The Economics Of The Causes Of The Great Depression Essay, Research Paper

Looking back on the past century of American History, there are many ups and downs, triumphs and tragedies, booms

and busts. However, each one of these periods lasted for relatively short periods of time. There is one notable exception. The

Great Depression was truly that, the greatest low point this country has ever experienced. At its nadir, in 1932 and 1933, 14

million people were unemployed, over 25% of the nation’s workforce. All this occurred after a decade remembered as the

“Golden Twenties” in which prosperity was everywhere. Those who didn’t put their money in the stock market were judged

insane or incompetent.

There were, however, “Two Sides to Paradise,” during the Twenties. Forty percent of the nation’s wealth was

concentrated in only 5% of the population. Even though workers in the 1920’s increased their output by 40%, wages only rose

by 7%. This meant that the now greatly increased profits weren’t being passed on, simply making the very rich still richer.

Because antitrust laws weren’t enforced, there were also price-skimming scams, that allowed companies to make even larger

profits. Overall this meant that producers were slowly constricting their market. Without money to spend in workers’ pockets,

there could be no demand for goods.

The consequence of the rich having so much of the nation’s money was that they speculated with their money in the stock

market. They also spent much of the nation’s gross national product. This meant that if the stock market crashed, as it would,

much of the nation’s money would instantly disappear. As the rich disappeared, demand for luxuries and like products would

disappear with them.

Another false side to paradise was the farmers. During World War I much of Europe’s prime farmland went out of

production due to the war. The demand for food was increased by the needs of the vast armies. American farmers filled the

gap by stepping up production, thereby reaping huge profits. However, between 1919-1921 farm income went from $17.7

billion to $10.5 billion as European farmland came back into production. Farmers continued to take losses all through the 20’s.

Another unstable part of the 20’s economy was that most of the fantastic growth of the decade had been based upon

two industries, radio and the automobile. Any industry that was remotely connected to these had banner years. Take

construction for example. During the 20’s there was an incredible demand for new paved roads. On average America spent

$1.4 billion dollars annually on new roads. In addition, the automobile was responsible for much of the urbanization of the

country during the 20’s. Because so many new people were moving to the cities, there was demand for many new apartments,

factories and office buildings. Steel, lead, glass, leather, fuel and probably most of all, the tire industry benefited from cars.

The problem with so much of the nation’s growth being essentially centered on two industries was that the whole

economy was dependent on them. If the radio and automobile industries slowed down, the entire economy would slow down

with them. This might have been all right had it been a different industry, such as agriculture. However, these two industries

could not expand forever. You could only own so many radios and so many cars before you didn’t want any more; this is law

of diminishing marginal utility in action. Because agriculture had been dismissed as unprofitable, there was nothing left in the

economy after radio and construction went down.

As more and more people speculated in the stock market prices, were driven way up, beyond the actual worth of a

company. Instead of reflecting a company’s assets, dividends, or outlook, prices reflected what someone else might pay in a

week, or a minute, for their chance to make a profit in the same way. Another problem with the speculative boom was that

when people bought stock they usually bought it on margin. This meant that you only paid 40% of the value of the stock. The

broker got the rest of the money on credit, which you paid back when you sold the stock. If your stock’s value fell below the

breakeven point for the broker, he would either sell the stock, and take a loss, or ask you for more money. What all this meant

was that banks were indirectly, and sometimes directly, investing their depositors’ money in the stock market.

Generally the largest cause for the crash of 1929, and therefore the depression, was the fact that the stock market boom

was based on confidence, not actual reality. If investors lost confidence in the market’s ability to turn a profit the whole system

would come crashing down. Instead of being based on confidence, a crash would be based on fear.

During the summer of 1929 many warning signs of the impending crash were noticed. However, these signs were

generally ignored because most investors believed there was no way the market could crash. The one strong response to the

warning signs was when the Federal Reserve raised interest rates to 6%. However, this had little effect because banks could

still make 12% in stocks, an incredible profit margin.

October 24, 1929 is now remembered as “Black Thursday.” On this day the whole US financial system came tumbling

down. Investors lost all confidence in the value of their stocks and tried to sell at lower and lower prices. Some couldn’t find

buyers at any price. The ticker tape, which allowed those not in the actual exchange to know prices, ran two hours behind.

In response to the crash a group of incredibly wealthy bankers, whose personal fortunes totaled more than $300 million,

met to try and calm the people and stop the panic. They bought stocks at much higher prices than the going rate, calming and

stabilizing the exchange. However, since the ticker tape was running several hours behind, sell orders continued to pour in from

across the country. On “Black Thursday” the New York Stock Exchange alone lost $4 billion dollars. The magazine Variety

memorably summed up the crash with the headline, “Wall Street Lays an Egg.”

On the next day, Friday, prices remain relatively stable as investors tried to take stock of the situation. However, this did

not last. The next Monday, although trading was less, the market fell still further. “Black Tuesday,” October 29, proved even

more fruitless. The bankers that had tried to stop the crash were now selling. It was the worst day in the market’s 112-year

history.

As the prices fell further and further many brokers frantically sent out margin calls for more money. Some sold their

investors’ stocks outright. The problem was that the people getting called simply didn’t have the money, or didn’t want to invest

it, forcing brokers to take a loss. This money was, of course, on credit and the banks were demanding payment to pay for the

losses they had sustained. The brokers simply didn’t have the money and were forced to default. This meant that the banks lost

billions of dollars of their depositors’ money, which the depositors were now trying to withdrawal. Once again the banks simply

didn’t have the money and were forced to go bankrupt. Between 1929-33 more than 10,000 banks failed, greatly shrinking the

money supply. The speculative boom had been built like an “Upside-down pyramid” on credit. Now it collapsed like one.

On Halloween Thursday the New York Stock Exchange closed and didn’t reopen until the following Monday. During

this, the second week since “Black Thursday,” prices fell still further in even larger selling frenzies. By mid November the

market had sustained an average $26 billion, or 40% loss. Some companies had seen their value drop from $100 to $3 per

share as little as two days.

The stock market crash started a chain reaction throughout our economy, and, indeed, the economy of the world. Since

most of the money was with the rich, and these were the people that had lost everything, spending declined very rapidly,

especially on luxuries. Contributing to the continued downfall was the fact that industry hadn’t shared its profits with its workers.

This meant that there was no mass purchasing power left once the rich lost out. Another contributor was the huge inventories

kept by many retailers. Since no one was buying no orders came in for many months, forcing businesses to layoff workers. Due

to the strong anti-union sentiment of the 20’s, there were no unions left to prevent the mass layoffs. Laying-off workers

constricted business’s markets still further until they were forced to lay off still more workers in an almost unbreakable

downward spiral. By the spring of 1939, six months after the crash, 4 million people were unemployed and this was only the tip

of the iceberg. By 1933 24.9% of the workforce would be unemployed. There would be an attempted military coup and the

US would finally go off the gold standard. The Great Depression had begun.

The foremost question in most people’s mind when thinking about The Depression is, “Can and will it happen again?”

When asked this simple question most experts agree that in our present economic situation something like The Depression

couldn’t develop. This is because the US passed many laws during the 30’s to prevent a stock market crash from re-occurring.

If something like The Depression started again federal bureaus, like the Securities and Exchange Commission, would step in

and attempt to prevent it. However, this is of little importance sine many of the causes of the 1929 crash are now illegal. First of

all commercial banks are no longer allowed to speculate in stocks. Second, the Federal Reserve now has greatly increased

power over interest rates. Which gives them much greater power to prevent a crash. Another factor that makes it less likely for

a crash to occur is the elimination of the big investment trusts, except the mutual funds, which are highly regulated. Incredibly,

the current tax system helps prevent a crash by spreading the wealth from the very rich to the poor. Unemployment

compensation and social security, both passed in the 30’s, would help maintain an income base and protect the old should

another depression develop. Probably the single most important measure against another depression is FDIC insurance, which

insures depositors’ money, up to $100,000. Bank failures were one of the most demoralizing effects of the Depression. They

were also one of the most costly. FDIC insurance would reduce the effect of most bank failures, acting like a brick wall to any

impending depression.

There are, however, a few factors in favor of a depression. The current loss of power in most labor unions could allow a

depression to occur. This is because mass layoffs and reductions in pay could not be disputed without organized labor. A

further problem that could result in a crash is the current overvaluing of many stocks. During the twenties stock values soared

much beyond the actual worth of a company. The same thing is happening today with companies like Yahoo!, currently valued

at over $200 a share, even though it has yet to turn a profit Another problem is an inherent flaw in our free-enterprise system.

This flaw is that profit will always take precedence over the good of the people. This simple law means that poverty will always

exist if we are to maintain our free-enterprise system.

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