**Learning Objective:**

Explain the causes of the Great Depression and its effects on the economy.

**Thematic Focus:**

*The interplay between markets, private enterprise, labor, technology, and government policy shape the American economy. In turn, economic activity shapes society and government policy and drives technological innovation.*

1. The United States continued its transition from a rural, agricultural economy to an urban, industrial economy led by large companies.
2. Episodes of credit and market instability in the early 20th century, in particular the Great Depression, led to calls for a stronger financial regulatory system.
   1. Expansion of Credit
      1. Because corporations were raising much of their money through the sale of stocks and bonds, the demand for business loans declined. Commercial banks then put more of their funds into real estate loans, loans to brokers against stocks and bonds, and the purchase of stocks and bonds themselves. By doing so they made themselves vulnerable to economic disaster.
      2. Purchases of “big ticket” items such as automobiles, refrigerators, and furniture were made possible by installment or time payment credit. Availability of credit expanded tremendously during the 1920s.
   2. Agricultural Woes
      1. The least prosperous group in the 1920s consisted of farmers in the Midwest and South.
      2. For American farmers, the years 1921-1929 were a period of falling prices for agricultural products. European demand had dropped significantly, and farm prices were determined by a free market.
      3. While prices dropped, expenses rose with the cost of more sophisticated machinery and a greater use of chemical fertilizers.
   3. Changes in Labor
      1. Many firms sought to provide job satisfaction so that the workers would not want a union. Company-sponsored pension and insurance plans, stock purchase plans, efforts to ensure worker safety and comfort, social and sporting events, and company magazines were undertaken.
      2. Union membership dropped about 20% as many unions such as the AFL were on the defensive.
      3. The most violent labor confrontations occurred in the mining and southern textile industries. The United Mine Workers of America, headed by John L. Lewis, was involved in bitter strikes in Pennsylvania, West Virginia, Kentucky, and Illinois.
   4. 1920s Economic Policy
      1. Republicans, under President Warren G. Harding, Calvin Coolidge, and Herbert Hoover returned to power throughout the 1920s. Democrat Woodrow Wilson was blamed for wartime civil liberties abuses, the League of Nations controversy, and the strikes and inflation of the postwar period. 1920s “Old Guard” Republican presidents rejected progressivism and Wilsonian idealism. One difference between the Republicans of the 1920s and those of the Gilded Age was that in the 1920s, the Republicans modified laissez-faire to have all aspects of the government “hands on” in favor of business.
      2. While Harding made some excellent appointments to his Cabinet, he also appointed some of his corrupt cronies, including Secretary of the Interior Albert Fall and Attorney General Harry Daugherty. These men became involved in major financial scandals. Albert Fall secured the transfer of several naval oil reserves to his jurisdiction. Fall then secretly leased reserves at Teapot Dome, Wyoming to men from other petroleum companies. A Senate investigation revealed that he was given nearly $500,000 in cash and was imprisoned for bribery. The head of the newly-created Veteran’s Bureau stole or squandered $250 million in bureau funds. Attorney General Harry Daugherty took bribes from bootleggers, income tax evaders, and others in return for protection from prosecution.
      3. Republican presidents of the 1920s, along with three-time Secretary of the Treasury Andrew Mellon, favored tax cuts for wealthy Americans. This was designed to encourage investment. Republicans believed in an associative economic theory, whereby the voluntary cooperation of business and government would enable the U.S. to abolish poverty through continued economic growth. During the presidencies of Harding and Coolidge, the federal agencies created during the Progressive Era aided business.
   5. Stock Market Crash and Great Depression
3. Business was booming, but investments were made with borrowed money. This sort of over-speculation was rampant. Investors were buying on margin, meaning they bought stock on a margin of 10%, borrowed the remaining 90% from a broker’s loan, and put the stock up as collateral. Careful investors, realizing that stocks were overpriced, began to sell to take their profits. During October 1929, prices declined as more stock was sold.
4. Business failures led to bankruptcies. Bank deposits were invested in the market. When the market collapsed, the banks ran out of money. Clients panicked, attempting to withdraw their money from the banks, but there was nothing to give them. A loss of confidence in the stock market led to a reduction in the output of manufactured goods and a subsequent decline in investment in capital goods.
5. Workers were idle because firms weren’t hiring; firms weren’t hiring because they saw no market; and there was no market because workers had no money. Unemployment rose to 25%.
   1. Migrations
6. Millions of Americans were evicted from their homes and apartments because they could not pay their mortgage or rent. Hoovervilles, shantytowns of unemployed and homeless people, sprang up in most American cities.
7. During the 1930s, the Great Depression led to a mass migration of Americans looking for work.
8. African Americans continued to migrate from small Southern towns to urban centers in the North and West.
   1. Dust Bowl
9. The decline in farm prosperity in the 1920s was an important factor contributing to the Great Depression in the 1930s. Depression of the prices of agricultural products during the 1920s was an important sign of economic weakness.
10. The Farm Holiday Association called a farm strike in 1932. They urged farmers not to take their products to market in an effort to raise farm prices.
11. The picketing of markets led to violence, and the strike collapsed.
12. John Steinbeck was the author of *The Grapes of Wrath*. It describes the plight of “Okies” forced to leave Dust Bowl-stricken Oklahoma in a futile attempt to find work in California. During the Great Depression, many Mexicans returned to their homeland.
    1. Hoover’s Depression Policies
13. President Herbert Hoover and Secretary of the Treasury Andrew Mellon initially thought that the Depression was just a mild phenomenon due to the natural laws of the marketplace.
14. President Hoover believed that the economic recovery of the United States depended primarily on the business community. President Hoover approached the task of caring for unemployed workers by emphasizing the importance of private charity. Hoover staunchly opposed the use of federal funds for relief for the needy.
15. President Hoover established the Reconstruction Finance Corporation (RFC), the Federal Home Loan Act, and the Emergency Relief and Construction Act in a belated attempt to fight the Great Depression. President Hoover supported federal loans to private businesses and to state and local governments. In 1930, Congress appropriated $750 million for public buildings, river and harbor improvements, and highway construction in an effort to stimulate employment. Congress passed the Glass-Steagall Act in 1933 to impose banking reforms intended to control speculation.
16. The Hawley-Smoot Tariff of 1930 raised tariffs, thus triggering a decline in trade. Within three years, world trade declined in value by 40%.
17. Germany was permitted to delay payments on World War I debts.
18. In 1932, a ragtag “army” of World War I veterans known as the Bonus Expeditionary Force (or Bonus Army) marched on Washington, D.C. Their objective was to demand that Congress pay them a bonus, which had been promised to World War I veterans in 1926. President Hoover used force to disband the Bonus Army. The army officers responsible for the breakup of the Bonus Army included Douglas MacArthur, Dwight Eisenhower, and George Patton.
    1. Election of 1932
19. Hoover was nominated again by the Republican Party, calling for a continuation of his depression policies.
20. Franklin Roosevelt was nominated by the Democrats, proposing what he called a “New Deal” for the American people. His platform called for the repeal of Prohibition, government aid for the unemployed, and a 25% cut in government spending. Roosevelt called for bold, persistent experimentation, but did not give a clear picture of what he intended to do.
21. In addition to Roosevelt easily winning the presidency, Democrats increased their majority in the House and captured the Senate.
22. This total control of the government by the Democratic Party essentially prevented Hoover from continuing any policies in his last months as president and allowed Roosevelt the ability to pass any legislation he wanted.

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| **Causes of the Great Depression** | |
| **The Federal Reserve Management of the Economy** | * It was the policy of the Federal Reserve to promote economic growth in the twenties by keeping credit cheap. Cheap credit would allow businesses to increase investment. The supply of money remained stable (1920 there were $3.68 billion in circulation compared with $3.64 billion in 1929); available credit skyrocketed, growing from $45.3 billion in 1921 to 73 billion in 1929. The Fed combined this cheap credit with a policy of keeping interest rates artificially low (below the price that borrows and lenders would naturally agree on). |
| **Stocks were Overvalued** | * By September 1929, up to 40% of all stock value was not real. Stocks were selling for far more than the earnings of the corporations warranted. This inflation was based solely on the popular perception of individual stock traders. * Investors were trading on margin, borrowing money to buy stocks. However, the dividend yields (the profits investors earn by owning stocks) were far lower than the interest rates of the loans used to purchase the stocks. * The Federal Reserve came to fear that this speculation might cause a catastrophe so they decided to raise interest rates. Increasing the price of capital would hopefully make it more difficult to speculate on stocks. |
| **The Crash Increased Uncertainty** | * The most significant impact of the stock crash was an increase in economic uncertainty. Businesses and individuals became more conservative with their money, cutting back on spending. This drop in spending naturally sent the market lower. * Deflation reached high levels of up to 50%. Because money was now LESS expensive banks could not ensure that their loans would be repaid. Thus, it became almost impossible for businesses to invest in themselves. |
| **President Hoover’s Policies** | * Hoover decided to spend his way out of the Depression. He instituted a proto-New Deal, complete with large deficits. Congress resented this irresponsible spending and passed a huge tax increase, raising the highest rate to 63%. * He passed the Smoot-Hawley Tariff, which killed trade between Europe and America. To compete Europeans counties imposed their own tariffs. Britain went as far to revoke the Gold Standard, which made British goods cheaper than American goods. In 1933 FDR retaliated by dropping the gold standard in an attempt to make the dollar even cheaper. |
| **Banking Crisis** | * Customers began to pull their money out of US banks. In 1931-32 over 5000 US banks went bottom up. These failures completely destroyed all confidence in the economy. To shore themselves up, banks recalled their loans. To raise this capital, industries had to lay off workers and shut down production. This crisis created a cycle of ever decreasing spending. |