

The Panic of 1819, Silicon Valley Bank and the Danger of Bank Runs



Tom Williams/CQ-Roll Call, Inc. via Getty Images

By Elliot Chambers and Mark Higgins



“The Bank bubbles are breaking...the merchants are crumbling to ruin, the manufacturers perishing...there seems to be no remedy but time and patience, and the changes of events which time affects.”

President John Quincy Adams

ON MARCH 10, 2023, the FDIC placed Silicon Valley Bank (SVB) in receivership after depositors drained their accounts in a classic bank run. SVB’s failure also exposed a systemic vulnerability in the US banking system. Depositors with balances exceeding the FDIC insurance cap of \$250,000

Representatives (left to right) French Hill, Blaine Luetkemeyer, Bill Huizenga and Ann Wagner attend the House Financial Services Committee hearing titled “The Federal Regulators’ Response to Recent Bank Failures,” on March 29, 2023. Martin Gruenberg, chairman of the Federal Deposit Insurance Corporation; Michael Barr, vice chair for supervision of the Board of Governors of the Federal Reserve System; and Nellie Liang, undersecretary for Domestic Finance, US Department of the Treasury, testified.

suddenly had a rational incentive to withdraw funds. Realizing that a full-blown run on the banking system was imminent, the Fed quickly invoked Section 13(3) of the Federal Reserve Act and created an emergency lending facility to back uninsured depositors. The quick response has thus far prevented a catastrophic financial crisis, although a series of downgrades by Moody’s on August 8, 2023 demonstrates that risks in the banking system remain.

Throughout history, financial policymakers have used lessons from prior financial crises to prevent recurrence. The challenge, however, is that after each successful intervention, people begin questioning the necessity of the resulting safeguards. Over time, skepticism intensifies as the memory of past crises steadily disappears from the collective consciousness. The only reliable solution is to regularly revisit the past and re-learn the lessons that Americans in the past acquired through the more memorable experience of suffering.

This article recounts the Panic of 1819, which is a long-forgotten financial catastrophe. The Panic was caused by the convergence of several powerful economic currents, but the devastation was significantly amplified by the unconstrained

spread of bank runs. Americans suffered a painful and long-lasting depression in the early 1820s, yet they failed to create adequate safeguards in the aftermath. As a result, similar catastrophes occurred in the 1840s and 1930s. In 2008, the United States used lessons from the past to prevent the nation’s fourth Great Depression-level event. Several lessons were also used in March 2023 to contain the damage of the SVB bank run.

The Panic of 1819

“The demand for lands since the 1st of July seems as great as ever; all payments are made in the Mississippi Stock—which is sold at 25 percent discount...the demand for lands is so great I have not time within office hours to attend to my returns or books.”

Nicholas Gray, Land Office Clerk, 1816

In the aftermath of major financial crises, politicians, members of the media and the public at large tend to blame a small group of “bad actors.” This disguises the truth that large-scale financial crises only happen when multiple, powerful market

forces converge—which requires widespread participation.

The Panic of 1819 was caused by three major drivers that collided in the 1810s. The set-up began in February 1811 when Congress failed to renew the 20-year charter of the nation’s first central bank, the First Bank of the United States. The Bank’s disappearance created a void in credit markets. State-chartered banks proliferated and quickly filled the void, but they were lightly regulated and lacked the protection of a lender of last resort.¹

The second factor was trade related. On March 23, 1815, the British Parliament received royal approval for the Corn Laws, which placed steep tariffs on US agricultural exports.

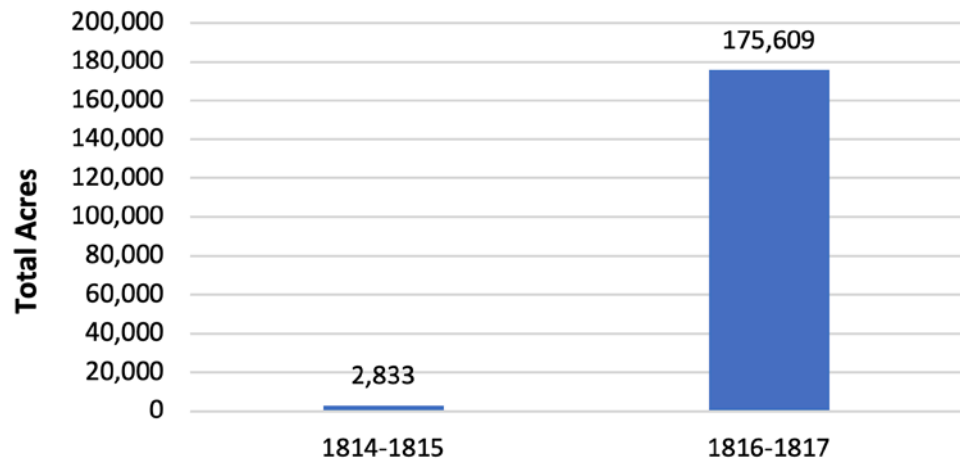
The third and most powerful factor was climate related. On April 10, 1815, Mt. Tambora exploded in the largest volcanic eruption in recorded human history. The volcano emitted a massive cloud of sulfur dioxide, which repelled sunlight and cooled global temperatures. The effects were especially pronounced during the summer of 1816, which was dubbed the “Year without a Summer.” Europeans suffered widespread crop failures, which drove sharp increases in wheat and cotton prices. Great Britain suspended the Corn Laws to prevent its citizens from starving.

America’s First Real Estate Bubble

Agricultural yields in the United States declined during the “Year without a Summer,” but the crops that were salvaged were of high quality. No longer impeded by the Corn Laws, American farmers exported wheat and cotton at exceptionally high prices. In 1814, American farmers sold wheat for an average of \$1.48 per bushel; by 1817, prices climbed to an average of \$2.41 per bushel.

Drawn by enormous profits, American farmers and speculators purchased farmland aggressively in the midwestern states (Figure 1 shows an example of increased land purchases), and state-chartered banks lent liberally and with little concern for borrowers’ capacity to repay. Everybody assumed that crop prices would remain at elevated levels for many years. Nobody realized that Mt. Tambora had caused the temperature to drop, much less that natural processes would quickly remove sulfur dioxide from the atmosphere. Global temperatures returned to normal within a few

FIGURE 1: Total Washington County Land Sales in State of Mississippi (1814–1817)



Source: Malcolm J. Rohrbrough, *The Land Office Business: The Settlement and Administration of American Public Lands, 1789–1837* (London: Oxford University Press: 1968).

years, and crop yields rebounded. When they did, overplanting produced record harvests that far exceeded global demand.

A Rough Start for the Second Bank

On April 10, 1816, Congress reintroduced a central bank with the approval of a charter for the Second Bank of the United States. The goal was to restore the stability of US currency, but this proved more difficult than anticipated. After the “Year without a Summer,” state-chartered banks issued bank notes recklessly, and several branches of the Second Bank initially engaged in similar behavior. As a result, the value of bank notes circulating in the United States far exceeded specie reserves.²

By late 1817, wheat and cotton prices were in freefall, and Britain reinstated the Corn Laws to protect domestic producers. By 1819, wheat sold for \$1.34 per bushel, and in 1821 it averaged only \$0.88. The prices of farmland soon followed the collapse of agricultural prices, as farmers and speculators valued land based on future cash flow expectations. Unable to cover loan payments, farmers and speculators began defaulting in large numbers.

In early 1818, the Second Bank was barely able to maintain adequate specie reserves to honor bank note redemptions. In an effort to repair its balance sheet, the Second Bank aggressively redeemed state bank notes for specie, called in loans and borrowed specie from abroad. These activities intensified when the US Treasury demanded a withdrawal of \$2 million in specie to fund a scheduled principal

payment to holders of Louisiana Purchase bonds that were issued in 1803. The actions of the Second Bank were equivalent to a sharp tightening of monetary policy during a time in which the US economy was under intense pressure.

Panic and Depression

In 1819, the contractionary monetary policies of the Second Bank amplified the effects of declining crop prices and land values. State banks throughout the nation suspended specie redemptions and many were forced into insolvency. The Second Bank lacked the ability to serve as a lender of last resort, which allowed bank runs to spread. Statistics are imprecise, but it is estimated that the rate of bank failures in the aftermath of the Panic of 1819 rivaled those of the Great Depression in the 1930s. By 1822, more than 80 state banks had closed, and the value of bank notes in circulation contracted by more than 50%.³

Tight monetary conditions forced thousands of businesses and individuals into bankruptcy, and the nation descended into a painful depression that lasted until the mid-1820s. It is difficult to capture the anguish of the depression because statistics are scarce, but one of the more reliable metrics is per capita GDP, and estimates are that it was cut by nearly 50% between 1814 and 1824.

Post-COVID-19 Policies and Inflation

Two hundred years have passed since the Panic of 1819, making it forgivable

The Dark Side of Financial Stability: The Forgotten Misery of a Major Depression

“People are less happy about the state of affairs than they were when things were way tougher. It’s weird for somebody my age, because I was in the middle of the Great Depression when the hardship was unbelievable.”

Charlie Munger

The United States has experienced three Great Depression-level events in its 235-year history. The depression following the Panic of 1819 was the first, and the Great Depression in the 1930s was the last.

Fiscal and monetary policy innovations have prevented subsequent depressions, but a dangerous side effect is that many Americans fail to appreciate the stability. Not only does this negatively affect their happiness, but it also encourages behavior that invites future financial catastrophes. One example is the nation’s refusal to deal with its unsustainable spending. Armed with the world’s reserve currency and guided by a population that is increasingly insensitive to deprivation, Americans continue issuing debt to fund benefits they cannot afford.

The most severe consequences of America’s chronic budget deficits likely remain in the distant future, but they will emerge eventually. America’s debt capacity is not unlimited, and if the nation loses its ability to borrow on attractive terms, future citizens may be unable to avoid economic traumas from which their parents were spared.

that few Americans can recite the lessons. But this knowledge gap is less excusable for financial executives and policymakers. A critical part of their job is detecting and mitigating risks early, and developing familiarity with past financial crises is essential to their success. During the COVID-19 pandemic, many financial leaders failed because they restricted their knowledge to the more recent past.

A Misplaced Faith in Low Rates

In Ernest Hemingway’s classic, *The Sun Also Rises*, when a character is asked how he went bankrupt, he responds, “Two ways. Gradually and then suddenly.” Many bank failures follow a similar path. The set-up for the SVB run can be traced to the Global Financial Crisis (GFC) in 2008. The Federal Reserve responded to the GFC by enacting monetary policies that were highly accommodative to economic growth. These policies contributed to low unemployment and low inflation that lasted for nearly a decade. Economic growth during this period remained relatively muted, but this is typical after the collapse of a debt-fueled asset bubble.

The extended period of low and stable interest rates anchored many investors’ expectations regarding the future trajectory of rates. Few envisioned a scenario in which the Fed would suddenly reverse its long-standing dovish philosophy. In December 2015, the Fed appeared to shift modestly when it initiated a series of nine, 25-basis point increases to the federal funds rate. The thesis was that the economy was more resilient, and it was important for the Fed to raise rates above the zero bound to restore its flexibility to respond to future financial shocks. But the economy proved more fragile than anticipated, and the Fed cut rates by a total of 75 basis points in the summer and fall of 2019. The Fed’s reversal of its rate increases reinforced investors’ perceptions that the Fed’s dovish bias would persist.

A Scared New World

On March 11, 2020, the World Health Organization (WHO) declared that the COVID-19 virus had metastasized into a global pandemic. Seemingly overnight, economies throughout the world came to a screeching halt. Absent government intervention, the US economy would have

descended into a self-reinforcing deflationary spiral ending in depression. Drawing from the lessons of the GFC, the Fed quickly cut rates back to the zero bound and the federal government injected several trillion dollars of fiscal stimulus to support labor markets, distressed businesses and displaced individuals. In retrospect, many of these measures proved to be excessive. Heightened levels of inflation and speculation were the inevitable consequences.

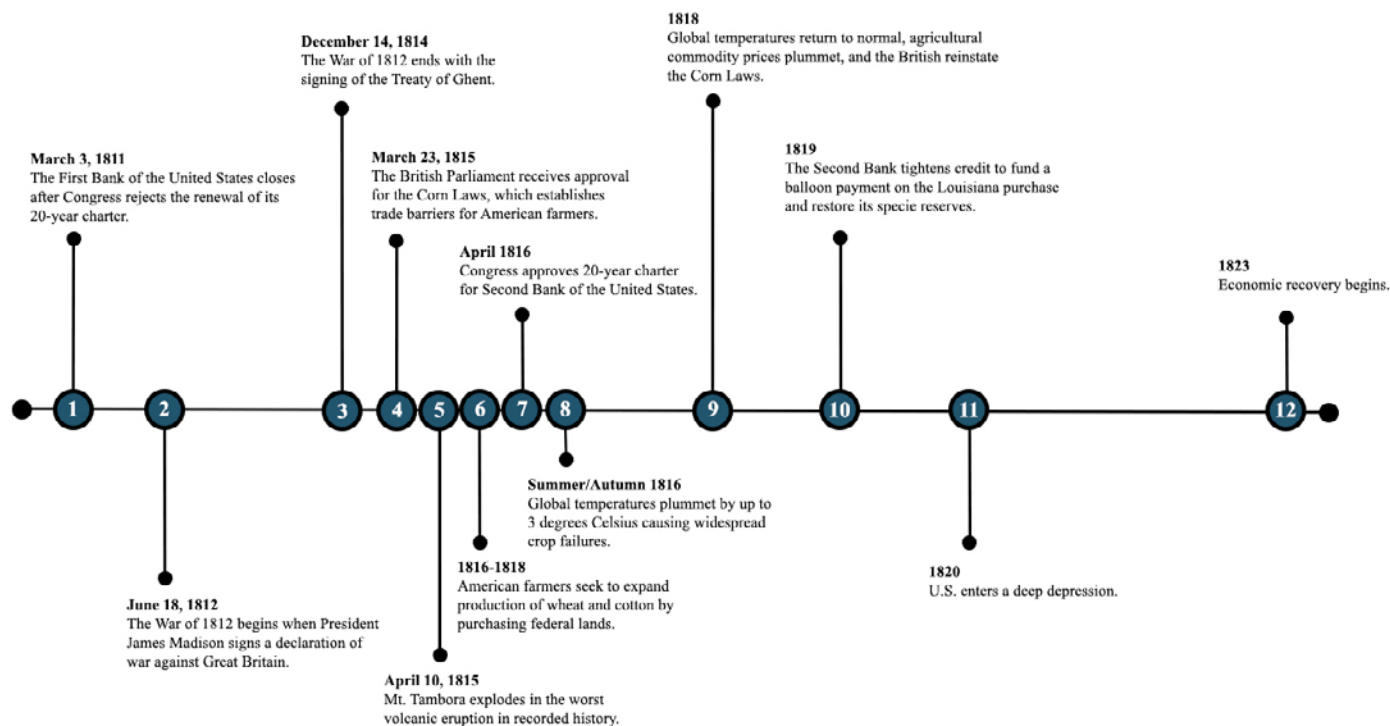
The financial effects of the COVID-19 pandemic caught many Americans off guard, even though the United States had experienced similar events in the past. The closest comparable event occurred one hundred years ago when Americans suffered a similar spasm of inflation and speculation following the end of World War I and the Great Influenza. The Federal Reserve regional banks responded by raising rediscount rates by a total of 225 basis points in the first half of 1920. This triggered a sharp recession and brief period of deflation in 1921.

The Fed’s response to COVID-19 mirrored the one that occurred 100 years earlier. Americans were less surprised by the aggressive monetary stimulus in 2020 and 2021 because most had witnessed similar policy responses in 2008 and 2009. But the sharp reversal of monetary policy in early 2022 caught many Americans off guard because they assumed that the dovish bias of the last 40 years was a permanent feature of Fed policy. There was a widespread failure to comprehend that conditions in 2022 were fundamentally different than they were over the prior 40 years, and a dovish bias was no longer feasible.

An Unanticipated Windfall in the Santa Clara Valley

Commercial banks are critical components of the US financial system, serving as essential liquidity sources for individuals and businesses. Prior to the pandemic, commercial bank deposits hovered around \$13.4 trillion and changed little from month to month. But after the onset of the COVID-19 pandemic, commercial bank deposits suddenly increased rapidly, as businesses and individuals received large stimulus payments and were reluctant to spend them due to quarantine-related restrictions and a desire to bolster their savings amid increased economic

FIGURE 2: Panic of 1819 Timeline of Key Events



uncertainty. By April 2022, commercial bank deposits peaked at \$18.2 trillion, an increase of 36% in only two years.

Commercial banks invested this windfall by issuing loans and purchasing investment securities. SVB was especially flush with cash because the bank not only received large inflows from stimulus-related deposits, but it also received huge inflows from technology firms. During the darkest months of the pandemic, technology innovation seemed to be one of the only promising investments. Digital health companies promised to re-engineer healthcare; social media companies promised to rescue people from loneliness; and remote working technologies promised to keep the gears of industry in motion. Venture capital firms responded by investing aggressively in a wide variety of technology startups, and a large percentage of the new cash injections were deposited in the vaults of SVB.

Silicon Valley Bank Goes Long

Founded in 1983, SVB had long served as the commercial bank of choice for Silicon Valley-based technology companies. It was unsurprising, therefore, that the flood of investment into tech companies was deposited with SVB. At the end of 2019, deposits stood at \$61.8 billion, but only three years later, deposits ballooned to \$173.1 billion.

All commercial banks struggled to invest new deposits, but SVB's challenge was particularly extreme. To win the deposit business in the first place, SVB enticed customers with aggressive terms and lower interest rates on various loan products. These terms were helpful in attracting customers initially, but they had limited power to keep customers with the bank should better rates become available elsewhere. Even more importantly, SVB invested a significant amount of the deposit windfall in long-term, fixed-rate US Treasury securities. These investments had little credit risk, but they had significant interest rate risk in a rising rate environment.

It is common practice in such situations to use interest rate hedges to reduce risk. Instead, SVB left these positions unhedged, mistakenly assuming that their deposits were safe from mass withdrawal. As the value of their loan and Treasury investment portfolio decreased as interest rates increased, SVB's balance sheet deteriorated, and the bank was unable to offer competitive rates. Depositors could plainly see better investment returns elsewhere, and they began withdrawing funds.

Silicon Valley Bank Goes Under

On March 9, 2023, several venture capital (VC) firms emailed and texted management of their portfolio companies and

advised them to withdraw funds from SVB. VCs were concerned that the failure of SVB could result in losses on the portion of deposits that exceeded the \$250,000 FDIC insurance cap. The moment that these firms hit "send," a catastrophic run on SVB was inevitable because the majority of its depositors had balances exceeding the \$250,000 FDIC cap. Within 48 hours, SVB customers demanded the withdrawal of more than \$100 billion, which constituted more than 50% of SVB's deposit base and was far in excess of its liquid cash reserves. On March 10, 2023, the FDIC placed SVB in receivership, and by Sunday, March 12, the Federal Reserve invoked Section 13(3) of the Federal Reserve Act to use its emergency powers to stop the run from spreading.

So, how did this happen? What mistakes did SVB make that other banks seemingly avoided? As is almost always the case with the collapse of a major financial institution, there were multiple factors. The following three were especially important in the failure of SVB.

- 1. Poor Economic Situational Awareness:** SVB management failed to appreciate that economic conditions in 2022 were fundamentally different than the ones that had persisted over the prior 40 years. Instead, conditions resembled those present in 1919 and 1920. The



Minh Nguyen

The Santa Clara headquarters of SVB.

passage of 100 years makes it understandable that SVB executives initially failed to grasp the situation, but their dismissal of the Fed's warnings is less excusable. In early 2022, the Fed clearly signaled its commitment to a much more aggressive monetary policy, often referencing the tragic errors that led to the Great Inflation of 1965-1982. SVB failed to heed these warnings. Instead, SVB locked in low rates on a significant portion of its loan portfolio by investing in long-term, low-yielding fixed-rate Treasury bonds, while removing interest rate hedges designed to protect against rising interest rates.

2. Inadequate Risk Mismanagement: The lack of appropriate risk management at SVB was probably its most egregious unforced error. SVB did not employ a head of risk management for an entire year prior to its collapse. This is a serious deficiency in any economic environment, but it was especially careless during a period of elevated price instability and interest rate volatility.

3. Fumbled Handoff of the Regulatory Baton: The Federal Reserve detected several deficiencies in SVB's management practices, but it did not act quickly enough to force mitigation. An important contributing factor stemmed from the transition of oversight when SVB assets crossed the \$100 billion mark, which is a threshold that triggers the enforcement of new regulatory requirements and transitions oversight to a new team within the Fed. This transition slowed the Fed's response to SVB and contributed to its collapse.

In summary, the failure of SVB was the result of a sharp increase in deposits, poor economic situational awareness, deficient risk management and a fumbled regulatory hand off. When rates increased and the economy faltered, technology companies began to withdraw deposits, leading SVB to experience significant liquidity pressures. The forced sale of depreciated fixed income assets to satisfy withdrawals created a hole in SVB's balance sheet. The death blow came during the week of March 10, 2023 when a botched effort to raise capital and

repair its balance sheet caused depositors to panic. When VC firms encouraged portfolio companies to withdraw their capital, SVB's fate was sealed.

SVB was an extreme manifestation of a broader problem. Commercial banks that fail to properly protect their income statements and balance sheets from rising rates continue struggling to retain depositors. Unable to offer competitive rates on deposits, customers withdraw funds and re-deposit them in higher yielding accounts and money market funds. This explains why similar runs occurred at Signature Bank and First Republic soon after the run on SVB.

Echoes of the Past

One of the greatest challenges for financial policymakers is proving that their actions were necessary when a crisis is averted. This is why revisiting the lessons of history is so valuable. The experience of 1819 strongly suggests that had the Federal Reserve, FDIC, Treasury and executives of large financial institutions failed to act

quickly and aggressively in 2023, the bank run at SVB would have spread further, faster and with much more destructive force than most people feared.

Envisioning counterfactual scenarios can also be applied to the past. What would have happened if Congress had renewed the charter of the First Bank of the United States? Would state-chartered banks have proliferated throughout the 1810s? Would land speculation have been contained? All evidence from the past 200 years suggests that the magnitude and duration of the depression in the 1820s would have been considerably less severe if policymakers had a more robust fiscal and monetary response.

There is also an interesting flip side to this thought experiment. The most haunting question is whether Americans would have appreciated the painful consequences of unconstrained bank runs if past generations never allowed them to happen in the first place. This is the question that lies at the heart of the issue of moral hazard. The experience of extreme economic suffering—especially the suffering that occurred in the 1930s—inspired the creation of many tools and policies that prevented the recurrence of major

financial catastrophes. But the problem is that if people never suffer the consequences of their bad behavior, they have no incentive to stop behaving badly, and this can create conditions that invite even bigger crises in the future.

Balancing the benefit of extinguishing financial fires early with the cost of allowing moral hazard to become entrenched is a constant challenge for policymakers. How much pain should be tolerated in the present to prevent potentially more painful crises in the future? What is most unsatisfying about this question is that we simply do not know the answer.

In 2023, Americans are privileged to have access to many valuable lessons revealed by the mistakes and sacrifices of past generations. In 1819, Americans were afforded no such luxury. Almost everything was new: a central bank, a newly democratic nation and a seemingly unbounded frontier of land to the West. It is essential that we regularly revisit these lessons because many remain transferable to the present. Financial crises will always be a feature of human civilization. Only by comparing the past to the present, can we incrementally improve our ability to navigate the future. 💰

Elliot Chambers is the Founder and CEO of The Aurelian Companies. He's a business advisor with decades of experience across multiple industries and at all stages of the company life cycle, with involvement in over \$35 billion of capital formation transactions, mergers, acquisitions and divestitures.

Mark Higgins, CFA, CFP® is a financial historian, experienced institutional investment advisor, and frequent contributor to Financial History magazine. His book, Investing in US Financial History, recounts the full financial history of the United States from 1790 to 2023. The book will be published in February 2024 by Greenleaf Book Group.

Notes

1. The First Bank also lacked the ability to serve as a lender of last resort, but it coordinated with the Treasury to use a sinking fund to serve in a similar capacity.
2. Specie is a term used to describe the commodity for which bank notes were redeemable. In the 1810s, specie reserves took the form of gold and silver.
3. There were an estimated 261 state banks in existence at the end of 1819, which would mean that roughly 30% of banks failed.



INTERNATIONAL BOND & SHARE SOCIETY

PUTTING FINANCIAL HISTORY IN YOUR HANDS

Join the **International Bond & Share Society**, supporting collectors of vintage bonds and shares from all countries for over forty years. For \$35, £28 or €32 annually, receive:

- ◆ Three issues a year of our full color 52 page journal *Scripophily* with news, in-depth articles, auction reports and more
- ◆ Membership Directory listing dealers, auction houses and fellow collectors
- ◆ Members-only part of the Society website, **scripophily.org**
- ◆ Members' Newsletters with up-to-date information and event schedule

Subscribe to our Newsletter:



www.scripophily.org

membership@scripophily.org