



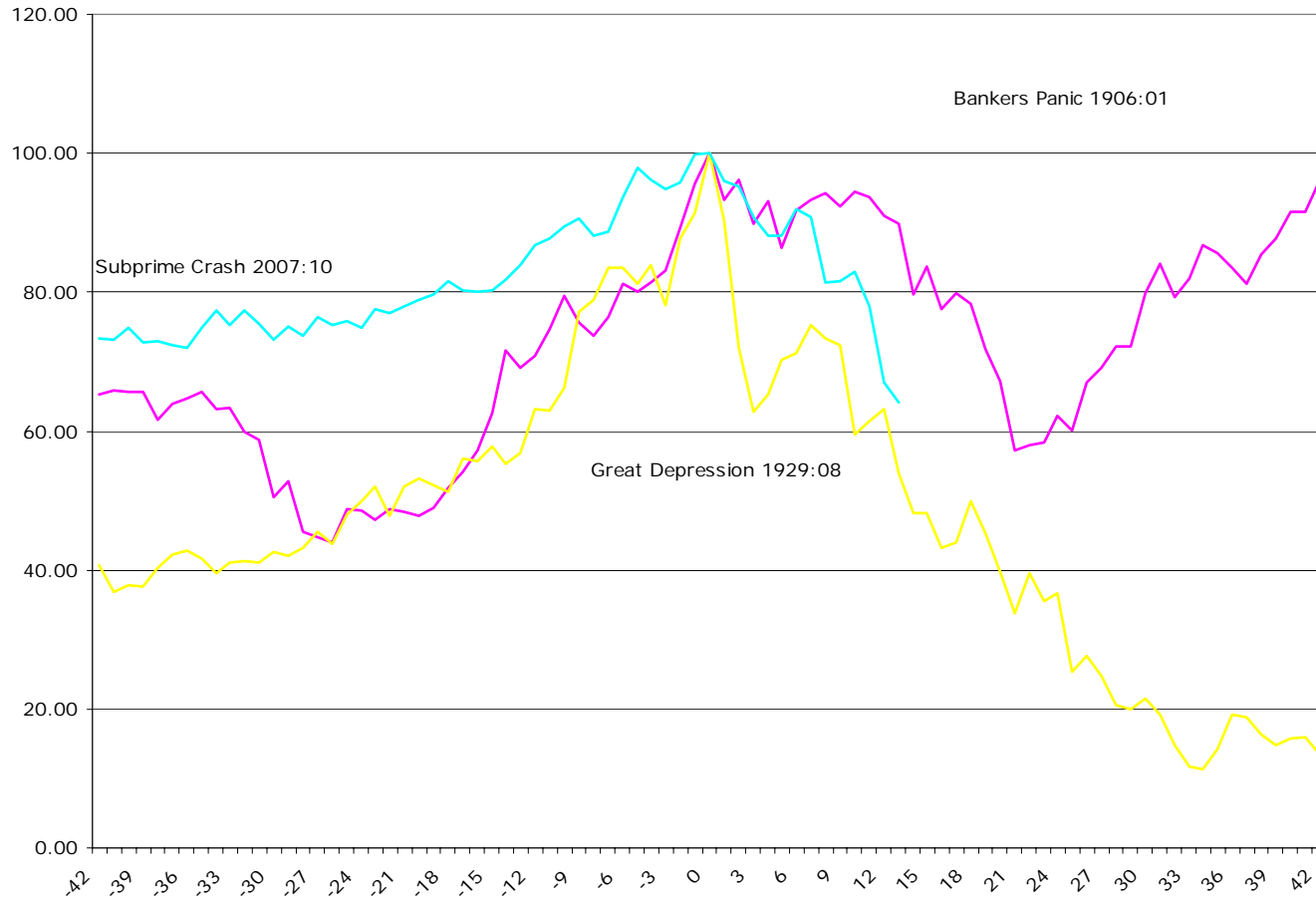
Three Crashes: 1907, 1929, 2008

What can we learn?

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Three Crashes (DJIA = 100 at Top)



GDP Changes

Event	Boom	Change GDP %	Contraction	Change GDP %
Bankers Panic	1897- 1907	62.74	1908	-8.60
Great Depression	1921- 1929	59.31	1930-1933	-26.55
Subprime Crash	1991- 2007	62.30	??	??

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

Notes



- **Debate about Great Depression**

- Friedman and Schwartz (1963): Fed did too little
- Hayek (1984): Fed did too much
- 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

9.6.1905 - 2.26.1906

- 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

Knickerbocker Trust Co.



Two Weeks of Panic: Bank Runs on the Manipulators

- United Corner (12-15 Oct) Fails.
- 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)