

LESSON 14 What Caused the Great Depression?

Glossary of Terms on the Depression

The Great Depression, which began in late 1929 and lasted until roughly 1940, was the worst depression in American history. Historians disagree sharply on the main cause of the depression. Since the topic is quite complicated, you need to have a clear understanding of the terms involved in order to evaluate the arguments.

Banking Panic A situation in which many bank depositors withdraw their money (called a run on the bank) causing a large number of banks to close.

Bull Market A situation in which the prices of stocks rise significantly.

Consumption Spending money to purchase or buy goods and services.

Depression A dramatic slowdown in the economy, characterized by a significant decline in the Gross National Product (GNP) and national income, and a great increase in unemployment.

Federal Reserve Bank An independent government agency which controls, through various procedures, the supply of money. It also has significant influence over interest rates.

Gross National Product The measure of all the goods and services produced in a country in one year, measured in dollars in the United States.

Interest Rates The amount charged for borrowing money. Many businesses borrow money to expand their output. Thus, higher interest rates can slow down business (and economic) growth, and lower interest rates can lead to business growth.

Money Currency (paper money and coins) plus demand deposits (checking accounts)—most money is in the form of checking accounts, not currency.

National Income The total net income earned in production of goods and services. It is the same as Gross National Product except that it does not include things such as allowances for wear and tear on machinery and buildings.

Production The making of goods or performance of services.

Recession A mild slowdown in the economy, less dramatic than a depression.

Speculation Buying a product with the hope that the product can be sold later at a higher price.

Stock Crash A dramatic drop in the price of stocks.

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Relevant Information



Use the relevant information below, read the viewpoints, and answer the questions which follow.

- A. One economist estimates that total stock market investment was a very small percentage of the whole economy (between 1% and 2% of total national income).
- B. National income declined by 36% from 1929 to 1933.
- C. The richest 5% in America increased its share of income from 24% of total national income in 1922 to 26% of total national income in 1929.
- D. There have been numerous bank panics and stock crashes in the United States. Some have been followed by depressions and some have not.
- E. In any economy which is changing, there will be growing industries and declining industries.
- F. Short-term interest rates declined dramatically after the stock market crash and remained low in 1930. Long-term rates on government securities stayed about the same. Long-term private interest rates went up.
- G. Output of goods and services in 1933 was 50% below what it could have been, according to one economist.

Historian A

When the stock crash took place in the last months of 1929, America plunged into its worst depression ever. The seeds of the depression lay in the seemingly prosperous American economy of the 1920s. Although the economy expanded in the '20s, there were a number of weaknesses in it.

First, there were several weak industries in the 1920s, notably agriculture, textiles, and coal mining. Second, there was the phenomenon of technological unemployment. With more machines used to make

goods, some workers were laid off. The result was that although employment increased in the 1920s, it did not increase fast enough to keep up with population growth. Even in the best years of the 1920s there were 1.5 million people unemployed. Third, the income of the country was concentrated more in the hands of the wealthy. The poor people did not share equally in the prosperity of the 1920s. Fourth, Americans experienced numerous foreign trade problems, especially with Europe, in the 1920s.

Historian B

The economic collapse of 1929, known as the Great Depression, was caused by several weaknesses in the American economy of the 1920s. These weaknesses included

the decline of certain industries (especially agriculture), technological unemployment, and foreign trade problems. The most important weakness in the economy

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Historian C

The 1929 stock crash obviously caused the Great Depression which followed it. There are three ways the crash contributed to the economic decline: 1. it reduced the money wealth of households, causing less spending; 2. it deprived business of

an important way of raising money for investment (through stocks); and 3. it caused people to take a pessimistic view of the economy, thereby reducing investment. With spending and investment in decline, the economy had to decline.

Historian D

It goes without saying that the 1929 stock crash caused the Great Depression. Throughout 1928 and 1929 people speculated on the great bull market. That is, they bought shares of stock on the gamble that the price of the stock would keep going up, rather than on the basis of the real value of the stock. The speculative boom was fueled by easy credit policies, especially buying on margin. Individuals could buy stocks

on margin by putting down as little as 10 percent of the amount purchased and borrowing the other 90 percent from the stock broker. With people bidding on the stocks with borrowed money, stock prices soared. When prices declined in October 1929, many people had to sell fast in order to pay back their loans. Thus, the initial downturn in stock prices turned into a collapse.

6. Which historian, C or D, makes a stronger argument that the stock crash caused the Great Depression? Why do you think so?
7. Using the relevant information and your own thinking, show one weakness in Historian C's viewpoint.

Historian E

In 1929 the American economy went into a recession. There is no need to explain why this occurred since the regular ups and downs of an economy cause periodic recessions as a matter of course. The important question

is why the economy did not recover within a year as it usually does, but rather, plunged into the worst Depression in our history.

The answer is that the supply of

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Historian E

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money shrank, causing less spending and thus higher unemployment. The money supply shrank first because there was a bank panic. People started withdrawing their deposits, and since bank deposits were not insured by the government (insured today by the FDIC), the other depositors removed their money before they lost it. As deposits were withdrawn, loans were called in and the money supply was drastically reduced.

Second, the Federal Reserve Bank took no action to stop the money supply from shrinking. In fact, in 1931, it actually took steps that made the supply of money even smaller! The money supply continued to decline up to 1933. By that time, it was 33 percent smaller than it had been in 1929. Notice how close that

reduction is to the 36 percent drop in national income which occurred during the same four years.

As the supply of money shrank, people had less money with which to buy goods and services. Consequently, prices fell and fewer goods were sold. With fewer goods being sold, fewer goods were made, unemployment went up, and national income and GNP declined. The country was plunged into the Depression, not by businessmen, but by poor government policy in not protecting the banking industry, and by the foolish policy of the Federal Reserve Bank (a government agency) in reducing the money supply at the very time when the country needed a larger supply of money.

8. What is the main point of Historian E?

9. What is a possible weakness in Historian E's argument?

Historian F

The stock market crash of 1929 was one factor that contributed to the Great Depression, but it was not an important factor. By reducing people's wealth, the crash caused a decline in spending, but the decline was not large enough to cause the tremendous drop in national income that occurred from 1929 to 1933.

The Depression was caused mainly by

the dramatic decline in consumption in 1930. For some as yet unexplained reasons, buying declined greatly in 1930—the drop was five times as large as the 1929 drop.

The decline caused investments to fall. This decline in consumption also caused the decline in the supply of money, not the other way around. If the money supply had declined

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Historian F

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first, short-term interest rates would have been high (since the supply of money would have been smaller than the demand). But short-term interest rates were actually low, showing that the demand for money (due to

less spending) was lower than the supply.

Other theories do not adequately show what primarily caused the Great Depression. The best explanation is the decline in spending during 1930.

10. What is Historian F's main point?

11. What is one question you would ask Historian F to better evaluate his viewpoint?

12. Using the relevant information and your own thinking, show one weakness in Historian F's viewpoint.

13. Based on the arguments they make on the causes of the Great Depression, what do you think each of the following would recommend to avoid or cure depressions?

Historian B -

Historian D -

Historian E -

Historian F -

14. Which viewpoint do you think is strongest? Why do you think so?