SECTION 1

◄ An affluent middle-class family, 1925

▲ Stock ticker tape

WITNESS HISTORY AUDIO

Stock Market Prosperity

As the 1920s roared along, millions of Americans poured their savings into the soaring "bull" market. Excited investors bought and sold stocks based on "tips" from friends or brokers. Many investors amassed huge fortunes on the strength of rising stock prices. Families who had to scrimp and save at the beginning of the decade found themselves fabulously wealthy by its end. In 1929, a prominent magazine printed a poem that captured the essence of America's market fever:

> "Oh, hush thee, my babe, granny's bought some more shares,
> Daddy's gone out to play with the bulls and the bears,
> Mother's buying on tips and she simply can't lose,
> And baby shall have some expensive new shoes!"
>
> —*The Saturday Evening Post,* 1929

Causes of the Depression

Objectives

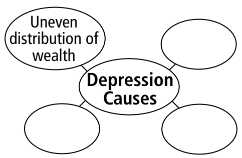
- Discuss the weaknesses in the economy of the 1920s.
- Explain how the stock market crash contributed to the coming of the Great Depression.
- Describe how the Depression spread overseas.

Terms and People

Herbert Hoover	business cycle
speculation	Great Depression
Black Tuesday	Hawley-Smoot Tariff

NoteTaking

Reading Skill: Recognize Multiple Causes Identify the causes of the Great Depression.



Why It Matters During the Roaring Twenties, many Americans enjoyed what seemed like an endless era of prosperity. Then, in October 1929, the mighty bull market crashed. As production fell and unemployment rose, the U.S. economy lurched into a period of dramatic decline. Years after the Great Depression began, many Americans came to see this contraction as a regular feature of the nation's business cycle. **Section Focus Question: How did the prosperity of the 1920s give way to the Great Depression?**

Prosperity Hides Troubles

In 1928, Republican leaders exuded confidence about both their party and their country. The Roaring Twenties had been a Republican decade. In 1920, Americans sent Warren G. Harding to the White House, and four years after that they sent Calvin Coolidge. Neither election had been close.

Once in office, both Presidents watched the country grow increasingly prosperous. As the decade passed, consumption went up, the gross national product went up, and the stock market went up. No matter what index an economist chose to consult, the conclusion was always the same: Times were good in America—and they were getting better. Republicans took credit for the bullish economy, and Americans heartily agreed.

Optimism Sweeps Hoover to Victory When the Republicans met at their 1928 nominating convention, they chose **Herbert Hoover**—an accomplished public servant—to run for the White House. Born in Iowa, Hoover was orphaned as a child. But he overcame this personal tragedy and eventually graduated from Stanford University with a degree in geology. He became a mining engineer and worked all over the world. By 1914, after amassing a vast fortune, he retired from engineering and devoted himself to public service.

Herbert Hoover came to the attention of Americans during World War I, first as the brilliant coordinator of the Belgium relief program and then as head of the Food Administration. During the Harding and Coolidge administrations, Hoover served as Secretary of Commerce. His philosophy was simple but effective. He stressed the importance of competition, but he also believed in voluntary cooperation between labor and management. American greatness showed itself, Hoover maintained, when owners, workers, and government officials converged on common goals.

Vocabulary Builder
converge–(kuhn VERJ) *v.* to move or be directed toward the same purpose or result

With a solid record of accomplishments behind him and seemingly endless prosperity in front of him, Hoover was a formidable presidential candidate in 1928. While his campaign ads noted how Republicans had "put the proverbial 'chicken in every pot,'" Hoover spoke glowingly of ending poverty in America:

Primary Source "By adherence to the principles of decentralized self-government, ordered liberty, equal opportunity, and freedom to the individual, our American experiment in human welfare has yielded a degree of well-being unparalleled in all the world. It has come nearer to the abolition of poverty, to the abolition of fear of want, than humanity has ever reached before."

—Herbert Hoover, campaign speech, 1928

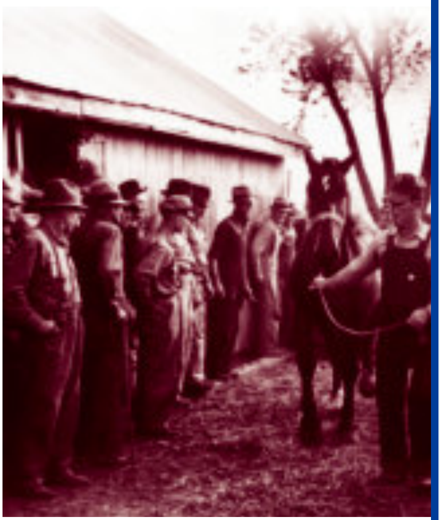
Hoover's contest with Democratic nominee Alfred E. Smith of New York was, in the end, no contest at all. Americans voted overwhelmingly for Hoover, prosperity, and the continuation of Republican government. When the new President took office in March 1929, America was awash in a sea of confidence. Few imagined that an economic disaster lay just seven months in the future.

But even as Hoover delivered his victory speeches, economic troubles were beginning to worry some Americans. The prosperity of the 1920s was not as deep or as sturdy as Hoover claimed. Throughout the U.S. economy, there were troubling signs.

Problems Plague the Agricultural Sector American farmers faced difficult times during the 1920s. Farmers made up one fourth of the American workforce during the decade. To meet the unprecedented crop demands created by World War I, they had increased harvest yields and bought more land to put under the plow. They also bought costly tractors and other mechanized farm equipment. Farmers contracted huge debts doing this, and the additional mortgage payments followed them into the 1920s.

After the war, the demand for American crops fell sharply. Despite this drop, postwar production remained high because of increasingly mechanized farm equipment and more intensive farming methods. Farms were getting bigger and yielding bumper crops at harvest. However, farmers were failing to sell off their huge crop surpluses and to pay the debts they owed banks and other institutions.

The result was a rural depression that affected millions of Americans. Hard-pressed to pay their debts, forced to sell in a glutted and competitive world market, and confronted by several natural disasters, farmers did not share in the boom times of the 1920s. They did not have the cash to buy the new consumer goods produced by



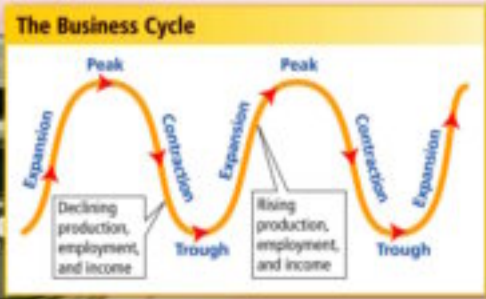
Farmers Struggle to Get By
Farmers who could not meet their debts faced bank foreclosures on their land, equipment, and livestock. Here, a horse is paraded in front of prospective buyers at a Missouri farm sale.

INFOGRAPHIC

Causes of the Great Depression

History remembers the 1920s as a decade of bull markets and new fortunes. However, by 1929, the surging American economy was on the brink of financial collapse. Soaring stock prices made rich people richer and concentrated more wealth into fewer hands. Excited by a stream of new products and buyer-friendly payment plans, consumers piled up huge debts as they purchased goods on credit. Everywhere, the economy expanded, soaring toward its peak in the summer of 1929 and then pausing on the verge of contraction—and economic chaos. (See the diagram below.)

Lured by luxury and easy credit, many Americans bought expensive new cars during the 1920s. ▼



▲ American consumers racked up more than $6 billion of debt by 1929—more than double what they owed at the beginning of the decade.

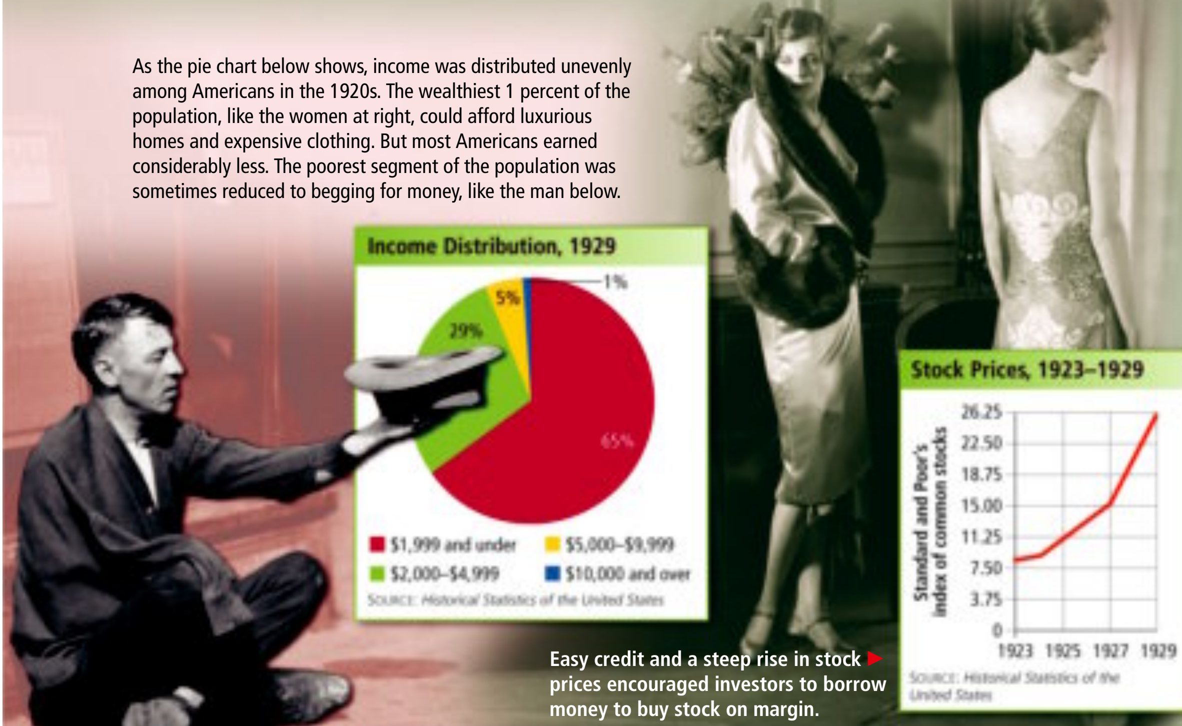
American industries. They lived largely on credit from month to month, often teetering on the brink of financial ruin. Any downward slide in the economy was likely to hit America's struggling farmers first and hardest.

Wealth Is Distributed Unevenly Unlike farmers, industrial workers participated in the great national success story. During the 1920s, their wages rose steadily, as did their disposable income. Many purchased Model T Fords along with a variety of other consumer products. Though they were certainly not wealthy, industrial laborers were in a better financial position than their fathers had been a generation before.

But the problem was that while wages rose gradually, worker productivity increased astronomically. Between 1923 and 1929, output per person-hour jumped 32 percent, but workers' wages inched up only 8 percent. During that same period, corporate profits from worker output skyrocketed 65 percent. All these figures pointed to the fact that during the 1920s, the rich became much, much richer, while industrial workers simply became less poor. In few periods of the country's history have so small a number of rich Americans dominated such a large percentage of the country's total wealth. In 1929, for example, the wealthiest 1 percent of the population earned about the same amount of money as the bottom 42 percent.

This uneven distribution of the nation's wealth created economic problems. More than 60 percent of all American families had yearly incomes of less than $2,000 per year. Twenty-four thousand of the country's wealthiest families enjoyed annual incomes of more than $100,000, which was 50 times more than what most families were earning. But these wealthy families did not eat 50 times more food than lower-income families. The wealthiest households did not

As the pie chart below shows, income was distributed unevenly among Americans in the 1920s. The wealthiest 1 percent of the population, like the women at right, could afford luxurious homes and expensive clothing. But most Americans earned considerably less. The poorest segment of the population was sometimes reduced to begging for money, like the man below.



Easy credit and a steep rise in stock prices encouraged investors to borrow money to buy stock on margin. ▶

Thinking Critically

1. **Make Generalizations** Is it fair to suggest that the American economy stood "on thin ice" in 1929? Why or why not?
2. **Analyze Costs and Benefits** How did easy credit and buying stock on margin provide both costs and benefits to the U.S. economy?

purchase 50 times more automobiles or radios or ovens. The rich undoubtedly spent a lot on consumer products. The problem was that the wealthiest few did not buy enough to keep the economy booming.

A healthy economy needs more people to buy more products, which in turn creates even more wealth. In this way, a healthy economy avoids underconsumption that can limit economic growth. The uneven distribution of wealth in the 1920s pointed to an uncertain future for the American economy.

From the overproduction of the struggling farmer to the underconsumption of the lower-income industrial worker, deep-seated problems created economic instability. Too many Americans did not have enough money to buy what they needed or wanted.

Easy Credit Hides Problems For a time, the expansion of credit partially hid this problem. Americans bought automobiles, appliances, radios, and other goods on credit. Using the installment plan, they paid a small percentage down and the rest over a period of months or years. By the end of the decade, 80 percent of radios and 60 percent of cars were purchased on installment credit. Americans even bought stock on credit, making such stock purchases on margin. Every year, Americans accumulated more debt. In the past, they had feared debt and put off buying goods until they had the cash to pay for those items. However, easy credit changed this behavior during the 1920s. The growing credit burden could mask the problem of Americans living beyond their means for only so long before the economy imploded.

✓ **Checkpoint** **What economic problems lurked beneath the general prosperity of the 1920s?**

The Panic Spreads
The sudden collapse of stock prices sent brokers and investors into a panic throughout New York's financial district and across the country. A cartoonist for the *New York World* captured the feelings of many Americans in the aftermath of the Great Crash.

The Stock Market Crashes

By 1929, some economists observed that soaring stock prices were based on little more than confidence. Prices had no basis in reality. Although other experts disagreed, it became clear that too much money was being poured into stock **speculation.** Investors were gambling, often with money they did not even have, on stock increases to turn quick profits. If the market's upward climb suddenly reversed course, many investors would face economic devastation.

On September 3, 1929, the stock market began to sputter and fall. Prices peaked and then slid downward in an uneven way. At the end of October, however, the slide gave way to a free fall. After the Dow Jones average dropped 21 points in one hour on October 23, many investors concluded that the boom was over. They had lost confidence—the very thing that had kept the market up for so long.

The next day, October 24, came to be known as Black Thursday. With confidence in the stock market failing, nervous investors started to sell. Stock in General Electric that once sold at $400 a share plunged to $283. Across the United States, investors raced to pull their money out of the stock market. On October 29, **Black Tuesday,** the bottom fell out. More than 16 million shares were sold as the stock market collapsed in the Great Crash. Billions of dollars were lost. Whole fortunes were wiped out in hours. Many speculators who had bought stock on margin lost everything they had. President Hoover tried to soothe Americans by insisting that the "business of the country is on a sound and prosperous basis." But by November 13, the Dow Jones average had dropped like a brick from its September high of 381 to 198.7. The Great Crash represented another hallmark of the nation's **business cycle,** which explained the periodic growth and contraction of the economy.

✓ **Checkpoint** **What happened on October 29, 1929?**

The Great Depression Begins

The stock market crash marked the beginning of the **Great Depression,** a period lasting from 1929 to 1941 in which the economy faltered and unemployment soared. Though it did not start the depression by itself, the crash sparked a chain of events that quickened the collapse of the U.S. economy.

The Banks Collapse One of the first institutions to feel the effects of the stock market crash was the country's banking system. The crisis in confidence continued as frightened depositors feared for their money and tried to withdraw it from their banks. Few banks could survive a sustained "run" of requests by depositors for their money. In 1929, 641 commercial banks failed. A year later, 1,350 failed. And a year after that, 1,700 went under. By 1932, many Americans believed that no banks would be left standing.

Another cause of many bank failures was misguided monetary policy. During the 1920s, the Federal Reserve, which regulates the amount of money in circulation, cut interest rates to stimulate economic growth. But in 1929, worried about investor overspeculation, the "Fed" limited the money supply to discourage lending. As a result, there was too little money in circulation to help the economy after the stock market crash. When plummeting stock prices sent investors to the banks to secure whatever hard money they had left, the banks were cleaned out of currency and forced to close.

Businesses Close and Unemployment Rises Banks were not the only institutions to face the harsh financial realities of the depression. The collapse of stock prices, combined with reduced consumer spending, spelled trouble for American businesses. Business leaders believed that the survival of their companies depended on production cutbacks, to maintain price levels, and layoffs, to reduce payroll. While their stocks were still falling, companies began closing plants and forcing workers onto the growing lists of the unemployed. In August 1931, Henry Ford closed several of his Detroit automobile factories, putting nearly 75,000 people out of work.

Like a snowball rolling down a hill, the problem of production cuts kept getting bigger and bigger. As businesses closed plants and fired workers to save money, more Americans lost their jobs. As unemployment grew and incomes shrank, consumers spent less money. So businesses cut production even more, closing more plants and firing more workers. By 1933, nearly 25 percent of all American workers had lost their jobs.

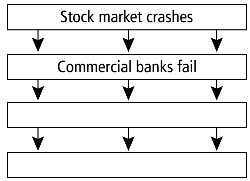
Tariffs Add to the Woes Hoping to reverse the downward slide, the government moved to protect American products from foreign competition. In June 1930, Congress passed the **Hawley-Smoot Tariff,** which raised prices on foreign imports to such a level that they could not compete in the American market. The tariff inspired European countries to retaliate and enact protective tariffs of their own.

Far from solving the problems of the depression, the Hawley-Smoot Tariff added to them. At a time when American manufacturers and farms had a glut of unsold products, the international move toward high protective tariffs closed markets. This closure was not just harmful to American producers. It was equally disastrous to the global economy. The ripple effect caused by the Hawley-Smoot Tariff helped to destroy international trade.

The Depression Goes Global The Hawley-Smoot Tariff was only one of the causes of a depression spreading across the globe. As we saw earlier, the European problems of reparation payments, war debt payments, and international imbalance of trade had already created a shaky economic structure. In the early 1930s, the structure collapsed. Germany ceased their reparation payments, and the United States agreed to suspend France and Britain's war debt payments. The international economy had largely been funded by American loans to Europe, but the crisis in the United States drastically curtailed those loans. As a result, European nations

NoteTaking

Reading Skill: Recognize Sequence Use a flowchart to note what happened in the wake of the stock market crash.



Banks Fail

In 1931, more than 1,500 banks ran out of money and closed their doors. Depositors lost untold savings. Here, a crowd gathers outside the closed doors of a bank in New York City. *How might Americans react today if hundreds of banks failed?*

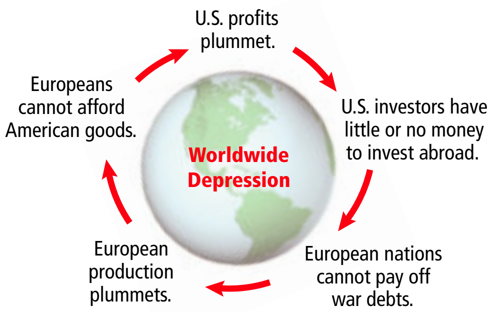


Diagram Skills The diagram above shows how the stock market collapse contributed to a global economic crisis. *How did European war debts affect the U.S. economy?*

experienced the same cycle of business failures, bank collapses, and high unemployment as the United States. The depression had become a global nightmare.

✓ **Checkpoint** **How did the stock market crash contribute to the onset of the depression?**

What Caused the Great Depression?

Historians and economists disagree on the exact causes of the Great Depression. Some have stressed a single root cause in their explanations of the financial crisis. Milton Friedman, one economist, believed that the depression resulted from a contraction in the money supply. The twin events of the stock market crash in 1929 and the run of bank failures in 1930 left too little money in circulation for the nation's economic needs.

John Maynard Keynes was one of the most influential economists of the depression. He argued that the lack of government interference in the economy led to the depression. Critical problems in money supply, distribution of wealth, stock speculation, consumer spending, productivity, and employment could have been controlled, he said, by proactive government policies. Keynes's work points to a fundamental difference between many economists regarding the depression. While Keynes recommended that governments spend more money to keep people employed when the economy slows, other noted economists like Ludwig von Mises and Friedrich von Hayek criticized centralized economic planning and management.

There will never be a fully accepted answer to the question of what caused the Great Depression. But clearly, problems in consumption contributed heavily to it. Economic hardships before 1929 in Europe and rural America, coupled with an uneven distribution of wealth and overspeculation in the stock market, created dangerous economic conditions. When this was combined with poor or misinformed economic decisions by Congress and President Hoover, the Great Depression resulted.

✓ **Checkpoint** **What were the primary causes of the Great Depression?**

SECTION 1 Assessment

Progress Monitoring *Online*
For: Self-test with vocabulary practice
Web Code: nea-0802

Comprehension

1. **Terms** For each term below, write a sentence explaining its significance.
   - speculation
   - business cycle
   - Great Depression
   - Hawley-Smoot Tariff
2. **NoteTaking** **Reading Skill: Recognize Causes** Use your concept web to answer the Section Focus Question: How did the prosperity of the 1920s give way to the Great Depression?

Writing About History

3. **Quick Write: Define a Problem** Choose one topic from this section that you could use to write a problem-solution essay. For example, you could write about the weaknesses in the agricultural sector of the economy. Make a list of details, facts, and examples that define the problems that this weakness poses to a stable economy.

Critical Thinking

4. **Explain Causes** How did the uneven distribution of the nation's wealth weaken the American economy?
5. **Analyze Information** Why was recovery so difficult after the stock market crash?
6. **Draw Conclusions** Do you think the nation would have experienced an economic depression even if the stock market had not crashed? Why or why not?