SECTION 1

Causes of the Depression

Guide to Reading

Connection

In the previous chapter, you learned about the prosperity of the 1920s. In this section, you will discover the factors that contributed to the Great Depression.

Main Idea

- In an election marked by religious prejudice and the issue of Prohibition, Herbert Hoover won the presidency in a landslide. (p. 469)
- The long period of rising stock prices led many people to risky investment practices. (p. 470)
- The October 1929 stock market crash led to bank failures across the nation. (p. 471)
- An uneven distribution of income, the lack of foreign markets for exports, and the Federal Reserve's mistakes contributed to the Great Depression. (p. 472)

Content Vocabulary

stock market, bull market, margin, margin call, speculation, installment

Academic Vocabulary

invest, sum, reaction

People and Terms to Identify

Alfred E. Smith, Black Tuesday, Hawley-Smoot Tariff

Reading Objectives

- **Describe** the characteristics of the 1920s stock market.
- **Identify** the causes of the Great Depression.

Reading Strategy

Categorizing As you read about the election of 1928, complete a graphic organizer similar to the one below comparing the backgrounds and issues of the presidential candidates.

1928 Presidential Campaign		
Candidate	Background	Issues

Preview of Events

November 1928 — *September 1929* — *July 1930*

November 1928 Herbert Hoover elected president

October 24, 1929 Stocks fall during Black Thursday

October 29, 1929 Black Tuesday stock market crash

June 1930 Congress passes Hawley-Smoot Tariff

The following are the main History–Social Science Standards covered in this section.

11.5.1 Discuss the policies of Presidents Warren Harding, Calvin Coolidge, and Herbert Hoover.

11.6.1 Describe the monetary issues of the late nineteenth and early twentieth centuries that gave rise to the establishment of the Federal Reserve and the weaknesses in key sectors of the economy in the late 1920s.

11.6.2 Understand the explanations of the principal causes of the Great Depression and the steps taken by the Federal Reserve, Congress and Presidents Herbert Hoover and Franklin Delano Roosevelt to combat the economic crisis.

The Big Idea

Societies change over time. Following the presidential election of Herbert Hoover, most Americans were optimistic about the future of the country. Stock prices were soaring, and many people invested in the stock market. As the number of new investors began to dwindle, the market first slowed and then crashed. The stock market crash resulted in the collapse of many banks. At the same time, overproduction brought an excess of products that many people could not afford to buy. This led factories to lower production and lay off workers. Due to a low number of exports, companies were not able to make up for the reduction in consumer spending. All of these factors, combined with the Federal Reserve's decision to keep interest rates low, led to an economic depression.

The Election of 1928

Main Idea **In an election marked by religious prejudice and the issue of Prohibition, Herbert Hoover won the presidency in a landslide.**

Reading Connection What issues in school elections or local elections have been important to you? Read on to learn about important campaign issues in the 1928 election.

The economic collapse that began in 1929 had seemed unimaginable only a year earlier. Many people found themselves without work as jobs became scarce.

★ An American Story ★

In the years just after the 1929 stock market crash, Annetta Gibson taught English in a Rockford, Illinois, grade school. As a teacher, Gibson was lucky because she was at least able to keep her job, unlike many other American workers.

> "Everyone knew that the teachers' salaries were being held up. . . . The stores charged anything we wanted, and we'd pay them when we got paid, so it wasn't too bad.
>
> The one thing that was bad was that we had worked hard at school to get the children to save. . . . The children would bring, oh, maybe just a few pennies that they would put in their banks. Some of them had nice little bank accounts when the Depression hit, and some of them never got their money back. It wasn't too good a lesson . . . because they thought they might as well spend their money as save it and then have it gone."

—quoted in *Centenarians: The Story of the Twentieth Century by the Americans Who Lived It*

In the election of 1928, the presidential candidates vied with each other to paint a rosy picture of the future. Republican Herbert Hoover declared, "We are nearer to the final triumph over poverty than ever before in the history of any land."

The Candidates When Calvin Coolidge decided not to run for president in 1928, he cleared the way for Herbert Hoover to head the Republican ticket. A successful engineer and former head of the Food Administration during World War I, Hoover had also spent over seven years as secretary of commerce in the Harding and Coolidge administrations. The Democrats chose **Alfred E. Smith,** four-time governor of New York. Smith was an Irish American from New York's Lower East Side and the first Roman Catholic ever nominated to run for president.

Campaign Issues By 1928 Prohibition had become a major issue among voters. Because he favored the ban on liquor sales, Hoover was considered a "dry" in the popular language of the day. Smith, who disliked the ban, was a "wet."

The candidates' religious differences sparked a smear campaign against Smith. Many Protestants were willing to believe that the Catholic Church financed the Democratic Party and would rule the United States if Smith got into the White House. These slurs embarrassed Hoover, a Quaker, and he tried to quash them, but the charges seriously damaged Smith's candidacy.

Smith's biggest problem, however, was the prosperity of the 1920s, for which the Republicans took full credit. Republican candidates promised to continue the trend with such slogans as "two cars in every garage." Hoover received over 6 million more votes than Smith and won the Electoral College in a landslide, 444 to 87.

On March 4, 1929, an audience of 50,000 stood in the rain to hear Hoover's inaugural speech. Sound movie cameras covered the inauguration for the first time and radios broadcast the address worldwide. "I have no fears for the future of our country," Hoover said. "It is bright with hope."

Reading Check **Examining** What campaign issues led to Herbert Hoover's election to the presidency?

Bank run at a Newark, New Jersey bank

The Long Bull Market

Main Idea **The long period of rising stock prices led many people to risky investment practices.**

Reading Connection What are your strategies for saving money? Read on to find out about people's efforts to make money in the stock market during the 1920s.

The wave of optimism that swept Hoover into the White House also drove stock prices to new highs. The **stock market** was established as a system for buying and selling shares of companies. Sometimes circumstances in the stock market lead to a long period of rising stock prices, which is known as a **bull market.** In the late 1920s a prolonged bull market convinced many Americans to **invest** heavily in stocks. By 1929 about 3 million Americans, or roughly 10 percent of households, owned stocks.

As the market continued to soar, many investors began buying stocks on **margin,** meaning they made only a small cash down payment—as low as 10 percent of the price. With $1,000 an investor could buy $10,000 worth of stock. The other $9,000 would come as a loan from a stockbroker, who earned both a commission on the sale and interest on the loan. The broker held the stock as collateral.

As long as stock prices kept rising, buying on margin was safe. For example, an investor who borrowed money to buy $10,000 worth of stocks had to wait only a short time for them to rise to $11,000 in value. The investor could then sell the stock, repay the loan, and make $1,000 in profit. The problem came if the stock price began to fall. To protect the loan, a broker could issue a **margin call,** demanding the investor repay the loan at once. As a result, many investors were very sensitive to any fall in stock prices. If prices fell, they had to sell quickly, or they might not be able to repay their loans.

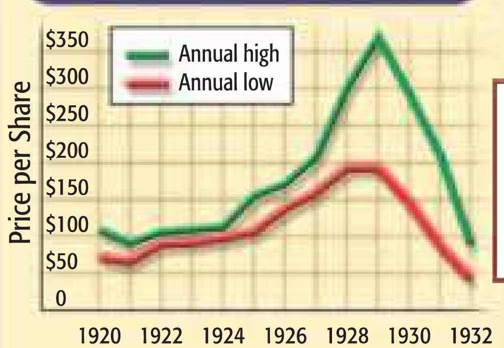
The Great Depression

Causes

- Overproduction and low demand leads to employee layoffs
- Low wages reduce consumer buying power
- High tariffs restrict foreign demand for American goods
- Unemployment reduces buying power further

Cyclical Effect

Stock Prices, 1920–1932



Source: Standard and Poor's *Security Price Index Record.*

Graph Skills

1. **Interpreting Graphs** Stock prices peaked in 1929. Before this peak, when did they begin to rise sharply?
2. **Making Generalizations** How did the decline in auto sales affect many other industries?

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Before the late 1920s, the prices investors paid for stocks generally reflected the stocks' true value. If a company made a profit or had good future sales prospects, its stock price rose, while a drop in earnings or an aging product line could send the price down. In the late 1920s, however, hordes of new investors bid prices up without regard to a company's earnings and profits. Buyers, hoping to make a fortune overnight, engaged in **speculation.** Instead of investing in the future of the companies, speculators took risks, betting that the market would continue to climb, thus enabling them to make money quickly.

✓ Reading Check **Summarizing** What was the stock market like in the 1920s?

The Great Crash

Main Idea **The October 1929 stock market crash led to bank failures across the nation.**

Reading Connection If a stock market crash were to occur today, how would your family be affected? Read on to learn about the stock market collapse in 1929.

The bull market lasted only as long as investors continued putting new money into it. By the latter half of 1929, the market was running out of new customers. In September professional investors sensed danger and began to sell off their holdings. Prices slipped. Other investors sold shares to pay the interest on their brokerage loans. Prices fell further.

Crash! On Monday, October 21, Groucho Marx, the comic star of stage and screen, was awakened by a telephone call from his broker. "You'd better get down here with some cash to cover your margin," the broker said. The stock market had plunged. The dazed comedian had to pay back the money he had borrowed to buy stocks, which were now selling for far less than he had paid.

Other brokers made similar margin calls. Frightened customers put their stocks up for sale at a frenzied pace, driving the market into a tailspin. When Marx arrived at the brokerage, he found ticker tape "knee deep on the floor." He further recalled, "People were shouting orders to sell and others were frantically scribbling checks in vain efforts to save their original investments."

On October 24, a day that came to be called Black Thursday, the market plummeted further. Marx was wiped out. He had earned a small fortune from plays and films, and now it was gone in the blink of an eye. Like many other investors, he was deeply in debt. Arthur Marx recalled his father's final visit to the brokerage, as Groucho looked around and spotted his broker:

> “He was sitting in front of the now-stilled ticker-tape machine, with his head buried in his hands. Ticker tape was strewn around him on the floor, and the place . . . looked as if it hadn't been swept out in a week. Groucho tapped [him] on the shoulder and said, 'Aren't you the fellow who said nothing could go wrong?' 'I guess I made a mistake,' the broker wearily replied. 'No, I'm the one who made a mistake,' snapped Groucho. 'I listened to you.'”
>
> —quoted in 1929: *The Year of the Great Crash*

The following week, on October 29, a day later dubbed **Black Tuesday,** prices took the steepest dive yet. That day stocks lost $10 to $15 billion in value.

By mid-November stock prices had dropped by over one-third. Some $30 billion was lost, a **sum** roughly equal to the total wages earned by Americans in 1929. The stock market crash was not the major cause of the Great Depression, but it undermined the economy's ability to hold out against its other weaknesses.

Picturing **History**

Herbert Hoover The nation and its new president felt confident about the future in early 1929. Why were Americans so optimistic?

Banks in a Tailspin The market crash severely weakened the nation's banks in two ways. First, many banks had lent money to stock speculators. Second, many banks had invested depositors' money in the stock market, hoping for higher returns than they could get by using the money for conventional loans.

When stock values collapsed, the banks lost money on their investments, and the speculators defaulted on their loans. Having suffered serious losses, many banks cut back drastically on the loans they made. With less credit available, consumers and businesses were unable to borrow as much money as they had previously. This helped to put the economy into a recession.

For some banks, the losses they suffered in the crash were more than they could absorb, and they were forced to close. At that time, the government did not insure bank deposits; therefore, if a bank collapsed, customers lost their savings. The bank failures in 1929 and early 1930 triggered a crisis of confidence in the banking system.

News of bank failures worried many Americans. They began to make runs on the nation's banks, causing the banks to collapse. A bank run takes place when many depositors decide to withdraw their money at one time, usually for fear the bank is going to collapse. During this time, there were no guarantees to protect people's money in case of a bank collapse.

Most banks make a profit by lending money received from depositors and collecting interest on the loans. The bank holds on to only a fraction of the depositors' money to cover everyday business, such as occasional withdrawals. Ordinarily that reserve is enough to meet the bank's needs, but if too many people withdraw their money, the bank will eventually collapse. During the first two years of the Depression, more than 3,000 banks—over 10 percent of the nation's total—were forced to close.

✓ **Reading Check** **Evaluating** How did bank failures contribute to the Great Depression?

History *Through Art*

Wall Street Panic This painting shows the confusion and chaos surrounding the financial industry in October 1929. How does the artist depict a sense of disorder?

The Roots of the Great Depression

Main Idea **An uneven distribution of income, the lack of foreign markets for exports, and the Federal Reserve's mistakes contributed to the Great Depression.**

Reading Connection What do you believe is the current distribution of income in America? Read on to learn about the distribution of income just prior to the Great Depression.

The stock market crash helped put the economy into a recession. Yet the crash would not have led to a long-lasting depression if other forces had not been at work. The roots of the Great Depression were deeply entangled in the economy of the 1920s.

The Uneven Distribution of Income Most economists agree that overproduction was a key cause of the Depression. More efficient machinery increased the production capacity of both factories and farms.

Most Americans did not earn enough to buy up the flood of goods they helped produce. While manufacturing output per person-hour rose 32 percent, the average worker's wage increased only 8 percent. In 1929 the top 5 percent of all American households earned 30 percent of the nation's income. By contrast, about two-thirds of families earned less than \$2,500 a year, leaving them little expendable income.

Newspaper headline the day after Black Tuesday

During the 1920s many Americans bought high-cost items on the **installment** plan, under which they would make a small down payment and pay the rest in monthly installments. Some buyers could not pay off their debts without reducing other purchases. This low consumption then led manufacturers to cut production and lay off employees.

The slowdown in retail manufacturing had repercussions throughout the economy. When radio sales slumped, for example, makers cut back on their orders for copper wire, wood cabinets, and glass radio tubes. Montana copper miners, Minnesota lumberjacks, and Ohio glassworkers, in turn, lost their jobs. Jobless workers had to cut back purchases, further reducing sales. This kind of chain **reaction** put more and more Americans out of work.

The Loss of Export Sales Many jobs might have been saved if American manufacturers had sold more goods abroad. As the bull market of the 1920s accelerated, U.S. banks made high-interest loans to stock speculators instead of lending money to foreign companies. Without these loans from U.S. banks, foreign companies purchased fewer American products.

Matters grew worse after June 1930, when Congress passed the **Hawley-Smoot Tariff** raising the average tariff rate to the highest level in American history. The Hawley-Smoot Tariff aimed to protect American manufacturers from foreign competition, but it damaged American sales abroad. Because imports now cost much more, Americans bought fewer of them. Foreign countries responded by raising their own tariffs against American products, and this caused fewer American products to be sold overseas. In 1932 U.S. exports fell to about one-fifth of what they had been in 1929, which hurt both American companies and farmers.

Mistakes by the Federal Reserve Just as consumers were able to buy more goods on credit, access to easy money propelled the stock market. Instead of raising interest rates to curb excessive speculation, the Federal Reserve Board kept its rates very low.

The Board's failure to raise interest rates contributed to the Depression in two ways. First, by keeping rates low, it encouraged member banks to make risky loans. Second, low interest rates led business leaders to think the economy was still expanding. As a result, they borrowed more money to expand production, which led to overproduction when sales were falling. When the Depression hit, companies had to lay off workers to cut costs. Then the Fed made another mistake. It raised interest rates, tightening credit. The economy continued to spiral downward.

✓ Reading Check **Examining** How did the decline in worldwide trade contribute to the Depression?

HISTORY Online **Study Central**

For help with the concepts in this section of *American Vision: Modern Times* go to tav.mt.glencoe.com and click on ***Study Central.***

SECTION 1 ASSESSMENT

Checking for Understanding

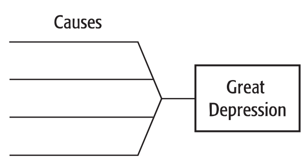
1. **Vocabulary** Define: stock market, bull market, invest, margin, margin call, speculation, sum installment, reaction.
2. **People and Terms** Identify: Alfred E. Smith, Black Tuesday, Hawley-Smoot Tariff.
3. **Explain** the significance of the stock market crash, including Black Tuesday.

Reviewing Big Ideas

4. **Interpreting** How did the practices of buying on margin and speculation cause the stock market to rise?

Critical Thinking

5. **Evaluating** Why did the stock market crash cause banks to fail?
6. **Organizing** Use a graphic organizer similar to the one below to list the causes of the Great Depression.



Analyzing Visuals

7. **Analyzing Graphs** Study the graphs on page 470. Note that decreased demand for automobiles ultimately led to layoffs. These layoffs further decreased the demand for automobiles. What do you think might have ended this cycle?

Writing About History

8. **Expository Writing** Write an article for a financial magazine explaining the rapid decline of the stock market in 1929 and the reasons for the Black Tuesday crash. CA 11WA2.1a