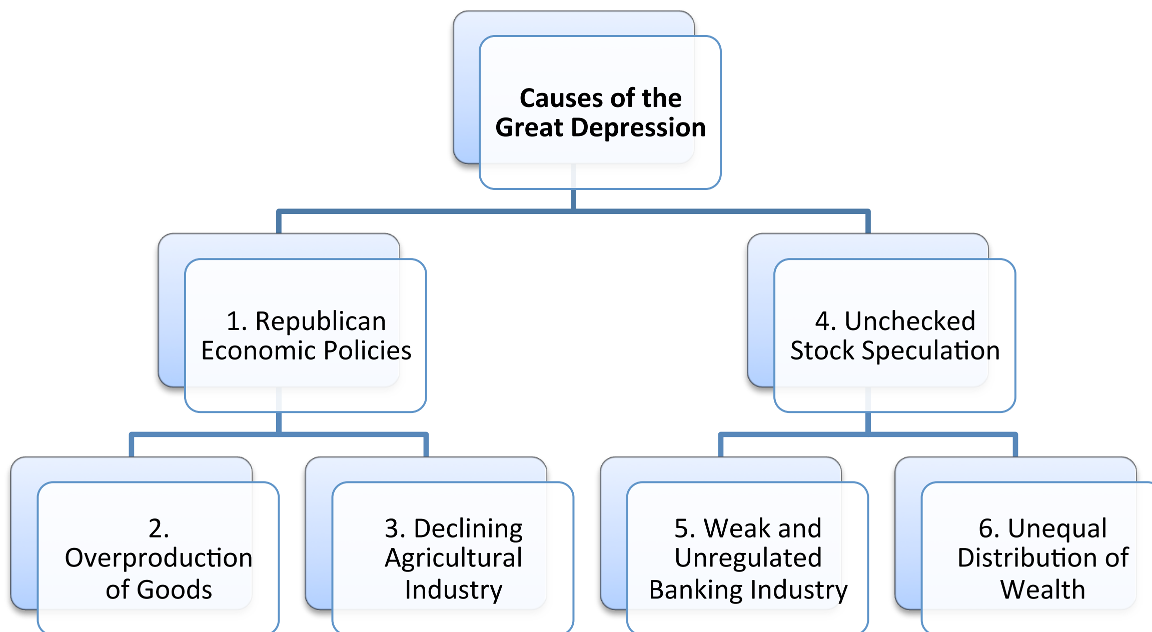
CAUSES OF THE GREAT DEPRESSION

Historical Context: Following the Presidential election of Hervert Hoover in 1928, most Americans were optimistic about the future of the country. With stock prices soaring, many people invested in the stock market to get rich quick. As the number of new investors began to dwindle, the market first slowed and then crashed. Contrary to popular belief, the stock market did not cause the 10-year long Great Depression. Rather, the crash was one factor among many complex factors. One author stated: "The stock market lowered the U.S. economy's resistance to the point where already existing defects could mulitply rapidly bringing down the whole organism." While historians continue to debate the exact causes of the Great Depression, they generally agree on six factors.

Directions: *Use the following readings to better understand the various factors that helped to cause the economic crisis known as the Great Depression.*

While reading each section ***take notes in your own words*** *on a separate sheet of paper to describe the specifics of each particular factor. Make sure to* ***explain and analyze the connection*** *between each factor and its impact on the overall failure of the American economy in the late 1920s and early 1930s. Write down key statistics and evidence that better explain each particular factor.*



1. REPUBLICAN ECONOMIC POLICIES

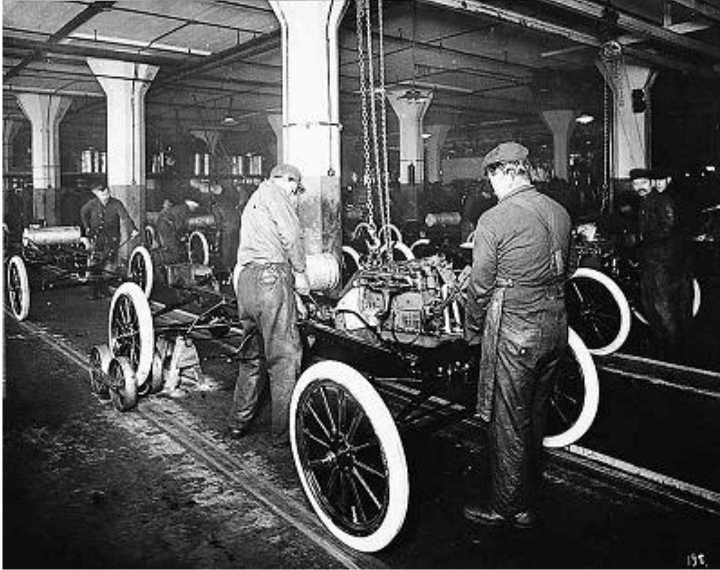
Photo Caption: Here we see the three leaders of the 1920s and 1930s Republican Party: President Coolidge on the left, Secretary of the Treasury Andrew Mellon in the middle, and Herbert Hoover, former secretary of commerce and candidate to succeed Coolidge as president, on the right.

Domestic Economic Policies: Republican president Calvin Coolidge, who led the United States from 1923 to 1929, summed up his party's economic philosophy when he stated, "The business of America is business." His administration and the administration of his republican successor, Herbert Hoover, implemented many pro-business policies based on the doctrine of trickle-down economics and a conservative approach to international economics.

Coolidge's secretary of the treasury, wealth businessman Andrew Mellon, was a key proponent of trickle-down economics. He believed that economic policies that benefited big business and America's wealthiest citizens would eventually benefit all Americans, and that prosperity would "trickle down" from the upper classes to the middle and lower classes. Mellon argued that if the government provided businesses and wealthy individuals with significant tax cuts, they in turn would reinvest the money in the U.S. economy. For example, a business might use its tax refund to expand its facilities, thereby providing people with jobs and raising their standard of living. Using trickle-down theory as a justification for his policies, Mellon slashed taxes for big business and reduced personal income tax for people who made over $60,000 a year; one corporation, U.S. steel, received a tax refund of $15 million. To make up for the loss in government revenues, Mellon cut government expenditures and raised taxes for the middle and lower classes.

However, despite Mellon's and other Republican's projections, wealth did not trickle down to the American worker in any significant way. Instead, corporations devoted their profits to expanding their work facilities, increasing the production of good, and lining their own pockets. While industrial expansion created some new jobs, the slight growth was offset by business owners' increased reliance on machines, rather than people, to produce goods. Furthermore, owners kept workers' wages low. In the end, trickle-down economics simply increased the gap between rich and poor.

International Economic Policies: The Republicans favored a conservative approach to the economic problems of Europe. During World War I, the U.S. had lent over $11 billion to its European allies. After the war, most European nations were in economic ruin and could not repay the U.S. They appealed to the U.S. government to release them from having to repay the loans, or to at least reduce the amount they owed. Coolidge's administration found that idea economically imprudent and refused to forgive the debts. Instead, the U.S. rescheduled the loan payments and began lending the European nations even more money in a misguided attempt to help them repay the original debt, and soon began defaulting on their loans. In addition, Republicans imposed high tariffs on imported goods to discourage Americans from buying foreign merchandise and to promote consumer spending on American-made products. Without a substantial market for their goods, European nations had no hope of repaying their loans, nor could they afford to buy American goods or invest in its economy. But until the late 1920s, many Americans were too busy investing in the stock market themselves to care.



2. OVERPRODUCTION OF GOODS

Industrial Goods: During the 1920s, U.S. industry enjoyed a postwar boom that lasted until the end of the decade. During World War I, technological advances in such fields as aviation and ground transportation fundamentally changed the way people waged war. After the war ended, technological advances in such areas as agriculture, electrical power, transportation and factory production profoundly changed the way American people lived and worked.

Before 1929, American industrial production seemed to parallel the course of the stock market: it kept going up fast. First, the consumer demand for goods was very high after WW I. Americans eagerly pursued the acquisition of material goods in an effort to forget the horrors of war. Advertisements for such items as cars and households appliances enticed consumers with promises of increased convenience and a higher standard of living. Second, newly invented machines allowed U.S. factories to produce more goods in less time. Third, American industrialists believed in unrestricted capitalism and unrestricted growth. They continually expanded their facilities, increased their factories' production, and flooded the market with an endless stream of goods. For a while, industrialists' profits soared. However, by 1929 many companies had more plants than they actually needed, and they market was saturated with goods that few Americans could afford to buy.

Agricultural Goods: The Great Depression exacerbated the already-existing problem of overproduction in the American agricultural industry. American farmers had prospered during World War I, supplying both U.S. armies and war-torn European countries with foodstuffs such as corn, wheat, and vegetables. Like their industrialist counterparts, after the war farmers took advantage of technological advances to mechanize a great deal of their work. The new technology helped farmers become more efficient, and they produced more goods than ever. However, by this time European farmers had resumed their own production, and the foreign demand for U.S. agricultural products dropped significantly. As a result, farmers were often stick with a surplus of crops they could not sell, or could sell only for a very low price. When the Great Depression hit, it hit the already vulnerable farming industry particularly hard.

3. DECLINING AGRICULTURAL INDUSTRY

The Farming Industry Decline: Farming had historically been the backbone of the American economy. By 1929, however, the U.S. agricultural industry was in deep decline. During the 1920s, farmers borrowed heavily from banks to pay or new, technologically advanced equipment. But as farmers failed to sell their surplus crops, they became unable to repay their bank loans, including their mortgages. As a result, many farmers defaulted on their loans and some lost their farms to bank foreclosures. The banks would then attempt to auction off the foreclosed farmland and equipment in an effort to recoup the money. However, most farmers could barely hold onto their own farms, let alone purchase another's. Consequently, the banks frequently ended up taking a loss. In 1929 many banks collapsed under the combined pressure of farmers' ongoing economic problems and the stock market crash.

Farmers During the Great Depression: Farmers' situations only grew worse as the Depression deepened. Between 1929 and 1933, farmers' income dropped by 50 percent and their property values decreased by billions of dollars. To make matters worse, farmers in the mid and southwestern U.S. were hit with a drought so severe that the soil turned to a powdery dust that swept across the plains in choking black clouds. The region became known as the Dust Bowl, and farmers fled it in droves. Altogether, over one million families lost their farms between 1930 and 1934.

The Dust Bowl: Farmers fleeing the Dust Bowl headed west to California in search of employment and land. People often referred to the migrating farmers as "Okies" an allusion to the Oklahoma origins of many of the refugees. Unable to afford decent housing, many of these families lived in makeshift shacks and shanties outside city limits. One such housing area near Salinas, California – nicknamed "Little Oklahoma" by locals – contained roughly 10,000 inhabitants. An inspector describing farmers' living conditions in Sacramento, California, wrote "the dwellings are built of brush, rags, sacks, boxboard, odd bits of tin and galvanized iron, pieces of canvas, and whatever other material was at hand at the time of construction…Entire families, men, women and children, crowded into hovels, cooking and eating in the same room. The majority of the shacks have no sinks or cesspools for the disposal of kitchen drainage, and this together with garbage and other refuse, is thrown on the surface of the ground." The unrelenting poverty of the American farmer not only contributed to the nation's overall economic decline during the Great Depression, it also threw into dramatic relief the tremendous gap between America's "haves" and "have-nots."

4. UNCHECKED STOCK SPECULATION

Unchecked Stock Speculation: As the 1920s progressed, traders at stock exchanges around the country – particularly the New York Stock Exchange on Wall Street – whipped themselves into a virtual feeding frenzy of buying and selling. Investors believed that the stock market would go up indefinitely and that companies' profits would continue to increase. In accordance with this belief, investors speculated which company's stock would rise and then bought large quantities of the stock. They then turned around and sold the stock for a higher price, making a quick, easy profit. The investors who bought the stock at the higher price would in turn sell it to other investors for an even higher price. In this way, the value of many companies' stock became artificially inflated and bore little correlation to the companies' actual worth.

Some crooked investors purposely inflated the value of a company's stock in order to make a quick profit. First, these investors would pool together other investors' money and buy a large quantity of company stock at a cheap rate. Investors outside the investment pool would note the buying frenzy and conclude that the company bust be highly profitable and, consequently, its stock valuable. The outside investors would also start buying up the company's stock, which as a potentially valuable commodity became more and more expensive. When the company's stock prices peaked, the investment pool operators quickly sold their investors' stock for a much higher price than the original cost of the stock. Since the high demand for the company's stock was artificially generated by the pool operator, the demand – and consequently the value of the stock – plummeted when the operator pulled out. Outside investors would then discover that the company was not as profitable as they speculated, and that their stock was worth far less than what they had paid for it.

As rampant stock speculation drove stock prices higher and higher, some economic analysts and investors predicted that the market was headed for a fall. They warned that stock prices could not continue to rise at such an inflated rate and that the prices were far exceeding most stocks' actual worth. As evidence, analysts pointed out that many companies simply did not possess enough assets or generate enough profit to justify the high price of their stocks. Even Herbert Hoover, who assumed the presidency in early 1929, warned investors to curb their speculation and began to sell some of his own stocks in the fear that "possible hard times are coming."

<u> THE STOCK MARKET CRASH **</u>**

BLACK TUESDAY

NEW YORK, TUESDAY, OCTOBER 29, 1929

THE STOCK MARKET CRASH OF 1929

BY BARBARA SILBERDICK FEINBERG

NEW YORK, OCTOBER 29 — Another hurricane of liquidation hit the stock market today, as financial uncertainty fed on rumor and turned to panic. Frightened investors ordered their brokers to sell at any price, and the stock market crashed. Those on the floor of the Wall Street exchange waded in paper and tried to add up their losses.

It is believed those losses total billions of dollars. Thousands of accounts were wiped out as a record number of shares were traded. Some stocks were almost given away. Millions of shares traded hands.

Brokers on the floor of the Exchange have never seen a day like this. The shock on Wall Street spread to other exchanges and markets. It was a country-wide collapse of security values in which losses were the most disastrous and far-reaching in the history of the Stock Exchange. There was near-panic on the Chicago commodities exchange. Rumors spread from one end of the United

Crowds Gathered On Wall Street As The Market Went Into Historical Decline

<u>1929 Stock Market Crash</u>: Analysts' warnings that the bull market (a market in which prices are constantly rising) could not continue indefinitely made some investors nervous. In 1929 many investors began selling their stocks while they could still get a high price for them. As investors began withdrawing from the market, stock prices started to fall. As stock prices fell, companies slowed down production, which in turn let to additional price drops. By October 1929, stock prices were on a devastating downward spiral. On October 24, 1929, investors flooded the New York Stock Exchange with sell orders in an attempt to get rid of their stocks. Stock prices soon plummeted, and investors starting losing large amounts of money. A group of bankers led by J.P. Morgan attempted to stabilize the market by purchasing investors' stocks at a higher price than the market was offering. While the bankers managed to pump some much-needed cash back into the market, they ultimately could not prevent its continued descent.

On October 28th, investors again rushed the stock exchange and sold their stocks at a loss of over $4 billion. On October 29, known as "Black Tuesday," orders to sell at any price swamped the stock market. In a matter of hours, people lost fortunes it has taken an entire decade to make. First National Bank executive George Baker, who has once made $22 million on the stock market in one day, claimed he lost over $15 million as a result of Black Tuesday. One distraught president threw himself off the ledge of a New York hotel after his company's stock fell from $113 to $4. By the end of Black Tuesday, investors had lost $16 billion. By October's end, the stock market was in ruins and the Great Depression had officially begun.

5. WEAK AND UNREGULATED BANKING

Unregulated Banking Institutions: The stock market crash triggered a collapse of the U.S. banking industry, which had grown increasingly unstable over the course of the 1920s. This instability was due in part to the Republican policy of laissez faire and banks over-extension of credit to stock investors and brokers.

The Republican presidential administrators of the 1920s strongly favored economic and political laissez faire. The founding principle of laissez faire (which means "leave alone" in French) was the belief that the government should not interfere in or impose any regulations on commerce. As a result, many industries – including the banking industry – were operating with little or no government oversight. The Federal Reserve Board was in charge of regulating U.S. Banks and protecting bank depositors, but its regulations were weak and inadequately enforced. For example, the Reserve Board did nothing to prevent banks from speculating depositors' money on high-risk ventures, nor did it demand that banks keep a certain percentage of their money on reserve and available. In addition, depositors' money was uninsured. Therefore, when banks folded after the stock market crash, their customers had no way of getting their money back. Thousands of families were instantly impoverished.

During the speculative frenzy of the 1920s, banks permitted investors to buy stocks on large margins of credit. This practice allowed investors with very little money to purchase large amounts of stock. Typically, investors put 10 or 20 percent cash down on a stock purchase. Then, banks lent the investors the rest of the money they needed to buy the stock, accepting the stock itself as collateral. For example, if an investor wanted to purchase $20,000 worth of stock, she typically had to put up 10 percent – or $2,000 – of her own money. She would then ask the bank to loan her the remaining 90 percent, or $18,000. The bank would lend her the money with the expectation that if she could not repay the loan, it could seize her stock and sell it for instant cash. Like other Americans in the 1920s, bank officers were confident that stock prices would continue to rise. They believed that accepting stock as loan collateral was just as safe as accepting a house or any other form of personal property. The bankers could not envision a day when many stocks would not be worth the paper they were printed on.

The Banking Industry Collapse: When the stock market crashed on October 1929, it precipitated a similar crash in the banking industry. First, families that had played the stock market lost all their savings, depleting banks' already small cash reserves. Second, investors who had bought stocks on margin either could not sell their stocks at all, or were forced to sell them at a fraction of their original price. As a result, they had little or no money with which to repay the bank that had extended them the margin of credit. The bank in turn could not replace its depositors' money, which it had used to fund the speculator's loans. Therefore, even people who had not speculated in the stock market lost all their money. Finally, as unemployment soared, an increasing number of people began defaulting on their mortgages and other types of loans. As the Great Depression deepened, many banks had no assets, no cash reserves, and no new money coming in. Hundreds of banks immediately closed their doors after the stock market crashed, and by 1932 one fourth of the nation's banks had closed – almost 6,000 banks.

6. UNEQUAL DISTRIBUTION OF WEALTH

The Gap Between the Rich and Poor: While statistics showed that Americans were more prosperous than ever during the 1920s, most of the country's wealth remained in the hands of a few people at the top of the economic pyramid. As the decade wore on, the gap between rich and poor grew wider and the distribution of wealth grew increasingly unequal. In 1929 the Federal Trade Commission reported that 1 percent of the American population possessed over 59 percent of the country's wealth. Moreover, experts estimated that over 60 percent of U.S. families lived on or below the minimum subsistence level of $2,000 a year; many African Americans, Latinos and other non-white populations were even poorer. From 1920 to 1929, the average American saw his net income increase by a modest 9 percent. In comparison, the income of rich Americans rose a whopping 75 percent. In short, the rich were getting richer. This maldistribution of wealth had a significant impact on the U.S. economy.