LESSON 1

The Causes of the Great Depression

The Wall Street crash of 1929 was such an unprecedented event that nobody knew exactly what to expect. Would the economy spring back quickly? Slowly? At all? President Hoover took to the radio to assure the American public that the damage would be limited and would pass quickly.

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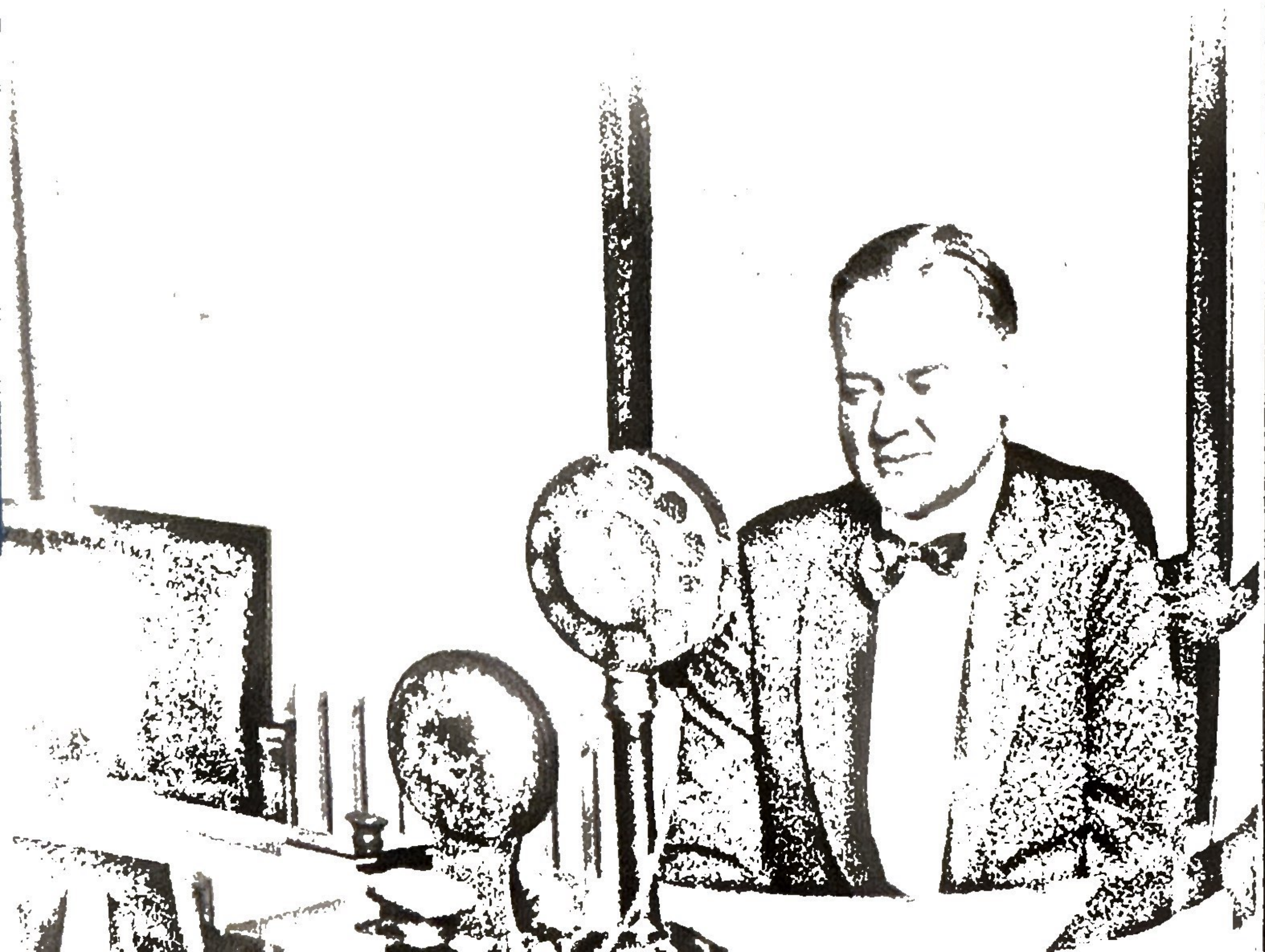
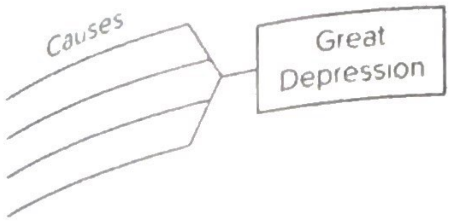
> "The sum of it is, therefore, that we have gone through a crisis in the stock market, but for the first time in history the crisis has been isolated to the stock market itself. It has not extended into either the production activities of the country or the financial fabric of the country, and for that I think we may give the major credit to the constitution of the Federal Reserve System."
>
> —Herbert Hoover, Message on the Economy, November 5, 1929

As the effects of the stock market crash rippled through the economy, however, the public realized that President Hoover was very wrong. Voters would not give him a second term in the White House.





ANALYZING KEY IDEAS AND DETAILS

ORGANIZING As you read the lesson, complete a graphic organizer similar to the one here to list the causes of the Depression.

THE LONG BULL MARKET

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

The economic **collapse** that began in 1929 seemed unimaginable months before. In the 1928 election, both presidential candidates painted a rosy picture of the future. Republican presidential nominee Herbert Hoover declared, "We are nearer to the final triumph over poverty than ever before in the history of any land."

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THE ELECTION OF 1928

For the presidential election of 1928, the Democrats chose Alfred E. Smith, governor of New York. Smith was the first Roman Catholic to win a major party's presidential nomination. He faced a tough challenger, as Herbert Hoover was secretary of commerce and former head of the Food Administration.

Smith's religious beliefs became a campaign issue. Some Protestants claimed the Catholic Church financed Smith's campaign and would have inappropriate influence on American politics. The attacks embarrassed Hoover, a Quaker, and he tried to quash them, but the charges damaged Smith's candidacy.

The prosperity of the 1920s—for which the Republicans took full credit—was a bigger challenge to Smith's candidacy. Hoover won in a landslide. On March 4, 1929, an estimated 50,000 onlookers stood in the rain to listen to Hoover's Inaugural Address. "I have no fears for the future of our country," proclaimed Hoover. "It is bright with hope."

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THE STOCK MARKET SOARS

The optimism that swept Hoover into office also drove stock prices to new highs. Sometimes the **stock market** has a long period of rising stock prices, or a bull market. The **bull market** of the 1920s convinced many to invest in stocks. By 1929, approximately 10 percent of American households owned stocks.

R2

Before the late 1920s, stock prices generally reflected their true values. In the late 1920s, however, many investors failed to consider a company's earnings and profits. Buyers engaged in **speculation**, or betting the market would continue to climb, thus enabling them to sell stock and make money quickly.

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Many investors bought stocks on **margin**, making only a small cash down payment (as low as 10 percent of the price). With $1,000, an investor could buy a **sum** of $10,000 worth of stock. The remaining $9,000 came as an interest-bearing loan from the stockbroker. Quick profits were possible as

ANALYZING KEY IDEAS AND DETAILS

1. **CITING TEXT EVIDENCE** Why did Republican Herbert Hoover win the election of 1928? What phrase or phrases in the text indicates this? ELA RH.11-12.1, ELA RI.11-12.1
2. **ANALYZING EVENTS** At what point did stock prices stop reflecting their true value? ELA RH.11-12.3, ELA RI.11-12.3

DETERMINING MEANING

Think about the characteristics of a bull. Why is the term **bull market** appropriate for a long period of rising stock prices? ELA RH.11-12.4, ELA RI.11-12.4

long as stock prices kept rising, but problems came when prices began to fall. To protect a loan, a broker could issue a **margin call**, demanding the investor repay the loan at once.

☑ CHECKING FOR UNDERSTANDING

1. **IDENTIFYING CONNECTIONS** What economic choices caused the economy to become unstable in the late 1920s? HSS HI.1
2. **DETERMINING CONTEXT** Where had each 1928 presidential candidate gained government experience? HSS HI.2
3. **UNDERSTANDING CONTEXT** What was the mood of the American people at the time of Hoover's election? HSS HI 3

THE GREAT CRASH

GUIDING QUESTION *How did the stock market crash trigger a chain of events that led to the Depression?*

ANALYZING KEY IDEAS AND DETAILS

1. **ANALYZING EVENTS** What happened when investors started selling stock instead of buying it? ELA RI 11-12 3
2. **DETERMINING MEANING** What were Black Thursday and Black Tuesday? ELA.RH 11-12 4, ELA RI 11-12 4

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The bull market lasted only as long as investors continued putting new money into it. In September 1929, the market peaked. Prices then began an uneven downward slide. As investors decided the boom was over, they sold more stock, causing prices to decline even further.

THE STOCK MARKET CRASH

On Monday, October 21, 1929, the comedian Groucho Marx was awakened by a telephone call from his broker. "You'd better get down here with some cash to cover your margin," the broker said. The stock market had plunged. The dazed comedian had to pay back the money he had borrowed to buy stocks, which were now selling for far less than he had paid for them. Other brokers made similar margin calls. Customers put stocks up for sale at a frenzied pace, driving the market into a tailspin.

THE MARKET FALLS

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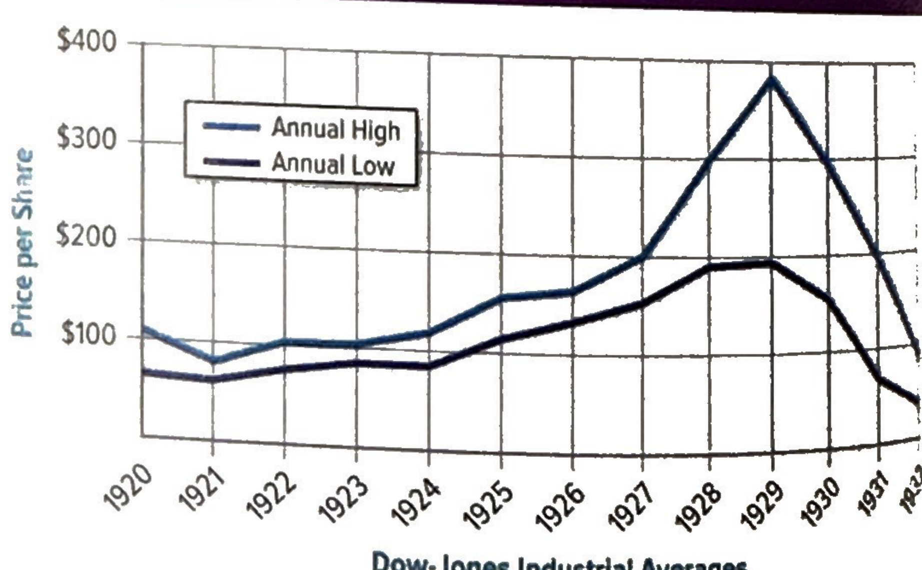
Until the crash of 1929, investors pumped money into the market, often buying stocks on margin

1. **INFERRING** What can you infer about the health of the stock market prior to 1929? HSS HI 6
2. **EVALUATING INFORMATION** How What generalization can you make about the variation in highs and lows of the stock market from 1920 to 1932? ELA.RI.11-12 7



Source: *Standard and Poor's Security Price Index Record*

Background Knowledge

On October 24, a day that came to be called Black Thursday, the market plummeted further. Marx was wiped out. His earnings from plays and films were gone, and he was deeply in debt. His son recalled his visit to the brokerage firm, as Groucho spotted his broker:

> "He was sitting in front of the now-stilled tickertape machine, with his head buried in his hands. Ticker tape was strewn around him on the floor, and the place . . . looked as if it hadn't been swept out in a week. [Groucho] tapped [him] on the shoulder, [and said] 'Aren't you the fellow who said nothing could go wrong—that we were in a world market?' 'I guess I made a mistake,' said Mr. Green. 'No, I'm the one who made a mistake,' said [Groucho]. 'I listened to you."
>
> —from *Life with Groucho*, 1954

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The following week, on October 29, a day that was later dubbed Black Tuesday, prices took the steepest dive yet. That day, more than 16 million shares of stock were sold, and the value of the industrial index (a measure of the value of leading industrial companies) dropped by 10 percent. By mid-November, the market price of stocks had dropped by more than one-third. Some $30 billion was lost, a sum roughly equal to the total wages Americans earned in 1929. Although the stock market crash was not the main cause of the Great Depression, it undermined the economy's ability to overcome other weaknesses and revealed problems with the nation's banks.

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BANKS BEGIN TO CLOSE

The market crash weakened the nation's banks in two ways. First, by 1929, banks had lent billions to stock speculators. Second, many banks had invested depositors' money in the stock market, hoping for high returns. When stock values collapsed, banks lost money on their investments, and speculators defaulted on their loans. The serious losses led banks to drastically reduce the money they were willing to loan. With less credit available, consumers and businesses were not able to borrow money, sending the economy into a recession.

ANALYZING PRIMARY SOURCES

1. **EVALUATING EVIDENCE** What is Mr. Green's relationship to Groucho? How can you tell? HSS HI 1, ELA RH 11–12.3
2. **CITING TEXT EVIDENCE** What sort of mood is Mr. Green in? How can you tell? ELA RH 11–12.1

MAKING CONNECTIONS: TECHNOLOGY

TICKER TAPE

In the earliest days of public stock trading, information was mailed or carried by messenger. That changed in 1867, when the New York Stock Exchange developed ticker tape technology. Ticker tape machines used telegraph-like methods to print stock price information on long ribbons of paper. Ticker-tape parades, in which ticker tape was showered onto Guests of Honor from surrounding buildings, became an American tradition. The first one, celebrating the dedication of the Statue of Liberty, occurred in New York City in 1886.

Some banks could not absorb the losses they suffered and had to close. The government did not insure bank deposits at the time, so if a bank failed, customers, including those who did not invest in the stock market, lost their savings. As a growing number of banks closed in 1929 and 1930, a severe crisis of confidence in the banking system further destabilized the economy.

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News of bank failures worried Americans. Some depositors made runs on banks, thus causing the banks to fail. A **bank run** takes place when many depositors decide to withdraw their money at the same time, usually out of fear that the bank will collapse. Most banks make a profit by lending money received from depositors and collecting interest on the loans. The bank keeps only a fraction of depositors' money in reserve. Usually, that reserve is enough to meet the bank's needs. If too many people withdraw their money, however, the bank will collapse. By 1932, about one in four banks in the United States had gone out of business.

☑ CHECKING FOR UNDERSTANDING

1. **EXPLAINING CAUSES** How did the stock market crash trigger a chain of events that led to the Great Depression? HSS HI 2
2. **SUMMARIZING** What happened to investors' deposits when banks closed? HSS HI 3
3. **EXPLAINING CAUSE AND EFFECT** Why did bank runs result in bank closures? HSS HI 2

THE ROOTS OF THE GREAT DEPRESSION

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

INTEGRATING KNOWLEDGE AND IDEAS

1. **INTEGRATING INFORMATION** How did industrial mechanization and mass production contribute to the Great Depression? ELA.RI.11-12.7
2. **EVALUATING INFORMATION** How did installment buying make things worse for families with low incomes? ELA.RI.11-12.7

The stock market crash played a major role in putting the economy into a recession. Yet the crash would not have led to a long-lasting depression if other forces had not been at work. The roots of the Great Depression were deeply entangled in the economy of the 1920s.

THE UNEVEN DISTRIBUTION OF INCOME

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One of the factors that lead to the Great Depression was overproduction. More efficient machinery increased the production capacity of factories and farms. Most Americans did not earn enough to consume the quantities of goods they helped produce. Manufacturing output per person-hour rose 32 percent, but the average worker's wage increased only 8 percent. In 1929, the top 5 percent of all American households earned 30 percent of the nation's income. In contrast, about two-thirds of families earned less than $2,500 a year, leaving them with little disposable income.

Farmers, in particular, did not share in the prosperity of the 1920s. Many had gone into debt to buy land or equipment during World War I, when demand for their products was high. When prices fell, they tried to produce even more to pay their debts, taxes, and living expenses. The extra they produced helped drive prices so low that many farmers went bankrupt and lost their farms.

What Caused the Economy to Collapse?

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

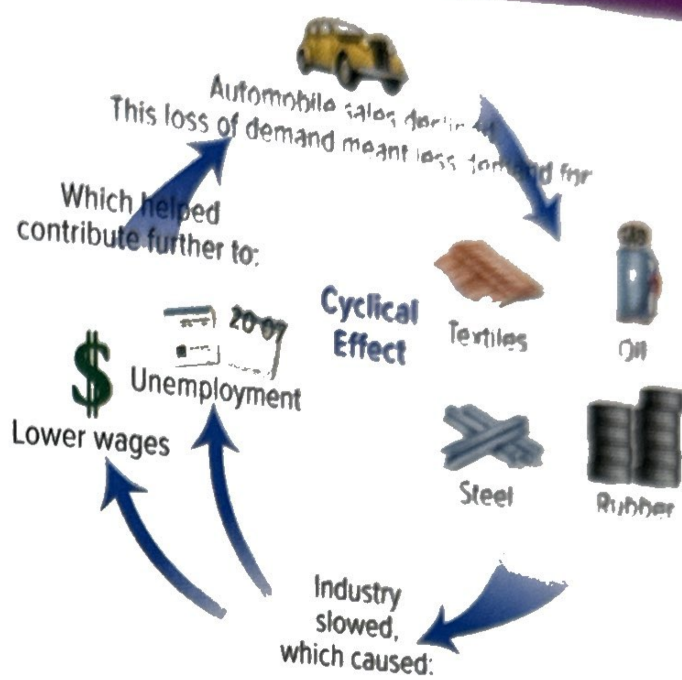
Overproduction
Companies made more goods than could be sold.

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.



1. **IDENTIFYING CENTRAL IDEAS** What basic economic principle underlay the cause of the Great Depression? ELA.RH.11-12.2, ELA.RI.11-12.2

2. **ANALYZING EVENTS** What effect did the decline in automobile sales have on related industries? ELA.RI.11-12 3

During the 1920s, many Americans had purchased high-cost items, such as refrigerators and cars, on the **installment** plan. Purchasers could make small down payments and pay the remainder of the item's price in monthly installments. The accumulation of those debts, and their corresponding monthly payments, eventually forced some buyers to stop making new purchases. As demand for their products decreased, manufacturers cut production and laid off employees.

The slowdown in retail sales reverberated throughout the economy. When radio sales slumped, orders for copper wire, wood cabinets, and glass radio tubes slowed. Montana copper miners, Minnesota lumberjacks, and Ohio glassworkers lost jobs. Jobless workers had to cut back on purchases, further reducing sales. This put even more Americans out of work. At the time, there was no unemployment insurance. Many families had little or no savings, and lost jobs often meant dire circumstances. In 1930 alone, about 26,000 businesses failed.

DETERMINING MEANING

One meaning of the word *install* is "to put into place." Explain the meaning of the word **installment** using that definition. ELA.RH.11-12.4

THE LOSS OF EXPORT SALES

Many jobs might have been saved if American manufacturers had sold more goods abroad. As the bull market of the 1920s sped up, however, U.S. banks made loans to speculators rather than loans to foreign companies. Previously, loans from U.S. banks had helped European nations make war reparations and pay down war debts. Loans had also secured foreign markets for U.S. exports. Without these loans from U.S. banks, foreign companies purchased fewer American products.

In 1929, Hoover wanted to encourage overseas trade by lowering tariffs. Congress, however, decided to protect American industry from foreign competition by raising tariffs. The resulting legislation, the Hawley-Smoot Tariff, raised the average tariff rate to the highest level in American history. In the end, it failed to help American businesses because foreign countries responded by raising their own tariffs. This meant fewer American products were sold overseas. By 1932, exports had fallen to less than half the levels that they had been in 1929. A decrease in exports hurt both American companies and farmers.

MISTAKES BY THE FEDERAL RESERVE

In the 1920s, easy access to credit had helped consumers to buy more goods on credit. Access to easy money also propelled the stock market. Instead of raising interest rates to curb excessive speculation, the Federal Reserve Board kept its rates low throughout the 1920s.

The Board's failure to significantly raise interest rates helped cause the Depression in two ways. First, by keeping rates low, the Board encouraged member banks to make risky loans. Second, the low interest rates led business leaders to think that the economy was still expanding. As a result, they borrowed more money to expand production. This led to overproduction when sales were falling. When the Depression finally hit, companies had to lay off workers to cut costs. Then the Federal Reserve made another mistake: it raised interest rates, thus tightening credit. The economy continued to spiral downward.

☑ CHECKING FOR UNDERSTANDING

1. **INTERPRETING** What were the underlying conditions that led to the collapse of the U.S. economy? HSS HI 3
2. **ANALYZING CHANGE** How did farmers respond when prices for their output dropped? HSS CS 2
3. **UNDERSTANDING CHANGE** How did factories respond when demand for their output dropped? HSS CS 2

Time and Place

1. **INTERPRETING** Why did 10 percent of Americans own stock by the late 1920s? HSS HI 3

Building History-Social Science Analysis Skills

2. **EXPLAINING CAUSES** Name a specific cause of the Great Depression, and explain its contribution. HSS HI 2
3. **EXPLAINING CAUSE AND EFFECT** Why was it risky to speculate on stocks? HSS HI 2
4. **CITING TEXT EVIDENCE** What happens during a bank run? ELA.RI.11-12.1

Writing About History

5. **NARRATIVE WRITING** Write a narrative essay about conditions during the period leading up to the Great Depression. Be sure to sequence the events correctly to make them easier for readers to understand. ELA.WHST.11-12.4, ELA.W.11-12.3, ELA.W.11-12.4

Collaborating

6. **COLLABORATING** As a group, write a short skit about time travelers who travel back in time to attend a session of Congress in 1925. The purpose of their visit is to advise the government of the actions it can take to avert the Great Depression. Conduct research to help craft convincing arguments. ELA.SL.11-12.1 ELA.SL.11-12.2