Chapter 9 Lesson 1

The Causes of the Great Depression

The election of 1928:

The election of 1928 pitted Alfred Smith (Democrat) against Herbert Hoover (Republican). Herbert Hoover had an advantage in that he was the Secretary of Commerce and had been head of the Food Administration. He was also a Republican and many credited the country's prosperity to the Republicans (because they had the White House since 1920).

The other issue that plagued Smith was his religion. Alfred Smith was the first Catholic to win a major party's nomination for President. Some believed that The Catholic Church was funding his campaign to gain influence on American politics. Hoover tried to stop the attacks but Smith's campaign was damaged. Hoover won in a landslide.

The Stock Market Soars:

Pushed by optimism that America was looking towards a brighter future, the stock market had a long period of rising prices (bull market). Many stock buyers engaged in speculation (buy at a risk in the anticipation that the prices will rise). Many investors also bought stocks on the margin (buy the stocks on credit, pay a fraction of the cost and borrow the rest. These risky behaviors were relatively new in the 1920's and would both make an investor money as long as stock prices went up. However, these two ideas could have a huge negative impact if prices fell.

The Great Crash:

In September of 1929, the market began a downward slide. Investors believing that the boom was over began selling stocks which pushed prices even lower. In October, brokers began making margin calls (calls asking investors to pay up on the borrowed money). Investors began to sell stocks at a rapid pace, which pushed the market into a tailspin. On October 24 (Black Thursday) the market fell dramatically again and many investors were wiped out.

On October 29 (Black Tuesday) stocks took the deepest dive yet and over 16 million stocks were sold that day. The industrial index dropped 10 % and by mid- November, the market price of stocks had dropped a third or more. The stock market crash does not cause the Great Depression, however it makes it difficult for the economy to recover.

Banks Closing:

The crash weakened banks.

1) Banks had lent billions to stock investors. After the crash, many defaulted on these loans.
2) Banks had invested depositors' money in stocks, hoping for a return on the investment. When the market crashed banks lost money on these investments.

3) Some banks could not survive these blows and closed. There was no insurance on deposits at this time, so when a bank closed, the depositors lost their money.
4) Worried about their deposits, some made a run on the bank. A bank run is when many depositors withdraw their money at the same time. Since banks do not keep all of a depositors' money on hand, a bank run can cause a bank collapse.
5) By 1932, about ¼ of all US banks had closed.

The Roots of the Great Depression:

1) Overproduction:
    a. Machinery made production more efficient
    b. Most Americans did not have enough money to buy lots of goods
    c. Farmers were in debt and suffered from overproduction
    d. When prices fell, producers (esp. farmers) tried to produce more to cover the losses, this forced prices down
    e. Many farmers went bankrupt and lost farm and home
    f. Many Americans used the installment plan and could not cover their debts, they then stopped making new purchases which helped lead to overproduction first then reduction in production with loss of jobs
    g. Slow sales impacted the whole economy
    h. Workers lost jobs, then lowered purchases, which resulted in other workers losing jobs
2) The loss of export sales
    a. Manufacturers could have been saved by exports
    b. In the later 1920's banks made loans to speculators instead of European countries
    c. The earlier loans to Europe had ensured that Europe could pay its war debts and purchase US goods
    d. Without these loans, Europe stopped buying goods
    e. Hoover asked Congress for a lower tariff
    f. Congress passed the Hawley-Smoot Tariff, which raised tariffs
    g. Europe responded by raising their tariffs, exports dropped by half
3) The Federal Reserve
    a. Credit was cheap and easy to get, this fueled speculation
    b. The Federal Reserve kept interest rates low, which helped to cause the depression
        i. By keeping low rates, banks were encouraged to make risky loans
        ii. Low interest rates led business leaders to believe that the economy was still expanding (so they borrowed to fund expansion, which led to overproduction)
    c. When the depression began the Fed raised interest rates, which tightened credit and pushed the economy into a downward spiral