

## Introduction

Financial panics and crises occur so frequently in the United States nowadays that the boom-and-bust pattern is becoming alarmingly commonplace. During the past twenty years, for example, US investors have weathered the \$4 billion failure of the Long-Term Capital Management hedge fund, the Internet stock blast-off and crash, and the massive Enron and WorldCom accounting frauds and bankruptcies. Of course, the economic conflagration of 2008, which began as a financial brushfire among subprime mortgage lenders, superseded all of these events in size and devastation.

It is not immediately clear why the frequency and severity of financial scandals is increasing in the United States. What *is* clear is that we need to understand the origins of these disasters, as well as the policies and people that bring them on.

Studying past crises is one way to do that. While distant actions may seem unrelated to current events, rereading about the past almost always provides surprising insights into the present.

Such is surely the case with *The Lords of Creation*, written by longtime *Harper's Magazine* editor Frederick Lewis Allen. First published in 1935, the account chronicles the vast expansion of corporations and finance in the United States between the 1890s and the 1930s and analyzes the people and practices spanning that period of epic boom and bust.

Some might contend that an examination of this period has little relevance today. Certainly a lot about the world of finance has changed during the past century: derivatives, collateralized debt obligations, negative amortization mortgages, and other financial instruments of mass destruction were not around at the turn of the twentieth century.

But Allen's history of sharp practices on Wall Street and in company boardrooms—practices like insider trading by executives, which became rampant and acceptable, as well as the various government responses to the

financial woes of 1907 and 1929—shows not only how different those years were but also how little has changed about our markets and our government.

Consider this assessment from Allen, which could easily have come from yesterday's news report: "Though there was much sheer rascality in the Wall Street of the nineteen-twenties, much sheer greed roaming at large, and a widespread betrayal of the fiduciary principle, it may be that none of these things did as much damage to the country, in the sum total, as the sheer irresponsibility of men who, possessing vast powers, played the game of profit and loss without regard for the general public interest."

Central to Allen's riveting story is the amalgamation of industries and financial organizations that took place at the turn of the twentieth century, and the effects of this consolidation on society. Because that trend continues to this day, understanding its impacts over a century ago can help show what may lie ahead for us.

The merging Allen describes occurred in all manner of industries—railroads, finance, retail, and automobiles. And yet, while this practice enriched corporate insiders and their Wall Street bankers, Main Street felt a sense of foreboding.

"The outside public looked on in mingled admiration and alarm and bewilderment," Allen writes. "They feared the power which was now concentrating in downtown New York and the other financial centers of the country, they watched with dismay the inroads being made on the domain of free competition, and yet the processes of change were so multiple, so obscure, and so baffling that they did not know what to do."

Allen's tone in *The Lords of Creation* is that of a knowledgeable observer. But it is also amusing and wry. Describing the New York Stock Exchange, he writes: "During those years it might well have been called the Association for Improving the Condition of the Rich." He is equally trenchant on the power of government regulation, which "depends upon the vigilance, imagination, and honesty of officials—very variable qualities, all of them."

In telling his story, Allen introduces readers to well-known characters as well as those who have been lost to history. Among the latter is John W. Gates, a steel industry giant and "jovial buccaneer of finance" who, during the late 1890s, worked on many corporate combinations. Allen tells of Gates's impoverished upbringing in Illinois, followed by a rapid rise in the barbed-wire business. Gates was soon rubbing shoulders and doing deals with J. P.

Morgan himself.

“He was a good fellow and a remorseless trader,” Allen writes of Gates. “The sort of man who will sit up all night at a friend’s bedside and then destroy the man financially the next day.”

Some of the events recounted in *The Lords of Creation* highlight the differences between the turn of the twentieth century and today. For example, the Glass-Steagall legislation—the government’s chief response to the dubious Wall Street practices that led to the Crash of 1929—had real teeth. Until 1999 when Congress killed it off, that law had helped protect the public from rapacious bankers for almost seventy years.

Contrast this with the Dodd-Frank law, Congress’s response to the debacle of 2008. It is riddled with loopholes and does little to protect taxpayers against future bailouts of reckless financial institutions.

Far more of Allen’s history, however, shows how little has changed on Wall Street and in Washington. Listen, for example, to his description of the zeitgeist during the seven fat years of 1922 through 1929: “The overwhelming majority of the American people believed with increasing certainty that business men knew better than anybody else what was good for the country, and that the government had better keep its hands off their affairs and thus permit economic nature to take its course.”

Such words could easily have been written about the 1990s and early 2000s, when Alan Greenspan, the former head of the Federal Reserve, held sway and deregulatory fervor ran high.

Allen also tells readers of the ineffectual regulators in the 1920s, ancestors to the see-no-evil government officials who allowed and enabled the 2008 disaster. Indeed, Allen’s description of regulation during the Roaring Twenties has a very familiar ring.

“Although most of the regulatory legislation of the two preceding decades remained on the books, the public zeal for enforcement had weakened,” he writes. “The officials responsible for enforcement were naturally not always selected for their vigilance. More often they were selected for their party regularity or their pliability. Some were exasperatingly ignorant of the industries which they were supposed to supervise; others, in the process of learning about them, had become so inoculated with the ideas of the men who ran them that they could hardly see the need for any supervision at all.”

Equally familiar is Allen’s description of the individual stockholders of the

early twentieth century, an impotent group whose ownership of company shares granted zero ability to effect change at those institutions. “The working control of most of the very large corporations rested in the hands of groups of insiders who owned only a fraction of the stock,” Allen writes. “The vast majority of shareholders regarded their stock certificates as token of liquid wealth rather than as tokens of responsible ownership.” Insiders, he added, were subject “to very little effective check by the scattered majority owners.”

Ditto for today.

But perhaps the best proof of the relevance of *The Lords of Creation* to our current financial system is Allen’s call to arms at the book’s end:

“The problem was nothing less than how to adjust our institutions under the new circumstances created by the vast financial and economic changes of the past generation, so as to multiply effectively and distribute with some decent approach to fairness the products of the earth, the fruits of labor, and the unprecedented gifts of science—and to do this without destroying human liberty.”

That ideal, so beautifully articulated by Allen eighty years ago, remains maddeningly out of reach to this day.

Gretchen Morgenson