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Is the Fed pulling another 1929?

by David Goldman

It may be more than coincidence that the stock market's 2.5% decline Jan. 8 occurred as the Federal Reserve Board announced restrictions on "junk bonds," the speculative vehicle used to finance corporate takeovers. More than $10 billion of such paper financed corporate mergers, takeovers, leveraged buyouts, and whatnot during 1985, i.e., supported the sort of chicanery that kept stock prices rising atop a dead economy. Wall Street's sensitivity to the issue probably has less to do with the restriction of financing as such, than with Fed Chairman Paul Volcker's cavalier contempt for the protests lodged earlier by White House Chief of Staff Donald Regan. If the Fed ignored the White House, the speculators believe, it may be about to take the punch bowl away.

The Federal Reserve may well be repeating the stock market crash of 1929, under chillingly comparable conditions. As market history buffs recall, a snap tightening of credit starting September 1929 led rapidly to the slaughter of November 1929 and the beginning (in popular folklore) of the Great Depression.

Contrary to folklore, the Great Depression began in 1928 in Germany, crushed under the weight of Versailles reparations, and the Dawes Plan reorganization of war debt imposed by the Bank of England and the Morgan Bank in the United States. Germany was the principal recipient of short-term loans, provided by American banks either directly, or via the tarnished City of London. The exhaustion of Germany's ability to borrow coincided with the promotion of America's stock market bubble, and all free-floating cash headed to Wall Street.

Germany's collapse led to a series of austerity governments (on the Gramm-Rudman model), then Hitler.

By early 1929, the Bank of England's imperious governor, Sir Montagu Norman, was sending cables almost daily to the New York Federal Reserve, demanding steps to suppress the speculation draining funds from the rest of the world. The New York Fed, by August, won approval of the Bank of England's policy through the entire Federal Reserve System. The November market crash followed, as it was supposed to; the next day, Montagu Norman sent a congratulatory telegram to his stooges in New York.

That much is history. Reading the central bankers' cables of that time, against the 1985 *Annual Reports* of the International Monetary Fund and World Bank, the cable traffic of 1929 seems very up to date.

The United States, with a $125 billion per year trade deficit, is borrowing a like amount on international markets to finance this deficit. America's foreign debt is projected to reach $1 trillion—more than the foreign debt of the Third World—by 1990. Some $50 billion of the $125 billion borrowing requirement appears as "errors and omissions" on our balance of payments—funds whose source cannot be identified. An additional $35 billion comes in via numbered Swiss accounts and the like—funds of equally obscure origin. Federal Reserve and Commerce Department officials believe that most of this is narcotics revenues.

Hot money from abroad has financed the speculative bubble in all sectors of the U.S. economy, including the doubling of the Dow-Jones average, since 1982. The Fed had a hand in this; during 1985, the narrowly defined money supply grew by 11%, one of the highest rates on record, while, even according to the Fed's own fraudulent data, industrial production remained flat. That financed such things as a 20% rate of consumer debt expansion.

The IMF and World Bank argue (not without a diabolical twist of truth) that the huge flow of funds to the United States has denied credit to all other borrowers, including the hard-pressed developing sector. Therefore, the United States must cut its borrowing, starting with a massive reduction in the budget deficit.

Leave the stock-market columns in the newspaper to the next generation of stand-up comedians; the Fed, in its own way, has given notice that the days of unlimited money-supply growth are over. One example that did not make it from the wire-service desk into the newspapers: On Jan. 8, the Fed first announced a generous injection of funds into the banking system, and then, a half-hour later, denied its own report, claiming that the New York Fed had been the victim of a hoax. In its own peculiar way, the Fed is giving signals, and Wall Street responds.

Will the next stock market crash devastate the economy as in 1929? The question is formulated wrong: It was not the stock market crash per se, but the Versailles war reparations system, that caused the Great Depression.

Although there is no direct relationship between the impulsive spasms of the Dow-Jones average and economic activity as such, the rise in U.S. equity values of the past three years characterizes a more general speculation which will die along with the stock-markt bubble. Five-sixths of the 112 million Americans now on the payrolls are involved in so-called services. Practically all of the 10 million added to the payrolls since 1981, and a large part of those previously on the payrolls, owe their jobs pushing paper or flipping hamburgers to some form of speculation, usually in real estate.

Fast-food franchises and retail stores are not there to make money; they are there to justify the cancerous expansion of shopping malls, and the inflated real-estate values they are based on. An old-style panic will not just bring down equity values, but the entire speculative climate in which equity values rose; we will see a kind of mass unemployment which may well dwarf that of the 1930s.

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