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How the suckers lost it all the last time around

by William Engdahl

Editor's note: *Those who may still harbor some illusion that "the big guys," or "the computers," or some other mystical force, will prevent the world financial markets from collapsing at least as badly as they did in late 1929, should consider the following history, which is excerpted from a longer piece, entitled "The Treacherous British Role in the Great Depression Crisis." This doesn't tell you why, but it's a useful reminder. Back then, millions of American families had put their life-savings into stock options, which they used as collateral on home and other consumer financing; today, it is the entire world economy that has been collateralized, by the greatest speculative boom in world history. But this time around, if Americans wise up quickly, they will be able to permanently defeat the British financial gamemasters, who are positioning themselves to be the only ones remaining standing after the blowout.*

While the newly created Federal Reserve Bank diligently watched for any hint of inflation in commodity prices during the 1920s, they ignited a far more dangerous inflation, that of financial paper. Bank funds which were not going abroad to Germany and such destinations, were going to broker loans in the stock market bonanza of the "Roaring Twenties."

The greatest speculative bubble in American history was under way. Most domestic bank loans in the 1920s went directly to finance securities purchases, mostly stocks. After World War I, large U.S. corporations had turned to the growing New York Stock Exchange to raise their capital for expanded investment, through new issue of stock shares to an eager investing public. The American automobile industry was expanding at breathtaking speed, most of the expansion of plant and equipment financed by new stock issues from Chrysler, Ford Motor, or General Motors.

Further, because of these changes in how American big business financed their expansion, through selling stock to the public, rather than through traditional bank borrowing, banks were awash with liquidity, with few traditional places to profitably invest. So, ever resourceful, they turned to the "financing of finance."

The private American banking system, backed by the large U.S. gold reserves, extended credit to purchase of stocks on an unprecedented scale. The stocks and other securities were themselves then taken by banks as collateral for new lending. A vast financial pyramid was under construction.

In this manner, the Wall Street stock market bubble assumed gargantuan dimensions during the late 1920s. In 1925 alone, as bank loans to stockbrokers to finance stock purchases more than doubled, to a record $2.8 billion, the New York Stock Exchange index rose by 40%.

By early 1929, fully two-thirds of all U.S. bank credit was collateralized by various securities, usually stock shares. The potential of a stock market collapse to bring down the entire banking system, was theoretically clear for anyone to see. But, in the growing frenzy of citizens, of all walks of life, to share in the new riches of being a stock owner, few took heed of such unthinkable prospects.

With easy bank credit available to finance stock purchases, and the belief that interest rates would go ever lower, the demand for stocks from ordinary citizens with small savings to invest, began to grow. As the stock market itself continued to rise on the back of the new demand, mostly on borrowed money, the public's interest in stock ownership grew even more, as family after family began to put their life savings into the marvelous new money machine called Wall Street.

Stock prices ballooned 69% from the end of 1927 to the peak in September 1929. People were encouraged by their bankers to borrow money to buy stocks on margin—that is, by putting up only a few percent of the face value of the shares bought, the rest to be paid at a future date. This risky practice pushed the stock prices ever higher, drawing ever more people into the market, at ever riskier levels. Businesses which financed capital needs by issuing stock in this climate, reaped the rewards, as the public's appetite appeared insatiable. The total volume of common stock financing by companies, increased 661% between 1926 and 1929, a rise from $579 million to $4.406 billion. Never since the 1620s' Holland tulip speculation, had the world seen such a speculative delusion.

Far from trying to prevent this flow of bank credit into stock speculation during the 1920s, Benjamin Strong and the New York Federal Reserve attempted to feed the stock boom, at least until it was too far advanced to respond to ordinary reason. Strong told his Federal Reserve colleagues at the time, that the advantages to the nation of an "active and rising stock market," were a primary goal of his monetary policy.

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This significant shift in credit policy by the New York Federal Reserve bank in the period up to the October 1929 market panic, was of immense importance for what was to follow. By allowing the very heart of the established U.S. bank credit mechanism, based on gold reserves, to finance stock market speculation, Strong and his associates set the stage for the greatest economic contraction in American history. The pyramid of postwar U.S. credit in the 1920s, much like that of Japan during the 1980s, was built on the assumption of ever-rising stock values. When that ceased, the entire edifice collapsed, with breathtaking speed and efficiency.[1]

Hatry and Norman: springing the trap

Just as huge sums of capital had gone via the City of London into Germany and the continental economies of Europe after 1925, so, by the end of that decade, as the Wall Street stock market caught fire in its speculative frenzy, the City of London became the crossroads for a reverse flow, as capital began flowing out of Germany and the rest of Europe, Britain included, into Wall Street's feverish stock market speculation.

Within a short time, following the 1925 resumption of the gold standard, Bank of England head Montagu Norman had secured the role of *primus inter pares* among the world's major central bankers, largely through his skillful alliance with Benjamin Strong. The American Agent General for Reparations, Parker Gilbert, referred to Norman, with good cause, as, "the most powerful man in the world."

Emil Moreau of the Bank of France protested about what he called an alarming "imperialism" of Norman's Bank of England, since their rejoining the gold standard, despite the fact that French gold reserves had grown far more substantial than England's. In 1928, Moreau wrote to French President Poincaré, complaining that Norman and the British managed to dominate the Financial Committee of the League of Nations in Geneva (whose head was Montagu Norman's intimate friend, Sir Henry Strakosch), and that he was using that position to establish crucial influence over European economies.

Moreau charged, "England, having been the first European country to re-establish a stable and secure money, has used that advantage to establish a basis for putting Europe under a veritable financial domination. The Financial Committee at Geneva, has been the instrument of that policy. The method consists of forcing every country in monetary difficulty to subject itself to the Committee at Geneva, which the British control. The remedies prescribed always involve the installing in the central bank of a foreign supervisor, who is British or designated by the Bank of England, which serves both to support the pound and to strengthen British influence. To guarantee against possible failure, they are careful to secure co-operation of the Federal Reserve Bank of New York. In addition, they pass on to America the task of making some of the foreign loans if they seem too heavy, always retaining the political advantages of these operations."

Moreau noted that such maneuvers by Montagu Norman and the British government had allowed England to become "completely or partly entrenched in Austria, Hungary, Belgium, Norway and Italy."[2]

Such little-publicized maneuvers by Norman were to determine the ultimate fate in the 1930s of Germany, Austria, and much of the world.

The financial distress of an unconventional and now long-forgotten British businessman, Clarence Hatry, was to be the vehicle for Norman and the political establishment of the City of London in a far larger design.

Hatry, a financier who had built a large industrial conglomerate by merging financially troubled companies and reorganizing them after the war, had bought, and later sold, such known British firms as Leyland Motors. He created British Glass Industries, and owned the London *Globe* newspaper and the Commercial Bank of London. During the 1920s, he created Allied Ironfounders by merging 23 small firms in the British steel industry. He was widely regarded, on the way up, as having a "Midas' touch."

Hatry's empire, however, like many in the day, had been built on borrowed funds, and was overextended at the point when Montagu Norman and the Bank of England began to take steps in summer of 1929 to clamp down on the speculative frenzy which had also come into the London Stock Exchange, by tightening bank credit.

That fateful summer, Hatry's fate depended on securing an emergency infusion of new credit to weather his short-term cash problems. It was a top-down decision by no less than Montagu Norman personally, and City of London financier Marcus Samuel (Lord Bearstead), head of the Samuel & Co. banking house tied to Royal Dutch Shell, which triggered the collapse of the Hatry empire, and, with it, the largest collapse on the London Stock Exchange, on Sept. 17, 1929.

Hatry insisted that initially he had been given a verbal assurance by Lord Bearstead, for an emergency "bridge loan" of £4 million, enough to have saved the large conglomerate business empire from collapse. But Bearstead did not extend any loan. Hatry then went directly to the Bank of England's

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1. The policy of Benjamin Strong to support the stock market as well as the Bank of England's pound stabilization, was openly laid out in an internal memorandum from Strong to officers of the U.S. Federal Reserve, made public after the onset of the depression in 1931. See U.S. Senate Hearings (Senate Res. 71), Washington, D.C., 1931, Part VI. A useful account of the stock market frenzy of 1925-29 is in Giulio Pontecorvo, "Investment Banking and Security in the Late 1920s," in *Business History Review,* Harvard College, Cambridge, Massachusetts.

2. The comments of Moreau are cited in Andrew Boyle, *Montagu Norman, a Biography* (London: Cassell & Co., 1967). The remarks offer revealing insight into the skillful deployment of financial and political "leverage" to magnify the role of the Bank of England over world events far beyond its nominal monetary resources in the period. The role of Norman and of the Bank of England were to be decisive in the ensuing British geopolitical strategy of the 1930s.

Norman for help.

At this critical juncture, Norman used the hapless Hatry to detonate a financial crisis of world dimensions. Norman not only refused to help Hatry with what was, to be sure, a financial problem which could well have been managed with a small injection of new credit. Norman even went further, and issued a warning to all financial houses of the City of London, to refuse Hatry credit. Hatry had been blackballed, and as his large business empire collapsed, it triggered the collapse of the London Stock Exchange. On Sept. 20, 1929, the London Stock Exchange Committee suspended share dealings, after three days of panic selling with no buyers. Hatry's was the century's largest business failure in Britain.

Norman had little interest in Hatry per se, nor even in the reports that Hatry had engaged in suspicious bookkeeping to keep his empire afloat.

The unravelling begins

For want of extending a mere £4 million to a British company, Norman allowed the entire post-Versailles international monetary and economic system to collapse. No single individual in international banking was more aware than Montagu Norman, of just how fragile the international capital markets on both sides of the Atlantic were, as the Bank of England had carefully positioned itself in the center of post-1925 world capital flows.

The Bank of England began to reverse the global financial flows initially on Feb. 6, 1929, when Norman raised the Bank of England's main lending rate by a full 1% to 5½%, after two years at 4½%. The New York Federal Reserve, becoming alarmed at the out-of-control flood of funds into stock market speculation, reacted at the same time with a verbal "warning" of possible U.S. interest rate rise, from the 5% discount rate levels it had been for some months, but took no immediate action.

In late March, there was an attempt by the Federal Reserve banks to withhold funds from the New York stock market, triggering a "minor correction," a 5% drop in stock prices. But the effect was overshadowed by a public statement from the influential head of New York's National City Bank, Charles Mitchell, that he was prepared to personally extend his bank's capital to support the stock market. Wall Street stock speculation soon resumed its pace, as the players saw the Federal Reserve firmly resisting any decisive increase in its central discount rate.

The Bank of England's rate rise had immediate impact, however, in the most fragile capital market, Germany. By the end of that February, Germany began to see a sharp outflow of capital to London, attracted by the higher rates, and by German short-term borrowers attempting to pay down their foreign three-month loans. Action by Hjalmar Schacht's Reichsbank to tighten the German discount rate to 7½%, slowed the German capital outflow somewhat during the summer of 1929.

But the Reichsbank's rate action also exposed the fragility of the German economy to the huge foreign short-term capital borrowing. In September, a disaster was narrowly averted, when a large insurance group, Frankfurter Allgemeine, was rescued by a consortium of German banks and the German insurance company, Allianz. Frankfurter had 35% of its debt owed to foreign banks. The crisis brought to the fore an inherent conflict between the foreign bank creditors of German companies and domestic German creditors. It was the first tiny crack in the Germany's fragile edifice of post-1925 financing. It was far from the last.

Finally, after months of vacillation and unconvincing action to dampen the speculative fever in Wall Street stocks, the New York Federal Reserve Bank raised its discount rate a full 1%, to 6%, on Aug. 6, 1929. The intent was to discourage further purchase of stocks on borrowed funds, and to facilitate a gradual deflation of the dangerous Wall Street stock market levels, while maintaining easy credit to agriculture and business.

Thus, while the New York Federal Reserve Bank raised the discount rate, it simultaneously lowered another critical rate, the so-called bankers' bills of acceptance rate, to 5⅛%, convincing market speculators that the overall climate would not change. Banks merely took funds from the bankers' bills of acceptance market, from the financing of agriculture and commercial credit, sold them to the New York Federal Reserve for funds at 5⅛%, and used the funds to continue the speculative activity on the Wall Street stock market.

As Clarence Mitchell's National City Bank told clients that month, "There is a good deal of doubt the Federal Reserve can control the use to which credit is put, and once Federal Reserve credit has been released, it is likely to go where there is the greatest demand for it. After all, there is nothing to prevent a bank from selling acceptances to the Reserve Banks and using the proceeds in the stock market." And, in August 1929, demand was for more stocks on credit.

Stocks, not surprisingly, soon resumed their upward climb to new record highs as the total of broker loans passed the $6.2 billion level.

At this juncture, conditions were primed for the decisive blow from Montagu Norman, when Clarence Hatry presented Norman his convenient target of opportunity. On Sept. 26, the Bank of England announced that it had raised its principal base rate by another full percent, to 6½%, five days after the collapse of the shares of the Hatry Group of Companies closed the Stock Exchange, citing a loss of Bank of England gold reserves as the reason. With this move by the Bank of England, a full-scale international crisis was detonated.

The Hatry affair provided the credible pretext for the Bank of England to raise its interest rates. No one could claim there was no crisis in the London financial markets. What few realized, was that the decision to precipitate such a crisis had been willfully and knowingly made by Norman and the inner court of the City of London establishment, fully aware of the conse-

quences of forcing Hatry's collapse.

By early October, share prices on the New York Stock Exchange had fallen 15% from the pre-Hatry crisis levels of early September. Stock prices of American steel, automobile, and copper companies led the way down. The selling in New York came primarily from investors in the City of London. British investors were liquidating their holdings in the vulnerable New York market, partly to cover losses triggered by the collapse of the far-flung interests of the Hatry group of companies, but also to get out of the vulnerable New York market, taking advantage of the higher interest rates in London. In liquidating their U.S. holdings during the month of September, these British investors set the stage for what was to be the greatest collapse in U.S. stock market history only weeks later.

By Thursday, Oct. 24, 1929, the selling across the board of New York shares reached such a tempo, that an emergency meeting was called by Thomas Lamont of J.P. Morgan & Co., one of the city's leading bankers, to try to restore market confidence. It succeeded for all of two trading days, before renewed panic selling resumed. In one week, more than $1 billion in brokers' loans had been liquidated, bringing the reduction in such loans down by almost $2.5 billion for the month of October alone, more than one-third of the total such loans. On Oct. 31, the New York Federal Reserve signalled its attempt to calm matters by lowering the discount rate from 6% back to 5%, an attempt to ease liquidation pressures on those who had gone heavily into debt to buy stocks.

By mid-November, when the New York Federal Reserve again lowered its discount rate, this time to 4½% to calm matters, the value of stocks on the New York exchange had already fallen by 30%, a paper loss of a staggering $26 billion since September's peak. It was the beginning of the unwinding of the entire credit structure of postwar America.

Because most of the credit structure of America after 1920 had been built on a pyramid of rising stock prices, when those stock prices no longer rose, but, instead, began to fall precipitously, millions of citizens found their life savings wiped out, as banks demanded "margin calls" of new collateral to replace the disappearing market value of stocks used as collateral to borrow.

Further, during the 1920s, the United States had become the world's leading advocate of buying consumer goods or housing on "time," rather than for cash, as had been the practice earlier. In countless families, investment in the stock market had been used, or was to be used, as collateral against purchase of a new car or a house. When this began to collapse, new home construction and automobile production dropped precipitously. This meant that people who built cars and homes were suddenly unemployed, and without any state insurance to cushion the blow. People who were unfortunate enough to be living in homes or with a car bought against stock as collateral, found themselves evicted, because they were unable to afford higher mortgage payments to compensate loss of stock values, or their car was repossessed. In 1929, almost one-half of all homes in urban areas carried a bank mortgage, with total mortgage debt held by the banking system of some $19 billion. Rates of default on home mortgage payments, generally the last payment families sacrifice in a crisis, rose in many cities to double-digit levels. All this had dramatic impact on U.S. industrial output, which fell fully 12% from the peak in June to the end of December, two months following the October 1929 crash.

The collapse of the New York Stock Exchange in 1929 was not, then, merely a collapse of an isolated part of American savings; it decimated the very heart of the entire economy, in ways unimaginable even six months earlier.

One of the most prominent Wall Street speculators, Bernard Baruch, spent the summer of 1929 in England and Scotland, where he met his close friend Winston Churchill. Curiously, Churchill managed to be in the Gallery of the New York Stock on Oct. 24, "Black Thursday," with his friend Baruch, to personally watch the panic below on the exchange floor. Already back in early September, when the market had been near its peak, Baruch had sold his shares, and had advised Churchill to do the same. Baruch later advertised the fact that he had avoided the disaster, as proof of his investment acumen. It was more likely proof of his well-placed friends in London.

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