The Great Depression

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On October 29, 1929, the world turned upside down. For more than a month, stock prices, which had risen to giddy new levels throughout the decade now known as "the Roaring Twenties," had been faltering. Since early September, when stock prices peaked, the market had lost about 17 percent of its value, and the previous Thursday, October 24, the decline turned into a free fall, prompting leading U.S. financiers like Thomas Lamont to place bids substantially higher than market prices on large blocks of blue-chip stocks in a last-ditch effort to restore confidence and stave off a market meltdown.

But it was to no avail. On Monday, the market continued its sell-off, falling 13 percent further. On Tuesday, October 29, the damage continued. When the closing gavel finally fell just before eight in the evening of that calamitous day, stocks had lost an additional 12 percent. Stunned crowds of investors filled the streets outside the New York Stock Exchange on Wall Street. The Great Depression, the greatest economic and financial crisis in American history, was underway.

The "Black Tuesday" stock market crash has attained iconic status in American lore. But contrary to present-day misconception, the crash neither initiated nor was chiefly responsible for the depression that followed.

Americans were no strangers to economic downturns stretching all the way back to the Panic of 1819. Most such episodes, including the then-recent Panic of 1907, when the stock market fell almost 50 percent from its 1906 high, and the post-war recession of 1918-1921, in which the American economy shrank by a greater degree than it did during the Great Depression, tended to be severe but brief interruptions in otherwise robust economic growth. In late October 1929, there was little reason to believe that the latest market calamity would be otherwise.

But this time, things would turn out very differently. For although this economic downturn, like all other downswings in the business cycle, had been brought about by unwarranted credit expansion on the part of the banking system, spearheaded in this instance by the brand-new Federal Reserve, the actions of bankers and politicians before and after the stock market crash turned a much-needed market correction into an economic apocalypse.

Inflationary Roots

The roots of the Great Depression extended back as far as the Panic of 1907. That panic, primarily a bankers' affair that resulted in runs on numerous banks and trusts, especially in New York City, was over in a few weeks with minimal impact on the public at large. J.P. Morgan organized bankers and financiers to arrange new lines of credit amongst themselves and buy up stocks of otherwise healthy corporations. The panic was thus solved expeditiously by market forces and affected parties like Morgan acting in their own self-interest. Yet it persuaded many on Wall Street that the time had arrived for America to have a central bank, as England and most of the wealthy nations of Europe had had for many years. Bankers, like Jacob Schiff of the investment firm Kuhn, Loeb, and Co., were vociferous in demanding a central banking authority to stabilize the allegedly chaotic banking system.

Six years later, in 1913, they got their wish when the Federal Reserve Act, which created the Federal Reserve, was passed. The act was shepherded through Congress by Senator Nelson Aldrich, with the secret support of many of America's — and the world's — wealthiest men, like international banker Paul Warburg and the aforementioned Schiff.

The most powerful man at the new Federal Reserve was Benjamin Strong, the strong-willed and secretive head of the Federal Reserve Bank of New York from 1914 until his death in 1928. It was Strong, far more than the several chairmen of the Fed who came and went during his tenure, who was most influential in shaping U.S. monetary policy during the 1920s. Strong had been present at a secret meeting on Jekyll Island, Georgia, in 1910, where what became the Federal Reserve System was planned. Strong was also well connected in international banking circles, especially with Montagu Norman, governor of the Bank of England. It was Strong's

relationship with Norman, probably more than any other factor, that led to the Fed's inflationary (monetary expansion) policies of the 1920s and set the stage for the 1929 bust.

Montagu Norman, whom economist Murray Rothbard aptly termed "the Mephistopheles of the inflation of the 1920s," had great difficulty propping up Britain's postwar finances. Under pressure to restore British currency to the prewar gold standard — which would have required credit contraction to offset the effects of wartime inflation — Norman chose instead to open the money spigots wider. As a consequence, the British pound continued to lose value and, more alarmingly for British bankers, British gold migrated across the Atlantic to the United States, where it found more stable valuation in the U.S. dollar. As long as the disparity between American and British monetary policy continued, so would the flight of gold from a weaker to a stronger currency. From Norman's viewpoint, something had to be done.

That something was greater financial cooperation between Britain and the United States, with the former taking the lead. As detailed by Rothbard in *America's Great Depression:*

> The "isolationism" of U.S. foreign policy in the 1920s is almost wholly a myth, and nowhere is this more true than in economic and financial matters.... On Norman's appointment as Governor [of the Bank of England] during the War, Strong hastened to promise him his services. In 1920, Norman began taking annual trips to America to visit Strong, and Strong took periodic trips to visit Europe. All of these consultations were kept highly secret and were always camouflaged as "visiting with friends," "taking a vacation," and "courtesy visits." The Bank of England gave Strong a desk and a secretary for these occasions, as did the Bank of France and the German Reichsbank. These consultations were not reported to the Federal Reserve Board in Washington. Furthermore, the New York Bank and the Bank of England kept in close touch via weekly exchange of private cables.

What did Montagu Norman want of his American counterpart? Nothing less than for the Federal Reserve to inflate the dollar to protect the British pound and allow Norman's easy-money policy to continue. In other words, if the dollar were devalued in concert with the British pound, the flight of British gold to America would cease. The American public would eventually pay the price for the Fed's monetary inflation, but at least British and European politicians and bankers would be off the hook.

All of this was sold to Strong and other American bankers as a necessary step to allow Great Britain and other European nations to return to the pre-war gold standard — which never took place. What happened instead were several episodes of coordinated global inflation that allowed the European nations to return, not to a full-fledged gold standard (which would have included the resumption of the minting of gold coins) but to a gold *bullion* standard, in which only large amounts of currency could be redeemed in exchange for gold bars — suitable for international finance, but irrelevant to ordinary citizens forced to traffic thenceforth in paper money backed only by very dubious guarantees. Gold as a fully convertible international currency had been abandoned, and the age of paper money was ushered in.

This "close international Central Bank collaboration of the 1920s," Rothbard remarks, "created a false era of seemingly sound prosperity, masking a dangerous world-wide inflation. As Dr. [Melchior] Palyi has declared, 'The gold standard of the New Era was managed enough to permit the artificial lengthening and bolstering of the boom, but it was also automatic enough to make inevitable the eventual failure.' "

As for Benjamin Strong's motives, a memorandum from one of his staffers, cited by Rothbard, speaks volumes about the mentality of international bankers during the 1920s who were setting up the world for a colossal fall:

> He [Strong] was obliged to consider the viewpoint of the American public, which had decided to keep the country out of the League of Nations to avoid interferences by other nations in its domestic affairs, and which would be just as opposed to having the heads of its central banking system attend some conference or organization of the world banks of issue.... He said that very few people indeed realized that we were now [i.e., in 1928, when the first signs of trouble were appearing on the horizon] paying the penalty for the decision which was reached early in 1924 to help the rest of the world back to a sound financial and monetary basis.

In other words, Strong and his counterparts overseas were acting with flagrant disregard for the well-being of their respective citizenries and, in many cases, the laws of the land. Because Americans in the 1920s were still deeply suspicious of the motives of the international power elites, Strong carried out his pro-British, internationalist agenda in secrecy. He died in 1928, leaving millions of Americans to foot the bill for years of monetary exuberance in the service of foreign interests. When the inflationary bubble finally burst in late 1929, few ruined investors understood that their losses were part of the price to be paid for the machinations of Benjamin Strong and other international bankers.

Hoover's Interventionism

The onset of the Great Depression very nearly coincided with the presidency of Herbert Hoover. According to conventional wisdom, it was Hoover, the pro-free market Republican conservative, who was responsible for the Great Depression — by allegedly permitting the chaotic excesses of the market to make things worse after the 1929 crash. Nothing could be further from the truth.

Like most modern-day Republican leaders, Hoover the politician publicly sang the praises of the free market — while working sedulously to hamper the workings of the market with a welter of intrusive new government programs.

Early in the Hoover administration, such interventionism mostly took the form of presidential hectoring of industry leaders, pressuring them to keep wage rates at what the government deemed to be optimal levels, making threats against supposedly wicked stock speculators, and agitating for more public-works projects to create jobs.

But in 1931, things took a turn for the worse. The nations of Europe one by one went off the gold standard entirely, repudiating their obligations to redeem debt in gold into the bargain. Especially calamitous was Britain's renunciation of the gold standard on September 20 of that year, despite earnest assurances of the perfidious Montagu Norman to the head of the Netherlands Bank just two days previously that England had no such intention. The European crisis touched off by the exodus from the gold standard wrought havoc in American banking and sowed further distrust in the American public that their leaders would soon follow Europe's example. Stocks of gold held by American banks declined precipitously as the public redeemed its paper money for gold. Moreover, bank reserve levels dropped as the public, spooked at the prospect of bank failures, converted their savings into legal tender.

National productivity declined steeply throughout the year as businesses closed their doors and unemployment rose. By 1932, Hoover was ready to take more drastic measures. To cover a burgeoning federal deficit, President Hoover agitated for, and Congress passed, a huge tax increase. The Revenue Act of 1932 raised income, corporate, stock transfer, and estate taxes, and restored or created whole new tax categories, including gift taxes and a wide range of new sales taxes on items ranging from gasoline to automobiles to luxury items like furs and jewelry.

Adding to the folly of a huge tax hike in the midst of a depression was a range of new government programs destined to interfere further in the already hobbled American economy. Chief among them was the Reconstruction Finance Corporation (RFC), a credit agency designed to lend public monies to local governments, banks, agriculture, and a wide range of other industries. During 1932 the RFC loaned more than $2 billion to corporations teetering on the brink of insolvency — 80 percent of them railroads and banks. Where private capital tried to penalize such businesses for imprudent investment, the Hoover administration conducted one of the biggest bailouts in history — an event drearily familiar in our day, but more of a novelty in the still-comparatively laissez-faire climate of the early '30s. "Any attempt … to save the weaker debtors necessarily prolongs the depression," columnist John T. Flynn pointed out at the time. "The quicker the correction comes, the quicker the regeneration of the road will come."

Besides the RFC, the Hoover administration took a number of other actions, including the creation of a new Home Loan Bank System — the beginning of federal government involvement in the housing industry — and bullying of stock traders, in effect forcing them to impose regulations on short-sellers, whom Hoover believed were especially to blame for the stock market collapse.

Such measures might seem relatively benign in a time when a Congress can spend hundreds of billions of dollars on a new farm bill or maintain near-total regulatory controls on American industry without a peep being raised, but in the 1930s, when the federal regulation of business was still practically unknown, they were revolutionary. While Hoover's mini-New Deal was dwarfed by what was to follow under the Roosevelt administration, it set the tone for a new, overweening role for the federal government in

supervising and regulating nearly every aspect of American financial and economic activity.

FDR's "New Deal"

The American electorate, rightly ascribing the depression's unnatural length and severity to President Hoover's policies, hustled him out of office in 1932. His replacement, the former governor of New York, Franklin Delano Roosevelt, wasted no time making his predecessor look benign by comparison.

After declaring a four-day bank holiday the day after his inauguration in early March 1933, Roosevelt (and a compliant Congress) followed with the first of a long series of federal outrages: the Emergency Banking Act. This bill provided for new federal inspection of banks and conferred upon federal inspectors the authority to close down banks deemed insolvent. More ominously, the bill gave the Treasury the authority to confiscate all privately owned gold and compel Americans to accept the government's fiat (unbacked) money in exchange. Thus did the federal government, having driven gold into private hands by devaluing the dollar through inflation, neatly evade responsibility for its own misdeeds. Cowed Americans surrendered their gold to the federal government, and although foreign investors kept the right to exchange American currency for gold until 1971, American citizens were forbidden from owning gold until January 1, 1975, when all restrictions on the private ownership of gold in the United States were finally lifted.

Still worse was to come. Candidate Roosevelt, in his speech accepting the Democratic Party presidential nomination, had promised Americans a "new deal," which he characterized as both "a political campaign" and "a call to arms." Following the Emergency Banking Act, Roosevelt moved to bring agriculture under the federal umbrella, creating a new system of farm subsidies and production controls under the aegis of the Agricultural Adjustment Administration (AAA). Although the AAA was correctly ruled unconstitutional by the Supreme Court in 1936, Roosevelt soon replaced it with other, similar programs which later, more pliant courts refused to invalidate. Centrally planned agricultural production has been a feature of the American economy ever since.

In June of 1933, Congress passed the National Industrial Recovery Act which, mainly through its centerpiece program, the National Recovery Administration (NRA), set about transforming America into a centrally planned economy along socialist lines. Under the NRA, a welter of new regulations imposed price controls and production standards on numerous goods and services. Although the NRA, like the AAA, was eventually ruled unconstitutional, it too set an unhappy standard for future government regulation of just about every economic activity imaginable.

Under the cover of an acute economic crisis created by government itself, President Roosevelt waged nothing less than a counter-American Revolution, a comprehensive repudiation of the Constitution and of the twin values of federalism and the free market. Probably no American president since has done violence to the Constitution on so many fronts, establishing for future generations the melancholy precedent that the federal government should do whatever it deems proper in the name of upholding the "general welfare." Indeed, the Roosevelt administration slyly used the term "welfare" to describe government handouts and make-work programs that more self-reliant prior generations of Americans had derisively called "the dole." Under the Roosevelt administration, the foreign ideology of socialism made a home in Washington, putting to flight any lingering sympathies for limited government power.

Thanks to the New Deal, the agony of the Great Depression was drawn out until the onset of the Second World War. But the greatest casualty of that sad chapter in American history was not the bankruptcies, the fortunes lost, the livelihoods destroyed, or the millions of Americans plunged into poverty. It was the almost irreparable damage done to the U.S. Constitution. The Great Depression provided the pretext for repudiating sound money, empowering secretive international financial elites, establishing a federal government stranglehold on agriculture, and in general imposing a regime of industry controls that mirrored the so-called "reforms" of fascist and socialist regimes in the Old World.

Although we have so far been spared another depression as severe as the Great Depression, the unhappy legacy of that time persists, writ large. Today, however, most Americans take the revolutionary fruits of that time for granted: fiat money; Social Security; federal welfare programs; farm subsidies; federal intervention in housing, education, finance, and numerous other economic sectors; federal firearms laws — the Hoover-Roosevelt legacy goes on and on.

Next to war, nothing is so dangerous to liberty as economic turmoil. The American Great Depression, fostered from start to finish by

our own federal government, with the help of wily bankers and financiers, allowed government to magnify its powers in the name of rescuing us from ourselves — when in fact it is from government abuse that we need to be rescued, then as now. In the long run, freedom, not government, is the best cure for economic crises. Had the likes of Benjamin Strong, Herbert Hoover, and FDR believed this, we would never have had a Great Depression.

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