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A historical overview of financial crises in the United States ☆

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ABSTRACT

One of the few constants since the United States declared its independence is the presence of frequent financial crises with similar causes. In the nineteenth century, these panics were frequent with eight occurring over the century. However, following the Second World War there was a period of relative calm, which may have led to complacency. The Savings and Loans and the current financial crises have shown that these events remain a very real threat to economic stability.

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1. Introduction

Critics have long maintained that financial crises, booms and busts are an inherent part of the capitalist system. The current financial crisis that began in 2007 has reignited the debate about the causes and consequences of previous economic downturns. While some look at the differences among crises, both historical (e.g., Bordo, 2008; Bordo & Haubrich, 2010; Klomp, 2010), and as related to the specific mechanics of the shock triggering a crisis (e.g., Gorton, 2008), others emphasize their similarities across countries and historical episodes (e.g., Reinhart & Rogoff, 2008a, 2008b, 2009a, 2009b, 2010).

This paper presents an overview of the history of financial crises, primarily in the United States. The conclusion is similar to that by Reinhart and Rogoff (2009a, 2009b), namely, these crises are similar.

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According to Reinhart and Rogoff (2009b), severe financial crises share three characteristics. *First*, asset market collapses are deep and prolonged. Real housing prices decline an average of 35% over six years, while equity prices collapse an average of 55% over a downturn of about three and a half years. *Second*, the aftermath of banking crises is associated with profound declines in output and employment. The unemployment rate rises an average of 7 percentage points over the down phase of the cycle, which lasts, on average, over four years. In addition, output falls, from peak to trough, an average of over 9%, although the duration of the downturn, averaging roughly two years, is considerably shorter than for unemployment. *Third*, the real value of government debt tends to explode, rising an average of 86% in the major post-World War II episodes. As they point out, the main cause of debt explosions is not the costs of bailing out and recapitalizing the banking system. The main cause of debt increases are the inevitable collapse in tax revenues that governments incur as a result of deep and prolonged output contractions, and the countercyclical fiscal policies in advanced economies aimed at counteracting the downturn.

The remainder of the paper is organized as follows. Section 2 presents a narrative of three major nineteenth century American financial crises. Section 3 details the financial crises in the twentieth-century. Section 4 describes the current crisis from an American perspective, and the responses of the U.S. and the U.K. Section 5 summarizes financial crises in Poland. Section 6 concludes.

2. Nineteenth century financial crises in the United States

As a newly developed country, the United States experienced a period of frequent banking panics in the nineteenth century with eight major crises. These eight episodes include the Panics of 1819, 1837, 1839, 1857, 1873, 1884, 1893 and 1896. Details of the three major crises of that century that occurred in the years 1857, 1873, and 1893 are described below.

2.1. The Panic of 1857

The Panic of 1857 is characterized by the closure of the Ohio Life and Trust Company, a collapse of the stock and bond markets, and a sharp recession. Fig. 1 shows the collapse of the stock market, which fell 36% from August to October, 1857. This crisis began with an unprecedented discovery of gold. To illustrate the magnitude of the gold discovery, note that from the year 1492 until 1850, the annual value of gold mined averaged $9 million, whereas the corresponding value for the years 1851 until 1860 averaged $133 million (Conant, 1915, p. 637).

Since the United States was on a bi-metallic, gold and silver, standard at the time, the discovery of gold effectively doubled the money supply. Consequently, a speculative bubble emerged, mainly in railroads and the land required to build them with nearly $700 million spent over nine years accounting for seven-ninths of all railroads in the United States (Conant, 1915, p. 637).

As the bubble burst, speculators were unable to repay their debts causing some banks to fail. This increased the likelihood of further bankruptcies of financial institutions. Following these bank runs, the stock and bond markets collapsed exacerbating the problem. As banks failed, many cities and states suspended the convertibility of bank deposits into gold. However, lacking a central monetary authority, nation-wide coordination among banks was impossible. Thus, when Philadelphia suspended convertibility and New York City did not, bank runs induced by fear occurred in New York City. Eventually, on October 13, 1857, New York suspended convertibility (Calomiris & Schweikart, 1991, p. 822).

As the crisis continued, some regional coordination of banks emerged. Institutions, such as the New York Clearing House, coinsured coalitions in Indiana and Ohio, and branch banking in the South. The United States was relatively successful in responding to this panic limiting further bank failures. However, more isolated banks were unsuccessful during this crisis. For example, 14 of Indiana's 32 free banks failed during the crisis. On November 20, New York resumed partial convertibility and a major crisis was finally averted (Calomiris & Schweikart, 1991, p. 828).

2.2. The classical gold standard

Following the Panic of 1857, there was a shift from the bimetallic, silver and gold, standard towards the classical gold standard. The passage of the Coinage Act of 1873 ended the legal status of bimetallism in the

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