The population of the entire county in 1868 was just over 600, and raids

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5 G.W. TYLER, *HISTORY OF BELL COUNTY* (SAN ANTONIO:THE NAYLOR CO., 1936), PP. 385-389.

6 *ELLIS COUNTY HISTORY*, ELLIS COUNTY HISTORICAL MUSEUM. (FORT WORTH:HISTORICAL PUBLISHERS, 1972), P.140.

by marauding Comanches were still a very real concern to the settlers. Dr. George F. Perry was the first banker in the county. He owned and operated a drug store in Hico that also sold general merchandise. Dr. Perry had an iron safe in his office and cattlemen and farmers left their money with him for safe-keeping. Dr. Perry began lending small amounts to customers who needed extra cash, and also extended credit on purchases made at the store. His banking business grew as the population of Hico increased, and the banking section of his store was continually improved to handle the business. First, he set up a desk that was designated solely for banking business. Later, to further isolate the banking business from the mercantile operations, he fenced in a corner of the store and placed the banking desk behind it. In 1890, he discontinued the drugstore business and became a full-time banker.[7]

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7 ORAN J. POOL, *A HISTORY OF HAMILTON COUNTY* (MASTER'S THESIS, UNIVERSITY OF TEXAS, AUSTIN, 1954), P. 118.

Palo Pinto County

Palo Pinto County saw its first settlers in 1857, but it wasn't until twenty years later that its first town was established at Mineral Wells on the Brazos river. Mr. D.M. (Dock) Howard was the town's first banker. He owned and operated the D.M. Howard Dry Goods Store in Mineral Wells. He extended credit to farmers in the form of merchandise, and people also deposited their savings with the store's office. The banking portion of his business proved to be very successful, and in 1890 he sold the dry goods business and opened the Bank of Mineral Wells. His rival, G.C. Poston ran the Poston Dry Goods Store and also engaged in banking. Like Dock Howard, he too phased out his mercantile business after a few years in favor of full-time banking.[8]

Kaufman County

Prior to the Civil War, Kaufman county's only money lenders were William Burgett and Cal Maples. They were known as the "pants pocket bankers" who made

[8] *PALO PINTO COUNTY HISTORY,* PALO PINTO COUNTY HISTORICAL ASSOCIATION (DALLAS:TAYLOR PUBLISHING CO., 1978), *ET AL.*

personal loans to local residents with money they just had on hand. Their lending operations were the ultimate in informal arrangements. They had no offices so business was usually conducted at the saloon or borrower's home. In 1875 the law firm of Waters, Bivens and Corley began offering banking services in Terrell and continued in operation until 1887. Around 1880, W.T. and A.J. Childress opened a mercantile, saddlery and banking business in Terrell. They operated this diversified enterprise until 1885 when they merged the banking portion of their business with that of Bivens and Corley to form an independent private bank. In 1890, in the southern end of the county, W.C. Mason, a merchant, cattleman, and banker, discontinued his other businesses and established a private bank in Kemp.[9]

Harrison County

The banking house of C.H. Raquet was the first bank in Marshall, Texas. His banking business was an adjunct to a very prosperous land office that had

[9] R.B. BUTLER, *A HISTORY OF KAUFMAN COUNTY* (MASTER'S THESIS, UNIVERSITY OF TEXAS, AUSTIN, 1940), PP. 118-125.

operated since just after the Civil War. During this time, E.J. Fry opened a dry goods store and began to conduct a banking business along with it. Another private banker, J.H. Starr also ran a bank in conjunction with his land office. Messrs. Garrett and Key were attorneys who conducted exchange operations in addition to their law practice. They ultimately merged their banking business with that of E.J. Fry in 1869, and all three men became full-time bankers in Marshall.[10]

Gray, Bastrop, Brazoria, and Montague Counties

The first bank in Gray County was housed in the Johnson Mercantile Company. This was the first store in the town of Pampa. Mr. Johnson later became a full-time banker and opened the first independent bank in Pampa.[11] In Bastrop County the privately owned Bank of Elgin originated in the Rivers and Carter General Store. W.H. Rivers later split from Carter and established his Bank of Elgin as an independent

10 HOBART KEY, JR., *OF MONEY AND MEN* (MARSHALL:PORT CADDO PRESS, 1965), PP. 11-22.

11 F.R. PROUSE, *A HISTORY OF GRAY COUNTY, TEXAS* (MASTER'S THESIS, UNIVERSITY OF TEXAS, AUSTIN, 1957), P. 268.

operation.[12] The Bank of Angleton in Brazoria County began as a sideline operation in a real estate office before spinning off on its own.[13] In Montague County, J.T. Harris operated the first general merchandise store in Ringgold. He offered banking services in the form of making loans and taking deposits at his store. Later, he closed the store and made banking has full-time profession.[14]

Because of the minimal barriers to entry into the industry, Texas was literally awash with private banking establishments. The Texas Almanac for 1858 lists an astounding 2638 money lenders operating in the state that year with loans of over $2.7 million.[15] That is one lender for every twenty-five citizens (white male, 18-45) or 1/206 for the total population. In Pennsylvania the ratio of merchant bankers to population was 1/260, and in Illinois and Missouri,

12 BILL MOORE, *BASTROP COUNTY* (WICHITA FALLS:NORTEX PRESS, 1977), P. 197.
13 JAMES A. CREIGHTON, *A NARRATIVE HISTORY OF BRAZORIA COUNTY* (WACO:TEXIAN PRESS, 1975), P. 303.
14 G.R. DONNELL, *THE HISTORY OF MONTAGUE COUNTY* (MASTER'S THESIS, UNIVERSITY OF TEXAS, AUSTIN, 1940), P. 96.
15 *TEXAS ALMANAC, 1858*, PP. 216-217.

1/340.[16] These private bankers could be found everywhere in the state. They averaged twenty-eight per county and ranged in number from one in Atascosa County with loans of $500 to 105 in Coryell County with $61,000 in loans. Harrison County, a cotton and sugar area, had 93 lenders with $135,000 in loans, while Galveston, a commercial center had just 32 money lenders but over $140,000 in loans.[17]

The 1859 Texas Almanac identifies 3021 money lenders in Texas with over $3 million in loans.[18] This apparent increase of nearly 400 new money lenders in one year is more of an indication of the difficulty of data collection during these days than a true picture of the rate of growth of money lenders. Many of their operations were exceedingly small and probably less than one-fourth of them submitted reports to any kind of state agency. This made an actual count of them very difficult. Hence, the available figures quite

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16 LEWIS ATHERTON, *THE FRONTIER MERCHANT IN MID AMERICA* (COLUMBIA:UNIVERSITY OF MISSOURI PRESS, 1971), P. 41.

17 *TEXAS ALMANAC, 1858*, PP. 216-217.

18 AVERY L. CARLSON, *A MONETARY AND BANKING HISTORY OF TEXAS* (DALLAS:TEXAS PUBLICATION HOUSE, 1930), P. 10.

likely understate significantly their true numbers and the total amount of credit they made available.

Probably a better indication of the smooth rate of growth of private bankers is the annual increase in those who engaged in banking exclusively. Most money lenders were merchants who did some banking on the side, but as the economy evolved banks could operate profitably as independent operations. New merchant banks appeared in the frontier areas while older, established operations evolved into independent private banks. From 1869 to 1878 the annual increases in private banks in Texas were: 20, 8, 8, 32, 10, 10, 7, 17.[19]

The laws prohibiting banks from incorporating apparently had little effect on banking's ability to attract and accumulate large amounts of capital. The history of Texas is rich with stories of small, private bankers who began with part-time operations and soon evolved into full-time, well-capitalized banks. The law firm and private bank of Burford, Good and Jordan

[19] ERICSON, P. 32.

of Dallas is a good example. They began their banking business in 1870 with only a few thousand dollars of capital. Within just five years the capital of their bank had grown to over $70,000. By 1884 their capital was nearly triple this amount at $208,000.[20] It appears that private banks were not at a disadvantage simply because they lacked a formal charter. This level of capitalization easily rivalled the capitalization of the two national banks in Dallas in 1886.[21] Ross estimates that the total capital of the private banks in Texas was considerably larger than those of their nationally-chartered counterparts.[22] And, in 1875, 1883, and 1887, national banks had capitalization of $1.2 million, $3.6 million, and $10 million respectively. At the close of the nineteenth century, some private bankers were even able to make several $100,000 loans to various businesses in Texas.[23]

20 *Ellis County History*, p. 140.
21 *Annual Reports of the Comptroller of the Currency, 1886* (Washington, D.C.:Government Printing Office, 1886), p. 493.
22 F.A. Ross, *Texas Banking Legislation 1853-1953* (Dissertation, University of Texas, Austin, 1954), p. 104.
23 Carlson, p. 50.

The constitutional provision prohibiting the issue of bank notes to circulate as money was also no impediment to the private bankers. They easily circumvented this part of the law which prohibited "individuals" from issuing any type of paper to circulate as money. Private bankers would nearly always operate as some type of partnership, and so no "individual" ever issued any paper to circulate as currency.

Many kinds of paper circulated as money during the early years of Texas' development, and most of it was circulated by private bankers. R and D.G. Mills, one of the earliest private bankers in the state created and circulated thousands of dollars of their own notes. What came to be known as "Mills Money" was a combination of both notes created by them and the bank notes of other banks from Louisiana and Mississippi which Mills endorsed. Most popular were the worthless bank notes from the defunct Northern Bank of Mississippi at Holly Springs. Thousands of dollars of this worthless paper found its way into Texas. The

Mills brothers simply endorsed them and circulated them as their own money. Their signature helped ensure the value of the notes. People were reluctant to accept paper unless they had confidence in the issuing authority. The R. and D.G. Mills Company had an estimated net worth of over $5 million so their notes were widely accepted. The total amount of Mills' money in circulation at any one time is not clear, but estimates put it at somewhere between $30,000 and $300,000.[24]

The bank of Garrett and Key of Marshall, Texas [25] and the Frost Bank of San Antonio [26] both issued blank checks to their customers and also wrote checks of their own. Both of these mediums circulated as money. The law office and private bank of J.W. Ferris of Waxahachie endorsed and circulated notes of New Orleans banks that had been brought to Texas by homesteaders.[27] Sometimes banks even circulated the checks of other

24 JOSEPH M. GRANT, *ANALYSIS OF THE EVOLUTION OF THE STATE BANKING SYSTEM OF TEXAS* (DISSERTATION, UNIVERSITY OF TEXAS, AUSTIN, 1970) P. 5.
25 KEY, P. 11.
26 MASON, P. 33.
27 *ELLIS COUNTY HISTORY*, P. 140.

banks as their own currency. Garrett and Key, on one occasion, simply lined out the name of the Chicago banker who had originally issued the draft, and penned in their company's name along with their signatures. Thus the check for $200 now circulated as a $200 bank note.[28]

The ability to accept deposits and issue checks added another dimension to frontier banks as they evolved, that of money creation. For many years, the Frost Bank of San Antonio reportedly made loans far in excess of his customer's deposits.[29] It is conceivable that all bankers practiced some form of fractional-reserve banking from time to time.

The private bankers of Texas faced few, if any, real barriers to entry into the industry, and few operating restrictions outside those dictated by sound business principles. There were no minimum capital requirements, loan portfolio restrictions or reports to submit. All that was required to begin operations was a perceived demand for loans and money available to

28 KEY, P. 32.
29 MASON, P. 22.

lend. As the edge of the frontier inched westward, new private bankers continually appeared at the margin. This resulted in a very smooth flow of development of the banking industry which evenly matched the growth in the demand for credit. Formal chartering of banks on a state level would have likely done little to increase their numbers or improve their ability to service the frontier economy of Texas.

CHAPTER IV

THE LURE OF INCORPORATION

The year of 1905 has been hailed as a watershed for the Texas banking industry by those who have written about its development.[1] After more than twenty years of continual agitation [2], this was the year after Texas deleted the anti-banking provisions from its constitution and finally began chartering state banks. The effects of this new legislation were dramatic. One cannot help but to be impressed by the immediate and substantial increase in the number of state-chartered banks that began appearing throughout the state in the months immediately following the implementation of the new law.

In the first six weeks after the law became effective, thirty-one new charters were granted, and at the close of 1905 there were one hundred thirteen

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1 SEE JOSEPH M. GRANT AND LAWRENCE L. CRUM, *THE DEVELOPMENT OF STATE-CHARTERED BANKING IN TEXAS* (AUSTIN:BUREAU OF BUSINESS RESEARCH, 1978), CHAPTERS 4 AND 5
SEE ALSO AVERY L. CARLSON, *A MONETARY AND BANKING HISTORY OF TEXAS*, (DALLAS:TEXAS PUBLICATION HOUSE, INC., 1930), *ET AL.*

2 ROSS, PP. 110, 146.

state-chartered banks in operation. This frantic pace continued for the next several years. From August 1906 to August 1907, another one hundred seventy-five banks were chartered and by August 1910, a total of six hundred thirty-six banking charters had been issued.[3] Economic historians have assumed that this dramatic increase in the number of state banks is *prima facie* evidence that Texas had an insufficient number of banking facilities prior to 1905. This lack was particularly evident in rural areas, they argue, since most of the new bank charters were for operations in small towns.[4] However, these numbers are misleading, and have lead to an erroneous conclusion.

The Banking Law of 1904 did not significantly affect the path of development of the Texas banking industry. Most of the new state banks were not new entrants into the industry. Rather, previously existing banks became incorporated at a low level of capitalization. The dramatic increase in state-chartered banks was the direct result of private

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3 GRANT AND CRUM, P. 49.

4 GRANT AND CRUM, P. 58-60.

bankers converting to the state system to take advantage of certain provisions that were beneficial to all bankers. Since 1865, private bankers had been converting to the National Banking System in a steady stream. When the state chartering system began, far more private bankers were enticed to join it because the minimum capital requirements were significantly lower than for national banks,[5] and they could operate with almost the same degree of freedom that they enjoyed as private bankers.

The evolution of most of the banks in the seventy-five years of Texas' existence followed a fairly predictable course. Beginning as a tiny, diversified marginal operation at the edge of the frontier the enterprise would evolve slowly into a full-time

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[5] FOR NATIONAL BANKS THE MINIMUM CAPITAL REQUIREMENTS WERE:

POPULATION	CAPITAL	
1 - 3000	$ 25,000	
3000 - 6000	$ 50,000	
OVER 6000	$ 100,000	(WHITE, PP. 16 -17)

FOR STATE-CHARTERED BANKS IN TEXAS THE MINIMUM CAPITAL REQUIREMENTS WERE:

POPULATION	CAPITAL	
1 - 2500	$ 10,000	
2500 - 10000	$ 25,000	
10000 - 20000	$ 50,000	
OVER 20000	$ 100,000	(CARLSON, P.58)

independent bank. As the surrounding economy grew, so too would the bank, increasing its capital stock and the scope of its operations. Eventually, the owners of the bank recognized that for a larger banking operation, with a loan portfolio that was becoming more heavily weighted with commercial rather than agricultural loans, there could be advantages in obtaining a national bank charter.

On the upside, obtaining a national charter would give the private banker the opportunity to incorporate, something private banks were denied under Texas law. In addition, National banks had the privilege of issuing nationally-recognized currency. These benefits, however, had to be weighed against the potential drawbacks of a national charter. There would be new reserve requirements to observe, loan portfolio restrictions and the scrutiny of federal bank examiners. At various stages of a bank's development, each of these factors held more or less sway in the private banker's decision to convert to the National Bank System.

The opportunity to operate in a corporate form became more advantageous as a bank grew in size. In operating as an unincorporated enterprise the owners of the bank had total personal liability for all debts incurred by the business. As a bank increased in size, so too did its liabilities. Presumably, banks practiced fractional reserve banking to some degree, so as their capital increased, their actual liabilities likely increased at an even faster rate. Under incorporation, the owners of a bank (the investors) were less likely to be ruined financially should the business fail. Smaller merchant bankers, by contrast, contracted only limited liabilities from their banking operation, so incorporation was of minimal value to them. This was true also of the second benefit, the ability to issue currency.

Many private bankers issued checks and other paper that circulated freely as money in the local area[6], so a nationally recognized currency had no great appeal to them. However, for other banks whose customer's

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[6] SEE PP. 54 - 55.

business took them outside the local area, currency issue was an advantage.

The National Currency Act of 1864 placed a ten percent tax on all bank notes issued by state-chartered banks, effectively eliminating note issue as a profitable operation for any bank holding other than a national charter.[7] National banks, then, became the sole issuer of bank notes. From 1865 until the early 1880's, note issue was a profitable operation for those banks with the privilege.[8] National banks enjoyed the benefits of seignorage in this economy which often operated on a shortage of actual cash. The benefits of note issue, however, were short-lived.

The amount of notes a bank could issue was governed by the amount of U.S. bonds held by the bank. An increase in the price of these bonds could lead to a

[7] BARNETT, P. 224. NOTE THAT HAD STATE-CHARTERED BANKS EXISTED IN TEXAS THEY WOULD NOT HAVE HAD THE OPTION OF NOTE ISSUE. THERE WOULD NOT HAVE BEEN ANY MORE NOTES IN TEXAS HAD THERE BEEN STATE-CHARTERED BANKS.

[8] SEE JOHN A. JAMES "THE CONUNDRUM OF THE LOW ISSUE OF NATIONAL BANK NOTES", *JOURNAL OF POLITICAL ECONOMY*, VOLUME 84 (APRIL, 1976). PP. 362 - 367. JAMES CITES CAGAN'S(1965) CALCULATIONS SHOWING THAT NOTE ISSUE EARNED PROFITS OF 3.3% ABOVE OTHER BANK ASSETS WHEN THE MARKET PRICE OF THE BONDS EXCEEDED PAR VALUE. JAMES DOES NOT DISPUTE CAGAN'S ASSERTION, BUT ARGUES THAT BANKS IN THE SOUTH AND WEST COULD EARN HIGHER RETURNS BY USING THEIR CAPITAL FOR OTHER THAN NOTE ISSUE.

great reduction in the profitability of note issue. By 1880, the increased demand for bonds led to a widening difference between the amount of notes which might be issued and the cost of bonds. In order to issue $90,000 of circulation, a bank had to deposit bonds of par value of $100,000, the cost of which in the eighties ran as high as $128,000.[9] It wasn't long before the profit on the issue of national bank notes became so small as to be almost a negligible inducement to incorporation under the National Bank Act.[10]

Other major provisions of a national charter provided a downside to membership if a bank's operations were small and agriculturally oriented.

Before 1900, a national charter required a minimum initial capitalization of $50,000. This was a princely sum for a small town banker whose customers numbered only a few hundred and whose business amounted to only a few thousand dollars each year. The small demand for banking services simply could not justify this amount

9 *IBID.*, P. 225-227.
10 *IBID.*, P. 224.

of capital. Even if he could raise this amount it was unlikely that he could have found sufficient opportunities to employ it prudently and productively. Banks in the large cities like San Antonio, Dallas, Galveston, and Houston with many large commercial enterprises were not stymied by this provision. They had already accumulated this amount of capital during their years of operation and always had sufficient opportunity to employ it profitably.

Reserve requirements were also imposed by a national charter. A private banker enjoyed total freedom in determining his own level of reserves, but as a national bank he was required to hold fifteen percent of his aggregate capital in notes and as deposits in a reserve-city national bank.[11] In addition, national banks were required to retain one-tenth of one percent of their semiannual net profits in a surplus fund until it equalled twenty percent of

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[11] EUGENE N. WHITE, *THE REGULATION AND REFORM OF THE AMERICAN BANKING SYSTEM 1900 -1929* (PRINCETON: PRINCETON UNIVERSITY PRESS, 1983),P.27.

their required capital.[12] This surplus fund was designed to protect against unexpected losses.

The national charter also included some fairly restrictive loan portfolio regulations. Custom and the evolution of the enforcement of the National Currency Act of 1864 and the National Banking Act of 1863 dictated that national banks could only make short-term loans (90 days or less) and that these loans could not be secured by real estate.[13] These provisions effectively dissuaded many small frontier banks, and even some larger independent banks in predominantly agricultural areas, from seeking a national charter. Because they serviced farmers primarily, who required long term (12+ month) loans and had little to offer as collateral besides real estate, a national charter would have severely limited the number of customers a rural bank could accomodate. On the other hand, banks servicing commercial customers were not inconvenienced by these provisions. Their customers typically

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12 *IBID.*, p.16.

13 WALTER L. BUENGER, *BUT ALSO GOOD BUSINESS* (COLLEGE STATION:TEXAS A&M UNIVERSITY PRESS, 1986), P. 30.

required only short-term loans and had machinery, boats, or warehouse receipts to offer as collateral.

Finally, the supervision and examination of national banks was fairly strict. Enforcement of the federal laws was conducted by the Office of the Comptroller of the Currency whose auditors were known for their diligence. National banks were required to submit five call reports a year to the Comptroller of the Currency detailing their current status. Three of these reports were made on random days and included high penalties for non-compliance, up to $100 per day.[14]

A national charter was, obviously, not equally attractive to all private bankers. The size of the bank and the occupations of its customers were factors that weighed heavily in the decision process. Not surprisingly, the locations of the national banks are closely correlated with the commercial regions of the state. It was only logical that private banks in these

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14 *IBID.*, P.33.

areas would be the first to seek a national charter as their business was already commercially oriented.

The map of Texas on the following page shows a distribution by county of the seventy-two national banks operating in Texas in 1886.[15] The well defined north-south band, stretching from Grayson County on the north end to Bexar County on the south end is exactly in the middle of the famous blackland belt where commercial cotton growing was extensive.[16] Not coincidentally, one of the first railroads in Texas also bisected this region.[17] It connected Denison to Dallas, Waco, Austin, and Corpus Christi. The grouping of national banks in the western counties was also the result of growing commercial interests. This region is where two of the Texas cattle trails [18] intersected the newly constructed Texas and Pacific Railroad.[19]

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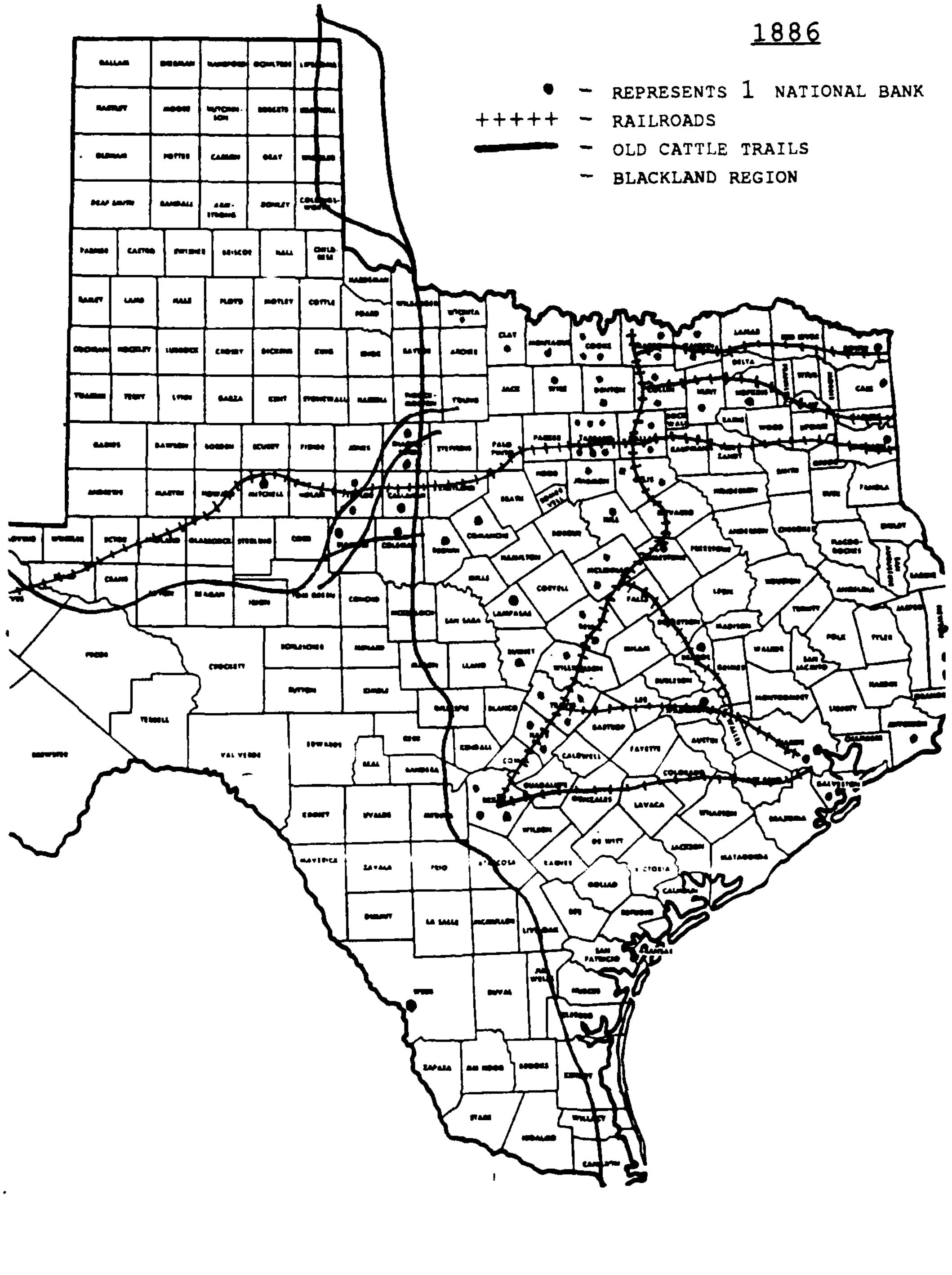
15 *ANNUAL REPORTS OF THE COMPTROLLER OF THE CURRENCY, 1886* (WASHINGTON, D.C.:GOVERNMENT PRINTING OFFICE, 1886), P. 493.

16 E.B. SCHWULST, *EXTENSIONS OF BANK CREDIT* (NEW YORK:HOUGHTON MIFFLIN AND CO., 1927), P. 51.

17 J.S. SPRATT, *THE ECONOMIC DEVELOPMENT OF TEXAS, 1875-1901* (DISSERTATION, UNIVERSITY OF TEXAS, AUSTIN, 1953), P. 51.

18 *TEXAS ALMANAC, 1936*, P. 261.

19 SPRATT, P. 62.


1886
• – REPRESENTS 1 NATIONAL BANK
+++++ – RAILROADS
– OLD CATTLE TRAILS
– BLACKLAND REGION

The number of national banks in Texas increased slowly during the first decade after the National Banking Act of 1863. The Texas economy was slowly recovering from the devastating effects of the Civil War which had destroyed over fifty percent of its farm capacity and machinery.[20] In 1875 there were only ten national banks chartered in Texas, but the appeal of a national charter was growing. As the Texas economy became more commercially oriented banks joined the system in ever increasing numbers.

In 1879 there were only eleven national banks in Texas, but only seven years later the number had increased to seventy-two. Between 1884 and 1887 the number of national banks in Texas grew by nearly fifty percent as did their capital, surplus, and undivided profits.[21] From 1887 to 1892, the number of national banks grew from 91 to 223 with nearly $85 million in total resources.[22]

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20 *IBID.*, P. 29.

21 R.U. SHIRLEY, *TRENDS OF DEVELOPMENT OF TEXAS FINANCIAL INSTITUTIONS* (AUSTIN:BUREAU OF BUSINESS RESEARCH, 1931), P. 4.

22 GRANT AND CRUM, P. 34.

The decision to switch to the national system was one that ultimately faced every private banker as his business grew and evolved into a full-fledged commercial bank. The private banker would have to surrender some of his freedom of operation but, in return he would gain the advantages of limited-liability incorporation. Many private bankers declined the opportunity to join the national banking system and remained as independents until well into the twentieth century. An even greater number, however, took advantage of the opportunity and began securing national bank charters. The following is a brief history of a number of these banks.

The First National Bank of Galveston, the first national bank in the state, was previously the private bank of T.H. McMahon and Co.[23] The First National Bank of Houston, chartered in 1866, was converted from the private banking company of House and Shephard.[24] The private bank of Tidball, Wilson, and Van Zandt, Co., established in 1868, became the Fort Worth First

23 ERICSON, P. 10.
24 BUENGER, P. 17.

National Bank in 1873.[25] Garrett and Key, the first private bankers in Marshall, Texas became the First National Bank of Marshall in 1884.[26]

In Kaufman County, the private bank of Childress, Bivens, and Corely, which had merged in 1885, became the Harris National Bank in 1895.[27] And, W.C. Mason, the ex-cattleman who became a private banker in 1890, opened the First National Bank of Kemp in 1900.[28]

In Bell County, the Miller brothers, who had operated a private bank in Belton since 1874, converted it to the Belton National Bank in 1884. The Downs brothers, who operated a private bank in Temple, transformed their operation into the First National Bank of Temple in 1882. Will and Sam Rancier who ran the Jeweler's Bank in Killeen beginning in 1890, converted their bank in 1901 to the First National Bank of Killeen. And, John T. Bartlett, a private banker in

25 KEY, P. 22.
26 *IBID.*
27 BUTLER, P. 121.
28 *IBID.*, P. 125.

Bartlett, Texas converted his bank into the Bartlett National Bank in 1904.[29]

This story was the same in virtually every county in the state. As the economy continued to develop, private banks converted to the national system.

The Mark Latimer and Co. private bankers of Ennis, who had operated since 1873, became the Ennis National Bank in 1883.[30] In Waxahachie, the Patrick, McMillan and Co. private bank became the First National Bank of Waxahachie.[31] Dr. George F. Perry, who had established the first private bank in Hamilton County, joined the national banking system in 1890 when he converted his bank into the National Bank of Hico.[32] The Cage and Crow private bank of Stephenville became the Hico National Bank in 1904.[33] In Washington County, F.A. Engelke, a private banker in Brenham since 1875, transformed his bank into the First National Bank of Brenham in 1883.[34] The Frost brothers of San Antonio,

29 TYLER, PP. 385-389.
30 *ELLIS COUNTY HISTORY*, P. 142.
31 *IBID*.
32 POOL, P. 119.
33 *IBID*, P. 123.
34 SCHMIDT, P. 87.

who had engaged in private banking since just after the Civil War, became the Frost National Bank in 1899.[35]

The reduction of the minimum capital requirement from $50,000 to $25,000 by the Gold Standard Act in 1900 enabled a much greater number of banks to join the system. After 1900, the annual increase in new charters was dramatic. From 1885 through 1899, the number of national charters in Texas had increased at a rate of approximately nine per year. From 1899 until 1905, the annual increase jumped to forty per year. The number of national banks in Texas soared from 199 to 440, an increase of over two hundred percent in just five years![36] The lower minimum capital requirement was especially attractive to private bankers that were located in smaller towns where $50,000 was more difficult to accumulate and employ profitably. After 1905, however, when the prohibition on state banking was abolished, there was a net gain of only 73 national banks in the next five years. The conversion of private banks to the national system had been

35 MASON, P. 33.
36 GRANT AND CRUM, P. 34.

supplanted by the conversion of private banks to the state system.

Beginning in August, 1905 the opportunity to operate as an incorporated banking institution became available to all but even the smallest independent banks in Texas. The Texas State Banking Law of 1904 offered bankers the chance to incorporate their operation with an initial capitalization of only $10,000. Naturally, the opportunity to incorporate at this level of capitalization was especially appealing to the bankers in the smaller towns. They had correspondingly smaller operations and were much more likely to have $10,000 already available and could more reasonably justify holding that amount than the $25,000 required with a national charter. Of the 113 state banks chartered in the first year, nearly sixty percent were located in towns with a population of 2500 or less.[37] It appears that the national system had already attracted those banks in the medium-sized towns of 2,500-10,000 population. Only 14 of the first state

[37] FOR A COMPLETE LISTING OF ALL STATE BANKS CHARTERED BETWEEN 1905-1910 SEE: TEXAS DEPARTMENT OF BANKING AND INSURANCE, *BANKING REPORT 1909/10*.

banks chartered had an initial capitalization of $25,000 or more. Banks joining the state system with $25,000 and above in capitalization were large banks that had declined to join the national system, but perceived certain advantages in belonging to the state system. It was these advantages, along with the tremendous economic expansion Texas was experiencing after 1900, that lead to the remarkable increase in the number of state banks.

The State Banking Law of 1904 included in it several provisions for conducting bank operations which were particularly appealing to the small private banker. In addition to the low level of capitalization it also permitted the banker to operate as a corporation, thus removing him from unlimited personal liability. Admittedly, this was not an overwhelmingly significant factor to most of the small banks, but it remained an advantage over being a private banker. Second, state banks were permitted great freedom in loan portfolio diversification. Whereas nationally chartered banks were prevented from making loans secured by real estate, the provisions of the state system allowed banks to loan up to fifty percent of their securities on real estate. In addition, state banks could loan up to twenty-five percent of their capital and surplus to a single individual or company (national banks were restricted to only ten percent) and there was no limit on the amount a state bank could lend on cotton secured by warehouse receipts.[38] The ability to make loans on real estate and cotton was absolutely essential to rural bankers whose customers came primarily from the agricultural sector of the economy. As an additional inducement to private bankers to join the state system (though nowhere specifically included in any provision of the State Banking Law) the state promised that there would be much less supervision than in the national system.[39]

The individual histories that are available for several of the state banks show that private bankers converted to the state system *en masse*.

38 BUENGER, P. 49.
39 CARLSON, P. 54.

The Hamilton Bank and Trust was created in 1906 by J.L. Spurlin and C.E. Horton who had conducted banking operations in their Dry Goods and Hardware Store.[40] In Holland, Bell County, the Reed brothers private bank which opened in 1892 became the First State Bank of Holland in 1909.[41] The First State Bank and Trust of Mineral Wells was opened by G.C. Poston who ran the Poston Dry Goods Store and was one of the town's first bankers.[42] In Mexia, Limestone County, the first state bank to open was the Prendergast, Smith and Co. who had formerly been private bankers.

In Ellis County, T.A. Ferris who ran a hardware store opened the First State Bank of Red Oak.[43] The Citizen's State Bank in Maypearl was opened by S.M. Dunlap, a private banker from Italy, Texas, just a few miles away.[44] The State Bank and Trust of Waxahachie was converted in 1906 from the Phillips, Cole and Co. private bank.[45] The first general merchandise store in

40 *HISTORY OF HAMILTON COUNTY*, P. 14.
41 TYLER, P. 388.
42 *PALO PINTO COUNTY HISTORY*, P. 20.
43 *ELLIS COUNTY HISTORY*, P. 10.
44 *IBID.*, P. 15.
45 *IBID.*, P. 17.

Montague County was operated by J.T. Harris in Ringgold. His banking operation became the Ringgold State Bank in 1905.[46] In Gray County, the Johnson Mercantile Co., the first store in Pampa, housed the First State Bank of Pampa after June 21, 1906.[47]

Undoubtedly, some new banks were created as a result of the state banking law, but it was only logical that most of the chartered banks in Texas, both in the state and national systems, would have originated as private banks. The private banker had never faced any real barriers to entry. Therefore, if there existed sufficient demand for banking services to justify a new national or state bank, then there had long since been enough demand to justify a small, diversified, private bank. There were over 2600 money lenders operating in every corner of the state in 1858. They existed to provide for even the smallest of demand. These private bankers were in the best position to become a town's first chartered bank. They had been serving the needs of the local economy for

46 DONNELL, P. 96.
47 PROUSE, P. 268.

many years, and they had the opportunity to accumulate capital and experience during their years as a merchant banker.

The dramatic increase in the number of national or state banks is a statistical illusion. As the histories of many of the first chartered banks show, it was the private banks that had been in operation for years that were simply converting, first to the national then to the state systems and were only now appearing in official statistics.

An additional factor which strongly contributed to the explosive increase in the number of banks in the state system was the very favorable economic climate in Texas during the first decade of the Twentieth century. During these years Texas was not only growing, but continuing to evolve from a primarily self-sufficient economy to a commercial economy and along with it came an increasing demand for commercial banking services.

From 1890 to 1920, the population of Texas more than doubled from 2,236,000 to 4,663,000, making it the fifth largest state in the union. The population density increased from only 2.3 per square mile in 1860 to nearly 18 per square mile by 1920. The number of farms grew by 90 percent during this time from 228,000 to 433,000, despite an increase in the percentage of the population living in urban areas from 17 percent to 32.4 percent.[48]

With the help of the internal combustion engine, commercial farming was rapidly supplanting self-sufficiency farming in Texas. During this era, more corn and wheat was marketed than consumed at home, but it was cotton, with its high value and low spoilage that led the move to commercial agriculture.[49] By 1900, Texas led the country in cotton production, accounting for more than twenty-five percent of the total for the country and more than twice as much as any other state or country. In 1900, there were 7.2 million acres planted with cotton, and by 1910 this had increased to 10.1 million acres. From 1910 to 1919, the value of the Texas cotton crop soared from $82 million to $533 million as the price of cotton rose

48 *Texas Almanac, 1926*, p. 67.
49 Spratt, p. 99.

from 8.94 cents/lb. in 1890 to 38.21 cents/lb. in 1920.[50] Total cultivated acreage also increased from 19.6 million acres in 1900 to 27.1 million acres in 1910. By 1906, Texas ranked fifth in area under cultivation, had the largest number of farms with the highest value per acre of $9.91.

The spread of commercial cotton farming was greatly aided by the expansion of the railroad system. Because Texas has no truly navigable rivers, its economic development relied heavily on the construction of the railroads.[51] In the first ten years of the twentieth century railroad track mileage increased by forty percent. In 1900 Texas had 9867 miles of track, and expanded considerably to a total of 13,819 miles by 1910, making Texas first in railroad mileage.[52]

By 1901 the Spindle Top oil field was in full production and pumped 17 million barrels of oil in its first year. This field alone moved Texas from the seventh largest producer in the world to the second.

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50 *Ibid.*, p. 182.
51 Spratt, p. 42.
52 *Ibid.*, p. 43.

By 1902, twenty-four percent of all U.S. oil came from Texas, and ten percent of all the world's oil came from the Spindle Top oil field.[53]

This rapid increase in the size and prosperity of the economy made banking a very profitable business. The national banks of Texas during this era enjoyed profits well above those of national banks in the rest of the United States.[54] This prosperity allowed many marginal banks that had been an adjunct to another operation to evolve more quickly and stand on their own much sooner. As these merchant banks spun off as small, independent operations they joined the state banking system giving the appearance that a new bank had been created when only a marginal bank had simply matured.

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53 *TEXAS ALMANAC, 1904*, P. 154.
54 SEE AVERY CARLSON, PP. 55-57.

CONCLUSION

This thesis corrects some fairly prevalent misunderstandings about the impact of the anti-banking legislation of 1845 on the Texas banking industry. Contrary to what some economic historians have written, my research suggests that the anti-banking legislation was, for the most part, inconsequential. It did not prevent the creation of private banks nor did it prevent them from performing all the customary banking functions or accommodating the credit needs of the rural economy. It did not affect the creation of commercial banks in frontier areas as only small, diversified private banks could operate there profitably. Its only effect was to prevent the incorporation of small banks. This eventually lead to a mass conversion of private banks to the state system when the State Banking Law of 1904 offered private banks the advantages of incorporation at a low level of capitalization. Many have incorrectly concluded that this rapid rise in the number of state-chartered banks was an indication that Texas had insufficient banking facilities between 1845 and 1905. But, the apparent increase in the number of banks was only a statistical illusion as private banks joined the new state system. Since the earliest days of the Texas republic private banks had existed in sufficient numbers to adequately serve the banking needs of the developing Texas economy.

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VITA

Thomas P. Kerins was born on April 16, 1959, in Salinas, California. He is the second of the five sons of Herbert J. and Sheila M. Kerins. He is a graduate of Del Campo High School in Fair Oaks, California and the University of California, Davis. He received a Bachelor of Arts degree in Economics in June, 1981, and in July, 1981 he entered Air Force Officer's Training School in San Antonio, Texas. He was commissioned a second lieutenant on November 6, 1981, and attended flight training at Reese AFB, Lubbock, Texas and Mather AFB, Sacramento, California. He was assigned to the 343rd Strategic Reconnaissance Squadron in Omaha, Nebraska where he flew the RC-135 strategic reconnaissance aircraft. Captain Kerins was selected to be an economics instructor at the U.S. Air Force Academy and entered the graduate program at the University of Texas, Austin in the Fall of 1988.

Permanent address: 7333 Spicer Drive
Citrus Heights, California 95621

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