

# THE CRISIS OF 1847 IN EUROPE

Joaquín Pérez Cano

## Abstract.

This essay deals with the origin, development and end of the crisis of 1847 in different countries of Europe, from the point of view of the Austrian School of Economics. It can be observed that in all of them, the origin of the crisis is the same: the government action to emit public debt massively and lower interest rates below their natural level. Likewise, the evolution of the crisis is the same -with differences of a few months- in reaching its maximum aggravation. We can see how in all of them, there was a massive issuance of fiduciary money and an excess of investments in stages of production away from consumption,- in this case, the railways-.

Classification JEL: B53, E32

Key Words: Business cycle, 1847, public debt, fiduciary media.

## INTRODUCTION

This historical period, despite what John Stuart Mill writes in his *Principles of Political Economy*<sup>1</sup>, did not suffer a generalized crisis through Europe due to the bad harvests and the famine ..., but the cause was the great increase in the issuance of fiduciary documents (banknotes, debentures and public debt) without the backing of savings that would endorse them, when they were presented for redeeming or had to be repaid. In these previous years only a severe crisis had occurred in England (1825) and economists and politicians were not very familiar with the origin of that events. One of the only two central bank existing at that time was the Bank of England, but after this crisis there were created in all countries of Europe. Huge amounts of fiduciary media and public debt were introduced in the economy with terrible consequences for European citizens, producing a clear case of an "Austrian" business cycle. The interest rate fell below its natural value, which meant that investing was allocated in production processes far away from consumption, without existing previous savings in the economy that backed these investments, to

---

<sup>1</sup> Mill, John Stuart, *Principios de Economía Política*, pp. 459-460.

later detect that these were unviable, and therefore, to give way to a process of restructuring the economy to adapt to the true level of savings in it to these investments, to later detect that these were unviable, and thus, to give way to a process of restructuring the economy to adapt to the true level of savings that were in it.

## SPAIN

In Spain, the crisis began to develop when the government decided, first of all, to "centralize all credits" - in 1841 - by handing over titles to 4 percent; secondly, the Spanish holders of funds in London and Paris, were given 3 percent repayable debt for coupons due and not paid during the last five years; and third, -in 1844, by Royal Decree of June 26th-, it was decided to transform the floating debt, which amounted to 498.5 million reales into consolidated debt at 3 percent, debt that would not reimburse principal but would only pay interest.

By Royal Decree of June 26th 1844, were converted into consolidated debt at 3%, funds advanced at a rate of 35%; also canceled Treasury bills, centralized debt inscriptions and the ultramar turnings. Loans were canceled from floating debt and converted into consolidated debt, totaling 659.3 million reales. The conversion decrees were approved by law sanctioned and promulgated on February 14th 1845. All the values of the conversion of public debt went to the Stock Exchange; almost 2,000 million reales in 'paper' was suddenly quoted in the market, so everyone began to speculate on the stock market -bankers, politicians, literati, ministers, journalists, etc.-<sup>2</sup>, getting to negotiate some days until 200 million reales. During the week of October 28th to November 2nd, 1844, 212 million reales of public debt were traded at 3%, 12 million in bonds at 5% and 7.7 million reales in Treasury Debt. Throughout the year of 1844, 15 billion reales were traded<sup>3</sup>. In 1844, in the Stock Exchange of Madrid, only the shares of the Bank of San Fernando and the titles of Public Debt were quoted.

At the same time as this feverish rise of the stock market was taking place, the railways were being built in Spain; the investments that were made were important. On April 6th 1845, José Salamanca was granted the rail line Madrid-Aranjuez. The society for the realization of this infrastructure was constituted by José Salamanca in April 1844, with the name "Camino de Hierro de Maria Cristina", with a capital of 45,000,000 reales. In May 1846, construction began with

---

<sup>2</sup> Torrente Fortuño, José A., *Salamanca, bolsista romántico*.p.67.

<sup>3</sup> op.cit.p.90.

25 men, after a few days had been hired more than 500 and the following month, the number of men working in the construction of the railway was 7000<sup>4</sup>. The works were paralyzed at the end of 1847, then, Jose Salamanca resorted to the government to be able to continue the works; which granted him loans through the Banco de San Fernando. In Barcelona, a little earlier, specifically on August 13th 1843, had formed the company “Caminos de Hierro a Mataró”, with a capital of 20,000,000 reales. On June 27th 1845, the company was authorized to start construction of the railway after the government approved the budget, which amounted to 19,000,000 reales<sup>5</sup>. Likewise, in that period before the crisis of 1847, in 1846, in the north of Spain, the company operating the railroad Gijón and Villaviciosa to Sama and Mieres was established, with a branch to Oviedo, whose concession had been granted to Vicente Beltrán de Lis y Rivas in the year 1845. Other companies were created in order to exploit the railway: English companies were the ones that operated the Madrid-Valencia line, whose president was Luís Mayans; the Madrid-Badajoz line, called “Camino de Hierro del Centro de España”, whose director was Duc of Frias; the Barcelona-Camprodón line and the Madrid to Barcelona one; French companies were the Madrid to Cádiz line, the Figueras to Murcia one and the San Juan de las Abadesas to Rosas.<sup>6</sup>

On the other hand, the banknotes in circulation increased considerably. In the Banco de San Fernando, they went from 17 million reales from 1841 to 24.5 million in 1843, 60.2 million in 1845 and 80 million reales in 1846. In addition, loans to the public sector meant more of 50% of the Bank's Total Assets in 1846, with an amount of 223.7 million reales. In the Bank of Isabel II there were metallic shortages at the end of 1845. Two directors of the Bank sold their shares, thus, they resigned their position. It began not to pay the "cédulas" (notes) in cash in that date. José Salamanca requested several loans to the Bank -30 million reales - with a 3% Public Debt guarantee, on the shares of his company "Caminos de Hierro de Aranjuez" and on the Bank of Isabel II's own shares, which were valued to 75% of its nominal as of November of 1846. This had loaned 12 million reales to the Bank of San Fernando, reason why it proposed - if its clients accepted it - that the notes of this last one, as well as his cheques were used like they were "metallic". In February 1847, in the absence of cash, the Bank of Isabel II authorized the management of the same to purchase gold and silver bags, which meant a cost of 78,000 reales. The Bank's Commission reduced its operations, applied for a cash loan in Madrid at 9% of interest and brought some more remittances from Bayonne. The shortage of cash was such that a loan was

---

<sup>4</sup> Hernández Girbal, F., José de Salamanca, p.275.

<sup>5</sup> Casares Alonso, Aníbal, *Estudio histórico-económico de las construcciones ferroviarias españolas en el siglo XIX*, pp. 63-65.

<sup>6</sup> Hernández Girbal, F., *José de Salamanca*, p.275.

requested again in metallic money in the amount of 14,423,540 reales at an interest rate of 9%. According to the Acts of the Bank of Isabel II the maximum amount of cash in "Caja" was in March 1846, with 97.4 million reales; in May there were 83.5 million, to decrease later to 10.5 million reales in June of the same year; and 6.5 million in October 1846. Subsequently the balance of metallic money increased to 13.5 million reales. In 1847, in February, the balance continued to decrease and there were only 2,766,857 reales in metallic money and 54,5 million reales in notes.

On December 30th, 1845, by Royal Order, the Bank of San Fernando became the "bank of the Government" for the whole year 1846. In addition, on August 3rd, 1846, the Bank of San Fernando increased the issue of banknotes to 80 million reales. Besides to this increase in the fiduciary media, in January 1847, the Banco de Fomento and Banco de la Unión - which, despite their names, were credit societies - issued bearer payment orders or nominal that like what happened in Valencia - circulated like bills.

The Bank of San Fernando brought gold and silver from France for an amount of 36 million reales in exchange for 3% Public Debt securities. Rothschild also lent the Bank on February 12th 1846, 10,600,000 reales at 9% interest; also paid another 10,789,291 reales of accepted promissory notes to various merchants. In 1846, the deposits of the Bank of San Fernando had increased remarkably, going from the 19.6 million reales to 37 million; likewise, loans to the public sector increased from 144.1 million in 1845 to 223.7 million in 1846; also, the bills to be negotiated also increased to 50.2 million reales. At the end of 1846, the Bank of San Fernando had in "Caja" 87 million nominal reales of Public Debt of 3% and 124 million in coupons. The Public Debt securities could be valued at 33% of nominal and coupons at 18%, with which, in the treasury - at market price-, would be about 45 or 50 million reales. However, the Bank of San Fernando had agreed with the Rothschild House the sale in Paris of Public Debt of 3% with a discount of less than 30%. This was done and 30 million reales in metallic money were deposited. Also, and through third parties (not to create panic) was proceeded in Madrid on the sale of titles of 4 and 5%. This cash revenue slightly eased the Bank's financial situation during the last months of 1846, but in February 1847, the situation worsened again: the stock market boom of previous years turned into a drop in the price of the Public Debt of 3% of the 27%.

During the year 1847, the situation of the two banks of Madrid was critical; to the Bank of San Fernando, the Treasury owed him 166 million reales and, faced with the shortage of metallic money in which he was, he used the collection of contributions to improve his situation. The

Bank of Isabel II could not appeal to this resource, so they went to the government for help<sup>7</sup>. In view of this situation, Minister Ramón Santillán suggested and effected the merger of both banks.

During the years before the crisis, everyone had been interested in buying and selling shares of companies - no matter what they were doing - or Public Debt. The only thing that was intended was that shares went up on the Stock Exchange<sup>8</sup>. It was lent on the same ones regardless of whether or not they had been fully disbursed: the only thing taken into account was the stock market listing. Panic appeared in March 1848, following the events of the revolution in France. Bankruptcies became widespread. The Public Debt of 3% declined in its price by 6% and continued to fall because the one in France was returning to the Madrid Stock Exchange<sup>9</sup>. Metallic money disappeared from circulation; the notes were rejected and those that were accepted, they were with a great discount. The blame for everything that happened was attributed to the stock market, so the government decided on 24th March 1848 to prohibit the forward operations of the Public Debt, which ..., further aggravated the situation !

In Spain, there was a period of "Austrian" economic cycle, caused by the excessive issuance of fiduciary money without the existence of metallic money to support it. The circulation of banknotes in Madrid had gone from 24 million reales in January 1844 to 110 million reales in September 1844, of which 50 million corresponded to the Bank of Isabel II<sup>10</sup>. It went from issuing 10 million reales in 1844 to issuing 27.5 million reales in 1846; the Bank of Barcelona went from issuing 2.75 million reales in 1846 to 7.7 million in December 1847. Also, during that period, numerous credit companies issued bonds, which circulated as notes in the market. Specifically, in Valencia, the "Compañía Valenciana de Fomento", -created in May 1846-, had a dual mission: investment banking and commercial banking. This Company invested more than 50% of its capital in the Drinking Water Company. The company's share capital was fully subscribed by the Sociedad Valenciana de Fomento. The credit companies financed the industry, but also promoted the constitution of corporations, subscribing shares and obligations that later sold in the market. Likewise, in Cadiz, at the same time -1846-, the "primitive" Bank of Cadiz issued "documents" payable at sight which circulated as bank notes.

---

<sup>7</sup> Zumalacárregui, Leopoldo, *El Banco de Isabel II y la crisis de la banca de emisión de 1847*, pp.215-225.

<sup>8</sup> Pastor, Luís María, *Filosofía del Crédito*, p.226-227.

<sup>9</sup> op.cit., p.229.

<sup>10</sup> Tedde, Pedro, *El Banco de San Fernando*, p.159.

## UNITED KINGDOM

In England had been the same as in Spain, ... rather, in Spain was happening as it was in England, due to it was here where the Industrial Revolution had emerged and was a more advanced country in industry and the financial system . A few years earlier than in Spain, it was planned to invest in the rail network about 200 million pounds, of which 80 million had already been invested in 1846. By 1844, 37 applications had been approved for the creation of railway companies, with a planned investment of 13,981,000 pounds; 118 applications had been approved in 1845, with a planned investment of 45,849,000 pounds. By 1847, 1,118 new railroad companies had been registered, not only in the United Kingdom but also in that year, the formation of 270 railway companies had been approved by parliament, which authorized them to build 4,500 miles of roads, with an expected investment of 95,625,934 pounds, an amount which could be added by new loans 36,087,272 million more<sup>11</sup>.

Sir Robert Peel reported on January 26th, 1847, that a total of 815 new business applications had been submitted for government approval for the construction of 20,675 miles of railway line, with an investment of 350 million pounds. Excessive investment was taking place in production stages away from consumption, caused by an artificial decline in the natural rate of interest on the market. All this investing fever in the railway companies was encouraged by a commercial law that allowed the payment of only 5% of the shares bought (May 1844), leaving the remainder to be disbursed, favoring leverage and speculation with the shares of the railway companies. The government, in view of the speculation that was taking place, raised the requirement to disburse the shares to 10% in July 1845. Interest rates for discount bills were at 2.5% and for The notes were 3% up to September 1844. Interest rates were lowered to 2.5% for both types of documents in March 1845, increasing to 3% in October of that same year. Subsequently, they were raised to 3.5% in November and remained at that rate until the end of August 1846. Then they fell back to 3% and were not raised again to 3.5% until January 14th 1847, to raise them again to 4% on January 21st 1847, which lasted until April<sup>12</sup>. On April 8th of that year, interest rates for 95-day bills were raised to 5%; meanwhile, the market interest rate during those months was at 7%!

The bank reserve was at its lowest on April 17th, 1845, its amount was 2,558,000 pounds, but when raising the interest rate, gold ceased to leave the country; it recovered in the month of June, but fell sharply from July 1st, 1845. Afterwards it increased again in September to

---

<sup>11</sup> Grote Lewin, Henry, *The Railway mania and its Aftermath*,p.115

<sup>12</sup> Clapham, John, *The Bank of England*,p.200.

8,190,000 pounds in the issuing department: 591,000 pounds in currencies and 4,112,000 pounds in banknotes at the banking department. On August 2nd, the Governor of the Bank of England set the interest rate for 1-month bills at 5%, 5.5% for two-month bills and 6% for three-month bills. The General Assembly set the general minimum rate on August 5th at 5.5%.

But by the autumn of 1845 the first signs were already emerging that the speculative fever in the railway companies was coming to an end. The construction costs of most railway companies had increased by 50%, with the result that the share price of these companies began to decline. Share prices between August and the end of November fell 18%. Fear began to emerge in the market due to the decline in the price of shares, which were already discounted. The government passed a law to "facilitate the dissolution of certain railway companies," by which a company could be dissolved with the approval of three-fifths of the shareholders, through the provisions of the Bankruptcy Act or through Of the rules governing the termination of the partnership through mutual consent.

In October 1847 there was a great shortage of metallic money. Several financial institutions declared their inability to meet their debts and panic seized the market. The bankruptcies of the companies during the month of September 1847 presented debts of about 10,000,000 pounds. The Bank of England's reserve banknotes had fallen from £ 4,466,000 on September 11th to £ 3,409,000 on October 2nd; in this case, the bank reserve of banknotes was, on October 23rd, 1847, at 1,547,000 pounds. Gold and silver coins had also declined in the banking department, from £ 562,000 on September 11th to £ 447,000 on October 23rd.

The Royal Bank of Liverpool suspended payments, even though the Bank of England had lent it Public Debt Consolidated for £ 300,000; even so, it broke. ( This bank had a disbursed capital of £ 600,000 and had lent to a single company £ 500,000 ). Two more banks in Liverpool also broke. In Newcastle, three days later, the Newcastle Union Bank suspended payments. London banks held out, but many companies of all kinds broke. People crowded into the doors of the banks of Manchester and Liverpool to withdraw their deposits.

From September 15th, 1847, to October 25th of the same year, the Bank of England lent about £ 2,255,000 through various means, such as mortgages and non-mortgaged property, with an interest rate ranging from 5 at 9%; additionally £ 400,000 in Consolidated Public Debt. Stock and commodity markets collapsed. Panic was aggravated, as the banks of Scotland sought help from the Bank of England. Help requests were generalized to the latter and to the banks of the city of London. Two intermediaries of bills broke and the rest discounted nothing. The Bank of England did so only with that "paper" which fulfilled its requirements, thus most of the bills were rejected. In October 1847, the Bank of England was in a critical situation because of the decrease

in reserves - both in notes and in coins-. Notes had gone from £ 2,630,000 on October 13th to £ 1,547,000 on October 23rd and £ 1,176,000 on October 30th. Coins had gone from 447,240 pounds on October 23rd to 429,384 on October 30th. Also, private deposits at the Bank of England amounted to 8,580,000 pounds by the end of October. Then, on October 22nd, the bankers went to Downing Street to ask for a "relief" in the implementation of the Charter Bank Act. Immediately after the government sent a letter to the Bank of England requesting the increase of discounts and loans on some securities and that the interest rate should not be less than 8%. The Bank of England replied on the same day October 25th, responding that the discount rate for bills less than 95 days would be 8% and that loans of bills, stocks or Exchequer bills in amounts over 2,000 pounds would be made at a rate above 8%. Bankruptcies in October had been very numerous. The interest rate of the few operations that were carried out that month, before the "relaxation" granted by the Bank of England, was around 60%.

During the month of November the situation improved in the money market, although the bankruptcies did not stop completely. The Scottish banks had also improved with the intervention of the Bank of England. On November 20th its cash reserve had increased to £ 4,228,000 and bullion up to £ 10,000,000. On November 23rd, the Bank of England agreements were repealed on October 25th, and the day before this decision was taken, the Bank directors reduced the interest rate to 7%. In December 1847 the effects of the crisis have not finished, but its severity had passed.<sup>13</sup>

## FRANCE

In France, since 1843 the interest rate had been set at 3%. There was an abundance of "money" in the market; everything was paid in "cash" and any commercial effect was discounted. During the year of 1845, numerous investments were made in railroads, highways and ports and canals (by December 31st, 1846 298,600,000 francs had been invested in the railways). From the second half of 1846 the financial situation of the business worsened. The enthusiasm for the rail-

---

<sup>13</sup> Morier Evans,D, *The Commercial Crisis of 1847-1848*,p.107.

way concessions was extinguished after seeing that the expected costs and revenues were not what was foreseen (the Paris-Orleans and Paris-Lyons companies were in bankruptcy).

Savings Banks collapsed and in the spring of 1848 because the government was taking the savings in them through the General Deposit Savings Bank in order to purchase public debt, which had increased from 85 million francs in April 1847 to 325 million in February 1848. Most banks in Paris and the provinces had suspended payments. The prices of securities fell during the first half of 1848. In May, due to paper money was rejected in economic transactions, the government decreed the suspension of metallic money payments and approved the legal tender of banknotes, wherewith its circulation increased again from 250 million francs from 1847 to 500 million in August 1850 - the date when legal tender was abolished-. 733 million francs had been discounted and the cash reserve of the Bank of France had declined from 279 million francs in 1844 to 57 million in January 1847. The circulation of banknotes amounted to 311 million francs. The discounts of the Bank of France amounted to 256 million francs in 1847; the money supply was 4.45 billion francs, the floating debt in February 1848 to 959,067,921 francs. In view of this financial situation, the Bank of France ordered 5 million francs of gold and silver from the provinces to Paris, requested 25 million francs from English financiers, and coined 15 million francs in silver coins which were worn by its use. The finance minister authorized to convert the silver, jewels and ingots of the royal residences into money. At the same time, and in view of the extreme gravity of the situation, the Board of the Bank of France decided to raise interest rates - after twenty-seven years - from 4 to 5% on January 14th, 1847; from this moment, the metallic reserve began to increase: of the 57 million francs that had a metallic reserve on January 15th, 1847 was increased to 110 million on March 16. Discounts fell in the first half of the year from 735 million francs to 701 million in the second half of 1847.

As the economic situation improved at the end of the year, the discount rate was reduced to 4% on December 27th, 1847. The nine departmental banks that existed suspended the metallic money payment of the notes and after six weeks they were absorbed by the Bank of France, which extended its privilege of emission to all the nation in May of 1848.

## CONCLUSION

In this essay we can observe how an "Austrian" economic cycle occurred in different countries of Europe - simultaneously or with very few months of difference-. This was promoted by the central banks of these countries or by the government - in the case of Spain when issuing public debt massively in the market -, with the consequences that had in the reduction of the interest rate below its natural rate. These low interest rates artificially established, led to the realization of huge investments in production stages away from consumption, which, when the savings in the economy became evident, broke down, resulting in a fierce struggle for savings and the resources that actually existed in the economy, liquidating the bad investments made in the period of monetary expansion. All this process meant for European societies a great impoverishment, due to the misallocation of resources as the normal functioning of the market economy did not work properly.

## BIBLIOGRAFY

Cameron,Rondo (1971[1961]), *Francia y el Desarrollo Económico de Europa 1800-1914*, editorial Tecnos, Madrid

Caron, François (1979), *An Economic History of Modern France*.Methuen & Co. Ltd.,London

Casares Alonso, Aníbal (1973), *Estudio Histórico-Económico de las Construcciones Ferroviarias Españolas en el Siglo XIX*, Instituto Iberoamericano de Desarrollo Económico, Madrid.

Clapham, John (1944), *The Bank of England*, Cambridge University Press, Cambridge.

Clapham, John H. (1961[1921]), *The Economic Development of France and Germany 1815-1914*, Cambridge University Press,Cambridge.

Dimsdale, Nicholas y Hotson, Anthony,eds.(2014), *British Financial Crisis since 1825*, Oxford University Press, Oxford.

Fortuño, Torrente (1969), *Salamanca, Bolsista Romántico*, Taurus ediciones,Madrid.

Juglar, Clement (1862), *De Les Crises Commerciales et de leur Retour Périodique*, Guillaumin et Cie., París.

Hernández Girbal,F (1992), José de Salamanca, ediciones Lira,Madrid.

Kinnear, John G. (1847), *The Crisis and the Currency with a Comparison between the English and Scotch systems of Banking*, John Murray, London.

Mill, John Stuart (1996[1848]), *Principios de Economía Política*, Fondo de Cultura Económica, México.

Morier Evans, D. (1848), *The Commercial Crisis 1847-1848*, Letts, Son & Steer, London

Pastor, Luis María (1858) *Filosofía del Crédito*, Imprenta de los señores Matute y Compagni, Madrid

Tedde, Pedro (1999) *El Banco de San Fernando*, Alianza editorial, Madrid.

————— (2015), *El Banco de España y el Estado Liberal (1847-1874)*, Gadir editorial, Madrid.

Zumalacárregui, Leopoldo (1952), *El Banco de Isabel II y la Crisis de la Banca de Emisión Española de 1847*, Gráficas Reunidas, S.A., Madrid