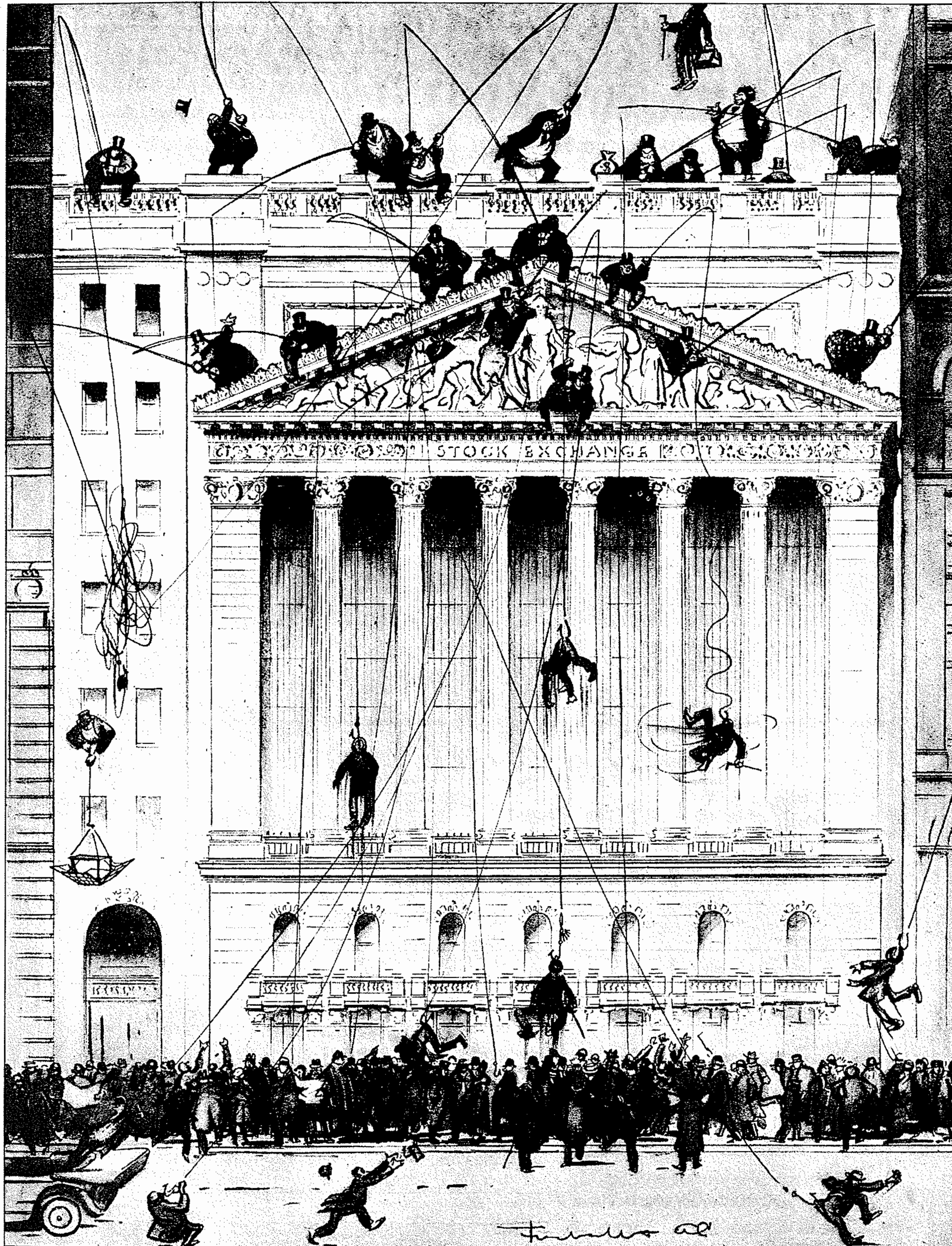


*A warning ignored: This 1921 cartoon showed Wall Street operators fishing for suckers.*

# American Finance

Michael Milken, the erstwhile junk-bond king who is now serving time in a federal prison, will likely go down in history as a symbol of the sins of the 1980s—greed, excess, and worse. Yet he also was the most significant figure in American corporate finance since J. P. Morgan. From Morgan's time to Milken's, financiers have sought the best way to finance, and by extension to manage, American business. That search, J. Bradford De Long argues, has been a hapless departure from sound beginnings; Roy C. Smith, however, contends that it has helped to create a more competitive U.S. economy.

## WHAT MORGAN WROUGHT

*by J. Bradford De Long*

They control the people through the people's own money," thundered future Supreme Court Justice Louis Brandeis in 1913. Brandeis, then a Boston corporate lawyer and an adviser to President Woodrow Wilson, was trying through a series of articles in *Harper's Weekly* to rally progressives for a political offensive to break the financial stranglehold that he thought the infamous Money Trust created by J. Pierpont Morgan held over turn-of-the-century America.

One year earlier, during the sensational Pujo committee inquiry into the Money Trust on Capitol Hill, Brandeis's fellow progressive, chief investigator Samuel Untermyer, had argued that Morgan, his partners, and their peers at a handful of smaller banks were directors, voting trustees, or principal shareholders of corporations capitalized at $30 billion—the equivalent, in proportion to the size of the economy, of $7.5 trillion today. Perhaps 40 percent of all industrial, commercial, and financial capital in the United States was in some way under the penumbra of this Morgan-centered Money Trust. The small fraternity of Money Trust bankers reaped immense profits. The commissions they earned on the creation of U.S. Steel in 1901 constituted as large a share of the economy then as $15 billion would today. The investment bankers of the 1980s did not reap even a fifth as much from the largest Wall Street deal of the decade.

Brandeis and other progressives saw the Money Trust's dominance as much more dangerous than any of the nation's other monopolies. Unlike the Sugar Trust or other one-industry monopolies, the Money Trust might ultimately subject every industrial firm in America to its will. Any

American corporation that sought to raise more than $10 million in capital in the early 20th century was forced to do so by hiring J. P. Morgan & Co. or one of a handful of smaller, and according to the reformers, loosely allied banks—such as Kuhn, Loeb; Kidder, Peabody; the National City Bank—to underwrite its stocks or bonds. If Morgan did not think a corporation deserved money, money would not be raised. The firm's expansion plans would not be carried out. The flow of investment in the United States was thus directed to industries and firms that Morgan and his counterparts wished to see expand, not elsewhere. The New York Central; Northern Pacific; Erie; and Atchison, Topeka & Santa Fe railroads issued their bonds under Morgan auspices and had Morgan representatives on their boards of directors. Morgan partners had strong voices in the selection of management and corporate strategy of American Telephone and Telegraph (AT&T), General Electric, and Westinghouse. Morgan masterminded the merger that created U.S. Steel in 1901. He helped gather the individual railroads of the United States into continent-spanning systems. Overall, Morgan and a small band of fellow financiers exercised a degree of control over corporate America not even remotely paralleled by any group since World War II. In Japan and Germany, however, the comparable forms of "finance capitalism" that arose in Morgan's day survive today more or less intact.

The rise of the House of Morgan matched the growth of the U.S. industrial economy. The half century before World War I saw America's population and standard of living both multiply fourfold. New capital and new businesses arose at a pace never seen before or since. Before 1890 the stock and bond markets were overwhelmingly dominated by railroads and government borrowings, and Morgan's father, Junius Spencer Morgan (1813–90), operating in London, became the leading banker channeling British savings into American railroads. When industrialization accelerated, pushing the stocks and bonds of U.S. Steel, International Harvester, General Electric, and other new corporations into prominence, the Morgan partnership rode the crest of the wave. And early in the 20th century, when the transatlantic flow of capital reversed, the House of Morgan was at the forefront, funneling American capital to Britain.

Junius's son, J. Pierpont Morgan (1837–1913), superintending the Morgan interests at 23 Wall Street in New York, was already the nation's leading railroad financier and maestro of industrial reorganization by the 1880s. The imperious Pierpont was, moreover, a leading banker not only for foreign governments wishing to borrow money in the United States but for the U.S. government itself. And at times, J. P. Morgan & Co. (or Drexel, Morgan & Co., as it was called before 1894) appeared more powerful than the government. When Congress temporarily refused to pay U.S. Army salaries in 1877, the House of Morgan did so. In 1894–95, when a sudden outpouring of gold from the U.S. Treasury threatened to create a domestic and international economic crisis, J. P. Morgan stepped in. And when the month-long Panic of 1907 left several important banks—and possibly the rest of Wall Street—teetering on the brink of disaster, Morgan, by then 70 years old, led a small group of bankers who did what Washington alone could not, lending enough money to the endangered institutions to see

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*J. P. Morgan at the funeral of a U.S. senator in 1911. Often in the headlines, he was rarely photographed, in part because a nose enlarged by a skin disease made him self-conscious.*

them through the crisis. So great was Morgan's influence that it seemed he could only be a god or a demon. On Wall Street he was worshipped (and feared). It was said that crowds parted for him as he barged down the narrow sidewalks of the financial district during the crisis of 1907. "God made the world in 4004 B.C.," *Life* magazine said, "but it was reorganized in 1901 by James J. Hill, J. Pierpont Morgan, and John D. Rockefeller." In Washington, Senator Robert M. La Follette (R.-Wis.), accusing Morgan and his peers of tripping off the panic themselves to further their own interests, claimed they had the power to "withhold and dispense prosperity."

Progressives were alarmed by the sheer size of the Morgan firm's interests. Brandeis, an advocate of small-scale capitalism, warned that the nation's future depended on "the freedom of the individual. The only way we are going to work out our problems in this country is to have the individual... free to work and trade without the fear of some gigantic power threatening to engulf him every moment."

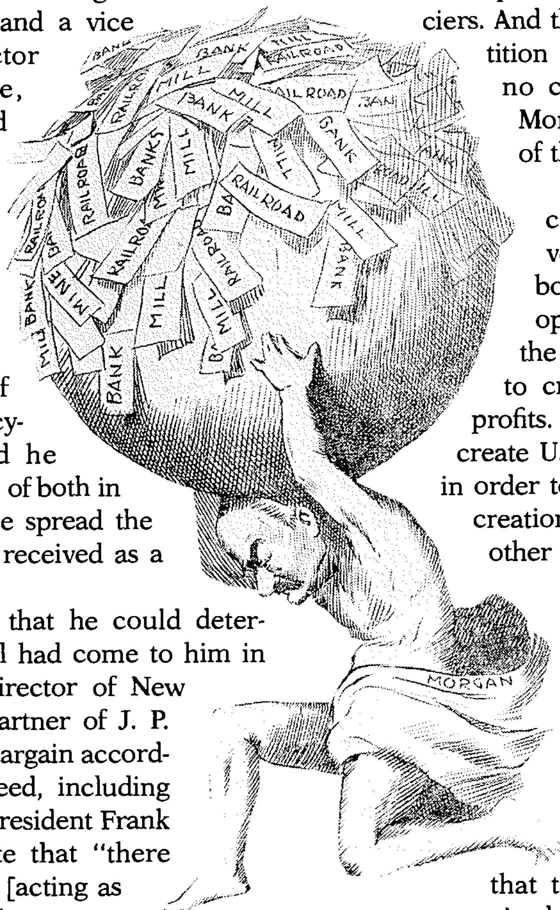
To Brandeis and his allies, the greatest danger was posed by the many conflicts of interest caused by the Money Trust's methods. First National Bank Chairman George F. Baker, a close Morgan friend and ally who was called Morgan's secretary of the

treasury on Wall Street, sat on the boards of six railroads that together owned 90 percent and carried 80 percent of Pennsylvania anthracite. How cutthroat was competition among these railroads likely to be?

George W. Perkins, a charming master manipulator of politics and finance, was both a Morgan partner during the first decade of the century and a vice president and director of New York Life, which invested heavily in securities underwritten by the Morgan partnership. Would Perkins advance the interests of his clients in his role as Morgan partner, or of New York Life's policyholders—or would he sacrifice the interests of both in order to increase the spread the Morgan partnership received as a middleman?

Perkins claimed that he could determine whether a deal had come to him in his capacity as a director of New York Life or as a partner of J. P. Morgan & Co., and bargain accordingly. Others disagreed, including National City Bank president Frank Vanderlip. He wrote that "there were times... when [acting as a board member of the Union Pacific Railroad] I opposed underwriting fees because I felt they were too high." Vanderlip's fellow directors then "pointed out to me, in a hurt tone, that the City Bank [of which Vanderlip was then president] was sharing in those underwriting profits that I thought were too fat."

Progressives saw the Money Trust's seats on corporate boards of directors, its control over new issues of securities (stocks and bonds), and its high profits as the three corners of an iron triangle of conflicts of interest. High dividends voted by Money Trust-dominated boards generated funds to reward those who cooperated with the Money Trust. Fear of the Money Trust restrained competition from other financiers. And the absence of competition gave industrial firms no choice but to accept Money Trust domination of their boards.




THE ATLAS OF FINANCE

THE NEW YORK PRESS

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Courtesy of the Archives, The Pierpont Morgan Library, New York

A "Morganized" company, with an investment banker on its board, would seek every opportunity to jack up the prices of its products to create large monopoly profits. Morgan was eager to create U.S. Steel, for example, in order to protect his previous creation, Federal Steel, from other producers and to generate such monopoly profits. Even when no formal merger occurred, common directors and cross-ownership of shares created a "community of interest."

It is surprising that the Money Trust survived as long as it did. It was the subject of two major congressional investigations and innumerable polemics. Senator Gerald P. Nye (R.-N.D.) charged the bankers with having conspired with munitions makers, the "merchants of death," to drag the United States into World War I in order to protect their investments in British bonds. But the debate over the Money Trust was resolved only by the stock

market crash of 1929 and the Great Depression, which left the securities industry virtually without political defenders. Indeed, it was Republican president Herbert Hoover, believing that Wall Street had the power to restore prosperity, who triggered the 1932–33 Senate Banking Committee investigations that finally curtailed the influence of the Morgan bank—ruled since Pierpont's death in 1913 by his son, J. P. ("Jack") Morgan, Jr. Hoover used the threat of an investigation to prod the bankers into action. Instead, the old guard of progressives won during the 1930s what they had not been able to win for three decades.

The Glass-Steagall Act of 1933 said that investment bankers could no longer be commercial bankers: Depositors' money could not be directly used to support the prices of newly issued securities. Glass-Steagall said that directorates could not be interlocked: Bankers could not serve on the boards of firms that were their clients. Glass-Steagall said that the bankers who issued and priced securities for a firm could not serve as fiduciaries for investors who bought the securities.

The links that the Morgan partnership had used to gather information, raise capital, and exercise influence were thus broken. Investment bankers could continue to float stocks and bonds for corporate customers, but they could not invest depositors' money in those securities. Nor could they serve on the corporations' boards and oversee management. They could only serve as middlemen in financial transactions. Since World War II, the two pieces into which Morgan's American empire were divided—J. P. Morgan & Co. and Morgan Stanley & Co.—have continued their business as commercial and investment bankers, respectively. They have earned high profits. But their earnings have been an order of magnitude lower and their influence over American industrial development nonexistent compared to what would have been had the pre-Depression order continued.

Today, finance historians debate whether the Money Trust was real or imagined—a product of what the historian Richard Hofstadter called the "paranoid style" in American politics. Vincent Carosso of New York University, for example, argues that financiers did not "purposely act together; and even if they had, they would have been unable to impose their will upon the other directors . . . [who were] always more numerous than the representatives of Wall Street." Untermyer and other investigators, says Carosso, were unable even to demonstrate the existence of a Money Trust in the narrow way they defined it: not a conspiracy but a "close . . . understanding among the men who dominate the financial destinies of our country and who wield fabulous power."

Citibank's official history depicts Untermyer as an aspiring politician guilty of bad faith. Two years before the investigation, he had said that "monopolies and substantial domination of industries could be counted on the fingers of your hand." In the same speech, Untermyer attacked "political partisans who seek to make personal and Party capital out of a demagogic appeal to the unthinking."

But neither the progressive's "paranoid" vision nor the rebuttal provides a complete picture of the Money Trust. If, as the progressives had it, the Morgan partnership was little more than a very large financial-protection racket, why did so many firms willingly enter its embrace? But if the financial market was as competitive as historians like Carosso believe, why were Morgan's profits so high?

Even Morgan's supporters did not argue that the Money Trust was a fiction. John

## 'MORGANIZING' A RAILROAD

J. P. Morgan developed many of his financial techniques as a reorganizer of troubled railroads in the late 19th century, a time when railroads were not only the nation's leading growth industry but were as essential to growing communities as water.

The Richmond & West Point Terminal line was not unlike many other railroads of the day when Morgan was approached to reorganize it in 1891. Mismanaged and run down, its treasury plundered by its officers, its stock, as J. P. Morgan, Jr., put it, a "football of speculation" in the hands of a few insiders, the railroad was on the verge of bankruptcy. The elder Morgan summoned three of the company's major stockholders to 23 Wall Street, where the Morgan firm occupied a single large room on the ground floor. At one end, Morgan sat in his own glass-walled office. The banker told his visitors that he would step in only if a majority of the company's bondholders and stockholders deposited their securities at the Morgan bank to guarantee against speculation. Few men had the nerve to say no to J. P. Morgan, nearly as large a presence physically as he was financially, brusque and self-assured, but William P. Clyde did. "I've bought the Richmond Terminal at seven or eight and sold it at 15 twice in the last few years—and see no reason why I should not do it again," he drawled.

But Clyde was forced to relent after several other banks turned down Richmond Terminal. The Morgan plan was announced in May 1893, having been drawn up by partner Charles Coster, a nervous wizard with numbers who, like most Morgan partners then, worked himself into an early grave. A new company, Southern Railway, would be created to take over Richmond Terminal and two of its subsidiary lines; other less profitable lines would be excluded, left to fend for themselves. To slash debt, many bondholders were forced to accept new, lower-interest bonds in place of their old securities; shareholders were forced to contribute fresh capital to finance improvements in the Southern Railway's lines; and new stock was issued. The lynchpin of this and many other Morgan deals was the creation of a voting trust: Shareholders were required to surrender their votes to a new trust controlled by Morgan and his allies George F. Baker and Charles Lanier. They would select the corporation's directors and officers. A trusted Morgan associate, Samuel Spencer, of the Baltimore and Ohio Railroad, was installed as president.

"Contemporary commentators were enthusiastic in praising Morgan's work," notes historian Vincent Carosso, "several of them asserting that the reorganized property promised the start of a 'new era' for railroading in the South. And indeed it did." Initially covering 7,000 miles, the new Southern added track, reacquired some of the lines left out of the original deal, more than doubled its rolling stock, and invested millions in roadbed and other improvements.

Who benefited? Certainly the line's passengers and business customers throughout the South. So did the Morgan partnership. It reaped commissions worth $850,000 and acquired a virtual lock on Southern's future banking business, as well as a strong voice in the firm's management. Stockholders suffered in ways not likely to be repeated today. They were forced to pay assessments, to surrender their authority over the firm's man-

Moody, the founder of Moody's Investor Services, maintained that it did exist—and that it was a good thing. Individual shareholders simply were not capable of monitoring or evaluating the performance of corporate managers, he said. Others made similar arguments. Investment banks exercised control and influence over firms because doing so put investors' minds at ease. Companies welcomed the bankers' oversight because their stamp of approval made it possible for them to tap investors' savings for expansion. As New York, New Haven, and Hartford Railroad president Charles Mellen said, "I wear the Morgan collar, but I am proud of it."

Mismanagement was not the only thing investors had to fear in a firm where no one wore the Morgan collar. Among other things, corporate insiders were known to

agement, and to sacrifice short-term returns to allow the railroad's modernization.

By the turn of the century, the nation's railroads were concentrated into six huge systems controlled by Morgan and a few others—and Morgan held seats on the boards of several railroads he did not control. It was as if one person today controlled IBM, Apple, and several other major computer manufacturers. Morgan labored to assure that the systems did not compete, not always with success. His war with Edward H. Harriman for control of the Northern Pacific line in 1901 led to a stock-market panic that caught up speculators and innocent bystanders alike. When asked by a reporter if he did not owe the American people an explanation of the struggle, Morgan shot back, "I owe the public nothing." The public, however, writes one Morgan biographer, was beginning to think "that it owed Morgan too much."

manipulate stock prices, to "play bulls and bears," in Wall Street argot. Morgan had little patience with such shady practices, telling one executive who did not know his place: "Your railroad? Your railroad belongs to my clients."

Thomas Lamont, the most politically adept of the Morgan partners, told Louis Brandeis during a famous meeting that he and his partners had only reluctantly joined boards of directors: "As you realize, we have drifted onto these various boards because we had first undertaken to place a large block of the corporation's securities with our [investor] clients, and we felt a sense of responsibility to those clients which we fulfilled by keeping an eye on the corporation in which they had invested. We have felt that this was a strong factor in enabling us to market these securities, and

while the responsibility was a very onerous one, nevertheless, we shouldered it."

Another Morgan partner, Henry Davison, argued that the extent of Morgan control over investors was exaggerated. If another firm proved a superior judge of risk, or if the Morgan firm lost its reputation for "character" by recommending securities that profited it at the expense of investors, then Morgan influence would quickly disappear. (The banks likewise claimed to look for "character" in their clients. In a famous exchange during the Pujo hearings, J. P. Morgan was asked by Untermyer, "Is not commercial credit based primarily upon money or property?" The old man replied: "No sir; the first thing is character.") The big firm's hard-won reputation also explained its ability to charge high fees and reap great profits. Moreover, because the continuing success of J. P. Morgan & Co. depended on its reputation for "character," it was not tempted by quick profits; a smaller or less-established firm might be tempted to take the money and run.

Morgan's great antagonist, Untermyer, was himself reportedly the victim of just such a firm. In 1899, Standard Oil magnates H. H. Rogers and William Rockefeller capitalized the new Amalgamated Copper Corporation at $75 million, traded on their reputations as the financial wizards behind the growth of Standard Oil, and sold about half of the company off to other investors. It then developed that the only assets of Amalgamated were copper companies that the two had recently purchased for $40 million. When the dust cleared, Rogers and Rockefeller held half of Amalgamated—worth $20 million in fundamental value—and outside investors had put up $40 million but had acquired in return only the other half of Amalgamated. The two promoters' reputations as investment bankers were shot, but they had not been interested in investment banking in the first place.

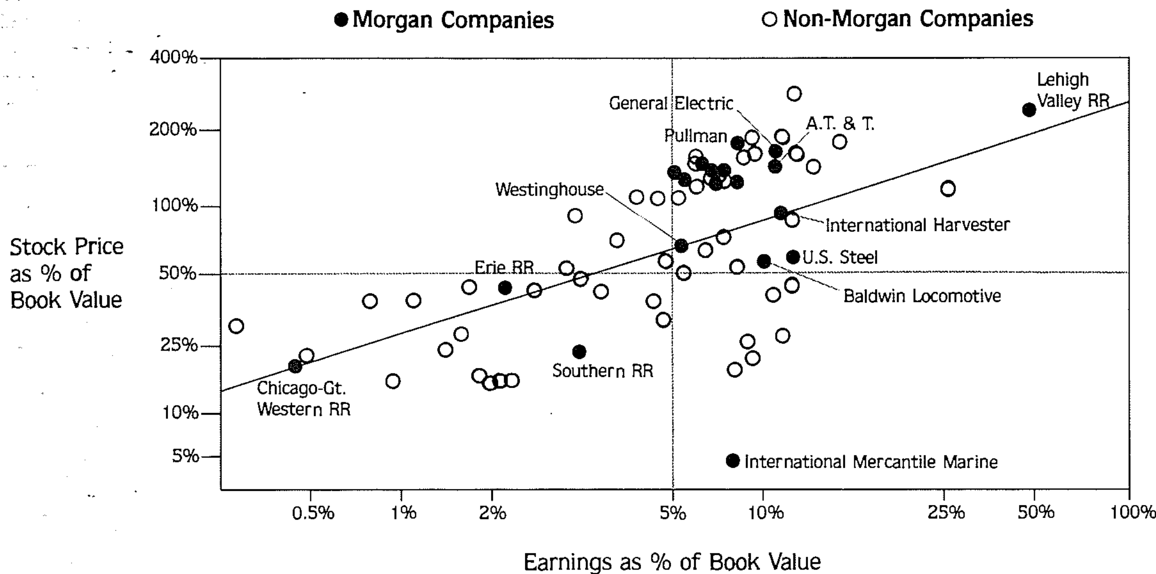
It is ironic to find stout defenders of private privilege and property such as Moody and Davison advocating a system of allocating investment that might be termed "socialist." The Morgan partnership had about a dozen partners and 145 employees. The partners approved and vetoed proposed top managers for individual firms and decided which firms' securities they would underwrite, and thus implicitly which lines of business should receive additional capital and so expand. The effect is not dissimilar to what would be done by a centralized investment-planning directorate. Of course, there are major differences. Morgan and his partners were not a bureaucracy; nor were they paid like bureaucrats. And the Morgan partnership felt itself under severe pressure to run an efficient operation and make investment decisions that would profit investors—for in the long run it faced competition.

Was there any truth to the Morgan partnership's self-justification? Or was it just another plausible but specious argument thrown up to protect power and privilege against democratic reform?

In fact there was considerable truth to the partnership's claims. A chart showing the ratios of earnings and stock price to book value among big American companies around 1910 (facing page) establishes that companies with Morgan partners on their boards made higher profits and fetched higher stock prices than other companies.

*Book value* is an accounting concept that roughly captures the value of a firm's assets: how much it would cost to replace its machines, buildings, liquid assets, and intellectual property (patents, etc.). The ratio of earnings to book value is thus an index of a corporation's efficiency as a profit-

## MORGAN VS. NON-MORGAN COMPANIES, 1910–1912




making engine. The ratio of stock price to book value shows what investors think of the firm's management and prospects. The more positive their view, the higher the premium over book value they are willing to pay. By both of these standards, Morgan firms fared extremely well. The average non-Morgan firm was assessed at half of its book value by the stock market and had earnings equal to five percent of book value. Of the 19 Morgan firms, 16 performed better than this average.

It is a point against the progressive position that Morgan companies had high ratios of earnings to book value. One of Brandeis's most frequent criticisms of the Money Trust was that it "watered" stock to overstate book values—as the two promoters of Amalgamated Copper did in 1899. Stock-watering would inflate book values and tend to move Morgan companies down and to the left in the chart. Yet they are clustered in the upper right.

The chart also shows a solid line that plots the relationship between earnings and stock prices for non-Morgan companies. Of the 19 Morgan-influenced companies, 15 lie above this line. They had higher stock prices than would be expected given their earnings. In short, investors believed they had better growth prospects than other companies.

On average, adding a Morgan partner to the board of directors appears to have raised the value of common stock by roughly 30 percent. Such an increase does not seem out of line if one considers how much Morgan's financial services cost. For the creation of International Harvester in 1902—a simple and straightforward deal—the investment bankers collected about four percent of the capital value floated; for U.S. Steel the investment bankers' share was 10 percent. Such enormous fees can be justified—if they can be justified—only if the unique value added by this particular group of financiers was substantial, and it appears that it was.

The presence of a Morgan partner was a signal that good things were happening to a company. Good managers were being promoted. Bad managers were being fired. The organization had free access to capital for expansion when it needed it, and thus could take advantage of the opportunities open to it. Experienced businessmen were giving executives advice and warning them of pitfalls.

One famous example of banker intervention is the return to the Bell System of Theodore N. Vail. First hired by Alexander Graham Bell's father-in-law, Gardiner Hubbard, at the end of the 1870s, Vail oversaw the initial expansion of the telephone network to the urban East and Midwest. In 1887, however, he resigned. Vail wanted to plow retained earnings back into the rapid creation of a single national telephone network, but the major stockholders had a different view. They saw that the telephone company was a money machine, and they wanted to milk it for generous dividends.

After Vail's departure, the Bell system did pay high dividends. It also steadily lost market share to local telephone networks. When AT&T tried to raise money for renewed expansion, its massive financing requirements and the approach of the Panic of 1907 brought the Bell system close to default. The Morgan group of investment bankers, led by George F. Baker, was willing to finance the Bell System's expansion drive only if its new president would be someone they were confident could do the job. Who better than Vail?

Vail did for AT&T what he was installed to do. He oversaw its expansion into a true nationwide telephone system. He also turned out to be very skillful at keeping the government and public convinced that AT&T was a productive "natural" monopoly, not an exploitative artificial one. By choosing Vail, the investment bankers enhanced not only shareholders' long-term interests but the long-term economic growth of the United States.

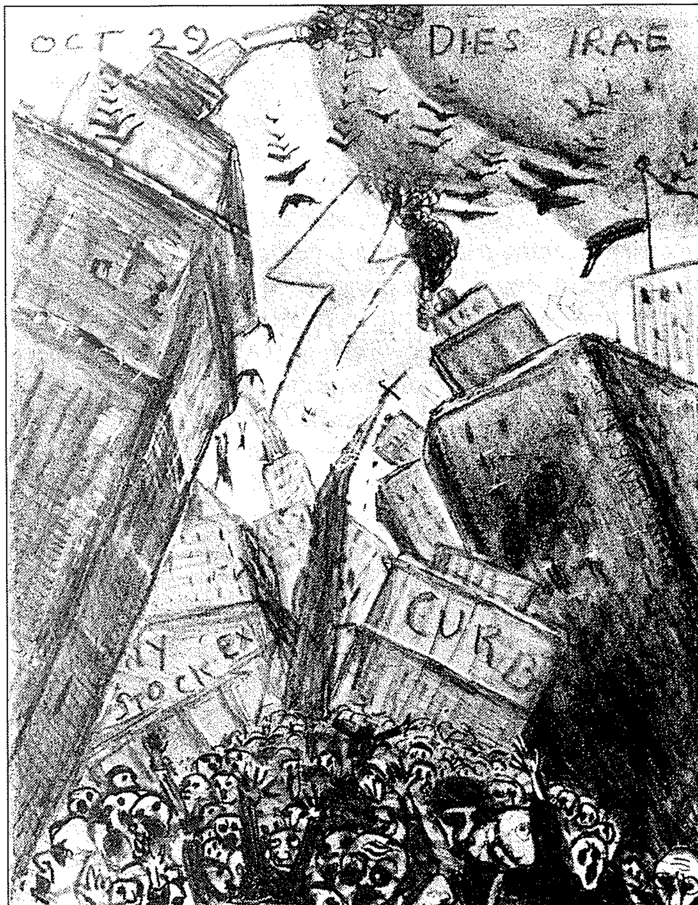
The eve of World War I saw the high-water mark of both the Morgan partnership and the financier-centered system that it dominated. The half century before 1914 had seen Morgan and his peers channel new capital into railroad construction and combination, into steel, into electricity, into telephones, and into the other high-tech growth industries of the day. Investors had followed their lead. And the horses that Morgan had bet on had run well. Thanks in part to the skill with which Morgan had selected industries for expansion and selected executives for large, rapidly growing firms, the United States on the eve of World War I had surpassed Great Britain as the world's economic leader and richest industrial nation.

So why did the Morgan era end? As historians such as Robert Sobel see it, the decline of the House of Morgan occurred in three stages, beginning during World War I. Morgan had always sold bonds quietly to institutions and to relatively wealthy individuals, waiting for them to come to him and ask what securities he might recommend. During the war, however, the federal government's unprecedented deficits created a huge supply of bonds that could not easily be sold by the old means. Enterprising firms, notably Charles Mitchell's National City Bank, seized the opportunity to sell government bonds through aggressive door-to-door sales campaigns, and after the war Mitchell applied the lesson to sell bonds to people who had never thought of buying them before.

The investment banks' imprimatur lost more of its weight during the decade-long bull market of the 1920s. In books such as Edgar Smith's *Common Stocks as Long Term Investments*, middle-class Americans were told that they could reap high profits

by investing in just about any collection of common stocks. Many investors became willing to bet on the genius of financial celebrities such as utility king Samuel Insull even without the implicit warranty of J. P. Morgan & Co. or Kuhn, Loeb.

The third stage was the Glass-Steagall Act in 1933. It forcibly divorced the commercial bankers who had the capital to take substantial long-term positions in firms from the investment bankers who issued securities and set prices. And it removed both from their places on the boards of directors of operating companies, from which they had monitored managerial performance and exercised control.




*J. P. Morgan's heirs tried in vain to halt the Crash of 1929, hoping to repeat his 1907 miracle. Financial institutions have never fully regained the public confidence the Great Depression cost them.*

The upshot was that after the Great Depression and World War II, American finance looked very different from how it had looked in 1913 or even in 1929.* Investment banking was still an oligarchy, and investment bankers still became rich. But in relative terms they were much less wealthy than Morgan and his partners had been at the turn of the century. And they no longer exercised substantial power over individual companies. No executive of any major American corporation in the 1950s, '60s, or '70s would have said under any circumstances that he wore the Morgan—or the Goldman Sachs, or the Salomon Brothers—collar, as Charles Mellen had said before World War I. America had moved from a loose form of "finance capitalism" to a new "managerial capitalism."

After World War II, the fact that corporate executives no longer answered to investment bankers raised a new question: To whom *did* they answer? Even as the grip of investment banks was being loosened before the war, Adolf Berle and Gardiner Means had suggested in *The Modern Cor-*

*Two developments after World War II further diminished the financiers' power: the rise of Merrill Lynch and other brokerage houses that attracted masses of relatively small individual investors through advertising and provided them with investment advice and tips of dubious value, and the boom of 1945–73, which provided corporations with ample profits for reinvestment, sparing them the need to go to the capital markets, and thus investment banks, for additional funding on a regular basis.

*poration and Private Property* (1932) that corporate executives had become effectively independent. They could use the resources of the firm to get their candidates elected to the board of directors, but there were no effective channels for those who opposed them. Before 1929, stockholders or others seeking a change in a company's management could have gone to talk to one of the Morgans or their partners. If their arguments were convincing, the old management might soon be gone. After Glass-Steagall, such challengers had to find some way of reaching and persuading a scattered and ever-changing cast of shareholders. The lack of a long-term relationship between investors and managers led John Maynard Keynes to these musings in 1936: "The spectacle of modern investment markets has sometimes moved me towards the conclusion that to make the purchase of an investment permanent and indissoluble, like a marriage, except for reason of death or other grave cause, might be a useful remedy for our contemporary evils. For this would force the investor to direct his mind to the long-term prospects and to those only."

Not surprisingly, management teams and boards of directors became inbred. Corporation presidents were no longer appointed because someone in the Morgan partnership had confidence in their skills and energy but because they had built a coalition of supporters within the executive ranks and won an internal tournament for the succession. By the 1970s, government regulators, economists, and others were beginning to ask if American corporations were producing the most value possible for shareholders and if they were maximizing the pace of industrial development. The self-replacing oligarchies of managers often seemed to follow the paths that gave them the highest salaries, the largest empires, and the least risk. As economist John Hicks wrote, "The best of all monopoly profits is a quiet life."

In recent decades there have been two unsuccessful attempts to restore balance to the relationship between owners and managers. The conglomerate movement of the late 1960s and early '70s, for example, created a new form of economic organization with many parallels to the old "finance capitalism." Conglomerates such as ITT combined many different operating units, each pursuing independent businesses, under one top financial management that provided the units' capital, chose their executives, and monitored their performance. A chief executive like ITT's Harold Geneen would deal with the bosses of the conglomerate's operating companies much as J. P. Morgan and George F. Baker had dealt with Theodore Vail and others.

The first conglomerates worked reasonably well, but those created in the 1970s did not. In fact, the leveraged buyout (LBO) movement of the '80s was in many respects a partial undoing of the previous decade's conglomerate-creating mergers. The LBO movement was also sold as a way of forcing discipline on corporation managers: Corporations took on extraordinarily high levels of debt, and managers set to work to repay it under the implicit threat of losing their jobs and their savings if they failed. Economist Michael Jensen of the Harvard Business School proclaimed the end of the public corporation and the coming of organizations in which financiers would be the bosses. "In effect," Jensen wrote in 1989, "LBO partnerships and the merchant banks are rediscovering the role played by active investors prior to 1940, when Wall Street banks such as J. P. Morgan & Co. were directly involved in the strategy and governance of the public companies they helped create." But the LBO era was coming to a close even as Jensen wrote. The first LBOs, like the first conglomerates, were success-

ful, but later ones were not.

These two waves of financial innovation got as far as they did in part because financiers believed there was money to be made by correcting flaws in the post–World War II system of American finance and by imposing new forms of supervision on corporate executives. The fact that both waves ultimately failed suggests that there remains a need for something new—or perhaps something old—in American finance.

The Morgan partnership had a vision of industrial development in which corporate executives had relatively little discretion and in which "community of interest" was to replace "competition" as the watchword. Progressives believed that this was the wrong vision of economic development for America's future—and that, indeed, its worst flaw was that Morgan could come close to implementing it. In the generation after World War II it appeared that the progressives had been completely correct. American companies earned high profits. American technology and productivity levels were the best in the world. Economic growth was strong.

But no longer. Economic growth in recent years has been lackluster. American technology has not been as dominant as it once was. And productivity growth in U.S. industry now lags behind that of Germany, Japan, and other major competitors. These setbacks have triggered a reexamination of how the American industrial order works, and a reconsideration of the Morgan model.

That German and Japanese securities markets to a large degree still hew to the turn-of-the-century "finance capitalist" pattern suggests that such a reconsideration is not unrealistic. The growth of "finance capitalism" in Germany paralleled the rise of the House of Morgan in the United States: The largest of the German *Grossbanken* (great banks), the Deutsche Bank, had representatives on the boards of 159 companies in 1912. Germany's "great banks" played a Morgan-like role in monitoring and supervising corporate managements. Yet while the Morgan partnership had perhaps a few dozen analysts and partners, the Deutsche Bank had analysts, engineers, and industry experts by the hundreds. It was capable of doing much more thorough and detailed analyses, and of providing much more soundly based advice, than the Morgan bank. Morgan railroad expert Charles Coster was a director of 59 railroads. How thorough could his knowledge of each have been? The German system, though weaker than it once was, is still relatively strong. In corporate elections individual German shareholders routinely authorize the Deutsche Bank to vote their shares for them as it sees fit.

In Japan, the prewar *zaibatsu* and their more diffuse postwar *keiretsu* replacements played similar roles at the turn of the century and do so today. Banks and trading companies in these "enterprise groups" exercise influence over the policies and senior-personnel appointments of the affiliated companies. Should an industrial company run into trouble, the enterprise group is there to assess the situation, shift directions, and pump in additional expertise and resources. In 1973, for example, the tripling of oil prices suddenly knocked the bottom out of the market for Mazda Motors. Mazda had bet heavily on its technologically sophisticated Wankel rotary engine, but the Wankel required more gasoline per mile than conventional engines. The enterprise group examined the corporation, concluded that its problems were the result not of bad management but of bad luck, and financed its reorganization and restructuring. It was quite a different story when Chrysler ran into trouble in the late 1970s. A lobbying campaign yielded

government money and restrictions on competing imports that restored the company to short-term profitability. But as analysts Jack Donahue and Robert Reich have pointed out, the government did not require the kinds of internal changes needed to rapidly improve the corporation's productive efficiency.

In Britain, finance followed an entirely different course. As historian Alfred Chandler notes, Britain at the turn of the century clung to a form of "personal capitalism:" Founding families kept large stakes in their companies and continued to manage them. Investment bankers and salaried managers, so important in the United States, Germany, and Japan at the time, played only a small role in Britain. And Britain commenced a relative industrial decline at the turn of the century. In Arthur Lewis's words, by the end of the 19th century, "organic chemicals became a German industry; the motor car was pioneered in France and mass-produced in the United States; Britain lagged in the use of electricity, depended on foreign firms established there, and took only a small share of the export market. The telephone, the typewriter, the cash register, and the diesel engine were all exploited by others."

Yet even as this was happening, British investment overseas surged. Britain had vast amounts of capital, but British investors did not believe that it was worth investing in British industry.

Comparisons across nations and across eras are tricky. Nevertheless, industrial economies that grew extraordinarily fast—Germany and Japan before the Great Depression and after World War II, the United States before the Great Depression—had "finance capitalist" forms of organization. Countries that grew more slowly—Great Britain, the post–World War II United States—did not. And the continued viability of "finance capitalism" in Germany and Japan suggests that the system's relative decline in the United States was not a "natural" development of the market.

The ills of the contemporary American corporation—the near-autonomy of management, the influence of the skittish stock market—appear to call for large-scale financial institutions to take an interest in corporate management by establishing and holding major long-term positions in individual companies. The ills of the corporation appear to call for more waves of financial innovation and reform, such as the conglomerate and LBO movements, to alter the balance between financier control and executive autonomy. Among liberals in particular there is wide agreement on the need for such a readjustment. The Glass-Steagall restrictions, already being eroded by Washington regulators, seem to have little remaining purpose. Lester Thurow of MIT now calls for the rise of "merchant bankers" in the United States who will do for American industry what the Deutsche Bank does for German industry or the Mitsubishi *keiretsu* does for Japanese industry—or what J. P. Morgan & Co. did for American industry nearly a century ago. It is an irony that today the intellectual descendants of the progressives are among the strongest voices calling for a return to "finance capitalism."