Chapter XVI

Fundamental Review

There have been many who have written of the causes and effects of the Great Bull Market and its famous demise. Many market analysts and economists have looked back at this turmoil taking only what they desired in an effort to support a current theory that was most likely preconceived from the outset. In the final conclusion of this work, I too will make an attempt to tie everything together in a neat and orderly theoretical package. But for now, it is much more important to gather all the facts and to make certain that they are absolutely correct and within the proper perspective so that our conclusions will not be based upon an unwarranted preconception.

When I began this project, I too had many preconceived ideas and notions, but in trying to draw some logical sense from current market trends in the 1970s and 1980s, I found stark contradictions to what we have all come to simply accept as standard economic theory. When you line up all the various writings about the Great Depression and the opinions as to its causes and effects, one is left with perhaps more questions than answers. Most economists and analysts have tried to view the causes of the Great Depression solely in a domestic light. A few have broadened their mind's eye by glancing at the corresponding events in other nations. But for the most part, the political propaganda of the 1932 Presidential elections has lived on in the minds of the majority who cite the tariffs, while others seek to draw conclusions to support a socialistic model by pointing the finger at disproportions of wealth among the various classes.

There is little doubt that the events of the Great Depression had a profound impact upon the world both socially as well as geopolitically. The seeds of the tragic world war that followed were unquestionably sown through the hardships of the Great Depression. The drastic escalating income tax structure within the United States was born from the notion that it was the rich who were responsible for the Depression through the collapse in the stock market at the hands of speculation. The socialistic forms of government that emerged in Britain and throughout Western Europe are also the children of interpretations of this tragic era.

Yet most of the conclusions and theories that have surfaced in the post- Depression years are based upon observations that perhaps skimmed the surface of the issues of the time. Politicians and economists alike drew conclusions and answers only from what they wanted to see. Those who were convinced that the entire affair was forged into history at the hands of wild and uncontrolled speculation clung to those ideas despite the fact that the Senate investigations failed to turn up any evidence to support the notion that huge groups of bear-raiders purportedly destroyed the stock market for pure profit. The issue of governmental bond defaults hardly gained any press, for this issue would have tainted the political structure, shifting in part some of the blame from the private sector to wild and uncontrolled government spending.

Trying to fundamentally assess the Great Depression and its causes is by far no easy task. No matter what I could ever write, there will always be someone who will disagree. Fundamental analysis lacks definition in itself. For example, picture a man who is standing on a ladder painting the side of a building in downtown New York. Suddenly a cat runs by a little old lady who is walking her dog. The dog becomes excited, breaks away from the little old lady and runs after the cat, dragging the leash just behind him. The cat runs under the ladder and the dog is in hot pursuit. The leash gets caught around one of the legs of the ladder and the jerking motion that results from the dog's running speed pulls the ladder right out from underneath the man. The man falls and along with him the can of paint. The paint lands upon the head of a grumpy sort of chap who now becomes enraged at the painter. He proceeds to pick the painter up by his neck and blames him for dropping the paint on his head.

The painter in turn blames the man for walking too close to his ladder, while a witness to the whole scene breaks in to point out that it was the dog's fault. The little old lady finally catches up to the scene and then everyone blames her for letting go of the dog. She gets upset and blames the little boy down the street who let his cat out. The little boy blames his friend for holding the door open at his house, allowing the cat to get out in the first place. Since the boy is just a boy, everyone will pin the blame upon his father who just happens to be the painter.

Well you could go on and on and blame the person who gave the little boy the cat or you could chalk the entire affair up to just a freak accident. Such is the case of fundamental analysis. Often there are so many complex relationships existing simultaneously that any attempt to sort them out and place them in the proper order becomes impossible. This is now the task which I will attempt to complete in a rational and logical sequence. Anyone who attempts to argue must realize that placing the blame for the Great Depression on any one source is doing society a grave injustice. Extracting only what we want to hear to support a theory for socialism or to usurp some new power in the hands of government will not help us to avoid similar circumstances of this nature in the future. If we allow such personal biases to color our words, there can be no hope of social or economic progress. The time has come when honesty must prevail over personal desires. If we do not make an honest assessment of society's past mistakes, we will be doomed to repeat them. That is a terrible legacy to leave our children. Perhaps at the very least, progress should allow each generation to make its own NEW mistakes rather than to repeat the old because they were ignorant of lessons which history has tried to convey. If we fully understand our mistakes even within our own personal lives, then we have something upon which we can build to create a new future, which hopefully will not be a rerun of the past.

GALBRAITH

One of the famous books on this period was written by John Kenneth Galbraith and entitled the Great Crash. Galbraith basically concluded that the Depression was something which could be explained in part by five causes. According to Galbraith, these five causes of the crash were:

1) BAD DISTRIBUTION OF INCOME:

The well-do, Galbraith claimed, made up only 5% of the population yet they accounted for one-third of the wealth. Thus this disproportionate measure of wealth could not be counted upon for great expenditures within the economy other than in luxury or investment areas. Thus, he claimed that this type of spending was subject to greater fluctuation than spending upon necessities from the wage earner. He concluded that this type of high-bracket spending and investment was especially susceptible to the sudden drop in the stock market.

2) BAD CORPORATE STRUCTURE:

Galbraith asserted that the period was marked by excessive "promoters, grafters, swindlers, impostors and frauds" which created a sort of flood-tide of corporate larceny. In addition, another weakness in the corporate structure was the advent of the holding companies and investment trusts. Galbraith concluded that these holding companies and investment trusts controlled too great a portion of stocks which were dependent upon regular dividends. If the dividends stopped, this would influence investment trusts to liquidate the shares in that company. Thus, corporate loans diverted capital into dividends instead of expanding their business and new plants. This, he concluded, added to the deflationary fears and pressures. Income was then earmarked for repayment of debt instead of new business expansion.

3) BAD BANKING STRUCTURE:

Galbraith wrote that the bankers were not exceptionally foolish in their lending. But as the value of their collateral declined, many loans were needlessly called through no fault of the borrowers who became victims of the times. As market value for goods and services as well as real estate, bonds and stocks declined, good loans under normal conditions were made to appear as foolish ventures on the part of banks. This is the net effect during any serious recession as Galbraith pointed out. Lending $60 against IBM today may be prudent for the moment, but if IBM falls to $12, or 10 cents on the dollar, everyone chastises the banker for being foolish since he should have foreseen such an event.

But Galbraith went on to point out that the inherently weak structure of the banking industry itself was something separate and apart from good loans turning bad. This weakness in the banking system lay solely within the large number of independent banks. As one bank fell, this often sent vibrations of fear into the public who would then turn on their bank, often forcing its closure as well through needless panic withdrawals. Thus one failure led to other failures, and these spread with a domino effect. Galbraith concluded that this domino effect of banking failures influenced depositors not merely to withdraw funds, destroying weak banks, and weakening even strong banks, but this effect also had a repressive influence on the spending of the various classes as well as investment. Therefore, the hoarding of funds further contracted the money supply and greatly reduced investment.

4) THE DUBIOUS STATE OF THE FOREIGN BALANCE:

Galbraith pointed out that the United States had become a creditor nation. This meant that the loans that it had extended to foreign nations both during the war and in the immediate post-war years had to be repaid through expanding trade with the

United States. Failing to achieve a trade surplus, payments for the difference were made to the U.S. in the form of gold. But this could only be maintained on a temporary basis. Galbraith concluded that when Hoover increased the tariffs, thereby cutting off the possibility of the Europeans gaining a trade surplus against the United States, he also cut the only means of settling their debts, which forced their debts into default. Thus he concluded that the tariffs hampered the U.S. economy. The reduction was not vast in relation to total output of the American economy, but it contributed to the general distress and was especially hard on farmers, Galbraith added.

5) THE POOR STATE OF ECONOMIC INTELLIGENCE:

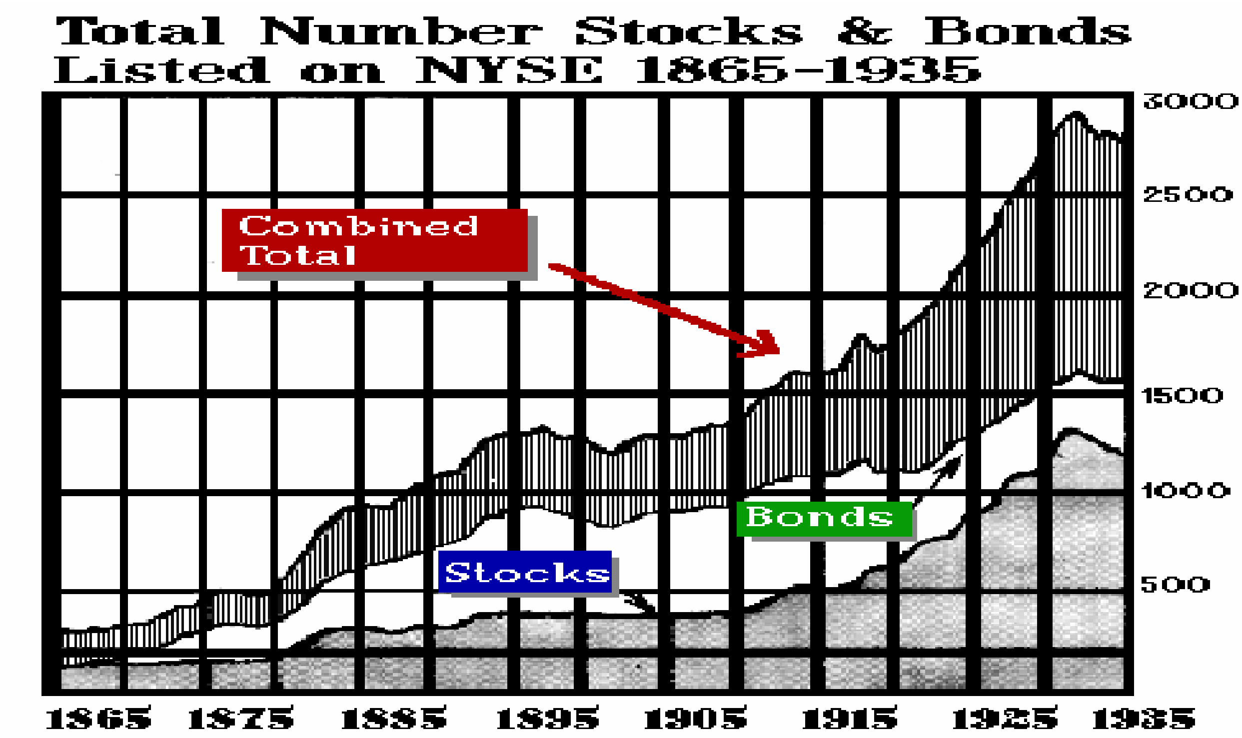
Here Galbraith stated that the economists and those who offered economic counsel in the late twenties and early thirties were almost uniquely perverse. He suggested that the tax breaks instituted by Hoover in late 1929 were negligible because they gave a greater break to the upper income brackets. In my opinion there is a little contradiction here. Galbraith, in part, blamed one of the causes on the concentration of wealth within the upper 5% of the population, stating that the stock market crash hurt this segment especially helping to curtail investment. To now say that the tax breaks favoured the higher brackets because they were an equal cut across the board contradicts the first observation. If the upper classes lost the most through the crash in proportion to their total net assets, where is an across-the-board tax cut unfair? This seems to be an argument trying to attack the upper classes for a high degree of concentration of wealth.

Galbraith then jumps to the 1932 era pointing out that both parties were calling for a balanced budget. He said: "A commitment to a balanced budget is always comprehensive. It then meant there could be no increase in government outlays to expand purchasing power and relieve distress. It meant there could be no further tax reduction.

Here Galbraith hints that perhaps the distress could have been reduced had government lowered taxes and shifted into deficit spending. Galbraith does point out that the budget went into a deficit under Hoover, but this he concludes was not enough. Perhaps this is true, but the issue of public confidence seems to have played a more definitive role in this debacle rather than a passive role as we will soon explore.

Professor Irving Fisher took another approach. In referring to the stock market crash he wrote:

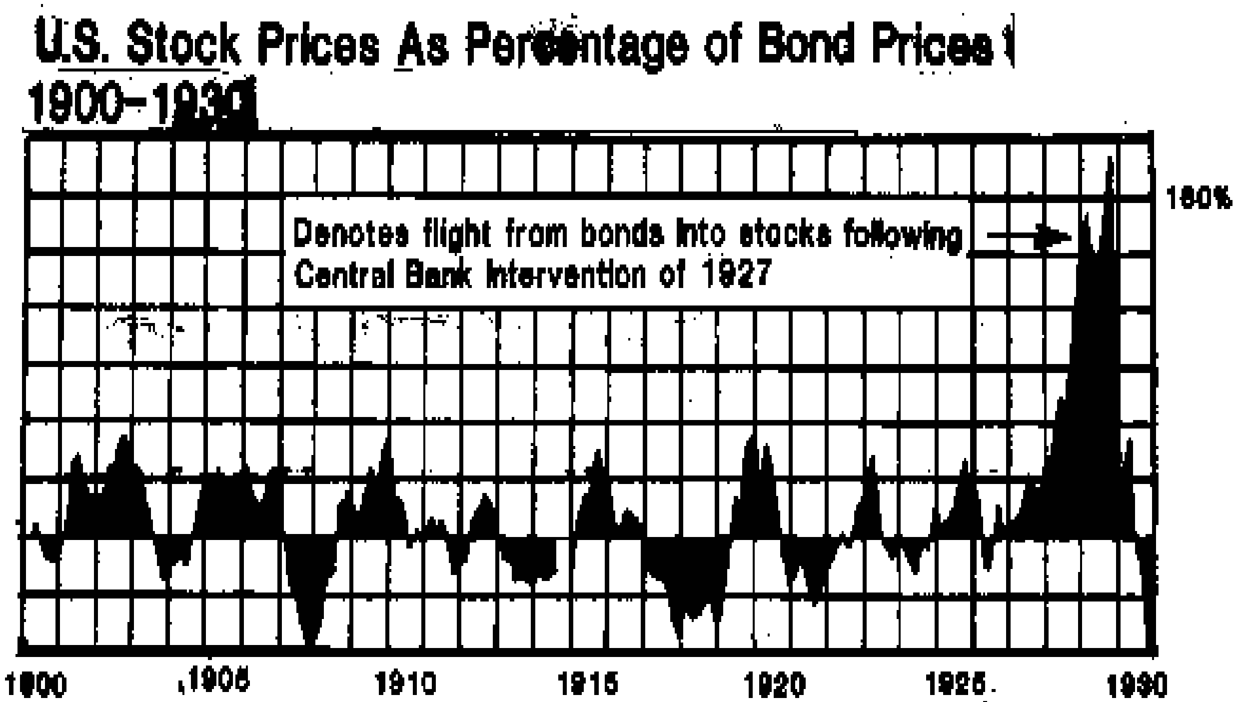
"That the stock market crash was primarily precipitated by foreign liquidation is the view expressed by John S. Sinclair in the New York Times of October 27th. This liquidation accompanied the so-called Hatry Panic on the London Stock Exchange which resulted in a deeper fall of the London stock price level - 45.4 per cent from August 30th to December 27th (1929), according to the British Index - than occurred on the New York Stock Exchange between the high point on September 7th and the bottom of November 13th. Few realize today that the greatest fall of stocks in British history comparable only with the Baring Panic of 1890, preceded and was an actuating cause of the American panic, and that a coincident fall in Paris and Berlin accompanied the British liquidation. It began with the failure of the banking house of Clarence Hatry in August, followed by his arrest in September and subsequent conviction for a gigantic forgery of stock certificates. This



started the British liquidation in London and in New York. Barron's Weekly of December 9th (1929) notes that Britons were extremely active in distributing stocks at the high level in New York during September as seen by the movement in sterling exchange..."

Indeed, in both cases, Galbraith and Fisher touched upon certain issues which no doubt contributed to the greatest panic in history. But neither offers a conclusive statement to sum up the events of the era. Both admit that some influence from foreign sources played a role in the events of the times but dealing with the situation by purely increasing U.S. government spending was not the answer either. The problem facing any author on this period is still the famous question: who was responsible for knocking the painter off the ladder?

A historian on any subject can go over the facts of a period and draw a different conclusion from another. I personally disagree with those who have focused upon the high concentration of wealth within the upper 5% of the population as being a leading cause of the Great Depression. This concentration of wealth during this period served as the excuse for using the escalating tax brackets which at one time were as high as 90% in the United States. This is **PURE SOCIALISM** disguised in the cloak of democracy. There is simply no excuse for such laws in a land where the slogan of its Supreme Court is: "Equal Justice For All." If the super rich become richer, they are the very people who funded and built General Motors, Ford and Alcoa Aluminum. With wealth greatly dispersed, capital must be pooled together among so many to form such new ventures. Far too often those types of situations are impossible. The rich who do not invest in new companies, which in turn create jobs for the middle class, perhaps leave their funds in a bank on deposit, which in turn provides loans for mortgages so that the average person can buy a home. But above all, destroying the upper

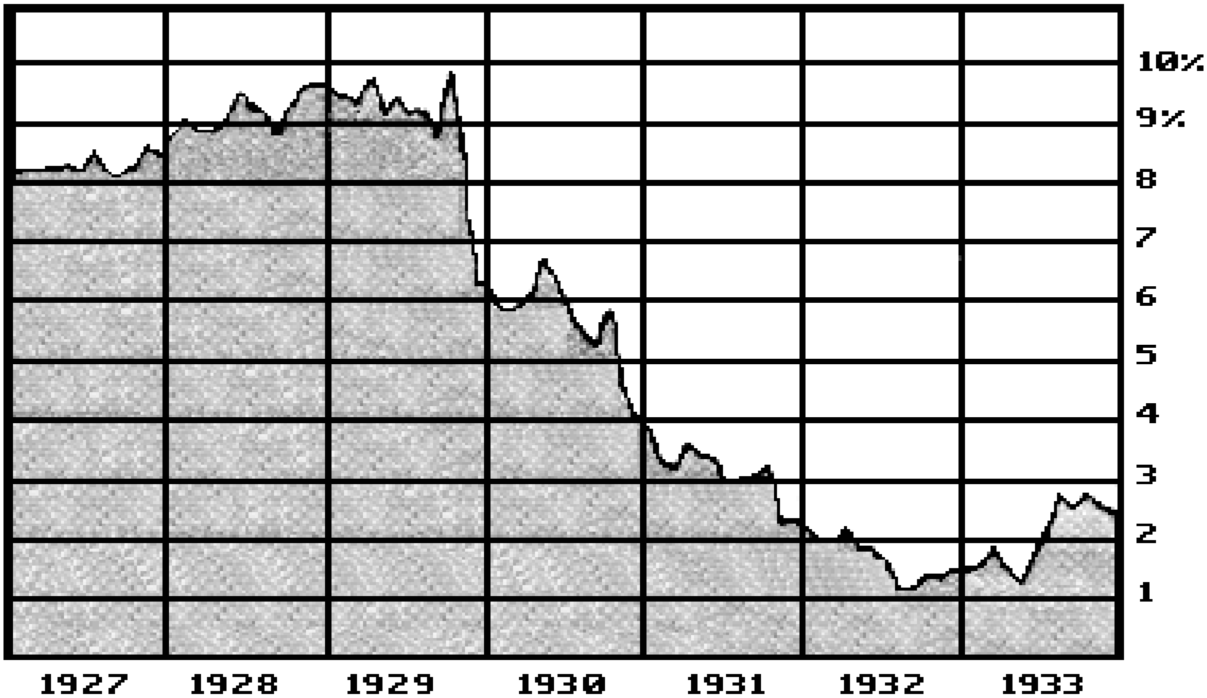


class destroys the American dream. It is that hope of becoming successful that has made the concept of the United States great. It is the inspiration of the young to achieve their degrees. To attack the success of the upper class out of petty jealousy is merely an attack upon the very concept of the free system. Those who often attack the upper classes are those who lack the drive, brains, and ambition to achieve those goals and in turn they lash out from a jealous bitter attitude as did Karl Marx.

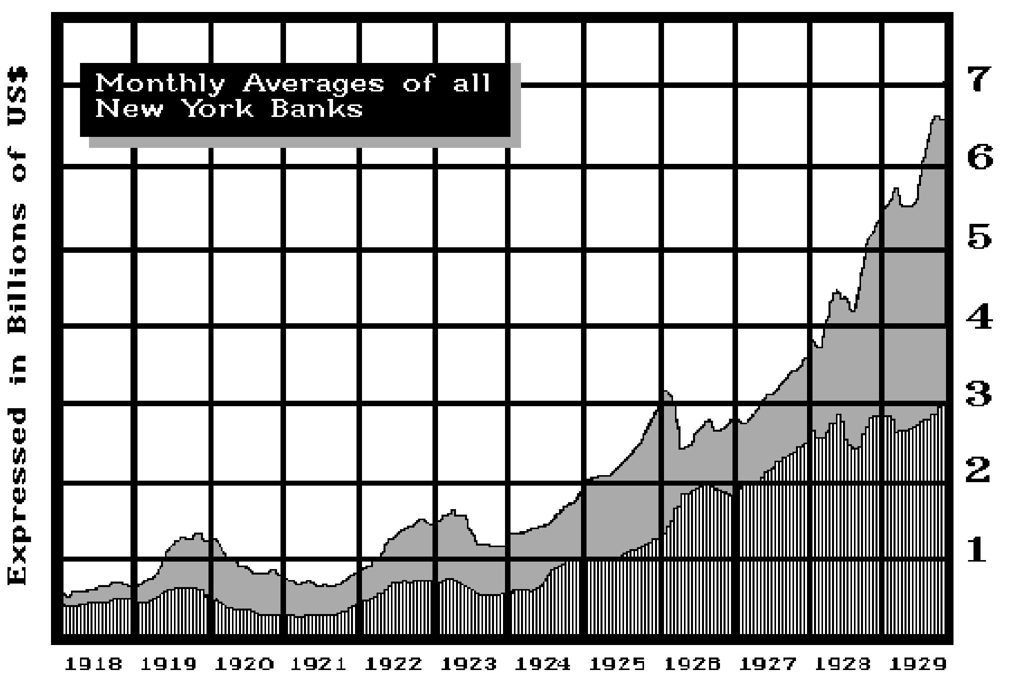
The populace can be so easily swayed into thinking that success is fine but super success is something that is a sin and should be outlawed. Man has to face the facts. He is a horrible creature who derives pleasure from attacking his own kind be it through physical action or through the rumor mills that attempt to assassinate another's character because of his success or notoriety. Man's actions are often similar to a pack of dogs fighting over a single bone. Just a few of the men we have discussed thus far - Willy Durant (founder of General Motors), Ogden Armour (Armour Meats), William Fox (Fox Films) - have each helped in their own way to create a part of that American dream and many jobs to this day owe a debt of thanks to these men for their visions. It is exactly as Adam Smith described in his "Wealth of Nations" back in 1776. Society is guided by an "Invisible Hand." Each person does not necessarily act with the intention of building a society. But while in his own pursuit of financial success, he in turn furthers the advancement of society as a whole. Each of these men indeed furthered the American dream for us all. Yet each died a poor and beaten man at the hand of bitter and jealous enemies.

Among the advertising that has illustrated this first section leading into the Crash, you will find several examples that refer to the manner in which the bond market was portrayed. Bonds were the "safe" investment while stocks were the "speculative" ventures for high rollers.

Broker Loans
Ratio to Total Market Value



Broker Loans 1918-1929



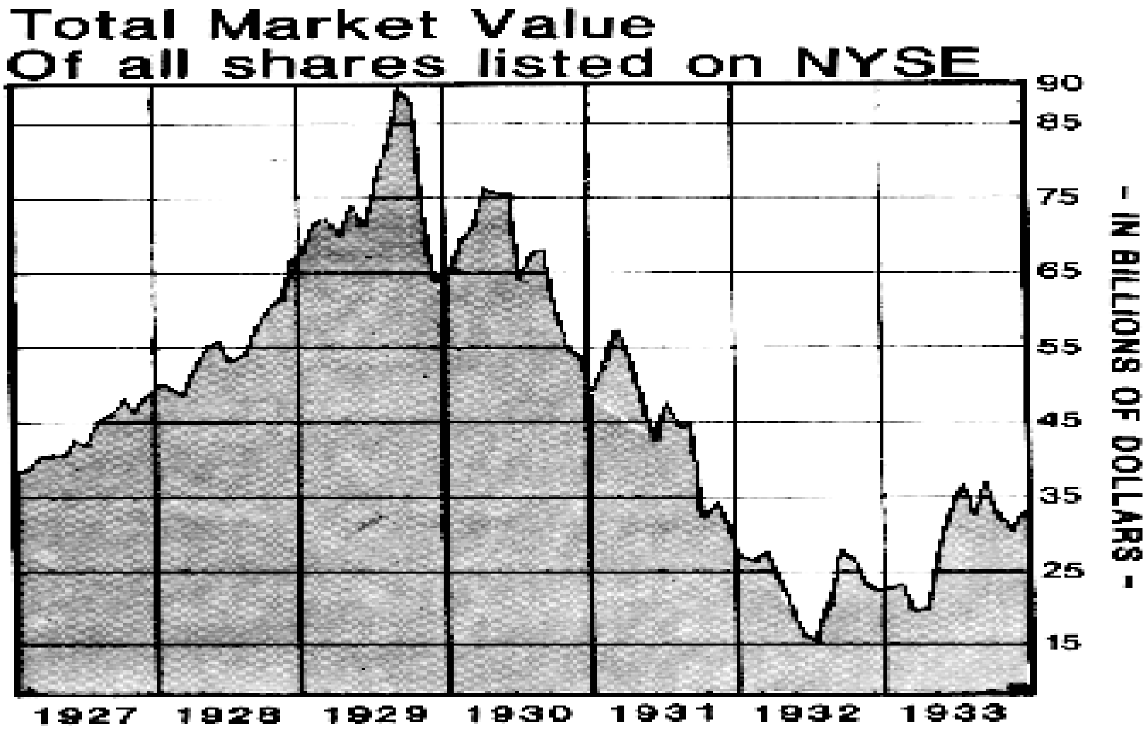
One main factor that must be placed in perspective is the scope of the bond market in comparison to that of the stock market. We have undoubtedly heard much about this stock market's demise and little of the collapse in the bond market. To this day, if you ask a municipal bond dealer if any U.S. municipal bond has ever defaulted, his answer will be **NO** with the possible exception of some obscure fire company in the Bronx. History has chosen to bring us facts about the stock market's demise but not about that of the bond market.

The Senate hearings revealed years later that the total number of accounts within the nation's twenty-nine various exchanges came to 1,548,707 customers out of a population of 120 million. Of this, only some 600,000 accounts traded on margin. The balance were cash accounts. And among the 600,000 margin accounts, there was duplication because obviously there were high rollers who held an account at more than one broker.

Now let us take a look at the chart provided here which illustrates the **NUMBER** of stock versus bond issues listed on the New York Stock Exchange. Take note that bonds greatly outnumbered stocks. Far more capital was lost in the bond markets during the Great Depression than in the stock market. This chart illustrates that the number of listed bonds since 1865 had always been greater than the listings of stocks. Although the greatest gap between the number of bonds listed versus stocks came during the late 1890s, overall it has essentially remained close to that level of better than a 2 to 1 ratio until 1921. By 1929, the growth in the number of stock issues had still not surpassed that of the bond market numerically as the Great Bull Market came to a peak. This chart definitely illustrates that during the 1920s, stock offerings grew more favorable than new bond offerings in the eyes of the public at large.

In our second illustration, "U.S. Stock Prices As Percentage of Bond Prices 1900-1930," we can see clearly that a flight from bonds into common stock picked up great momentum beginning directly in 1927 during the period of the Central Bank intervention. Stocks reached a multiple of 168% above bond prices. Note that stock prices also peaked during 1902 just prior to the panic of 1903, and again in 1906 just prior to the panic of 1907. The peaks in 1909 and 1915 also corresponded to peaks in the Dow Jones Industrials as well. Therefore, in each crest on this chart we find waves of speculation where capital began to shift from bonds into stocks. But still the wave between 1927 and 1929 was greater than at any point in previous history. Concern over the vast amount of bond offerings on the part of shaky foreign governments at rates of three to five times that of U.S. domestic time deposits somehow began to lose their attractiveness when security was to be questioned.

We read how the Fed and government officials became concerned over the amount of money in the brokers loans. Yet here we can see that the ratio of brokers loans to total market value never even reached 10%. At the peak in brokers loans, a total of nearly $6.5 billion was involved. We read that the amount of kited short-term German bills and notes in 1931 amounted to $10 billion. By the time you add up all the vast amounts of foreign debt and losses incurred through U.S. municipal bonds as well as real estate loans, which became frozen assets or outright defaults, the figures came close to $100 billion. This amount vastly overshadowed the amount of money on loan in the U.S. stock market.

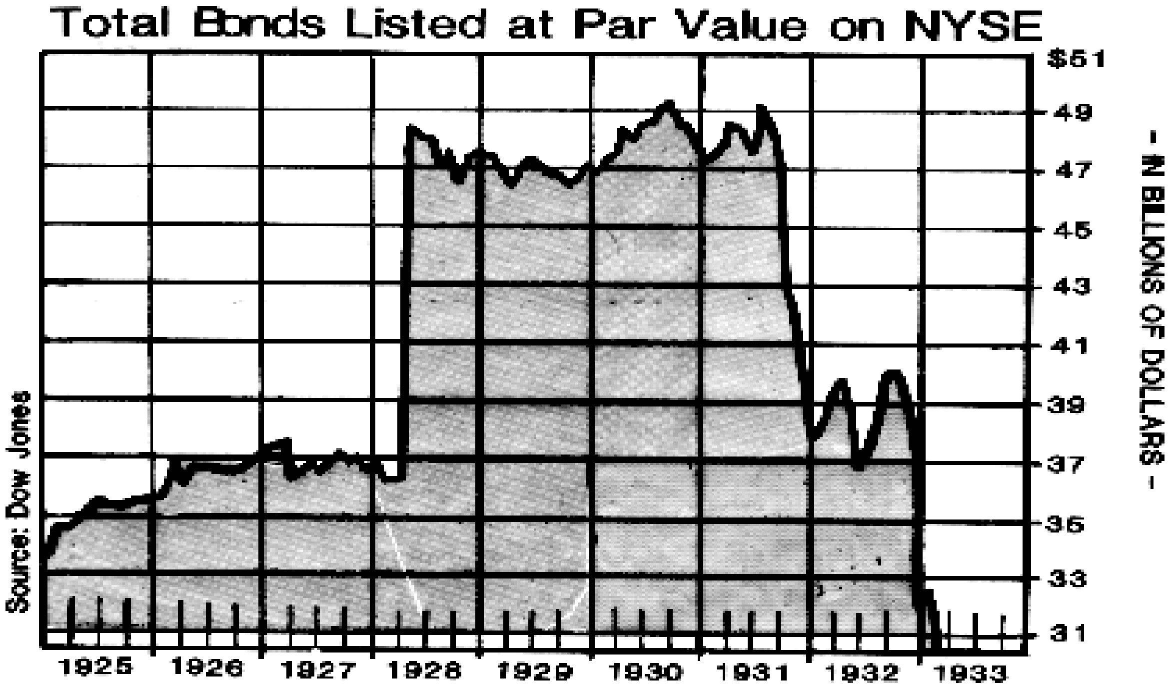


Indeed, the $10 billion kite of German debt had made the brokers loans out to be a minor problem considering the low ratio to total market value.

The next two charts that have been provided to illustrate that at the market's peak in 1929, the total value of all stocks listed on the New York Stock Exchange amounted to nearly $90 billion. The total bonds listed at par value on the New York Stock Exchange came close to reaching $49 billion in 1928. When the stock market began to decline in 1929, capital immediately began to flow into the bond market taking with it a rise in the total par value up to slightly above $49 billion. The abrupt up move in total par value in 1928 is attributed to the listing of the British War Debt issue which was later withdrawn after 1932.

Keep in mind that 99% of the total stock values were U.S. issues, NOT foreign which had been precluded from listing during the pre-1928 years. No flood of European stock issues came rushing into the NYSE when the ban against foreign issues was eventually lifted. Remember that foreign stock had to show a track record of consistent dividends in order to gain a listing. This prompted a greater tendency for foreign issues of bonds to be listed where the qualifications were odd enough, less stringent. The vast majority of bonds were not listed on the NYSE. They traded within the cash markets. Peru, Chile, Germany, etc., were among these off exchange issues. Therefore, in a very real sense they were out of the major lime-light of the Indexes, which meant that history too has tended to forget their impact on the causes and effects of the circumstances. The stock market, however, was right up front and it managed to capture center stage.

The yield on corporate U.S. bonds rose sharply from just below 5% in early 1929 to nearly 9.75% in 1932. You can imagine what happened to the yield on many foreign issues which had previously been 7% prior



to 1929 and exceeded 25% by 1931. The flood of weak bond issues and the default on municipals, such as that of the City of Detroit, did more damage to the aftermath resulting in the Great Depression than any other single factor. Capital was literally scared to death of bonds as well as stocks. As a result, corporate bonds of even the highest quality were somewhat tainted. Common stock in the very same companies was often viewed as still better buy than bonds. Capital did swing, however, into U.S. government bonds. Here I have provided several yearly charts of the U.S. Liberty Bonds of various yield and issue. In all cases, we can see that an important low had been made in 1929 as the Fed hiked the discount rate up. Note, however, that the initial reaction of the U.S. Treasury Bonds was one of a positive nature, rising into early 1931. But during the Monetary Crisis of 1931, when rumor spoke of the U.S. abandoning gold, the Liberty Bonds collapsed. Confidence internationally had reached a low and the treasury bonds by and large bottomed during early 1932 along with the dollar. Their gains made into early 1933 were again shattered under the prospects of the inflationary policies of Roosevelt.

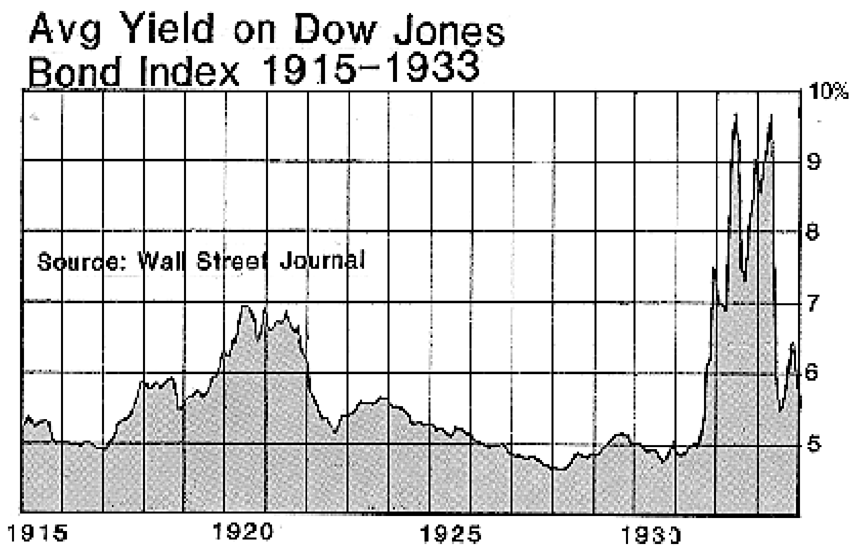
The next illustration of the yield on high-grade railroad bonds from 1857 to 1930 illustrates the general overall trend of corporate bond yields for an 87- year period in the United States. The 1920 high on the railroad bond yields was not as high as that on the overall corporate bond yields if you compare this chart to that of the Dow Jones Bond Index. The Dow Bonds registered nearly a 7% peak in 1920, whereas the rails reached only 5.5%. The railroads had been the leading companies during the Bull Markets up to 1907. The public viewed the rails as less speculative as if one might consider them to be a utility in today's terms. To some degree, the rail bonds were among the best performing corporate issues during the debacle.

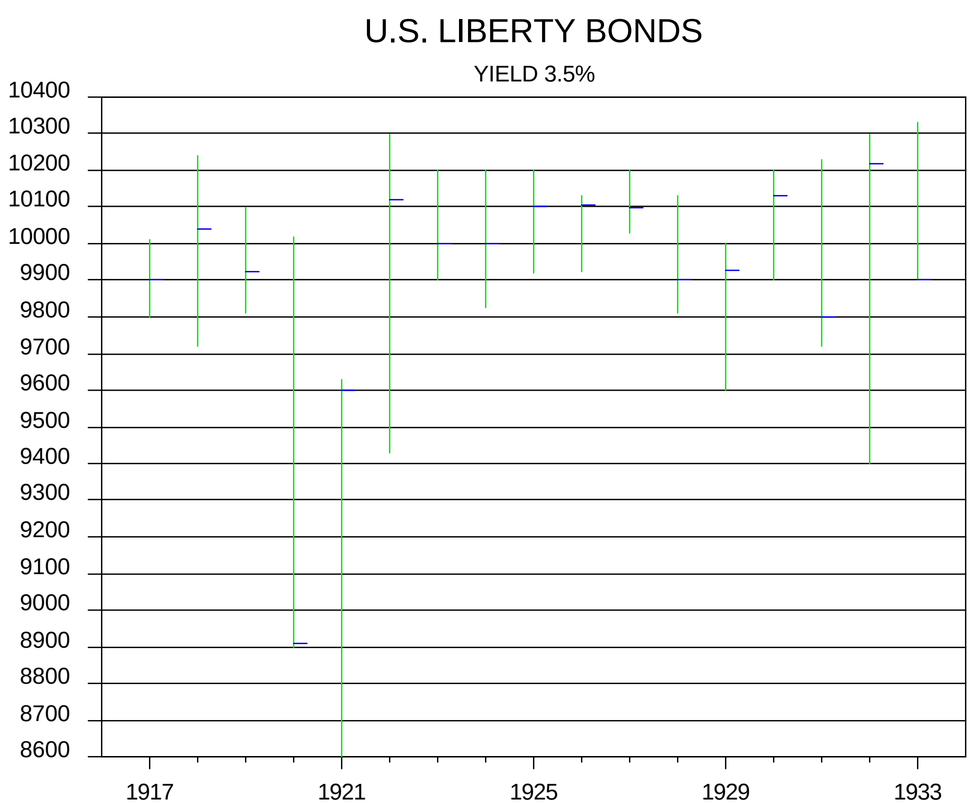
The United States was undoubtedly a greater lender of money during this period. Capital flowed back and forth internationally on the whims of confidence as we have noted for various reasons, including war and foreign exchange fears of devaluation. The greatest of all factors which led to the Great Depression was the collapse in this credit structure resulting in the contraction in money supply which many have blamed on the Federal Reserve's fears of reflating. Although Galbraith criticized the economic thinking of the period as perverse because of the calls for a balanced budget in 1932, I find myself in disagreement. The economic logic of calling for a balanced budget emerged after the monetary crisis of 1931. Hoover indeed took the road toward deficit spending, trying to stimulate and prop up the economy as Galbraith claimed was necessary and, indeed, as Keynes portrayed as mandatory. The switch to balanced budget did not arrive until 1932 when rumor had attacked the dollar. Calling for a balanced budget was a step toward trying to restore confidence to the international economy in so far as the U.S. would stand by the gold standard, assuming the role of the lighthouse in a torrent of fiscal irresponsibility. The unbalanced budget did not support the U.S. markets and those who simply argue that Hoover didn't spend enough and that is why Hoover did not work must convince me that huge government expenditures can prevent a deflationary mode when such periods as that of 1981-1985 exist. Never before did the U.S. fiscal budgets go so far out of balance year after year, yet inflation yielded to deflation in spite of such theory to the contrary. No, criticizing Hoover for not spending more as being a cause of the Depression is not logical in the face of economic circumstances of today. The call for a return to a balanced budget did not come in 1930 nor in 1931, but only after the monetary system of the world cracked wide open within its very foundations at the hand of fiscal irresponsibility stemming from abroad. Yet again, we find the philosophies of the spend thrift extracting only what he wants to hear and claiming that it could have been prevented by not less irresponsibility, but instead greater fiscal irresponsibility.

Another example of a period when government spending continued to rise while the economy failed to be stimulated was the recession of 1937-1940. During those years, further advances in government spending failed to prop up the economy in exactly the same circumstances that took place between 1930 and 1931.

The calls for a balanced budget were not perverse. The entire investment stimulus around the world had been dealt a shocking blow by the numerous banking failures along with sovereign defaults on outstanding bond issues. Investment capital was driven into hibernation and its emergence in 1933 was not a testament to the policies of Roosevelt, but to the fears of a dollar devaluation and a hedge against inflation. As long as capital viewed deflation before its eyes, hoarding of resources was the smart thing to do. When inflation of major proportions was suspected on the horizon, idle cash would then depreciate and the smart thing to do was to invest in something else which would appreciate with the new trend. Thus Roosevelt's policies were not brilliant in the sense that they offered a formula for future generations to follow. But they were successful in scaring capital out of hiding and under such circumstances they would work. But when capital is not in hibernation, such policies have failed.

Thus, the state of the international situation dominated the time. The collapse in the credit structure perhaps dealt the most


Avg Yield on Dow Jones
Bond Index 1915-1933
Source: Wall Street Journal
10%
9
8
7
6
5
1915
1920
1925
1930


U.S. LIBERTY BONDS
YIELD 3.5%
10400
10300
10200
10100
10000
9900
9800
9700
9600
9500
9400
9300
9200
9100
9000
8900
8800
8700
8600
1917
1921
1925
1929
1933


U.S. LIBERTY BONDS (1ST ISSUE)
YIELD 4.25%
10500
10400
10300
10200
10100
10000
9900
9800
9700
9600
9500
9400
9300
9200
9100
9000
8900
8800
8700
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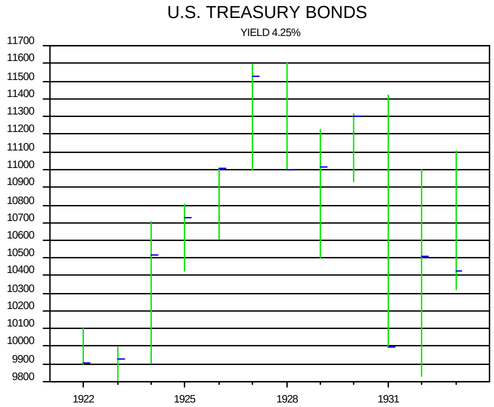
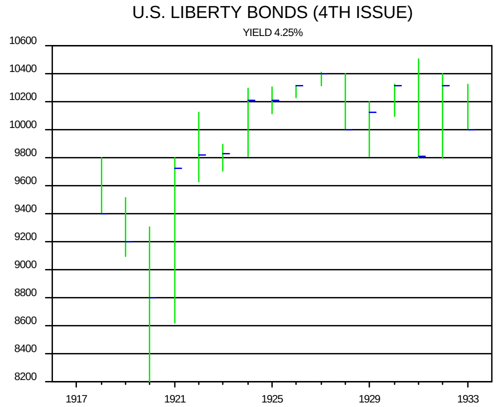
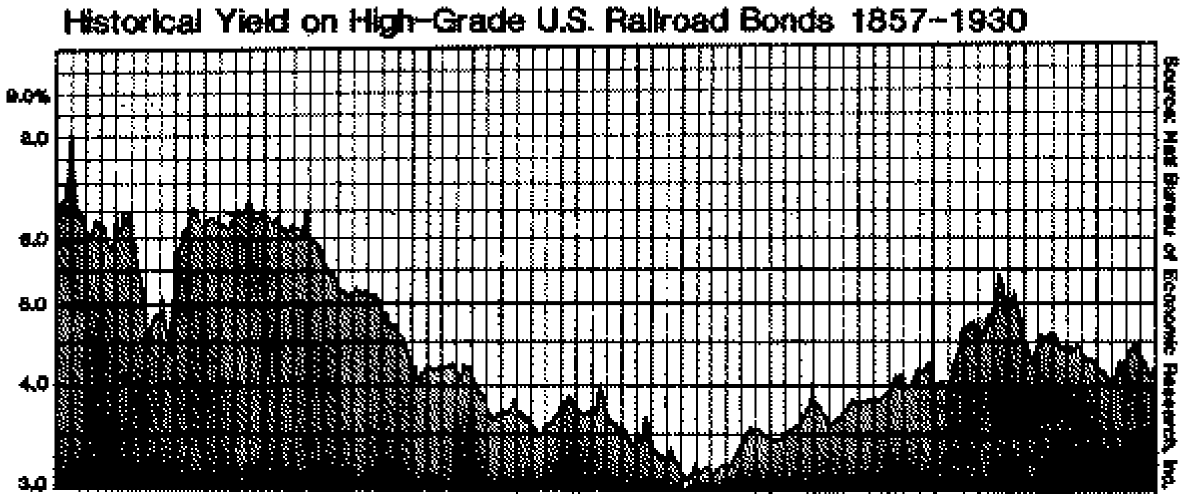
1917
1921
1925
1929
1933


U.S. TREASURY BONDS
YIELD 4.25%
1922
1925
1928
1931


U.S. LIBERTY BONDS (4TH ISSUE)
YIELD 4.25%
1917
1921
1925
1929
1933



serious blow to all nations, particularly in 1931.

Perhaps the simplest example of this credit structure can be viewed as a parallel to a popular child's game of musical chairs. Five children begin the game with five chairs. When the music begins, they all stand up and begin to walk around the chairs but the adult watching over the group takes one chair away. When the music stops, the five children fight for the four remaining chairs. The process continues until only two children and one chair remain and when the music stops for the final time only one will win the game. He is the lucky soul holding the last chair.

Thus was the fate of the credit situation which dominated this era. Germany, for example, was saddled with reparation payments it could not make for France, and others were reluctant to allow it free reign in selling its exports. Each nation contributed by its various tariffs in a game of competition to rebuild. Each also floated substantial amounts of bonds, notes and bills seeking capital largely aimed at rearming itself rather than in stimulating economic growth. Germany was forced to issue short-term notes which it used to make its reparation payments as well as to pay its interest on its long-term bond obligations. Thus the game of musical chairs began, but in real life it was a deadly game of musical kiting bonds.

Capital had become concentrated within the United States following World War I and was largely in the form of gold. This capital came from two basic sources. First, it came through American supplies sold to Europe during the war, which resulted in direct profits for American industry and agriculture. Second, capital arrived in the U.S. on the heels of fear which spread around Europe as war cast doubt on not only who would survive as the victor but on the victor's ability to meet its incurred debt as a result of fighting the war.

The vast concentration of wealth produced the inflationary period which came to its crest in 1919. With European capacity to manufacture and even cultivate food for itself destroyed in the ensuing European battle, commodity prices had to rise. This spawned criticisms that American business had been extravagant in 1921 which led to the deflationary years of 1920 and 1921.

American business had become addicted to the high demand for its products and expanded as if it would retain that high level of demand in the post-World War I era. That was a bad business judgment which cost the financial fortunes of many, including Ogden Armour.

If we look at the chart of Wholesale Commodity Prices in the United States from 1800 to 1934, commodities reacted in a normal manner as they had previously during the War of 1812 and the U.S. Civil War. Whenever productivity is disrupted by war, prices of raw commodities rise rapidly.

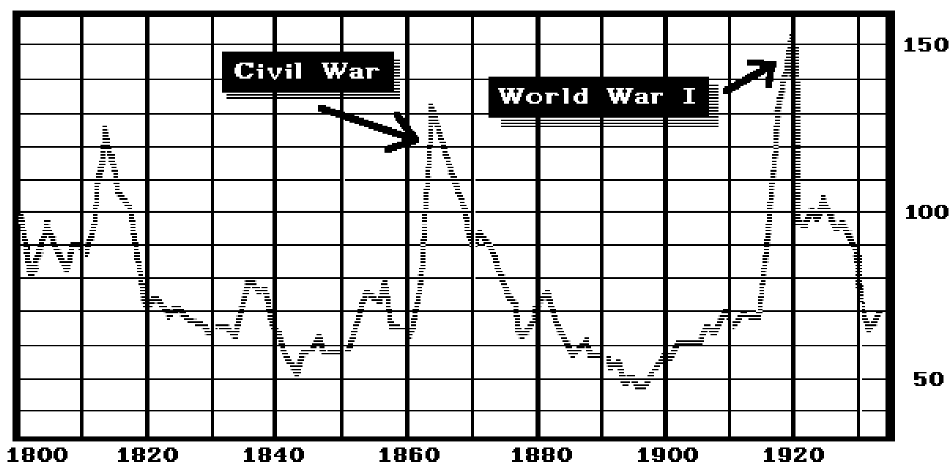
But unlike the events which followed the War of 1812 and the U.S. Civil War which necessitated the rebuilding of the United States' industry itself, the aftermath of World War I left U.S. industry all dressed up with nowhere to go and in a vulnerable over-expanded state. However, industry became fat and loaded with cash following 1920, which is why it was capable of gearing up quite rapidly to supply the rebirth of Europe in the post-1921 years and the resurgence of economic expansion through the guides of new and exciting developments in technology.

That rebirth of Europe came on the notion that lending to foreign sources would in turn result in their buying of U.S. goods. This was the concept and the dream at first, but toward the end of the 1920s, a trade war began and the U.S. saddled its own industry through numerous anti-trust proceedings. This had a dampening effect upon U.S. competitiveness during the late 1920s, which finally gave way to imposing tariffs to protect U.S. industry instead of lifting the very restraints which had made it uncompetitive in the first place - the Sherman Anti-Trust Act.

With wealth concentrated in the United States, Europe had to attain a trade surplus in order to repay its loans. Thus the essence of a trade war began. American industry had provided goods for which it was paid out of lending U.S. capital to its foreign consumers. Therefore, this created a vast amount of foreign debt which floated around waiting to be repaid like a game of musical chairs. With American industry being prohibited by trade barriers set up by the Europeans and U.S. capital being sucked up by foreign sources, the foundation of the American economy was undermined.

We read that for each dollar in gold, $13 in credit was created in the banking system. Money is merely a medium of exchange. It cannot be eaten or used for anything unless the party on the other end recognizes it to be worth something. Thus the strict perception of money was not actually paper dollars but gold bullion when all things were sold and done. There are two forms of wealth which man accrues in life - cash and tangible assets. Within these forms of tangible assets, one finds stocks, bonds, real estate, fine art, precious stones, automobiles, etc. As credit is created, these forms of tangible wealth increase greatly. Thus the rise in the stock market does not create more gold nor does it create more paper dollars in physical form. It creates paper profits as we call

US Wholesale Commodity Price Index
1800-1934 (1926=100)



them which expand the available credit structure.

Therefore, during great waves of prosperity and speculation, these forms of tangible assets gain in value tremendously yet no more physical gold or paper currency was created in the process. When the musical floating bonds came to a halt, suddenly hitting the world economy, a massive wave of liquidation took place. People naturally become frightened and in the process try to sell off these tangible forms of wealth. Because these forms of wealth vastly outnumber the actual real gold bullion or physically existing dollars, the value of these tangible assets drops dramatically on a reverse leverage basis. As the value of these tangible assets declines, the value of collateral also declines at the bank. Thus, the Great Depression was a period during which a massive contraction in the "tangible value" of hard assets took place.

As this unfolds, the dollars created at the bank through multiple loans contract in proportion. There is only so much gold or physical paper dollars to go around. In this case, new gold could not be created. Thus many blame the Fed for contracting the money supply because they nourished fears of rekindling inflation. Although they did have such fears which were unjustified, they did not understand the magnitude of the reverse leverage which was taking place within the economy. We will see when we review the Monetary Crisis of 1971 that the only vital difference between 1971 and 1931 was in what the public physically considered to be money itself. The 1971 monetary crisis internationally came when the U.S. gold reserves could not meet its international debts exactly the same as we have seen in the case of Germany, Britain, and many other nations during the 1931 period. The only difference was that there was not a shortage of paper dollars in 1931, but a shortage of gold. As long as Americans were prohibited from owning gold and after two generations being ignorant as to gold actually being money, no domestic panic took place within the United States during 1971. No hoarding of paper dollars took place in 1971 so the banking deposits did not contract to spark massive banking failures as occurred in 1931 to 1933. The confidence of the population was not lost because they knew not of gold, nor of its role in the international monetary system. But in 1931, gold was money and with everyone demanding only gold around the world, the contraction in credit was inevitable, unlike the monetary crisis of 1971.

During the Great Depression, hoarding of gold by American citizens further contracted the credit reserves of the banks, forcing more failures and a further deterioration in the value of tangible assets including bonds, stocks, and real estate.

There is little question as to the major role foreign debt played during this period. Shifting international capital from one nation to another sparked currency controls which brought the international trade almost to a screeching halt, inflicting for more damage than tariffs alone. Thus it was the changing tides of international confidence which both gave America vast amounts of excess wealth during the 1920s that in turn had taken it away through the monetary contraction and international defaults. The Great Depression was no more created by the rise and fall in stock prices nor by the frauds perpetrated by stock brokers and bankers in the 1920s than the lack of effect which the rising U.S. trade deficits and federal budget deficits had on the massive rally in the dollar between 1980 and 1985.

The massive hoards of capital and debt which revolved around the world simply came to a halt and in the process the slightest increase in demand for cash, in this case gold, resulted in a reverse leverage effect upon the money supply within the world. The Fed would have had to have created in physical form enough paper dollars equal to the amount of "paper profits" placed as collateral for loans at the banks in order to offset the contraction within the money supply. This was a position both highly inflationary in perspective yet in reality non-inflationary. The inflation within the value of these tangible assets had already been created through the banking system by means of credit. The Fed did not understand the magnitude of this reverse leverage effect and therefore the increased government spending implemented by Hoover was vastly overshadowed by the wiping out of $10 billion on the part of Germany alone.

The effects of the Great Depression are not unique to this period. It was not a freak in man's history, merely a repeat of similar circumstances in a more advanced international economy. These same forces are at work at all times and the threat of setting them off again will never disappear. Government's concept that by borrowing from the public rather than monetizing its deficits neither creates less inflation nor does it solve the problems. It merely postpones the issues at hand as did Germany through its massive rolling over of debt throughout the 1920s and early 1930s. Eventually the problem must come to a head and this is what politics seem to fail to understand.

Enacting laws and sanctioning witch hunts to chastise traders who shorted stocks were merely futile exercises in trying to shift the blame from official defaults on bonds into the laps of the speculative stock traders. No massive bear pools were ever uncovered and most who were prosecuted had lost their fortunes in the decline of the market itself.

Those who look back at the 1920s, claiming that it was a period of no inflation and therefore drawing the conclusion that stocks rise during periods of noninflation, have missed the entire lessons this period had to offer. It was a period of great transition from a heavily commodity oriented economy into a new age of mass-production. Inflation is not purely a rise in commodity prices but it is a rise in the general level of all tangible assets including stocks and real estate. The very presence of the Florida land boom in the mid-20s is reflective of the rise in the value of real estate throughout the United States to varying degrees. The rise in the value of stock was in reality inflating the assets of American industry. Raw commodities declined because of a wave of great overproduction which followed 1919 and kept prices in check for twelve long years.

The United States vastly improved its capacity to produce but the growth rate of the world to consume did not keep pace. Once the saturation level was reached, a decline was inevitable. Looking for causes within the domestic situation will no more lead to the answers of the Great Depression than trying to blame the inflation of the 1970s on the backs of the Hunt brothers for bidding up the price of silver into 1980.

In the post-World War II years that followed, the free markets have been greatly influenced by the shifting tides of international capital flows. The quest of nations for a trade surplus continued and the trade battles and competitive devaluations merely became a tool in the postwar era to gain trade advantages. The lessons of the Great Depression were not learned and instead governments would seek to control many more aspects of their economies, resulting in greater levels of taxation and public debt. The war over trade and the exchange controls on capital nearly brought the international economy to a final end in 1931-1932. But those tactics would not be relinquished in the decades that followed.

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