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Atlantic articles from the 1930s reveal how Americans reinvented banking, restructured the economy, and dealt with challenges unsettlingly parallel to those of today.

by Theodore Kahn and Laura Brunts

The Great Depression

In recent weeks, our mounting economic woes have sent financial experts, journalists, and average citizens running to the history books in search of clues about the causes and potential fixes for our present mess. Many are seeing disturbing parallels between today's state of affairs and the period that preceded the Great Depression of the 1930s. Not surprisingly, the onset of the Great Depression provoked a similar spate of economic soul searching. A series of *Atlantic* articles published in the aftermath of the 1929 stock market crash captures that era's collective grappling with the situation—and reflects a broad range of thinking on the future of our economy, politics, and society.

In a February 1930 article entitled "The Revolution in Banking Theory," Bernhard Ostrolenk sought to explain the forces at work behind the failure of so many banks during the previous decade. For the first century and a half of our history, he explained, the federal government, and most of the states, had prohibited "branch banking"—the ownership of one bank by another—instead fostering a system of small, independent "unit banks." It was felt, Ostrolenk noted, that "each bank should be a local institution, locally financed and managed, drawing funds from local depositors and using its financial resources for the development of local business enterprises."

The unit bank was well suited to financing the small, independent businesses that had dominated the American economic landscape throughout the 19th Century. But the trend toward centralization of the economy, set in motion during the Industrial Revolution, called for banks with far greater resources. Ostrolenk described the shifting economic situation as follows:

> The independent retail stores have given way to chain stores; electricity, gas, water, and transportation are now supplied by public-utility corporations that are state-wide or regional in character. Local industries have merged with larger corporations.

And as for the nation's banks:

> The financing of these enterprises, once a profitable outlet for investment of the funds of the local banks, is now being done by central banking institutions, equipped to render adequate service to the larger business units.

Thus, the traditional unit bank began to disappear, replaced by the chain bank, described by Ostrolenk as "a group of banks owned by a holding company, a group of individuals, or by one person—not by a bank, as in branch banking."

Ostrolenk emphasized that this restructuring of the national banking system "has sprung up in accordance with economic

need." The chain bank, he argued, was "an essential substitution for branch banking." Still, as with any economic evolution, changes in the banking system had dire consequences for those left behind. "Within eight years," Ostrolenk reported, "almost one sixth of the United States banks have been suspended with losses to the depositors." Not surprisingly, the vast majority of these had been small unit banks.

Investment banking had undergone significant changes as well during that same period. In the January 1930 *Atlantic*, Edgar Lawrence Smith described how Wall Street's lending practices had come to violate the basic principles of sound banking. In a well-conducted bank, he wrote,

> When a man wishes to borrow…his credit is appraised and a loan is made proportionate to his credit standing. Banks rarely, if ever, make loans to people with whose affairs they are not reasonably familiar.

But during the high-flying '20s, when a customer borrowed from a stockbroker to invest in the market, Smith observed, such caution was abandoned. Eager to cash in, individuals assumed large amounts of debt in order to purchase stock they should not have been able to afford. And stockbrokers, in pursuit of commissions and with an eye towards driving prices ever higher, readily extended these unwise loans, which were referred to as "debit balances."

Debit balances thus underwrote a financial system that was unsustainable. For Smith, the collapse of the stock market could be traced back to abuses of the simple principle of credit. Solid credit, he explained, is based either "(1) upon the competence, character, and earning power of the borrower, or (2) upon documents representing genuinely self-liquidating transactions."

In the case of debit balances, however, stockbrokers extended credit on neither ground. Instead, the ability of the borrowers to pay back the loan depended on "the general level of stock prices." But those prices, Smith pointed out, were "a function of the volume of credit so granted." The flaws in this system soon became tragically apparent, ruining many unwitting investors.

Smith was quite clear on the question of who bore the responsibility:

> The community depends upon the fraternity of bankers to see to it that the credit of the community is not squandered, that it is sound in character and can be depended upon…No Federal Reserve or other system can be devised to protect the *quality* of credit if bankers throughout the country do not apply sound judgment in the making of each loan.

In an April 1931 *Atlantic* piece "Whirlwinds of Speculation," Samuel Spring blamed the collapse on more structural causes, showing how the promise of fantastical profits—proving to be "more potent than experience or reason"—had driven speculative booms and busts in three distinct sectors of the economy.

Spring pointed to a common cycle in each outbreak of speculation. In the first stage, economic conditions conspire to create "an apparently miraculous opportunity for industries and investors permanently to enlarge earnings." Adding to the frenzy, investors soon imagine "an urgent scarcity of the units of speculation—commodities or real-estate lots or sound common stocks." Prices rise rapidly; credit becomes scarce—but can still be obtained "by diversion from other channels of trade."

The final, fatal phase of a speculative boom, Spring wrote, is "a forced and rapid multiplication of the units of speculation":

> The pouring forth of this great torrent of new units of speculation results in the inevitable

> consequences dictated by the law of supply and demand … a consequent collapse due to the excess of sellers over buyers.

In this final part of the cycle, according to Spring, speculation attains its most delirious heights—and inflicts its most lasting damage. "The wilder the outpouring of new units of speculation, the more acute and distressing the consequent panic," he argued.

But Spring was a committed capitalist, and he viewed speculation simply as "a necessary and a beneficent human instinct gone wrong." Government intervention to control it, he argued, should be beyond consideration:

> Fraud and coercion the State can restrain; but, unless we wish to go the road toward communism, the State must leave every buyer and every seller free to act as wisely or as foolishly as his intellectual and emotional capacities dictate.

Other *Atlantic* contributors, however, advocated an expanded role for the federal government so as to mitigate the social consequences of the economic downturn. Though labor advocates had been pushing for years for such protections as unemployment benefits and health insurance, the intense suffering that took place during the Great Depression gave their cause greater urgency.

In May 1930, *The Atlantic* published an essay by Alice Hamilton (the first female professor at Harvard Medical School and the founder of the industrial toxicology field), making the case for government-funded pensions for the elderly poor. In "State Pensions or Charity?" Hamilton criticized the "characteristically American method of dealing with the problems of poverty," which was then a patchwork of private organizations. She argued instead for state-funded pensions, which she contended would be more reliable and would lack the stigma of charity.

Interestingly, Hamilton largely attributed the increasing numbers of the unemployed not to the economic collapse, but to "the dark side of the amazingly rapid increase in labor-saving machinery since the war." At the end of the essay, however, she alluded to the nation's dire economic situation to bolster her cause:

> This year, if ever, it behooves us to think soberly of the need of giving some form of security to those upon whom the fluctuations of business throw the heaviest burdens. These are men and women who have no control over discount rates, or credit, or the manipulation of bull markets and bear markets, yet they are the first victims of the battles fought in those high and mysterious regions. … It is time for us to devise ways of meeting the inevitable disaster of old age and the almost equally inevitable disasters of sickness and unemployment, and these must be ways that will not fail when the stock market breaks or a new machine is invented, that will function in the lean years as in the fat years, and that can be accepted without loss of self-respect.

Another *Atlantic* contributor, Sidney Hillman (founding president of the Amalgamated Clothing Workers of America and a prominent labor advocate), likewise focused on the importance of safeguarding citizen welfare. In his November 1931 essay, "Unemployment Reserves," he argued for an expanded system of unemployment benefits, and drew on his own experience with the men's clothing industry as a case study to illustrate how such a system could work. In Chicago in 1923, he explained, the clothing manufacturers had agreed to implement an unemployment reserves system into which workers and their employers each contributed 1.5 percent of their weekly payroll. Anyone who lost their jobs through no fault of their own would then be able to receive 30 percent of their full-time earnings for up to seven weeks.

Hillman described the success of this program, and further argued that had there been a similar program implemented in 1925 on a national scale, American workers would have been much better off:

> By January 1930, at the beginning of the severe part of the present depression, there would have been built up a public reserve for the mitigation of the distress of millions of unemployed Americans. … Millions of wage-earning Americans would have been spared the humiliation of cooling their heels in charity offices, of begging in the streets, of marking time in bread lines, and, after all the torture and humiliation, of being for the most part starved, cold, and bare.

Many government entitlement programs still in place today have their roots in the Great Depression. In a February 1934 article, "The Roosevelt Experiment," the British economist Harold J. Laski defended President Franklin D. Roosevelt and the interventionist reforms he initiated in the first year of his presidency.

Laski dismissed critics who characterized Roosevelt's policies as radical departures from the *laissez faire* tradition of American political economy. He saw the Securities Act of 1933 as legislation simply mandating "the most elementary precautions required by the investor under modern conditions," and argued that the National Recovery Act "merely gives effect to ideas which have been the commonplace of economic discussion these thirty years." He also defended the need for public works projects and credit relief for those with mortgages.

Like Hamilton and Hillman, he argued that these reforms had all been a long time coming, but emphasized that the Depression made them more urgent. The motivations behind the "Roosevelt experiments," he explained, were linked to "the realization that the centralization of financial power in Wall Street had become incompatible with the public well-being, especially when Wall Street had shown itself so incapable of distinguishing between that well-being and its private interests."

His biggest worry was that Roosevelt might not win over Wall Street with his "New Deal," and that big business interests would undermine his efforts, and with them his chances for election:

> The failure of Mr. Roosevelt means the end of political democracy in America, for the simple reason that it will prove itself thereby incapable of adapting to its purposes the institutions of its economic life. … But if he succeeds, he will write a new page in the history of the world. For, having saved America by his energy, he will, as one trusts, save Europe by his supreme example.

We know with the clarity of hindsight that FDR did succeed in building support for his policies and his own reelection, though it took the manufacturing boom of World War II to truly rescue the American economy (and the Marshall Plan to save Europe's). But Laski certainly recognized the sweeping scope of Roosevelt's reforms. The president's intention, he noted, was not only to dissipate the effects of the Depression, "but also to lay the foundations of a new social order from which, so far as human prescience can avail, such disasters have been banished." If only Roosevelt had succeeded.

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