
CONFRONT THE ISSUE
WHAT CAUSED THE GREAT DEPRESSION?
TOUCH TO BEGIN

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WHAT CAUSED THE GREAT DEPRESSION?

What caused the Great Depression? Historians and economists have debated this question since the 1930s. In the popular imagination Wall Street speculation and the 1929 Stock Market Crash were to blame.

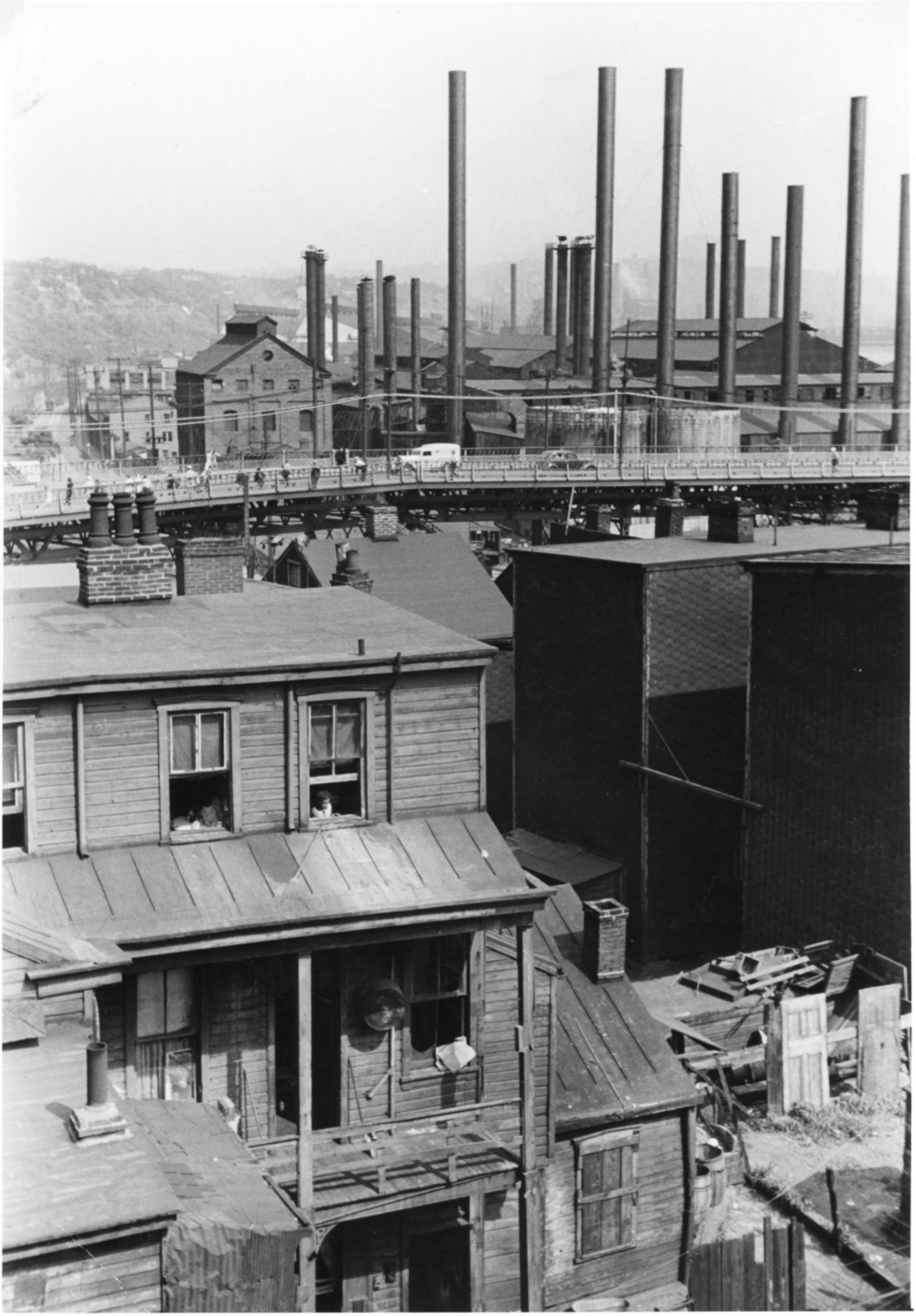
The reality is more complicated. Most scholars believe a combination of long and short term factors led to the crisis. During the 1920s, America experienced an economic boom. But the boom was built on shaky foundations.

Scroll down to learn more about the causes of the Great Depression.

Lack of Economic Diversity

The economy lacked diversity. Prosperity rested too heavily on a few basic industries, notably construction and automobiles. In the late 1920s, purchases in those industries declined and newer industries did not emerge to take up the slack.

Photo below: *Factories closed or reduced production. FDR Library Photograph Collection, NPx 65-593(57)*



Unequal Wealth Distribution

Unequal wealth distribution undercut consumer demand. During the 1920s, the proportion of business profits going to workers as wages was too small to create an adequate market for the goods the economy was producing. In 1929, after nearly a decade of strong economic growth, more than half of American families lived near or below the minimum subsistence level. When they made major purchases, they did so on credit.

Photo below: *Wife and children of a sharecropper, Washington County, Arkansas. FDR Library Photograph Collection, NPx 53-227(541)*

Unstable Banking System

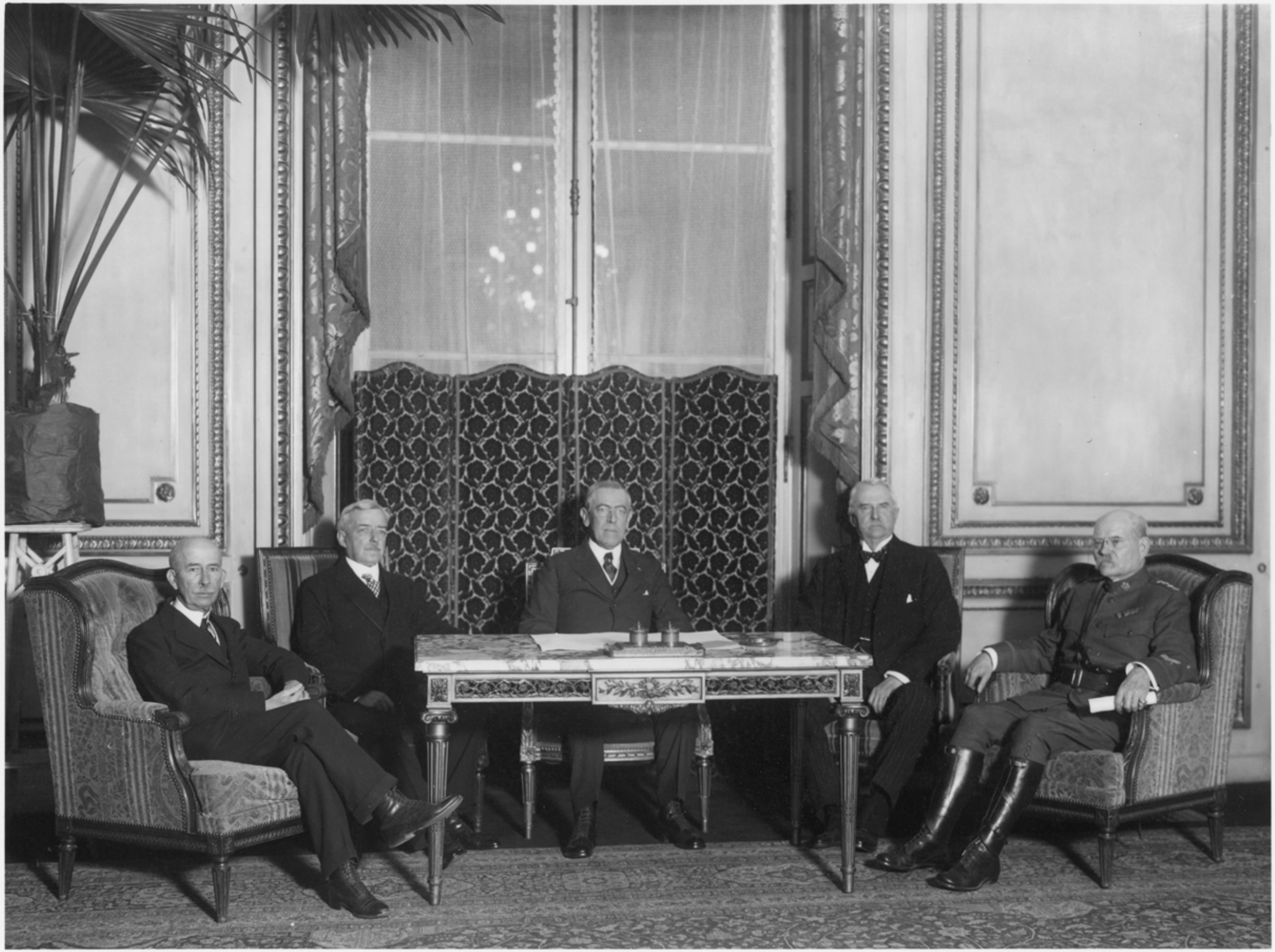
The banking system was unstable. During the 1920s, nearly half of Americans lived in rural areas. But farmers didn't share in the decade's prosperity. Many were deeply in debt—their land mortgaged and commodity prices too low to pay off their loans. These difficulties in the agricultural economy put thousands of small rural banks in financial peril. At the same time many of the nation's largest banks were investing recklessly in the rapidly rising stock market.

Photo below: *A farm foreclosure sale in Iowa in the early 1930s. FDR Library Photograph Collection, NPx 65-684(8)*

Breakdown of International Credit and Trade

International credit and trade was threatened. In the late 1920s, demand for American goods began to decline as some European nations experienced growing financial difficulties. Those difficulties were connected to international debts dating back to World War I. At the war's end, all the European nations allied with the United States owed large sums of money to American banks. This led the European Allies to insist on large reparation payments from Germany and Austria at the Versailles Peace Conference. But when those nations experienced postwar economic troubles, they became unable to make their reparations payments or service their debts. American banks then stepped in and made large loans to Germany and Austria which they then used to pay their reparations and other debts. Consequently, a dangerous cycle was created whereby the entire system of reparations and war debts payments—including war debts owed to the United States—was dependent on funds borrowed from American banks. This unstable system could not be sustained when America's economy ran into severe economic difficulties.

Photo below: *President Woodrow Wilson (center) and the American delegation to the Versailles Peace Conference. FDR Library Photograph Collection, NPx 48-22:3833(102).*

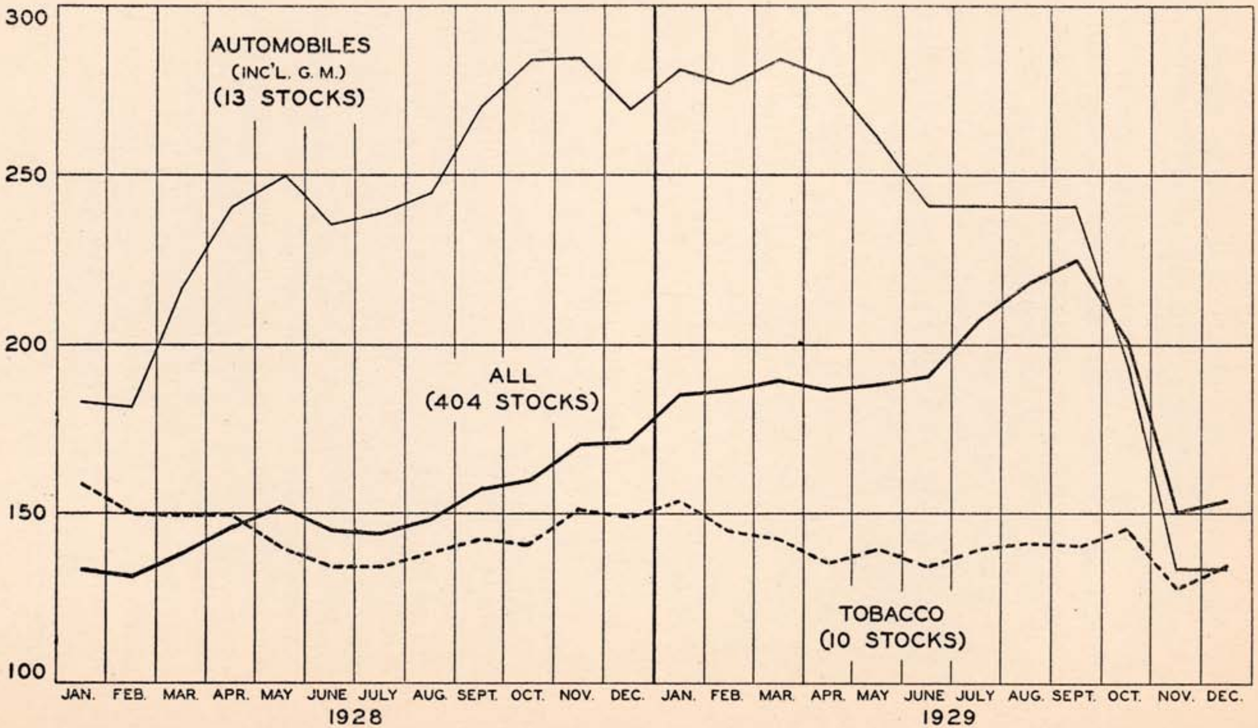


Stock Market Crash of October 1929

All these underlying problems came to a head in 1929. The Federal Reserve Bank became concerned about growing speculation on Wall Street. For years, many investors had been buying stock with borrowed money, betting prices would keep rising. Commercial banks also joined in the stock buying mania. In late 1929, the Federal Reserve tightened credit to reduce stock speculation. Instead, it helped set off the great October 1929 Stock Market Crash. Stock values plummeted nearly 40% in one week. They wouldn't return to pre-Crash levels until 1954.

Photo below: *Chart of Stock Price Indices, 1928-1929. Vertical File: Stock Exchange*

1928-1929
GROUP AVERAGE (ADJUSTED) STOCK PRICE INDICES
(Standard Statistics Co.)



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Stock Crisis Impacted Other Economic Sectors

The Stock Market Crash did not so much cause the Depression as help unleash a chain of events that exposed the longstanding vulnerabilities in the American economy.

Stock losses led to lower consumer spending by investors. The Federal Reserve then made matters more difficult by further tightening credit. Businesses reacted by cutting back on purchases. This led to falling production and rising unemployment. As joblessness spread, consumer spending fell further. This created even greater drops in production and employment. The country fell into a dangerous deflationary spiral.

The crisis soon spread to the banking system, in part because many commercial banks had speculated in stocks. When several prominent banks collapsed, depositors rushed to pull money out of the remaining banks. This led to more bank failures and severe credit restrictions. In rural areas, falling crop prices caused thousands of small rural banks to fail. Millions of people across the nation lost their life savings.

America's pivotal position in the global economy drew other nations into the crisis. When the U.S. economy began to weaken, European nations suddenly found it much more difficult to borrow money from America. At the same time, high U.S. tariffs made it hard for them to sell their goods in American markets. Strapped for cash, they began defaulting on their loans, further expanding the financial/economic crisis both in the U.S. and abroad.

Photo below: *A run on a bank by depositors, 1933. FDR Library Photograph Collection, NPx 74-20:1007*


SAFE DEPOSIT

Government Made a Bad Situation Worse

Subsequent government action—and inaction—made a bad situation much worse.

Photo below: *The unemployed search for jobs. FDR Library Photograph Collection, NPx 74-20(241)*


JOBLESS MEN
KEEP GOING
WE CAN'T TAKE CARE OF OUR OWN

Congress Raised Tariffs and Stifled Trade

In 1930, Congress raised American import tariffs to record levels to protect American businesses. Other nations retaliated, reducing international trade and creating a deeper financial crisis in Europe and the U.S.

Photo below: *Business leader John H. Fahey criticized U.S. tariff policy in this 1931 speech. Vertical File: Tariff-U.S.*

TARIFF BARRIERS AND BUSINESS DEPRESSION

BY

JOHN H. FAHEY

EDITOR, *Worcester Post;* FORMER PRESIDENT
U. S. CHAMBER OF COMMERCE

AN ADDRESS
BEFORE THE
ACADEMY OF POLITICAL SCIENCE
AT ITS
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1931

The Federal Reserve Bank Tightened Credit

The Federal Reserve Bank maintained tight credit in an effort to preserve a strong U.S. dollar. This contributed to higher interest rates that made economic recovery even harder.

Photo below: *Eugene Meyer, Chairman of the Federal Reserve, 1930-1933. FDR Library Photograph Collection, Px 66-328(41)*

Failure to Provide Relief to the Unemployed

Republican President Herbert Hoover did not act aggressively to end the crisis. Hoover made some moves to combat the Depression, but he believed in limited government and relief through private charity. Though he eventually approved credit assistance for banks and businesses and some public construction spending, he was reluctant to fund massive public works projects and other stimulative measures, and he refused to provide federal relief money to the unemployed. With the private sector in crisis and the federal government unwilling to step in boldly to restore economic demand, the Depression continued to deepen.

Photo below: *The unemployed at a breadline. NPx 74-20(244)*


ST PETER'S MISSION