

## *Chapter Thirteen*

### **DOWNFALL AND CONFUSION**

WHEN a wave breaks, it is the top that crashes first. Watch a great roller surging in upon a shelving shoal. It may seem to be about to break several times before it really does; several times its crest may gleam with white, and yet the wall of water will maintain its balance and sweep on undiminished. But at last the wall becomes precariously narrow. The shoal trips it. The crest, crumbling over once more, topples down, and what was a serenely moving mass of water becomes a thundering welter of foam.

When the American economic system broke, it was likewise the top that broke first: the crazily inflated structure of common-stock values which had been built up in the speculative madness of the Bull Market. Several times this structure had toppled—just as the crest of a roller curls over—in the successive stock-market breaks of June, 1928, of December, 1928, and of March, 1929; prices had cascaded down and thousands of speculators had been caught in the spate; yet each time the structure had recovered its balance and had lifted itself higher and yet higher. When, in the early autumn of 1929, another cascade of prices began, most observers supposed that, at the worst, these earlier episodes would once more be repeated. There would be a brief storm of selling, prices would drop thirty or forty or fifty points, a few thousand insecurely margined traders would lose everything, but the wave of values and of stock-market credit would catch its balance again and move forward. That the whole wave would go crashing down seemed almost inconceivable.

For a brief interval these observers seemed to be right. Prices broke early in September—very soon after that sweltering day when the pinnacle of prices had been reached—and recovered. They broke again, later in the month. The cascade continued in October, with added volume because the collapse of Hatry's speculative schemes in England had prompted European selling. It grew more and more torrential. And at last on Wednesday, October 23, the volume of liquidation became genuinely disturbing. Over six million

shares changed hands, the ticker fell 104 minutes behind in its attempt to record immediately all the transactions on the floor of the Exchange, and the decline in prices was very severe.

Even then, however, there were few observers who anticipated what was to follow. The brokers' offices all over the country were crowded with worried traders, but among them there were many who were saying to themselves that this would be the very moment to buy—if one had the money; that this was the culmination of the worst break since the Bull Market had begun, and that presently the march of speculative prosperity would begin once more.

They did not realize how completely the whole structure of stock-market values had become honeycombed with brokers' loans. Still less did they realize that the wave of stock-market prosperity was running upon a shoal. The construction industry had been weakening since 1928, for in the Florida boom and the various winter-resort and summer-resort and suburban booms which had followed it, more houses had been built than could be paid for, and even the craze for putting up higher and higher skyscrapers in the great cities could not maintain the industry at its former pace of operations. The automobile industry had begun to slow up in the early summer of 1929, and with it the steel industry. The furious drive for bigger and bigger profits, and the financial inflation which was predicated upon the continuance of such profits, had prevented the distribution of the fruits of prosperity in the form of higher wages or lower prices, and thus the general purchasing power had become overstrained. In fact, so topheavy had the American economy become that only the lavish expenditures of the fortunate and the extravagant resort of the somewhat less fortunate to installment buying and other forms of personal credit were maintaining business at its full volume. But the speculators were unaware of the full meaning of the slight downturn in the business indices. And still less, of course, did they or anybody else realize to what far-reaching destruction any serious collapse in the stock-market might ultimately lead.

It was the very next day—Thursday, October 24, 1929—at a little after ten o'clock in the morning, that the wave broke.

What happened that day is highly instructive as we view it in retrospect. In the first place, it seems well established that what brought down the avalanche was no attack of concerted short-selling; the amount of short-selling was small. What brought it down was the inexorable working of the

very machinery of gambling which had facilitated the previous advance. When a margin speculator pays, let us say, only thirty dollars to buy a hundred-dollar share of stock, and his broker borrows the other seventy dollars to complete the purchase, the broker shares neither the speculator's gains nor his losses. If the price of the stock goes up to one hundred and thirty, the speculator has a nice hundred-per-cent profit. If it goes down to seventy, he has a not-so-nice hundred-per-cent loss. And more than that—if the stock goes down to seventy and the speculator is unable to put up any more cash, the broker inevitably sells the stock to rescue his own seventy dollars. The process is virtually automatic. When in a crowded market the prices of speculative common stocks slide down simultaneously, the money put up by thousands of speculators is exhausted and their brokers rush to sell. Unless there are other thousands of people standing ready to buy—and these other men are not frightened by the torrent of selling—a panic (large or small) almost automatically develops.

That is what happened on a huge scale on the morning of that doomsday of Wall Street prosperity, October 24, 1929. There was a vast flood of simultaneous selling orders. There were not enough people standing ready to buy. Prices did not merely decline—they fell hard and fast. Anxious traders took fright and sold in sheer alarm. Whereupon prices plunged downward as if bound for a bottomless abyss.

America was beginning to pay the inevitable price for a long chain of events: the general acceptance of the theory that the way to prosperity was through having as many people as possible buy securities which could be converted into cash at short notice; the acceptance of the theory that the way to make such instant conversion possible was through encouraging margin speculation; the widespread craze for common stocks as the cream of investments—and of vehicles for margin speculation; and the consequent conversion of the market for common stocks into a great gambling casino.

Some of the losses on that morning of October 24 were staggering. Though United States Steel, which a few weeks before had been selling for more than \$260 a share and had opened today at 205½, slid down only to 193½, there were other more abrupt nose-dives. Radio, for example, opened at 68¾ and within three frenzied hours was selling at 44½. Montgomery Ward, which had opened at 83, coasted to 50. The volume of trading was terrific. The ticker fell so far behind that its report became almost useless to board-room

traders. The telephone system of the Exchange was hopelessly clogged with frantic inquiries. This was panic indeed, sudden, bewildering, appalling.

But another instructive thing happened that day. Shortly after noon a group of Wall Street bankers met at the House of Morgan to form a pool for the support of the market. Thomas W. Lamont was there, representing the Morgan firm; the others were William C. Potter of the Guaranty Trust Company, Seward Prosser of the Bankers Trust Company, and two other gentlemen whose exploits we have specifically noted in a previous chapter of this book—Albert H. Wiggin of the Chase National Bank and Charles E. Mitchell of the National City Bank. The moment that the word got about that these men were on their way to the rescue, the rout stopped and a quick rally took its place. Wall Street—and with it the great company of the prosperous—still believed in the omnipotence of its gods.

The illusion was brief. For the rest of that day and the two succeeding days the market almost held its own, but not quite; on the following Monday the avalanche began again with such fury that all the bankers' pool could do was to try, by intervening now and then where there were no purchasers at all, to prevent utter demoralization. On Tuesday, October 29, the avalanche reached its maximum force; more than sixteen million shares were sold and the losses in value were enormous. Nor was that catastrophic day the last one of the panic. A rally was followed by further liquidation, and this liquidation continued until November 13.

By that time some thirty billion dollars in capital values had vanished into thin air. If you find such an immense sum almost meaningless, reflect that it was almost as great as the entire cost to the United States of the war against Germany; that it was about ten times as great as the cost to the Union of the Civil War; and that it was considerably greater than the national debt. An overwhelming loss—and the irony of it was that a good deal of it represented money which had already been spent as income by fortunate speculators as the market went up: spent on automobiles and radios, and part payments on houses, and innumerable other purchases which had helped to keep the wheels of industry rolling.

It must clearly be borne in mind that it was the prosperous upon whom fell the brunt of this body blow at the American economy. To be sure there were thousands of stenographers, clerks, janitors, and even day laborers whose painfully acquired savings had gone over the dam; but broadly speaking it

was the rich who were soaked—directly. It was stock-brokers and promoters who were committing suicide in October and November of 1929, not unemployed clerks and laborers. Indeed, there were millionaires in those days who looked through the windows of their Rolls Royces with a new envy at the crowds of wage-earners in the streets—the lucky poor who were losing nothing in this catastrophe! The fact that the rich were the immediate victims of the panic helps, perhaps, to explain some of the lavish dividend disbursements of American corporations in 1930. Directors who voted for higher dividends in a season when their companies were dismissing workmen were not simply adhering to the philosophy of prosperity through big profits, not simply trying to re-establish the prestige of their companies among investors; they also, one suspects, felt that they were recompensing the chief losers in the debacle of 1929.

Yet it must also be borne in mind that the indirect effects of the crash were far-reaching. Luxury businesses were hard hit. The fashionable dress-shops were suddenly almost empty. Chauffeurs, maids, gardeners were dismissed. The demand for automobiles and radios and furniture and other expensive goods fell off, and with it, the demand for materials which went into them. Frightened lest their goods pile up on their shelves and uncertain of the future, manufacturers cut down on their production. Thus unemployment rapidly increased; from Maine to California, factories began letting men go.

And of course the panic had a further effect: the whole precarious edifice of values which had been built into the financial system was shaken. The ubiquitous investment trusts were shaken. The pyramided holding companies which had written up their holdings were shaken. Flimsily financed real-estate and building developments were shaken. Every bank which had an up-to-date investment affiliate or had lent money in quantity against stock collateral was shaken. Every other company which was dependent upon the business of such concerns felt the shock. People still talked as if a speculative stock market were something apart from the rest of the national economy; a loud and wishful chorus of financiers and public men, led by the president of the United States, chanted in unison that no matter what happened in Wall Street, business conditions were “fundamentally sound”; yet when an earthquake took place in Wall Street its tremors inevitably ran far and wide.

President Hoover now swung into action.

What he did, if we judge it by the prevailing economic philosophy of the time, was on the whole highly reasonable. He called to the White House a large group of insiders—bankers and industrialists—and labor leaders as well. He urged these men to continue business as usual. The industrialists were not to cut wages, not to abandon construction programs. The labor leaders were to refrain from rocking the boat. Wide publicity was given to the agreement of these men to go along as if nothing had happened. In order to encourage the rich to scatter prosperity about once more, Hoover asked Congress to cut the income tax. He also advocated a public-works campaign to take up any possible slack in employment, thus taking a leaf out of a different book of economics. And he continued, as did everybody else, to assert that conditions were fundamentally sound and becoming sounder. Under his baton, the chorus of insistence that everything was all right, that business was going ahead, that prosperity—in the well-worn phrase of the day—was “just around the corner,” became almost deafening. If loudly expressed wishes had been horses, the American people would have ridden to wealth at a full gallop.

And what happened? The pool managers in Wall Street scrambled to their feet and began to push stocks up again. During the late winter and the early spring of 1930 there was a bull market of considerable dimensions; the volume of trading actually became for a time as great as in the summer of 1929.

It was piously believed in those days that the American public had “learned a great lesson” in the disaster of the preceding autumn, yet apparently to hundreds of thousands of people the lesson of the disaster was that the bright thing to do was to buy early and sell at the top. The prices of some of the favored securities mounted fast and far. By April, 1930, for example, Steel was once more nudging the 200 mark and American Telephone and General Electric had almost reached their preposterous pre-panic heights.

Though unemployment remained severe and the bread-lines in the streets were longer than at the worst of the post-war depression of 1921, stock-market-minded business men hoped and half believed that this was but a temporary trouble: did not the graphs of security prices on the financial pages show an encouraging up-trend? Many corporations, as we have already

noted, increased their dividend rates; the total amount of money paid out in dividends was only three per cent less in 1930 than in 1929. New investment trusts were coming to birth, and the pattern which prevailed among them hardly suggested any widespread doubt in the resumption of old-style prosperity; for most of them were “fixed trusts,” the managers of which were to invest in the stocks of the leading corporations of the country (as of 1930) and were not to be permitted to change these investments unless the corporations in question passed their dividends. Tom, Dick, and Harry were cheerfully buying participations in these curiously rigid trusts. Why shouldn’t they? They knew enough economics to know that business ebbed and flowed in cycles; if you knew economics, you knew that the time to buy was after a panic, and that it was the leading corporations of the country that were likely to prosper most in the bull market of the nineteen-thirties.

Something was wrong, however. Business was not actually gaining; it was barely holding its own at a volume considerably less than that of 1929. Presently it began definitely to lose ground. The speculators who had learned the great lesson of the panic hastened to sell. In May, 1930, the stock market collapsed again. And presently the depression entered a new phase—the long, grinding, inexorable, almost uninterrupted disintegration of late 1930 and 1931 and early 1932.

### 3

Let us try to analyze what was happening in those dolorous years of 1930 and 1931 and 1932.

The analysis cannot be simple, clear cut, dogmatic; for the sequence of cause and effect in our world of endlessly involved mutual relationships is exceedingly complex.

We must remember, in the first place, the continued existence of various distortions in the American economy which had made the recovery and prosperity of the country during the nineteen-twenties an astonishing achievement against odds. We must remember how curiously our foreign trade was balanced—that the only way in which we had been able to permit Europe to buy our goods was by lending her huge amounts of capital, and that obviously this could not keep up indefinitely. We must remember that the farmers who grew our staple crops had never fully recovered from the

distress into which the collapse of their overseas markets had plunged them shortly after the war; and that as soon as industry languished, the country as a whole was likely to feel the dragging weight of a comparatively impoverished farming population.

Nor must we overlook the fact that the economic breakdown of the early nineteen-thirties was not simply an American phenomenon, but was world-wide. Europe in particular, staggering under a terrific burden of debts incurred during the war, and hampered by trade barriers built up by bitter national rivalries, had never enjoyed any such boom in the nineteen-twenties as had the United States, and was now drifting into a fresh economic crisis. This was bound to prolong and intensify the American crisis.

But it is doubtful if any of these factors—or all of them together—quite explain a breakdown as cumulative and appalling as that which actually took place. Let us look for other clues.

One of these clues is the increase in efficiency which was being brought about by improved methods of manufacture and of business, and especially by the machine—above all by the power-driven machine. As we have already noted (in Chapter VIII) machines were constantly replacing men. A given number of people were becoming able to produce and distribute more and more goods. There is no need to present specific illustrations of this fact; the Technocrats of 1932 deluged the country with them. But it may not be amiss to remark that the tendency toward technological unemployment about which the Technocrats talked so furiously was not confined to industry; consider, for example, how the output of American farms had been increased by the use of huge reapers and combines and also by the spread of knowledge about better farming methods; or consider how machinery and improved organization had likewise speeded up work in business offices. That the machine was an instrument for the production of plenty is undeniable—but that its increasing use was attended by economic strain is also undeniable. During the seven fat years the men whom it had thrown out of work had been absorbed in other occupations: the man who had lost his job in a textile mill became an apartment-house janitor, the man who had been fired from the automobile factory ran a filling station, and so on. But the strain was there—and it was just barely met.

To meet it, the American economy had to expand. There had to be constant growth—new factories, new construction, new industries, new occupations,



new expenditures. The moment this expansion stopped for any reason, the American economy would begin, so to speak, to die at the roots—to suffer from an increasing technological unemployment. Prosperity had to go ahead very fast to stay in the same place.

For years past, this expansion had been achieved with the aid of a huge inflation of credit, and in particular with the aid of the speculative boom in real estate and then of the boom in the stock market. It was as if a huge bellows were blowing upon the industrial system of the country, making the fires burn brightly. Meanwhile, however, this expansion had had other effects—and they, too, are clues to what happened when the bellows ceased to blow.

For one thing, it had helped to bring about an immense increase in the internal debt of the country. One needs only to glance at the tabulations in Evans Clark's study of *The Internal Debts of the United States* to realize what a change had been brought about by the "investment consciousness" of the American people, plus the urgent salesmanship of the dispensers of securities and of life-insurance policies, plus the new financial gadgets of the time, plus the reckless optimism of the boom years. During these years, to quote Mr. Clark's book, we had "piled up our debts almost three times as fast as our wealth and income increased." While our wealth was growing only by an estimated 20 per cent, and our income by an estimated 29 per cent, the total amount of our long-term debt had been growing by an estimated 68 per cent—from 76 billion dollars to 126 billion dollars. A large increase? Yes, and it had come on top of another large increase during the war years. If we compare the long-term debt of the United States in 1929 with that in 1913–14, we find the increase in fifteen or sixteen years to have been no less than 232 per cent!

Part of this huge accretion was due to the same factor which had placed such a heavy burden of indebtedness upon Europe—the war. The Federal Government's debt was 1154 per cent larger in 1929 than in 1913–14. But the states and the smaller governmental units had also increased their obligations—by 248 per cent. And business, too, had succeeded in cumbering itself with fixed claims of unprecedented magnitude. The debt of the railroads had not increased very much, if only because they had been notoriously overbonded in 1913–14; here the gain amounted to a mere 26 per cent. But meanwhile the total debt of the public utilities had grown by 181 per cent; the

debt of industrial concerns, by 172 per cent; the debt of financial concerns (including especially investment trusts and insurance companies) by 389 per cent; and a series of real-estate booms had lifted the total amount of urban mortgages by no less than 436 per cent.

Now it is obvious that no man can say with certainty how large a burden of debt an economic system can carry. No man can say with assurance that this vastly enlarged debt was enough to break the American system. For one thing, one man's debt is another man's wealth. Yet here was at least a potential source of strain: a rigid structure of claims—many of them imprudent—in an otherwise highly flexible economy.

Nor was this mass of outright debt the only source of strain. There was also the huge body of claims upon future earning-power represented by issues of stock. The wild financial expansion during the nineteen-twenties had multiplied these claims. Many of them, as we noted in Chapter XI, did not represent any substantial investment of money in the companies against whose earnings they were a charge, but represented stock bonuses to insiders or the issue of stocks for "services." Again and again, in this book, we have noted the extent to which dividend claims—as well as debt claims—set up in the boom years were based upon hopes of steady fair weather in the future. Investment trusts and holding companies, for example, were largely dependent upon the cream which could be skimmed off the milk of corporate earnings. Write-ups and stock-watering operations necessitated fair-weather earnings to give them the appearance of validity. The stock-market boom had built up a general expectation of high earnings which corporate managers were bound to justify if they possibly could.

The burden of claims represented by issues of stocks was not, of course, rigid; it was not outright debt; yet it was very real. Not without a bitter struggle did corporations cut—or stop altogether—their dividends. Sometimes the dividends were continued even at the risk of disaster, as for instance in the Insull public-utility system. Even in the terrific year of 1932, when the corporations of the country were collectively more than five and a half billion dollars in the red, they were still paying dividends to the extent of more than four billion dollars; and of these four billions, over a billion and a half was paid by companies which were actually losing money.

Here, then, we have two circumstances appearing in conjunction. We have an economy that must grow in order to provide jobs for Americans. And we

have this growth brought about by building up a vast load of fixed debt (and of dividend claims) which the economy must carry if it can.

Now according to the old-fashioned economics of rugged individualism, there was no reason why the country could not in due course adjust itself to the ups and downs of trade. From time to time deflation might be necessary—but this deflation would shortly bring about a cure. For one thing, as purchasing power fell off, the prices of goods would drop until latent buying-power was tempted into the markets and shops and the process would reverse itself. For another thing, during any serious depression enough companies would go into bankruptcy to reduce the burden of debt until it could easily be carried. Automatic adjustments of this sort had taken place during previous depressions; business men under the domination of the respected ideas of laissez-faire economics expected them to take place again and bring early and automatic recovery. Why did this not happen?

One reason was that there were now a great many big corporations—more than in any previous depression—with heavy administrative overhead expenses and heavy investments in plant and machinery. It was hard for these concerns to reduce their administrative expenses very much, or to reduce the fixed charges on their plant or machinery at all. The wages of machinery cannot be reduced. If these companies allowed prices to slide, they could not make enough money to meet their fixed charges, to say nothing of paying dividends. They were under an overwhelming compulsion to keep prices up if they possibly could, even if this meant making and selling less goods.

Some companies could hold prices up because they possessed monopolistic power, directly or through secret agreements with their rivals (ranging all the way from gentlemen's understandings to racketeering combinations); but the same pressure of circumstances was felt by monopolies and non-monopolies alike. The easiest item of expenditure on which to save was the wage bill. They actually were better off—for a time—if they ran their factories or mills on an abbreviated schedule, or shut some of them down altogether, than if they let prices slide. The result—particularly in the capital-goods industries—was that the prices of goods did not fall so fast as did the wage bill.

Gardiner C. Means, in his pamphlet on *Industrial Prices and Their Relative Inflexibility*, throws light on what happened. Between 1929 and the spring of 1933, while the prices of agricultural commodities (responding in

the orthodox way to the law of supply and demand) fell 63 per cent and the production of these commodities fell only 6 per cent, a very different sort of change was taking place in other departments of the national economy. For example:

Prices of textile products	fell 45 per cent;	production, 30 per cent
" " automobile tires	" 33 " " ;	" 70 " "
" " iron and steel	" 20 " " ;	" 83 " "
" " cement	" 18 " " ;	" 65 " "
" " motor vehicles	" 16 " " ;	" 80 " "
" " agricultural implements	" 6 " " ;	" 80 " "

According to the computations of Frederick Mills, between 1929 and 1932 the average price of capital goods as a whole fell only 20 per cent; yet production in the capital-goods industries fell 76 per cent.

The causes of this phenomenon are not wholly clear, but it seems reasonably accurate to say that in the effort to carry a load of irreducible charges, these corporations were throwing off workers—and thus were killing the goose that laid the golden egg of revival. A new burden of unemployment was being added to that which would naturally have come about anyhow as soon as the national economy ceased expanding.

But why did not the situation cure itself speedily through a succession of bankruptcies? The answer is that the financial superstructure of debt and of dividend claims had become so enormous—and so pervasive in its influence upon the whole economic structure—that the country could hardly have stood the shock of such bankruptcies. Here we come upon still another possible clue to the situation.

To a much greater extent than ever before in the history of the country, the investments of the country were now in liquid form—in other words, in such a form that they could quickly be turned into money. Securities were listed upon stock exchanges to a greater extent than ever before. Banks, as we have seen, had less of their funds in commercial loans and more in bonds and in loans on securities than ever before. According to the estimates of Berle and Pederson, the total of liquid claims in the United States had never amounted to more than 20 per cent of the national wealth until 1912; between 1912 and 1922 it had gone up to about 25 per cent; by 1930 it had shot up to 40 per cent. A liquid investment had its advantages for the individual: he felt safer if

at any moment he could turn his holdings into money. But the existence of a large proportion of liquid investments enormously increased the chances of panic. When a large number of banks and of businesses were trying to unload simultaneously in the same market-place, a panicky market quickly developed. Not merely the bonds and stocks of companies which were in difficulties dropped in price, but nearly all bonds and stocks. Furiously as corporations were attempting to meet their fixed obligations and their unfixed dividend obligations by throwing men into unemployment, the prices of these obligations cascaded as a result of fear and of forced sales. When there was a big failure—like that of the Bank of United States at the end of 1930, or those of Insull and Kreuger in early 1932—the shock to these markets was immediately visible and for this reason all the more staggering. If the process had gone on....

But it did not go on. President Hoover prevented it from going on by calling for the formation of the Reconstruction Finance Corporation to bring first aid to harassed banks and corporations and to stop the epidemic of bankruptcies. Thus another traditional cure for a business depression was withheld. Rightly or wrongly, the property interests of the country felt that the financial system could not stand such strong medicine. The debt structure—now supported by government intervention—remained almost intact. Many long-term debts—especially mortgages—were in default, but new ones had taken their places. The cold figures show what was happening: according to the computations of Dr. Simon Kuznets for the National Bureau of Economic Research, the amount of money paid out in interest in the year 1932 was only 3.3 per cent less than in 1929—though meanwhile salaries had dropped 40 per cent, dividends had dropped 56.6 per cent, and wages had dropped 60 per cent.

Thus the American economy went into a vicious downward spiral. The cutting of wage bills meant a decrease in purchasing power; the decrease in purchasing power meant a decrease in sales; the decrease in sales made the burden of capital obligations heavier and heavier and led to further cutting of production and of wages, and so on. Nor did the owners of debt claims and of stock prosper; for as the crisis was intensified, claims which they owned were becoming less and less valuable. The capital markets were demoralized, the demoralization of the capital markets demoralized the banks, and so on through another spiral of cause and effect.

Add to this chain of circumstances the unbalanced foreign-trade situation, the depression and financial panic in Europe, the weakened economic position of the American farmers, the inherent weakness of our collection of forty-nine banking systems, the direct though belated effects of the financial abuses and excesses and frauds of the nineteen-twenties, and the stubborn belief of American business men that a turn of the business cycle would inevitably bring back prosperity if wages were permitted to drop and capitalists waited hopefully for the dawn, and you have, perhaps, a reasonably adequate explanation of the great toboggan-slide of 1930 and 1931 and 1932. The era of high finance had so swollen the mass of claims upon the future that only roaring prosperity could sustain it; and the effort to sustain it even at the cost of purchasing power undermined the foundations of that prosperity.

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It was a bitter time in which to be President of the United States. No presidential reputation can withstand an economic depression; even those people who are most insistent that the government should keep its hands off business will blame the government when business goes wrong. It was a particularly bitter time for a President who had proclaimed in his speech of acceptance that “given a chance to go forward with the policies of the last eight years, we shall soon, with the help of God, be in sight of the day when poverty will be banished from this nation.” Hoover had gone forward with the Coolidge policies; Andrew Mellon, the idol of the conservative business world, was still Secretary of the Treasury; and yet disaster was descending upon the nation with cumulative force.

By the autumn of 1930, the Hoover recovery moves of late 1929 and early 1930 were clearly failing. The cut in the income tax was accentuating a mounting governmental deficit. The public works program had not gone far—the deficit stood in its way. The President’s insistence that wages must not be reduced was being widely disregarded, and even where the wage *rate* still stood firm, the amount of money paid out in wages was becoming smaller and smaller as factories went on part time or shut down entirely. The Federal Farm Board’s effort to sustain the price of wheat was a dismal failure, involving the government in huge losses. And as for the campaign of

synthetic optimism, by the autumn of 1930 it was already becoming a sour jest, and by the end of 1931 a compilation of the cheerful prophecies made by Hoover and his aides and by the leaders of business and finance, published under the scornful title of *Oh Yeah?* was greeted everywhere with derisive laughter.

What should the President do next?

From the middle of 1930 to the middle of 1931, he did virtually nothing. "This was the period," George Soule justly reminds us, "which gave rise most of all to the legend that the depression President was a spineless mass of jelly in the face of the nation's difficulty, that he was incapable of action. Yet he was pursuing a definite policy, a policy endorsed in theory both by the financially powerful and by the conservative economists. It was a slightly different one from that which he had attempted to practise at the beginning, to be sure, and yet the two were related. The first theory had assumed that there was nothing much the matter, and that if everyone could be induced to believe this, there would be no danger. The second theory had to admit that there was something the matter: in some mysterious manner, the system had got out of kilter. But the way to remedy the disease was to let it run its course without interference. The economic order was a self-compensating one, and if left alone would get into balance." Accepting, then, the traditional *laissez-faire* theory that nature must take its course, Hoover stood aside.

The expected self-compensation, however, did not take effect. All through the autumn of 1930 and the winter and the spring of 1931 the decline continued, with but a momentary flare-up of hope in midwinter as the indices of production turned briefly upward.

Then in the early summer of 1931 the débâcle went into a new phase. The debt structure in Europe cracked. The Credit Anstalt, the largest and most powerful bank in Austria, was in difficulties; the Austrian Government was trying frantically to borrow enough money to shore it up; and throughout the Continent there was spreading a wild fear that the whole fiscal system of Central Europe would go to pieces. Here, felt Hoover, was an opportunity for constructive action by an American President. He proposed a year's moratorium on governmental war debts and reparation payments. The essence of his plan was that the groaning weight of the mass of international private debt would be eased by postponing for a year all payments on the inter-governmental debt, so far as this grew out of the war and the peace

settlement.

His proposal was accepted—with modifications insisted upon by the French. But although the announcement of it had provoked another outburst of hope—and of speculation for the rise on the Stock Exchange—the Hoover scheme was not enough to stop the spread of financial panic. The Austrian crisis was followed by a German crisis, and the German crisis by a British crisis; in September, 1931, England was driven off the gold standard; and by this time the panic had leaped the ocean and was raging in America too. On the New York Stock Exchange, the prices of foreign bonds of all sorts fell hard and fast. Other bonds followed their example as thousands of American banks and corporations and individual investors were forced to liquidate to save themselves. A crack in the structure of debt was proving to be a very serious matter indeed.

In American towns where not one person in a hundred had ever heard of the Credit Anstalt, disquieting whispers were soon running about: that the local bank was in difficulties, that its money was tied up in bad mortgages and depreciated bonds, that the local tire factory owed it a quarter of a million dollars and could not pay; that the only safe thing to do was to draw your money out and keep it in your mattress, in bills if not in gold. Panicky millionaires were transferring their funds to France, to Holland, to Switzerland, or were packing their safe-deposit boxes with gold. The Federal Reserve figures during the autumn of 1931 showed that something like a billion dollars was being hoarded in currency. Ever since the onset of the depression the rate of American bank failures—a rate scandalously high even in the nineteen-twenties—had been dismaying; but now all previous records were broken. In September, the month in which England left the gold standard, 305 American banks were suspended; in October, no less than 522.

The officers of thousands of other banks, miserable with worry lest the lines of men and women at the paying tellers' windows should suddenly grow to panic length, were deciding to call a few more loans, to sell a few more bonds, to make sure they had plenty of cash—and as their selling orders converged upon the market, the demoralization was intensified. Not only did the pressure of liquidation play havoc with bond prices; it also drastically reduced the amount of money in the country. The process through which banks create money by making loans and setting up checking-accounts—the process of bankers' inflation—was now working in reverse, automatically



and rapidly. In the space of eight months, the amount of money in the country was reduced by as much as twenty per cent. Some ten billions of dollars evaporated.

As fear spread—the fear of a total banking collapse, the fear that America would follow England off the gold standard, and that vague fear of the incalculable future which expressed itself in the frequently heard phrase, “If everything goes ...”—business shrank still more. Wage-cutting was general and unashamed. Unemployment was now going from bad to worse; it was now estimated that eight or ten million men were out of work.

It was during this panic of the autumn of 1931 that Hoover decided that the American debt structure must not be permitted to fall to pieces. He called a group of financiers to Washington to form a pool of credit for the rescue of distressed capital; and presently he asked Congress to take over the task by setting up the Reconstruction Finance Corporation.

The situation which thus arose contained, perhaps, a certain element of ironic humor. Now financial magnates who still cried out for “less government in business” and inveighed against “the dole” could go, hat in hand, to Washington and get the government to put itself into business by giving a dole of credit to their banks or their railroads. The apostle of rugged individualism had taken the longest step in American history toward state socialism—though it was state socialism of a very special sort.

Yet the situation had also a graver significance. Hoover and his advisers were acknowledging that the possible consequences of letting nature take its course were too terrific to contemplate. It was not simply that they feared that the rich would be impoverished—though this fear undoubtedly colored their thoughts. It was that they feared that the debt structure was so built into the economic fabric of the country that its disintegration would result in general chaos. Banks, insurance companies, and corporations large and small would alike be paralyzed, and in the catastrophe the poor would be ruined along with the rich. And so—to borrow George Soule’s phrasing once more—the government increased the rigidity of the most rigid element of the American economic system, while doing nothing to stop the decline of its most flexible element.

Hoover also made or encouraged other moves to stop the spread of destruction. He fought hard to balance the Federal budget, believing that a return of confidence in the ability of the government to pay its bills would

lead to a return of general confidence in the system which was collapsing; and in the spring of 1932 the Federal Reserve Board, having successfully protected the bulk of American banks from collapse until the Reconstruction Finance Corporation could aid in the work of rescue, did its best to inflate bank credit once more by open-market purchases of securities, hoping thus to prepare the way for a resumption of investments. But the budget could not be surely balanced without heavier taxes than Congress was willing to levy; meanwhile the general distress of the country was intensified by the fact that private charity and state relief could no longer pay the mounting cost of caring for the jobless unless the Federal government would help; and as for the Reserve Board's open-market policy, though it eased the situation somewhat for the stronger banks, it failed utterly to bring about a resumption of investment. The financial system of the country was still too shaken.

For Hoover, the struggle was a prolonged nightmare. He was being utterly defeated—not because he was stupid or indecisive or pig-headed so much as because the best devices of orthodox economics were helpless to meet the turn of events.

## 5

By the first day of July, 1932—the day when the Democratic delegates at Chicago, “stupefied,” as Walter Lippmann put it, “by oratory, brass bands, bad air, perspiration, sleeplessness, and soft drinks,” nominated Governor Franklin Delano Roosevelt of New York for the Presidency—the economic condition of the nation had become truly appalling.

American business as a whole was deep in the red, despite its furious efforts to save itself. The *New York Times* Index of Business Activity stood at almost exactly 50 per cent of its 1929 high. And the number of people unemployed was variously estimated at 13, 14, or 15 millions. (Cold, impersonal figures, those unemployment estimates; what they represented in frustration, demoralization, hunger, and suffering no statistics could even suggest.)

Three and a half years before, when the wave of stock-market prosperity had first curled over and broken, it had seemed to the bankers and brokers of Wall Street that—in the phrase of the day—“stocks had fallen all the way to the bottom.” Now it seemed to them, by contrast, as if the avalanche of 1929

had been halted on a plateau far up the mountainside. A few specific quotations will point the contrast.

	High price on Sept. 3, 1929—before the Panic	Low price on Nov. 13, 1929—after the Panic	Low price for the year 1932
American Can .....	181 $\frac{7}{8}$	86	29 $\frac{5}{8}$
American Telephone & Telegraph .....	304	197 $\frac{1}{4}$	70 $\frac{1}{4}$
General Electric .....	396 $\frac{1}{4}$	168 $\frac{1}{2}$	34 *
General Motors .....	72 $\frac{3}{4}$	36	7 $\frac{5}{8}$
New York Central.....	256 $\frac{3}{8}$	160	8 $\frac{3}{4}$
Radio Corporation .....	101	26	2 $\frac{1}{2}$
United States Steel.....	261 $\frac{3}{4}$	150	21 $\frac{1}{4}$

\* Adjusted to put the price on the same basis as the previous figures. The actual low price for 1932 was 81 $\frac{1}{2}$ , but meanwhile the shares had been split 4 for 1.

Nor was the bond market in better shape. Forced liquidation and panic had reduced the prices of 40 leading bonds listed on the Stock Exchange to an average of 41.39 per cent of par. The newspapers had been accustomed to print graphs to show the trend of bond prices; now these graphs had to be elongated at the bottom to allow the line which represented prices to pursue its jaggedly precipitous downward path.

The mighty corporate structures of the super-finance of the nineteen-twenties were wobbling. Insull's pyramid had already fallen. The Van Sweringens were deeply in debt to the House of Morgan, and their Alleghany Corporation was in such shape that the price of its common stock had sunk to thirty-seven and a half cents a share. The Transamerica Corporation, representing the Giannini pyramid of banks and other enterprises, was quoted at a low for the year of 1932 of 2 $\frac{1}{8}$ . Most of the investment trusts into which investors had crowded to put their money in 1929 now showed staggering losses. So many banks were in straits that sober bankers were arguing that bank examiners ought to delay their tours of inspection; and the president of Hoover's Reconstruction Finance Corporation, Charles G. Dawes, had had to resign his position in order that the R.F.C. might authorize the lending of ninety million dollars to prop up his bank.

Public confidence in the men of the financial world was obviously falling

fast, as the values of securities which had been distributed among investors during the boom years approached the vanishing point. The receding tide of business was uncovering corruption in the management of bank after bank, and even banking firms of unquestioned honor were losing their reputation for sagacity: had not Kreuger, the Swedish match king, twisted a group of conservative men round his finger and made them innocent partners in his gigantic frauds?

The men of Wall Street themselves were bewildered. They did not know whom or what to rely upon. When Andrew Mellon left the Secretaryship of the Treasury early in 1932 to become Ambassador to England, his departure caused hardly a flurry on the troubled waters of the stock-market. A few years before it would have caused a near-panic, but Wall Street was now losing faith even in its own gods. Fear was everywhere: once there had been no more rapturous optimist in the business world than Charles M. Schwab, but now—in April, 1932—he was quoted as saying, “I’m afraid, every man is afraid. I don’t know, we don’t know, whether values we have are going to be real next month or not.”

One by one, the pet economic theories of the Street had been annihilated. The theory of the business cycle (as most financiers had interpreted it)—the theory that business ebbed and flowed in such a way that the business man who watched the statistical indices carefully could buy at the bottom and prosper—had betrayed its faithful adherents again and again; indeed, one of the things which had helped to defeat this theory was perhaps the very fact that it was so widely believed in. The theory that forecasters could forecast was a wreck. The theory that common stocks were a satisfactory medium for long-term investment was a wreck. Indeed, so general was the intellectual wreckage in the world of conservative economics that it was hardly surprising to hear one of the ablest leaders in the banking world confess, in a news-reel talk, “As for the cause of the depression, or the way out, you know as much as I do.” Thus had the mighty fallen.

Looking for a scapegoat to blame for what was happening, Wall Street found it in Congress. Every time a Congressman proposed an inflationary program, Wall Street shivered and prices took another tumble. One might have supposed that the prospect of inflation would tend to lift the prices of equities; but no, the fear which possessed the men of property had become wild and unreasoning.

The rest of the country was bewildered too. Here and there one saw signs of revolt. During the summer of 1932 a bedraggled Bonus Army of war veterans descended upon Washington demanding funds—and were dispersed by the Army in a lamentably misplaced show of firmness. Farmers' strikes in Iowa bore witness that even staid and conservative citizens might be driven to violence by long-continued and unrelieved deflation. Yet the opposition to the ruling powers of the country was as yet incoherent and scattered. Hundreds of schemes for economic improvement were being advanced by business men, by economists of every school, by laymen, students, and cranks; magazine editors in those days had to spend half their time reading economic plans, most of them quite impossible of practical realization; yet the most striking thing about these plans, perhaps, was the multiplicity of divergent ideas which they represented. (The only radical economic plan which was to gain any large popular following prior to Roosevelt's inauguration had not yet caught the public attention: it was Howard Scott's Technocracy, a curious mixture of valid economic theory and exaggerated statistics and utopian proposals.) The Communists were making a great noise and converting many of the intellectuals of the country, but the rank and file of Americans—even among the unemployed—had no use for them. Discontent there was, and no wonder; a vague feeling there was that the government ought to pay more attention to the people at the bottom of the economic scale, and less to those at the top; but on the whole this sentiment was still formless and unorganized.

It was symptomatic of the temper of the time that when the Democrats met in Chicago to select a candidate to oppose Herbert Hoover, they wrote a platform which could hardly—considering the condition of the country—have been called radical. They called for the “protection of the investing public by requiring to be filed with the government and carried in advertisements of all offerings of foreign and domestic stocks and bonds, true information as to bonuses, commissions, principal invested, and interests of sellers”; they called for federal regulation of holding companies and of stock exchanges; they called for federal aid to the states for unemployment relief, and for expansion of public works; but they also called for a 25 per cent cut in the costs of the federal government, for a balanced budget, and for “a sound currency to be maintained at all costs.”

The man whom they nominated, furthermore, was certainly no radical.

Roosevelt was widely regarded in the West as a foe of Wall Street and a friend of the farmers and little business men and workers upon whom had descended the full weight of economic trouble; but there was nothing revolutionary about his program. It was an indistinctly liberal program, patterned generally after the progressivism of his late cousin and of the late Robert LaFollette. And as for the man himself, what Walter Lippmann had written about him a few months before his nomination expressed the opinion of a great many observers in the East who had watched closely his career as Governor of New York: "Franklin D. Roosevelt is an amiable man with many philanthropic influences, but he is not the dangerous enemy of anything. He is too eager to please. The notion, which seems to prevail in the West and the South, that Wall Street fears him, is preposterous.... Wall Street does not like his vagueness, and the uncertainty as to what he does think, but if any Western progressive thinks that the Governor has challenged directly or indirectly the wealth concentrated in New York City, he is mightily mistaken."

Behind Roosevelt, as the campaign of 1932 progressed, was concentrated a great mass of resentment at Hoover, of distrust of the financial chieftains whom Hoover had so often called into consultation, and of blind desire for change. But neither Roosevelt nor the majority of his followers proposed any major alteration in the economic organization of America. So completely had the American people accepted the financial and business order under which the country had grown and prospered that its downfall left them astonished, dazed, and unprepared with rational alternatives.

Indeed, their very bewilderment brought about a strange apathy, a downhearted quietness of mood. When one reflected that some fourteen million men and women were out of work; that many of them were in desperate want, and most of them faced a future empty of any definite promise of self-respecting self-support; that young people were coming out of school and college into a land which seemed to have no further use for their talents, and which no longer offered them a frontier to exploit; and that the crisis had been steadily becoming more grave for two and a half years, one could only conclude that the American people as a whole were behaving with extraordinary docility. Like a sick man who realizes that his illness may be mortal yet who distrusts strong medicine, the country waited, desperately patient, for recovery or for the end.

During the summer of 1932, recovery seemed once more to be beginning. Wall Street began to realize that some of its fears had been exaggerated: that Congress had not legislated the country into immediate bankruptcy, that the Reconstruction Finance Corporation was propping up the weaker banks (though at great cost), and that the European financial system had not utterly gone up in smoke. There were signs of decided financial improvement. The gold which had drained out of the country during the latter months of 1931 and the beginning of 1932 was returning in part; by the end of August, 40 per cent of it had come back. Cash was beginning to come out of hoarding. The big banks, especially in New York and Chicago, were in definitely improved condition. The formation of a new banking pool under the leadership of the House of Morgan had helped to bring about a belated upturn in bond prices. Signs of life appeared in the stock market, and prices made a brief but rapid recovery. And business, for a brief interval, definitely improved.

Had the American economy at last turned that momentous corner?

For a little while it seemed so. Yet while the political campaign was still in full cry, with Roosevelt promising to come to the aid of the Forgotten Man, and Hoover prophesying that a Democratic triumph would cause the grass to grow in the streets of America—the indices turned down again; not far down, but enough to check the country's half-despairing hope. The resiliency of the financial markets—even of the commodity markets—had not communicated itself to the general business structure. During the last months of the year 1932 business just about held its own. Roosevelt was overwhelmingly elected; the year 1933 began. And then suddenly, while the President-elect was engaged in choosing the members of his Cabinet, the economic system broke utterly at its weakest point.

## 6

It was the banks which gave way.

The final abrupt collapse might have begun in any one of a score of places. But there was perhaps a certain poetic justice in the fact that it actually began in Detroit, where the skyscraper-building boom in the nineteen-twenties had been especially grandiose and the subsequent difficulties of the banks had been correspondingly severe; that the specific bank which was in trouble in February, 1933—the Union Guardian Trust Company—was dominated by a

holding company, a characteristic flower of the financial exuberance of 1929; that this holding company controlled also not only nineteen other banks but also seven security companies and a variety of other financial enterprises, and had thus been tempted, as had innumerable other financial institutions, to serve more than one master; and that one of the things which now made the weakness of the Union Guardian Trust Company a matter of general concern was the very existence of this holding company: the fear that if the Union Guardian Trust Company went under, there would at once be a run upon the other banks under the same management, and that such a run would precipitate a general panic.

The Union Guardian had been sorely pressed for some time. It had already borrowed again and again from the Reconstruction Finance Corporation, its net borrowings amounting to some twelve and a half million dollars. Now, in February, 1933, it was slipping once more. It wanted more aid from the taxpayers' funds—much more, and quickly. There were frantic negotiations with the Federal officials. These negotiations—involving the Detroit bankers, the R.F.C., the Treasury Department, Henry Ford, and Senator Couzens of Michigan—have been the subject of much angry dispute, but they need not be discussed here. The significant fact was that the negotiations failed, and that in the early hours of February 14 Governor Comstock of Michigan, after conferring at length in Detroit with bankers and State and Federal officials, motored through the night to Lansing and issued a proclamation closing all the banks in Michigan for a “holiday” period of eight days.

This proclamation not merely paralyzed the financial machinery of Michigan; it also immediately set in motion the forces of panic elsewhere. Already the banks of the country had begun preparations to meet the probable storm. These preparations were now redoubled. Banks withdrew reserves from the Reserve Banks, and also withdrew money which they had on deposit in other banks: during February more than a billion dollars which had been deposited in New York by out-of-town banks left the city. They sold bonds; the bond market suffered fresh attacks of liquidation. Meanwhile corporations and individuals, all over the country, uneasy lest the panic spread, began withdrawing their deposits from the banks, and thus hastened the storm. In places hundreds and thousands of miles apart, there were bank runs of increasing seriousness. Hoarding began anew, to the extent of hundreds of millions of dollars. Gold began once more to leave the country in



quantity.

For some ten days these phenomena were largely hidden from the eye of the casual observer. Newspapers gave them as little publicity as possible; indeed, even as late as March 2, when the panic had acquired terrific momentum, the *New York Times* still kept it off the front page, and its chronicle of bank holidays on page eight was topped by the gentle headline, BANKS PROTECTED IN 5 MORE STATES. But on February 24 Governor Ritchie had to declare a three-day holiday in Maryland, and from that moment onward the progress of the collapse was very rapid. The Federal Reserve System, admirably as it had been devised to meet localized emergencies, could not withstand the simultaneous onslaught of panics on every front. State after state was driven to pass emergency laws permitting banks to limit withdrawals if not to close their doors entirely.

By March 3, the ability of even the big financial citadels of New York and Chicago to hold out was becoming hourly more doubtful. In Washington, President Hoover's financial advisers were urging him to declare a national banking holiday and to put an embargo upon gold, but he could not be induced to act unless the incoming president would join with him, and Roosevelt refused to take administrative responsibility until he entered the White House; so nothing was done.

At last, at 4:30 in the morning of March 4, Governor Lehman issued a proclamation closing the New York banks, and almost simultaneously Governor Horner of Illinois took similar action for his state. With the issuing of these two proclamations, the financial paralysis of the country became virtually complete.

History does not often time its climaxes with precision. But in this instance the timing was diabolically perfect. No drama written to throw into bold relief the defeat of the financiers and the failure of Hoover's measures for recovery could have hurried to a more effective curtain. During the days when the bank-holiday epidemic was spreading, Charles E. Mitchell and his colleagues of the National City Bank had been on the witness stand before a Senate investigating committee in Washington; their shocking testimony—which had forced Mitchell to resign on February 26—seemed to point the moral of the events that were taking place. And now on the very morning when the doors of the great New York and Chicago banks at last stood closed to the public, Herbert Hoover was preparing to ride to the Capitol to

relinquish the Presidency of the United States. His term of office had come to an end, and with it the financial order which he had labored so long to sustain.