# 1929: the Wall Street crash

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Bill Jenkins remembers the Wall Street crash of 1929, seventy years ago this month, which plunged the world economy into recession, and punctured capitalism?s dreams of an endless golden future

In 1996 Alan Greenspan, the Head of the US Federal Reserve, warned of the ?irrational exuberance? of the American stock market. Since his warning the Dow Jones index, the measure of US shares, has risen a further 80 per cent. It now stands at $12 trillion and, according to nearly all commentators, is set to crash.

The US has experienced a decade of growth: profits, output and the budget deficit are all up. It was the motor that drove the world economy through the Far Eastern crash of 1997-98. This growth is now slowing but through most of 1999, Wall Street has continued to ride high, despite nervous wobbles.

It was much the same in October 1929, when Wall Street crashed. Boom went to bust in the space of a month.

The ?roaring twenties? were a period of economic growth across the USA. The rich had never had it so good. In the mid-1920s, every sector of industrial production grew strongly and rates of return were rising rapidly.

The growth of industrial output was matched at every step by Wall Street?s rise. In May 1924 the New York Times Index was 106, by December 1925 it was 181. By December 1927, the index stood at 245.

In 1928 there were already warning signs. Agricultural prices were falling, there was a sharp contrast between the boom areas of the US and, for example, the depressed South. The first signs of overproduction could be seen in some consumer goods areas. But the stock market continued its upward trend. In March 1928 the market rose 25 points: in one month it had increased by as much as the whole of 1925. The speculative boom had begun in earnest.

There has been much speculation around the cause of this sudden surge in share prices in 1929. Some commentators blamed it on low interest rates. Others believed that misplaced over-investment in radio companies ? as in the Internet today ? triggered the rest of the market. But they are both wrong.

The real reasons lay in the nature of capitalism itself. As capitalism entered its imperialist phase at the start of the 20th century, the stock market became a vital source of investment funds, as production outstripped the limits of individual capitalist owners. The stock market was the means through which capitalists could concentrate and consolidate their enterprises and through which the banks could exert increasing control over industry.

Stocks entitle their owner to a share of the future profits of a company. Like anything under capitalism, they can be traded: and their price usually reflects the level of profits that the particular firm is expected to earn. The share price depends on future profits that do not yet exist.

There are periods however, like the mid 1920s, when a lack of profitable investments in the real economy means capitalists are driven to speculate in shares. They hope that their speculation will yield them returns beyond the given rate of profit. As profits decline across the economy, this instinct to speculate represents a real social force. If it is strong enough it can become a self fulfilling prophecy for a while.

The sudden influx of funds into the stock market leads to a rise in share prices irrespective of real profit rates. The value of the shares becomes increasingly detached from their ?real? worth. This in turn leads to a rise in rates of return as investments are not measured by dividends realised but in the rise in the value of shares themselves. For a period the rise becomes cumulative.

Ever wider and deeper strata of society are drawn into the speculation, easy money becomes the norm and this money seeks out the new sources of savings required to guarantee the next rise. In turn each rise leads to the further deepening and extension of the speculation, until there is no more money and reality intrudes with a bump.

But before the crash there are always several false alarms. As speculation grows the level of trading expands enormously. In March 1928 share trading reached an all time high of 3,875,910 shares. By June it stood at 5,052,790. The election of President Hoover in November led to a further surge in prices and volumes. But the market swings became increasingly exaggerated. On 8 December 1928, in a portent of things to come, radio shares fell by 72 points. Even so by the year end the market as a whole had grown from 245 to 331 points.

These hysterical levels of activity were financed on the never-never. The huge increase in brokers? loans provided a guide to the level of speculation across the market. The banks lent to the brokers, who lent to the customers, who speculated with the money, paying interest to the brokers, who in their turn paid the banks.

These loans grew from around $1 billion in the early 1920s to $6 billion by the end of 1928. They provided the funds to buy stocks ?on margin?. Paying for stocks on margin released the funds for an ever increasing scale of speculative activity. The speculator would pay for example 10 per cent of the cost of the stock they wanted to buy, using the broker?s loan for the remaining 90 per cent. The collateral for the loan is guaranteed by the value of the stocks themselves.

This is great while the market is rising since a 1 per cent increase in the value of the stocks provides a 10 per cent return on the speculator?s money. But it leaves a terrible hostage to fortune once the market begins to fall. A fall of 10 per cent will wipe out the speculator?s investment. Any fall greater than 10 per cent will mean they are unable to pay back their loan. They will have to sell. In turn this will reduce prices and so on.

In practice as loans were provided on a given rate of interest and the price of stocks was no longer related to dividends, stocks had to rise to pay the brokers and then the banks.

In this situation, standstill leads to collapse. Buying on a loan was not the only financial innovation invented to assuage the lust for speculation. For the first time in the US, investment trusts were organised on a large scale. These trusts held shares in a broad portfolio of firms, they produced nothing except financial speculation. Both the numbers of trusts and their worth grew massively between 1926 and 1929.

These trusts represented an unparalleled opportunity to fleece small investors. Behind each trust stood a sponsoring firm or bank. These organised the trusts and released their shares on to the market.

The sponsoring firm received share options that allowed them to buy shares at their original offer price. If the price increased, as it invariably did, these shares could be immediately sold and enormous profits generated.

For example, in 1929 Goldman Sachs was at the forefront of the new investment trusts. It launched a series of share issues, such as the Shenandoah Corporation. Oversubscribed sevenfold, its initial securities of $102,500,000 opened at $17.5 before reaching $36. In the crash to come the price fell to 50c.

In 1929, as today, the problem exercising the minds of the American bankers was how to squeeze the bubble. As today the Federal Reserve was led by austere men renowned for their financial conservatism but they failed to stem the speculative tide. They tried letters to the market, they tried meetings with financiers.

At one meeting in March 1929, the silence afterwards caused a panic. The index dropped 15 points and 8,246,740 shares were traded. The ticker tape that recorded the day?s transactions fell two hours behind. A crash loomed but did not arrive. The head of the New York Federal Reserve Bank, Charles Mitchell was forced to issue a statement: ?We have an obligation to avert any crisis in the money market?. It worked and the crisis abated.

The bankers considered interest rate rises to increase the cost of borrowing and so hopefully reduce speculation. But when stocks are rising in leaps and bounds who cares about the rate of interest? Any rise will more than cover the cost of debt incurred. So the Federal Reserve did nothing, only increasing interest rates in the summer of 1929.

The boom continued. From June to August, the index rose by a further 25 per cent. Brokers loans grew by $400 million a month. Professor Irving Fisher, the Yale economics professor cheerfully announced: ?Stock prices have reached what looks like a permanently high plateau.? There were voices of caution, but their repeated failure to accurately predict the end meant that, as J.K.Galbraith puts it in his description of the crash: ?Only a durable sense of doom could survive such discouragement.?

In September the index began to stall and falls in some areas began. Irving Fisher was not, however, perturbed noting: ?There may be a recession in stock prices, but not anything in the nature of a crash.?

By the end of the summer, the US economy had began to slow down. Industrial production was now falling. Steel production and house building both fell. Confidence was being shaken.

Confidence had become a material factor: the belief that the market would rise was central to sustaining Wall Street. Once selling started, more would follow ? to pay loans, realise profits and to protect vulnerable ?positions?.

The value of the market ? then as now? rested on an illusion: its wealth could never be realised. Any attempt to do so would cause the price of shares to collapse. Their value would simply disappear. This is exactly what happened.

On Saturday 19 October the crash began in earnest. On Wednesday 2,600,000 shares were exchanged in the last hour of trading and the index fell 31 points. On Thursday morning 12,894,650 shares changed hands. Chaos began to give way to panic. It was averted for the one and only time by the intervention of ?organised support?, the clique of bankers and traders at the head of the market. They guaranteed to support stocks at their former high levels. It was enough to halt the slide for that day.

But on Monday 28 October 1929 the index fell 49 points; on Tuesday the ticker tape could not keep up. By the close of play 16,410,030 shares had been sold. The index fell a further 43 points, wiping out the entire gains of the previous year.

The bankers met the next day. From now on they were looking after their own interests. Regional banks began to recall their loans.

Even so the market rallied on Wednesday and Thursday, before an early closure for three days designed to allow investors to ?return to their senses?. They did and the market collapsed. By the middle of November the index closed at 224 down from its 542 high on 9 September. In a little over a month the savings of the American middle class had halved in value.

Inevitably the Wall Street crash had a profound effect on the US economy. The collapse in demand for consumer goods led directly to mass unemployment. The destruction of share values affected so called ?sound? and ?unsound? firms alike.

Neither could raise money for investment capital. The demand for fixed capital goods plummeted. The banks which had lent on the basis of their share portfolios were robbed of their financial base. There were widespread banking failures.

Today as we survey the current Wall Street boom it is tempting to see every blip as the start of the crash. But it is simply impossible to predict the point at which the rise in share prices will exhaust the limits of investment capital needed to keep it at its currently exaggerated height. We can, however, be sure that point will come.

Today?s changed circumstances may mean that a stock market slide will not automatically lead to a total crash or subsequent world depression, but the 1929 crash remains an illustration of the instability inherent in the capitalist system.

Speculative bubbles are always likely to burst. And the workers are always the hardest hit.

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