Transcript of Castor Professor Ghironi, Justin Tsang, and Rayan Krishnan at University of Washington, Savery Hall, room 337

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Professor Ghironi: So. I am not sure whether I would put it that JP Morgan himself was "viewed as the wake-up call that US needed; needed a central bank." But it is certainly I think the case that the events of 1907 served that purpose. There had been "similar wake-calls" in previous years. The Panic of 1907 was not the first one the US had gone through previous crises in earlier years; two. But one thing that JP Morgan certainly highlighted was having an entity that would ultimately serve as a back stop for the financial system. Lander of last resort in times of crisis. The US until the creation of the Federal System essentially, well, so. You know, for decades, until the creation of the Federal Reserve System, the key difference between the US and European countries was the fact that US did not have a central Bank and therefore did not have an institution that would be in charge of providing the conduct of monetary policy and also sheriffing in this crucial function of lender of last resort of the financial system. The events of the Panic of 1907 and the role that JP Morgan played in these events certainly highlighted the importance of having this kind of entity. Then also, the position of JP Morgan as the richest, most important banker in New York, what ultimately the event of 1907 implied for his own financial "empire" raised questions about should a private entity, should a JP Morgan be in a position to exercise this type of role and potentially reap the benefits of it. Or should a, you know, a state or federal entity that was not "in the hands" of the private exercise this role, and in the end was to create the Federal Reserve System. Which is an interesting system. If you just look at the email addresses um, the internet addresses the URLs of the institutions involved, what you would notice that the addresses of the Original Feds, for example of the Federal reserve bank of new York, end with dot org. Whereas the addresses of the Board of Governors end with dot gov. Which kind of highlights in some level the legacies of the way these institutions formed the Federal Reserve System were formed and founded. IT shows how much of the the the heart of the system the governors of the fed is realy part of government from the start. We the regional Federal Reserve, at least at their start have more of a private participation in that you know the questions that you gave me, the first one. Call it a bullet point is two question is a crucial one. Why do you think the federal bank is important? Two reasons one you know the conduct of monetary policy. At that time, it is interesting, before world war one, there was much less of an understanding of both economist and bankers of how the conduct of monetary policy, the threats or the economics or the conditions of economy the when you look for instants at what long established central banks in other countries like the bank of England were doing in respect to monetary policy, in those years, it was much more dictated at least over the medium to longer term, be the appearance of the gold standard constraint. Than by the “active management” of the economic cycle. Although there were certainly instances, if you look at the behavior of the bank of England over shorter horizons, you can see the bank of England deviating from stricter than what would have been dictated by the gold standard. If at any point, you can feel free to interrupt me to ask clarifying questions. Even if we want to put in a second position, the role of the central bank of active management of monetary policy or the business cycle the crucial role of lender of last resort is something incredibly important. You know that was highlighted in by what happened in 1907. It was highlighted so it was very interesting because. Panics, financial sector crises’ often have shared featured. We only learn by sharing experiences in different points in time and what the key actors did in different points I time. If you look at 1907, at that point we had this panic spreading because of the failed attempt by the Hienze family to corner the… what was it called?

Justin Tsang: Knickerbocker Trust company.

Exactly, exactly. And then panic spreads and JP Morgan steps in. With the help of the government. Another question that you ask is “Could JP Morgan have don’t it without the help of”, how do you pronounce it? Cortelyou?

Justin Tsang: Yes

Okay. Secretary Cortelyou had a crucial role in the situation. Obviously it is impossible to say what would have happened without him. It is kind of the beauty of economics that we cannot review the counterfactuals it is not like physics or chemistry, where we can bring it to a lab and review all the counterfactuals. We cannot do it here. But let me get back on track. The Panic kicks in. JP Morgan steps onto the scene with the help of Secretary Cortelyou and other key bankers in NY they manage to save NY’s financial system and the country’s financial system. In 1913, the Federal Reserve System is created. It starts operating. Now fast forward to 1928, 1929. Then the crisis and the great depression. That was also a financial panic. The US solved it more relatively more rapidly than other countries. Why? Because the Federal Reserve was faster at abandoning the gold standard constraint than other countries. So if you look at the other countries, the experience in the aftermath of that particular financial panic, the onset of the great depression and you compare the experience in terms of you know how deep the depression was and how long it took to recover the experience of the countries who abandoned the gold standard constraint sooner was less painful that the countries that stuck with the gold standard. Why is that? Because the gold standard constraint created a very complicated dilemma for monetary policy in response to a financial crisis. On one you side you have the financial crisis, runs on banks require the central bank to inject liquidity I the system to sustain the survival of the banking system and that’s the role that ultimately JP Morgan played with the help of Secretary Cortelyou and other bankers exercised in the Panic of 1907. Now, fast forward into a situation when you have a central bank in the US after WW1 and or crisis even before WW1 the injection of liquidity is done by the central bank injecting liquidity in the system. However suppose you are also facing a convertibility constraint in that the supply of your currency is tied to your holdings of reserves of gold. So what is happening? Typically when your country is experiencing a situation of crisis, international investors are pulling out, there is a capital outflow. You tend to loose gold reserves. From the perspective of preventing gold reserve loss, what should the central bank do? The central bank should actually contract its monetary policy. It should try to exercise policy action that pushes domestic interest rates up in order to reverse capital flows, decrease domestic capital and foreign ports reduce the size of that balance of pay benefit and therefore reduce the loss of the international reserves. So you see the dilemma. Suppose that I am the central bank, my country is going through a crisis of the type of the 1907 panic in the US or the freezing of the financial sector in 1929. On one side I want to inject liquidity; I want to expand my monetary policy because I want to shower up the banking sector. Provide liquidity to ensure the survival of those financial institutions that are solvent and have become in liquid. On the other side, if I do inject liquidity, then I am in doom of the counter the idea; that if I am loosing gold reserves, I should try to contract my monetary policy. So central banks that stuck to the gold standard constraint found themselves in the wrong place. The crisis ended up being more costly for those countries that stuck with the gold standard constraint laws. The Federal Reserve and the bank of England, for example let go of the gold convertibility requirement faster than other countries and therefore were able to inject liquidity in their economy, reflate the economy, exercise this position of lender of last resort in the financial sector, more aggressively which helped as costly as the great depression was, help make it relatively less costly than other countries. Now in 1907 the liquidity injection system was played by JP Morgan by Secretary Cortelyou by the “Coalition of Bankers" that JP Morgan was able to secure. Now fast forward several more decades what happened in '07, '08, '09. Now you have a federal reserve that is no longer operating under any gold standard constraint. Led by the policy maker who has spent his entire academic career studying the great depression and similar crises. So crisis happens. What does the Federal Reserve do? Must inject liquidity in the economy. Again exercising before the lender of last resort. Liquidity backs up for the Financial System. And a crucial role of the Federal Reserve. And once again, we do not have the counterfactuals, we do not know if the Great Depression was caused by the crisis of 07, 08, 09 that is the great recession. We do not know if it would have been worse or better if the Fed had acted differently. It is very hard to do these counterfactuals. Personally, my view is that if we have to pick one person who deserves credit for the Federal Reserves that we did have the great recession but we did not have another great recession, it would be Ben Bernanke because he acted as the decision maker who provides liquidity to the system at a crucial time and pulls all the possible levers to act on the US economy in a stimulating matter. We can debate weather he was successful or not, but when you are on the brink on the abyss, as we were a few years ago and in the Panic of 1907, I think that it is important that you act only on all things that yo have disposable. I realize that I have deviated a little from the Panic of 1907, I talked a little about the Great Depression, I talked a little about the recent events, but I think that it is helpful to see how experiences across different points of time can have shared fixtures and how the roles of the players involved also can have shared fixtures.

Justin Tsang: It seems as though each one was each own learning experience.

It's always it is. It is the blessing and a curse in economics. Especially when we are talking about this phenomenon it is impossible to have the perfect counterfactuals and experiments. The situations that we experience… It is a constantly evolving financial system, it is a constantly evolving production system. It is constantly evolving. Here. What do you mean by sufficed? Is it what did it take for the US to finally create the central bank?

Rayan Krishnan: Yes

Well I would say that it would go back to the "sequence of wake up calls." And the particularly significant one with the understanding of the role of JP Morgan playing in the situation and the question that came with it. JP Morgan spent 20 plus million dollars of his own money in the process of engineering the financial sector "bailout" essentially but also as you suggest in our question, significantly profited. For instance, in your last pullet you mention the Tennessee Coal Iron Industry which JP Morgan already had control of. And in the later portion of the crisis, essentially got President Roosevelt who made it a crucial part of his agenda to fight monopolies, to agree to essentially recover Morgan's position in the industry.

Justin Tsang: Were they so desperate that at that point that Theodore Roosevelt felt, 'I will make this a steal for him [Morgan], just to restore the economy?'

I go back to the metaphor that I used before. When no one was talking about Bernanke, President Roosevelt was on the brink of the abyss. This showing up Tennessee Coal Iron and rail road, this entire operation maybe crucial to prevent… The Panic of 1907 had its own little cycles: its own little ups and downs. If Roosevelt did not approve the takeover, the Administration had already invested a lot of money into the resolution of the panic with the lot of money that had come through the intervention of Secretary Cortelyou. They were in a bit of a bind. They were staring into the abyss of panics happening again and our financial sector crashing, and the consequences this could have on the overall US economy. In economics a lot is about trade outs with the course of benefits of your actions. And at that point in time, I would say that the right decision of the operation was to move forward. But then it obviously triggers the questions: Do we want to find ourselves potentially again in this kind of situation where the showering up of the financial system is ultimately led by the private entities, a JP Morgan or someone else of that sort, who plays a crucial role as a catalyst of a backing of the financial system, but also ends up reaping some major benefits from it. Or, do we want to move to a system with an institution in charge of doing this which is part of government. And a commission was created and ultimately created and the commission as part of the progress. You read about JP Morgan having to testify explain what happened, explain the role of confidence versus money literally in the functioning of the banking system. And the outcome of this process was ultimately the Federal Reserve. It's fascinating and I think it is fascinating to think of it from the perspective of history and of economics and over time. I kind of touched on this. How did JP Morgan influence the creation of the Central Bank? Do I think he could have done it without the help of Secretary Cortelyou? Well again, we cannot review the counterfactuals. My view is that Secretary Cortelyou played an important role. I think 20 plus million dollars came from the US government and he exercised, he spoke up, he coordinated the conversation between JP Morgan and the other bankers and the US Government. I think that he played a crucial role. When things need to happen fast at that magnitude, it is very easy to derail. But at the same time, we do not know the exact counterfactuals. And you know, how would America be different if Morgan had not stepped up? Again, we fall into the same question. I would say, in the long-run I do not think – and this is a venture as much a guess as anyone – but in the long run I do not think that it would have been very different than what it is. Because what may have happened was the US having the great depression between 1907 and 1910 as a consequence of a financial sector meltdown that is not stopped. But ultimately, since 1907 was not one of the first of those wake up calls, and because the US was looking at the experiences of other countries, ultimately, I think that it may or may not have delayed the creation of the Federal Reserve. But I think within a reasonably short horizon, the Federal Reserve would have been able to be created anyway. And then the part that followed would have been followed anyway. There would have been differences along the way, and this is as much of a guess as anyone.

Rayan Krishnan: Right.

But do I think that America today would be very different than from what it is if JP Morgan had not stepped up in 1907? I would say no. I tend to think that the forces that were in place that made the Federal Reserve System and its role in the following century plus would have resulted in the Federal Reserve System. This is not to say that JP Morgan did not play a crucial leadership role, a catalyst role at that point in time. And he ended up being in the center of the crucial wakeup call that led to the creation of the Federal Reserve System in that point in time. So going back to the goal of your project. Studying the role of JP Morgan as a leader, yes, he stands as a monumental size leader in American economic history of the last hundred plus years and played a crucial role.

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