Chapter 1

Wall Street Oligarchs

A man I do not trust could not get money from me on all the bonds in Christendom.

—J. Pierpont Morgan[1]

In 1907, the young American economy was roaring. Between the mid-1890s and the end of 1906, the nation's annual growth rate was a stunning 7.3 percent, which had doubled the absolute size of all U.S. industrial production during a relatively brief period. The volatility of this growth also leaped from just over 6.5 percent to 8.0 percent per year—although, relative to the high rate of growth, this economic volatility was slightly lower than what it had been during much of the nineteenth century. Even so, compared with previous periods of major industrial expansion, the U.S. economy in 1907 was larger and growing faster than ever (see Figure 1.1).[2]

With the dramatic growth and economic development of the United States at the turn of the century came an enormous demand for capital. In 1895 the U.S. economy added \$2.5 billion to its fixed plant and inventories, and by 1906 the annual rate of capital formation was running at nearly \$5 billion, a blistering pace (see Figure 1.2). Much of this was

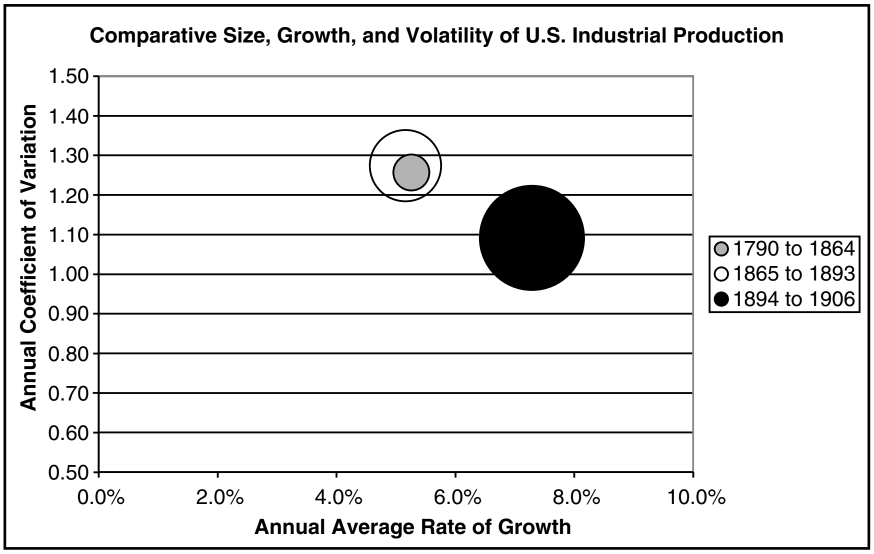

Figure 1.1 Comparative size, growth, and volatility of U.S. industrial production.

NOTE: The size of the circles indicates the relative size of the U.S. industrial production at 1864, 1893, and 1907 respectively. The growth rate is the compound average over each period. The coefficient of variation is a measure of relative volatility of growth (calculated as the standard deviation of growth rates divided by the compound average rate of growth for the period).

SOURCE: Authors' figure based on data from NBER, David Industrial Production Index.

financed by the country's exports, which appeared as a bulging current account surplus after 1895. But even exports were insufficient to finance the very large growth rate in the formation of capital in 1905 (12.7%) and 1906 (21.8%).

Into this prodigious vacuum moved a tightly knit network of financiers in New York and London who possessed the sophistication and credibility to raise the necessary funds for America's factories and infrastructure in the world's capital markets.* Their success in attracting foreign capital to America's "emerging market" was reflected in the immense importations of gold in 1906:† the inflow of gold to the United States spiked sharply upward to $165 million, dwarfing all gold flows after the Civil War, except during the year of a significant economic downturn in 1893.

* In part, the financial houses these financiers built served as a certification of quality that the securities of U.S. firms being sold in Europe were attractive investment opportunities

† Gold was typically imported through the sale of bonds or other promises to repay.

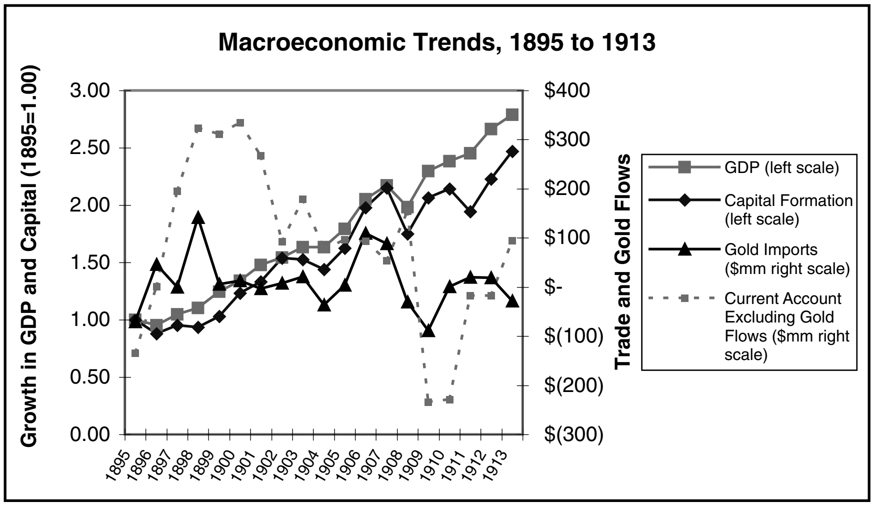

Figure 1.2 Macroeconomic trends, 1895 to 1913.
SOURCE: Authors' figure based on data from NBER Macro History Database.

America's rapid industrialization during this period also hastened the emergence of business entities of unprecedented scale, complexity, and power. Between 1894 and 1904, more than 1,800 companies were consolidated into just 93 corporations.[3] Some of these large firms had grown by buying up smaller competitors during times of economic distress, while others were organized by financiers seeking to control competition and build efficiencies of scale.* Much of the volume of new debt and equity financing for these large corporations again flowed through a relatively small circle of financial institutions in New York, including J. P. Morgan & Company; Kuhn, Loeb & Company; the First National Bank; the National City Bank; Kidder, Peabody & Company; and Lee, Higginson & Company.[4]

In 1907, the informal but undisputed leader of this financial community in the United States was J. Pierpont Morgan, known to his family and friends simply as "Pierpont." A complex man, biographers have found unusual clues to Morgan's personality. Historian Vincent Carosso characterized him as a devoted family man, a "strong-willed,

* The companies these financiers organized were popularly called "trusts," which a leading economist of the day defined as "an organization managed by a board of trustees to which all the capital stock of the constituent companies is irrevocably assigned; in other words, the original shareholders accept the trustees' certificates in lieu of former evidences of ownership." [See Ripley (1916), p. xvii.] The first and most famous of these business entities was John D. Rockefeller's Standard Oil Trust, created in 1882.

affectionate, protective, and generous paterfamilias."[5] Biographer Jean Strouse divined that Morgan was estranged (but not divorced) from his wife, that he had amorous relations with other women, and at the same time was a prominent figure in the Episcopal church in New York City. Strouse also determined that Morgan suffered from periods of clinical depression—indeed, business and family letters are replete with open references to his bouts with the "blues." But all biographers are agreed that Morgan was a forceful personality.

Historian William Harbaugh wrote of Morgan, "What a whale of a man! There seemed to radiate something that forced the complex of inferiority . . . upon all around him, in spite of themselves. The boldest man was likely to become timid under his piercing gaze. The most impudent or recalcitrant were ground to humility as he chewed truculently at his huge black cigar."[6] Morgan's nickname in the street was "Jupiter," suggesting godly power. Once he reputedly dismissed the threat of a government inquiry with a comment to President Theodore Roosevelt that, "If we have done anything wrong, send your man [the attorney general] to my man [one of Morgan's lawyers] and they can fix it up."[7]

J. P. Morgan operated within a circle of talented professionals and influential figures in the New York and European financial communities, and he demonstrated great faith in their collective abilities to "fix things up." Biographer Frederick Lewis Allen described vividly Morgan's attitude about the role of the Wall Street oligarchs, of which he was the most prominent:

> Morgan seemed to feel that the business machinery of America should be honestly and decently managed by a few of the best people, people like his friends and associates. He liked combination, order, the efficiency of big business units; and he liked them to operate in a large, bold, forward-looking way. He disapproved of the speculative gangs who plunged in and out of the market, heedless of the properties they were toying with, as did the Standard Oil crowd. When he put his resources behind a company, he expected to stay with it; this, he felt, was how a gentleman behaved. His integrity was solid as a rock, and he said, "A man I do not trust could not get money from me on all the bonds in Christendom." That Morgan was a mighty force for decent finance is unquestionable. But so also is the fact that he was a mighty force working toward the concentration into a few hands of authority over more and more of American business.[8]

Two of the leading figures in Morgan's circle were George F. Baker, president of First National Bank of New York, and James Stillman, president of New York's National City Bank. Though Stillman and Baker were direct competitors of Morgan for securities underwritings, the three men commanded great mutual respect having worked together in business and on charitable boards. Morgan's son once told a biographer, "Mr. Baker was closer to my father than any other man of affairs. They understood each other perfectly, worked in harmony, and there was never any need of written contracts between them."[9] Baker and Pierpont Morgan were indeed warm friends; they respected each other and shared similar views on business matters. With Stillman, the relationship was perhaps more distant: "[T]hey did not always see eye to eye," wrote a biographer. "Their mutual attitude, however, was one of respect and a certain degree of friendship."[10]

Morgan's preference for the consolidation of power was matched by a record of consistent leadership in times of crisis and advocacy on behalf of investors. In 1893 Morgan stepped into the breach to help President Grover Cleveland raise gold in Europe as a means of resolving the deepening liquidity crisis facing the country. He was instrumental in the consolidation and reorganization of failed companies, most importantly railroads that had overexpanded prior to the depression of the mid-1890s. In the process, Morgan introduced firm discipline and an investor-oriented point of view. In one prominent exchange with a resistant railroad executive, J. P. Morgan, said, "*Your* railroad? Your railroad belongs to my clients."[11]

Morgan also sought actively to avoid what he viewed as "ruinous competition" by merging competitor firms to produce corporations whose names remain memorable a century later: American Telephone and Telegraph, International Harvester, American Tobacco, National Biscuit (Nabisco), to name a few.* In 1901, Morgan played a central role in the formation of U.S. Steel, the largest corporation in America. Capitalized at a value of $1 billion dollars, U.S. Steel was twice the size of the entire budget of the U.S. government in 1907. Carosso thus

* Other companies under the influence of Morgan also included Adams Express Co.; Atchison, Topeka, & Santa Fe Railroad; Baldwin Locomotive Co.; Chicago-Great Western Railroad; Erie Railroad; International Agricultural Co.; International Mercantile Marine Co.; Lehigh Valley Railroad; New York, New Haven, and Hartford Railroad; Northern Pacific Railroad; New York Central Railroad; Pere Marquette Railroad; Philadelphia Rapid Transit Co.; Public Service Corporation of New Jersey; Pullman Co.; Reading Railroad; Southern Railroad; United States Steel Co; and Westinghouse Co.

described J. P. Morgan's general approach to business consolidation:

> Conservatism . . . stood at the center of Morgan's general business views. If he had any fundamental, guiding business policy at all, it was to promote stability through responsible, competent, economical management, and to be aware of his obligations to an enterprise's owners and bondholders. There was nothing he disliked more than unrestricted competition and aggressive expansionism, which he considered wasteful and destructive. Morgan believed in orderly industrial progress, and he endorsed policies aimed at promoting cooperation. Large enterprises, he affirmed, should adhere to the principle of community of interest, not the Spencerian doctrine of survival of the fittest.[12]

Morgan was more than just a consolidator of existing businesses; he also played the role of venture capitalist. Not only were several Morgan partners investors in Thomas Edison's company, but Drexel, Morgan (the precursor to J. P. Morgan & Company) also served as the depository for the cash of Edison's firm, arranged loans for the company, facilitated foreign transactions, and helped to manage Thomas Edison's private wealth.* Morgan even helped Edison with mergers and acquisitions and underwrote the initial public offering for the Edison General Electric Company.[13]

By 1906, J. Pierpont Morgan was disengaging slowly from the day-to-day activities of his firm to attend to his passion for collecting art and literature, serving on boards of charitable institutions, and touring Europe. He relied heavily on his son, J. P. "Jack" Morgan Jr., to manage his firm's daily affairs, as well as his "right-hand man," George W. Perkins, a partner in J. P. Morgan & Company. On April 17, 1906, the aging Morgan turned 69 years old. By this time, he was unquestionably, according to one biographer, "the most powerful figure in the American world of business, if not the most powerful citizen of the United States. His authority was vague, but it was immense—and growing."[14] On the morning after his birthday, an historic catastrophe devastated the city of San Francisco, California, setting in motion a chain of events that would eventually call for all the power, wisdom, strength, and influence that Old Jupiter could muster.

* In the summer of 1882, Morgan himself patronized Edison's new technology, installing electric lighting in his Madison Avenue house, making it the first private house in New York City to be illuminated by Edison's new incandescent bulbs.