The Stock Market Panic in 1929

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# THE STOCK MARKET PANIC IN 1929

By Irving Fisher

To my mind the problem of the stock market panic is, and will be to some extent for many years, an enigma, but I think now is the time to gather data and to make preliminary estimates of what really happened and why, because as we wait, those involved are forgetting; and if we wait too long the people whose memories are most important will have died. Some one has said that the "perspective" of the historian, about which the historian boasts so, is simply due to the fact that all those people who had the data, from which they could contradict him, are no longer living.

I shall probably modify my opinion from time to time in the future as I have in the past. But I wish now to gather together what evidence there may be on the most important economic event in the lifetime of all of us here.

Perhaps some of you who are more or less familiar with my work in statistics may not realize it, but this is the first time I have ever tried to analyze an historical event and to trace all the causes at work. I have never studied or written a paper on business cycles as such. I have merely tried to trace individual threads, such as the rate of interest or the change in the purchasing power of money. Yet, much to my amazement, I have been credited with having a theory of the whole phenomena.

I conceived it to be a proper function of the analyst to trace faithfully what would occur if one individual force was at work unhindered by others, and on that basis I have tried to show how changes in the purchasing power of money, for instance, have explained a great deal in the business cycles, but I have never tried to explain "the business cycle."

Now it is my desire to try to get all the elements together in my forthcoming book on the stock market crash. It is an exceedingly complicated problem. For this reason it would be impossible to present all aspects at one short meeting like this.

I wish this preliminary explanation to be made and emphasized in order that you may not think that by picking out a few outstanding factors I am pretending to represent a complete view of the subject. To do so must, of course, over-simplify the problem. No problem as complex as that before us now can be expressed in two or three outstanding influences.

Nevertheless, if I were to try to pick out those influences which seem to me most important, they would be somewhat as follows:

The stock market crash had its roots primarily in the bull movement. If we want to explain the crash, we must explain the bull movement that preceded it.

As I see it, this bull movement was justified to a very large degree. Last night I was talking with a fellow student of this problem, whose judgment seems to me as good as anybody's, and who stated that, in his opinion, two-thirds of that spectacular 100 per cent rise in the stock market between 1926 and September, 1929, was justified by prospective earnings while the other third was due to unjustified speculation. I would concur in this conclusion as representing the composite of my own judgment, estimate or guess, whichever you choose to call it; although I would raise the figures a little and say that between two-thirds and three-fourths of the rise in the stock market between 1926 and September, 1929, was justified. The unjustified character of the remainder is best registered by the swelling of brokers' loans. This unjustified part was the outgrowth of the other part. It was just because there were great chances to make money such as have seldom if ever, in the aggregate, occurred before in the history of the world that so many people were eager to profit by them and went into debt for this purpose. They thereby erected a great credit structure beyond anything that had previously been erected.

On the face of it, it looks absurd to justify even two-thirds of the 100 per cent rise in the stock market. After this tremendous crash, it has become the fashion to decry the phrase "The New Era," which so many were using a few months ago. That phrase may perhaps be exaggerated in its implications, but I do believe that the Hoover Committee on Recent Economic Changes was right when it said that the "tempo" of invention and improvement in the arts was greater since the War than ever before, and I point out that even a slightly increased tempo is magnified in the equities of common stocks.

I think that what Mr. Snyder has pointed out is of very great interest—that the general rate of growth of production has been fairly constant for a long time. But we must not slur over the variations from the general trend.

I call attention to the particular line signifying the product per man. The product per man, according to Mr. Snyder's line, went up sharply in the last few years.

This has been due largely to inventions, and inventions have been due largely to the fact that invention for the first time in history has been making use of science where only a few large corporations had been doing it before the War, and, after the example of Germany, almost all important corporations now have their development and research laboratories. One has four thousand scientists at work all the time to improve its products. We have mass production of invention, and it is shown in the lagging of the Patent Office. The war inflation led a great many college professors who were living on their salaries to discover that they could no longer do so because the purchasing power of the dollar had fallen. It was necessary for them to increase their incomes, and they accepted whatever opportunities came to them to go into industry, and industry found it was the most profitable investment ever made.

Besides this historical accident of inflated cost of living there was another. The same inflation had brought up wages. This was aided by a stoppage of immigration. When deflation came, organized labor was strong enough to resist recession of wages. Industry had to put up with high wages, and decided that it should save labor by labor-saving inventions.

So there was a great impulse toward labor-saving invention. Besides, those owners introduced industrial management as never before. The War pyramided trusts, and we have been condoning them ever since. We have been praising mass production and scientific management where before we criticised them. Labor has been coöperating as never before, especially under the leadership of William Green. These causes and the flight from bonds to stocks, especially after the publication of Edgar Smith's book on stocks and long term investments, and the coming of investment trusts that exploited that idea, have led to greater confidence in common stocks.

These are some of the reasons why there was a bull market, and a justified bull market. How did it happen that there was an unjustified expansion of loans? It would happen necessarily, I suppose, to some degree anyway because whenever there is a good thing to be exploited people become over-enthusiastic and swing to extremes. But aside from this, there were special reasons why there should be a going into debt. One reason was that during the War many people, who had never before known what investment was, were induced to buy Liberty Bonds and to do so on borrowed money, and when the Liberty Bonds were paid off, as they have been to a large extent, those funds were then seeking investment by the same process—borrowed money. The psychology had been set for investing in whatever seemed most profitable on borrowed money.

Then again, and this I think is of very considerable importance, the rate of interest ought to have been raised in sympathy with the big investment opportunities. I have a book that is in the course of preparation on *The Theory of Interest* in which I have emphasized the importance of invention, and when new invention gives an opportunity to make more than the current rate of interest there is always a tendency to borrow at low rates to make a higher rate from the investment.

Now the rate of interest was artificially low, partly, because we had so much gold after the War and gold had a fictitious influence upon the rate, and then, a little later when Europe began to get back on the gold standard, we tried to help Europe by not re-attracting that gold to this country by raising the rate of interest. And finally, when the bull market came into being the Federal Reserve system not only still wished to prevent the exodus of gold back from Europe to the United States but also wanted to maintain the low rate of interest for what it considered legitimate business as distinct from speculation. It was confronted with the problem of how to discourage the speculation in Wall Street and at the same time not to discourage business by a too high rate of interest. It tried to make a discrimination, but it was like putting a log across half the stream. The water merely went around it. In so far as the banks coöperated with the Federal Reserve system, in not loaning in Wall Street, to that extent the "bootleg" lenders, came into the market and supplied the deficit.

I think, as we look back—and hindsight, of course, is always better than foresight—we may now say that it would have been wiser had the Federal Reserve system, in order to nip this speculation in the bud, raised the rate of re-discount indiscriminately over a year ago. It certainly would not have deterred business as much as the stock market crash, which was the fruit of the other policy.

In other words, the same mistake, in a different form, was committed as was committed in 1919 when in order to encourage business after the War there was an easy money policy. It then led to commodity inflation while this time it led to stock market inflation.

So, without trying to introduce any complications into this over-simple statement of the situation, I shall conclude that there was underlying this bull movement a justification in fundamental conditions, and on top of that justified bull movement there was an unjustified going into debt, encouraged by the fact that investors found themselves confronted on the one hand by wonderful opportunities to make money and, on the other, a low rate for loans. They could borrow at much less than they expected to make.

In short, both the bull movement and the crash are largely explained by the *unsound financing of sound prospects*.