The Economics of the Great Depression

Mr. Brink

United States History

12.1

Optimism Sweeps Hoover to Victory

- Why popular?
  - 1.
  - 2.
  - 3.

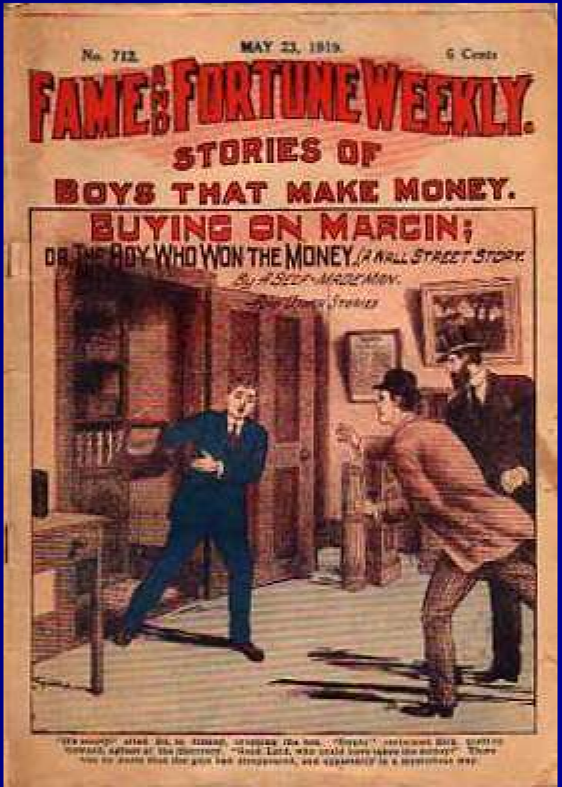
What is a Depression?

- A severe economic downturn.
  - High Unemployment
  - Low GNP (Gross National Product).

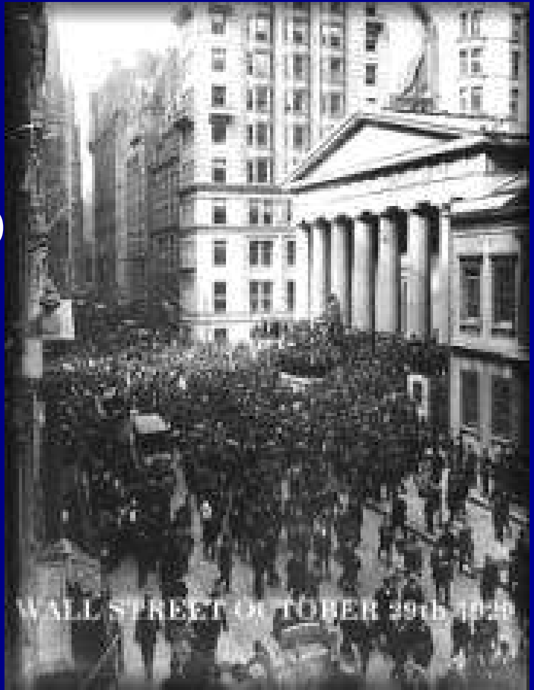
What is GNP?

- Gross National Product is a measurement of the total value of goods and services produced by a nation.

- The stock market: the public invests in cos. by purchasing stocks; in return for this they expect a profit
- b/c of booming 1920's economy, $ were plentiful, so banks were quick to make loans to investors
- also investors only had to pay for 10% of the stock's actual value at time of purchase
  - this was known as **BUYING ON MARGIN**, and the balance was paid at a later date

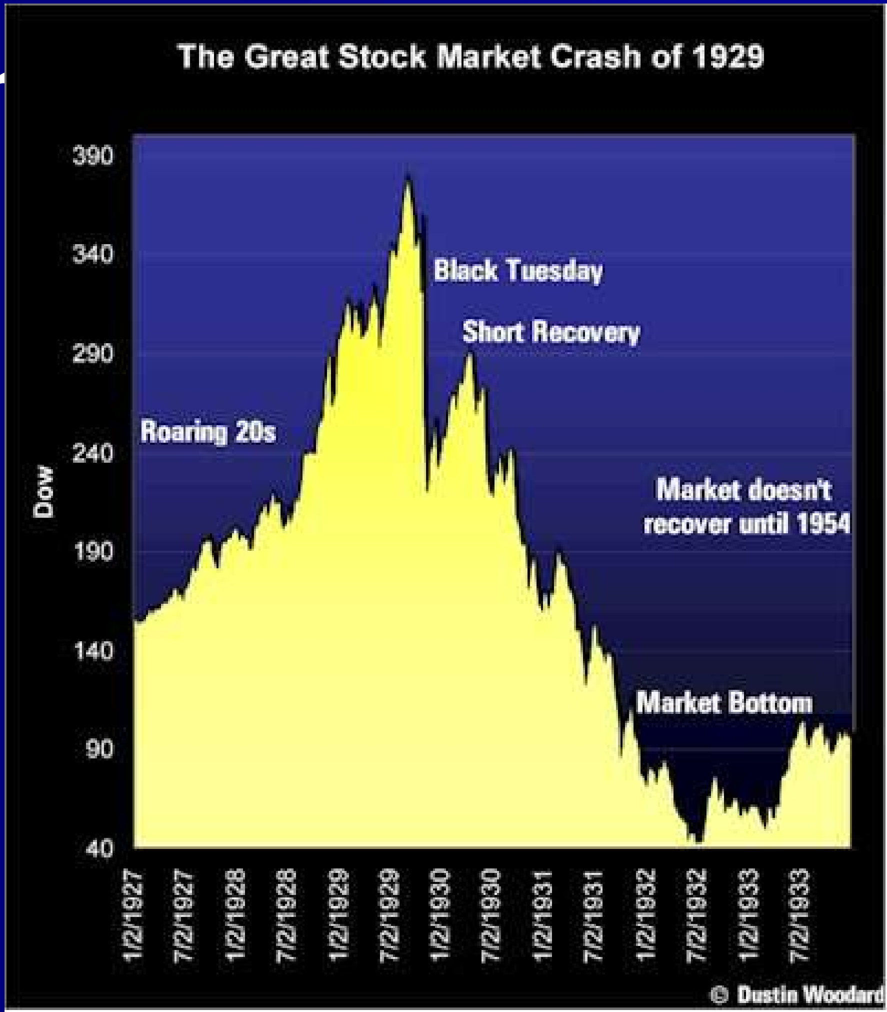


- this encouraged **STOCK SPECULATION** - people would buy and sell stocks quickly to make a quick buck
- b/c of all this buying & selling, stock value increased (Ex: G.E stock \$130 → \$396/share)
- this quick turnover didn't aid cos. → they needed long term investments so they could pay bills (stock value was like an illusion)
- unscrupulous traders would buy and sell shares intentionally to inflate a given co.'s stock value
- all of this gave a false sense of security/confidence in the American market



Stock Market Crash

- 1920's had been a period of good economic times
- Tues. Oct. 29th, 1929 - NYC Stock market crashed, causing a depression th[...] would last until 1942



The Reality of the Great Depression

- Hundreds of banks close which wipes out billions in savings.
- In 1933
  - 364,000 farms went bankrupt
  - GNP had decreased by 40%.
  - Unemployment Rate = 25%

Cause #1: Stock Market Crash

- Many investors were buying on margin
  - Paying for only part of the stock and borrowing the rest from the stockbroker.
  - If the stock goes up, you make $ and can pay back the loan.
  - But if the stock goes down you will lose $ and may not be able to pay back the loan.
- Also called speculation.

Cause #1: Stock Market Crash

- As more speculators entered the market, stocks became over-valued.
- When the economy slowed, big investors started to pull their money out of the market.
- This caused a panic (a sudden massive sell off of stocks).

Cause #1: Stock Market Crash

- On Black Tuesday (October 29, 1929), the Dow fell by 40% and $30 billion was lost.
- Many investors went bankrupt.
  - Some committed suicide.
- This is the official start of the Great Depression.

The Big Crash

BROOKLYN DAILY EAGLE

And Complete Long Island News

LATE NEWS

WALL ST. IN PANIC AS STOCKS CRASH

Attempt Made to Kill Italy's Crown Prince

ASSASSIN CAUGHT IN BRUSSELS MOB; PRINCE UNHURT

Hollywood Fire Destroys Films Worth Millions

FEAR 10 PERISHED IN LAKE MICHIGAN; FERRY IS MISSING

PIECE OF PLANE LIKE DITEMAN'S IS FOUND AT SEA

High Duty Group Gave $700,000 to Coolidge Drive

CARNEGIE CHARGE OF PAID ATHLETES ROUSES COLLEGES

HOOVER'S TRAIN HALTED BY AUTO PLACED ON RAILS

MURDER SOUGHT TO KEEP SEA TRIP SECRET, AID SAYS

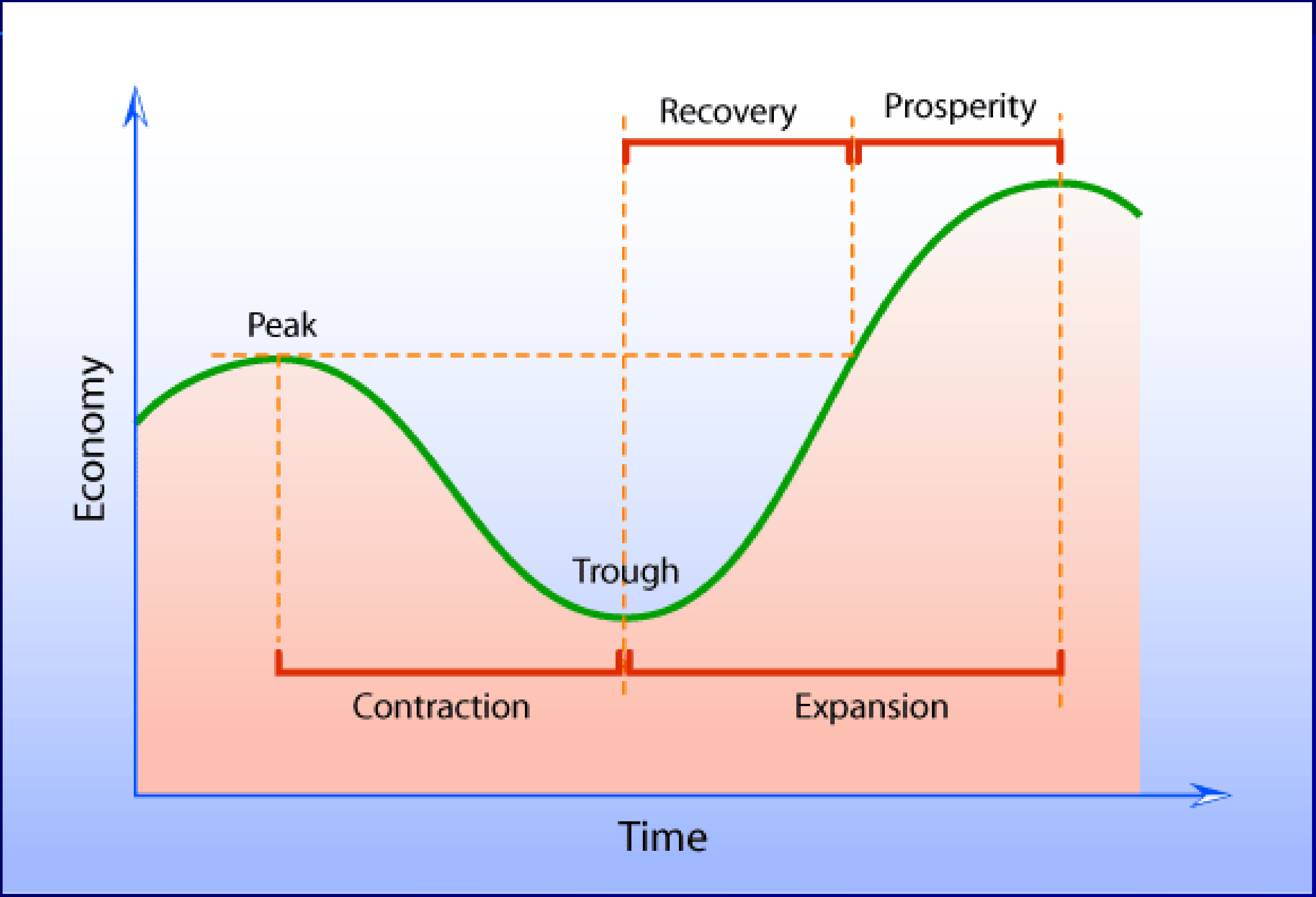
SIMMONS NAMED AS HEAD OF NEW EXCHANGE BANK

- beginning in Oct. 1929, investors' confidence dropped, leading to a market collapse
- all tried to sell at once and bottom fell out of market = **panic selling**... (many bankruptcies as banks called in loans)
- only a tiny minority of people traded on the stock exchange, but they possessed vast wealth, and the crash had a **ripple effect** on the economy

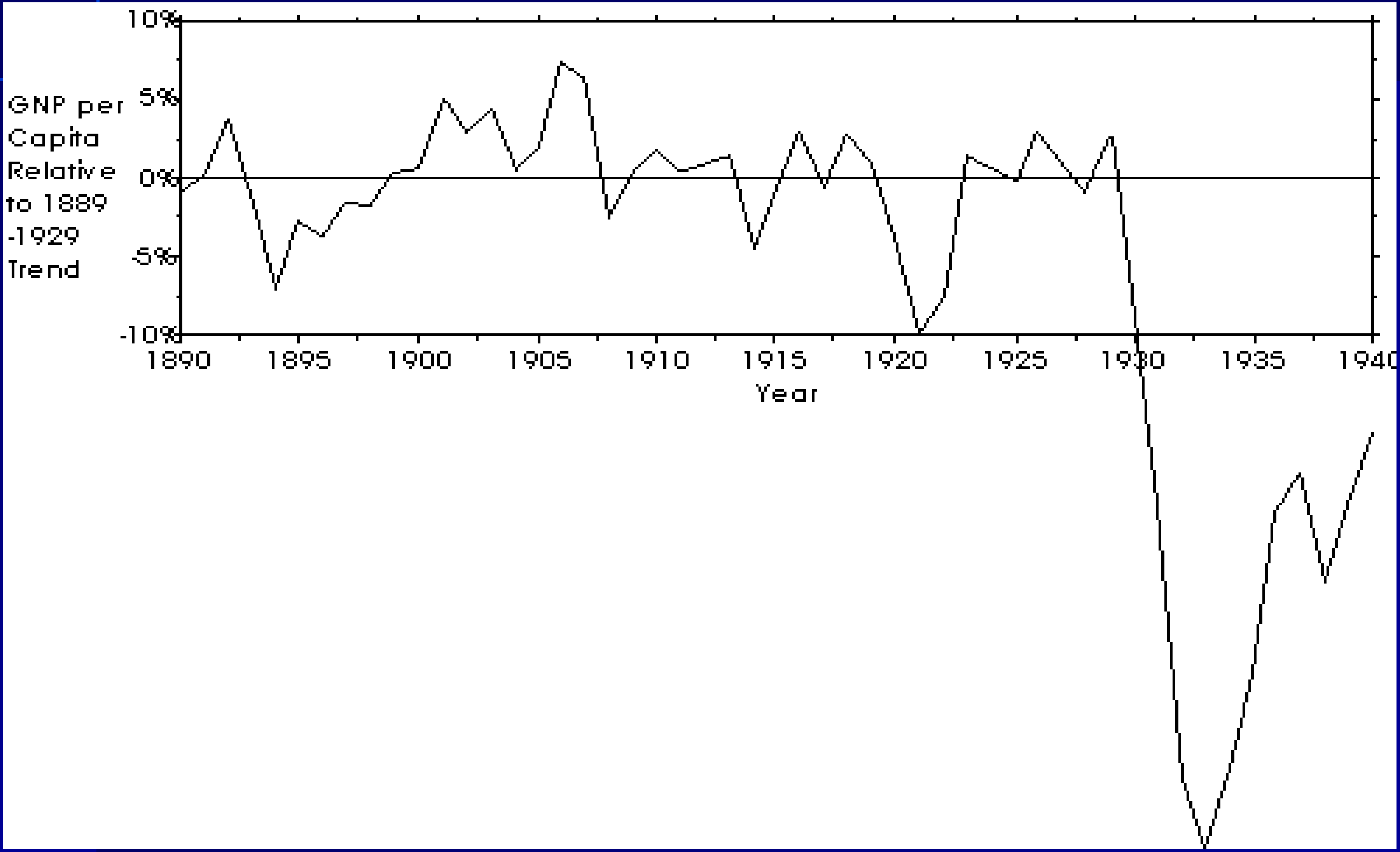
Cause #2: Economic Overconfidence

- Business Cycle: periodic regular up and down movement in the economy.

The Business Cycle



Great Depression Business Cycle



Cause #2: Economic Overconfidence

- The government and individuals defied the business cycle in the 1920s – many thought the economy would continue to go up.

Cause #3: Wealth Distribution

- In 1929,
  - The top 5% of the U.S. received 70% of the nation's income.
  - Thus, little money trickled-down to the common laborers in the form of higher wages or lower prices for products.

Cause #3: Wealth Distribution

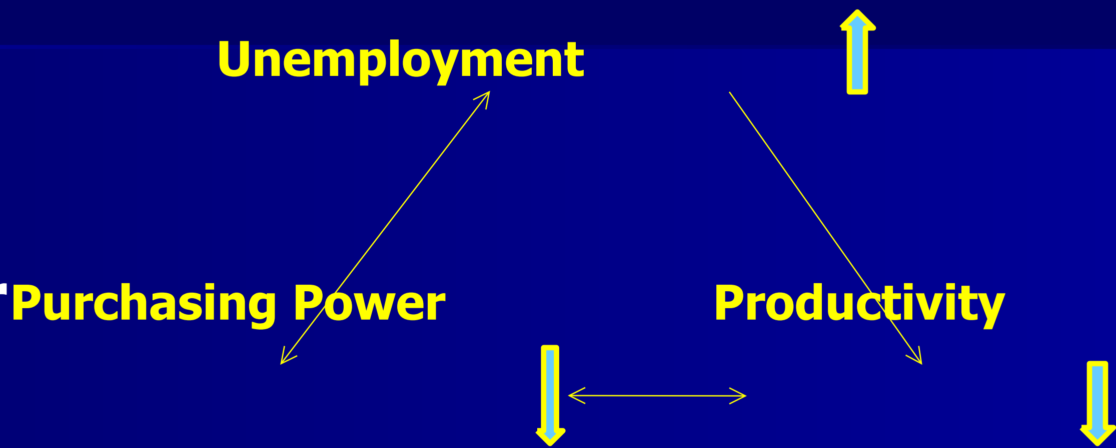
- The rich can only buy so many cars, houses, etc.
- Lower consumer spending led to less need for labor.
- The rich put their excess money into the stock market, causing overvaluation.

Cause #4: Credit Spending

- Too many consumers were buying products on credit.
- As bankruptcies rose, fewer businesses extended credit.
- This led to less consumer spending = fewer products bought = fewer jobs.

Unemployment

For the poor…….
mass consumption was already low (poor could afford to buy little)
unemployment rose → no gov't assistance at first
since people could not buy, productivity was cut back = further unemp.
so w/ additional unemployment → purchasing power declined again → reduced productivity yet again (= **ECONOMIC CYCLE**)



Cause #5: Industrial Overproduction

- Products such as cars and ovens are durable goods (they last a long time).
- As factories started to have a surplus of products, they started to lay off workers.

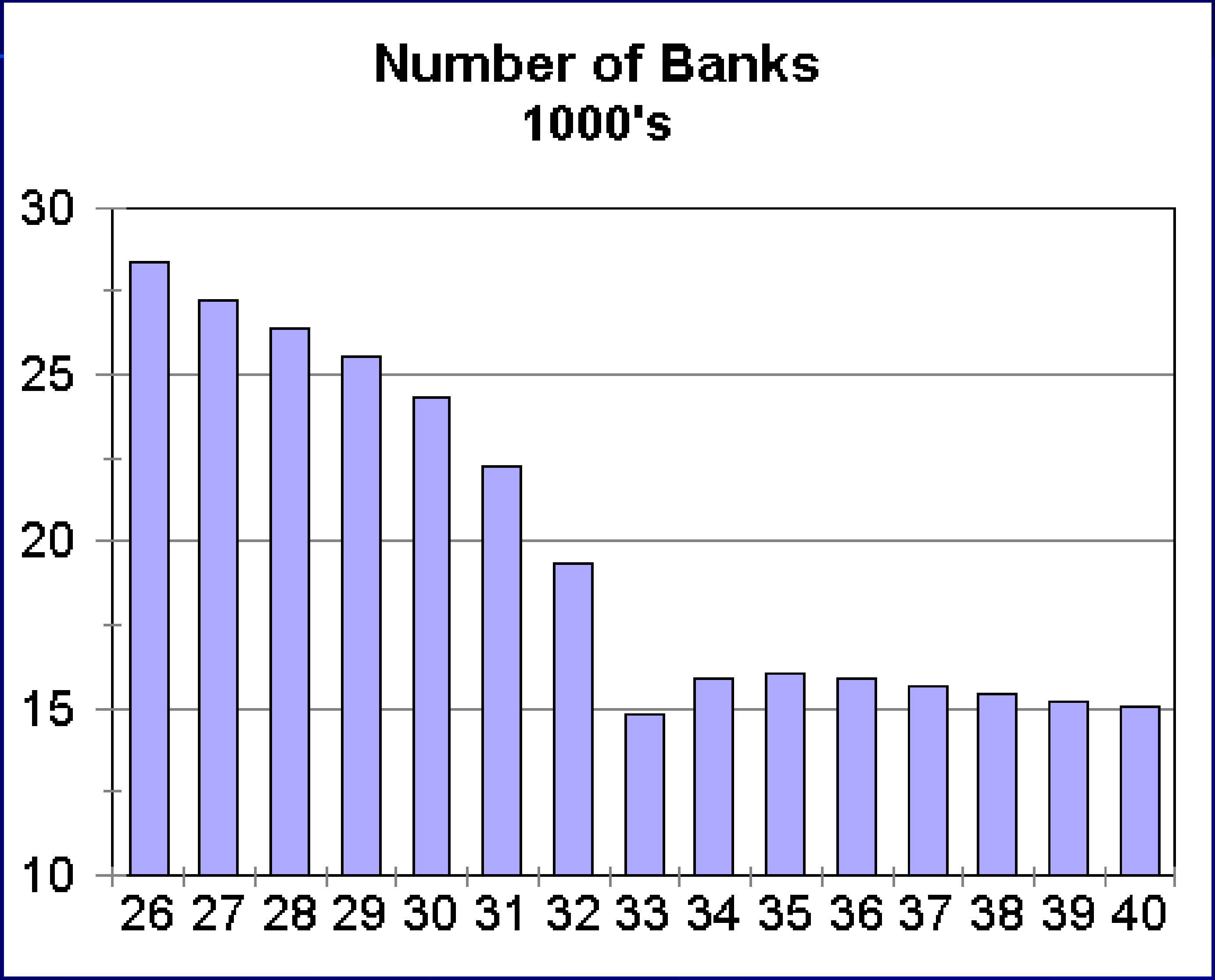
Cause #6: Agricultural Overproduction

- Farmers had huge surpluses of crops, and they would take a loss if they sold them on the private market.
- Government (laissez-faire) would not buy their surplus crops.
- Farmers lost huge amounts of money and some even burned their crops in protest.

Cause #7: Bank Failures

- Banks make money by loaning out the money of their depositors.
- Banks were making risky investments as well (stock market).
- Bank Runs – panicked investors try to withdraw their money from banks, but the banks do not have enough money left.

Bank Failures

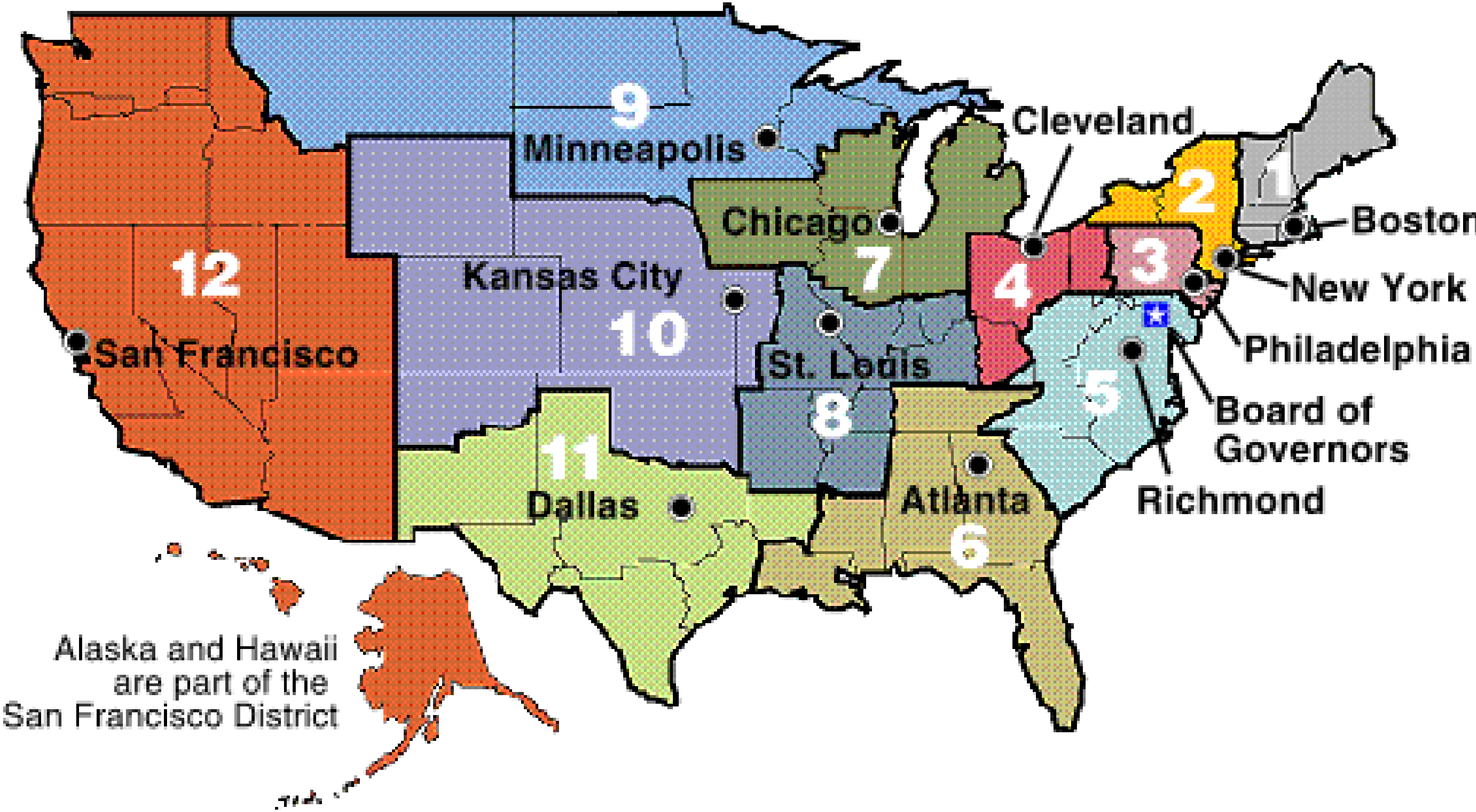


A Depression Era Bank Run

Cause #8: Federal Reserve

- The Federal Reserve is the Central Bank of the United States.
- It is an independent government agency
  - Its chairman is appointed by the President.

Cause #8: Federal Reserve



Federal Reserve Cleveland

Cause #8: Federal Reserve

- Federal Reserve Monetary Policy:
  - Reserve Requirement – the amount of money banks must keep in reserve to satisfy withdrawals (not lend out).
    - Member banks could not satisfy the withdrawal needs of bank runs.

Cause #8: Federal Reserve

- Federal Reserve Monetary Policy:
  - Discount Rate: the amount of interest the Fed charges banks for borrowing money from them.
    - Influences interest rates for other loans across the nation.
    - In the early 1930s, the Fed would not adjust the discount rate and allowed banks to fail in mass.

Hawley-Smoot Tariff

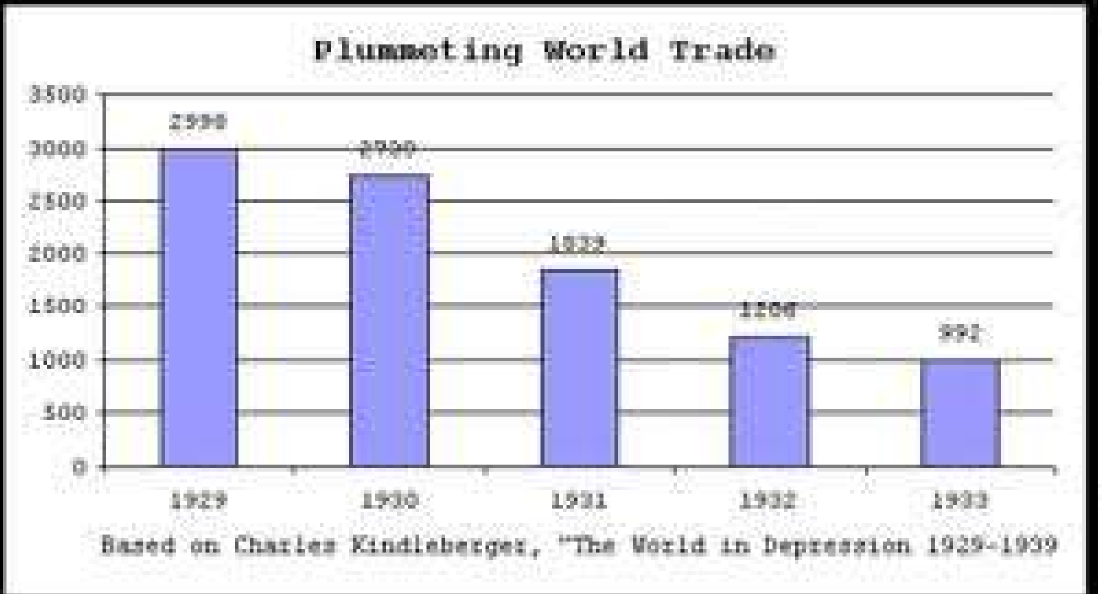


Table 1

Tariff Rates on Selected Articles, 1921 and 1930

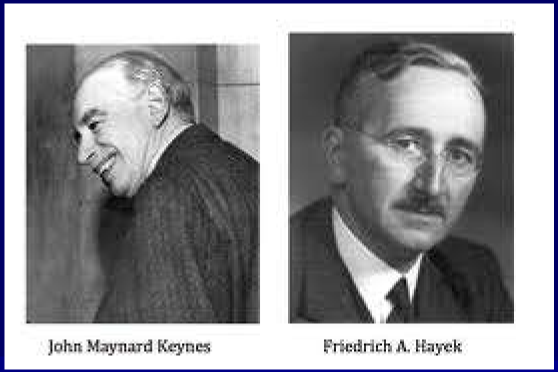
Article	1921	1930
Raw sugar	1.206¢/lb.	2.5¢/lb.
Cattle	Free	3¢/lb.
Milk	Free	6.5¢/gal.
Cream	Free	56.6¢/gal.
Butter	2½¢/lb.	14¢/lb.
Wheat	Free	42¢/bu.
Oats	6¢/bu.	16¢/bu.
Lemons	½¢/lb.	2.5¢/lb.
Pig iron	Free	$1.125/ton
Manganese ore	Free	1¢/lb.
Tungsten ore	Free	50¢/lb.
Cotton	Free	7¢/lb.
Wool	Free	34¢/lb.

Source: Abraham Berglund, "The Tariff Act of 1930," *American Economic Review* 20 (September 1930): 472.

Effects of the Crash

- Individuals
- Banks
- Business
- Overseas

Economists



John M. Keynes

more government control

Deficit spending

Hayek