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## The Australian Bank Crashes of the 1890s Revisited

In the early 1890s, financial crises occurred in many countries, most of which were connected to international capital flows. Australia, a major importer of capital, had difficulty borrowing after the Baring crisis of 1890. This article argues that local factors shaped the consequences of the banking crash in early 1893. A fortuitous legislative change averted a calamity by allowing for reconstruction rather than liquidation of banks, economic activity was depressed as banks became more conservative lenders, and the reconstructions reduced the wealth of domestic bank creditors and shareholders. The article concludes by noting that there was no targeted policy response in the short or medium term to prevent a recurrence of such an event.

Previous studies of the Australian bank crash of the 1890s have taken a local view of the episode within the context of a surge in British capital inflow and then cessation of it. Contemporary writers drew a link between the inflow of British capital and a speculative bubble in real estate, mining shares, and farm property. They identified the tightening of British credit and end of the land boom as the tipping point for the stability of the banking system. Journals such as the *Australasian Insurance and Banking Record* provide a detailed chronology of the failure and liquidation of fringe banks, then contagion leading to the suspension and reconstruction of most banks. Later writers followed a number of lines of inquiry. Some have highlighted corruption amongst the colony of Victoria's political and mercantile elite and weaknesses of corporate governance within businesses at the height of the boom in "Marvellous Melbourne." Others have delved into decision-making

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within banks particularly with respect to liquidity and capital ratios, the quality of lending decisions, and prudential controls. The efficacy of the decisions taken by the Victorian Banking Association and by governments in Victoria, New South Wales, and Queensland in preventing the crisis provided another strand to the literature. Interpretation of the reasons for failure remains a contested domain.<sup>1</sup>

The recent global financial crises have generated a renewed interest in the systemic instability of financial systems across time, space, and regulatory regimes. There is a search for commonalities and overarching explanations and for more detailed analysis of similarities and linkages with earlier events.<sup>2</sup> In his recent study of the evolution of banking, Richard Grossman suggests a high degree of commonality across countries with respect to the life cycle of the industry: crises, bailouts, merger movements, and regulation.<sup>3</sup> The Australian banking crisis of 1893 occurred around the same time as a series of banking, currency, and sovereign debt crises in many other countries.<sup>4</sup> Michael D. Bordo and John S. Landon-Lane note that these crises were connected and note “a significant risk of a global financial crisis.”<sup>5</sup> However, Australia was an outlier in many respects. It had not been prone to serial crises. The 1890s was a spectacular exception. A comparative perspective shows that this was a focused affair: a banking crisis. There was no associated crisis in sovereign debt markets; yields on New South Wales’s stock spiked only 46 basis points in April 1893.<sup>6</sup> By comparison, the value of Argentina’s public debt fell by more than 60 percent during the 1890

<sup>1</sup>For a review of the historiography, see David Tolmie Merrett, “Australian Banking Practice and the Crisis of 1893,” *Australian Economic History Review* 24 (Mar. 1989): 11; and “Preventing Bank Failure: Could the Commercial Bank of Australia Have Been Saved by Its Peers?” *Victorian Historical Journal* 64 (Oct. 1993): 122–25; and Charles R. Hickson and John D. Turner, “Free Banking Gone Awry? The Australian Banking Crisis of 1893,” *Financial History Review* (Oct. 2002): 33.

<sup>2</sup>Carmen M. Reinhart and Kenneth S. Rogoff, *This Time It Is Different: Eight Centuries of Financial Follies* (Princeton, 2009); Robert F. Bruner and Sean D. Carr, *The Panic of 1907: Lessons Learned from the Market’s Perfect Storm* (Hoboken, 2007); William A. Allen and Richhild Moessner, “The International Propagation of the Financial Crisis of 2008 and a Comparison with 1931,” *Financial History Review* 19 (Aug. 2012): 123–47. On the roots and wider implications of the recent US financial crisis, see Andrea Ryan, Gunnar Trumbull, and Peter Tufano, “A Brief Postwar History of US Consumer Finance,” *Business History Review* 85 (Autumn 2011).

<sup>3</sup>Richard S. Grossman, *Unsettled Account: The Evolution of Banking in the Industrialized World since 1800* (Princeton, 2010).

<sup>4</sup>Michael D. Bordo and John S. Landon-Lane, “The Global Financial Crisis: Is It Unprecedented?” Paper presented at 2010 EWC/KDI Conference on Global Economic Crisis: Impacts, Transmission, and Recovery, Honolulu, Hawaii, 19–20 Aug. 2010, Appendix 11, <http://www.ssc.wisc.edu/~mchinn/01Bordo-Lane-Aug2010.pdf>, accessed 15 Aug. 2012; Reinhart and Rogoff, *This Time It Is Different*, Appendix A3, 344–45.

<sup>5</sup>Bordo and Landon-Lane, “Global Financial Crisis,” 6.

<sup>6</sup>New South Wales Government Statistician’s Office, *New South Wales Statistical Register, 1893* (Sydney, 1894), Public Finance, Table 21.

Baring crisis, when Barings Bank nearly went bankrupt due to risky investments in Argentina.<sup>7</sup> In Australia by contrast, currency markets and government finances remained on a remarkably even keel throughout.<sup>8</sup>

This article will focus on the local character of the crisis. I will discuss three issues. The first concerns the path to the closure of most Australian banks within a six-week period between Easter in April and mid-May of 1893. The question is not why did a widespread banking collapse occur, but why did the episode unfold as it did and when it did. I shall argue that the amendments made to the Companies Acts in 1891 and 1892 and the courts' interpretation influenced the course of the crisis, particularly the emergence of contagion and an acceptance of reconstruction as a mode of work out. Without this change in the law dealing with the winding up of companies only several months prior to the bank crashes, an alternative outcome was possible that would have had far more calamitous impacts. The second question is the link between the bank crashes and the depression experienced in the real economy. Recent research suggests that by some measures the 1890s depression in Australia was deeper and longer lasting than that of the 1930s. The 1890s depression differed from the 1930s in that it was preceded by a much larger increase in credit and then experienced a major banking collapse.<sup>9</sup> In the 1890s, nearly all of the banks that suspended operations reopened after "reconstruction." I will argue that the impact of the banking crash on the real economy worked through a combination of expenditure and wealth effects. Being borne by non-residents mitigated the latter, which fell heavily on depositors and shareholders. The third question is, What was the short- and medium-term response to this crisis? The short and puzzling answer is surprisingly little. I offer some speculative answers for the failure to address the specific issue of prudential standards and regulatory oversight.

### What Happened to Failed Banks?

The backstory is that sustained capital flowed through public and private channels into capital formation and created an asset bubble. By the 1880s, speculation was rife in urban real estate, particularly in Melbourne, the capital of Victoria, and there was evidence of overinvestment

<sup>7</sup>*Economist*, 6 June 1891, cited in H. S. Ferns, *Britain and Argentina in the Nineteenth Century* (Oxford, 1960), 461.

<sup>8</sup>E. A. Boehm, *Prosperity and Depression in Australia, 1887–1897* (Oxford, 1971), 315–16; Alan Barnard, "Government Finance," in *Australians: Historical Statistics*, ed. Wray Vamplew (Sydney, 1987), 254–87.

<sup>9</sup>Chay Fisher and Christopher Kent, "Two Depressions, One Banking Collapse," Research Discussion Paper 1999-06, Reserve Bank of Australia, Sydney, 1999.

in the pastoral industry and in public utilities. Australian financial intermediaries, the most important of which were note-issuing banks known colloquially as trading banks, raised funds domestically and in Britain, which they lent with abandon. Specialist intermediaries—such as land banks, building societies, and pastoral finance companies, which borrowed from the trading banks as well as collecting deposits and issuing debentures—funneled credit into building and the pastoral industry. The ratio of credit to Gross Domestic Product (GDP) rose strongly as the balance sheets of both the intermediaries and their customers became highly leveraged.

By the late 1880s, the boom had run its course. Falling asset prices, compounded by shrinking commodity prices, increased pressure on borrowers, whose defaults undermined the stability of lending institutions. Widespread failures were evident among the land banks and building societies through 1891 and 1892 and intensified the fears of trading bank depositors.<sup>10</sup> The suspension and liquidation on March 5, 1892 of the Mercantile Bank of Australia and on January 28, 1893 of the Federal Bank of Australia, both of which were closely linked to building societies, heightened anxiety about the safety of the other twenty-two banks. Many bank shares carried additional liability, some of which would be triggered by suspension. Bank shareholders began dumping stock long before depositors began to look for safer waters. A number of the trading banks were heavily exposed to the building societies. In late 1892 and early 1893, those banks felt increasing strain, losing deposits and gold coin, a dangerous position, as their notes were fully convertible. The Commercial Bank of Australia, the largest bank in the colony of Victoria, whose capital Melbourne was the epicenter of the speculative building boom, shut on April 5, 1893. Within six weeks, thirteen of Australia's twenty-two trading banks had suspended operations.

What happened next? All of the banks had reopened within a few months of suspending.<sup>11</sup> Almost immediately they were accepting new business as trustees, anticipating the formal reconstruction whereby the “old” bank became a “new” bank. The bargain with creditors was that instead of liquidation they accepted a conversion of their deposits into longer-dated securities and, in some cases, preference shares. The shareholders had to meet fresh calls for capital, and their dividends ranked below payment of interest on deposit claims and preference

<sup>10</sup>Sydney James Butlin, *Australia and New Zealand Bank: The Bank of Australasia and the Union Bank of Australia Limited, 1828–1951* (London, 1961), 288; Noel George Butlin, *Investment in Australian Economic Development, 1861–1900* (Cambridge, U.K., 1964), 428–30.

<sup>11</sup>S. J. Butlin, *Australia and New Zealand Bank*, 301.

shares.<sup>12</sup> Poorly performing loans and worthless advances were heavily written off at the time of suspension. However, there was no credit crunch. There was no spike in interest rates, and banks honored one another's checks and bank notes through clearing exchanges.<sup>13</sup> By mid-1893, banking went on as usual.

This favorable outcome was not inevitable. Some banks were insolvent in early 1893, but those that were not possessed little defense against withdrawals by depositors wanting the security of gold. After the closure of the Commercial, panic withdrawals of deposits and gold triggered the suspension of other banks. Bankers also suspended in anticipation of the withdrawal of British deposits, some 40 percent of the total, much of which matured at the end of the Scottish Whitsun term in mid-May.<sup>14</sup> The suspension of the Commercial and the likelihood of wholesale withdrawal of British deposits bookended the period when banks were most likely to suspend.

The likelihood of suspension by banks under pressure increased, as no colonial government in Australia had the financial capacity to mount a "bailout" in the modern sense. The Associated Banks of Victoria did offer support at the margin for banks by liquidating good quality assets but could not offer a general lender of last-resort mechanism.<sup>15</sup> Governments in each of the three colonies where bank failures occurred undertook a variety of measures to prevent or alleviate the crash. The newly appointed Victorian government, particularly the Treasurer, G. D. Carter, was anxious to protect the Commercial Bank from going into liquidation.<sup>16</sup> Senior figures in the government may well have known that the Commercial's directors had plans to suspend as early as March 10, 1893.<sup>17</sup> The Chief Justice, Sir John Madden, would have been involved in any such discussions, as he acted as Administrator in the absence of the Governor, the Earl of Hopetoun, and was a member of the Executive Council from January 26 until May 11, 1893.<sup>18</sup> The proclamation of the Banking Companies' Shares Sale and Purchase Act on February 27,

<sup>12</sup> For a summary of the initial schemes see *Australasian Insurance and Banking Record* (July 1893): 661–63, 688–91.

<sup>13</sup> Sydney James Butlin, Alan Ross Hall, and Roland Charles White, *Australian Banking and Monetary Statistics, 1817–1945* (Sydney, 1971), Table 51.

<sup>14</sup> Boehm, *Prosperity and Depression*, Table 67; J. D. Bailey, "Australian Borrowing in Scotland in the Nineteenth Century," *Economic History Review* n.s. 12, no. 2 (Dec. 1959): 268–79.

<sup>15</sup> Merrett, "Preventing Bank Failure," 129–30.

<sup>16</sup> The Patterson Ministry assumed office on the 23 Jan. 1893. Colin A. Hughes and B. D. Graham, *A Handbook of Australian Government and Politics, 1890–1964* (Canberra, 1968), 105–6.

<sup>17</sup> Rodney J. Wood, *The Commercial Bank of Australia Limited: History of an Australian Institution, 1866–1981* (North Melbourne, 1990), 182.

<sup>18</sup> Hughes and Graham, *Handbook of Australian Government*, 101.

1893, making the short selling of bank shares a misdemeanor, may have delayed the panic among shareholders, although the horse had long bolted.<sup>19</sup> Pressure from the Treasurer forced the Associated Banks of Victoria to publish a statement on March 14 indicating its support for failing banks, notably the Commercial.<sup>20</sup> However, a retraction the following day only increased suspicion about the safety of individual banks. Later Carter arranged an agreement between the government and the banks to make £1.9 million available to the Commercial, an offer it rejected.<sup>21</sup> Moreover, he attended the meeting of creditors of the Commercial Bank on April 24 where he stated he was “sure that anything the Ministry can do to facilitate the reconstruction of this bank they will only be too glad to do.”<sup>22</sup> The proclamation of a five-day bank holiday on April 30, 1893 by the unfortunate Carter increased uncertainty, and the strong banks ignored it.<sup>23</sup>

Both the New South Wales and Queensland governments undertook action to alleviate the crisis in their colonies. In an attempt to retain confidence in bank notes, which were not in the first charge on bank assets in New South Wales, the government legislated to make bank notes legal tender for six months, with the assent of the Bank Issue Act on May 3. However, all but one of the banks did not wish to be party to the action. Consequently, the act was not proclaimed until after the suspension of the Commercial Banking Company of Sydney on May 16. In New South Wales the passage of the Current Account Depositor's Act, passed on May 26, promised to pay half of the locked-up current account deposits. This may not have had much benefit, as the Commercial Banking Company of Sydney had released its current accounts.<sup>24</sup> The Queensland National Bank enjoyed a particularly strong relationship with the government. In 1896, after the death of Edward Drury, the Bank's general manager, it was discovered that the company was hopelessly insolvent. The government rushed through the National Bank of Queensland Guarantee Act to safeguard depositors until it could revise a reconstruction scheme in 1897.<sup>25</sup>

<sup>19</sup> Boehm, *Prosperity and Depression*, Chart 40.

<sup>20</sup> Merrett, “Preventing Bank Failure,” 126. The Treasurer, Godfrey Downes Carter, was a director of the Bank of Victoria, which suspended on May 10, and also a depositor in the Commercial Bank. Wood, *The Commercial Bank*, 182; Henry Rosenbloom, “Carter, Godfrey Downes (1830–1902),” *Australian Dictionary of Biography*, <http://adb.anu.edu.au/biography/carter-godfrey-downes-3174/text4573>, accessed 15 Aug. 2012.

<sup>21</sup> *Australasian Insurance and Banking Record* (Apr. 1893): 236.

<sup>22</sup> *Ibid.*, 239.

<sup>23</sup> Rosenbloom, “Carter.”

<sup>24</sup> Boehm, *Prosperity and Depression*, 314–15; *Australasian Insurance and Banking Record* (July 1893): 662.

<sup>25</sup> Geoffrey N. Blainey, *Gold and Paper: A History of the National Bank of Australasia Limited* (Melbourne, 1958), 212–15.

What remedies were available to creditors in banks that were insolvent or that an inability to pay out in notes or gold coin might drive to failure? The extant Companies Act of 1890, drawn from British joint-stock companies acts, determined their rights. The stark choice was liquidation—through the alternative of voluntary or compulsory winding up under the court’s supervision or of trading on in the hope of recouping the losses. The collapse of the land boom in 1891 brought about a rise in personal bankruptcies and company failures of those speculating in property and shares. Politicians caught up in the failures rushed through new legislation, the notorious Voluntary Liquidation Act 1891, which “by protecting companies from being forced into winding-up under court control and allowing voluntary liquidation to proceed unrestricted, . . . facilitated concealment of mismanagement and outright fraud.”<sup>26</sup> The new legislation increased the likelihood of liquidation of any bank that was to suffer a loss of its depositor’s confidence.

Help came from an unexpected quarter. In May 1892, Agar Wynne, a member of the Legislative Council, introduced a private members bill to repeal the Voluntary Liquidation Act and to amend the Companies Act.<sup>27</sup> Inter alia, Wynne argued that the current legislation made it too easy for firms to be liquidated in a manner that did not respect the rights of all creditors.<sup>28</sup> Making little headway with his grand plan, on September 7, 1892 Wynne proposed to split the bill into two parts, “one of those parts dealing with the repeal of the Voluntary Liquidation Act, and [the other] embodying clauses with reference to compromise similar to those provisions in force in New South Wales.”<sup>29</sup> Treasurer Carter, speaking on November 24, presciently suggested that the bill “should deal with companies which were not yet defunct but which, if they did not get some legislative assistance, might become defunct.”<sup>30</sup> The rules of the game changed in December when the government enacted the Companies Act Amendment Act of 1892, which was a copy of sections dealing with reconstruction from the British Joint Stock Companies Act of 1870. The pendulum had swung towards a court-sanctioned process that was based on an easy test for compromise or reconstruction only months before the banking collapse. The Court noted that

<sup>26</sup> John Waugh, “The Centenary of the Voluntary Liquidation Act 1891,” *Melbourne University Law Review* 18 (June 1991–92): 174. For descriptions of commercial practices of the time see Geoffrey Serle, *The Rush to be Rich: A History of the Colony of Victoria, 1883–1889* (Melbourne, 1971), ch. 8; Michael Cannon, *The Land Boomers* (Melbourne, 1966).

<sup>27</sup> Agar Wynne, “Companies Act Amendment Act,” *Victorian Parliamentary Debates*, vol. 69 (1892–93), 213; John Waugh, “Company Law and the Crash of the 1890s in Victoria,” *University of New South Wales Law Journal* 15 (1992): 381.

<sup>28</sup> Wynne, “Companies Act Amendment Act,” 394.

<sup>29</sup> *Ibid.*, 1446.

<sup>30</sup> Godfrey Downes Carter, “Companies Act Amendment Act,” *Victorian Parliamentary Debates*, vol. 70 (1892–93), 3014.



before sanctioning a scheme for compromise or arrangement made between a company and its creditors under the Companies Act Amendment Act 1892 (No. 1269). secs. 3 or 4, the Court will consider whether or not the scheme proposed is such that men of business might reasonably come to the conclusion that it was a fair scheme and likely to be beneficial to all classes of creditors concerned. Subject to this, it is the intention of the Act that the majority of the creditors should be allowed to bind the minority, *but the Court must be satisfied that as far as possible the approval of the majority was founded on sufficient information as to the financial position of the company.*<sup>31</sup>

The Court's reception of the scheme of arrangement proposed by the Commercial Bank of Australia was of critical importance. If the Court rejected, delayed, or seriously modified the proposal, one can conjecture that the creditors of other banks would have increased pressure on their own institutions. If banks started selling assets on a falling market to raise cash, then the moment would have arrived when insolvency rather than illiquidity was the issue for most banks. In these circumstances, it is likely that the crisis would have been far more severe and the banking system deeply compromised. No previous study has attempted a formal analysis of this counterfactual. Rather, I identify a number of plausible assumptions about what might have happened. For instance, only a handful of banks may have survived, the contenders being the Bank of New South Wales, the Union Bank of Australia, and the Bank of Australasia. However, they lacked the capital and human resources to meet the banking needs of the whole country by providing bank notes, supporting domestic and international payments, accepting deposits, and making loans. The government-owned savings banks in each of the colonies did not possess the capabilities or the branch networks to offer the range of services provided by the defunct trading banks. Some form of public-sector bailout may have been necessary, possibly nationalization of the private banks via government capital injection. Shareholders in the reconstructed banks operating in Victoria—including two British banks, the English, Scottish & Australian Chartered Bank and the London Chartered Bank of Australia—were to provide the fresh capital of £4.7 million.<sup>32</sup> Raising a comparable sum would have placed great burdens on the government resources of that colony, which in 1893 collected only £2.5 million in tax and whose total annual revenue was £6.9 million.<sup>33</sup> The chaos prior to any such bailout and the terms of the bailout itself might have led to a budget blowout,

<sup>31</sup> Much of this paragraph draws from "In re the Commercial Bank of Australia Limited," *Victorian Law Reports* (1893): 333–80. Quote at 333. Emphasis added.

<sup>32</sup> *Australasian Insurance and Banking Record* (July 1893): 688–91.

<sup>33</sup> Barnard, "Government Finance," G51–75.



which in turn might have triggered a crisis in sovereign debt and currency markets.

Sir Edward Dundas Holroyd, judge of the Victorian Supreme Court, received and accepted the petition for compulsory winding up.<sup>34</sup> Following subsequent meetings of the creditors and shareholders on April 24, 1893, Sir John Madden, a Chief Justice of four-months standing, heard a motion seeking reconstruction.<sup>35</sup> Madden, being persuaded by counsel that “a winding up at the present time would be disastrous to all concerned,” permitted the reconstruction scheme to go ahead without a searching examination of the issues involved or mandating statutory meetings with creditors in both Australia and Britain. Mid-May, the full Court heard an appeal on behalf of British depositors against a number of elements of the scheme. The three judges on the bench, including the highly experienced Holroyd, wrestled to interpret the extent of their authority under the new legislation and its British precedents. While the judges rejected nearly all the matters of the appeal, it was clear that they had a number of concerns about procedural issues. However, the transfer of the assets of the old bank to the new bank before the appeal influenced the Court’s decision to reject the appeal at the margin, and many new customers had made deposits with the new bank. To not sanction the scheme would harm the “new interests” that had been created.<sup>36</sup>

Fortuitously, given what was about to unfold, the test proposed in the act significantly increased the likelihood of reconstruction rather than liquidation. If more than three-quarters of the creditors at the meeting agreed to follow this course of action, the Court had little ability to overturn that decision unless the bench found it to be glaringly unfair or unreasonable. The Court felt constrained to reject the scheme on the basis of any doubts it might have about the financial position of the bank. The Court needed to be satisfied that the creditors at the meeting would hear a full disclosure of the financial position. In the judgment of the full Court, Holroyd stated that “if an institution is unsound, it is better that it go into liquidation at once than its subsequent downfall should inflict a more widespread disaster.”<sup>37</sup> However, the Court felt that it was not its role to decide whether the institution was insolvent. Holroyd argued that “even if the Court had before it all the materials relating to the bank’s position, the Court would find it

<sup>34</sup>I am greatly indebted to John Waugh of the Melbourne Law School for his guidance on these matters. He bears no responsibility for my interpretation. Personal communication with the author on 8 Aug. and 11 Aug. 2012.

<sup>35</sup>Ruth Campbell, “Madden, Sir John (1844–1918),” *Australian Dictionary of Biography*, <http://adb.anu.edu.au/biography/madden-sir-john-7453/text12981>, accessed 30 July 2012.

<sup>36</sup>*Victorian Law Reports* (1893): 369.

<sup>37</sup>*Ibid.*, 369.

difficult to pronounce an opinion as to what might be the ultimate success of a large institution like this.”<sup>38</sup> Its unwillingness to do so saved the day given that the Commercial’s revealed losses rose from £800,000 at the time of its suspension to £3 million, with another £1.5 million of non-performing assets held in an off-balance-sheet Special Assets Trust Company.<sup>39</sup> George Meudell, a plaintiff in the case, reflected long after the event, “When this bank failed in 1893 it should have stayed shut. It was in the most awfully putrid state, for out of its £13,000,000 of assets only about £2,000,000 were realizable.”<sup>40</sup> Margot and Alan Beever, having access to the bank’s internal records, imply that it was insolvent at the time of its suspension and remained so throughout the nineties.<sup>41</sup>

The wording of the act tied the hands of the judges. Banks under pressure readily obtained reconstructions. The decision in the Commercial case served as the template for others that followed, suspending and reopening even before the Court heard the Commercial’s appeal. New laws supported the reconstruction process. New South Wales’s Joint Stock Companies Arrangements Act, which was passed in January 1892, was identical to Victoria’s Companies Act Amendment Act. Queensland followed suit in 1894.<sup>42</sup> Importantly, Victoria assented to the Reconstructed Companies Acts in 1893 and New South Wales in 1894. These acts facilitated the transfer of business being done within Britain to their reconstructed counterpart.<sup>43</sup> Moreover, they waived stamp duty on the transfer of books from the old banks to the new, saving the new banks from an administrative nightmare and a crippling tax bill.<sup>44</sup>

### The Bank Crashes and the Depression

The existing literature has surprisingly little to say about the role of the 1893 bank crash in explaining the timing, depth, or duration of a depression, which in many respects was more severe than that of the 1930s.<sup>45</sup> Ernst Boehm’s seminal study, for instance, does not give the bank crash a central role in causing the depression.<sup>46</sup> He argues that

<sup>38</sup> “The Commercial Bank,” *The Argus*, 16 June 1893, 7. John Waugh brought this quotation to my attention.

<sup>39</sup> Merrett, “Preventing Bank Failure,” Tables 4 and 5.

<sup>40</sup> George Meudell, *The Pleasant Career of a Spendthrift* (London, 1929), 79.

<sup>41</sup> Margot Beever and Alan Beever, “Henry Gyles Turner,” in *Australian Financiers: Biographical Essays*, ed. Reginald Thomas Appleyard and Carl Boris Schedvin (South Melbourne, 1988), 130–32.

<sup>42</sup> H. E. Teare, *A Digest of the Banking and Currency Acts, Proclamations, Orders, etc. of Australia and New Zealand: Showing the Development of Banking and Currency from 1788 to Date* (Sydney, 1926), 58.

<sup>43</sup> Waugh, “Company Law,” 366, 369.

<sup>44</sup> Reconstructed Companies Act 1893, Victoria Act no. 1356, section 8.

<sup>45</sup> Fisher and Kent, *Two Depressions, One Banking Collapse*, 3–6.

<sup>46</sup> Boehm, *Prosperity and Depression*, 322–25.

Table 1  
Nominal GDP Peak, Trough, and Years to Recovery

Colony/State	Year Peak	Year Trough	Year Recovery	Trough as % of Peak	Years to Trough	Years to Recovery
New South Wales	1891	1895	1903/4	76	4	10
Victoria	1890	1894	1907/8	66	4	15
Queensland	1888	1891	1894	93	3	4
South Australia	1890	1895	1905/6	70	5	12
Tasmania	1889	1893	1899	74	4	7
Western Australia	1889	1890	1892	95	1	3
Australia	1889	1895	1903/4	66	6	9

Sources: W. A. Sinclair, *Annual Estimates of Gross Domestic Product: Australian Colonies/States 1861–1976/77* (2009), <http://arrow.monash.edu.au/hdl/1959.1/88855>; N. G. Butlin, *Australian Domestic Product, Investment, and Foreign Borrowing, 1861–1938/39* (Cambridge, U.K., 1962), Table 1. Note: Year of recovery is when GDP exceeds that of previous peak.

the depression resulted from an intersection of the creation of structural imbalances—excess physical capital stock—arising from overinvestment and from a tightening of credit in London. Exuberant lending by banks and other financial intermediaries had facilitated the emergence of asset bubbles. As economic activity slowed, asset values tumbled and bankers were left with impaired loan books. The banks reached a tipping point in early 1893 when many of these institutions faced critical liquidity and solvency issues, resulting in reconstructions and liquidations. Having purged the excesses of the speculative boom by writing off assets, the banks struggled to rebuild their balance sheets in a depressed economy. However, Boehm argues that the causation flowed both ways as the “rehabilitation” of the banks resulted in “a severely contractionary credit policy throughout the remainder of the nineties [which] contributed greatly towards the protracted nature of the recovery.”<sup>47</sup>

In Table 1 we see that the level of GDP had peaked in all six colonies years before the bank crash. Moreover, the trough of the depression occurred either before or at the same time as the crash in three of the colonies. A recent study of multi-country crises suggests that banking crises lead to severe recessions and that the American experience shows that “recessions associated with financial crises are generally followed by rapid recoveries.”<sup>48</sup> The Australian experience fits with the first

<sup>47</sup> *Ibid.*, 325.

<sup>48</sup> Bordo and Landon-Lane, “Global Financial Crisis,” 24, 28. Michael D. Bordo and Joseph G. Haubrich, “Deep Recessions, Fast Recoveries, and Financial Crises: Evidence from the American Record,” Working Paper no. 18194, National Bureau of Economic Research, Cambridge, Mass., 2012, 1–2, 11.

*Table 2*  
 Bank Advances as Proportion of Nominal GDP  
 in 1880 and 1892 by Colony and Australia

Year	New South Wales		Victoria	Queensland	South Australia	Western Australia	Tasmania	Australia
	Wales	Victoria	Queensland	South Australia	Western Australia	Tasmania	Australia	
1880	34.2	39.4	35.6	29.2	28.6	26.3	34.0	
1892	59.5	89.8	91.6	52.1	64.7	40.8	73.7	

Sources: Bank advances from Sydney James Butlin, Alan Ross Hall, and Roland Charles White, *Australian Banking and Monetary Statistics, 1817–1945* (Sydney, 1971), Tables 13–18. GDP data from W. A. Sinclair, *Annual Estimates of Gross Domestic Product: Australian Colonies/States 1861–1976/77* (2009), <http://arrow.monash.edu.au/hdl/1959.1/88855>; and N. G. Butlin, *Australian Domestic Product, Investment, and Foreign Borrowing, 1861–1938/39* (Cambridge, U.K., 1962), Table 1.

claim, but not the second. The Australian recovery, measured in terms of national GDP exceeding the earlier peak, was protracted, taking nine years. The impact of the depression differed markedly across the country. For instance, Victoria suffered a contraction of a third of its GDP between 1890 and 1894 and took until 1907–1908 to overtake its earlier peak. Do regional differences in the credit boom of the 1880s explain the variation in GDP movements? Table 2 shows that bank advances as a proportion of GDP grew fastest in Victoria and Queensland between 1880 and 1892. Victoria was home to banks that accounted for more than a half of the national total of loans and had the largest losses.<sup>49</sup> Table 3 supports the intuition that Victoria would suffer the deepest and longest lasting depression. However, Queensland, which experienced a comparable credit binge, did not. Other colonies, most importantly New South Wales, which escaped a Victoria-style banking boom and crash, suffered deep and long lasting depressions. Clearly, multiple factors were at work here, including droughts, swings in commodity prices, gold discoveries in Western Australia, flexibility in labor-market adjustment, deflation, and so on, which make disentangling the impact of the bank crashes on the depression and the process of recovery difficult.<sup>50</sup>

While economic activity peaked in all colonies years before the bank crash, I will identify two channels through which the crash did

<sup>49</sup> Advances by colony from Butlin, Hall, and White, *Australian Banking and Monetary Statistics*, Tables, 13–18. Capital write offs from Merrett, “Preventing Bank Failure,” Table 5.

<sup>50</sup> Boehm, *Prosperity and Depression*, ch. 11; William Angus Sinclair, *Economic Recovery in Victoria, 1894–1899* (Canberra, 1956). For a recent account of the complexity of this episode see Ian W. McLean, *Why Australia Prospered: The Shifting Sources of Economic Growth* (Princeton, 2012), 113–32.

Table 3  
Trading Bank Advances by Colony,  
Peak, Trough, and Recovery

Colony	Peak	Trough	Years Peak to Trough	Trough as % of Peak	Years Trough to Recovery	Years Trough to Recovery
New South Wales	1892	1900	8	73	1912	12
Victoria	1892	1905	13	54	1921	16
Queensland	1889	1900	11	70	1916	17
South Australia	1890	1900	11	45	1916	17
Tasmania	1891	1897	7	55	1921	24

Source: Sydney James Butlin, Alan Ross Hall, and Roland Charles White, *Australian Banking and Monetary Statistics, 1817–1945* (Sydney, 1971), Tables 13–18. Note: Year of recovery is when bank advances exceeds that of previous peak.

directly contribute to the severity and duration of the depression. I am not in a position to say which played the more important role in transmission. The first, discussed below, is the slower credit growth after the crisis. The crash precipitated a long and deep decline and slow recovery in bank lending, as shown in Table 3. However, it is difficult to determine whether this was a cause or consequence of the depression. Banks did accommodate themselves to falling demands for credit from their customers whose incomes were shrinking. Businesses and households were deleveraging their balance sheets as the asset bubble burst. The excess of physical assets in the housing and pastoral sector dampened demand for new investment. The behavior of interest rates suggests that demand for bank loans fell. Nominal interest rates charged for bank loans declined from 9 percent in March 1891 to a trough of 6 percent in 1897, and the spread between lending and deposit rates remained steady across the period.<sup>51</sup> Banks did slow the growth of credit by changing the way they managed their balance sheets. The total assets of the private banks fell by 25 percent from 1892 to a trough in 1899. Both the amount of bank advances and the money supply, M2, fell more sharply, by 35 and 47 percent respectively (see Table 4).<sup>52</sup> Holdings of cash grew relative to deposits, and the reconstructed banks siphoned off earnings and fresh investment made by shareholders to rebuild reserves. The amount of lending relative to the deposit base fell.

The second channel between the bank crash and the depression resulted from the reconstruction arrangements made between financial

<sup>51</sup> Butlin, Hall, and White, *Australian Banking and Monetary Statistics*, Table 51.

<sup>52</sup> *Ibid.*, Table 12, and Table 4 in this article.

*Table 4*  
 Money Supply Adjusted for Deferred Deposits within Australia

<i>Money Supply</i>	<i>Peak</i>	<i>Trough</i>	<i>Years Peak to Trough</i>	<i>Trough as % of Peak</i>	<i>Recovery</i>	<i>Years Trough to Recovery</i>
M1	1890	1893	3	82	1895	2
M2	1890	1893	3	53	1907	14
M3	1892	1893	1	59	1902	9
M2*	1890	1894	4	78	1906	8
M3*	1892	1893	1	83	1900	7

Source: David Merrett, "The 1893 Bank Crashes and Monetary Aggregates," Research Discussion Paper 9303, Reserve Bank of Australia, Sydney, 1993, Tables 4 and 6.

Notes: M1 Currency plus trading bank demand deposits; M2 Currency plus trading bank demand and time deposits; M3 Currency plus all trading bank and net savings bank deposits; M2\* with "market value" of deferred deposit receipts added back; M3\* with "market value" of deferred deposit receipts added back.

institutions, their creditors, and shareholders. The reconstruction schemes greatly reduced the wealth of bank creditors, who agreed to hold illiquid long-dated securities or preference shares, and of shareholders, who were forced to pay calls for fresh capital and ranked behind depositors and preference shareholders' interest before receiving dividends. Table 4 presents estimates of movements in the money stock because of the impact of the reconstruction schemes as indicators of the burden borne by depositors within Australia.<sup>53</sup> These are national figures. I suggest that the fall in the money supply in Victoria would have been higher than elsewhere. The key results are that M2 and M3 fell by over 40 percent from peak to trough and recovered slowly. Even after adding back a discounted market value of locked up claims once a secondary market was established, on the unrealistic assumption that all long-dated deposit claims were immediately sold into that market, M2\* and M3\* still contract by around 20 percent. These falls represent a range of 14 to 33 percent of Australia's GDP in 1893. The comparable decline would have been far higher in Victoria. These falls dwarf those occurring in the 1930s. In that depression, M3 contracted by 11 percent on an annual basis and 14 percent on a quarterly basis between March 1928 and June 1931.<sup>54</sup> Moreover, in his analysis of the relationship between changes in the stock of money and the real economy, Boris

<sup>53</sup> David Tolmie Merrett, "The 1893 Bank Crashes and Monetary Aggregates," Research Discussion Paper 9303, Reserve Bank of Australia, Sydney, 1993, Tables 4 and 6.

<sup>54</sup> C. B. Schedvin, *Australia and the Great Depression: A Study of Economic Development and Policy in the 1920s and 1930s* (Sydney, 1970), 207, Table C-1; C. B. Schedvin, "A Century of Money in Australia," *Economic Record* 49 (Dec. 1973): 601-5.

Table 5  
Decline in Value of House and Security Prices  
in Melbourne and Sydney

<i>City and Type of Asset</i>	<i>Peak</i>	<i>Trough</i>	<i>Trough as % of Peak</i>	<i>Recovery</i>
Melbourne house	1891	1903	63	1917
Sydney house	1890	1898	59	1913
Sydney financial shares	1890	1894	41	1922
Sydney industrial & commercial shares	1889	1894	69	1903
Sydney mining shares	1890	1895	20	After 1910

Sources: House prices from Nigel D. Stapleton, "Long Term Housing Prices and Some Economic Perspectives," unpublished PhD diss., Australian School of Business, School of Economics, University of New South Wales, 2007, Tables 2.1, 2.2. Security prices from D. McL. Lambertson, "Some Statistics of Security Prices and Yields in the Sydney Market, 1875-1955," *The Economic Record* 34 (Aug. 1958): Table 3.

Schedvin includes net assets held abroad by Australian banks, "London funds," as part of their cash holding or high-powered money. The willingness of the banks to let their reserve ratios fluctuate in a counter-cyclical way leads Schedvin to conclude there was not "any significant relationship between contraction of the money stock and the fall in income and employment."<sup>55</sup>

What happens to the wealth of bank shareholders caught up in reconstruction schemes? The data set is far thinner than for depositors, but the story seems worse. In my article on 1893 bank crashes, I argue that the market value of most Victorian banks was already below book value prior to the onset of the crash.<sup>56</sup> While Allan Hall calculates that the value of shares in "Melbourne banks" contracted by more than 80 percent between 1889 and 1900. Moreover, the value of all bank shares listed on the Stock Exchange of Melbourne, presumably including the Sydney and British banks, more than halved.<sup>57</sup>

The bursting of the asset bubble had considerable wealth effects. Table 5 shows the significant fall, around 40 percent, of residential property values in Sydney and Melbourne, and a long period to recovery. Moreover, values for various classes of securities on the Sydney Stock Exchange also exhibited heavy falls and slow recovery, especially

<sup>55</sup> Schedvin, *Australia and the Great Depression*, 209-10.

<sup>56</sup> Merrett, "The 1893 Bank Crashes," Table 3.

<sup>57</sup> Alan Ross Hall, *The Stock Exchange of Melbourne and the Victorian Economy, 1852-1900* (Canberra, 1968), Table 12.



for financial shares. Household and business balance sheets shrank further as value of their claims against banks shrank. A crude measure of this impact is to compare the 1893 fall of roughly a third in the value of M2 and M3 to GDP. We can assume that reduced income from the ownership of financial assets and associated dissaving would have depressed expenditure below what it otherwise would have been, contributing to lower production and rising unemployment. However, for those with cash and a sharp eye for business, accumulating cheap assets laid the foundations for future riches.<sup>58</sup>

A contraction in the value of assets on this scale begs the question of why the depression was not more severe and why it did not last even longer. Fortunately, foreign ownership diluted the full effect of liquidation and reconstruction schemes. British residents owned roughly 40 percent of bank deposits, and three-quarters of these were with banks that suspended.<sup>59</sup> Moreover, British depositors held around 45 percent of claims in suspended land banks and building societies.<sup>60</sup> Australian banks lent heavily to the pastoral industry but escaped the full force of low commodity prices and the drought through the greater exposure of specialist intermediaries whose major investors and creditors were also British.<sup>61</sup> The *Australasian and Insurance and Banking Record* estimated that British investors had committed £18 million in shares and £28 million in debentures in pastoral companies, and British insurance companies had invested another £7 million in mortgages against squatting properties.<sup>62</sup> Some of this capital was swept away as some of the leading pastoral companies followed the banks down the path of reconstruction.<sup>63</sup> Yields on investments fell heavily as reconstruction schemes, falling profits, and interest rates cut share values and dividends.

For two decades up to World War I, British investors liquidated large amounts of their portfolio positions in Australian activities. The British quit their deferred deposits upon maturity, leading to a radical and swift shift in the composition of the balances held by banks in London from a net liability of £24 million 1892 to a net credit of £200,000 in 1899.<sup>64</sup> Robert Nash's calculations shown in Table 6 highlight the

<sup>58</sup> Peter Yule, *William Lawrence Baillieu: Founder of Australia's Greatest Business Empire* (Melbourne, 2012), Part 2.

<sup>59</sup> Boehm, *Prosperity and Depression*, Tables 65 and 67.

<sup>60</sup> *Ibid.*, Table 64.

<sup>61</sup> N. G. Butlin, *Investment in Australian Economic Development*, 159.

<sup>62</sup> *Australasian Insurance and Banking Record* (Sept. 1893): 847–49.

<sup>63</sup> N. G. Butlin, *Investment in Australian Economic Development*, 436–40. For an account of the reconstruction schemes of the pastoral financiers see David Merrett, Stephen Morgan, and Simon Ville, "Industry Associations as Facilitators of Social Capital: The Establishment and Early Operations of the Melbourne Woolbrokers' Association," *Business History* 50 (Nov. 2008): 783–84.

<sup>64</sup> Butlin, Hall and White, *Australian Banking and Monetary Statistics*, Table 4(ii).

Table 6  
Change in Australasian and British Ownership of  
Australasian Securities, 1899–1912/13 (in millions of £)

Type of Security	Australasia 1899	Change 1899–1912/13	Britain 1899	Change 1899–1912/13
Government debt	25	93	209	65
Local government	8	17	14	0
Bank securities	25	–5	19	–5
Non-mining	42	59	72	–20
Mining	28	–1	80	–51
Total	128	165	395	–11

Source: Robert L. Nash, *The Australasian Joint Stock Companies' Year-Book* (Sydney, 1899), xxvii; and (Sydney, 1913–14), xxviii–xxix.

Note: Includes New Zealand public debt, bank deposits, and corporate securities.

growing importance of Australian and New Zealand ownership of claims against corporations and governments relative to the British investors, and the absolute fall in the value of claims against private sector entities by the British. This shift in the balance between domestic and British capital reflects more than a reduction in capital raising by non-mining Australian firms in London.<sup>65</sup> Existing British claims were being liquidated or sold to Australian resident holders.

The losses suffered by British investors in the 1890s signaled a change in the relationship between the two countries in terms of capital exports. Australian governments returned to the British capital market on a large scale before World War I and in the 1920s. However, I suggest that foreign direct investment by British companies in a new range of industries replaced passive portfolio investment by Scottish widows. It is difficult to know when the balance shifted decisively in favor of foreign direct investment (FDI) by British multinationals.<sup>66</sup> In the second half of the nineteenth century, much of direct private capital inflow from Britain had taken place through the agency of “free-standing” British registered firms, principally merchant houses and in resource-exploiting activities, whose operations were located overseas.<sup>67</sup> There was a shift towards direct investment in Australia by the more conventional twentieth-century multinationals whose overseas subsidiaries

<sup>65</sup> Alan Ross Hall, *The London Capital Market and Australia, 1870–1914* (Canberra, 1963), Table 11.

<sup>66</sup> Philip L. Cottrell, “Great Britain,” in *International Banking, 1870–1914*, ed. Rondo Cameron and V. I. Bovykin (Oxford, 1991), 28–29.

<sup>67</sup> Mira Wilkins, “The Free-Standing Company, 1870–1914: An Important Type of British Foreign Investment,” *Economic History Review* n.s. 41, no. 2 (1998): 259–82.

were minor adjuncts to home-market activities. By the 1930s, more than eighty leading British and American manufacturing companies had set up factories in Australia behind the rising tariff wall.<sup>68</sup>

### Responses to the Bank Crashes

What happened next? Peter Love wrote, “The depression of the 1890s left a profound impression on the minds of a whole generation of Australians and accentuated a number of concerns that helped shape the nation in the twentieth century.”<sup>69</sup> How did Australia respond to the banking crisis? Why was no action taken to ensure that a repeat of this type of banking failure was less likely, such as formal collective agreements about prudential standards enforced through clearinghouse associations, as in the United States of America, or the establishment of a central bank with prudential oversight? The varied reactions of the key actors—the customers, the banks, and the state—provide some clues.

The banks’ customers returned. For those who wanted only a savings instrument there were alternative and seemingly safer places to earn interest on savings, and the trading banks lost deposit market share to savings banks and life insurance offices up to World War I. By 1903, deposits in trading banks had barely recovered their 1893 level, but grew by 61 percent to 1913, to be nearly double those in the savings banks.<sup>70</sup> However, those customers seeking credit or making payments had fewer alternatives. Banks were still the dominant providers of credit to high-net-worth individuals and businesses. Moreover, banks continued to enjoy their monopoly on domestic and international payments. They alone provided checking accounts and organized inter-bank clearing through local clearinghouses. Extensive networks of correspondence arrangements with foreign banks allowed them to make and receive payments for importers and exporters and to process capital transfers inward and outward. Transaction fees on clearances, foreign-currency conversion, and running a bill book at their London branch further protected the banks’ revenue base.<sup>71</sup>

During the 1890s, the Australian banks battened down their hatches and hung on. Survival was their immediate focus, and salvation came

<sup>68</sup> Colin Forster, *Industrial Development in Australia, 1920–1930* (Canberra, 1964), Appendix 3.

<sup>69</sup> Peter Love, *Labor and the Money Power* (Melbourne, 1984), 20.

<sup>70</sup> Butlin, Hall, and White, *Australian Banking and Monetary Statistics*, Tables 1 and 53(ii).

<sup>71</sup> David Tolmie Merrett, “Paradise Lost: British Banks in Australia,” in *Banks as Multinationals*, ed. Geoffrey Jones (London, 1990), 62–84; David Merrett, “Global Reach by Australian Banks: Correspondent Banking Networks 1830–1960,” *Business History* 37 (July 1995): 70–88.

with the breaking of the drought, rising commodity prices, renewed immigration, and rising government spending in the new century. Around 1900, once banks had paid off obligations incurred as part of reconstruction schemes, they began rebuilding their holdings of cash overseas and locally and adopted a more conservative approach to lending.<sup>72</sup> Their actions could be construed as self-insuring against any further calamity. However, each bank made commercial decisions in accordance with the canons of sound banking. Board directors, some of whom represented the preference shareholders, played a far more active role in the affairs of their banks. Executive authority was diminished in both weak and strong banks, as the directors of both the Commercial Bank of Australia and the mighty Union Bank of Australia assumed executive responsibilities.<sup>73</sup>

Why was there such a lack of imagination, intellectual curiosity, and urgency in the response of the banking community? Part of the explanation may lie in the human-resource practices of these institutions. Toward the end of the nineteenth century, emerging internal labor markets gave lifetime employment to workers trained in bank-specific functional skills. However, these closed labor markets did not lead to new ideas and did not encourage mavericks reaching the top. Even those British banks operating in Australia had no transfer of staff between the two countries. Moreover, staff with firsthand experience of the Bank of England's role as a central bank were limited to the small number of British staff in the London offices. Moreover, the closure of the Australian market to foreign banks closed another avenue of new ideas and different experiences that might have widened the horizons of local bankers.

What of the government? Australia did have a "free banking" regime through the nineteenth century, minimal restrictions on entry, no controls on interest rates or balance sheet ratios, and only bank-issued notes—but politicians were giving serious thought to some form of central banking in the 1890s.<sup>74</sup> One reason for the absence of a government bank prior to this point was that two functions often performed by central banks at the time—issuing and managing government debt and issuing bank notes—were handled by other means. Independent colonies borrowed from individual banks, a consortium of "domestic"

<sup>72</sup> Schedvin, "Century of Money," 598; Merrett, "Australian Banking Practice," 83–84.

<sup>73</sup> For the Commercial Bank, see Beever and Beever, "Henry Gyles Turner," 129–32. For the Union Bank see S. J. Butlin, *Australia and New Zealand Bank*, 318–19; and David Tolmie Merrett, *ANZ Bank: A History of the Australia and New Zealand Bank and Its Constituents* (Sydney, 1980), 47–48.

<sup>74</sup> David Tolmie Merrett, "The State and the Finance Sector: Evolution of Regulatory Apparatus," *Australian Economic History Review* 42, no. 3 (2002): 270.

banks, particularly the Associated Banks of Victoria, or external institutions, such as the London & Westminster Bank and the Bank of England.<sup>75</sup> Moreover, local banks issued notes that were fully convertible into coin. Robin Gollan wrote, “One of the responses to [the crash] was a demand for a national bank and currency, more emphatic, more extensive, and somewhat more precise than ever before.”<sup>76</sup> The constitution of the new federation of Australian colonies in 1901 gave power to the Commonwealth to make laws with respect to banking. Political parties from the right and the left in the federal parliament were thinking long and hard about creating a national bank. Sir John Forrest, Treasurer in Alfred Deakin’s Ministry of 1905–1907, was corresponding with the Bank of England on detailed points of policy regarding a national note issue.<sup>77</sup> The turn of the electoral cycle enabled the Labor Government of Andrew Fisher, with majorities in both houses, to introduce legislation in 1910 addressing the note issue and in 1911 establishing the Commonwealth Bank of Australia.<sup>78</sup>

In the half century after the 1890s crash, the Commonwealth Bank of Australia grew in stature and influence, with its powers significantly enhanced by amending legislation in 1924, before becoming a full-blown central bank in the early years of World War II. In hindsight, there was no grand plan. Geoffrey Sawer reflected, “In the period of its foundation, when particularly feared for its socialist implications, the Bank was least equipped to carry out its ambitious plans for economic control, and the Fisher government (to the disgust of the Bank’s ideological father, King O’Malley) had almost no notion how to use it for such purposes.”<sup>79</sup> Rather, the bank responded to the most pressing matters of the day, whether these were financing rural producers or raising war loans during World War I, or coping with the emerging problems facing the Australian economy in the 1920s and 1930s.<sup>80</sup>

<sup>75</sup>S. J. Butlin, *Australia and New Zealand Bank*, 142–45, 178–81. Bernard Attard, “Imperial Central Banks? The Bank of England, London & Westminster Bank, and the British Empire before 1914,” paper presented at the Eighth International Conference of the Historical Mission of the Bank of France, Paris, 15 and 16 Mar. 2012, <http://www.banque-france.fr/la-banque-de-france/histoire/mission-historique/colloques-et-publications/8eme-colloque-international-de-la-mission-historique.html>.

<sup>76</sup>Robin Gollan, *The Commonwealth Bank of Australia: Origins and Early History* (Canberra, 1968), 27.

<sup>77</sup>Reserve Bank of Australia, *Documents on Australian Monetary and Financial History*, vol. 1 (Sydney, 1993), Documents 4–9, 5–15.

<sup>78</sup>Geoffrey Sawer, *Australian Federal Politics and Law, 1901–1929* (Melbourne, 1956), 89–91.

<sup>79</sup>*Ibid.*, 91.

<sup>80</sup>C. C. Faulkner, *The Commonwealth Bank of Australia: A Brief History of its Establishment, Development and Service to the People of Australia and the British Empire under Sir Denison Miller, K.C.M.G., Governor, June 1st, 1912–June 6th 1923* (Sydney, 1923), 63–94 and 101–260.

There were a multitude of pressures, not least from the Bank of England, for the creation of a central bank in Australia. The Commonwealth Bank did evolve into a policy maker, with considerable independence from the governments of the day, on a range of monetary matters, refusing to fund government debt and devaluing the Australian pound in the Great Depression.<sup>81</sup> The power that the Commonwealth Bank exercised came from amendments to its governing legislation in 1924 and from the accumulation of skill and experience of its board and executive staff, most of whom were drawn from the second tier of private bank management. Private bankers fought as best they could against the growing diminution of autonomy in their affairs.<sup>82</sup> However, on the eve of the Japanese attack on Pearl Harbor, the private banks still enjoyed complete freedom from central bank control over the composition of their balance sheets, the ability to lend to whomever they pleased, and to set interest rates. Moreover, the Commonwealth Bank of Australia had no responsibility for prudential regulation.

The Australian government's inability to respond directly to the issues of financial instability for decades after the 1890s crash is a puzzle. This inaction contrasts with the political will to federate and to create a host of new institutions to deal with particular problems, such as regulating the labor market and setting minimum wages, forming the Loan Council to coordinate international borrowing by the states and the Council for Scientific and Industrial Research to promote research. Could it have been that gaining an understanding of what needed to be done about instability in the Australian financial system in the 1890s and 1900s was just too difficult? There were no easily identifiable models to adopt as the evolution of central banking in the northern hemisphere in the late nineteenth century was an intuitive and organic process shifting shape between countries and embedded within country-specific institutional frameworks.<sup>83</sup> In contrast, in the 1930s, Australian economists employed by universities and having strong intellectual links to Britain rose to the challenge of the policy issues created by the Great Depression.<sup>84</sup>

Could it be that customers, bankers, and governments, both politicians and bureaucrats, came to believe that because there was no repeat of the 1890s banking crisis as the years passed then all was well? The

<sup>81</sup> Schedvin, *Australia and the Great Depression*, 130–68.

<sup>82</sup> For a perceptive account from the point of view of the private banks in their dealings with the Federal government and the Commonwealth Bank of Australia, see S. J. Butlin, *Australia and New Zealand Bank*, 340–54, 356–59, 366–76.

<sup>83</sup> Charles Goodhart, *The Evolution of Central Banks: A Natural Development?* (London, 1985), Appendix B, 90–174.

<sup>84</sup> William Coleman, Selwyn Cornish, and Alf Hagger, *Goblin's Platoon: The Trials and Triumphs of the Economist in Australian Public Life* (Canberra, 2006), 107–30.

great shocks of the new century, two wars and a depression, did not result in a banking crisis. Post-World War II monetary policy imposed tight liquidity ratios as a by-product of its management of bank credit. When financial deregulation in the 1980s permitted banks to lend once again with abandon and doubts arose concerning the solvency of some banks, the Reserve Bank of Australia found its cupboard of prudential controls embarrassingly bare.

### Conclusion

Many commentators have expressed incredulity at the enthusiastic reception given by the Commercial Bank's shareholders at the Melbourne meeting to endorse the proposal to reconstruct. I argue that the legislature and the courts made critical decisions that determined the outcome of the 1890s banking crisis. The passage of the Company Act Amendment Acts, first in New South Wales, prior to the suspension of a major bank, determined the outcome of the crisis. Judges had little discretion to reject or amend the proposal to reconstruction once three-quarters of the creditors at the meeting voted in favor. Consequently, Australia had a far softer landing than it would have experienced if there had been wholesale liquidation of its banks in 1893.

The reconstruction schemes set the terms for the workout of failed banks. The bargain was that both creditors and owners shared the pain by deferring claims and ownership rights for lengthy periods. There were externalities associated with these contracts—the banking system continued to function and the private costs to the parties spilled over into the real economy. The reduced wealth of depositors and shareholders depressed spending. Analysts can estimate the loss of wealth suffered by depositors. The upsurge in the 1880s of British deposits held by Australian banks was a contributing factor to the excessive growth of credit and their term of maturity as a source of instability.<sup>85</sup> However, the negative wealth effect on the Australian economy was reduced by much of the loss falling on non-residents. British investors also held claims on other non-bank financial intermediaries who suffered losses. Not surprisingly, there was a large-scale withdrawal of British private portfolio investment from Australia before World War I.

The lack of a targeted response in the aftermath of the crisis or in subsequent decades remains a puzzle. On one level, the 1890s crisis solved itself through workouts whose parameters were set by a series of court-sanctioned private treaties between the parties involved. The economy eventually resumed growth. Australians muddled through. To

<sup>85</sup>Boehm, *Prosperity and Depression*, 275.



my knowledge, there was no articulated view that a private rather than a public intervention was the optimal response. On the contrary, at that time the character of the Australian polity had a decidedly interventionist bent. The powers of the state rose as a consequence of Federation in 1901, and political parties fought to use the authority and resources available to government. However, bank reform to provide for prudential regulation was lost among the plethora of other initiatives for generations, partly because, in the absence of another bubble generating widespread instability at the core of the financial system, Australian bureaucrats, bankers, and politicians continued to neglect prudential issues.

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