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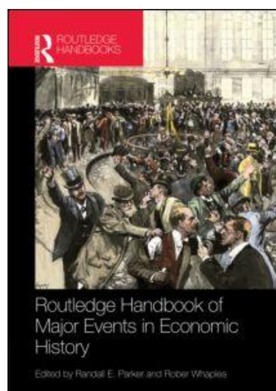

Routledge Handbook of Major Events in Economic History

Randall E. Parker, Robert Whaples

The Panic of 1893

Publication details
https://www.routledgehandbooks.com/doi/10.4324/9780203067871.ch5
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Published online on: 28 Jan 2013

How to cite :- Mark Carlson. 28 Jan 2013, *The Panic of 1893 from:* Routledge Handbook of Major Events in Economic History Routledge
Accessed on: 02 Dec 2023
https://www.routledgehandbooks.com/doi/10.4324/9780203067871.ch5

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5
THE PANIC OF 1893

Mark Carlson[1]

The Panic of 1893 was one of the most serious banking panics of the National Banking Era.[2] Of the roughly 9,500 banks that existed in 1893, about 550 were compelled to close their doors either permanently or temporarily during the panic (*Bradstreet's* 1893). Unlike some of the other banking panics of this era which appeared to originate in the financial center of New York City, the troubles in the banking sector were first manifest in the interior of the country and spread to New York. It can be helpful to divide the panic into two parts. During the first part of the panic there were widespread runs that forced bank closures in the interior which in turn put pressure on New York banks and the money markets there. In the second part of the panic, these pressures became sufficient to cause the New York banks to sharply restrict currency shipments to interior banks. As the New York banks played a key role in banking and payment systems, the restrictions on the convertibility of interbank deposits in New York to currency represented a second shock to the banking system that further disrupted financial markets.

The panic occurred against a backdrop of rising concerns about the currency and the economy. With respect to the currency, the commitment of the United States to the gold standard was viewed as being placed in jeopardy as silver purchases by the Treasury increased outstanding Treasury notes potentially redeemable in gold even as gold reserves at the Treasury declined (Lauck 1907). The health of the economy was also deteriorating around the time of the panic as mercantile and industrial bankruptcies rose and the railroad industry came under pressure (Sprague 1910). While scholars have debated the relative importance of these factors since shortly after the crisis, it seems likely that both factors played a role.

The economic downturn that followed the panic was one of the most severe in the history of the United States. An economic contraction appears to have already been underway at the time of the panic and there may well have been a notable slowdown even in the absence of the panic. Nevertheless, a variety of anecdotal information suggests that financial disruptions associated with the panic may have exacerbated the decline.

This chapter is organized as follows: the first section reviews the economic and political developments that preceded the crisis; the second provides a narrative of the panic itself, a review of the geographic impact of the crisis, and some discussion of the immediate impacts of the panic on the broader economy; the third section briefly describes the aftermath of the panic.

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Developments preceding the panic

There were two factors that likely contributed to rising concerns about the stability of the banking system. First, there was a deterioration in confidence regarding the commitment of the United States to the gold standard due to the silver purchase program by the United States government and a decline in the gold reserve held by the Treasury. Fears of a devaluation could have prompted depositors to seek to convert their dollar denominated deposits into gold. Second, a decline in economic activity and an increase in commercial bankruptcies may have caused depositors to become less confident in the solvency of the banking system. The relative importance of these factors was debated even by contemporaries with some, such as Lauck (1907) and Noyes (1909), arguing for the former and others, such as Sprague (1910), favoring the latter. This section reviews both these factors and provides a brief discussion regarding their relative importance.

Concerns about the gold underpinnings of the currency

During the 1890s the United States was on the gold standard, meaning that Treasury notes could be redeemed for a fixed amount of gold. To meet potential redemptions, the Treasury maintained a gold reserve. At the same time, the Treasury was also required to purchase silver on a regular basis. Such purchases had been mandated by law for some time, but the Sherman Silver Purchase Law of 1890 notably increased the amount of silver required to be purchased each month. These purchases were paid for in notes that legally could be redeemed for gold or silver at the discretion of the Secretary of the Treasury, but which were expected by investors to be redeemable in gold on demand.

The gold reserve maintained by the Treasury declined in the early 1890s. The decline occurred in part as the U.S. government shifted from running a budget surplus to running a deficit. The gold reserve also declined as foreign investors redeemed their holdings of American securities and demanded gold, which they then shipped abroad. In early 1893, the gold reserve had fallen to just over $100 million, down considerably from $190 million in 1890. Noyes (1909) reports that the Treasury Department was required to take some modest actions if the gold reserve fell below this level, such as suspending the issuance of gold certificates, but also that the $100 million figure had symbolic importance and was viewed by both financial market participants and elected officials as important in maintaining the U.S. commitment to the gold standard. Rising concerns about the commitment to the gold standard and the risk of a possible devaluation of the currency may have caused bank depositors to prefer to hold their wealth as gold and not as dollar denominated bank deposits.

Concerns about economic developments

Prior to the outbreak of the panic, economic activity appeared to be slowing. Davis (2004) reports that industrial production experienced a local peak in 1892 and was notably lower in 1893. Moreover, failures of non-financial companies began to accelerate. On February 26, 1893, the Philadelphia and Reading Railroad failed; Sprague (1910) reports that the immediate effects of this bankruptcy were fairly moderate, but that it did raise concerns about the health of other companies. Lauck (1907) reports that the number of mercantile and industrial failures started to climb in late 1892 and the liabilities of such failures more than doubled between the first and second quarters of 1893 (see Table 5.1).

Table 5.1 Mercantile and industrial failures

Period	*Number*	*Liabilities ($ millions)*
1892:Q1	3,384	39.3
1892:Q2	2,119	23.0
1892:Q3	1,984	18.7
1892:Q4	2,857	33.1
1893:Q1	3,202	47.3
1893:Q2	3,199	121.6
1893:Q3	4,105	82.5
1893:Q4	4,826	95.4

Source: Lauck (1907: 105). Data reported as compiled from Annual Supplement, *The Commercial and Financial Chronicle*, p. 17, *Financial Review*, 1894

The railroad industry suffered notably before and in the midst of the crisis. In addition to the failure of the Philadelphia and Reading railroad, Lauck (1907: 106) reports the collapse of a number of significant railroad corporations during this period including the Northern Pacific, the Union Pacific, the Atchison, Topeka and Santa Fe, the Erie, and the New York and New England. Markham (2002) reports that over 70 railroad companies failed, placing one quarter of American railroads in the hands of receivers.

With increased business failures, the quality of bank loan portfolios would have deteriorated.[3] Sprague (1910: 161) argues that lending standards had deteriorated in the years preceding the crisis and that by 1893 banks were "carrying a large amount of loans which should have been long since written off or at least written down." As a result, concerns about bank solvency may have increased.

Discussion of the relative importance of the factors

Both these factors likely had a role in the panic. Concerns about the commitment of the United States to the gold standard likely contributed to a reduction in foreign investment in the United States, some unsettling of financial markets in early 1893, and some stringency in money markets. However, concerns about the silver purchases and credibility of the gold standard likely played less of a role in the bank runs that occurred in the interior of the United States. Sprague (1910: 169) notes that the panic was concentrated in the western and northwestern parts of the United States where "there is no evidence that people were distrustful of silver money." Rather, deteriorating economic conditions likely mattered more for domestic depositors. Carlson (2005) finds a strong geographical association between the prevalence of business failures in 1892, which also were more prevalent in northwestern and western parts of the country, and bank suspensions during the panic. It is likely that the combination of the two factors made the crisis more severe. Indeed, Friedman and Schwartz (1963: 109, footnote 28) cite both factors as contributing importantly to an overall drain in the money supply with concerns about the gold standard causing an external drain and concerns about the solvency of Western banks causing an internal drain.

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The panic

A few events related to the concerns discussed above shortly preceded the onset of stresses in the banking sector. In mid-April 1893, the gold reserve dipped below the $100 million mark. Rumors circulated that the Treasury would tender silver rather than gold in the redemption of Treasury notes. The Secretary of the Treasury issued a statement that indicated he would continue to redeem notes in gold "as long as he ha[d] gold lawfully available for that purpose" (see Noyes 1909: 186). There was considerable uncertainty around the term "lawfully available" and financial markets reacted adversely to the statement. A subsequent statement by President Grover Cleveland more solidly affirming the commitment to gold appeared to calm markets but did not completely alleviate the uncertainty.

There were also further signs of economic troubles. On May 4, another notable corporation, the National Cordage Company, was put into receivership. Demonstrating the rising concerns, the stock market, already under some pressure following the failure of the Philadelphia and Reading Railroad, dropped sharply (Sprague 1910: 164).

Timing and scope of the banking panic

With financial conditions in May becoming unsettled, especially in eastern financial markets, there were a few bank runs, but they appear to have been isolated incidents. That situation changed considerably in June and bank runs began to be reported in earnest. Wicker (2000) reports that bank runs occurred in a number of western and northwestern cities including Chicago, Omaha, Los Angeles, and Spokane. The geographic dispersion of these communities points to fairly widespread deterioration in the confidence of bank depositors. During the month of June, 126 banks suspended operations. However, this figure understates how many banks were being affected by the panic as not all affected banks were forced to suspend. Wicker (2000) notes that in Chicago a run occurred on every savings bank in the city with long lines of depositors waiting to withdraw; nevertheless, no savings bank was forced to suspend operations although one did have to invoke a thirty-day withdrawal notice.

The impact of deposit withdrawals is evident in the regulatory reports filed by the banks. National banks were required to file reports of the condition of their balance sheets with the Comptroller of the Currency from time to time. In 1893, reports were filed on May 4 and July 12. These reports show that deposits, which accounted for about half of bank liabilities, declined 12 percent in just two months.

After a brief lull in early July, bank runs increased again. The period from mid-July to mid-August marked the height of the banking panic. About 340 banks suspended during July and August. City-wide panics were reported between July 11 and July 31 in Kansas City, Denver, Louisville, Milwaukee, and Portland. Bank suspensions trailed off over the course of August and were quite limited in September.

To get a better sense of the panic it is useful to describe in more detail some of the city panics that took place in July. The panic in Denver started on July 18.[4] The panic started as three savings banks closed. The banking system in Denver had reportedly been under pressure for some time and the savings banks in particular had experienced withdrawals and imposed a 60-day notice period before withdrawals could be made; that waiting period ended on July 17 and the savings banks were unable to meet withdrawals and closed. These closures were reported by the local newspaper as precipitating concerns about the health and liquidity of other banks in the town and triggering the panic in the city.[5] The result was a

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reported "stampede" by smaller borrowers to withdraw while business men were reported to have stood by with equanimity (*Rocky Mountain Times,* 1893, July 19). The panic struck with substantial force and nine more banks were forced to close within the next two days. While many banks were subject to runs, the targeted banks were reported to have been generally weaker institutions. Some of the stronger banks in the city reportedly had deposit inflows as depositors moved their funds to these banks. The panic ended by July 20; there does not appear to have been any particular event that quelled the panic.

The panic in Louisville appears to have been driven more by out-of-town banks rather than local depositors.[6] The panic started as one National Bank in Louisville closed on July 22 and another one closed on July 23; there were reportedly no visible signs of runs or depositor unrest at either institution. Instead, it appears that the out-of-town banks that used these institutions as correspondents had withdrawn balances with these two banks and forced their closure.[7] Following the closure of yet another bank on July 24, small depositors started to run other banks in the city. Two more suspended shortly thereafter amid withdrawals by depositors and by correspondents. On July 26, the Louisville bank clearing house announced that they would provide assistance to banks that needed support. This indication of support appears to have eased the situation and the panic subsided shortly thereafter.

It is important to note that bank suspensions are not the same as bank failures. Many banks closed their doors temporarily but reopened subsequently (*Bradstreet's* estimated that around 30 percent of the banks that closed were able to reopen). In the city panics described above, six of the eleven banks that closed in Denver reopened, all by the end of August, and four of the five banks that closed in Louisville reopened, all but one of those by the end of August. Moreover, the widespread reopening of banks is a particularly important feature of this panic. That many banks were able to reopen after suspension indicates that solvent banks came under pressure during the panic. In some cases, suspensions may have simply been the result of currency shortages; Friedman and Schwartz (1963: 109, footnote 31) note that some of the suspensions occurred as banks ran out of cash before shipments of money from New York could reach them.[8] In other cases, banks suspended for some time to allow examiners to assess their solvency.

The geographic distribution of bank closures (failures and temporary suspensions) is shown in Table 5.2. The data, and geographical demarcations, are from *Bradstreet's*. The western and northwestern parts of the country were the most severely affected. These areas accounted for close to two-thirds of all bank closures. As noted above, business failure rates also tended to be higher in these states. There were very few bank closures in the northeast or mid-Atlantic parts of the United States. The southern and Pacific regions accounted for a modest portion of closures.

Several kinds of banks operated during this period. Most common were (1) national banks, which were commercial banks with charters from the national regulator—the Comptroller of the Currency, (2) state banks, commercial banks with charters from a state regulator, (3) savings banks, state chartered institutions that took deposits but invested in securities or mortgages rather than making commercial loans, and (4) private banks, institutions operating without a bank charter. During the crisis, the number of closures was fairly evenly spread among national, state, and private banks, with only a modest number of savings bank suspensions. However, national banks, which tended to be larger, accounted for nearly half of the liabilities of closed banks while the typically small private banks accounted for only around one-tenth of such liabilities.

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Table 5.2 Location and timing of bank closures in 1893

	New England states	*Middle states*	*Western states*	*North-western states*	*Southern states*	*Pacific states*	*Territories*	*Total*
May	-	4	32	9	9	1	-	55
June	-	8	33	30	10	44	2	127
July	8	4	109	53	22	21	6	223
August	2	10	27	47	30	2	1	119
September	-	-	1	2	4	1	-	8
October	4	1	5	-	5	-	1	16
Total	14	27	207	141	80	69	10	548

Note: Table based on *Bradstreet's* November 11, 1893: 713–15. Regions follow *Bradstreet*'s classification. Bank closures include national banks, state banks, savings banks, trust companies, and private banks.

New England: Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, and Vermont
Middle states: New York, New Jersey, Pennsylvania, and Delaware.
Western states: Ohio, Indiana, Illinois, Missouri, Michigan, Kansas, Kentucky, and Colorado
Northwestern states: Wisconsin, Minnesota, Iowa, Nebraska, North Dakota, Montana, and Wyoming
Southern states: Maryland, Virginia, West Virginia, North Carolina, South Carolina, Georgia, Florida, Alabama, Mississippi, Louisiana, Texas, Tennessee, and Arkansas
Pacific states: California, Oregon, Nevada, Washington, and Idaho
Territories: Arizona, Indian, New Mexico, Utah, Alaska, and Oklahoma
(South Dakota is not included as *Bradstreet's* was prevented from doing business there.)

Impact on the New York banks

New York City was a focal point of the banking system during this period and deserves some special mention. During the national banking era, national banks—those chartered by the Treasury—were required to hold reserves against outstanding deposits by individuals and other banks and bankers. For banks outside major cities, up to 60 percent of reserves could be held as deposits at banks in larger cities referred to as reserve cities or, in the case of New York, as central reserve cities.[9] (For banks in reserve cities, deposits in central reserve cities counted as reserves.) The remainder of reserves needed to be held as cash. Deposits at banks in New York City had a variety of advantages so banks tended to keep a notable volume of deposits there.[10] Banks chartered by the states faced differing reserve requirements, but also tended to keep deposits with New York banks as part of the payments system. However, if banks needed to satisfy withdrawal demands by depositors, they needed vault cash. Thus, one signal of concern about depositor withdrawals would be for banks to reduce balances held in New York in favor of vault cash.

One advantage of deposits in New York was that they could be used as part of the payment settlement process (see James and Weiman 2010). Payments, such as those by merchants, were often made via the issuance of a draft—a check drawn by one bank against funds deposited in another bank, typically one with which the bank issuing the draft had a correspondent relationship. Drafts circulated in areas where both the party issuing the draft and receiving the draft were likely to have a correspondent in the same city, as it would be easier for those

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correspondents to clear the payments. As most banks had a correspondent in New York, drafts on New York banks were accepted nationwide and were vital for interregional payments.[11]

In 1893, deposits held in New York banks generally held steady through May, despite unsettled conditions. In June, there was a sharp decline in reserves held in New York banks, presumably as banks became increasingly concerned about depositor withdrawals. As the panic wore on, reserves continued to flow out of New York and pressures in money markets became tremendous. Call loans were loans to brokers used to finance the purchase of stocks and were regarded as a relatively safe and liquid investment; the rate on these loans was generally seen as an indicator of money market conditions. During the panic, the interest rate quoted on call loans reached as high as 72 percent. Prior to the crisis, this rate had been in the neighborhood of 5 percent.

On August 3, banks in New York severely restricted the shipment of currency to the rest of the country. This action had a variety of repercussions. First, due to a reduced ability to obtain cash, many banks throughout the country limited payouts of cash to their customers. Second, amid the inability to convert deposits into money, a currency premium developed.[12] The premium was highest shortly after the curtailment of cash shipments by New York and lasted for about a month. Third, drafts on New York banks were less able to be used as part of the payments system which hindered the ability of many firms to conduct business.

New York Clearinghouse member banks authorized the issuance of clearinghouse certificates in June, when pressures were starting to mount, although actual issuance of certificates at that point was minimal. These certificates could be used by banks that were members of the New York Clearinghouse to settle payments with each other, thereby reducing the amount of cash needed to clear payments among the members and allowed them to operate with lower cash levels. Use of these clearinghouse certificates by New York banks increased sharply around the time that these banks curtailed payments to banks outside New York. Lauck (1907) reports that use of such certificates in New York peaked between the last few days of August and first few days of September.

Impact of bank suspensions and the restrictions of currency shipments

Bank suspensions had a negative impact on trade and commercial enterprise. The *Rocky Mountain Times* reported several negative impacts on the local Denver economy from bank suspensions. Some businesses were "unable to reach their money to pay their bills" (July 19). Other merchants were obliged to reduce their business, "Retail dealers were advised to reduce their business to a cash basis, buying only for immediate want and in limited quantities" (July 20: 2).

Suspensions of currency shipments by New York banks also negatively affected the business environment. *Bradstreet's* reported that, subsequent to the loss of their typical source of currency, banks in some communities were unable to meet local demands. In other communities, sufficient currency was reportedly available, but banks were reluctant to process payments that would result in currency leaving the city. As a consequence, trade suffered:

> Business at Louisville is almost at a standstill, banks declining to receive country checks even for collection, and preferring not to handle New York exchange. General trade is almost on a cash basis at Indianapolis, and reduced in volume, which is also true at Milwaukee.
>
> (*Bradstreet's*, August 12, 1893: 511)

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> The complete unsettlement of confidence and the derangement of our financial machinery, which made it almost impossible to obtain loans or sell domestic exchange and which put money to a premium over check, had the effect of stopping the wheels of industry and of contracting production and consumption within the narrowest limits, so that our internal trade was reduced to very small proportions—in fact, was brought almost to a standstill—and hundreds of thousands of men thrown out of employment.
>
> (*Commercial and Financial Chronicle*, September 16, 1893: 446)

In the absence of currency, various substitutes for money were reportedly used. Warner (1895) details the variety of items used in place of the currency. The most common currency substitutes were "clearing house certificates" issued by local banks in small denominations intended to circulate as a means of exchange; often there was no official clearinghouse in the community, but the name did indicate that the local community of banks stood behind the notes. In some parts of the country, banks issued certified checks against themselves, again in denominations that allowed them to be used for transactions. In other places, paychecks, teachers' warrants, and scrip circulated as currency. Warner estimates that roughly $80 million in such emergency currency was issued, though not all of it was outstanding at any one point in time. For comparison, Friedman and Schwartz (1963) estimate that currency in the hands of the public in 1893 was $985 million.

End of the crisis

Several factors contributed to the end of the crisis. Noyes (1909) suggests that the panic ended when high interest rates and the premium for specie attracted gold from Europe and boosted domestic liquidity. He reports that gold imports during August amounted to $41 million, which was larger than any previous monthly inflow. These funds reportedly helped fill depleted bank reserves, contributed to satisfying the demand for currency, and reduced the currency premium.

Lauck (1907) argues that the passage of a bill repealing the silver purchase clause of the law of 1890 by the House of Representatives on August 28 was an important turning point. While the Senate did not pass the bill until October 30, the bill passed the House of Representatives with a significant majority. Lauck argues that this gave investors, particularly foreign investors, confidence in the bill's likely passage by the Senate and he notes that pressures in the New York money market diminished shortly after the vote by the House of Representatives.

Bank regulators appear to have played a role in helping to resolve concerns about which banks were solvent and which banks were simply illiquid. After the banks closed, the regulators examined them to determine their solvency. Banks that were solvent were allowed to reopen. In the *Annual Report*, the Comptroller of the Currency reported that:

> Many banks after paying out on the one hand all the money in their vaults and failing to collect their loans on the other, suspended and passed into the hands of the Comptroller. With a full knowledge of the general solvency of these institutions and the cause which brought about their suspension, the policy was inaugurated of giving all banks, which, under general circumstances, would not have closed, and whose management had been honest, the opportunity to resume business … In no instance has any bank been permitted to resume on money borrowed.
>
> (Annual Report of 1893: 10)

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Providing a regulatory "stamp of approval" regarding bank reopening likely had a positive effect on depositor confidence regarding the health of the banks.

Following the panic

By autumn, the banking panic of 1893 had ended. Bank suspensions had stopped and most banks that would eventually be allowed to reopen had done so. The premium on currency ended in September as New York banks lifted restrictions on shipping currency to banks located in the interior. Interest rates on call loans returned to near pre-crisis levels, which suggested that pressures in New York money markets had substantially dissipated.

Nevertheless, the contraction in business activity that appears to have been underway when the panic started continued for some time. Davis (2004) estimates that industrial production contracted almost as much between 1893 and 1894 as it had between 1892 and 1893; the 15 percent drop in industrial production during this recession was one of the most severe in the nation's history. It was not until 1897 that industrial production reached the levels observed in 1892. Similarly, Balke and Gordon (1986: Appendix B) estimate that real GDP declined about 13 percent. *Historical Statistics of the United States* indicate that business failures, in terms of both number and liabilities, soared in 1893 and remained elevated for the next several years (Carter et al. 2006: series V 24 and series V 27). It is uncertain whether the financial distress associated with the panic contributed toward making the economic downturn especially severe. However, the anecdotal evidence from the period and recent economic research suggest that there is a strong likelihood that it did.

Notes

1 The views presented in this paper are solely those of the author and do not necessarily represent those of the Federal Reserve Board or its staff.
2 The term panic is used to refer to a variety of phenomena. Here, the term banking panic refers to an episode in which a large number of banks in a geographically dispersed area experience fairly sudden, coincident, and large deposit withdrawals that force widespread bank suspensions. Once the deposit withdrawals have stopped and bank suspensions have subsided, the panic is considered to have stopped. Correspondingly, a bank run is a sudden and large-scale withdrawal of deposits from a single institution.
3 The notion that cyclical downturns might trigger panics has some support in economic theory. Depositors, reasoning that banks may fail as the economy deteriorates and loans go bad, have an incentive to get their money out before the bank fails. Supporting this idea, Gorton (1987) finds that consumption-weighted deposit losses predict panics. Calomiris and Gorton (1991) also find that real economic shocks tend to be associated with more bank failures during banking panics.
4 See also Carlson (2005) for a description of the Denver episode.
5 Ironically, rather than suffering concerns about silver purchases undermining the currency, the possibility of repeal of the silver purchase law may have had a negative effect on the perceived solvency of Denver banks given the dependence of the local economy on silver mining.
6 Wicker (2000) describes this episode, as well as events in Kansas City, Denver, Milwaukee, and Portland, in more detail.
7 Banks in smaller towns often had correspondent relationships with banks in larger communities. The larger city banks would hold deposits from other banks and move these deposits between accounts as part of the payment system. This process is described further below.
8 While such suspensions likely occurred during other panics, the data on temporary suspensions in this episode are uniquely available. *Bradstreet's* published information on closing and reopening to date on November 18, 1893. *The Annual Report of the Comptroller of the Currency* for 1893 also reports suspensions and reopening for national banks. These two sources differ slightly; the

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differences partly reflect reopenings that occurred between the respective publication dates but also suggest that the data quality may not be perfect.

9 Chicago and St. Louis were also central reserve cities, but were not nearly as prominent as New York. Some researchers, such as Smith (1991), argue that this pyramidal system made the system less stable and provided a mechanism for shocks in one part of the country to be transmitted to New York, which could then transmit them back to all parts of the country.

10 Sprague (1910) reports that interbank deposits constituted the bulk of the liabilities for several large New York banks.

11 For example, the bank would provide the merchant a draft indicating that the bearer of the draft could lay claim to some amount of the issuing bank's deposits in a reference bank in New York. The merchant could give that draft to a goods supplier. The goods supplier would give the draft to his bank and have his account credited and that bank would contact its correspondent in New York to have the funds from the account of the bank that had issued the draft transferred to the account of the bank that had received the draft from the goods supplier.

12 For instance, Noyes (1909) describes money-brokers willing to pay with a certified check a premium for currency (so that the certified check was being sold at a discount to its face value).

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