

WHODUNNIT?

The Great Crash of 1929

IN the past few weeks, the autobiography of the notable American economist John Kenneth Galbraith, the Keynesian in John F. Kennedy's liberal Camelot, has been launched and promoted in the media. *A Life in Our Times*, like all of Galbraith's books, is strong on anecdotal narrative, and compelling. Many of the more comprehensive assessments of the book also reviewed Galbraith's contribution to American political economy, dwelling on *The Affluent Society* and *The New Industrial State*, his best known studies of the economics and character of modern industrial society. In both books the author refers approvingly to the re-distribution of wealth that can be achieved by state intervention – through the use of taxation to finance the provision of public services and the subsidising of selected industries. He also shows how the American economy has developed along Keynesian lines following the Bretton Woods Agreement of 1944.

To me, however, Galbraith's most interesting work was probably the *Great Crash 1929*. Although commonly regarded as a minor work, akin to investigative journalism rather than a work of economics, it contains some penetrating observations and is of special interest in providing corroborative evidence for Henry George's theories on the cycle of boom and depression. *The Great Crash* grips like a thriller; it is immensely readable and one chuckles at its mock, sly humour even while aware of the grim disaster to which the story leads.

The book is an almost day-by-day account of the stock market collapse and an examination of the nature of the crazy speculations that led to Thursday, 24 October, the day that history identifies as the start of the great panic of 1929. On that day almost thirteen billion shares feverishly changed hands, many of them at prices that shattered a host of personal dreams. How did the collapse happen?

Early in the book there is an account of the Florida land boom and the extensive speculation, even in swampland, that occurred in the 1920s:

"In Florida land was divided into building lots and sold for a ten per cent down payment. Palpably, much of the unlovely terrain that thus changed hands was as repugnant to the people who bought it as to the passer-by. The buyers did not expect to live on it; it was not easy to suppose that anyone ever would. But these were academic considerations. The reality was that this dubious asset was gaining in value by the day and could be sold at a handsome profit in a fortnight. It is another feature of the speculative mood that, as time passes, the tendency to look beyond the simple fact of increasing values to the reasons on which it depends greatly diminishes. And there is no reason why anyone should do so as long as the supply of people who buy with the expectation of selling at a profit continues to be augmented at a sufficiently rapid rate to keep prices rising."

Thom Henvey

Such was the speculative rush that thousands of people flocked to Florida – "The Riviera of America" – reminding the observer of a gold rush. More land was subdivided each week until the landscape resembled the micro-divisions of graph paper. The congestion of traffic became so severe that the state was forced to invoke regulations controlling the flow of inessential freight, including building materials. And all the while the descriptions given out by the property-sellers were becoming increasingly bizarre. "Seashore properties" were often 20 miles from the nearest whiff of ozone; "suburbs" stretched into the swampland surrounding many towns. Commented Galbraith:

"Values rose wonderfully. Within forty miles of Miami 'inside lots' sold at from \$8,000 to \$20,000; waterfront lots brought from \$15,000 to \$25,000, and more or less bona fide sea-shore sites brought \$20,000 to \$75,000 . . . The Florida land boom contained all of the elements of the classic speculative bubble."

Galbraith quotes the total of bank clearings in 1925 as \$1,066,528,000. In 1928 they were down to \$143,364,000. The speculation like all bubbles burst upon the rocks of reality. There was a chain of defaults on property that, in the interim, had trebled and quadrupled in price. Through defaults, some farms were returned to the original farmer but now equipped with named, lit streets. The property taxes and assessments paid on such ghost towns exceeded the true economic value of the land.

Galbraith's presentation of these facts encourage the reader to expect that, at some point, he would begin to perceive land as a unique asset with a different reaction to monopoly and speculation than ordinary stocks and shares, especially as land was consistently providing the base collateral for investment trusts and brokers' bonds. He seems to be hot on the trail a few pages on:

"As noted, at some point in the growth of a boom all property ownership becomes irrelevant except the prospect for an early rise in price. Income from the property, or enjoyment of its use, or even its long-term worth are now academic. As in the case of the more repulsive Florida lots, these usufructs may be non-existent or even negative. What is important is that tomorrow or next week market values will rise – as they did yesterday or last week – and a profit can be realised."

The market evolved a method by which the speculator could pocket the increase in value without shouldering the burdens of ownership. In Florida, this was achieved by trading in 'binders.' Not the land itself but the right to buy the land at a *stated* price was offered. A ten per cent down payment was all that was required to secure this privilege. When values increased, the binder could be resold for the down payment plus the increased value. Thus a speculator might pay \$1,000 as a down payment on a property worth \$10,000. When the value of the land increased, say by ten per cent, he could resell his binder for \$2,000. Wrote Galbraith:

"The use of the binder multiplied tenfold the amount of acreage from which the speculator could harvest an

increase in value."

On Wall Street, the buyer of securities on margin got full title to them using a loan from his broker. (Although, in the same transaction, the security was given back to the broker to hold as collateral for the loan). The 'margin' which the buyer paid to the broker was required to be augmented should the security's value fall. At no stage did the buyer put up the full purchase price himself. When the value of the security increased, he could resell it to the broker, pay the interest on his loan and take his profit – the increase in the value of the security.

The brokers' funds were provided by the banks. In return, the banks required the collateral of the securities for *their* loans. In essence, the brokers traded in margins, the banks in loan-interest and the speculator in the increasing value of the property. Interest rates determined the supply of funds and kept them adjusted to the demand for margins.

Galbraith uses the statistics of the volume of brokers' loans as an index of the speculation.

In the early 1920s the volume of these loans – because of their liquidity they are often referred to as "call loans" or "loans in the call market" – varied from \$1 billion to \$1½ billions. In early 1926, they had swollen to \$2½ billions. At the end of 1927, they totalled almost \$3½ billions which Galbraith calls "an incredible sum" for that time. By June 1928 the volume was \$4 billions and by the end of the year it had reached an astronomical \$6 billions.

"People were swarming to buy stocks on margin – in other words to have the increase in price without the cost of ownership. This cost was being assumed, in the first instance, by the New York banks, but they, in turn, were rapidly becoming the agents for lenders the country over and even the world around. There is no mystery as to why so many wished to lend so much in New York. One of the paradoxes of speculation is that the loans that underwrite it are among the safest of all investments. They are protected by stocks which under all ordinary circumstances are instantly saleable, and by a cash margin as well. The money, as noted, can be retrieved on demand. At the beginning of 1928, this admirably liquid and exceptionally secure outlet for non-risk capital was paying around five per cent. While five per cent is an excellent gilt-edged return, the rate rose steadily through 1928, and during the last week of the year it reached twelve per cent. This was still with complete safety."

Galbraith refers graphically to the "great river of gold" that flowed into Wall Street to feed the gluttony of the speculation. Industrial companies who invested in securities at the higher rates could earn more profit by so doing than by expanding their production. Some firms decided to confine all of their investment capital to speculation and lent their surplus funds on Wall Street. The consequent contraction of their normal industrial activities, with its adverse effects of jobs etc., was regarded as a small price to pay for the profits of speculation.

Yet despite all the evidence that piles up around the author, the distinction between land and model T Fords never comes. The last chapter – Cause and Consequence – diffidently ascribes the 1929 collapse to a collection of reasons; (1) unequal distribution of income which limited the consumer goods market and made sound investment erratic; (2) bad and even fraudulent corporate structure ("a kind of flood tide of corporate larceny"); (3) the banking structure, which contained too many independent units not under central control (once one bank failed the whole system collapsed); (4) the dubious state of the foreign balance; (5) the poor state of economic intelligence.

Galbraith mentions rent as part of the securities income of the very rich in the first cause – bad distribution of incomes – but fails to follow up the argument in any substantial way.

Who, or what, was the prime cause of the collapse? Land speculation, robbing production at every stage, is the clear culprit, as Galbraith has demonstrated. According to original Keynesian theory, of which Galbraith was an advocate, interest rates were supposed to decrease progressively. It is ironic that, because of Keynesian inflation, lenders have had to increase interest rates progressively to compensate the speculator for falling money values. And, as we have seen, increasing interest rates provided the funds for the speculation of 1929. Georgist economists will find *The Great Crash* enlightening as an account of the mechanics of a financial orgy, which was soon followed by a financial famine as, in the early 1930s, interest rates collapsed and wages tumbled.

In *The Affluent Society*, Galbraith rejected the idea of a Henry George style property tax, preferring a host of mongrel taxes to control and supply demand. He wrote:

"If land were nationalised – more precisely if a tax were imposed equal to the annual use value of real property *ex* its improvements, so that it would now have no net earnings and hence no capital value – progress would be orderly and its fruits would be equitably shared. But this, obviously, was a very drastic prescription. Were the remedy not applied, and this was a reasonable prospect given the predictable reaction of property owners to the proposal, then the consequences would be continuing poverty combined with increasing inequality and increasing insecurity. If this was the American dream, it had little to commend it as compared with the meagre classical prospect. And, in fact, the mood of Henry George's followers was often one of misanthropic or frustrated radicalism."

Galbraith's words are a condemnation of himself and all other economists who allow political considerations to stifle the true teaching of their science. The clear message of *The Great Crash 1929* is that so long as land speculation thrives, so long will the developed world suffer the insidious cycle of booms and slumps.

A Life in Our Times John Kenneth Galbraith. Deutsch, 1981. *The Great Crash 1929* Penguin, 1980. *The Affluent Society* Sentry Books, 1971.