The History of the Twentieth Century
Episode 258
"The Great Crash I"
Transcript

[music: Fanfare]

In 1929 was the most prominent economist in the United States was a man named Irving Fisher. He's been called the world's first celebrity economist. He was perpetually bullish on the stock market, believing that Prohibition and new technologies had given the US economy a huge competitive advantage, and today he is most famous for his declaration on Tuesday, October 15, 1929, that the US stock market had "reached what looks like a permanently high plateau."

This declaration is famous for all the wrong reasons.

Welcome to *The History of the Twentieth Century.*

[music: Opening Theme]

Episode 258. The Great Crash, part one.

The British Chancellor of the Exchequer, Winston Churchill, had been riding high since his return to the Conservative Party in 1924. He had brought a charismatic flair to a difficult Cabinet post, which led the newspapers to dub him "The Smiling Chancellor." He'd put Britain back on the gold standard. That required budget cuts, so in the aftermath of the Washington Naval Conference, he ruffled feathers in the Admiralty by pushing through substantial cuts in the budget for the Royal Navy. He had also postponed plans to fortify the Royal Navy base at Singapore, questioning why it was necessary. He assured Prime Minister Baldwin that Japan "cannot menace our security in any way."

Then came the 1926 General Strike. The Tory Government had put down what some British socialists had hoped would be their October Revolution. Churchill, always a strident critic of socialism, had been particularly harsh in his denunciations of these strikers. Tories applauded, but a lot of working class people couldn't avoid noticing that the "Smiling Chancellor" could also crack a mean whip.

Churchill fiercely opposed Government efforts to open trade and normalize relations with the Soviet Union, and stung by Irish independence, was an equally ardent foe of proposals to grant more autonomy to other British colonial holdings, notably Egypt and India. He was frequently at odds with Neville Chamberlain, the Minister of Health. One of these two was seen as likely successor to Stanley Baldwin as Leader of the Conservative Party, although as the 1929 deadline for a general election approached, there was talk of replacing the controversial Churchill with the more conciliatory Chamberlain as chancellor in the next government.

On the evening of May 30, 1929, Churchill went to Number Ten to await the election returns with the Prime Minister. A ticker tape machine spit out the numbers. One eyewitness account has Churchill drinking whiskey, growing red in the face, and making comments that were characterized as “unprintable” as the numbers came in. This 1929 British general election has been called the “Flapper Election” because it was the first British election in which women in their twenties could vote. The Tories got the largest share of the popular vote, but Labour got more seats, and, with Liberal support, Ramsay MacDonald became Prime Minister for a second time.

The Liberal Party won 59 seats in the new Parliament, an improvement in their position, but this would be the last time for fifty years that a third party would win so large a share of seats, so you can look forward to a half-century of two-party politics in the UK. Say farewell to Liberal Leader and former Prime Minister Herbert Asquith, the man who had led Britain into the Great War. He resigned his leadership post in 1926 and passed away in 1927 at the age of 75. David Lloyd George now leads the Liberal Party.

Churchill looked askance at his former party and Lloyd George, his former colleague. He was appalled that the Liberals would back a Labour government. He ardently believed that the Tories and the Liberals represented the anti-socialist majority of the British public and were therefore duty-bound to form an anti-socialist coalition, at least until the Bolshevik madness that was sweeping certain parts of the country finally receded.

Churchill was able to hold onto his own seat this time, but the change of government meant he was reduced to the modest salary of an opposition MP. He was a man accustomed to an upper-class lifestyle but didn’t have an upper-class income to back it up. He had written an acclaimed multi-volume account of the Great War entitled *The World Crisis,* prompting one colleague to joke that Winston had written a great big book about himself and titled it *The World Crisis.* I am reminded of how Finlay Peter Dunne joked that Theodore Roosevelt should have called his book on the Spanish-American War *Alone in Cuba.*

In Churchill’s case, he really did follow up *The World Crisis* with an autobiography, *My Early Years.* Both books sold well. He also wrote for the newspapers and magazines, but he was more than capable of spending his income as fast as he earned it. Like many of his peers of the time, Churchill sought to make up the shortfall by taking advantage of the booming stock market in New York City.

Not that there weren't investment opportunities closer to home. By September 1929, everyone in London was talking about the financier Clarence Hatry. [I hope I'm pronouncing that correctly.] Hatry was born in 1888, the son of a successful silk merchant. He had made a fortune in silk before the Great War and then lost it. But he made it back investing in oil and manufacturing during the war. After the war ended, he engineered mergers, managed trusts, and had gone bankrupt three times, but had somehow emerged from each bankruptcy richer than ever and with his reputation for business acumen enhanced rather than tarnished. I assume you've seen this type of business figure before. I don't know how they do it, but they do it. He owned the largest yacht in Britain, with a crew of forty. His house in Mayfair was the only one in London with a swimming pool on the roof, where he hosted lavish parties for the rich and famous. And his flamboyance was seen as evidence of genius, and not as a personality disorder, for some reason.

In 1928, Hatry got into Photomatrons. The Photomatron was an American product, invented by Anatol Josepho, a Jewish immigrant from the Russian Empire. (Have you noticed how often Jewish immigrants to America from the Russian Empire keep cropping up in the podcast?) Anyway, the Photomatron was a booth you sit in, alone or with a friend, and insert a quarter. The machine then takes eight pictures of you, with or without a friend, and spits them out in a strip of finished photographs in less than ten minutes, all automatically. This was just the sort of modern technological marvel that would catch the fancy of the fad-crazed public during the Roaring Twenties, and it made Josepho a millionaire.

When these machines were first introduced in New York, owners found they had to hire attendants to manage the crowds of people waiting their turn to try them out. A few years later, Photomatons were introduced to Europe, and now Hatry was bringing them to Great Britain. Not a bad idea. Not a bad idea at all. Other investors agreed, and put a lot of money into Hatry's investment group in early 1929. That led him to undertake his biggest merger ever: the leveraged buyout of a number of Northern iron and steel companies, which would be consolidated into the United Steel Companies, a project no doubt inspired by the success of United States Steel in America.

But this latest deal began to go awry in June, just after the general election. Hatry would later blame his financial troubles on investors becoming skittish following the installation of a Labour government. This may even be true, or maybe the bankers simply began to notice that Hatry seemed overextended. Lenders began to back out. Hatry spent the summer of 1929 scrambling to attract the financing he needed to finish the deal. He had to put up his own holdings as collateral. He even approached Montagu Norman at the Bank of England for money. Good luck with that. Norman told him he'd paid too much for his new steel holdings and that was his own lookout.

By September, Hatry couldn't get a loan from anyone and the values of his holdings had plunged. The jig was up and he confessed to forgery. He had forged duplicate copies of bond notes he actually held, thus allowing him to use the same bond as collateral for multiple loans. Hatry was arrested and prosecuted, his investors and creditors forced to reckon with the disappearance of some £25 million.

Stock market crashes typically begin with a story like this. One business, one financial entity thought to be sound collapses dramatically. What follows is a sudden crisis of confidence as investors begin to wonder which of their other investments will prove to be just as hollow.

And beyond the shifting mood of investors, there are more concrete effects, ripples generated by Hatry's collapse that now flow through the financial markets. One such ripple was a sharp decline in British stocks. Another was composed of nervous investors pulling out of the UK altogether, selling assets denominated in pounds and then converting their pounds, putting even more pressure on the Bank of England's dangerously thin gold reserves. The Bank was forced to raise its interest rate to 7.5% to shelter its gold supply, which in turn made other UK investments less attractive.

Another ripple traveled all the way across the Atlantic as British investors suddenly short on cash began selling their US holdings and pulling their money out of US brokers' loans. The day the news of Hatry's collapse broke, the Dow lost 8 points. By the end of September, it was at 325, back to the level it had first reached in July. In early October though, the Dow rallied some and was back at 350. Perhaps Wall Street had weathered the storm.

The following weekend, Thomas Lamont, the acting head of J.P. Morgan & Co. and himself one of the wealthiest men in America sent an 18-page letter to President Hoover in reply to Hoover, who had asked him for his views on the effects of speculation on the stock market. In this lengthy letter, Lamont assured Hoover that everything was just peachy, that a little speculation was good for business and that greater and greater numbers of Americans investing in stocks could only be a healthy development for the nation. There was no need for the government to intervene, Lamont assured Hoover, because "[t]he future appears brilliant."

Before filing the letter away, Hoover scrawled at the top of the first page, "This document is fairly amazing."

The following Wednesday, October 23, the market opened at about 300, down considerably from September's peak, but hardly a national crisis. But a sudden flood of sell orders came in at 2:00 that afternoon, and the market closed down 20 points in just one day. The next day, Thursday October 24, opened quietly enough, but after 11:00, the sell orders began flooding in. Not from New York, but via telephone and telegraph from investors and brokers across the United States. Modern technology made it possible for more investors to get more sell orders onto the floor of the exchange more quickly than ever before.

The result was unprecedented. Panic selling took over on what would go down in history as Black Thursday. By lunchtime, news of the turmoil on the stock exchange floor drew thousands of onlookers, drawn by the same ghoulish instinct that draws people to fires or car crashes. Those in the know might have recognized the biggest names in New York banking, including Charles Mitchell, the chairman of National City Bank, who was known as “Sunshine Charlie,” for his perennially optimistic assessments of the US economy, as well as the heads of Chase, Bankers Trust, Guaranty Bank, and more entering 23 Wall Street, the headquarters of J.P. Morgan & Co. Half an hour later, Thomas Lamont, he of the 18-page letter to the President, came down to the lobby to announce to the press, “There has been a little distress selling on the Stock Exchange,” a remark that would go down in history right next to “permanently high plateau.” Lamont went on to say that it was a “technical” problem, and the situation would improve.

In fact, New York’s leading bankers had agreed to form a purchasing pool to buy up stocks in order to arrest the slide. That afternoon, the bankers purchased about $25 million worth of US Steel, GM, Ford, RCA, GE, the bluest of the blue chips. It worked, and at the end of the day, traders on the floor cheered and whistled at the news the Dow was off a mere 9 points. The apocalypse had been averted, today. Privately though, Lamont warned the Stock Exchange board: “There is no man or group of men who can buy all the stocks that the American public can sell.”

That same day, uptown at the New York Fed, the board voted to lower its lending rate from 6% to 5.5%, only to have that decision reversed by the Board of Governors in Washington the same day.

On Friday morning, American newspapers were headlining stories about how a quick and decisive move by New York banks had nipped a stock panic in the bud. Prices were stable on Friday, although the volume of trades was unusually high. By Friday afternoon, some of the banks were feeling confident enough to begin selling off the shares they’d bought on Thursday.

But another round of investor panic set in over the weekend. Remember that a lot of investors, small middle-class people and large pooled funds alike, were investing on margin, meaning they paid only 20% of the price of the stock. The rest of the stock price was borrowed money, from those brokers’ loans, and the stock itself was collateral for the loan. This means your investment is leveraged five times. If the stock goes up, that’s great, because every 1% increase in the stock price represents a 5% profit to you. The bad news is, if the stock goes down, the reverse is also true. If the stock goes down 20%, you lose your entire investment. If the stock goes down further, you lose your entire investment, plus you are now on the hook to your lender for additional money.

In practice, you don’t even get that far, because the loan agreement specifies you have to put up collateral equal to the value of the loan. So if the value of your stock drops below the amount of your loan, the lender will require you to put up additional collateral, probably in the form of more stocks or bonds. If you have collateral to offer, that's fine. If you don't, the loan becomes due. Right now. So you have no choice but to gather up the money you need to repay the loan by whatever means you have. Right now.

For most investors, the first recourse would be to sell that stock before it drops any lower. That should pay off most of your loan. Then you'll have to beg, borrow, or steal the rest, by whatever means possible.

Got it? Now multiply that rising sense of anxiety by a couple of million investors across the country, who are suddenly realizing that not only is all the money they put into stocks gone, but maybe the rent money as well.

When the market opened on Monday, October 28, a slew of sell orders came in and never let up. The Dow closed at 260, dropping 38 points, or 13%, the largest one day decline in its history. $14 billion in share value disappeared in a single day. Economic historians, remarkably imaginative people that they must be, call this Black Monday.

Reporters camped out in front of 23 Wall Street that day, waiting for the bankers to gather once again to rescue the market. Just after 1:00, Sunshine Charlie was seen entering the building. That news alone sparked a brief rally in the market, but nothing came of it. It turned out that Charles Mitchell had dropped by to ask for a personal loan. His own private investment portfolio was crumbling.

That evening, Mitchell and the other big-name New York bankers were invited to a dinner at the Fifth Avenue residence of the financier Bernard Baruch. You may recall we met Baruch briefly in episode 158, when he accepted a position in the Wilson Administration's War Industries Board, where he did sterling work managing US government purchasing and shipping of military supplies during the Great War. Now, 12 years later, the 59-year-old Baruch was hosting this dinner to welcome a special guest from England, Winston Churchill. Despite what must have been a difficult day, Mitchell offered the guest of honor a toast, in which he jokingly addressed the assembled New York elite as "friends and *former* millionaires."

The following day, Churchill was invited to visit the floor of the New York Stock Exchange and witness the magic of American capitalism for himself. What he witnessed was another terrible day for the stock market, not quite as bad as yesterday, but still terrible. Can you guess what economic historians call this day? If you guessed "Purple Tuesday," you're wrong.

Churchill now faced the unpleasant task of explaining to his wife Clementine that the $50,000 he had invested in Wall Street was gone. He would spend the next few years writing articles and books, trying to earn enough of an income to fill the sudden void in the family finances.

The New York Fed injected over $100 million into the local economy by buying up US government securities. That surely helped contain the damage. The Board of Governors protested against this rash act, done without clearance from Washington. The president of the New York Fed retorted that the world was on fire and there had been no time for consultations. The Governors would eventually agree, and by then also agree to buy up a further $200 million.

The Federal Reserve likely prevented the crash from getting even worse, but it was bad enough. By the end of the year, the Dow had settled down to the neighborhood of 240, down 40% from its September high. The Dow would not set another record high until 1954.

[music: Beethoven, *Symphony No. 9 in D minor*]

There was a silver lining to the stock market crash of 1929. Remember that in the period between the Civil War and the Great War, the US economy had suffered multiple economic panics, perhaps as many as ten or eleven, depending on how you want to define "panic." Every one of these previous panics had seen bank failures and bankruptcies. The crash of 1929 was different. It was bigger than anything that had come before, but still, no major businesses went under. No banks failed. The stock market had been overvalued. It had experienced a bubble. But now the bubble had popped and stock prices had settled down to a more realistic level. That was a good thing, right? The fundamentals of the economy hadn't changed.

The New York *Sun* argued this very point. No New York housewife was going to take the kettle off the stove because the stock price of Consolidated Gas was down, was she? No one was going to stop driving their car because General Motors' share price had plunged. No farmer in Iowa was going to stop buying out of the Sears Roebuck catalog just because its stock wasn't priced as high as it used to be.

The view that the end of the stock market bubble had to be a good thing for the US economy became widespread. *BusinessWeek*, the publication that had literally been born criticizing the bubble in the stock market, now declared that with American business no longer distracted by the ups and downs of the Dow, it could get back to fundamentals.

But economics is not only about the numbers. It's about people, their attitudes, and their moods. When the stock market was going up, even Americans who weren't personally invested took the rise as a sign that the future looked bright and felt secure. People who feel secure spend money. After the crash, even wealthy people were less wealthy than before, and hence more reluctant to spend. Industrial production dropped 5% in October 1929 and another 5% in November. Unemployment had been at 3% in the summer. By early 1930, it was at 6%. Particularly hard hit were companies that produced expensive consumer goods, like automobiles, refrigerators, and radios, all of which had until now been *the* must-have modern conveniences of the Roaring Twenties. Suddenly, no one was buying them.

The US Federal Reserve gradually dropped its lending rate from 6% to 2.5% by summer of 1930, and added $500 million to the money supply. These moves were controversial, even within the

Fed. Some bankers with a shaky grasp of economics argued that low interest rates had sparked the orgy of speculation in the first place, so bringing them back would be a mistake.

In Europe, a common reaction to the crash was "I told you so." British stocks dropped 15%, not nearly so steep a plunge as in New York, while the French and German stock markets, which were much smaller, fell scarcely 10%. John Maynard Keynes, by his own account, heaved a great sigh of relief on hearing this news, while a French economist compared the crash to the draining of an abscess—*ew*—painful and messy, but necessary to promote healing.

Lower interest rates in the US were good news for European central bankers, who were now free to lower their own interest rates. The Banque de France, flush with gold, could afford to match the Fed's 2.5%. The Bank of England went to 3.5% and the Reichsbank 4.5%.

The opportunity to lower interest rates was especially welcome at the Bank of England, as it would make it easier for the bank to meet its goal of building up its gold reserve without choking the British economy. The same was true in Germany, and even more so. Since 1924, when the Dawes Plan went into effect, Germany had been borrowing heavily, especially from the USA. The Dawes Plan encouraged American lenders by prioritizing repayment of their loans over the reparations payments. The idea behind this prioritization scheme was to grant Germany easy loan terms; the Germans would then use the loans to rebuild the German economy, which in turn would make reparations easier. Germany also got a five-year reprieve of lower reparations payments, again to give Germany breathing room to rebuild its economy.

German corporations and government entities had borrowed about US$3 billion in the five years since the Dawes Plan went into effect. Some of that money went to productive purposes, but a lot of it went to projects like public swimming pools, which are nice to have, but aren't going to improve your GDP. Don't be too hard on the Germans, though. American bankers have something to answer for here. They were marketing loans to Germany aggressively, because of the high interest rates they could get.

Some of these loans had long terms, but about $1 billion worth were short term. By 1928 or 1929 though, American lenders began focusing more on those brokers' loans, closer to home, where you could charge rates as high as 20%. German debtors found their American credit drying up, and by 1929, the German economy had slipped into a recession. This was horrible timing, because under the Dawes Plan, signed back in 1924, episode 240, after this five-year respite, Germany was supposed to go back to full reparations payments this year, 1929.

There were some in Europe who argued that the whole international financial system was headed for disaster, and some among those who welcomed the coming collapse. If Germany and France and Italy and Britain all defaulted on their debts at the same time, that would force the Americans to come to terms with a restructuring of the interlocking framework of war debts that would relieve Germany and the Allies alike of the economic burdens they had been saddled with.

In his more intemperate moments, Hjalmar Schacht, the head of the Reichsbank, toyed with the idea of precipitating an international financial collapse. In his more temperate moments, he tried to warn other bankers of what lay ahead. You'll recall from last episode how at the international bankers' meeting on Long Island in 1927, he had tried to sound the alarm.

In early 1929, a new international conference met once again for another round of negotiations over Germany's reparations obligation. At the time it was called the Second Dawes Conference, although it would soon be known as the Young Conference after Owen Young, the head of the American delegation. You'll recall Owen Young from episode 237 as the person who put together the deal to create RCA, the Radio Corporation of America, and had served as its first chairman.

Hjalmar Schacht led the German delegation, and he went into the talks convinced that the large debt Germans now owed to American bankers would persuade those bankers to support reparations relief for Germany, as a matter of self interest. It did not work out that way, much to his dismay. The US government continued to insist on full repayment of all Allied debt owed to America; this in turn made the British and French adamant that they could accept annual payments from Germany of no less than the amounts they owed the Americans, about $500 million per year.

Schacht stunned the Allied representatives with his counteroffer: if the Allies expected Germany to make full reparations, the Allies would have to restore to Germany the territories taken from it by the Treaty of Versailles, beginning with Germany's four African colonies, which Schacht implausibly estimated as worth $20 billion. But more than that, Schacht also asked that the Polish Corridor and the other formerly German territories granted to Poland at Versailles also be restored to Germany. With this additional population and industrial base, he argued, Germany would then be able to meet its obligations.

The meeting erupted. Were the Germans trying to abrogate the Treaty of Versailles? Were they suggesting that Germany would only meet its treaty obligations under one article if it were permitted to renege on another? The French, who also had considerable sums invested in Germany, threatened to pull out all their money, literally tomorrow, if the Germans did not back down.

The Germans did, and a crisis was averted. For now. The final agreement that came out of this conference, the Young Plan, held Germany to that minimum of $500 million per year for the next 36 years, and then $375 million for the next 22 years after that, to cover Allied debts to the US. This would mean that Germany would be making reparations payments for 68 years altogether, three generations, until the unimaginably distant year of 1988.

Hjalmar Schacht reluctantly signed the agreement on behalf of Germany. The signing ceremony, held in the King George V Hotel in Paris, was briefly disrupted when a photographer's flash set fire to the curtains in the meeting room. You can take that as an omen. Schacht returned to

Berlin, gloomily predicting that the world economic crisis had been averted, but only for two years.

He was exactly right about that.

But that is a story for another episode. We'll have to stop there for today. I thank you for listening, and I'd especially like to thank David and Marek for their kind donations, and thank you to Scott for becoming a patron of the podcast. Donors and patrons like David and Marek and Scott help cover the costs of making this show, which in turn keeps the podcast available free for everyone, so my thanks to them and to all of you who have pitched in and helped out. If you'd like to become a patron or make a donation, just visit the website, historyofthetwentiethcentury.com and click on the PayPal or Patreon buttons.

The podcast website also contains notes about the music used on the podcast. Sometimes it's my own work, sometimes it's licensed, but many times, the music you hear here is free and downloadable. If you hear a piece of music on the podcast and you would like to know more about it, including the composer, the performers, and a link to where you can download it, that would be the place to go. While you're there, you can leave a comment and let me know what you thought about today's show.

And I hope you'll join me next week, on *The History of the Twentieth Century,* as we continue the story into the aftermath of the Great Crash of 1929. We already saw the Panic of 1907 and the depression that struck the world in 1920. Both of these were bad, but in both cases, the US economy had bounced back in a year or two. In isolation, the story of the Crash of 1929 might have ended the same way. But it did not happen in isolation. The Great Crash, part two, next week, here, on *The History of the Twentieth Century.*

Oh, and one more thing. When I was a kid, in the 1960s, thirty-some years after the crash, it was commonly said that a number of investors and stockbrokers killed themselves by jumping out of skyscraper windows in New York City on the news that the crash had wiped out their wealth, or perhaps after receiving a margin call, and realizing they could not meet the conditions and were now bankrupt. It was a comedy staple of the time that the mere rumor of bad news on Wall Street would induce brokers and investors to climb onto the window ledge. Then they'd be told no, it was just a misunderstanding, so they'd heave a sigh of relief and climb back into their office.

Rumors of suicides on Wall Street were circulating even in 1929, but there's no evidence of any sudden spike in suicide following the crash. The New York City medical examiner must have heard the rumors, because he announced in November 1929 that the number of suicides in New York City in the previous four weeks had actually been lower than in the same period a year earlier.

So where did these stories originate? One possible source is our old friend Winston Churchill, who actually witnessed the suicide of a fellow guest at the New York hotel where he was staying at the time, and recounted this event in an article he wrote about the crash that was published in *The Daily Telegraph.* The story was true as far as it went, although contrary to Churchill's speculations, it does not appear that the suicide Churchill witnessed had any connection to the stock market crash.

Comedians of the time joked about stockbroker suicides in the aftermath. Humorist Will Rogers claimed in his newspaper column that stockbrokers had to wait in line to get to a suitably high window. Similarly, comedian Eddie Cantor told a story about requesting a room in a high-rise hotel in New York and having the desk clerk ask him, "For sleeping or jumping?"

Come to think of it, they were still telling that joke in my day, four decades later.

[music: Closing Theme]