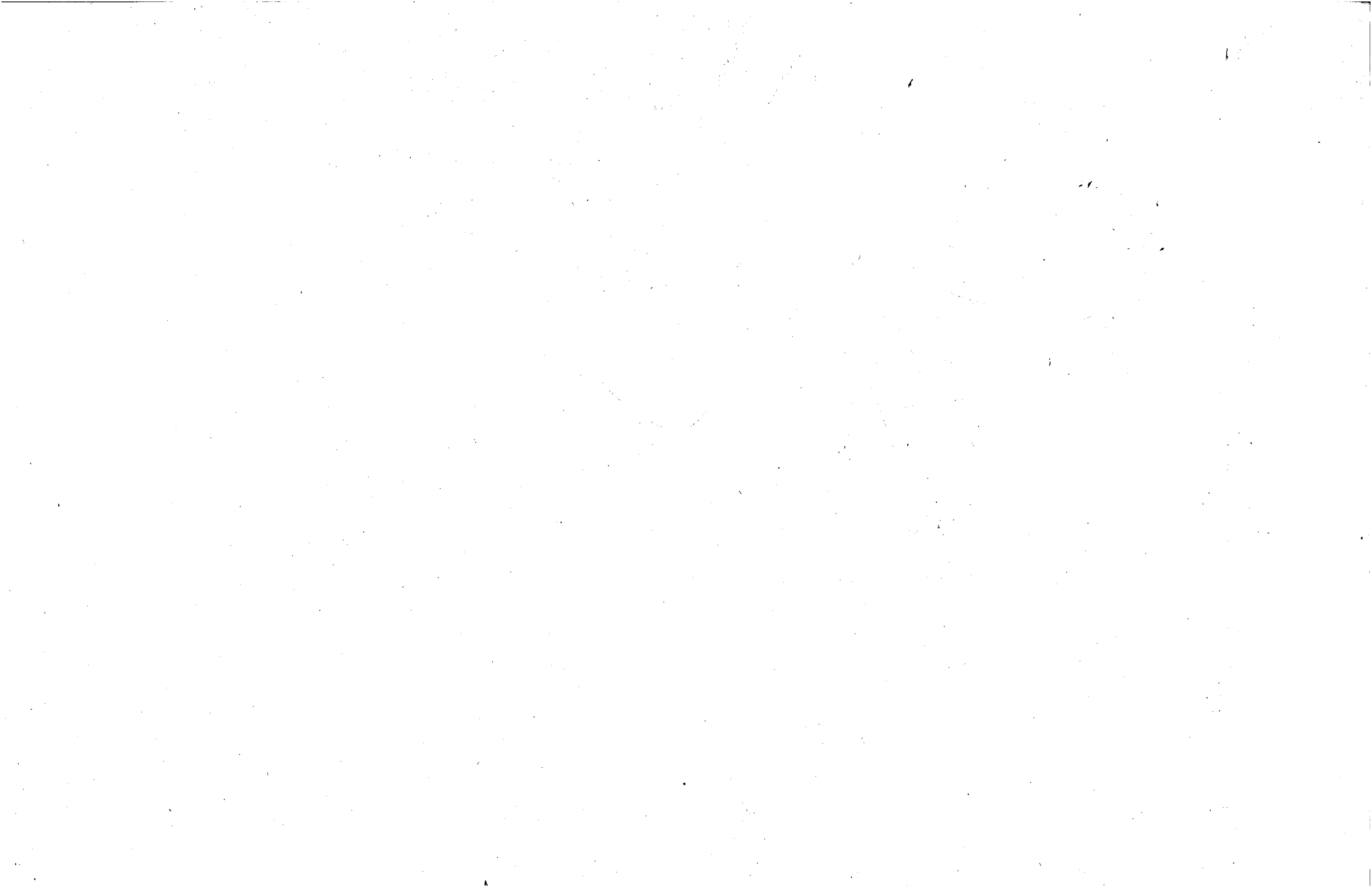

Great Depression

Background

The 1920s were a time of economic prosperity. Millions of Americans purchased radios and automobiles. Cities and homes were lit by electric light bulbs. The stock market soared to dizzying heights. The nation's GNP rose 40% to cross $1 billion for the first time ever. But, on October 29, 1929, the stock market dropped by about 13%. By 1933, stocks were selling for one-fifth their previous highs, unemployment had risen to 25%, 9,000 banks were bankrupt, the income of Americans was cut in half, and the country was in the middle of the Great Depression.

Private Business Caused the Depression
by "Frank Veltrose"

Before the 1930s, there were few government regulations on businesses or the stock market. And, there were no federal government programs to help the poor. The result was a disaster.

Business boomed and the stock market soared during the 1920s. But, the economy was unstable. It is true that businesses made lots of money, but the owners did not use that money to increase wages or provide benefits to workers, such as unemployment insurance. Instead, business owners either kept the profits for themselves or used them to expand their business and make even more products.

Businesses recognized that eventually most of the people who could afford their products will have bought them. So, they invented "installment buying." This allowed people to pay only about 10% of the cost for something, and then owe the rest. But even this could not make up for the fact that only a small portion of the people were paid enough to afford their products.

The stock market crashed at about the time that all who could afford the new products had already bought them. Companies were left with warehouses full of goods and no one to buy them. So, they shut down their factories. This left even fewer people who could afford to buy things and more factories shut down.

Even more important, lots of people who owed money for the things they had bought on an installment plan were now unemployed. Since there was no unemployment insurance or government welfare programs, people could not pay what they owed. Many of the businesses that were owed money went bankrupt, leading to even more unemployment.

The stock market crash had other effects. Many businesses used false advertising to get people to buy their stock. Banks used deposits to invest in risky stocks, instead of making safer loans. To get more people to buy stocks, stock-brokers allowed people to "buy on margin." This was similar to installment buying, in that someone only had to pay about 10% of the money they wanted to invest and then borrowed the rest.

All of these tactics drove up stock prices. But, when stock prices eventually fell, disaster struck. Banks went bankrupt and people lost the money they had deposited in the banks. Individual investors who had bought on margin lost everything they owned.

When the U.S. entered the industrial age, the government should have regulated the corporations and started welfare programs for the poor and unemployed. Unregulated businesses caused the Great Depression.

Government Caused the Depression
by "Melanie Manfreid"

The economy was humming along in the 1920s. New companies were forming and old ones expanding. This created thousands of jobs, partly because it was so easy for people to buy and sell shares of companies in the stock market. When the stock market crashed, people panicked.

The stock market was fairly new then, but we now know that such swings are common and stock prices would have gone back up eventually. Unfortunately, the U.S. government then did two things that turned a temporary downturn into the Great Depression.

First, in 1930, Congress raised tariffs to the highest level in U.S. history. A tariff is a tax on products imported into the U.S. Tariffs are good for the government, but bad for the economy. Any consumer or business that uses products that have a tariff on them must pay more for those products. Tariffs also reduce international trade and the economic benefits of trade.

The 1930 tariff law raised tariffs to an average of more than 50%! Foreign-made products suddenly became much more expensive. This bankrupted many American businesses that used foreign-made products.

Second, in 1931, the Federal Reserve reduced the amount of money in circulation. The Federal Reserve is often called the "banker's bank," because, instead of lending money to individuals and businesses, it lends money to banks.

The Federal Reserve has a dramatic impact on the amount of money in circulation. For example, if it reduces the interest rate it charges banks, banks will borrow more money. The banks then have more money to lend to businesses. While this helps businesses, it may lead to inflation, so the selection of the Federal Reserve's interest rate is more complicated than it seems.

During 1931, after the stock market had dropped and the tariff had been raised, businesses were going through a downturn. They needed money so they could raise wages and expand.

At this point, the Federal Reserve should have lowered the interest rate it charged banks. This would have encouraged banks to borrow money from the Federal Reserve. Then, they could have loaned businesses the money they desperately needed. Instead, the Federal Reserve actually increased the interest rate from 1½% to 3½%!

This may not seem like much, but it was enough to make it impossible for many banks to borrow money. When business needed money the most, there was none to borrow.

The industrial age changed the role of the federal government. Unfortunately, it was not up to the task and its unwise actions turned an economic slump into a national disaster.

Name ______________________ Date ______________

Great Depression Worksheet

1. What is one thing they both agree on? ______________________

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2. According to Veltro, what two things should businesses have used their money to do in the 1920s? ______________________

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and what two things did business owners and executives do instead?

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3. According to Veltro, what is installment buying? ______________________

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4. According to Veltro, what are three tactics business used to raise stock prices?

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5. Why does Manfreid claim tariffs hurt business? ______________________

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(Over please)

6. According to Manfreid, the 1930 tariff law raised tariffs to an average of what? ___________

7. According to Manfreid how does the Federal Reserve control the amount of money in circulation? ____

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8. According to Manfreid, the interest rate the Federal Reserve charged banks was raised from ______% to _______% in 1931.

9. Who do you agree with and what is their most persuasive argument, statistic or example?

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