Contents

Foreword to the 1975 Edition

The pages that follow tell of the greatest cycle of speculative boom and collapse in modern times – since, in fact, the South Sea Bubble. There is merit in keeping alive the memory of those days. For it is neither public regulation nor the improving moral tone of corporate promoters, brokers, customer's men, market operators, bankers, and mutual fund managers which prevents these recurrent outbreaks and their aftermath. It is the recollection of how, on some past occasion, illusion replaced reality and people got rimmed.

In the wake of the 1929 crash, and with a view to preventing another runaway boom and the associated abuse, the Congress passed some tolerably astringent legislation including the Securities Exchange Act of 1934. It was not, at the time, especially necessary. Markets and financial adventure were then and for a long while after restrained not by SEC but by the memory of what happened to so many in 1929.

By the sixties this memory had dimmed. Almost everything described in this book had reappeared, sometimes in only a slightly different guise. Instead of the investment trusts there were now the mutual funds. Matching Blue Ridge and Shenandoah in general scope and financial peril were the International Investment Trust and the Fund of Funds. Matching and possibly surpassing the vaulting imagination of Harrison Williams and Waddill Catchings, of Central States Electric and Goldman, Sachs was that of Edward Cowett and Bernard Cornfeld, the miracle men of IOS. The admiration for skill in deployment of corporate capital that was once lavished on Samuel Insull and Howard Hopson settled now on the men who were parlaying smaller firms into big conglomerates. There were glamour stocks in both periods; in both periods glamour was a substitute for substance. Scholars and politicians lent their names and blessings to the new promotions as had their counterparts forty years before. In the sixties as in the twenties men intended by nature for mentally undemanding toil became rich for a little while. It was only that the market was going up. Some things in 1970 were worse. Wall Street houses in the sixties were markedly more incompetent in their management than in the twenties and expanded much more recklessly. The consequences when the collapse came were far more troublesome than in 1929.

The new laws were not without effect. The gamiest of the promotions of the sixties had to be sold to foreigners – thus the offshore funds. There was much less speculation on margin. In both periods leverage – the purchase of common stocks with bonds or debentures allowing the investor to have all of the increase in value with minimal personal outlay – was rediscovered and heralded as the financial innovation of the age. But the suppression of the holding company kept leverage from being used as extravagantly in the sixties as in the twenties. In consequence it went less violently into reverse – as leverage does when a firm must pay interest out of declining earnings from common stock. The collapse of the Van Sweringen railroads in the thirties was the result of reverse leverage. Penn Central went down only as the result of gross mismanagement. The day of reckoning in 1970 was disagreeable – and the magnitude of the market decline was not so different from that in the autumn months of 1929. But it did not become cumulative. And the effect on consumer spending, business investment and the economy generally was far less severe.

Yet the lesson is evident. The story of the boom and crash of 1929 is worth telling for its own sake. Great drama joined in those months with a luminous insanity. But there is the more sombre purpose. As a protection against financial illusion or insanity, memory is far better than law. When the memory of the 1929 disaster failed, law and regulation no longer sufficed. For protecting people from the cupidity of others and their own, history is highly utilitarian. It sustains memory and memory serves the same purpose as the SEC and, on the record, is far more effective.

Foreword to the 1975 Edition

The main body of the text of this edition is identical with that of its predecessor. I've retained in slightly abbreviated form, in the pages following, the introduction to the second edition for it tells of the origins of this book and of the exceedingly lively reception that it was accorded by the Senate Banking and Currency Committee and Senator Homer Capehart of Indiana. And there are a few changes in the final chapter – which, however, still speculates on the effect on the economy of the next really great crash. All else is as before.

JOHN KENNETH GALBRAITH

On the Origins of This Book

I

I wrote this book during the summer and autumn of 1954. At the time I was engaged on the manuscript which eventually became *The Affluent Society.* Or, more precisely, after months of ineffective and frustrating labour which had produced a set of chapters so vapid in content and repulsive in style that I could not bear to read them, I was totally stalled. Suicide seemed the only answer; unfortunately it was an exceptionally lovely summer in southern Vermont. My neighbour, Arthur M. Schlesinger, Jr, had once made the modest request that I do the definitive work on the Great Depression. It would be convenient, he thought, for his work on Roosevelt. I resolved to compromise and write a book on the dramatic days that ushered the depression in.

I never enjoyed writing a book more; indeed, it is the only one I remember in no sense as a labour but as a joy. I did the research in the Baker Library at Dartmouth College, working under the Orosco murals on the ground floor. They somehow supported the mood of unreality, gargantuan excess and hovering disaster of the months before the crash. And, as might happen toward the end of the morning or the end of the afternoon if this mood became too overpowering, one could walk out into the sunshine, across the most exquisite village common in all New England, and have a martini and a good meal at the Hanover Inn. I scamped my teaching that autumn to work on the manuscript; when I left it with the publisher, I felt that I was saying goodbye to a close and valued companion.

2

My labours during the autumn had been made to seem rather more relevant by the contemporary boom in the stock market. This was small compared with 1929; it was very small compared with the bidding up of values and the bidding down of yields that subsequently took place. But it was plain that an increasing number of persons were coming to the conclusion – the conclusion that is the common denominator of all speculative episodes – that they were predestined by luck, an unbeatable system, divine favour, access to inside information, or exceptional financial acumen to become rich without work.

In the spring the boom, or boomlet, continued. The Democrats had won the Congressional elections the previous autumn; the Republicans had the White House for the first time since Hoover. It seemed worth the while of the Senate Committee on Banking and Currency to see if the boom portended another bust. Chairman William Fulbright decided that it would be a quiet and friendly investigation. I was called to testify. This was not entirely by accident. While testifying a few weeks earlier on another matter before another Committee, I used the opportunity to tell Mr Robert A. Wallace and Mr Myer Feldman, two of the distinguished and self-effacing men who serve the public by serving Congressmen and their Committees and then staff members of the Banking and Currency Committee, of what I had under way. An invitation to testify on the 1929 experience came promptly and was not an unbearable surprise.

I believe that almost everyone enjoys testifying before a friendly Congressional Committee or even a moderately censorious one. For the moment you are an oracle, a minor oracle to be sure, but possessed of knowledge important for the future of the Republic. Your words go down in an imperishable, if sadly unread, record. Newspapermen, one or two at least, are present to transmit your better thoughts to the world or, more frequently, your worst ones, for these, being improbable, have novelty and seem more likely to merit a minor headline. An audience is on hand. Except for an exceedingly dramatic investigation, this audience is always about the same. Apart from watchdogs from the Executive Departments and one's friends, it consists of connoisseurs of the Congressional Hearings who attend them every day. Quite a few are of advanced years and none has alternative employment, and if they are not our best, they must at least be our most widely informed citizenry. Labour rackets, the missile gap, influence on the FCC, the economic outlook, the organization of the National Security Council are all grist for their highly diversified mill. They listen attentively and critically; and Congressional Hearing has about it a touch of theatre and this is helped by having a competent and critical house.

The witness at the Congressional Hearing is treated with courtesy and deference, which in politics is always a trifle more effusive and therefore a great deal more pleasant than in any other walk of life. He must, however, expect to be seduced into statements damaging to his case if that is beneficial to the political needs or beliefs of an interrogator. This adds interest, and the stakes are not very high. My professional colleagues occasionally complain of the time they spend in preparing for or attending these inquiries. This is strictly for the purpose of impressing the others at the Department meeting. They enjoy it and wouldn't dream of declining.

3

I testified at the morning session of the stock market hearings on Tuesday, 8 March 1955. Several witnesses from the financial world, including Mr G. Keith Funston and a bevy of vice-commissars of the New York Stock Exchange, had preceded me. The market had reacted to their testimony with admirable equanimity perhaps because they had said nothing although they had said it very well. Nor was my testimony sensational. I had brought along the proofs of this book; I drew on them to tell what had happened twenty-five years before, in 1928 and 1929. Toward the end I suggested that history *could* repeat itself, although I successfully resisted all invitations to predict when. I did urge a stiff tightening of margin requirements as a precautionary step. Similar action to minimize the use of credit for speculation had been taken during the war when the speculative enthusiasm was much less. Through it all the newspapermen sat gazing with partly open mouths at the ceiling of the Senate caucus chamber or looking down briefly to scribble a random note. An aide appeared occasionally, sidling along the wall behind the Committee, to pass a note to one of the Senators. The audience, I knew from waiting my turn on earlier occasions, was following me closely and, on occasion, exchanging a critical aside on my facts, logic, or diction. As the testimony gave way to questions, more Senators came in. This is perhaps the most trying time of any hearing. Each in his turn apologizes graciously for being late and then asks the question that has occurred to him on the way over. The question is always the same; and the Senator does not know that it has been asked before:

SENATOR ROBERTSON: Well, Professor, we have been told by all the witnesses so far that present stock prices are not too high? What is your view on that?

SENATOR IVES: You do not think we are faced with a bust, do you?

SENATOR MONRONEY: I am wondering if there is any substance to the oft-repeated reason for the new high levels . . . That the stock market is merely catching up with the inflationary boom . . .

SENATOR PAYNE: I am sorry I came in late . . . would you want to indicate whether or not some of these increases have perhaps more truly reflected the true value of stocks in relation to their earnings?

The experienced witness observes that the question, though it bears a resemblance to some already asked, has been formulated in a novel way. Then he gives an answer which is the same in substance but decently different in form from those offered before. The audience is especially appreciative of able handling of such details.

Toward the end of the morning, interest appeared to increase. First one and then several photographers appeared. Then a newsreel camera or two. Through the weariness that develops with even so modest a sojourn in the public eye, I thought I sensed a certain tension. I remember noticing that the normal attrition of the Committee – which on a subject such as economics can leave one in a matter of an hour or so with only the Chairman and a precautionary member of the opposition – was not taking place. All Senators were staying. And soon I was the only one in the room who did not know the reason. The stock market was taking a nasty plunge.

I still did not know the reason when the hearing recessed at 12.57, just as a harried man from CBS came dashing into the chamber followed by two beasts of burden carrying a vast poundage of electronic marvels. He had been off in another room photographing Dulles. The real history had passed him by. In response to his almost tearful plea, I repeated several minutes of my testimony to an open window. The substitution of this for the Senators led to a considerable release from inhibition. I rather let myself go with the gestures – at times grave and statesmanlike, at others perhaps a trifle flamboyant. It was this that the world and my children saw.

I still did not realize what had happened until someone handed me a paper with a big headline. The *New York Times* industrials went off 7 points on the day. Stocks lost $3 billion in value on the New York Stock Exchange.

4

Back in Cambridge the next few days were among the most interesting in my memory. The phone rang continuously – so continuously that my secretary went home in annoyance, leaving me to answer it myself. Some of the calls were from the very great Ed Murrow, who wanted me to extend my remarks for an even larger audience. I declined. A few wanted to know if I was likely to say anything that would affect the market in the near future. I promised them silence. The rest merely wished to denounce me for destroying their dream.

The telephone calls were supplemented, beginning the morning after the testimony, by a mountain of mail. All was unfavourable. Some was denunciatory; more was belligerent; much was prayerful. The belligerent threatened various forms of physical violence. My wife professed particular concern over five communications from a man in Florida announcing that he was on his way north to kill me. Her alarm subsided when I pointed out (having thoughtfully checked the point myself) that all were postmarked Palm Beach. The prayerful all said they were beseeching their God to have me meet with a bad accident – some were asking that I be deprived of life, some of limb, and the minimum request was that I lose all ability to open my mouth. On Wednesday night, I crawled into bed reflecting, with less than characteristic piety, on all of the prayers that were spiralling up at that moment petitioning my dismemberment or destruction. I thought of saying a word on my own behalf and then struggled with the shattering thought that these matters might be decided by majority vote.

The next morning dawned bright and clear, and my wife and I decided to take a day away from it all. We went to Mount Snow, Vermont, to ski. Toward the end of the afternoon I turned from shaded and hard snow to some that had been softened by the sun and had a bad spill and broke my leg. The papers carried a note about my mishap. I now heard from those whose belief in the existence of a just and omnipotent God had been deeply strengthened.

A few days later, the market started up again. My mail fell off and stopped. A representative collection of the letters was posted in a seminar room and viewed admiringly by students for weeks. But there was more to come.

5

The state of Indiana was then represented in the Senate of the United States by Homer E. Capehart. He was a Republican, conservative and wealthy. It is possible, as partisan Democrats, at least, believed, that the people of Indiana could have had a better representative. But he was not a wicked man. His colleagues found him pleasant. So had I on previous brief encounter. These were the diminuendo days of Senator Joseph McCarthy. Unlike his colleague, William Jenner, Capehart had never been much involved in McCarthy's crusades. The senior Republican on the Banking and Currency Committee, he had not been present on the day I testified.

On 20 March, in the course of a network television programme, Senator Capehart announced that I would be recalled before the Committee to answer for having spoken favourably of communism and then, presumably, having advanced its cause by collapsing the market. I had had some warning. A gentleman from the Senator's office had called me a day or two before to see if I admitted to authorship of the offending encomium. The programme had been filmed the day before. Also present on the programme was a good and gallant friend, Senator A. S. Mike Monroney of Oklahoma. After extemporizing a brilliant defence of my dereliction, he called me to tell me what was coming.

The praise of communism had been extracted from a pamphlet of the National Planning Association dealing with problems of post-war Europe. It noted that the communists had a better reputation for sincerity and determination in attacking old social grievances and that they also had a solution to the problem of petty nationalism by asserting the higher loyalty to the worker's state. But Senator Capehart's case was not without flaw. The kind words were marred by a caveat, expressing suspicion and distaste of communism on other grounds, which had been put into the very middle of the paragraph for the precise purpose of preventing any inconvenient use, a precaution normal in those days. The Senator had thought it necessary to delete this offending clause, a distinctly noticeable act. The pamphlet had been based on a lecture given originally at the University of Notre Dame in, of all states, Indiana. An earlier version had been published by the University. The pamphlet had been endorsed in principle by Allen Dulles, the brother of the Secretary of State, and Milton Eisenhower, the brother of the President, an underwriting which, however, could cause some doubts as to the utter originality of the ideas advanced. Even a brilliant improviser like Joe McCarthy might have wished for a better case.

A day or so later, the Senator made the further discovery that, at a meeting of the American Economic Association not long before, a conservative professional colleague had jeopardized any possible reputation for understatement by saying that I was, though perhaps unconsciously, 'one of the most effective enemies of capitalism and democracy' in all the land. But this evidence did not retrieve matters as much as might have been hoped. My friend thought me dangerous because I was too soft on industrial monopoly.

Like most other liberal academicians, I had been a thoughtful observer of the methods of the Wisconsin Titus Oates. Two had always seemed to me worth adopting by anyone attacked. The first was to avoid defence of one's self and instead assault the accuser. The second was to avoid any suspicion, however remote, of personal modesty. I put these methods to test when I heard of the charges. I sent a telegram to the network carrying the programme, to key stations, the wire services, and to important papers indicting the Senator for incompetence. I identified incompetence with failure to know my views and these I implied – indeed, I stated – were an imperishable chapter in the intellectual history of our time. I followed the wire a few days later with a press conference, which, by a fortunate accident of travel, I was able to hold in Indiana.

The effect of my efforts, I am persuaded, was to convert an attack that otherwise would have been wholly ignored into front-page news. Neither of us was ever so featured before and I trust will never be so featured again. But I have no complaint about the press. It concluded that I had been assailed for being unkind to the stock market. This it refused to condemn as seriously subversive.

The Senator then took the floor of the Senate for a further denunciation. Some of this centred on my characterization of communism as a monolithic force, which he regarded as seriously suspect. 'Mr President, "monolithic" means like a monument, or a pillar of strength . . . That is like describing communism as a monument or as a pillar of strength; or, as we used to say, like the Rock of Gibraltar.'

But by now he was losing power. He said, handsomely, that there were things in the offending pamphlet with which 'we can all agree'. It was unfair, he added, to suggest that he had called me a Red. After some further bickering in the Committee, he subsided. The Senator has had no further reputation as a witch-hunter. I like to think that