Stock Inquiry Told of Boom Psychology; Economist Recommends 100% Margins

Dr. Galbraith Asks Action to Bar 'Bust'—Market Off Up to 6 Points

By BURTON CRANE

Special to The New York Times.

WASHINGTON, March 8—Senators studying the behavior of the securities market heard today that, although stocks might not now be too high, the public was developing an all-too-familiar type of speculative hysteria.

Dr. John Kenneth Galbraith, Professor of Economics at Harvard University, said he believed that this boom psychology should be checked before it became dangerous.

[Prices of some leading stocks fell two to six points Tuesday in an unorderly fashion. The break, however, was not as extensive as those on Jan. 17 and Jan. 5, even though it rolled prices back to their lowest levels of this month. At the close, when prices were the weakest, the New York Stock Exchange's high-speed ticker tape was running nine minutes late.]

Associated Press Wirephoto

Prof. John K. Galbraith of Harvard testifying yesterday.

Dr. Galbraith told the Senate Banking and Currency Committee that the margins, or down payments, on stock buying should be raised, perhaps gradually, to 100 per cent. He recom-

Continued on Page 12, Column 3

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BOOM PSYCHOLOGY IN STOCKS DECRIED

Continued From Page 1

mended further that Federal authorities receive the power to vary the period for which stocks must be held before their profits were taxable as long term capital gains.

A stock market trader who operates on margin today is required to put up in cash only 60 per cent of the market value of a stock that he wishes to buy or sell short. His broker borrows the balance of the money from a bank and charges him interest.

When the stock is sold short, the broker borrows the stock, but is obliged to keep on deposit with its owner an amount equal to its market value. The hope of those who sell short is that they will be able to replace the borrowed stock at some later date by buying it at a lower price than at which it was sold.

The Government's intention to control over-speculation should be made crystal clear, Dr. Galbraith asserted.

"The occupation disease of the speculator," he added, "is acute uneasiness, and anything that plays on his uneasiness has great virtue as far as keeping the market under control is concerned. And it is not difficult to play on his uneasiness."

[An explanation of the margins system in securities trading appears on Page 38.]

Dr. Galbraith's proposal for putting stock trading on a cash basis was attributed by Wall Street to having played on that uneasiness and having brought about the sharp break in the stock market.

Senator J. William Fulbright, Democrat of Arkansas, said after the hearing that he could see "no connection whatever" between Dr. Galbraith's testimony and the market decline. He doubted that any existed. The professor's statements were "not gloomy, only cautious," the Senator said.

Also appearing before the committee, but in the afternoon was Harold E. Wood of St. Paul, Minn., chairman of the National Association of Securities Dealers, Inc. During much of his time on the stand he was faced with a one-man investigating committee—Mr. Fulbright.

Senator Herbert H. Lehman, Democrat of New York, was the only other committee member present, and he was not able to give the session his whole time.

Mr. Wood attacked uranium share peddlers with some violence. The association he heads is the policing organization for that part of the securities business that does not operate on the registered stock exchanges.

"I wish you would do something about them," he told the committee. He agreed with Senator Fulbright that many of the prospectuses for uranium share issues "look like deliberate plans to entrap and cheat people."

The trouble is, Mr. Wood said, that when the prospectus says almost in so many words that the stock is worthless, that is "full disclosure" under the law and the authorities are helpless. The speculators simply do not read. He said that he would welcome seeing all uranium companies compelled to register fully with the Securities and Exchange Commission.

Dr. Galbraith was introduced as the author of a soon-to-be-published book, "The Great Crash," dealing with the 1929 stock market crash and events thereafter. He is noted as a historian of the American economy.

Boom Psychology Noted

Much of his prepared statement dealt with the similarity of boom psychology through history. People, he said, insist on fooling themselves.

"Reassurances — explanations as to why things are sound—soon partake of the proportions of a minor industry," Dr. Galbraith said. Before long, he added, there is a flight into unrealty.

The belief that everyone was "playing" the market in 1929 appeared from his testimony to be inaccurate. Dr. Galbraith has discovered that there were then only 1,548,707 brokerage house customers of exchange members, and that only 600,000 had margin accounts.

The witness said that formidable safeguards had made the economy less brittle than it was in 1929, but he pointed to these danger signs:

Increasing interest in capital gains to the exclusion of yields, (the percentage relationship between dividend payments and the price of a stock) the 54 per cent advance in stock prices in the last sixteen months (against the 78 per cent rise in the sixteen months before the 1929 crash) and the present wave of mergers.

"Some remarkably fanciful explanations are beginning to appear to explain the recent rise in values and to reinforce hopes for more," he continued.

"It would be an exaggeration to say that there has yet been any wholesale escape from reality, such as occurred in 1929, but enough has happened to indicate that we haven't yet lost our considerable capacity for self-delusion."

In response to a question by Senator A. Willis Robertson, Democrat of Virginia, Dr. Galbraith said that "the kind of catastrophic break we had in the early Thirties seems to be improbable, but I think it is the better part of wisdom not yet to begin talking as though everything were perfect both for the future and the hereafter."

Senator Irving M. Ives, Republican of New York, brought up the precautions against market rigging that had been taken since 1929.

We owed the 1929 market levels, Dr. Galbraith said, "not to rigging, but to the enthusiasm of people for capital gains and the hope of stretching their present position into a still further gain."

Rigging is a stock market term for manipulation, or the devices used to create an appearance of activity and force prices upward in the absence of genuine demand.

Inquiry Called 'Healthy'

Possibly with a touch of the good politician's prescience—the market was still fairly steady when he spoke—Senator Fulbright remarked:

"I quite realize that if the market should fall out of bed [which means to fall abruptly in the next month we should be blamed for it. But do you not think that the fact that we have the inquiry, whether or not we conduct it properly, may be a healthy thing?"

"I am sure that a market inquiry in 1928 would have been extremely useful," the witness replied. "While the newspapers might deal unkindly with you for having caused the market setback, the historians would be very kind to you.

"As we historians look back on 1929, it is the pessimists we cherish, not the optimists."

"You know I am up for election next year," the Senator said, "and I am afraid a historian would not help me very much."

Senator A. S. Mike Monroney, Democrat of Oklahoma, asked about the often-expressed view that the market today was merely "catching up" to the inflation built into the economy since World War II began.

"To some extent," Dr. Galbraith said, "there was certainly a catching up in the last ten years. The market was in some measure coming abreast of the inflation of the war and the immediate post-war period. This was also true in the Nineteen Twenties. The danger is of it going into a speculative world of its own."

Senator Monroney asked how the speculative rush could be stopped "without throwing on the air brakes on a train going ninety miles an hour and throwing people on the floor." He called for a gentle way, something other than tinkering with money rates.

"My own honest view," the witness said, "is that we must rely on prevention rather than on control. And it is for that reason that I stress that the fact that we are still in the beginning stages of a speculative venture should not cause us to rest easily.

"I should regard putting trading for a time on a cash basis as essentially a preventive or precautionary step, rather than one that would have the consequence of collapsing the boom.

"If it did have the effect of collapsing it, Senator Monroney, I should say that it is much better to do it now than it is a year from now or two years from now. There will be much less damage to the economy as a whole. "Maybe the step toward 100 per cent [margin] should be taken in steps."

"Maybe we should not do it all at once," Dr. Galbraith said in reference to raising the margin requirements from 60 to 100 per cent at one stroke.

Interest Rate Discussed

"I should not be in favor of doing too much on the interest rates," he added. "This has, unhappily, much more effect on ordinary nonspeculative business activity than it does on speculation and, therefore, is unhappily a type of regulation that unhappily hits the wrong people.

"The speculator who is looking for a 25 or 50 per cent capital gain is not deterred by a 1 per cent increase in the rate of interest. But a farmer, a small business man, a merchant, a home builder, may be deterred by these movements in the rate of interest."

"Our problem at the present time," he continued, "is not to slow down the general rate of activity, because we are still somewhat below capacity there as things now stand."

Senator Fulbright, disclaiming any advocacy of the proposal, asked the witness what he thought of abolishing the capital gains tax, or perhaps to restrict taxation of capital gains at ordinary income rates to gains made on the exchanges.

Dr. Galbraith said what might have to be considered "if this boom were to continue and to become serious" would be to vary the holding period, "which would be an immediate cure to the so-caled 'locked-in' problem."

This referred to the argument, often advanced, that the maximum long-term capital gains tax of 25 per cent "locks" investors with large gains into their holdings, reduces the supply of securities on the market and destroys liquidity.

"Another possibility would be a specific surtax on capital gains," he said. "These all look to be pretty horrible suggestions. A person who is horrified by them should, however, measure them against the alternative, which might be a bad speculative bust, which would be even worse."

Backed by an imposing panel of experts, Mr. Wood faced a searching inquiry into the over-the-counter securities market. This market trades all securities not listed on registered exchanges and some that are as well.

Senator Fulbright questioned Mr. Wood about several prospectuses for uranium stocks, including one in which the underwriters and promoters of a $1,500,000 issue drew down more than $500,000.

"Is that healthy?" he asked.

Warns on 'Paternalism'

Mr. Wood did not believe that it was, but noted that speculators would be scared away if they bothered to read the prospectus. Unfortunately, they do not, and since there has been "full disclosure," the hands of the S. E. C. are tied, he said, adding:

"Once you get into controlling offering prices you get into paternalism and I think that is dangerous."

A great many issues are floated under what are called "Regulation 'A' exemptions." These are for less than $300,000 and therefore do not have to make full registration with the S. E. C.

Senator Fulbright asked Mr. Wood if he would be in favor of denying Regulation "A" exemptions to uranium share issues.

"I would be for anything, no matter how drastic, in order to control them," he said.

Senator Fulbright asked Mr. Wood's opinion of the suggestions made by Stock Exchange executives that unlisted companies be required to make much fuller reports to their stockholders.

"Should your committee sponsor legislation requiring every company to make reports?" the witness asked.

"We are seeking light," Senator Fulbright said.

"I think it is a terrific amount of regulation to impose on the business of the country," Mr. Wood said. He added that most companies made periodic reports even though not required to do so.