Three Crashes: 1907, 1929, 2008

What can we learn?

Presented by Miguel Cantillo

Nov 11, 2008
Three Crashes (DJIA = 100 at Top)

- Subprime Crash 2007:10
- Great Depression 1929:08
- Bankers Panic 1906:01
<table>
<thead>
<tr>
<th>Event</th>
<th>Boom</th>
<th>Change GDP %</th>
<th>Contraction</th>
<th>Change GDP %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bankers Panic</td>
<td>1897-1907</td>
<td>62.74</td>
<td>1908</td>
<td>-8.60</td>
</tr>
<tr>
<td>Great Depression</td>
<td>1921-1929</td>
<td>59.31</td>
<td>1930-1933</td>
<td>-26.55</td>
</tr>
<tr>
<td>Subprime Crash</td>
<td>1991-2007</td>
<td>62.30</td>
<td>??</td>
<td>??</td>
</tr>
</tbody>
</table>
Common Factors

- High Previous Growth
- Bubbles in Commodities, Real Estate.
- Preceded by Merger Wave
  - Do all Merger Waves end with Crashes?
  - Merger Wave -> Industrial Shocks.
- Banking is the weakest (?) link.
- Political change
Debate about Great Depression
- Friedman and Schwartz (1963): Fed did too little
- Keynes (1936): Exhausted Consumption & Investment
- Schumpeter (1939): Exhausted Investment Possibilities
- Bernanke (1983): Banking Crises
- Eichengreen (1992): Protectionism

Will only look at Bankers Panic

Concept of Trust is ambiguous
- Voting Trust
- Corporate Trust form
- Financial Trust
Merger Movement 1893-1903

- Big Industrial Corporations (Chandler 1976)
  - Take advantage of lower transport cost (RR)
  - Telegraph

- Horizontal Mergers
  - 1800 firms make 93 Corporate Trusts
  - Tobacco, Oil, Food, Electric, Telephone.
  - Middlemen eliminated.
  - Lamoreaux (1985) Mergers are rational.
Financial Trusts: The Banks of the Rich

- Made in 1890s under liberal banking laws.
- Could invest in speculative assets.
- Avoided by individuals.
- Insurance companies and Trusts.
  - Insurance deposits with Trusts.
  - Insurance officers invest individually with Insurance loans.
Banking without a Central Bank

The pecking order was
- Rural banks: high reserve requirements
- Reserve City Banks: medium reserve requirements, received rural bank deposits.
- Money Center Banks (NYC) collected most of the money.

Clearing Houses
- Trusts did not have clearing house privileges
- Settled with cash
Political Climate

- Republican Dominance post Civil War.
- Sherman Act of 1890.
- Debate about Gold Standard.
- Theodore Roosevelt:
  - Antitrust
  - "Malefactors of Great Wealth" speech.
The Armstrong Investigation

- Conflicts of interest of insurance officers.
- April 1906: forbade Insurance companies
  - Underwriting securities.
  - Buying corporate stocks and collateral bonds.
- January 1906: Peak of DJIA
The San Francisco Earthquake

- April 18, 1906.
  - Money in West temporarily locked
- European Insurers liabilities means that they must send money to the US.
- Bank of England
  - Oct 19, 1906: raises rates from 4 to 6%
  - Concerned by the loss of gold reserves
  - Summer 1907: forbids US finance bills
- Silent Crash (30% from 1906.01 to 1907.09)
The United Copper Corner (10/1907)

- **Augustus Heinze (Copper Fortune)**
  - Owner, Otto Heinze & Co. (NYSE seat)
  - Owner, Mercantile National Bank
  - Director of at least 28 financial institutions.

- **Charles W. Morse (Ice King)**
  - Controlled National Bank of North America
  - New Amsterdam National Bank
  - Chain Banking

- **Charles T. Barney**
  - President of the Knickerbocker Trust Co.
  - Third largest Trust Co. in New York City

- **Gross & Kleeborg: Broker for the Corner**
Two Weeks of Panic: Bank Runs on the Manipulators

- Oct 15: Gross & Kleeborg closes
- Oct 17: Heinze is discovered
  - Otto Heinze & Co. suspended
  - State Bank of Butte insolvent
  - Clearing House stands by Mercantile Bank
- Oct 21: Morse is discovered
  - Runs on National Bank of North America, New Amsterdam National Bank
- Oct 22: Knickerbocker discovered
  - Run begins,
  - Strong studies it, finds it insolvent
Two Weeks of Panic: Bank Runs on Innocent Bystanders

- Oct 22 (Tuesday)
  - Run on Trust Co. of America
  - Appeal for help from J. Pierpont Morgan
  - Examined by Benjamin Strong, Bankers Trust
  - $3MM injected in 20 minutes

- Oct 23 (Wednesday)
  - Morgan convenes with Trust presidents,
    - Trusts unwilling to lend to Trust Co.
  - Westinghouse declares bankruptcy
  - Pittsburgh Stock Exchange closes
  - Run on Lincoln Trust Co.
  - NYC unable to pay salaries
Morgan Library
Two Weeks of Panic: Liquidity

Oct 24 (Morgan Library)
- Trust Presidents agree to lend $10MM to Trust Co. of America.
- Banks agree to lend $23 MM to NYSE Brokers
- 8 Banks fail
- Call rates reach 100%

Oct 25 (Friday)
- Banks lend $9.7MM to Brokers
- 7 banks fail
- Bankers impose 60 day withdrawal notices
Two Weeks of Panic: the Weekend

Oct 26 (Saturday)
- Banks: impossible to keep up with bailouts
- Convince clergy to preach on Sunday.
- Agree to use scrip to settle in Clearing House.

Oct 28 (Monday)
- Bankers learn that NYC is insolvent
- Morgan, Citi, First National Bank lend $30MM, backed by Clearing House Certificates
Two Weeks of Panic: Moore & Schley

Nov 2 (Saturday)
- Moore & Schley (broker) near collapse
- Collateral is Tennessee Coal & Iron (TC&I)
- Proposed that US Steel buy TC&I
  - US Steel executives (Gary & Frick) opposed
  - Need Roosevelt approval (antitrust)
- NY State Bank Examiner suppresses report
- Strong presents the state of Trusts
- Morgan locks library until Trust presidents resolve situation.
The Resolution

- Nov 4 (Monday)
  - London: sharply lower American stocks in LSE
  - Implies massive stockbroker failures
  - 11 am: Roosevelt OKs US Steel purchase of TC&I.

Summary
- $350 MM have been withdrawn from banks
- $300 MM stashed by individuals
- Treasury only had $5 MM
- Banks create money like instruments
Lessons

- Let insolvent financial institutions fail.
- Defend healthy institutions.
- Liquidity important
- Asymmetric Information
  - Among bankers (medium)
  - With the public (high)