Chapter 1
The World in Debt

However various the explanations for the Great Depression have grown, they share an understanding that the world wracked by the crisis of the late 1920s differed significantly from the world in which most people had grown up. Inasmuch as the world had a single, integrated economy, it had recently undergone profound changes as a result of World War I. The war made it harder for people, goods, and money to move around the globe, and it shifted the direction in which they flowed, too. Putting the United States at the center of this new system, the war also changed America, rendering the once-peripheral New World nation's peculiarities central to the planet's concerns. Nor do these events and their potential for disaster appear only in retrospective clarity—some observers saw them coming.

Looking forward from the Treaty of Versailles at 1919, the economist John Maynard Keynes forecast what lay in wait for the industrial world: "depression of the standard of life of the European populations to a point which will mean actual starvation for some (a point already reached in Russia and approximately reached in Austria). Men ... in their distress may overturn the remnants of organisation, and submerge civilisation itself in their attempts to satisfy desperately the overwhelming needs of the individual."[1] Depression, desperation, and the dismantling of civilization would result, Keynes wrote, from "the economic

consequences of the peace," and although Keynes, perhaps mistakenly, attributed this impending disaster partly to the treaty's provisions, he also criticized its omissions.[2] World leaders at Versailles might have restored and codified the global system that prevailed from about 1870 to 1914, a system Keynes described as an "economic Utopia." But they missed this chance, producing instead a world quite unlike Utopia.[3]

Before 1914, people, goods, and capital crossed national borders with relative impunity. In consequence, they had the greatest possible scope to seek a place where their work would yield the greatest possible profit. To a considerable extent, this movement across borders meant the export of excess from industrial Europe.

Between the middle of the nineteenth century and World War I, about fifty-five million people left Europe to find their fortune in New World nations. Mostly industrial workers looking for higher wages in a worldwide market for their labor, their departure from Europe decreased the supply of workers there, raising wages for the laborers they left behind. Their arrival in the land-rich nations of the New World helped push development out into the frontiers. This migration did not occur altogether without hindrance. To describe the international markets of the nineteenth century as truly global represents some exaggeration, in large measure because New World nations preferred some parts of the globe over others when forging a cross-border market in, for example, labor. Notably, in the 1850s Australian states began limiting Chinese immigration, and by the early twentieth century the United States, Canada, and Australia all had erected high hurdles to immigration from both China and Japan; the United States in 1917 not only added a "barred zone" that blocked almost all the rest of Asia but also adopted a literacy test to reduce the number of incoming people. Nevertheless, these restrictions let millions of immigrants, particularly from southern and eastern Europe, move to better employment in the New World.

During the same period, the British empire generally backed the free movement of goods across borders. The relatively untaxed passage of things in trade—raw materials and finished products alike—between the Old World and the New allowed each nation to produce mainly what it was best suited to make. Although countries of the era sometimes raised barriers to trade as they did to migration—Latin American countries had especially high tariffs—international trade moved with relative freedom, especially compared to the 1920s, and Britain led in the promotion of lower tariffs.[4]

Observers noted that trade with Britain proved especially useful to many developing countries. British banks backed the builders of roads, canals, and railways as these countries stretched into their hinterlands and prairies. Bringing the fields under tillage made the New World more productive, and selling products back to their lender, Britain, helped developing countries defray their debts. Combined with the movement of goods and people, the movement of capital created a virtuous circle, at least so far as Europe was concerned. As a British economist wrote in 1909, "by the investment of capital in other lands we have, first, provided the borrowing countries with the credit which gave them the power to purchase the goods needed for their development, and secondly, enabled them to increase their own productions so largely that they have been able to pay us the interest and profits upon our capital and also to purchase greatly increased quantities of British goods."[5]

Keynes regarded this vanished system so highly because it had allowed Europe for the first time to relieve the pressure that an increase of population had appeared inexorably to put on the supply of food. Keynes explained: "With the growth of the European population there were more emigrants on the one hand to till the soil of the new countries, and, on the other, more workmen were available in Europe to prepare the industrial products and capital goods which were to maintain the emigrant populations in their new homes, and to build the railways and

ships which were to make accessible to Europe food and raw products from distant sources."[6] The war shut down this system. People and goods could no longer move freely, and their formerly productive power went instead toward destruction. Capital funded the war's western front instead of the New World frontier. But worse, once the war ended, the peace did nothing to restore the lost world. "The Treaty includes no provisions for the economic rehabilitation of Europe . . . or to adjust the systems of the Old World and the New," Keynes complained.[7]

Looking back from the 1930s, the British historian E. H. Carr wrote, "In 1918 world leadership was offered, by almost unanimous consent, to the United States . . . it was then declined."[8] Most notably, the United States declined to lead the world in reconstructing the old, open economy. Indeed, it moved in the opposite direction.

The United States had tried to limit immigration before the war, but it turned to the task with greater energy and effectiveness in the 1920s. Congress established quota limits on immigration with the laws of 1921 and 1924. Other New World countries blocked immigration in their own ways. Some joined the United States in barring political radicals and classes of the criminal, poor, or disabled. Brazilians tried to steer immigration to farms, rather than cities. Canada's 1919 immigration act allowed officials to bar "immigrants . . . deemed unsuitable owing to their peculiar customs, habits, [and] modes of life."[9] These restrictions made it harder for Europeans to find opportunities overseas, as Keynes had foreseen in 1919.

The movement in goods slowed owing to restrictive law as well. The United States raised tariffs in 1921 and 1922, and other countries began following suit. Alarmed diplomats convened conferences whose delegates advocated lifting these barriers, culminating with the League of Nations' World Economic Conference in 1927, which declared itself strongly against tariffs, to no effect. The Americans had a history of high tariffs stretching through the nineteenth century, but as the *New York Times* noted in 1926, circumstances had changed since then: "It needs no political economist to see that our situation in the world of trade has been radically altered by the events following 1914. A fiscal policy which might have been defensible before that year has since gone hopelessly awry. Our immense and increasing investments abroad cannot indefinitely be paid for unless we are willing to take what our foreign debtors can offer us."[10]

With the war the United States had switched positions, almost overnight, from the world's great debtor to the world's great creditor. New York replaced London as the central lender in the world's credit network. This move meant more than merely a shift in position and priority. Postwar debts differed from prewar borrowing. New World borrowers spent nineteenth-century British loans on railroads and ranches, building the capacity to repay their lenders. Belligerent borrowers spent wartime American loans on shot and shell, destroying that capacity. Nations wounded in war borrowed more money to repay their debts, sometimes borrowing from America to pay other belligerents who in turn paid America.

This new global system of the 1920s, less open and flexible than its predecessor, relied on continued American lending to fund deficits and debts around the war-impoverished world. And for a time, American lending served this purpose. Then, in 1928, it all but stopped, sending Germany, Poland, Brazil, Argentina, Australia, and Canada into recession.[11] But Americans were not looking at the limping world. They had their eyes on the racing economy at home.

After the United States recovered from a postwar recession in 1921, its economy grew at a healthy annual rate. American workers produced more goods more efficiently, and their incomes increased, if not quite so quickly as the profits born from their

greater productivity.[12] Many Americans' optimism grew, too: they thought they had entered a new era of prosperity, when more Americans could afford more luxury goods and live, at least materially, better lives than ever before. So securely did they hold this belief that they accepted newly available offers of credit in order to buy what they could not afford from their own pockets. By the end of the decade Americans were living lives well-furnished with debt.

Before World War I, the average American household went a little more into debt each year—maybe a $4 increase over the year before, excluding mortgages. In the 1920s, the average increase more than tripled to about $14 a year.[13] With that borrowed money Americans bought the same goods they were increasingly making: expensive, durable, luxury items that gave them more varied amusements and higher expectations from life. The 1920s brought regular radio programs, and Americans bought radio sets and phonographs. They bought household appliances, like electric refrigerators. Most visibly, they bought cars.[14]

The production, purchase, and financing of automobiles drove the perception and reality of American prosperity in the 1920s. The output of America's automobile factories more than doubled over the decade, so that by 1929 the 4.4 million cars they produced were the single most valuable chunk of U.S. manufacturing output. At decade's end about 447,000 people worked in the automotive industry—only slightly fewer than worked in iron and steel, the nation's biggest manufacturing industry. The more cars Americans made, the more they drove up demand for glass, rubber, steel, and petroleum. Car-buyers drove the growth of roads, suburban houses, shopping centers, and other roadside attractions.[15]

In 1920 American motor vehicle bureaus recorded only one car registered for every three households; by the end of the decade the country had a car for almost every household. In 1929 there were about 23 million cars for a nation of about 123 million people: at a cozy fit of six per car, the whole country could have gone on the road at once.[16]

Henry Ford's motor company provided some of the technical and business innovations that made these changes possible. By World War I, Ford had settled on the Model T as its all-purpose consumer model, developed the moving assembly line as a method of mass production, and began touting the high wages its workers earned, as a way of ensuring their loyalty and their ability to purchase the company's signature product, whose price fell and fell over the years, from around $950 in 1909 to a low of $290 in 1926.[17]

Were Ford's the whole story of the automobile industry and, by extension, American manufacturing in the 1920s, it would sound something like this: higher wages, lower prices, and the mass production of a standard item made what was once a luxury into a commonly available commodity. But this is not the whole story. Despite the Model T's falling sticker price, major durable goods generally cost more in relation to other products in the 1920s than they had before the war. Americans did not buy these products in such quantities because they were cheap: they bought despite the expense.[18]

Ford's inexpensive, standard Model T made it possible for more, different people to own cars. But at some point, everyone who could afford a car would have one, and then who would buy? General Motors (GM) decided to make sure that the same people would keep buying different cars: it introduced planned obsolescence by annually changing its models, and to allow for the extravagance of regular new cars, GM began extending credit through the General Motors Acceptance Corporation.[19]

Often the ready credit of the 1920s came dear, at an annual interest rate of around 30 percent on an installment plan for a new car.[20] Even though moralists—Henry Ford among them—fretted over the ever-expanding definition of what Americans needed to buy,

consumers themselves hearkened to the doctrine *Advertising and Selling* promulgated in 1926: "every free-born American has a right to name his own necessities."[21] Through the decade the list of these new necessities grew.

Yet credit could not stretch cash infinitely. Installment plans sent bills with clockwork regularity. Americans' income did not arrive with equal reliability: cyclical unemployment always loomed, and social insurance against it scarcely existed. So buyers had to take considerable care before they plunged into long-running debt. Any added uncertainty in consumers' outlook might make them wait, just a while, to see what might happen to affect their paychecks. In a time of economic crisis, even a short pause in purchasing could slow or even stop the nation's assembly lines.

As Americans eagerly heeded the advertisers' blandishments, they ran closer to the limits on their good fortune. The countries borrowing from the United States found out beginning in 1928 what happened when American credit dried up, and soon after Americans found out what happened when their own credit-fueled spending slowed. Both looked for the source of their problems and for possible solutions at the headwaters of debt in Wall Street.

If the world economy of the 1920s consisted of concentric circles, the outside ring held peoples remote from the industrial center and little touched by its booms and busts. The next ring inward included the industrial nations tied by debts to the United States. Next from them dwelt most of the Americans themselves, divided further into finer rings: those still struggling to get by, then those better off if perhaps in hock to fund their routine purchases, and then the minority—maybe under 10 percent—of Americans who owned stocks.[22] And inward at last from them lived the near-aristocracy, the moneymen who made decisions that determined how easily everyone else could get their credit and who increasingly fidgeted as they watched the stock-tickers.

The best-connected and most diligent public servants of their day worked on Wall Street and around it in lower Manhattan. In the 1920s they included the once and future Supreme Court Justice Charles Evans Hughes; the once and future Secretary of War Henry Stimson; the future New York governor Herbert Lehman; and the future president and sometime foe of all that Wall Street stood for, Franklin Roosevelt.[23] They handled mergers, stock offerings, and all the great business of the nation's businesses.

They also, along with their less reputable neighbors, handled other transactions. For example, with a sufficient sum of capital a group of investors could establish a "pool" specifically for the purpose of manipulating a stock. Members of the pool would buy and sell to one another at times and in increments calculated to tell a particular story to an outsider watching the ticker tape. The numbers on the tape showing the bare facts of trading did not lie, but the pattern of numbers might deceive an imaginative observer eager to know what the insiders knew. The ebb and flow of sales conducted among the members of a pool would intimate to an obsessed investor that someone, somewhere, had inside information that a company's stock should rise. Investors would flock to the pool stock, driving its price up. Then, when it seemed they had driven it as far as it would go, the original members of the pool would cash in, sending the price back down to its former level. It happened all the time and was not illegal. Nor was it even secret: the *Wall Street Journal* reported on the doings of pool stocks, published information about who led which pools, and trafficked regularly in the opinions of analysts as to which stocks best attracted uninformed enthusiasm ("anything which has electricity or light or power in its title," one analyst reported).[24]

Americans sometimes distinguished between this sort of activity, which they called "speculation," and ordinary purchase of stock, which they called "investing." Investors bought stock based on the soundness of the underlying enterprise over the long

term, choosing securities on the basis of whether they thought the company would do its business competently in the months and years to come. Speculators bought and sold stock based on their intuitions as to everyone else's impulses in the market that day. And as speculative activity overshadowed investment, more speculators came into the market, and more observers worried.

By 1928, Wall Street men knew, and the *Wall Street Journal* affirmed, that they were working in "the kind of market that makes for larger commissions than profits."[25] Even so, increasing numbers of Americans wanted to play this evidently rigged game. People flocked to the big money, hoping to buy into the inner circle. Even a loss could give them the thrill of having brushed up against the big men.

Watching the increase in trading on the exchanges and in the borrowing to trade on the exchanges, the Federal Reserve decided to make it more expensive to borrow money. In June of 1928 the *Federal Reserve Bulletin* noted "an unprecedented volume of transactions on the exchange and a continued rise in security prices" while "brokers' loans reached a record figure . . . and continued to increase." So the Federal Reserve began "withdrawing funds from the money market."[26]

Yet speculation flourished into the new year. Early in 1929, just before Herbert Hoover's inauguration as president, the Federal Reserve warned publicly that it did not wish banks to use its credit for "maintaining speculative security loans."[27] Although speculation continued at a high rate, U.S. overseas investment did not: capital leaving America averaged around $800 million annually from 1925 to 1928, rising to $1,250 million in 1928, but fell to $628 million in 1929 and averaged about $360 million annually from 1929 to 1932.[28] The Federal Reserve's tighter monetary policy helped slow American capital going to foreign countries. Nations like Germany, which had depended on American loans, began to struggle under this handicap.

In later years, pronouncements reflecting incautious optimism, an insistence that everyone should become rich, that everything was for the best—comments so comforting to contemporaries and so reckless in retrospect—became a staple of every story about the Great Crash. And such remarks showed up all over in the weeks before they altogether ceased. Newspapers regularly sought the cheery views of professional soothers, who obligingly declared that they saw smooth sailing ahead. But by the late 1920s, a growing number of bankers and policymakers had the impression that the world simply could not sustain the current state of its finances. Both around the globe and within the United States too many people had borrowed too much money for unproductive purposes. The financier Bernard Baruch wrote, "Whereas it is wise to buy things on the partial payment plan that will result in time in increased economies and better living, at the same time it can be overdone. I am afraid it has now been overdone."[29]

Too few reliable investments remained. And even though only a few Americans actually bought and sold stocks, the market had become a kind of entertainment, a set-piece of idle chat. In itself, this prevalence of market talk warned those in the know that it was time to get out before it was too late. The financier Joseph P. Kennedy, who by summer of 1929 had sold out of his major holdings and kept his money in cash, advised a friend that "Only a fool holds out for the top dollar."[30] Self-aware fools went into the market assuming that still greater fools had yet to buy in. It took a shrewd judge of national character to decide just when the United States would run through its supply of fools.

Generally, those with means to leave Manhattan in summer regarded as fools those who stayed. Yet in August of 1929, traditionally a time to flee the city's unreasonable heat, the moneymen stayed in town to see if they could beat the big bull market as it rose. Even through Labor Day, even through hot days of high humidity, to the September 3 peak of market prices, they stayed. Then a few days later the market dropped a bit. A couple of weeks later it dropped a bit more.[31] The heat broke too. Rumors spread that the pool operators had decided to see if they could work their wiles in reverse and drive prices down. In the next weeks the market slid, rallied, and slid again.

Through the morning of October 24, in the streets of New York, crowds walked quietly downtown to Wall Street where they gathered silently and stood looking at the New York Stock Exchange, as if suddenly its abstract activities could become manifest, giving evidence of the disaster now plainly happening to them all.[32] That was Black Thursday. The market rallied afterward but then fell again. The oil tycoon John D. Rockefeller announced that "there is nothing in the business situation to warrant the destruction of values that has taken place" and that he was busy buying.[33] Neither this gesture nor others like it shored up stock prices. By mid-November, more than a third of the stock market's value had vanished.[34]

This fall in value immediately afflicted only a few Americans. But so closely had the others watched the market and regarded it as an index of their fates that they suddenly stopped much of their economic activity. As the economist Joseph Schumpeter later wrote, "people felt that the ground under their feet was giving way."[35] Facing a dubious future, Americans made important decisions not to buy. Particularly, they stopped buying the expensive durable goods like cars that they had learned to buy on credit. Each signature on an installment-plan contract represented a consumer's prediction about his or her ability to pay in the future. Suddenly Americans no longer felt able to see far enough ahead to make sound forecasts. Within a few months of the crash new car registrations had fallen by almost a quarter of their September number.[36] In 1930 spending on consumer durables fell by 20 percent.[37] Factories closed and banks failed. Unemployment more than doubled its 1929 level.

In 1931 John Maynard Keynes visited the United States and in a lecture attributed the increasingly severe Depression to "extraordinary imbecility."[38] On this point observers generally do agree: someone had blundered and, given the structure of global finance after World War I, that someone must have had an address ending in "United States of America." The principal candidate, then and later, was Herbert Hoover, who in his memoirs defended himself by agreeing with the earlier Keynes: "the primary cause of the Great Depression" Hoover wrote, "was the war of 1914–1918."[39] But Hoover stood little chance of escaping blame. By 1930 Joseph Kennedy was already calling one of Hoover's backers to say, "jot down the name of the next president. . . . It's Franklin D. Roosevelt."[40]

Notes

1. John Maynard Keynes, *The Economic Consequences of the Peace* (London: 1919), 213.
2. On Keynes's critique of reparations, see Niall Ferguson, *The Pity of War: Explaining World War I* (New York: Basic Books, 1999), 395–432.
3. Keynes, *Economic Consequences*, 8.
4. Christopher Blattman, Michael A. Clemens, and Jeffrey G. Williamson, "Who Protected and Why? Tariffs the World Around, 1870–1938," in *Conference on the Political Economy of Globalization* (2002), 30.
5. Eric Rauchway, *Blessed among Nations: How the World Made America* (New York: Hill and Wang, 2006), 156.
6. Keynes, *Economic Consequences*, 7.
7. Ibid., 211.
8. Edward Hallett Carr, *The Twenty Years' Crisis, 1919–1939*, 2nd ed. (London: Macmillan, 1962), 234.
9. Immigration Act, chap. 25 of 9–10 George V, p. 7, sec. 13, consulted online 2/27/2007, www.canadiana.org/ECO/ItemRecord/9_08048.
10. Rauchway, *Blessed among Nations*, 157.
11. Barry Eichengreen, "The Origins and Nature of the Great Slump Revisited," *Economic History Review* 45, no. 2 (1992): 223.
12. George Soule, *Prosperity Decade: From War to Depression, 1917–1929* (New York: Rinehart, 1947), 220.

13. Martha L. Olney, *Buy Now, Pay Later: Advertising, Credit, and Consumer Durables in the 1920s* (Chapel Hill: University of North Carolina Press, 1991), 91.
14. Ibid., 40.
15. Peter Fearon, *War, Prosperity, and Depression: The U.S. Economy, 1917–1945* (Oxford: Philip Allan, 1987), 55–56.
16. Soule, *Prosperity Decade*, 164.
17. John Bell Rae, *American Automobile Manufacturers* (Philadelphia: Chilton Company, 1959), 107–9; John Bell Rae, *The American Automobile* (Chicago: The University of Chicago Press, 1965), 61, 88.
18. Olney, *Buy Now*, 182.
19. Roland Marchand, *Advertising the American Dream: Making Way for Modernity, 1920–1940* (Berkeley: University of California Press, 1985), 156; Olney, *Buy Now*, 127.
20. Olney, *Buy Now*, 115.
21. Marchand, *Advertising the American Dream*, 160.
22. Peter Fearon, *Origins and Nature of the Great Slump, 1929–1932* (Atlantic Highlands, NJ: Humanities Press, 1979), 34.
23. John Brooks, *Once in Golconda: A True Drama of Wall Street, 1920–1938* (New York: Wiley Investment Classics, 1999), 58–59.
24. "Market Comment," *Wall Street Journal*, 3/21/1928, 22.
25. "Broad Street Gossip," *Wall Street Journal*, 1/13/1928, 2.
26. *Federal Reserve Bulletin* 14:6 (June 1928), 373.
27. John Kenneth Galbraith, *The Great Crash, 1929* (Boston: Houghton Mifflin, 1972), 38.
28. United Nations, *International Capital Movements during the Inter-War Period* (New York: Arno, 1979), 10, table 1.
29. Bernard M. Baruch, *Baruch*, 2 vols. (New York: Holt, 1957–60), 2:218.
30. Richard J. Whalen, *The Founding Father: The Story of Joseph P. Kennedy* (New York: New American Library, 1964), 104.
31. Brooks, *Once in Golconda*, 110.
32. Ibid., 117.
33. "Rockefeller Buys, Allaying Anxiety," *New York Times*, 10/31/1929, 1.
34. Brooks, *Once in Golconda*, 119.
35. Joseph A. Schumpeter, *Business Cycles: A Theoretical, Historical, and Statistical Analysis of the Capitalist Process* (New York: McGraw-Hill, 1939), 2:911.