

Causes of the Great Depression

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The Way Back to Prosperity

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Member of the British House of Commons, 1919-1931

WE still pray to be given each day our daily bread. Yet there is too much bread, too much wheat and corn, meat and oil and almost every commodity required by man for his subsistence and material happiness. We are not able to purchase the abundance that modern methods of agriculture, mining and manufacture make available in such bountiful quantities. Some economists call it overproduction; but there cannot be overproduction with millions of people living on the border line of starvation in the backward countries and many more millions below the poverty line in the advanced and more highly developed industrial communities. The problem is one of underconsumption and can only be solved by increasing the purchasing power of the masses of the people.

The need today in the world is not for bread but for more pay, more money so as to enable its inhabitants to consume what they produce. Instead of praying to be given our daily bread when the farmers in India, Ru-

mania, Canada and the United States complain loudly of a wheat "glut," we should pray for daily pay for the many to be able to purchase the abundance and richness of the earth and the products of man's energy and invention. What is the cause of this extraordinary situation that we are witnessing in the third decade of the twentieth century? Why is mankind being asked to go hungry and cold and poverty-stricken in the midst of plenty?

The scientists, the inventors, the engineers, the metallurgists and the agriculturists have, by their achievements, removed the spectre of want and famine from the world, and in their achievements they have far outstripped the capacity of our governments and rulers. The science of government has been left behind in the system of the eighteenth century while the science of production is well ahead in the twentieth century.

The machinery of government falls into two parts. There are two governments in every modern nation—the

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visible and the invisible. The visible government is that exercised by political dictators, as in Italy, or through national Legislatures in Great Britain, France, Germany, the United States and other countries. This visible government takes care of foreign relations, decides on peace and war, maintains or tries to maintain order and tranquillity, looks after the poor and indigent, the sick and the insane, either nationally, as in Great Britain and Germany, or through the States and local governments, as in the United States. But it is becoming more and more divorced from, and less powerful than, the invisible government; and this invisible government takes the form of financial control.

In the United States the invisible government consists of the organization of the Federal Reserve Bank, "Wall Street" and a few powerful bankers, aided by their economists and statisticians. Naturally, it keeps in touch with the President, the Secretary of the Treasury and the political leaders of the party in power. But it functions independently and is directly answerable to no one.

In Great Britain the invisible government consists of the court of the Bank of England, whose directors are appointed by the inner circle of the financiers who control the large international banking houses. The court of directors and the governor have a close working arrangement also with the permanent officials of the British Treasury, who in their turn advise or inform the Prime Minister and the Chancellor of the Exchequer. In theory, the Bank of England, the bank of the bankers, is divorced from political control and interference. Actually it works closely with the treasury, as already stated; but the treasury itself, the most powerful department of State, attempts to work independently of Parliament and, as much as possible, independently of the political heads of the government.

I was a member of a special committee set up by the British Labor

party, when in office, to investigate the economic difficulties of last Spring, when the situation was working up to the crisis which overthrew the Labor Government and installed the present National Government in office and forced Great Britain off the gold standard. One of our witnesses was the governor of the Bank of England, and toward the end of the third session, at which he testified, I asked him outright what were the relations between the Bank of England and his Majesty's Treasury. His reply was that they were the relations of Tweedledum and Tweedledee.

In France the invisible government consists of the governor of the Banque de France, the central bank of issue, the permanent officers of the French Ministry of Finance and the *grande bourgeoisie*, principally located in Paris and consisting not only of the great bankers and financiers but of the leading industrialists. The alliance between the political leaders of the party in power and the invisible government of France is similar to that of Great Britain. Thus, if there is a strong and well-informed Minister of Finance or Prime Minister, or both, he or they insist on being informed or consulted on matters of high finance.

The German situation is very similar, except that the functions of the central bank of issue are even more independent of the popularly elected government. This was brought about by direct allied action after the World War as part of the policy of exacting reparations from Germany and after the great German inflation.

In all these cases, including that of the United States, the central bank is supposed to be divorced from commercial profit-seeking interests and to work as a public utility. And, no doubt, the controllers of these central banks try to interpret their functions in this way. But the whole of this system of financial government is in a

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rudimentary stage of development, especially in its international sphere.

Now it is becoming increasingly evident, and recognized by all informed persons, that the monetary problem itself is at the root of all our present difficulties and that it cannot be solved by any nation acting independently. The United States is nearly self-supporting and almost independent economically. Only 10 per cent of the total production of the Union is exported abroad. But this 10 per cent makes just the difference between profit and loss, between success and failure. Political isolation is theoretically possible, but economic isolation means poverty and a lower instead of a higher standard of living.

There have been increasing attempts at cooperation between these invisible governments on both sides of the Atlantic, but the process is slow and cumbrous, and all sorts of difficulties have arisen owing to differences of outlook and opposing policies. For example, with regard to the crucial question of intergovernmental indebtedness and reparation obligations, there are an American policy, a French policy, a British policy and a German policy, and all four are opposed to each other, though there is more concurrence between the financial policies of Italy, Great Britain and Germany than between those of France and the United States.

The nearest approach to an international financial body is the Bank of International Settlements at Basle, Switzerland, set up as a clearing house for reparation payments. With its American president and its governing body nominated by the central banks, it may, in time, develop into a real central *international* bank for all the member nations. But here again the process of development is slow, and there are only too clear indications of a lack of any settled policy. In other words, the leaders of banking and finance in the world are uncertain as to what is wanted, what policy they should pursue and what

action they should take. And so each of these invisible governments drifts along, acts independently, tries to help commerce and industry, no doubt, and hopes for the best.

Yet regard the power of these invisible governments! Their policy, or lack of policy, has tremendous influence on the lives of the mass of people. The governing bodies of the Federal Reserve System and the member banks in the United States can decide on prosperity or penury for millions of people. They can extend or restrict credit, either making fortunes for thousands or bankrupting and ruining other thousands of corporations, firms and individuals. They raise or lower the bank discount rates, making business, commerce and agriculture profitable or unprofitable.

As the former centre of world finance and the seat of operations of the most experienced international bankers, England has developed the system more highly than any other nation. Nevertheless, in the United States and France the power of the central banks over the life of the community is tremendous. Though the power exists, it is not always used, and when it is used it is used incorrectly or tardily. A case in point is the great stock market boom in the United States in the years before 1929, which was the American equivalent of inflation and which was recognized as dangerous by the governors of the Federal Reserve Banks and other financial leaders for a considerable period before the break. It was known that the prices of industrial and other securities were being forced up to fantastic and unhealthy heights.

Rightly or wrongly, the governors of the Federal Reserve Banks and their advisers, the invisible rulers of America, desired to check this boom in 1927; they did not do so because there was a Presidential election coming in 1928, and tremendous pressure was brought to bear on the Federal Reserve Banks to do nothing, in the

interests of the Republican party, to check the prosperity wave. Therefore, although warnings were issued, the market was given its head, allowed to rush along the road of inflation, not of the currency, but of values, and the curb was not applied until 1929.

Not so long ago I asked a prominent spokesman of American high finance, who had a good deal to do with the final decision to check speculation and Stock Exchange gambling, whether the American boom could not have been continued indefinitely by the simple expedient of a Presidential election annually. He replied that this would work well enough for a few years, but the subsequent slump would have been all the more violent.

Let me now turn to a British example of the working of the invisible government of finance and its effect on the fortune of millions of people, both in Great Britain and elsewhere. During the World War there was a tremendous expansion of currency and credits, in Great Britain as in the United States. Great Britain, despite the yield of high taxes, piled up a debt of \$40,000,000,000. Our industrial, mining and agricultural equipment and production were trebled. Money was cheap and plentiful and, despite certain privations due to the war, the standard of living of the working people and middle classes was considerably raised. Great Britain was able to finance her allies, later with the assistance of the United States, and to pour out an enormous volume of munitions and instruments of destruction for the waging of the war. The pound sterling was pegged to the dollar; that is, it was not allowed to alter in exchange value. And then the armistice brought about a standstill and a new situation.

The pound was unpegged in 1919 and fell from its parity of \$4.86 to about \$3.30. Nevertheless, trade was good. Most of the world was suffering from a shortage of various manufactured goods, and there was brisk demand for British products. But here

was this tremendous equipment, more land under cultivation than at any time during the previous fifty years, and more ships sailing the seas under the British flag than before the war. Despite the slaughter on the battlefields, there were actually more persons engaged in mining, industry and agriculture than in 1913, which was a boom year.

The financial powers, faced with this problem, decided that there must be contraction, in other words, deflation; the pound sterling was to be forced back to parity with the dollar. The Chancellor of the Exchequer was Sir Austen Chamberlain, a weak though well-meaning man, with a rigid, orthodox mind. The Prime Minister was Lloyd George, engaged up to his eyes in the peace treaty negotiations. Chamberlain acquiesced in the deflation policy, and the long struggle began.

The bank discount rate was raised; credit was restricted; loans were called in, and the Bank of England sold securities in the open market. This process continued for five years. The result was rapidly rising unemployment and increasing difficulties for industry, mining and agriculture. There was one very serious mining strike and a number of other industrial disputes.

In 1925 the pound sterling had risen on the international exchange and a decision had to be reached as to whether Great Britain should return to the gold standard. Winston Churchill was now Chancellor of the Exchequer under Mr. Baldwin as Prime Minister. Baldwin it was who had, when Chancellor of the Exchequer, made the British debt settlement with the United States. Obviously the higher the value of the pound in comparison with the dollar the easier it would be to meet the obligations under that settlement. Furthermore, the debts owed by France, Italy, Belgium and other countries to Great Britain were repayable in sterling, as is the interest on the \$20,000,000,000 worth

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of foreign investments held by British private citizens and commercial and banking corporations all over the world.

From the banking point of view, therefore, the return to the gold standard, with the pound worth its full twenty shillings, was advantageous. Actually, however, the pound was not worth twenty shillings, for its parity was artificial. Nevertheless, the risk was taken, despite some protests from the economists and by one important public leader. It is noteworthy that at the time of the return to the gold standard in 1925 Lord Beaverbrook, a millionaire, a very successful business man and an important newspaper owner, made his views heard in opposition, and has done so ever since, and that in the Spring of 1931 he advocated abandoning the gold standard. As I am opposed to Lord Beaverbrook's economic policy of a "free trade British Empire" with tariff walls against the rest of the world, I have pleasure in testifying to his far-sightedness in this matter.

But the return to the gold standard was brought about in 1925 and had important results. It immediately put up the price of British coal by between 5 and 10 per cent to foreign purchasers, and in the keenly competitive market for coal, owing to the increasing use of oil and electricity, this struck a heavy blow to the coal export trade. The mine-owners demanded lower wages to make up for the higher gold standard price of their product. The million miners resisted and were locked out. They called for aid to the Trade Union Congress, and not in vain. There followed a general strike, when all the working men organized in unions and their comrades not in the unions downed tools in aid of the miners.

The general public defeated the strikers, who were never revolutionary and not well led, but the locked out miners continued to resist for an-

other six months with increasing poverty and distress, while the country lost trade. It took a long time for British industry to recover from this blow. There was some kind of recovery in 1929, until the Hatry bankruptcy upset the British markets. To this blow was added the break in Wall Street. The Hatry bankruptcy and many other failures in industrial combines were largely brought about by the deflation policy and the restriction of credit and banking accommodation as part of the policy of remaining on gold.

To remain on the gold standard and to continue the lucrative international banking business of the City of London, it was necessary also to induce foreign investors to leave their deposits with the English merchant banks or the Bank of England. This, in turn, entailed high bank rates of discount and was a further blow to business. Unemployment figures mounted; agriculture and mining suffered; social measures of relief increased in cost; and, finally, the Austrian and German breakdown and the run on the British gold reserves led to the abandonment of the gold standard by Britain in September, 1931.

If there had been better cooperation between the central banks of London, Paris and New York, the Wall Street boom could have been checked more gently and earlier and with less dire results, Great Britain could have remained on the gold standard, and many of the bank failures in the United States, Germany and France would have been avoided. But there was lack of such cooperation until too late. And, despite the continuance of the depression, there is still very meager cooperation.

The idea in the public mind, widely held in all countries, is that booms and slumps in trade are uncontrollable and are acts of God, like bad weather and earthquakes or the tides of the oceans. These slumps and booms, however, depend on the price level—

the prices which commodities command in the world markets, which in their turn determine international trade conditions. The most sensitive prices are those for primary commodities, the products of the land, mines and forests. If prices fall, the producers of primary commodities are unable to purchase manufactured goods. Furthermore, with a falling price level for raw materials, the manufacturers themselves are afraid to purchase more than for their day-to-day needs.

If, for example, a textile manufacturer finds the cotton market weak, he is afraid to buy cotton because his competitor, by holding off the market until the price falls further, will be able to undersell him in the future. The manufacturer therefore only buys from day to day or even stops production altogether. The falling price level therefore has a double effect. It reduces the purchasing power of the producers, and it leads to a diminishing demand for their products.

Today the wheat, cotton and tobacco farmers in the United States are saddled with debts and mortgages contracted when their products were worth three times as much in gold dollars as they are today. It therefore needs three times the amount of crop to meet the same interest charges on a debt or mortgage. We here see the phenomenon of the iron dollar and the elastic goods; that is, debts remain at the same value in gold but the goods with which to pay them have fallen steeply to a fraction of their value.

This fall in the price level is not determined, as the older generation of economists taught, by the laws of supply and demand, but by the volume of money and credit available. It has been proved statistically, without any possibility of refutation, that throughout the last fifty years the price level in the United States has been directly dependent upon the ratio between volume of credit and volume of trade. When trade was increasing, with

greater productivity and new inventions, and when bank credits were made easy, prices rose and booms followed. When credit was restricted—remember always that productivity has steadily increased throughout the world during the last fifty years—prices fell. When credit, which is the modern currency of commerce, was sufficient but not more than sufficient for the expansion of trade, prices remained steady.

In passing let it be noted that coins, paper money, bank notes and so forth are only the small change, the till money of industry and commerce. In all the larger transactions no money actually passes; bills of exchange or bankers' checks are tendered in payment.

Suppose a group of business men desire to erect a skyscraper in a Western town. Having arranged for the necessary bank credits, they sign a contract with a builder. He is paid by check at intervals while the work is going on or when it is completed. With the bank credit created by the checks, drawn probably on the same bank, the builder purchases his steel, concrete, electrical fittings, and so forth. And with checks he pays the architect, the sub-contractors, the hauling companies and the like. The only "money" involved is the weekly wages paid to the workmen, which would be rarely more than one-quarter of the total cost involved. The wives of the workmen pay the dollar bills over the store counters on Friday and Saturday; the storekeepers put them back into the banks on Monday; and they are drawn out again on the following Friday to be paid once more in wages.

It is bank credit that matters today, and it is bank credit that has been restricted in Great Britain since 1919 and in the United States since 1929. In each of the last three years in the United States bank credits have been contracted 20 to 25 per cent. Is it any wonder then that the real estate mar-

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ket has collapsed, that agriculture is nearly ruined, that manufacturers have ceased production and that there are bread lines of unemployed in the cities? Is it any wonder that prices of all primary products, with the one exception of gold, have fallen steeply? Is it not obvious that the present monetary system is hopelessly out of gear and unsuitable for modern requirements?

There are many causes for this breakdown. One of them, though not the most important, is the abandonment of bimetallism. The devaluation of silver has led not only to a restriction of trade and credit, but also to a shortage of gold. To re-evaluate silver would be a help, especially for the commerce of Asia, but by itself it would be inadequate.

Another cause of the depression is the misuse of gold. It is being used as a commodity of commerce and, still worse, an instrument of international policy, especially by France. There is a gold shortage also owing to the policy of the creditor nations, especially France and the United States, who insist on their debts being paid but who refuse, by the erection of high tariff walls, to take payment in goods. But in any case there was bound to be a world-wide shortage of gold, owing to the non-discovery of new mines since gold was found in Alaska.

Yet shortage of gold would not in itself cause all this distress if the metal were used only as a measure of value and not as a commodity or as a means of making international payments. Mankind is used to the idea of hard metal, cash money. But this is only a sentiment. An excellent substitute for gold as a medium of exchange and payments has been found in bank credits, national and international. But if credits and currency are to be limited by the amount of gold sterilized in the vaults of the central and reserve banks, the situation becomes hopeless. The production of

gold has not kept pace with the increase in the production of goods and commodities. True, gold does not deteriorate or wear out, but it is increasingly used in industry and the arts and is being hoarded in many countries, notably India. A few bold dealers are selling Indian gold. But it has been made into jewelry or buried in India by her 300,000,000 inhabitants for many centuries, and the quantity hidden in the Indian Peninsula is enormous.

The world production of gold in 1903 was 15,934,268 fine ounces, equal in value to \$347,000,000. In 1929 the production of gold for the whole world was 20,191,478 ounces, or \$403,000,000. In 1903 the production of the leading basic commodities for the whole world, excluding Russia, was valued at \$26,049,000,000. In 1929, with world production far below capacity, the value of commodities produced was \$46,500,000,000. Obviously, the production of commodities had outstripped the production of gold during the twenty-six years. Each of the former gold discoveries—the looting of the New World by the Spanish conquerors, the Australian and Californian gold rushes, the opening of the mines in South Africa and in the Klondike—led to an expansion of trade and industry. But now we have discovered in modern banking and credit practice—if we will only use it—something better than new gold fields.

It would be possible today for the Federal Reserve Banks to raise prices in the United States to the 1927 or 1929 level by buying securities in the open market to the extent of \$200,000,000 or \$300,000,000. This would make more funds available for the member banks; eight or ten times that amount could be given in credit or lent out to industry.

But this might weaken the dollar in the world markets. Fluctuating exchanges are another great hindrance to international trade. Yet if the cen-

tral banks of *all* the leading financial and industrial nations decided to expand credit simultaneously, there would be no fluctuation or little fluctuation in the exchanges and world trade would revive. Better still, the exchanges could be pegged in relation to one another and fluctuations thereby avoided.

If prices rose too high, by selling securities the central banks could restrict credits and check the boom. The ideal would be to keep prices steady, to encourage the growth of production and to issue enough credits and currency to meet the increased needs of expanding activity. By this means we could steadily raise the standard of life of the people of all countries, avoid alternate slumps and booms and eventually abolish unmerited poverty.

The economics of today as taught by the orthodox are out of date because they were meant for a world situation in which famine and scarcity were the normal conditions and in which mankind was engaged in a fierce struggle against the forces of nature. Men had to save and hoard and put by for a rainy day. But now modern science and industry, with better means of transport and communication, have removed the spectre of famine and want. The need now is

to spend, consume and thereby use up the overflowing abundance which every civilized community can produce. Mass production must be accompanied by mass consumption, otherwise society will either bankrupt itself or seek relief in warfare and destruction. Nevertheless, we continue to urge the practice of thrift and penury, to deflate and restrict credits, when markets, warehouses and granaries are choked with unsalable goods.

The position is like that of a party of explorers who have crossed a desert. There it was necessary to conserve their water supply, to dole out the precious liquid in daily rations. But now the travelers are in a boat on a great fresh-water lake, and still they dole out their scanty supply of water in little cupfuls and suffer thirst and privation.

The test of whether our present civilization will survive depends upon our solving the modern problem of under-consumption in a world materially richer than ever before. Is mankind really to sit down and starve, because of lack of leadership and courage in the invisible governments of high finance, or will the common sense of the common people demand that a way out of the apparent impasse be found?