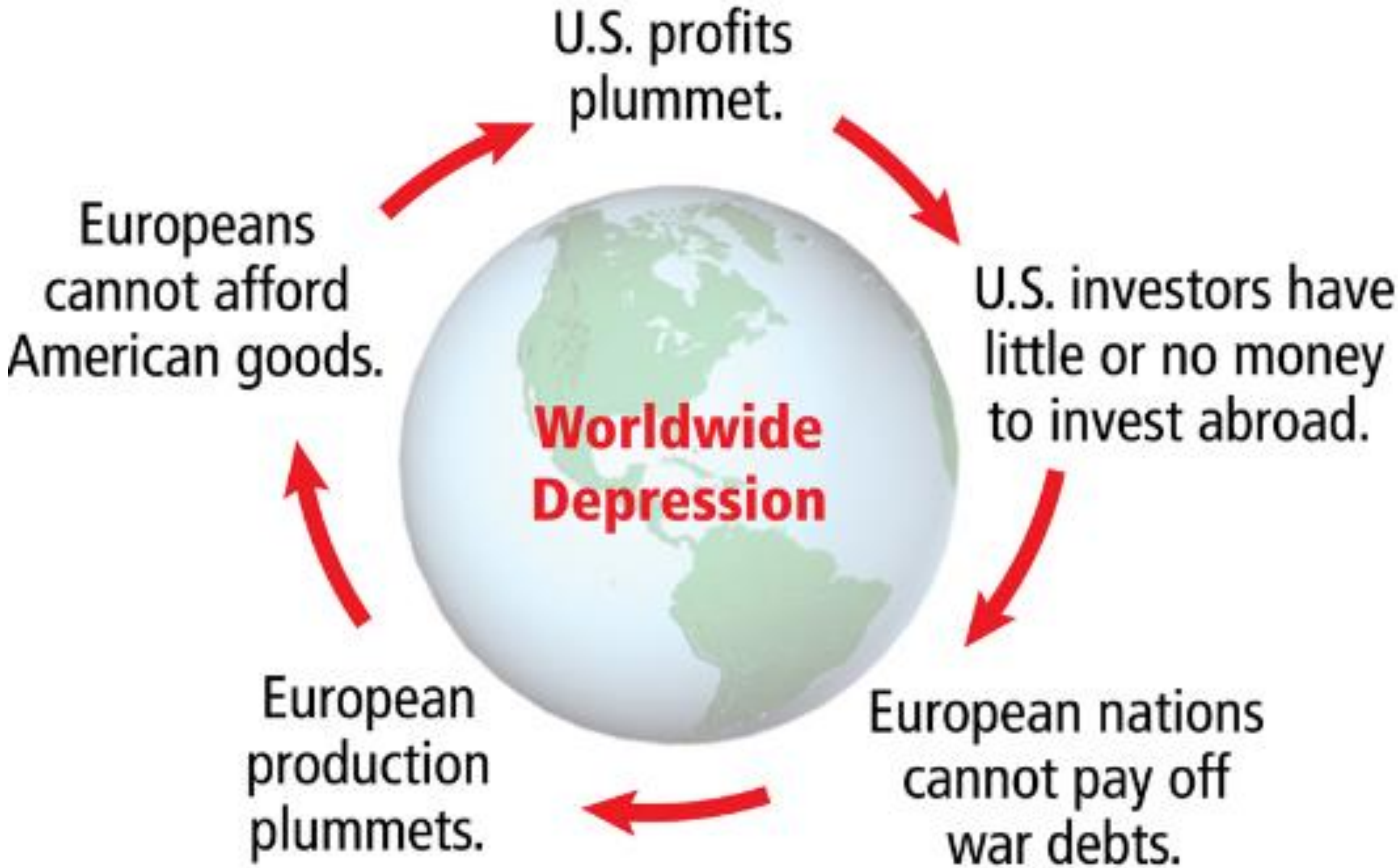
Causes of “The Great Depression”



The Great Depression was a worldwide event:

– By 1929, unemployment increases worldwide

American Farmers Face Problems First

Farm overproduction during WWI

- Govt subsidized crops (paid higher prices for grain and wheat)

– **Farmers borrowed money to enlarge and modernize farms**

After wartime subsidies were cut

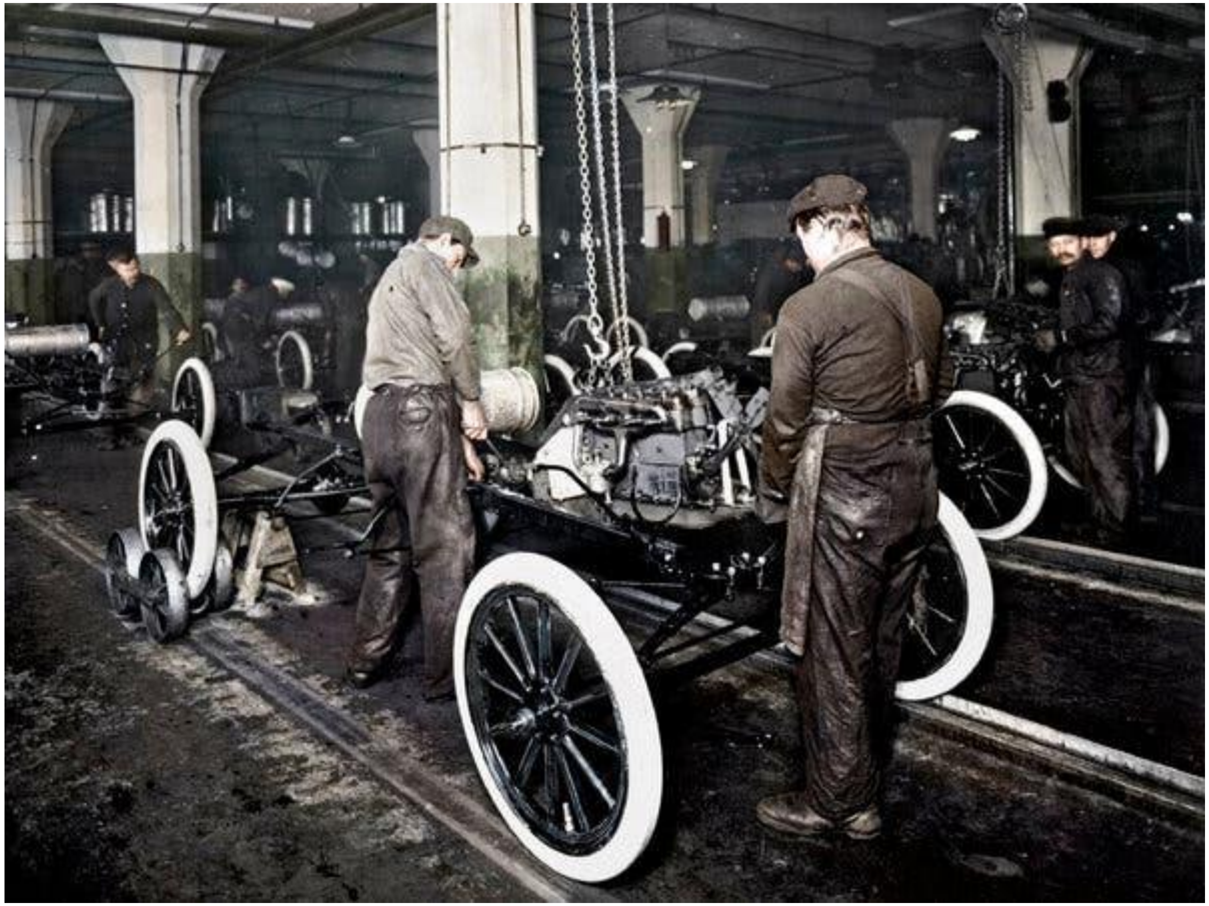
- With the same payments needing to be made month to month → farm foreclosures increased

There are 4 causes of the Great Depression

1. Overproduction
2. Banking and Monetary Policies
3. Stock Market Actions
4. Political Decisions

1. Overproduction

- High availability of consumer goods
  - Electric appliances, automobiles
- Americans feel they deserve to reward themselves following WWI



Availability leads to a high demand for goods

- Companies begin to produce more and more to attempt to meet growing consumer demand

The continued uneven distribution of wealth didn't stop the poor and middle class from being able to possess "luxury items", such as cars and radios

Reality:

-Real <u>under</u>-consumption is creating a "bubble":

Although people wanted the items, they didn't have enough cash to buy everything they wanted → bought "on credit"

-Uneven distribution of wealth and income

Wages were not keeping up with prices of goods

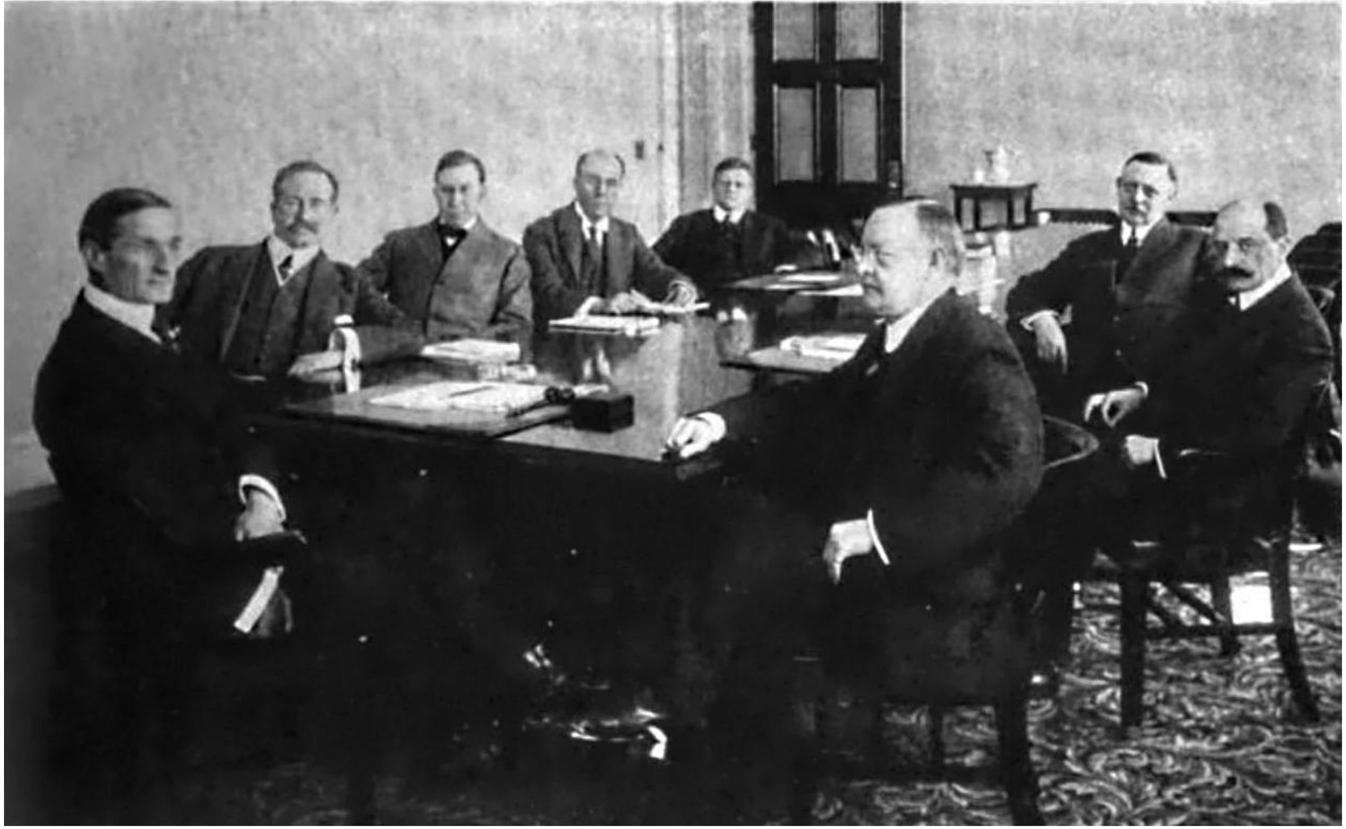
- Solution: buy "on credit"
- By end of 1920s - 60% of cars and 80% of radios were bought on installment credit

2. Banking and Monetary Policies

The Federal Reserve Board

Federal Reserve Act (1907) in response to the banking crisis

- Meant to be protective "Watchdog" of economy by managing the money supply
- Set the interest rates for loans issued by banks



In 1920s: “The Fed” set interest rates very low

- To encourage people to take out loans to try to stimulate the economy
- More consumers → higher profit → companies can afford to produce more → leads to a surplus of goods

1929: Fed worried growth was too rapid

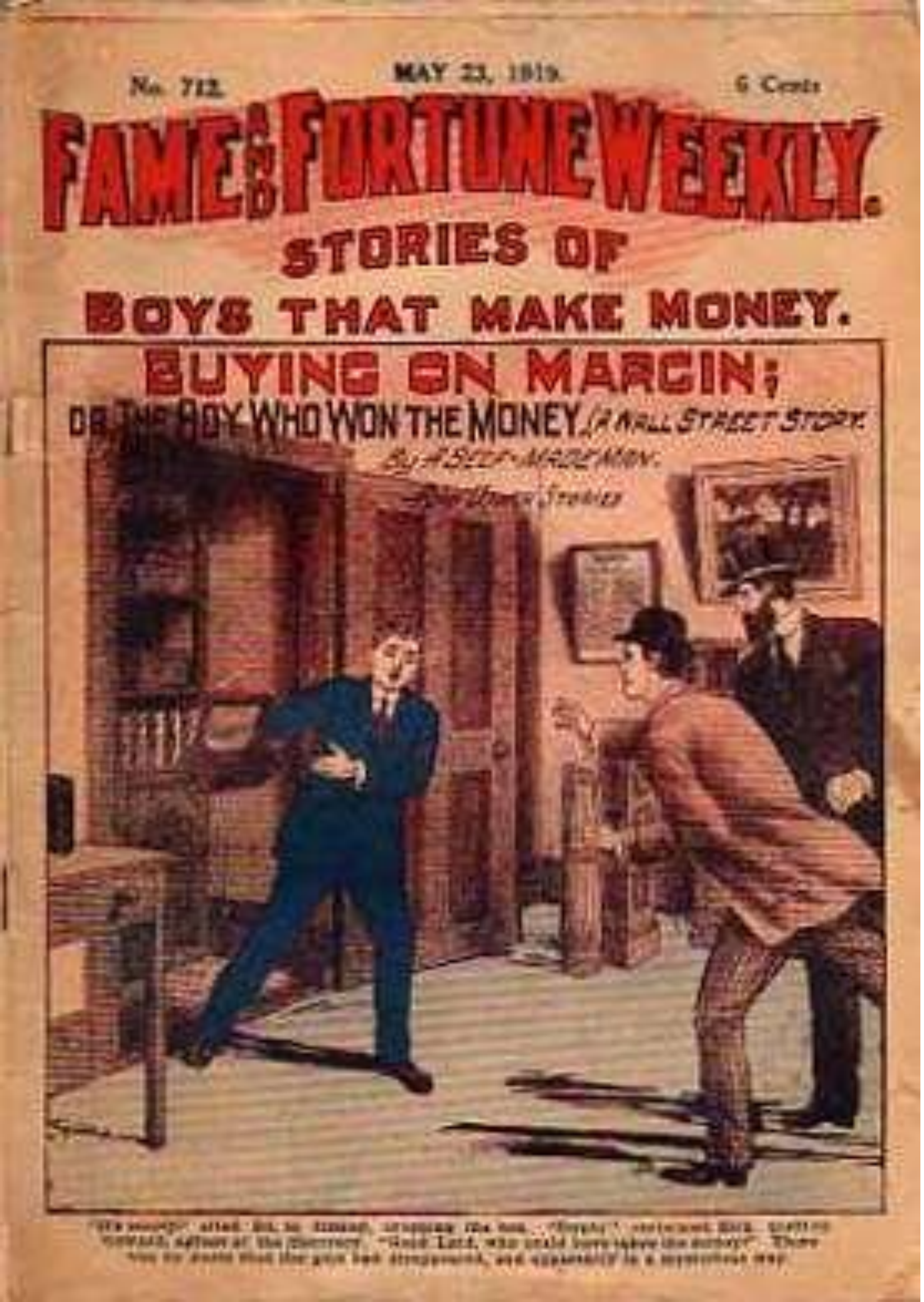
- Raise interest rates and tighten supply of money → consumers responded

3. Stock Market Actions

The Stock Market was/is an indicator of national prosperity

Buying "on margin"

- **Just like one could buy goods on credit, it was easy to borrow money to invest in the stock market**
  - "Margin investing" or "buying on margin"
- **Small investors more likely to invest in stock market in large numbers because the "margin requirement" was only 10%**
  - $1000 worth of stock could be bought with 10% down and you pay the rest with your dividends



1920s: business is "booming"

- Stock prices rising
- Growing profits

Speculation: stockbrokers predict which stocks will do well

- Causes prices to rise

What went wrong?

Banks began to loan money to stock buyers/brokers

- Allowed to use their stock as “collateral” for defaulted loans

<u>What does this mean for banks if the stock loses value?</u>


VARIETY

25¢

WALL ST. LAYS AN EGG

Going Dumb Is Deadly to Hostess In Her Serious Dance Hall Profesh

DROP IN STOCKS ROPES SHOWMEN

Kidding Kissers in Talkers Burns Up Fans of Screen's Best Lovers

The Crash

- Stock prices decline in September
- 24 October "Black Thursday"
- 28 October "Black Monday"
- 29 October 1929 "Black Tuesday", prices collapsed completely and a share selling frenzy occurred
- Over 16m shares sold
- Losses exceeded $26 billion

Some historians say it was a symptom of more than a cause of the GD

The Federal Reserve Could Have Intervened

The Fed was established (in part) to prevent banks from closing

- However, The Fed had previously lowered the reserve requirement of cash to be held by banks
- Many banks didn't have enough cash to match amount of money in customer accounts

Bad Banking Practices

-Loss of confidence in stocks led to loss of confidence in security of money being held by banks

-Customers raced to banks to withdraw their savings

-“Bank Runs” become a regular occurrence

1930

- 60 bank failures per month

1930 - 1933

- 9,000 bank failures

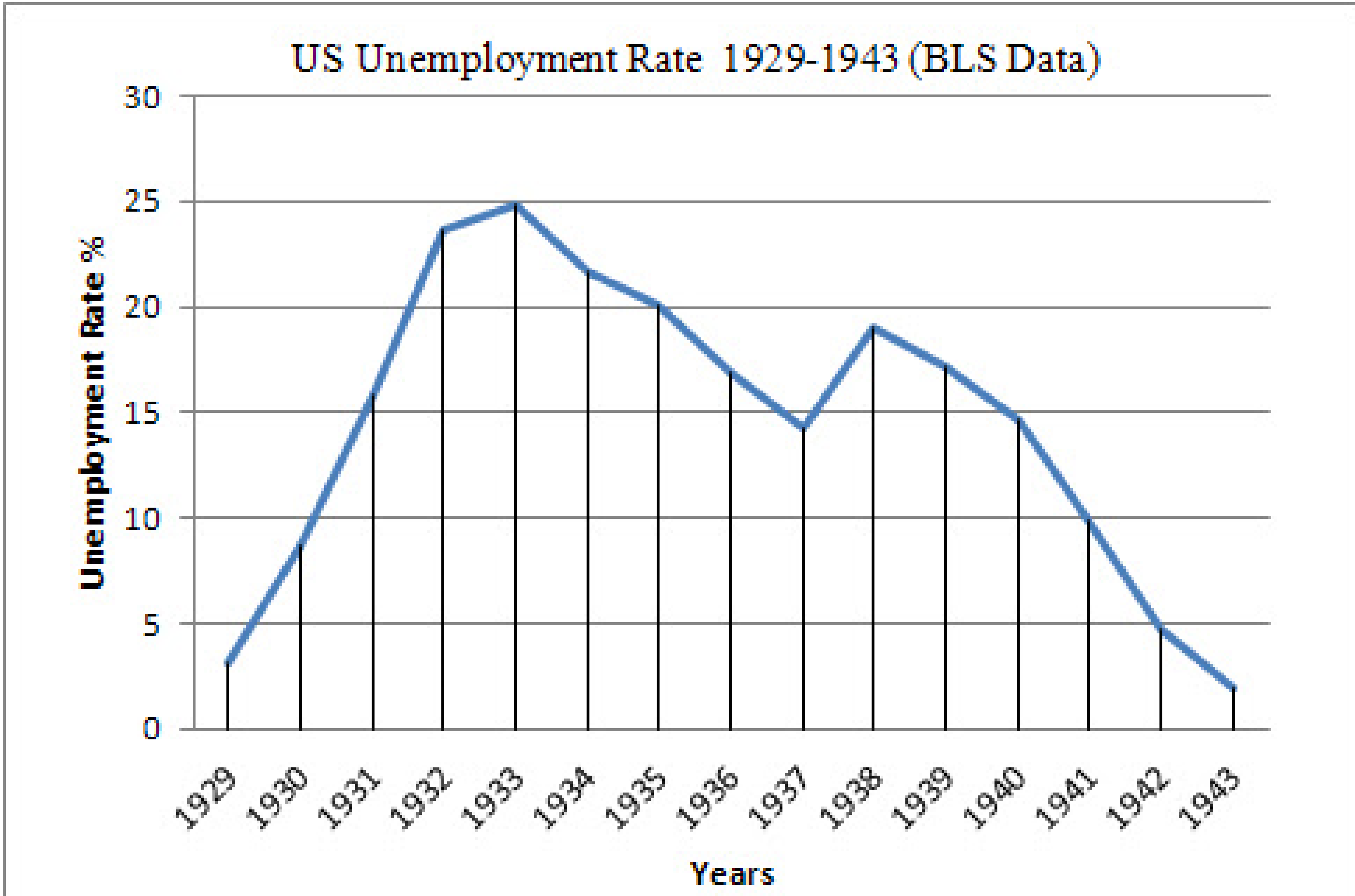
A Downward Spiral:

When banks fail, money just "disappears" from the economy

- No insurance for savings deposits → many lost their life savings
- As more banks close → people lose money → more fear of banks and more runs

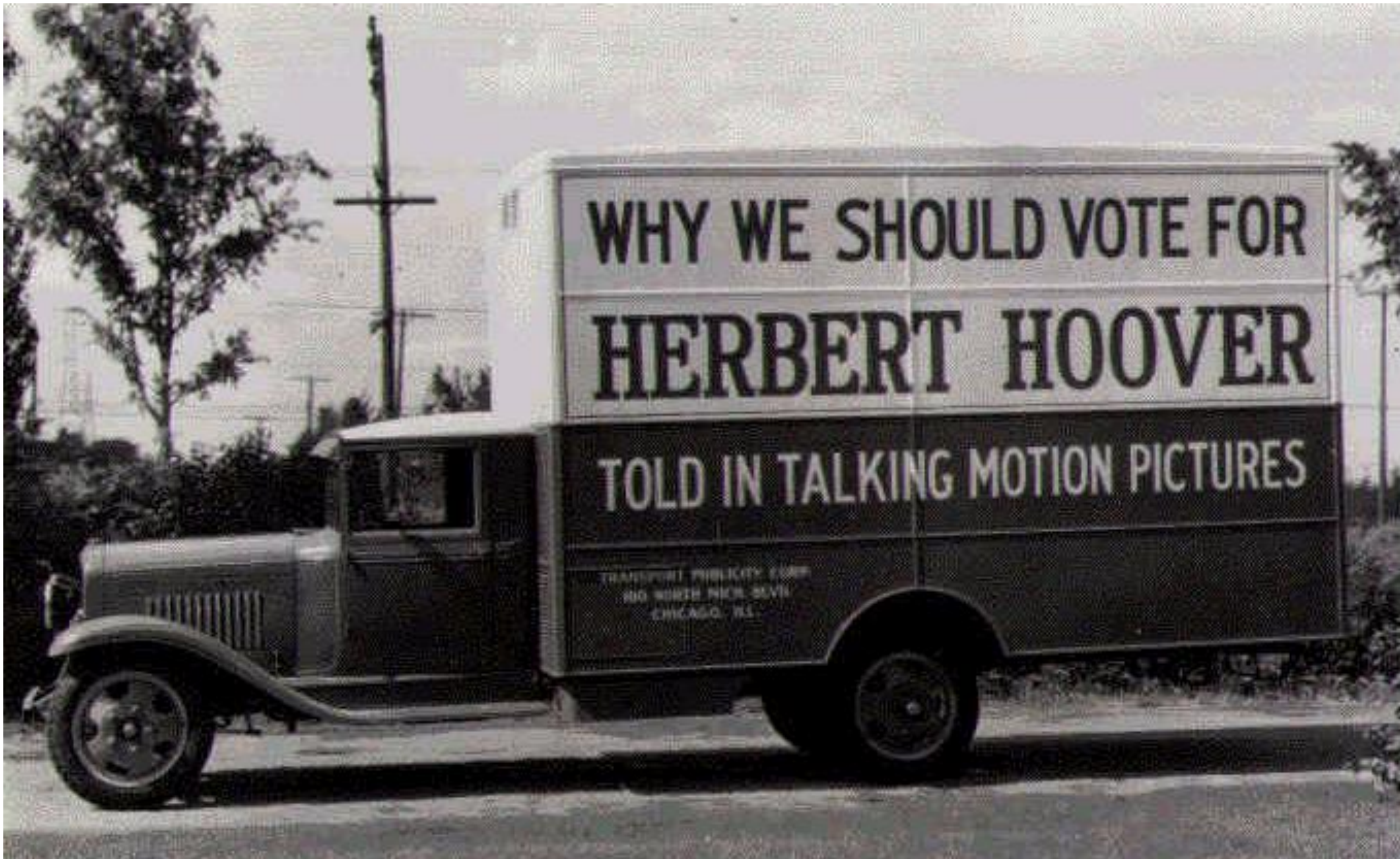
Businesses lose money

- Many go bankrupt → close their doors → leaving workers unemployed



US Unemployment Rate 1929-1943 (BLS Data)
Unemployment Rate %
30
25
20
15
10
5
0
1929
1930
1931
1932
1933
1934
1935
1936
1937
1938
1939
1940
1941
1942
1943
Years

4. Political Decisions



The Depression could have been less severe had policy-makers not made certain mistakes

Leaders in govt and business relied on poor advice from economic and political experts

"The sole function of the government is to bring about a condition of affairs favorable to the beneficial development of private enterprise."

-Herbert Hoover (1930)

By Warren, in the Philadelphia *Public Ledger*

RAIL-SPLITTING

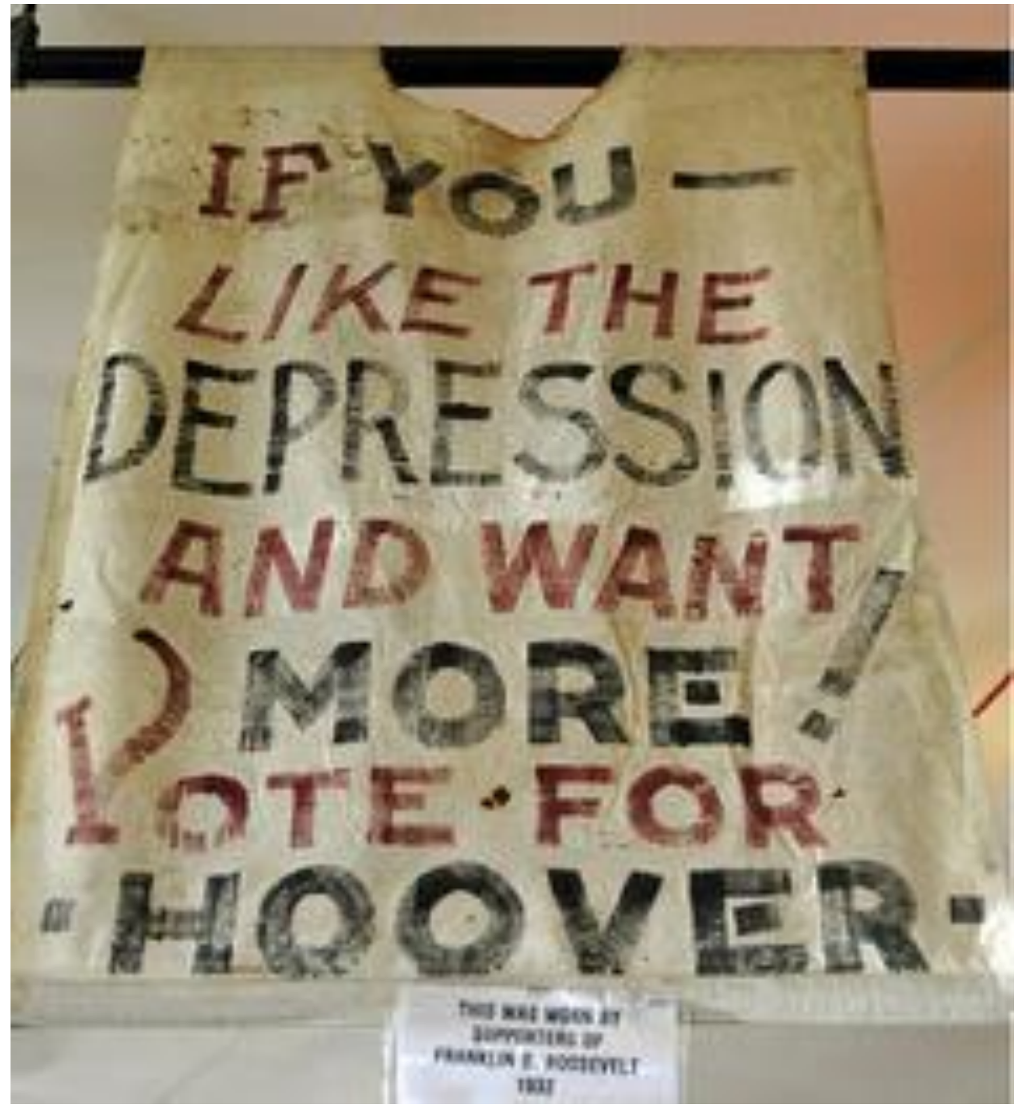
Did Hoover really believe in a "hands-off" free market philosophy?

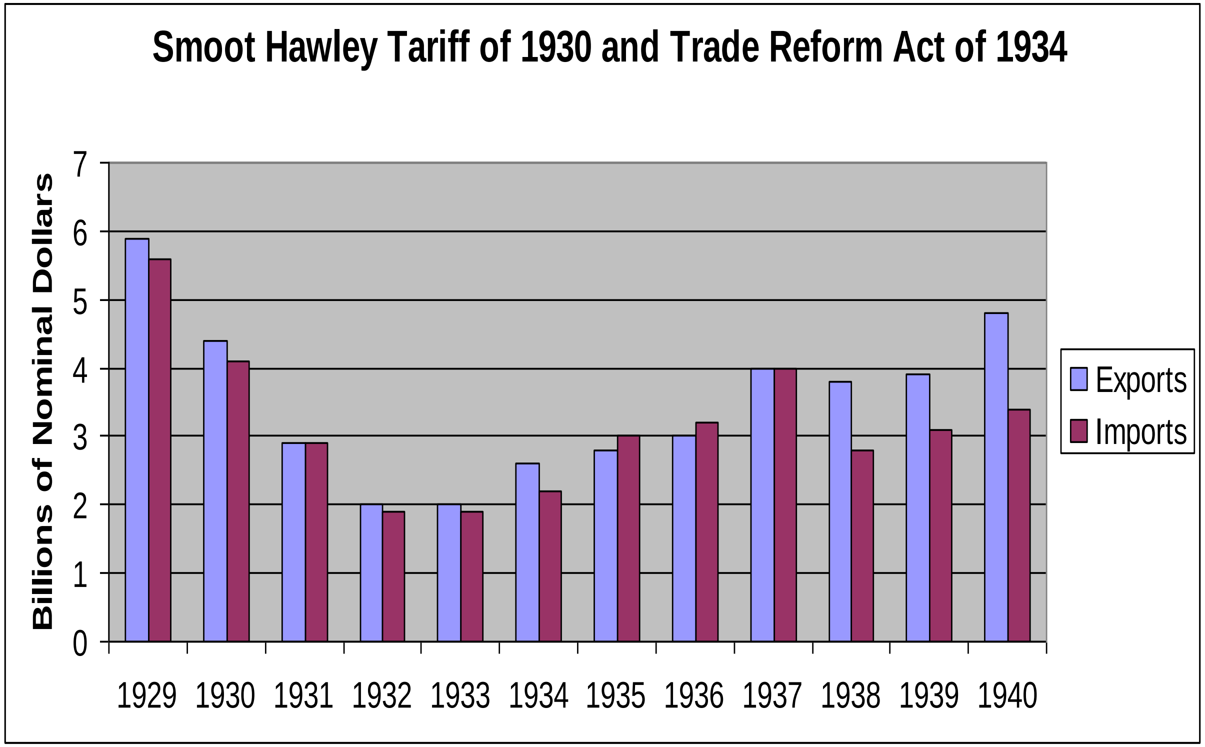
Within a month of “The Crash”, Hoover met with key business leaders:

- **Urged them to keep wages high, even though prices and profits were falling**

Biggest mistake of Hoover administration was the Hawley-Smoot Tariff Act (1930):

- **Raised most tariffs to 40-48%**
- **Believed trade barriers would force Americans to buy American, therefore producing jobs**





Leaders ignored that trade is two-way street

- If foreigners can’t sell goods in the U.S., they will cut down our exports there