

**Financial Disturbances and Depressions:
The View from Economic History**

by

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Events of the past quarter century have renewed the interest of economic historians in major financial disturbances. The study of financial crises was common before World War II, but for the next quarter century little fresh work was done in the area. The chief exception was J. K. Galbraith's The Great Crash, 1929 (1954). Then came M. Friedman and A. J. Schwartz's Monetary History of the United States, 1867-1960 (1963) with its bold analysis of the great contraction of 1929-1933. Just as that analysis was gaining the attention of economic historians, the United States began to experience credit crunches, steeply rising interest rates, bank failures, debt crises, and a host of other financial disturbances the likes of which had not been seen for a good long time. Soon C. P. Kindleberger's widely read book, Manias, Panics, and Crashes--A History of Financial Crises (1978) reminded economic historians and others of the long history of such disturbances.

My assignment here, from H. Minsky, is to review what economic historians, especially in recent years, have had to say about financial disturbances and depressions. I inferred from discussions with Prof. Minsky and from some familiarity with his own work that he very much wanted to tie together the two concepts, financial disturbance and depression. The "It" in his book, Can "It" Happen Again (1982) is, it will be recalled, a Great

Depression. In Minsky's work, a Great Depression results from a debt deflation or, in other words, from an extreme form of the financial instability that he and others regard as inherent in a capitalist economic system.

As I tackled the assignment I discovered that in recent years economic historians, for all their renewed interest in financial crises, have not had a great deal to say, with the exception of the "It" of 1929-1933, about crises and depressions. Most of the recent work has been concerned with the causes and nature of financial crises rather than with their aftermaths or economic consequences. Even Kindleberger (1978), who compares financial crises dating from the 1720s to the 1970s with one another, says little about the distinction between crises that led to depressions and those that did not. More recently, two colleagues and I (Wilson, Sylla, and Jones, 1990), to help celebrate the first anniversary of the 1987 crash, studied the U.S. crises under the National Banking System, 1863-1914, and the 1929 and 1987 crashes; like Kindleberger and others, we drew no distinction between the ones associated with depressions and the others.

In U.S. history, financial crises are commonly dated in 1819, 1837, 1857, 1873, sometimes in 1884 and 1890, and in 1893, 1907, and 1929-1933. Not all of these crises were connected with or followed by protracted depressions. But 1837, 1873, 1893, 1929, and possibly 1819 fall into that category. The years 1837-1843, 1873-1879, 1893-1897, and 1929-1933 were post crisis periods of depression by nearly all accounts, and the crisis of 1819 fell in

a period of postwar depression lasting from 1815 to 1821. In contrast, after the crises of 1857, 1884, 1890 (assuming it was not part of the larger crisis that also included 1893-1897, an assumption I would challenge), 1907, and the stock market crash of 1987, there were brief lulls before recovery. No protracted depressions resulted.

What causes some crises and not others to lead to depressions? Are the seeds of depression planted in the period leading up to the financial disturbance? This might have been the case after periods of speculative manias and debt creation, from which, after the financial crisis, many months or years of gradual liquidation followed. Or is the depression more a result of responses made to the financial disturbance after it occurs? This might depend on the presence or absence of an effective lender of last resort. With these questions in mind, I here examine the record regarding the nineteenth-century U.S. crises that were followed by depressions. I can add little to what is now generally known, well beyond the domain of economic historians, about 1929-1933. If there is any problem with the extensive modern discussion of that crisis and depression, it lies in the tendency to treat it as unique rather than merely the last in a sequence of similar occurrences stretching back into history. I proceed chronologically.

The Disturbance of 1819

The financial panic of 1819 came in the middle of what Thorpe

in Business Annals (1926) described as a generally depressed period following the War of 1812. (There are no reliable annual GNP data for the nineteenth century; I refer to Thorpe's qualitative descriptions of within-year and year-to-year changes in economic conditions as the best guides available for that era.) Although the postwar period may in some sense have been depressed--see the Appendix for Thorpe's descriptions--there is evidence of considerable speculation in it. Between 1811 and 1818, the number of chartered banks nearly tripled, and bank capital increased about 2 1/2 times. Public land sales increased from about half a million acres per year before the war, to 3 1/2 million acres in 1818. During the war the federal debt soared. Foreign capital inflows average \$27 million per year during 1816-1819, while in the 4 to 5 year periods before and after 1816-1819, the annual averages were close to zero.

The 1819 financial panic proper appears to have been caused by the newly organized Second Bank of the United States. According to Kindleberger (1978. p. 124), the Bank

precipitated the panic by having its branches call on state banks to redeem large balances and notes held by the Second Bank. The purpose was to assemble \$4 million in specie to repay the borrowing undertaken in Europe in 1803 to effect the Louisiana purchase. But the Second Bank itself was a bubble.... It was run by greedy and corrupt directors who accepted promissory notes in payment of stock, registered stock in different names to get around the laws limiting concentration of ownership, voted loans on the security of bank stock, permitted other loans without collateral, and allowed accounts to be overdrawn.

In addition to pressuring the state banks to contract, the Second Bank itself contracted sharply in order to accumulate the gold

needed to pay the government's debt in Europe. Its deposits and circulation had risen from \$13 to \$21 million, 1817 to 1818, and then fell to \$12 and \$10 million in 1819 and 1820 (Historical Statistics, 1976, p. 1018). According to Peter Temin's estimates, first available for the year 1820, the U.S. money stock in that year was \$85 million, so the contraction from 1818 to 1819 was relatively large. Prices fell 28 percent from 1819 to 1820. The Second Bank was obviously the antithesis of a lender of last resort in this crisis. Rocked by scandal, the Bank's president, William Jones, was forced to resign in the midst of the financial crisis, leaving it to his successor, Langdon Cheves, to pick up the pieces.

In the wake of the panic, the federal government--a creditor in land sales--and many state governments enacted a variety of debtor relief measures (Rothbard, 1962). The depression appears to have run its course by 1821.

The Disturbances and Depression of 1837-1843

The 1837-1843 crisis was international in scope, in part because two of the main items of U.S. speculation, cotton and securities, were sold extensively in Europe. Annual land sales, primarily cotton land in the South, soared ten-fold between 1830 and 1837. Much of this was financed by banks, which nearly doubled in number during the same period, while the money stock rose nearly 2 1/2 fold (Temin, 1969, p.71). The land and banking bubble burst in 1837 after the Bank of England contracted. But speculation continued--possibly even increased--in securities, mostly the

bonded debt of state governments seeking money for internal improvement projects that likely would have turned out to be bad investments even if the collapse into depression had not taken place. State bond issues totaled \$27 million in the 1820s, rose to \$40 million in 1830-1835, and further to \$108 million in 1835-1838 (Studensky, 1930, p. 8). Mira Wilkins (1989, pp. 50-51) reports that \$50 million of U.S. securities were held abroad in 1833, and \$200 million in 1840.

The Second Bank, having been emasculated by Jacksonian politics, was in no position to act as a lender of last resort in 1837. Instead, rechartered in 1836 as a Pennsylvania state bank, it attempted to engage in profitable public service by speculating in cotton and state debts. It enjoyed some success in these ventures in 1838-1839, but, bloated with securities it could not sell, it had to close its doors forever in 1841. By then many states had defaulted on their debts and some of these debts were actually repudiated. Foreign lending to the United States came to a screeching halt.

Temin (1969, ch. 5) argues that the period 1839-1843 was a deflation rather than a depression. Although real investment fell sharply, real consumption and GNP, by his calculations, actually increased in this "depression." Since the U.S. economy was still largely agricultural, he may be correct that the contraction was more nominal than real, even though the data are imprecise. But in the commercial and industrial components of the economy, the small but dynamic sectors, and in government finances at the state and

federal levels, it appears that there was a severe and protracted depression.

The Disturbances and Depression of 1873-1879

Like 1837-1843, the period 1873-1879 appears to have been a "growth" depression, with steeply falling prices and rapidly increasing real output. Or at least the period 1867-1879 was (Friedman and Schwartz, 1963, ch. 2). If the period is divided into pre- and post crisis segments, the years from 1867 (or 1868) to 1872 (or 1873) show increasing trends in money, railroad construction, and capital inflows. The years from 1873, in contrast, indicate flat or declining trends in these categories. Even prices, which fell throughout, fell considerably faster after the 1873 financial crisis. Federal debt, with a couple of exceptions, fell each year, but much more was retired before 1873 than after (see Appendix).

Speculation in this, the gilded age, centered on railroads and railroad securities, but also appeared in gold (the 1869 corner, for example) and in urban land, especially in Chicago (Kindleberger, 1990). More railway mileage was constructed in 1868-1873 than had been built in the entire antebellum era. Some of it was built ahead of demand. Where there was demand for railway services, the Granger movement attacked the railways' freight rates. As in the 1830s, it became increasingly difficult to market securities in Europe, and this ultimately led to Jay Cooke's failure in September 1873, the central event that marked

the financial panic and ushered in the depression. There was, as Kindleberger (1978) notes, no lender of last resort. In this era, in a perverse way the U.S. Treasury acted much as the Second Bank had done in 1819 and the 1830s. The Treasury supplied a lot of cash to financial markets through debt retirement during the period of speculation up to the financial panic, and then as the depression unfolded it sought to keep its cash and build up its stock of gold for purposes of resuming the gold standard at prewar parity.

Peter Temin (1989), after a long, scholarly debate concerning "It," in which he was one of the major participants, argues that the cause of the Great Depression was adherence to the pre-1914 gold standard when, after and as a result of World War I, it was no longer appropriate. This adherence imparted a deflationary course to economic policy in all the major countries during the 1920s, a course which a number of them continued to follow into the 1930s. One could tell a similar story about U.S. policy during the late 1860s and 1870s.

The Disturbances of the 1890s

Many writers (going back to Lauck, 1907, if not earlier) ascribe the panic of 1893 entirely to the U.S. silver situation, which, it is said, caused both Americans and foreigners to doubt that the United States would be able to maintain its commitment to the gold standard. This led to a run on the U.S. gold stock. I tend to agree more with Sprague, who formed his judgment on the basis of an exhaustive comparative study of the financial crises that occurred under the National Banking System. Sprague (1910, pp. 154-55) wrote of 1893:

The crisis itself was a result of complex causes among which the monetary situation was by no means certainly the most important. This is especially true of the causes of the long years of depression which followed its outbreak. Among these causes may be mentioned unremunative prices for agricultural staples, and the heavy load of farm mortgage indebtedness; also railway receiverships which were due to oversanguine estimates of the future and reckless financing of the wildest sort. Even the unsatisfactory banking position at the time of the crisis seems to have been far less a product of monetary conditions than has usually been supposed.

In many ways the 1890s are similar to the 1870s. Before 1890 or 1891, as before 1872 or 1873, prices were relatively stable, the money stock grew rapidly, federal debt retirement was increasing, railway building was rapid (1887 being the all-time peak year), land settlement was extensive, and foreign capital inflows were large (see Appendix). These trends reversed themselves in the early 1890s, after the Baring crisis in Britain, which had a strong contracting effect on New York financial markets. The speculative unwinding began then. The connection of the crisis of 1890 to the full-fledged panic of 1893 was masked by "prosperity" in 1892, which seems mostly to have been due to bumper U.S. crops and poor European crops, and also, to be sure, by the emerging silver problems. The European crisis reduced the flow of capital to the United States, and American securities began to be repatriated. Perhaps wisely, for during the next few years an estimated one fourth to one third of U.S. railway mileage passed into receiverships. It seems unlikely that this was a result of silver agitation. Given the competitively induced overbuilding of railways, the roads would have had difficulties in servicing their debts without silver problems and without a depression.

As in 1873, there was no lender of last resort when the panic broke out in 1893. Kindleberger (1978, p. 259), in his stylized outline of financial crises, lists repeal of the 1890 Sherman Silver Purchase Act in August, 1893, under the category of lender of last resort. This is odd. The Act was repealed in order to protect the Treasury's gold reserve, which is hardly the action one supposes that a lender of last resort should undertake in the midst of a financial panic. Indeed, protecting the gold reserve was the order of the day for the next few years of depression, again as in the 1870s.

Although the depressions of 1837-1843 and 1873-1879 may have been much worse in nominal than in real terms, it does appear that the depression of the 1890s was a true economic contraction. Estimates of unemployment range from 12 to 18 percent between 1893 and 1897 (Lebergott 1964, p.522; Romer 1986, p.31).

Conclusions

What lessons may be drawn from this brief and limited survey of U.S. financial disturbances and depressions in the last century? On the question of whether the characteristics of the speculative "manias" that preceded nearly all financial crises determined which crises would lead to depressions, I believe that the answer is affirmative. Disregarding the 1819 episode, which one may doubt led to a deep and protracted depression such as those of the 1830s, 1870s, and 1890s, it does appear that in each of the latter three cases speculation took place on a number of fronts simultaneously

and that at least some of these fronts were unlikely to have panned out financially even if financial disturbance and depression had not ensued.

In the 1830s the high price of cotton before the panic was not sustainable, and most internal improvement projects of the states were not destined to produce normal investment returns with or without a depression. In the 1870s and the 1890s, speculative euphorias and competitive necessities led to railroad building ahead of demand, with likely adverse investment results even if depressions had not subsequently materialized.

What about the three pre-1914 instances (again, excluding 1819) of financial disturbances that did not lead to depression? In 1857, according to Calomiris and Schweikart (1990), the distressed assets were localized (being the securities of a few western railroads), and the Ohio Life Insurance and Trust Company, whose failure marked that panic just as Jay Cooke's failure marked 1873, happened to hold a large portfolio of those assets. In 1857 there was nothing like the general speculative movement involving several classes of assets that seems to have been the characteristic of financial disturbance-depression scenarios.

Much the same can be said of the panic of 1884, which was confined mostly to the financial markets of New York City and was inspired, if that is the right word, by the failures of a few prominent financial houses including that of former president U. S. Grant. In 1907, a more serious panic with national consequences

and long-term ramifications, it was centered in the trust companies. Speculation was not rampant in several areas at once.

So there do appear to be differences between the events leading up to a financial disturbance that then leads to a depression and the events that lead to a disturbance that does not lead to a depression. Could this be generalized, one wonders, to the period after 1914?

Since at least some depressions were avoided in the aftermath of financial disturbances, one also wonders whether the others might also have been avoided. This raises the issue of the lender of last resort. It is interesting, I think, to note that in nearly all of the U.S. cases of major financial disturbances, namely 1837, 1857, 1873, 1884, 1890, 1893, and 1907, there was present no designated lender of last resort. During the era of the two Banks of the United States, 1791-1811 and 1816-1836, there was only one major disturbance, in 1819, and it came in an already depressed period when the Second Bank, by consensus, was both new, poorly managed, and behaved very much the opposite of the way a true lender of last resort would have behaved. It was not the last time that this would happen.

From 1914 to the present, the Federal Reserve era, there has been only one instance of financial disturbance followed by protracted depression. The Fed's role therein, ever since Friedman and Schwartz (1963), has been prominently noted in most discussions. It would be interesting to know how many potential financial disturbances between 1791 and 1811, between 1820 and

1836, and between 1914 and the present were averted by timely central bank action. But that is to know why what did not happen did not happen, a task far more difficult than the already quite difficult one of determining why what did happen happened. On the whole, however, the evidence of two centuries tends to support those who argue that the presence of a lender of last resort tends to minimize the adverse effects of financial disturbances, if not actually avoid them altogether.

Lastly, I think that Peter Temin's point about 1929-1933, namely that a depression can be caused by an inflexible and even blind attachment to some past policy prescription, such as the gold standard at old parities, after circumstances have made it outmoded and dangerous, has precedents in the U.S. depressions before World War I.

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Appendix

The information in the following tables comes from Historical Statistics, with the following exceptions: Money 1820 to 1843 is from Temin, Jacksonian Economy, and 1867 to 1897, from Friedman and Schwartz, Monetary History, Appendix A; Prices 1890-1897 are from G. F. Warren and F. Pearson, Money and Prices (New York, 1934); and Banking data are from J. Van Fenstermaker, The Development of American Commercial Banking 1790-1837 (Kent, OH, 1965).

Appendix

Year	Description (Thorp)	Assets (1000000)	Liabilities (1000000)	Δ Assets	Δ Liabilities	Δ Net Worth	Assets (1000000)	Liabilities (1000000)	Net Worth (1000000)
1811	Business property	1000	1000	-52	0	52	1152	1000	152
1812	Real estate, various property	1250	1250	-22	0	22	1474	1000	474
1813	Property	1250	1250	182	0	182	1656	1000	656
1814	Property; business district	1250	1250	255	0	255	1911	1000	911
1815	Property; various, various depression	1250	1250	182	0	182	2093	1000	1093
1816	Depression	1250	1250	-25	0	25	2118	1000	1118
1817	Mild depression	1250	1250	-38	0	38	2080	1000	1080
1818	"	1250	1250	-200	0	200	1880	1000	880
1819	Severe depression; business property	1250	1250	-39	0	39	1841	1000	841
1820	Depression	1250	1250	-45	0	45	1796	1000	796
1821	Depression; mild	1250	1250	-16	0	16	1780	1000	780
1822	Rained; mild depression	1250	1250	36	0	36	1816	1000	816
1823	Rained	1250	1250	-32	0	32	1784	1000	784
1824	Business property	1250	1250	-77	0	77	1707	1000	707
1825	Property	1250	1250	-97	0	97	1610	1000	610
1826	Business property	1250	1250	-198	0	198	1412	1000	412
1827	Property; various, recession	1250	1250	-170	0	170	1242	1000	242
1828	Mild depression; mild	1250	1250	-37	0	37	1205	1000	205
1829	Property; property	1250	1250	-48	0	48	1157	1000	157
1830	Property	1250	1250	9	0	9	1166	1000	166
1831	Property; various, recession, depression	1250	1250	112	0	112	1278	1000	278
1832	Depression; slight recession	1250	1250	20	0	20	1298	1000	298
1833	Rained; various, recession	1250	1250	71	0	71	1369	1000	369
1834	Depression	1250	1250	-69	0	69	1300	1000	300
1835	"	1250	1250	62	0	62	1362	1000	362
1836	"	1250	1250	83	0	83	1445	1000	445
1837	" ; rained	1250	1250	181	0	181	1626	1000	626

Year	Description (Thorp)	Assets (1000000)	Liabilities (1000000)	Δ Assets	Δ Liabilities	Δ Net Worth	Assets (1000000)	Liabilities (1000000)	Net Worth (1000000)
1867	Depression	150	150	170	0	170	1676	150	1526
1868	Rained	150	150	23	0	23	1700	150	1550
1869	Property; various, depression	150	150	77	0	77	1777	150	1627
1870	Recession; mild depression	150	150	-7	0	7	1770	150	1620
1871	Rained; property	150	150	-104	0	104	1666	150	1516
1872	Property	150	150	-115	0	115	1551	150	1401
1873	Property; various, recession, depression	150	150	57	0	57	1608	150	1458
1874	Depression	150	150	7	0	7	1615	150	1465
1875	"	150	150	-3	0	3	1612	150	1462
1876	"	150	150	-25	0	25	1587	150	1437
1877	"	150	150	-23	0	23	1564	150	1414
1878	" ; rained	150	150	51	0	51	1615	150	1465
1879	"	150	150	0	0	0	1615	150	1465
1880	"	150	150	0	0	0	1615	150	1465
1881	"	150	150	0	0	0	1615	150	1465
1882	"	150	150	0	0	0	1615	150	1465
1883	"	150	150	0	0	0	1615	150	1465
1884	"	150	150	0	0	0	1615	150	1465
1885	"	150	150	0	0	0	1615	150	1465
1886	"	150	150	0	0	0	1615	150	1465
1887	"	150	150	0	0	0	1615	150	1465
1888	"	150	150	0	0	0	1615	150	1465
1889	"	150	150	0	0	0	1615	150	1465
1890	"	150	150	0	0	0	1615	150	1465
1891	Depression; mild	150	150	170	0	170	1785	150	1635
1892	Rained	150	150	25	0	25	1810	150	1660
1893	Property	150	150	31	0	31	1841	150	1691
1894	Slight recession	150	150	21	0	21	1862	150	1712
1895	Property	150	150	-178	0	178	1684	150	1534
1896	" ; recession	150	150	-123	0	123	1561	150	1411
1897	Depression; mild	150	150	-114	0	114	1447	150	1297
1898	Property	150	150	-38	0	38	1409	150	1259
1899	Property; various, depression	150	150	7	0	7	1416	150	1266
1900	Deep depression	150	150	56	0	56	1472	150	1322
1901	Depression; mild	150	150	80	0	80	1552	150	1402
1902	Recession; depression	150	150	176	0	176	1728	150	1578
1903	Depression; mild	150	150	4	0	4	1732	150	1582