Lesson 1  The Causes of the Great Depression

ESSENTIAL QUESTION
What causes changes in the economy over time?
How do depressions affect societies?

Reading HELPDESK

Content Vocabulary
stock market  a system for buying and selling stocks in corporations
bull market  a long period of rising stock prices
margin  buying a stock by paying only a fraction of the stock price and borrowing the rest
margin call  demand by a broker that investors pay back loans made for stocks purchased on margin
speculation  act of buying stocks at great risk with the anticipation that the prices will rise
bank run  persistent and heavy demands by a bank’s depositors, creditors, or customers to withdraw money
installment  monthly plan made to pay off the cost of an item when buying it on credit

Academic Vocabulary
collapse  a sudden loss of force, value, or effect
invest  to put money into a company in order to gain a future financial reward
sum  a specified amount of money
The Great Depression Begins, 1929-1932

TAKING NOTES: Organizing

ACTIVITY Use the following graphic organizer to list the causes of the Great Depression.

IT MATTERS BECAUSE...
The 1920s were good times for the economy. However, risky stock market and lending practices began causing problems. So did overproduction and uneven income distribution. These problems helped cause the Great 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 impossible months before. In the 1928 election, presidential candidates said that the future looked good. Republican presidential nominee Herbert Hoover said the United States was closer to ending poverty than any other country in history.

The Election of 1928

For the election of 1928, the Democrats chose Alfred E. Smith, governor of New York. It was the first time a major political party chose a Roman Catholic to run for president. The Republicans chose Herbert Hoover, the secretary of commerce. He had also been head of the Food Administration. That made him tough competition for Smith.

Smith’s religious beliefs became a campaign issue. Some Protestants claimed the Catholic Church financed Smith’s campaign. They said the church would have inappropriate influence in the United States if Smith became president. The attacks embarrassed Hoover, who was a Quaker. He tried to stop them, but they still hurt Smith’s candidacy.

The prosperity of the 1920s was a bigger challenge for Smith. The Republicans took credit for the good economic times. Hoover easily won the election and became president. He told the nation that he had no fears about the future, saying that it looked very hopeful.

The Stock Market Soars

The hopeful feelings that made many Americans vote for Hoover also made stock prices rise. Sometimes the stock market has a long period of rising stock prices, or a bull market. The bull market of the 1920s convinced many people to invest in stocks. By 1929 about 10 percent of American households owned stocks.
Before the late 1920s, stock prices generally reflected their true values. Stocks sold for about the amount of money they were worth. In the late 1920s, that changed. Many buyers did not look carefully at a company’s earnings and profits. Buyers practiced **speculation**, or betting that prices would keep rising. Rising prices meant that buyers could sell stock and make money quickly.

Many buyers bought stocks on **margin**, making only a small cash down payment. This payment could be as low as 10 percent of the price. With $1,000, an investor could buy a **sum** of $10,000 worth of stock. The stockbroker loaned the other $9,000 to the buyer and charged interest. A stockbroker is a person in the business of buying and selling stocks for other people. Quick profits were possible if stock prices kept rising. 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.

**PROGRESS CHECK**

**Summarizing** What investment decisions destabilized the economy during the 1920s?

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The Great Crash

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

The bull market lasted only as long as investors kept putting new money into it. In September 1929, the market went as high as it would go. Prices began an uneven drop. Investors decided the bull market was over, so they sold more stock, causing prices to drop even more.

**The Stock Market Crash**

On Monday, October 21, 1929, the stock market dropped greatly. As stock prices dropped lower and lower, stockbrokers began to make margin calls. Many stockowners had to pay back the money they had borrowed to buy their stocks. But the stocks were now selling for much less than the owners had paid for them. Many customers rushed to sell their stocks, making the market drop even more.

On Thursday, October 24, the market dropped still more. The situation was so bad that people called the day Black Thursday. The next week was even worse for the stock market. Prices dropped to their lowest point yet on October 29, or Black Tuesday, when more than 16 million shares of stock were sold. The value of the industrial index—the measure of the value of leading industrial companies—dropped 10 percent. By mid-November, the market price of stocks had dropped by more than one-third. The total lost was about $30 billion, or about as much as total wages that Americans earned in 1929. Although the stock market crash was not the main cause of the Depression, it made it harder for the economy to overcome other problems.
The Great Depression Begins, 1929-1932

Banks Begin to Close
The market crash hurt U.S. banks in two ways. First, by 1929, banks had lent billions of dollars to stock speculators. Second, many banks had invested their depositors’ money in the stock market. The banks hoped to earn a lot of money on the investments when stock prices rose, but stock values dropped instead. When that happened, speculators could not repay their loans, and banks lost money on their investments. In response, banks greatly reduced the number of loans they made. People and businesses found it harder to borrow money, causing the economy to enter a recession.

Some banks failed, or went out of business. At that time, the government did not insure bank deposits. If a bank failed, customers lost the money they had deposited, or put into their accounts. As more banks closed in 1929 and 1930, more people stopped trusting the banking system. That hurt the economy even more.

News of bank failures worried Americans. Some depositors made runs on banks. A bank run happens when many depositors decide to take their money out of the bank at about the same time. Runs usually happen when people are afraid the bank may have to go out of business. Most banks make a profit by lending money received from depositors and collecting interest on the loans. The bank keeps only a small part of depositors’ money on hand, in reserve. Usually, that reserve is enough to meet the bank’s needs. But it may not be enough if a lot of people unexpectedly withdraw their money at the same time. When that happens, a bank may fail. By 1932 about one in four U.S. banks had gone out of business.

PROGRESS CHECK
Determining Cause and Effect How did the failure of the stock market contribute to a larger economic decline?

The Roots of the Great Depression
GUIDING QUESTION What were the underlying conditions that led to the collapse of the U.S. economy?

The stock market crash helped cause a recession. But the crash alone did not cause the long-lasting Great Depression. Other situations added to the economic problem. The roots of the Great Depression went deep into the economy of the 1920s.

The Uneven Distribution of Income
Overproduction helped lead to the start of the Great Depression. By using more and better machines, factories and farms produced more. Yet most Americans did not earn enough money to buy all the goods they helped produce. Manufacturing output per person-hour rose 32 percent. At the same time, the average worker’s salary rose 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. After paying their bills, those families did not have much money left to spend on other things.

Farmers, in particular, had a hard time. Many had gone into debt to buy land or equipment during World War I. At that time, the demand for their products was high. When prices fell, farmers tried to produce even more to pay their debts, taxes, and living expenses. Prices dropped so low that many farmers went bankrupt. This caused them to lose their farms.

During the 1920s, many Americans had bought high-cost items, such as refrigerators and cars, on the installment plan. Buyers could make small down payments. The buyers then paid the rest of the item’s price in monthly installments, or payments. Over time, paying such debts made some buyers unable to afford new things. The demand for products then went down. Manufacturers responded by cutting production and laying off workers.

The slowdown in store sales affected other parts of the economy. When radio sales dropped, for example, orders for copper wire, wood cabinets, and glass radio tubes slowed. Montana copper miners, Minnesota lumberjacks, and Ohio glassworkers lost jobs. People who had lost their jobs bought fewer things. Therefore, sales went down even more. This put even more Americans out of work. Unemployment insurance did not exist, and many families had little or no savings. As a result, lost jobs often meant very hard times. In 1930 alone, about 26,000 businesses failed.

The Loss of Export Sales
Many jobs might have been saved if American manufacturers had sold more goods in other countries. During the bull market of the 1920s, however, U.S. banks made loans to speculators. They did this instead of making loans to foreign companies. Loans from U.S. banks had helped European nations make war reparations. War reparations are payments made by nations for losses caused by war. Loans also helped pay war debts. Loans had also helped the United States sell goods in foreign markets. Without these loans from U.S. banks, foreign companies bought fewer American products.

In 1929 Hoover wanted to encourage trade with other countries by lowering tariffs. Congress did not want lower tariffs, however. It decided to protect American industry from foreign competition. To do this, it passed the Hawley-Smoot Tariff. It raised the average tariff rate to the highest level in U.S. history. In the end, higher tariffs did not help American businesses. Foreign countries raised their own tariffs in response to higher U.S. tariff rates. The result was that fewer American products were sold overseas. By 1932 exports had fallen to less than half the level that they had been in 1929. Fewer exports hurt U.S. companies and farmers.

Mistakes by the Federal Reserve
Just as consumers were able to buy more goods on credit, access to easy money helped the stock market grow. Instead of raising interest rates to discourage heavy speculation, the Federal Reserve Board kept interest rates very low throughout most of the 1920s.

The Board’s failure to raise interest rates was an important cause of the Depression for two reasons. 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 growing. As a result, they borrowed more money to expand production. This was a serious mistake because it led to overproduction when sales were falling. When the Depression finally began, companies had to lay off workers to cut costs. Then the Federal Reserve made another mistake. It raised interest rates, which made it harder for people to get loans. The economy continued to get worse.

☑ PROGRESS CHECK

**Determining Cause and Effect** What were three existing economic conditions that contributed to the Depression?

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