The Causes of the Great Depression

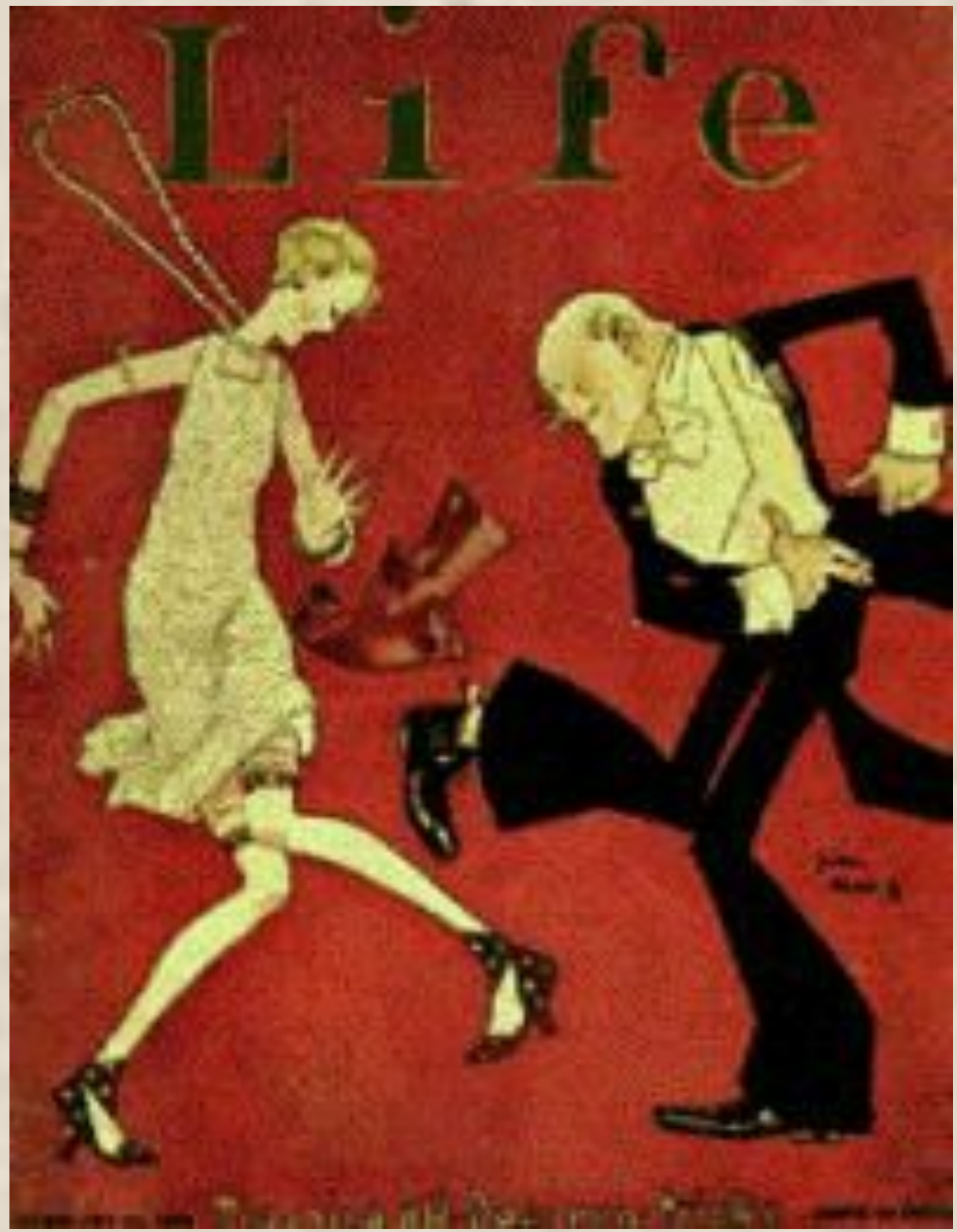
A Depressing Power Point Presentation Brought to You by Ms. Shen

What is the difference between a recession and a depression?

- **<u>Recession</u>**:
  - A period of temporary economic decline that is visible in production, employment &/or income.
  - Recession are a normal (unpleasant) part of the business cycle.
  - Recessions generally last 6-18 months and are less severe than a depression.
- **<u>Depression</u>**:
  - A period of significant, prolonged economic decline.
  - Depressions are characterized by decreased business activity, falling prices, and high unemployment.

- The mood of most Americans in the late 1920s was optimistic.

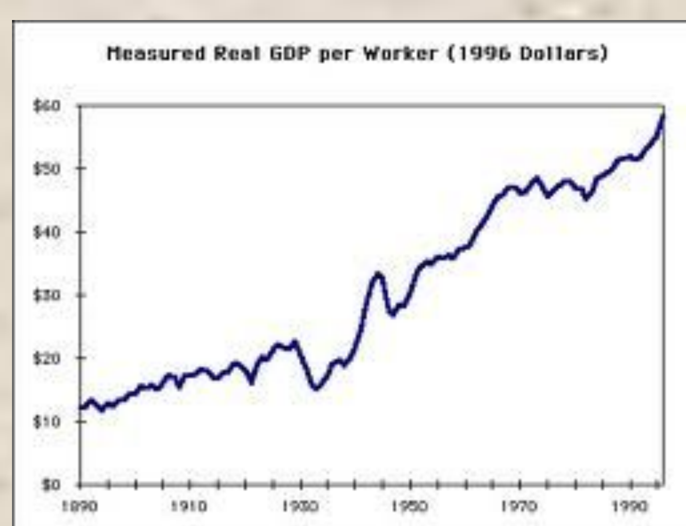
- Unfortunately, there was a disconnect between how people thought life was and what the reality was.



- For instance, people's **perception** (*what they believed was the reality*) was that the "Roaring Twenties" was a time of wealth.
  - The '20s saw the introduction of new technology, cars, electricity, national heroes, bootlegging, flappers, and people making more money while working fewer hours.

The economy of the 1920s also appeared to be booming in the 1920s:

- Between 1925 and 1928, the value of stocks rose from $27 billion to $38.4 billion. By 1929, it was valued at *$87 billion*.
- *Real wages* (what $ could actually buy) had increased more than 40%.
- Unemployment averaged below *4%* (today it is roughly 5%)



People started to believe that anybody could be rich.

- Lots of people started wildly buying stocks with *borrowed money*.
- Lots of people hoped to "get rich quick."
- It was definitely a time of great optimism.


REALITY
CHECK
AHEAD

In spite of these positive changes in life in the 1920s, the reality was much less sunny. There were some troubles under the surface.

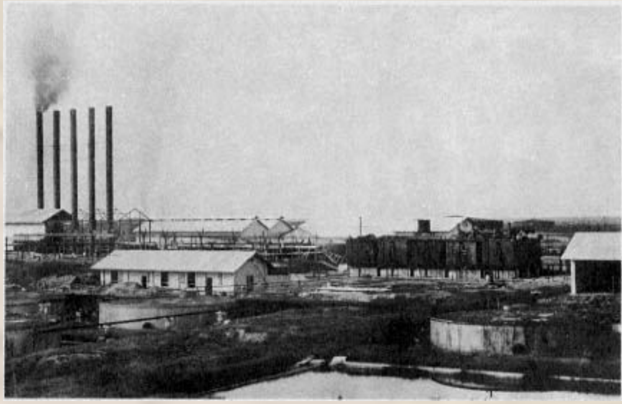
- In reality, the economy was *out of balance*.
- It was mostly the rich who were getting richer. Wealth was concentrated in a tiny percentage of American families only.
  - In 1929, only .1% of the population had incomes of more than $100,000.
  - 71% of families earned less than $2,500 per year and *80%* of households had no savings.
- Also, while wages did increase in the 1920s, they didn't increase enough to narrow the gap between the classes.

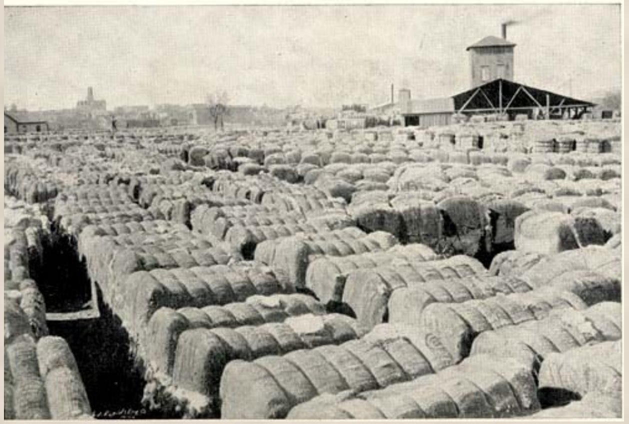
The problem with businesses/ consumer spending

- With the introduction of credit, things got complicated.
- Advertising made people believe that they HAD to buy things.
- Store owners had enough confidence in the economy to let customers buy goods with an *installment plan (credit)*
- Credit buying also meant that people were pumping money into the economy that actually didn't exist. MEANING?

The problem with businesses - overproduction

- There were too many consumer products being made (thanks to the assembly line & business' overconfidence) and wages weren't rising as fast as production.
  - People could not afford to buy the goods as fast as they were made and even when they did buy, people often paid in credit so no money changed hands.
- By the late '20s, the country's warehouses held piles of un-bought consumer goods. Industries like auto, steel, rubber and glass were all experiencing a slowdown. SIGNIFICANCE?

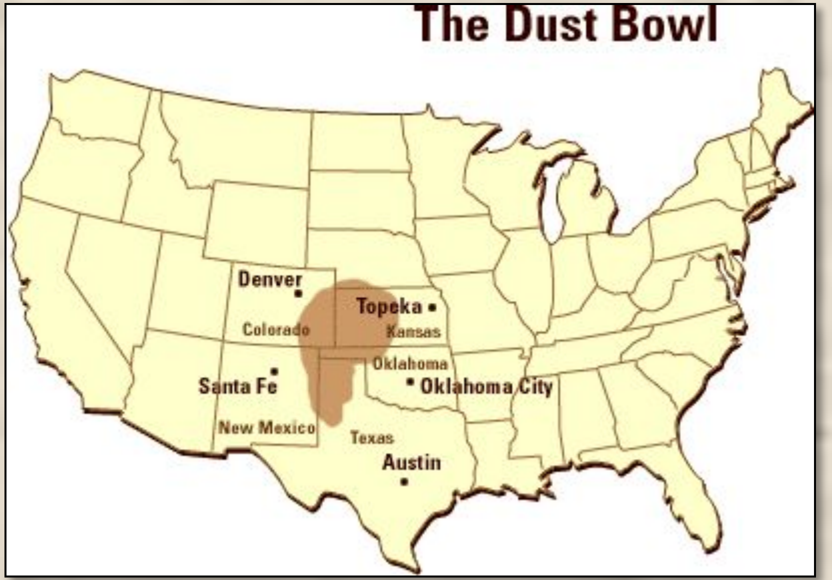




The problem with farming

- The same problem of overproduction extended to agriculture
- Farmers did not experience some of the positive changes of the 1920s.
  – Thanks to technological advancements like the tractor, farmers began to make more food in the 1920s. However, as they made more, food prices dropped, and farmers responded by making more food, which only lowered the prices more.
  – Due to their planting more and making less money each year, farmers began defaulting on their loans, leading banks to foreclose on their farms (taking their farms as a form of payment.)

The Dust Bowl



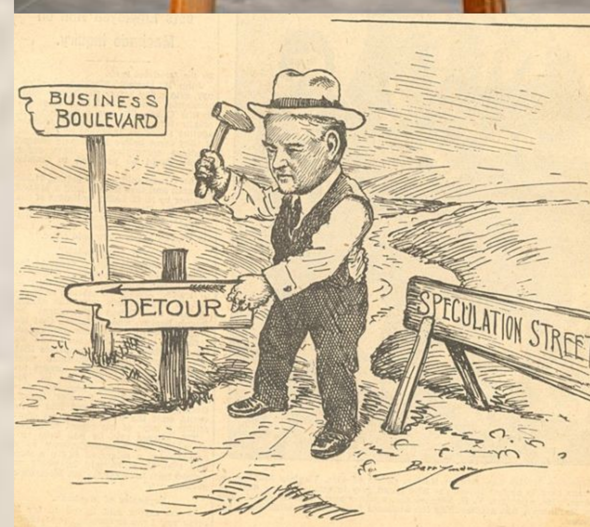
May 1933 -- A three-day dust storm blows an estimated 350 million tons of soil off of the terrain of the West and Southwest and deposits it as far east as New York and Boston. Some East Coast cities were forced to ignite street lamps during the day to see through the blowing dust.

- At the same time as farmers struggled financially, drought hit the center of the country, turning that region of the country into what was called the "*Dust Bowl.*"
- Created by:
  - Poor farming practices on the part of farmers who over-plowed and planted the land
  - Severe & long-lasting drought
  - Series of violent wind storms that picked up dark, nutrient-rich topsoil and carried it eastward – left behind sand
- Terrible weather and low prices for farm products led 60% of people in the Dust Bowl to lose their farms.

Photo courtesy the National Archive, Washington, D.C. A wall of dust approaches a Kansas town on Oct. 4, 1935, during the Dust Bowl.

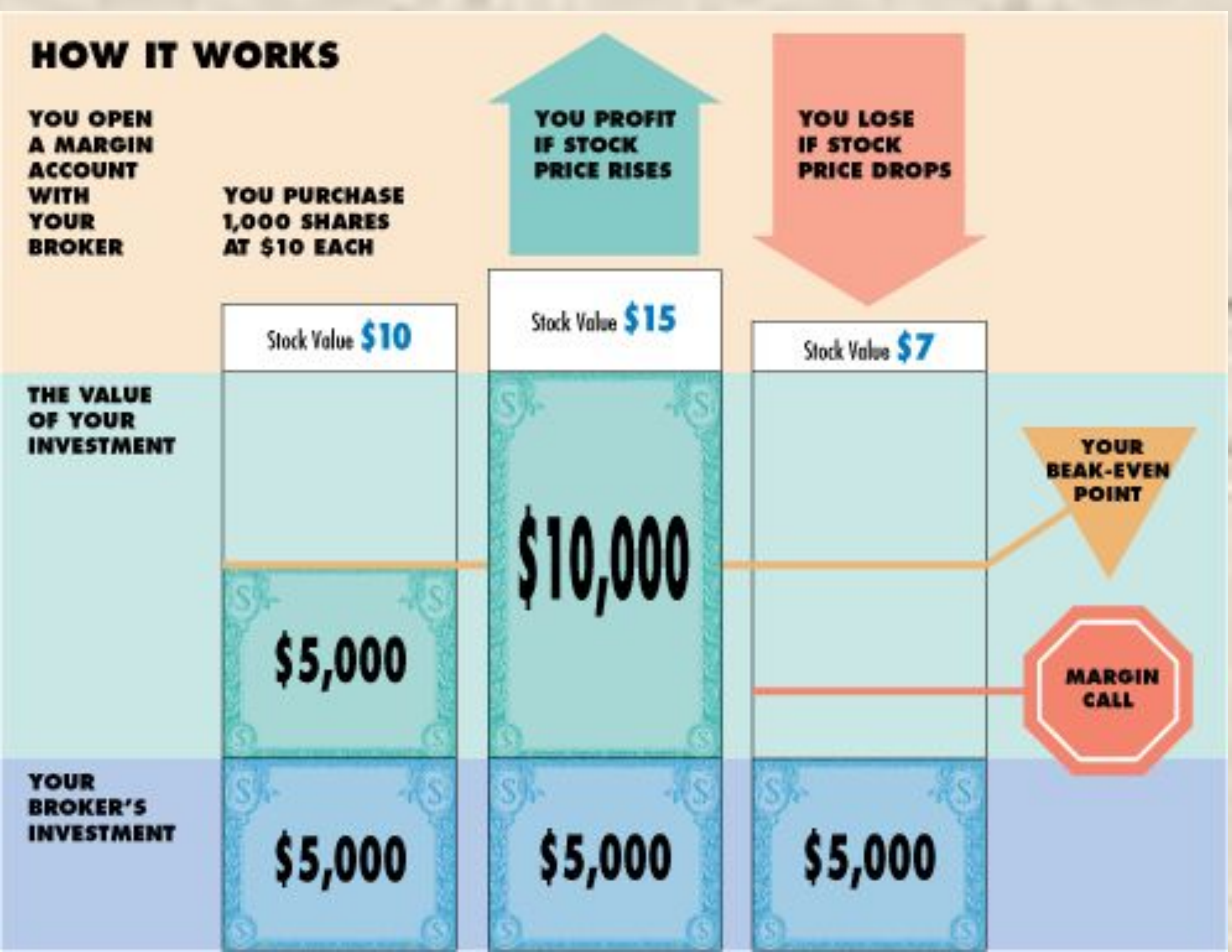
The problem with the stock market – lack of regulation

- Making the problem even worse was the fact that thanks to changes in stock buying practices, more people began to buy stock in the 1920s hoping they could get rich quick.
  - People were encouraged by stock brokers, banks and even the president to ***<u>speculate in stocks</u>*** (consumers would invest lots of $ in stocks which they had not researched.)



Margin Buying

People were also buying stocks with money they didn't have through something called **buying on margin**, meaning that they would pay a fraction of the price (10 to 50%) and borrow the rest.

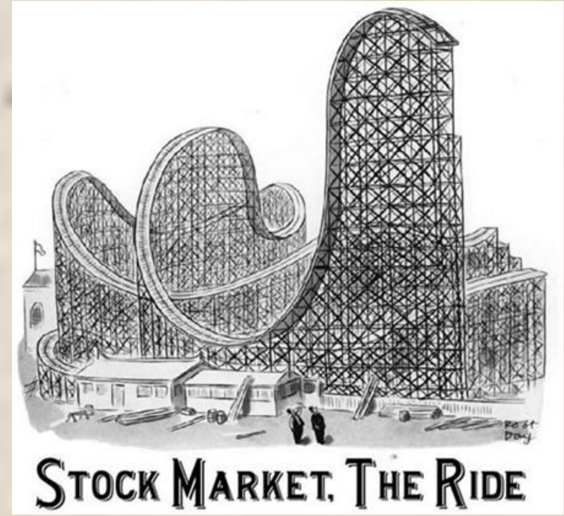


- Brokers also inflated their claims about a company's assets and profitability, and sold stocks for more than the company's actual value.
- This practice, known as "**stock watering**" was introduced to the NY financial district by a cattle driver turned financier. The term was came from the practice of feeding cattle salt to induce them to drink large amounts of water just before they were sold, thereby increasing their weight. Thus, the buyer - whether of stock or of livestock - pays for more than is actually received.

Why did the stock market crash?

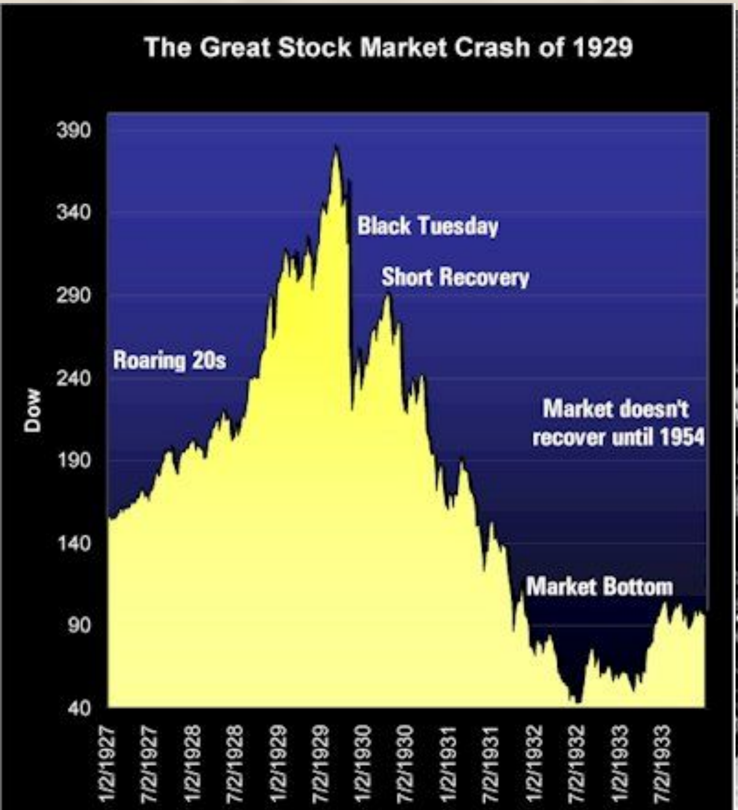
- In 1929, stock prices climbed and climbed. (Prices for many stocks soared far above their real value.)

- After the peak in September, 1929, stock prices fell slowly.
  - As the stock market closed on Oct. 23, the Dow Jones average dropped 21 points in a single hour.
  - The next day, worried investors started to sell, and once some started to sell, the stock prices dropped more, which made people panic and rush to sell before they lost any more money.



On October 29, 1929, known as **<u>Black Tuesday</u>**…

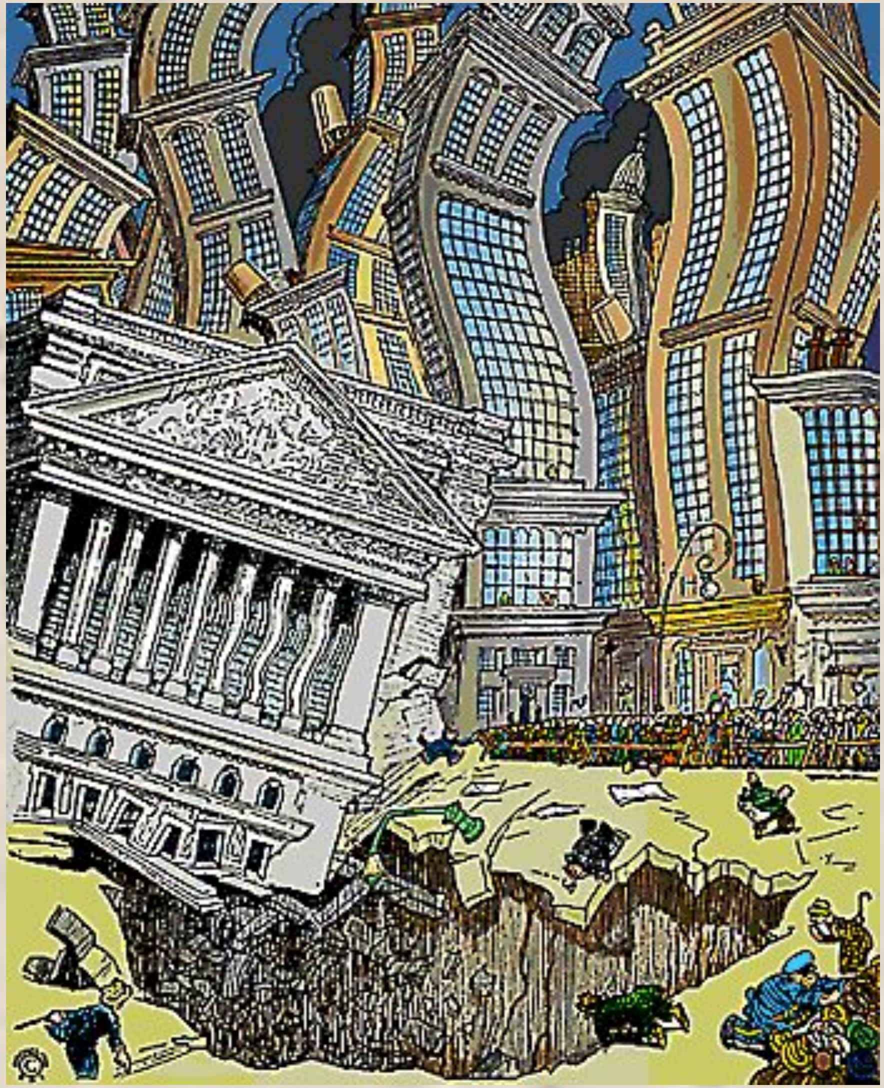
- A record 16.4 million shares were sold (vs. the average of 4-8 million shares a day in 1928.)
- Overall losses amounted to $30 billion.



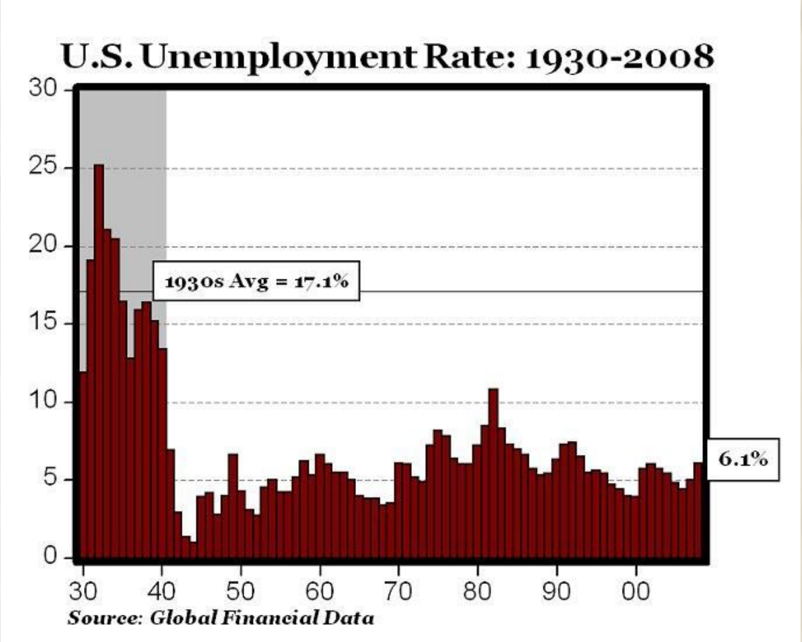
How did the stock market crash affect the American people?

- By 1929, about 4 million out of 120 million (3%) Americans had invested in the stock market. These people lost basically everything.

- Eventually, it ended up affecting the people who had never owned a single share of stock.



- For example, as income & profits fell, factories closed and thousands of workers lost their jobs or had their pay cut.
  - When Henry Ford shut down his Detroit car factories over 75,000 people lost their jobs.
  - HOW DID THAT THEN IMPACT THE REST OF DETROIT? (THINK!)
- By 1932, a *quarter* of the American labor force was out of a job.

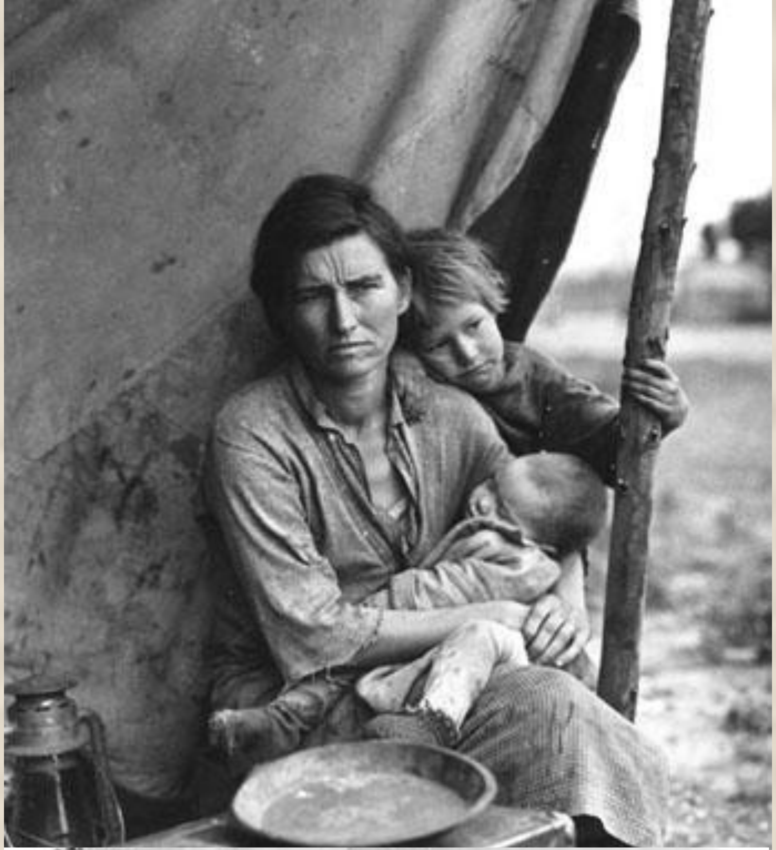


- Restaurants and other small businesses closed because customers could no longer afford to go there.

- Rich families could no longer afford to hire household help.

- Farm prices fell even more.

- Thousands of banks closed because they could not return their depositors' money or sell foreclosed properties.



Bank run ->

So let's put it all together.

- The stock market crash of 1929 was NOT the cause of the Great Depression. Instead, it was only the day the prosperity bubble burst.
- Deeper problems were the REAL underlying causes of the Great Depression.

And what were those deeper problems you ask?

- The seemingly booming economy was actually unstable.
- Wealth was unevenly distributed (a few really rich people held most of the nation's wealth.)
- Businesses made more products than customers wanted or could afford to buy.
- Even though wages rose in the 1920s, most people were not making enough money to balance out what they were buying with credit.

Because of the previously mentioned reasons, rapid recovery after the crash was impossible.

And so we had a big depression!