Causes of Great Depression

Chapter 9 Section 1
The Long Bull Market

• GUIDING QUESTION *What economic choices caused the economy to become unstable in the late 1920s?*

• Economic collapse seemed unimaginable

• President Herbert Hoover “We are nearer to the final triumph over poverty than ever before in the history of any land.”
Election of 1928

GUIDING QUESTION What economic choices caused the economy to become unstable in the late 1920s?

- Democrats chose Albert E. Smith – governor of New York
  - Roman Catholic – campaign issue
- Herbert Hoover – secretary of commerce and former head of Food Administration
- Some said Catholic Church funded Smith’s campaign
- 1920s were so prosperous – Republicans took credit for this – this helps Hoover win
Election of 1928

• GUIDING QUESTION What economic choices caused the economy to become unstable in the late 1920s?

• Hoover wins in a landslide

• “I have no fears for the future of our country... It is bright with hope” – Hoover
Stock Market Soars

- GUIDING QUESTION *What economic choices caused the economy to become unstable in the late 1920s?*
- Optimism with Hoover in office drove up stock prices
- Bull Market – rising prices
- Many wanted to invest to get rich
- 1929 – 10% of American houses owned stocks
- Before late 1929, stock prices reflected true value of stock
Stock Market Soars

• GUIDING QUESTION What economic choices caused the economy to become unstable in the late 1920s?

• Late 1920s, many investors didn’t consider the company and their earnings

• Just buying on speculation – betting the market would continue to climb
Stock Market Soars

• GUIDING QUESTION What economic choices caused the economy to become unstable in the late 1920s?

• Buying on margin – borrowing money to buy stocks
  • $1,000 could get you $10,000 in stocks
  • $9,000 was in loans

• If prices fell, to protect loans, a broker would give a margin call – demand the investors repay the loan
Stock Market Soars - Discussion

• How did speculation weaken the stock market?
• Speculation pushed prices up without regard to the actual value of a company’s profits or sales. As stocks became increasingly overvalued, the market ceased to accurately reflect their true worth.
Stock Market Crashes

- Guiding Question: How did the stock market crash trigger a chain of events that led to the Depression?
- Bull market only lasted as long as investors put new money into stock market
- Sept 1929, market peaked
- Investors figured boom was over and pulled money from market (sold stock)
- This caused prices to decline
Stock Market Crashes

- Guiding Question: How did the stock market crash trigger a chain of events that led to the Depression?
- Mon, Oct 21, 1929
- Groucho Marx awakened “You better get down here with some cash to cover your margin”
- Had to pay back money he borrowed for stocks
- Stocks were selling for much less than he paid for them
- Market was in a tailspin with people selling stocks
Stock Market Crashes

- Guiding Question: How did the stock market crash trigger a chain of events that led to the Depression?
- October 24 – Black Thursday
- Market plummeted – Marx was wiped out
- October 29 – Black Tuesday – prices took steepest dive yet
  - More than 16 million shares of stock were sold
- By November $30 billion had been lost
- This undermines the economy’s ability to overcome other weaknesses
Banks Begin to Close

- Guiding Question: How did the stock market crash trigger a chain of events that led to the Depression?
- By 1929 banks had lent billions to stock speculators
- Banks had invested depositors’ money in the stock market, hoping for high returns
- Stock market crashed, banks lost money on their investments and people who had taken loans couldn’t pay it back
- Less credit available, people couldn’t borrow money
Banks Begin to Close

• Guiding Question: How did the stock market crash trigger a chain of events that led to the Depression?

• Some banks had to close

• Government did not insure bank deposits so even if someone didn’t have money in the stock market, if the bank closed, people lost their money

• People lost confidence in the banks
Banks Begin to Close

• Guiding Question: How did the stock market crash trigger a chain of events that led to the Depression?

• Bank Run – Many depositors decide to take out their money at the same time – fearful bank will collapse

• Banks make money by making loans and collecting interest
Banks Begin to Close

Guiding Question: How did the stock market crash trigger a chain of events that led to the Depression?

- Person A deposits $1000
- Person B needs $500
- Bank loans Person B $500 from Person A’s $1000
- Do this with enough people, the bank collects interest to make money
- If everyone who had deposits want their money at the same time, the bank won’t have enough to cover their costs
Banks Begin to Close

• Guiding Question: How did the stock market crash trigger a chain of events that led to the Depression?
• 1932, one in four banks had gone out of business
Discussion Question

• How did the failure of the stock market contribute to a larger economic decline?
  A: Because people had lost so much money in the stock market, the economy became increasingly unstable. Speculators could not pay back loans, and banks themselves lost so much money in the stock market that they could not cover depositors’ withdrawals.

• Stock speculation and buying on margin made the stock market very unstable. Investors made risky investments with very little money to back them up and the stock market became overvalued.
Roots of the Great Depression

• GUIDING QUESTION *What were the underlying conditions that led to the collapse of the U.S. economy?*

• Underlying Economic Problems
  • Uneven distribution of income
  • Overproduction and underconsumption
  • High tariffs and declining exports
  • Low interest rates
Roots of the Great Depression

• GUIDING QUESTION *What were the underlying conditions that led to the collapse of the U.S. economy?*

• Uneven Distribution of Income
• Overproduction – more efficient machinery produced more
• Most Americans did not make enough to buy the goods being produced
Roots of the Great Depression

• GUIDING QUESTION *What were the underlying conditions that led to the collapse of the U.S. economy?*

• 1929 – top 5% of all American households earned 30% of the nation’s income

• 2/3 of families earned less than $2,500 a year – little disposable income
Roots of the Great Depression

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• Farmers especially did not share in the prosperity of the 1920s
• Many were in debt – WWI they were purchasing machinery to keep up with demand
• Farmers were loosing money so produced more but prices dropped even further
• Many farmers went bankrupt
Roots of the Great Depression

• GUIDING QUESTION *What were the underlying conditions that led to the collapse of the U.S. economy?*

• Installment buying – buying on credit
• Eventually people had to stop buying new products to pay off credit
• Factories had to stop making new goods (demand was low)
• Cutting production meant laying off employees
Roots of the Great Depression

• GUIDING QUESTION *What were the underlying conditions that led to the collapse of the U.S. economy?*

• Example: Radio sales slow
• So did the need for copper wire, wood cabinets, and glass radio tubes
• Put even more Americans out of work
Roots of the Great Depression

• GUIDING QUESTION *What were the underlying conditions that led to the collapse of the U.S. economy?*

• During 1920s – US was flourishing so much, quit selling as much abroad
• Many jobs could have been saved if the US exported more to overseas markets
• US made loans to speculators, not overseas as much
• Without these loans, overseas markets could not buy American goods
Roots of the Great Depression

• GUIDING QUESTION What were the underlying conditions that led to the collapse of the U.S. economy?

• 1929 US government raised tariffs – harder to trade with Europe
• Hawley-Smoot Tariff – raised tariffs; highest in history
• Did not help American businesses
• Decrease in exports hurt Americans
Roots of the Great Depression

• GUIDING QUESTION *What were the underlying conditions that led to the collapse of the U.S. economy?*

• Federal Reserve Mistakes
• When the late 1920s were booming the Reserve did not raise interest rates that would protect speculation
Roots of the Great Depression

• GUIDING QUESTION What were the underlying conditions that led to the collapse of the U.S. economy?

• Failure to raise interest rates caused the Depression

• 1. By keeping rates low, Board encouraged member banks to make risky loans

• 2. Low interest rates led business leaders to think the economy was still expanding – businesses then borrowed more money to expand production – led to overproduction and had to lay off workers
Roots of the Great Depression

• GUIDING QUESTION What were the underlying conditions that led to the collapse of the U.S. economy?

• Then the Federal Reserve raised prices – tightening credit causing the economy to keep spiraling downward
The Great Depression

**Economic Causes**
- Agricultural overproduction
- Widening gap between rich and poor
- Stock market crash due to buying stock on margin.

**Political Causes**
- Hoover follows hands-off policy towards business
- Few regulations in place over companies

**Economic Effects**
- Deflation
- Unemployment at 25%
- Drop in production

**Foreign Affairs**
- Hitler takes power in Germany in part due to hyperinflation.

**Political Effects**
- FDR elected in 1932
- New Deal programs increase govt. role in economy
What Caused the Economy to Collapse?

Low Interest Rates
Federal Reserve kept interest rates low; companies borrowed money and expanded more than necessary.

Overproduction
Companies made more goods than could be sold.

Uneven Distribution of Wealth
Not everyone who wanted consumer goods could afford them.

High Tariffs
Tariffs restricted foreign demand for American goods.

Falling Demand
With too many goods unsold, production was cut back and employees were laid off.

Stock Market Speculation
Low interest rates encouraged borrowing money to speculate, endangering bank solvency.
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Cyclical Effect

Automobile sales declined.
This loss of demand meant less demand for:

- Textiles
- Oil
- Steel
- Rubber
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Which helped contribute further to:

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Directions: Drag and drop the items below into the chart to correctly match the causes and effects of events leading to the Great Depression.

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Discussion Questions

• What conditions combined in the late 1920s to cause the Great Depression?

• Uneven distribution of income, overproduction, low exports and high tariffs, and low interest rates all worked together to help cause the Great Depression. The interconnectedness of the economy meant that all of these factors together significantly destabilized the nation’s economy.
Discussion Questions

• **Ask**: What do you think could have been done to prevent the financial crisis?

• *Stronger regulation of the lending sector; stock market regulation; open, free trade; a safety net, such as FDIC insurance; greater distribution of wealth across the population.*
Discussion Questions

- Ask: What do you think would be the correct response to such a crisis?
- *Immediate government investment in the financial sector; stronger oversight and regulation; unemployment aid to people losing their jobs; low interest loans to corporations and banks; the creation of agencies to protect and employ the American population.*
Homework

• *Profits* a financial magazine has asked you to write a short article telling the chain of events leading to the Great Depression. Be sure to sequence the events correctly to make them easy for your readers to understand. Also be sure to illustrate your article.