The Panic of 1893: Boosting Bankers' Money and Power

Junius Morgan was, at best, a third-tier English banker in the 1850s, who was fortunate to have had a hand in a number of lucrative financings, mostly for industries seeking seasonal financing. His conservative nature was partly a cause of his lack of distinction. He'd inherited a substantial sum when his father died and was exceedingly careful when risking any part of it. One of the maxims Junius instilled into his son, John Pierpont Morgan (shown at left), was, "Never under any circumstances do an action which could be called into question if known to the world."

The two first-tier international banking families were the Baring Brothers and the Rothschilds. Barings financed the Louisiana Purchase and the French indemnity payment after Napoleon's loss to the Duke of Wellington at Waterloo. So influential was Barings that the Duke of Richelieu commented: "There are six great powers in Europe: England, France, Prussia, Austria, Russia, and Baring Brothers." It enjoyed an exclusive list of clients: the governments of Russia, Norway, Austria, Chile, Argentina, Canada, Australia, and the United States.

The other pre-eminent international banking family, the Rothschilds, served as the agent bank for England, and was spreading its influence into countries not served by Barings.

It was a rarified world — one that Junius aspired to join. There was only so much he could accomplish on his own, with his relatively limited capital base, or as Ron Chernow, author of *The House of Morgan*, put it: "Only so much glory could be gained from trading Chinese tea or Peruvian guano or selling iron rails to Commodore Vanderbilt." He needed something outrageously profitable that would propel him into the top tier. His opportunity came in 1870. The French provisional government was seeking a loan of $50 million, but it was turned down by both the Rothschilds and Barings. Putting together a syndicate of other banks, Junius offered bonds to investors with a par value of $100 at $85, meaning the bonds were sold to investors at a discount. (It was like buying a $100 bill for $85, but you couldn't get the $100 bill for two years.) The 15-percent discount reflected not only the risk that the French might not be able to repay the loan, but gave investors an extraordinary opportunity for substantial profits if the French did repay it.

{modulepos inner_text_ad}

When the French did repay the loan by buying back the bonds at par in 1873, Junius was catapulted into the top tier. And it was this lesson of recognizing opportunity and seizing it that he inculcated into the mind of his son, John Pierpont.

Pierpont, as he liked to be called, already had shown a flair for recognizing opportunity. During the Civil War, the U.S. federal government had 5,000 obsolete Halls carbines stored in an armory in New York, for which it had paid $3.50 apiece. An entrepreneur, Simon Stevens, saw an opportunity to refurbish the weapons and then sell them back to the government. Lacking the capital, he borrowed

$20,000 from Pierpont for a share of any profits. Stevens “rifled” the smooth-bore carbines, thus improving their accuracy, and sold them to Major General John C. Fremont for $22 each. In a three-month period, the government bought back its own rifles at six times their original price. Pierpont pocketed $5,400 on the deal.

During the last 30 years of Junius’ life (he died in 1890), he and his son worked closely together, despite being separated by the Atlantic Ocean. Junius would often travel to New York and stay with Pierpont for months at a time, while Pierpont would return the favor in the fall, staying in London with his father. In the meantime, they had a steady and fulsome communication by mail. And by the late 1880s, Pierpont knew an opportunity when he saw one.

The Panic of 1893

The “opportunity,” referred to later by historians as the Panic of 1893, had its roots in Argentina. In the early 1890s, British investors became enamored over investment prospects in Argentina and began to invest heavily there with the encouragement of the Argentinean agent bank, Baring Brothers. A failure of the wheat crop and a coup in Buenos Aires, however, abruptly ended any enthusiasm for continued foreign investing of any kind, even for investments in the United States. And thus began a run on gold in the U.S. Treasury as investors liquidated their holdings.

Causing the bubble to balloon before it burst in February 1893 were two additional forces: the Sherman Silver Act and the McKinley Tariff Act, both enacted under President Benjamin Harrison. Since 1879, when the last of the greenbacks Lincoln used to finance the north in the Civil War was redeemed for gold, the country operated on a gold standard. While the economy enjoyed an explosion in growth, there were enormous difficulties in major parts of the country, especially faced by farmers. As crop prices fell (reflecting increased efficiencies in the economy), farmers were hard-pressed to pay back loans they had obtained to finance their seedtime.

In 1890, Senator John Sherman presented a bill to Congress to require the government to purchase and coin silver, thus creating a bi-metallic monetary standard. When the bill became law, currency was printed to purchase the silver required under the Sherman Act — it was one of the few times in history where there was “price inflation” due to an expansion of precious metals backing the currency. Miners were naturally pleased, as were the farmers who recognized that the inflation of the currency in circulation would allow them to pay off their loans in cheaper dollars. But Gresham’s law — stating that bad money drives out good if their exchange rate is set by law — could not be repealed, and since paper currency was now redeemable in either gold or silver, and since the ratio of silver to gold changed from the prevailing 16:1, silver became worth less, comparatively, to gold, and gold was hoarded. Silver was increasingly used in commerce. When new currency began circulating, holders would demand gold from the banks, and gold reserves at the U.S. Treasury soon declined below the $100 million “safe” level.

The McKinley Tariff Act, also passed in 1890, raised tariffs to an unbearable 48 percent, essentially raising prices on many commodities and slowing the economy. With the pressure from foreign investors for their gold, the demand from American citizens to redeem their currency holdings for gold, and the slowdown in the overall economy, a crack in the economy was impossible to avoid.

Behind the scenes there was another impetus: pressure for a central bank. When the National Banking Act was adopted at the end of the Civil War, national banks were created as a half-way measure to central banking. In his monumental *Tragedy and Hope*, Professor Carroll Quigley exposed this pressure:

> The powers of financial capitalism had another far-reaching aim, nothing less than to create a world system of financial control in private hands able to dominate the political system of each country and the economy of the world as a whole. The system was to be controlled … by the central banks of the world acting in concert, by secret agreements arrived at in frequent private meetings and conferences.

In 1892, an announcement to the presidents of each of the national banks was printed in the *United States Bankers' Magazine*:

> We must go forth cautiously and consolidate each acquired position, because already the inferior social stratum of society is giving increasing signs of agitation.

Therefore, prudence dictates to us a line of conduct that seems to give in to the will of the people, until the execution of our plans be well-enough established by us to be able to declare our intentions without having to fear any organized resistance.

The first crack appeared in February 1893 with the declaration of bankruptcy by the Philadelphia and Reading Railroad after failing to make interest payments on its debt. This was followed shortly by bankruptcies of the Northern Pacific Railway, the Union Pacific Railway, and the Atchison, Topeka, and Santa Fe.

The final push over the edge, following the bankruptcies of the railroads, was a leaflet (since called "The Panic Circular") published on March 11, 1893 by the American Bankers Association and sent to each national bank president:

> You will at once retire one-third of your circulation and call in one-half of your loans. [After this you are to] advocate an extra session of Congress to repeal the purchasing clause of the Sherman Law, and act with other banks of your city [to push] for its unconditional repeal…. The future life of national banks … depends upon immediate action, as there is an increasing sentiment of … silver coinage.

The bankers had two major objections to silver coinage: The first was that as silver was mined and converted into coinage, it expanded the monetary base (inflation), resulting in the loss of purchasing power for each unit of currency, which impacted negatively the bonds, denominated in dollars, held by the banks. The second major objection was that this particular inflation was occurring outside of the bankers' control.

In May, the final straw was the National Cordage Company's failed attempt to corner the hemp market, resulting in a selloff of its stock (it was one of the highest volume stocks traded at the time) and triggering the indiscriminate selling of stocks across the stock exchanges. The depression following the panic lasted five years, and resulted in the failure of more than 15,000 companies and 500 banks, with unemployment reaching nearly 20 percent.

The first opportunity that Morgan saw in the panic was the chance to re-organize the failed railroads into a private cartel. As Chernow explained:

> Oppressed by debt and overbuilding, more than a third of the country's railway package fell into receivership, and English investors exhorted Pierpont to bring order to the industry. Thwarted by gentleman's agreements, Pierpont now tried another approach to forming railway cartels: he would reorganize bankrupt [rail]roads and transfer control to himself. Then he wouldn't be at the whim of government or feuding railway chiefs.

In reorganizing railways, he ascended to a new plateau of power, beyond what any other private businessman had yet achieved. The lengthy catalog of railroads that fell under his control included the Erie, Chesapeake and Ohio, Philadelphia and Reading, Santa Fe, Northern Pacific, Great Northern, New York Central, Lehigh Valley, Jersey Central, and the Southern Railway. Virtually every bankrupt [rail]road east of the Mississippi eventually passed through such reorganization (or "morganization" as it was called). Some thirty thousand miles of railroad — one sixth of the country's trackage — were morganized. The companies' combined revenues approached an amount equal to half of the U.S. government's annual receipts.

Morgan took control of the railroads, Chernow wrote, through personal energy and attention to detail that allowed him to gain and maintain control over the railroads as they became available through bankruptcies. When the scope of the takeover became too large, Morgan set up management tools and reporting requirements. Too, he used the Interstate Commerce Act, which created the ICC in 1887, to control his cartel — the ICC was mostly operated and managed by his own men.

Much of current history lauds Morgan for his organizational talents, and Chernow goes along with most of it, but it was Morgan's insatiable desire to control that drove the cartel.

Holding Up a President

The second significant opportunity that Morgan capitalized upon was the nation's need for gold — a need so desperate that Morgan was able to strong-arm a U.S. President.

President Grover Cleveland was the only President to have served two non-consecutive terms and thus is the only one to be counted twice when Presidents are numbered. He was the only Democrat elected to the White House during the era of Republican domination from 1860 to 1912. He opposed free silver and the inflation that would result from unlimited silver coinage by the government, mercantilism in general, and subsidies in particular to business or farmers. He infuriated railroad interests and especially Morgan when he ordered an investigation into their land grants extended for building the lines. The investigation turned up corruption, and 81 million acres were returned to the government. He vetoed nearly 300 bills passed by a Republican Congress, citing his strict interpretation of the limits placed on the federal government by the Constitution. His most well-known veto was that of the Texas Seed Act. Congress passed a bill to allow purchase of $10,000 of seed for farmers who had suffered under a severe drought in Texas. He explained his veto:

> I can find no warrant for such an appropriation in the Constitution, and I do not believe that the power and duty of the general government ought to be extended to the relief of individual suffering which is in no manner properly related to the public service or benefit.... The lesson should be constantly enforced that, though the people support the government, the government should not support the people.... Federal aid in such cases encourages the expectation of paternal care on the part of the government and weakens the sturdiness of our national character.

However, when a bill to create the Interstate Commerce Commission was passed by Congress, Cleveland had little difficulty signing it, despite its obvious recombining, for the first time, of the executive, legislative, and judicial powers that the Founders had fought so hard to keep separate.

The Interstate Commerce Commission became the first agency of "the fourth branch of government" — a branch of government that unconstitutionally made and enforced its own laws, using federal power. Immediately after its passage, Morgan interests began holding classes to instruct bankers about strategies to help them secure the privileges granted to them through the Interstate Commerce

Commission, which, as was said, quickly became controlled by the railroad interests. Morgan's attempts to create a cartel of the railroads, this time through the sanction of government, were finally cemented into place.

Following four years as a private citizen, Cleveland was elected to his second term in 1893, just in time to face the economic pressures of the panic. He called a special session of Congress to repeal the free coinage of silver that had caused the run on the government's gold reserves. Congress repealed the essential part of the Sherman Silver Act, but the momentum towards monetary disaster was too great. The U.S. Treasury's reserves fell below the $100 million "safe" level, and speculators were actually betting on when the Treasury would default on its promises.

Cleveland was stuck. He couldn't get authorization from Congress to float a bond offering to replenish the Treasury's gold reserves. There were just too many who favored silver and sided with the farming and mining interests. And he couldn't approach Morgan directly, as the public revulsion to Morgan specifically, and international bankers in general, had grown too strong. Cleveland's attempt to get help from the English Rothschilds also failed, as they refused to do business with the American government unless they worked through Morgan.

By February of 1895, gold reserves had dropped to just $68 million, and Morgan smelled another opportunity. He even wrote to his London partners that the United States was "on the brink of the abyss of financial chaos," and that he was going to Washington to see the President directly to offer his "assistance." When Pierpont arrived at the White House, the President refused to see him, whereupon Pierpont exclaimed magisterially: "I have come down to see the president and I am going to stay here until I see him!"

In a scene out of a John Grisham movie, a meeting with the President and Morgan was finally arranged. Present were Attorney General Richard Olney and Treasury Secretary John Carlisle. As Chernow explained:

> At the meeting, [Pierpont] sat wordless while Olney and Carlisle debated the issue. Edgy, he crushed an unlighted cigar, leaving a pile of tobacco on his pants. Cleveland still clung to the hope of a public bond issue, which would spare him congression-al obloquy [and abuse.]

Not until a clerk informed Carlisle that only $9 million in gold coin remained in government vaults on Wall Street did Pierpont pipe up, saying he knew of a $10 million draft about to be presented: "If that $10 million draft is presented, you can't meet it," Pierpont said. "It will be all over before 3 o'clock." "What suggestions have you to make, Mr. Morgan?" replied the president.

Morgan most certainly had some suggestions. Specifically, Morgan and the English Rothschilds would loan the U.S. Treasury 3.5 million ounces of gold in exchange for 30-year bonds that promised not to be called before term. This insertion of specie was more than sufficient to keep the Treasury solvent, and spoiled the game speculators had been playing on the chances of a Treasury default. This, in essence, secured the gold market by removing that 3.5 million ounces from any claims by the bankers. It astonished the financial world. Speculators who were playing the "run" and counting on a government gold shortage lost out.

Under the terms of the deal, Morgan and Rothschild would purchase the bonds at $104.50 and then resell them immediately to the public at $112.25, booking a profit of between $6 and $7 million. So strong was the demand for the bonds that the price quickly soared to $119, and were sold out in 22 minutes.

Manipulation's Ripples

The uproar over Morgan's manipulation of the situation to his favor merely added to the outrage coming from a growing populist movement, spearheaded by William Jennings Bryan. Bryan tried to beat back the predominance and travails and manipulations of gold as the U.S. standard precious metal, as opposed to increasing the silver supply. His "Cross of Gold" speech astonished his audiences:

> Having behind us the producing masses of this nation and the world, supported by the commercial interests, the laboring interests and the toilers everywhere, we will answer their demand for a gold standard by saying to them: You shall not press down upon the brow of labor this crown of thorns, *you shall not crucify mankind upon a cross of gold*!

At the conclusion of the speech, Bryan stretched out his arms in a Christ-like manner for five seconds, while the crowd remained quiet. According to the *New York World*, at that point everyone seemed to go mad at once and shrieked and rushed the stage. The *New York Times* exclaimed that "a wild, raging, irresistible mob" had been unleashed.

The next order of business for the bankers was to neutralize Bryan's impact. When Cleveland declined to run again in 1896, Morgan interests backed William McKinley (of McKinley Tariff fame) who beat Bryan in the general election. The impact of that election can scarcely be overestimated.

When the Gold Standard Act of 1900 was passed during the McKinley administration, it represented a giant step toward the creation of what was to become the Federal Reserve System: Contained in the Gold Standard Act was a provision that Morgan and the Rockefellers, Kuhn Loeb, etc., wanted — namely, to create a commission to "study the need for a central bank." This was critical, and it allowed that commission to change the public's negative perception of central banking by bringing in outside experts (college professors, historians, disinterested third-parties with credibility, but nearly all trained under Germany's Iron Chancellor Otto von Bismarck).

With Bryan's defeat and McKinley's victory (Morgan's man), there would be little effective resistance to continued high tariffs, mercantilism, and centralization. Because of the election's outcome, the Democrat Party capitulated on its support for maintaining gold-backed currency, essentially turning both political parties into arms of the same political machine, promoting bigger government through spending made possible by ever increasing money creation.

Perhaps the kindest things that may be said of Pierpont Morgan are that he was perceptive, courageous, and willing to risk other people's money along with his own to turn a profit. Critics of Morgan recognize his insatiable desire for personal control and his utter and complete lack of ethics or loyalty to country or Constitution. He was an astonishingly wealthy pragmatist who, for all his efforts, left the world ultimately less free.

Photo: J.P. Morgan

In response to a reader's comment, the article was changed to correct the explanation of Gresham's law. The author thanks the reader for his attention.