Section 1

The Causes of the Great Depression

Guide to Reading

Big Ideas

Economics and Society Stock speculation on an unregulated stock market put investors and banks at risk in the 1920s.

Content Vocabulary

- stock market *(p. 628)*
- bull market *(p. 629)*
- margin *(p. 629)*
- margin call *(p. 629)*
- speculation *(p. 629)*
- bank run *(p. 631)*
- installment *(p. 633)*

Academic Vocabulary

- collapse *(p. 628)*
- invest *(p. 629)*
- sum *(p. 631)*

People and Events to Identify

- Alfred E. Smith *(p. 628)*
- Black Tuesday *(p. 630)*
- Hawley-Smoot Tariff *(p. 633)*

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

Although the 1920s were prosperous, speculation in the stock market, risky lending policies, overproduction, and uneven income distribution, eventually undermined the economy and led to the Great Depression.

The Long Bull Market

MAIN Idea A strong economy helped Herbert Hoover win the 1928 election, but increasing speculation in the stock market set the stage for a crash.

HISTORY AND YOU Have you ever taken a risk while playing a game or sport? How did you decide if the risk was worth it? Read on to learn about the risks people were willing to take in the stock market in the 1920s.

The economic **collapse** that began in 1929 seemed unimaginable only a year earlier. In the 1928 election, both presidential candidates tried 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 Election of 1928

When Calvin Coolidge declined to run for reelection in 1928, the Republicans nominated his secretary of commerce, Herbert Hoover. Hoover was well known to Americans because he had run the Food Administration during World War I. The Democrats chose **Alfred E. Smith,** four-time governor of New York. Smith was the first Roman Catholic to win a major party's nomination for president.

Smith's beliefs became a campaign issue. Some Protestants claimed that the Catholic Church financed the Democratic Party and would rule the United States if Smith became president. These slurs embarrassed Hoover, a Quaker, and he tried to quash them, but the charges damaged Smith's candidacy.

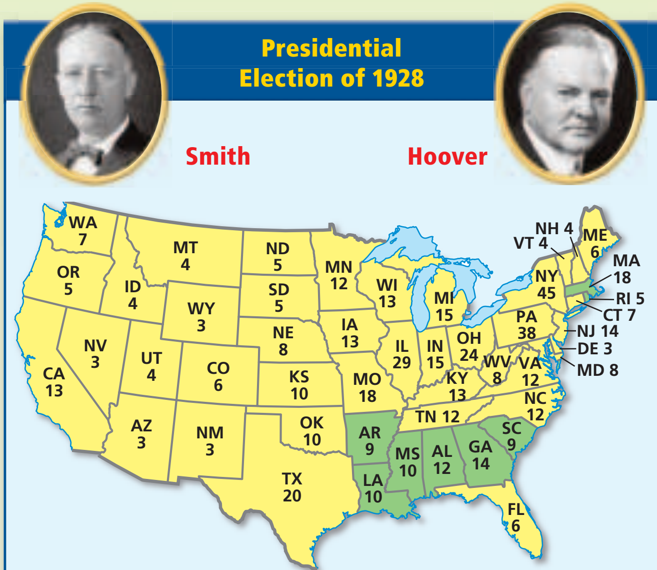
Smith's biggest challenge, however, was the prosperity of the 1920s, for which the Republicans took full credit. Hoover defeated Smith by more than 6 million votes and won the Electoral College in a landslide, 444 to 87. On March 4, 1929, an audience of 50,000 stood in the rain to hear Hoover's inaugural speech. "I have no fears for the future of our country," Hoover said. "It is bright with hope."

The Stock Market Soars

The optimism that swept Hoover into the White House also drove stock prices to new highs. Sometimes the **stock market** experiences

PRIMARY SOURCE

Hoover and "Rugged Individualism"



Presidential Candidate	Popular Vote	% of Popular Vote	Electoral Vote
Hoover	21,392,190	58.18%	444
Smith	15,016,443	40.84%	87

Primary Source

"This campaign now draws near to a close. . . . We were challenged with the choice of the American system of 'rugged individualism' or the choice of a European system of diametrically opposed doctrines—doctrines of paternalism and state socialism. The acceptance of these ideas meant the destruction of self-government through centralization of government; it meant the undermining of initiative and enterprise . . . .

. . . You cannot give to a government the mastery of the daily working life of a people without at the same time giving it mastery of the peoples' souls and thoughts. . . . Free speech does not live many hours after free industry and free commerce die. . . . The bureaucratization of our country would poison the very roots of liberalism that is free speech, free assembly, free press, political equality and equality of opportunity. It is the road, not to more liberty, but to less liberty."

—speech by Herbert Hoover in New York City, October 22, 1928

DBQ Document-Based Questions

1. **Contrasting** Against what other system does Hoover contrast "rugged individualism"?
2. **Analyzing Primary Sources** What does Hoover believe is at stake if free industry and free commerce die? Do you agree or disagree? Explain your position.

a long period of rising stock prices, or a **bull market.** In the late 1920s a prolonged bull market convinced many people to **invest** in stocks. By 1929 approximately 10 percent of American households owned stocks.

As the market continued to soar, many investors began buying stocks on **margin,** making 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.

If the price of the stock kept rising, the investor could make a profit. For example, the investor who borrowed to buy $10,000 worth of stock had only to wait for it 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.

Before the late 1920s, the prices investors paid for stocks had generally reflected the stocks' true value. If a company made a profit or had good future sales prospects, its stock price rose; prices fell when earnings dropped. In the late 1920s, however, many investors bid prices up without considering a company's earnings and profits. Buyers, hoping for a quick windfall, engaged in **speculation.** They bet the market would continue to climb, thus enabling them to sell the stock and make money quickly.

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

The Great Crash

MAIN Idea Rising stock prices led to risky investment practices; when the stock market crashed, banks were in trouble.

HISTORY AND YOU Have you ever paid more for something than it was worth? Read on to learn why the stock market collapsed 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.

The Stock Market Crash

On Monday, October 21, 1929, the comedian Groucho Marx 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 for them. Other brokers made similar margin calls. Nervous customers put their stocks up for sale at a frenzied pace, driving the market into a tailspin.

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, but now it was gone, and he was deeply in debt. His son recalled his final visit to the brokerage firm, as Groucho spotted his broker:

PRIMARY SOURCE

"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 that was later dubbed **Black Tuesday,** prices took the steepest dive yet. That day, almost 16 million shares of stock were sold; the stock

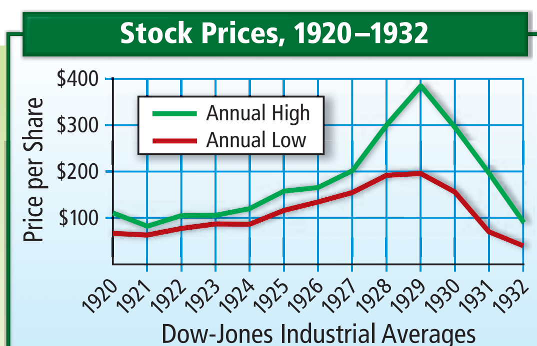
Turning Point

A Crash Becomes a Depression

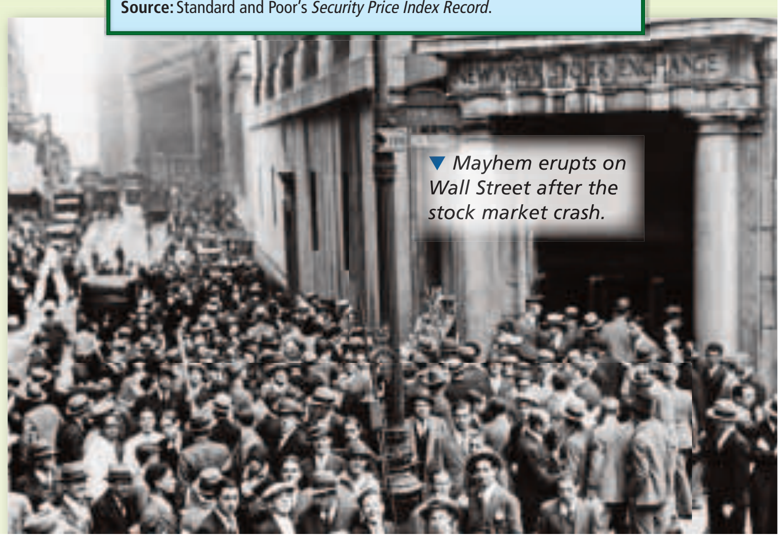
When the stock market crashed in October 1929, it exposed many weaknesses in the American economy. By 1932 over 25 percent of American workers were unemployed. Charities could not help all who were in need. Many cities had gone bankrupt and newly created state relief agencies had insufficient funds to help.

The Great Depression prompted major political changes. When Franklin D. Roosevelt ran for president in 1932, he had offered few details about how he would save the economy. Once in office, however, he launched a massive program to rescue the banking system, stabilize industry, and aid the unemployed. By the late 1930s, the federal government had taken on huge new responsibilities for the health of the economy and welfare of American families.

ANALYZING HISTORY **Do you think the Great Depression required government intervention to resolve? Write a brief essay explaining your opinion.**



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


▼ *Mayhem erupts on Wall Street after the stock market crash.*

market lost between $10 billion and $15 billion in value. By mid-November, stock prices had dropped by more than one-third. Some $30 billion was lost, a **sum** roughly equal to the total wages Americans earned in 1929. Although the stock market crash was not the major cause of the Great Depression, it undermined the economy's ability to overcome other weaknesses.

Banks Begin to Close

The market crash severely weakened the nation's banks in two ways. First, by 1929 banks had loaned nearly $6 billion 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 loans.

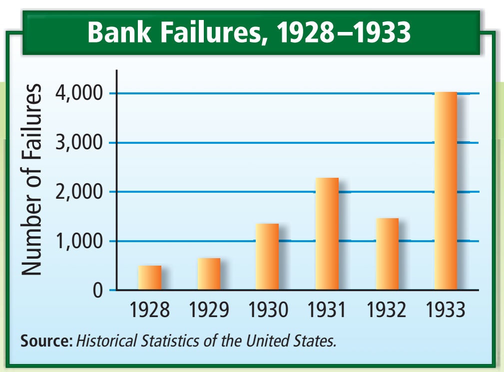
When stock values collapsed, banks lost money on their investments, and speculators defaulted on their loans. Having suffered serious losses, many banks cut back drastically on the loans they made. With less credit available, consumers and businesses were not able to borrow as much money. This helped to send the economy into a recession.

Some banks could not absorb the losses they suffered and were forced to close. The government did not insure bank deposits, so if a bank collapsed, customers, including those who did not invest in the stock market, lost their savings. Bank failures in 1929 and 1930 created a crisis of confidence in the banking system.

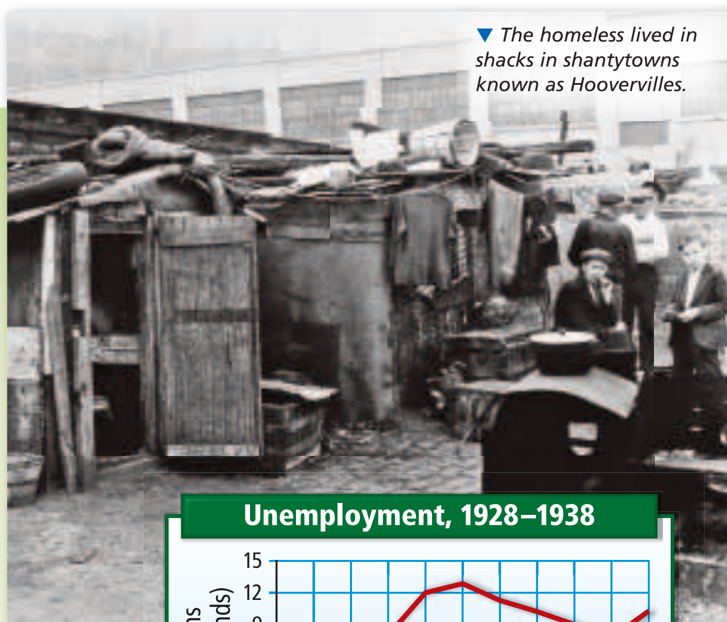
News of bank failures worried Americans. Some depositors made runs on banks, causing the banks to collapse. A **bank run** takes place when many depositors decide to withdraw their money at one time, usually because of fear that the bank is going to collapse.

Most banks make a profit by lending money received from depositors and collecting interest on the loans. The bank keeps only a fraction of depositors' money in reserve to cover daily business and withdrawals. Usually, that reserve is enough to meet the bank's needs. If too many people withdraw their money, however, the bank will collapse. More than 10 percent of the nation's banks—nearly 3,500—had closed by 1932.

Reading Check **Determining Cause and Effect** What chain of events led to the economic crash of 1929?



Source: *Historical Statistics of the United States.*


▼ *The homeless lived in shacks in shantytowns known as Hoovervilles.*


◀ *Depositors at a New York bank line up to withdraw their money in 1930.*

Source: *Historical Statistics of the United States.*

The Roots of the Great Depression

MAIN Idea An uneven distribution of income, tariff policies, and the Federal Reserve Board's mistakes contributed to the Great Depression.

HISTORY AND YOU How evenly is wealth distributed in your community? Read about the uneven distribution of income in the late 1920s.

The stock market crash played a major role in putting 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 Great Depression. More efficient machinery increased the production capacity of both factories and farms. Most Americans, however, 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. In contrast, about two-thirds of families earned less than \$2,500 a year, leaving them with little disposable income.

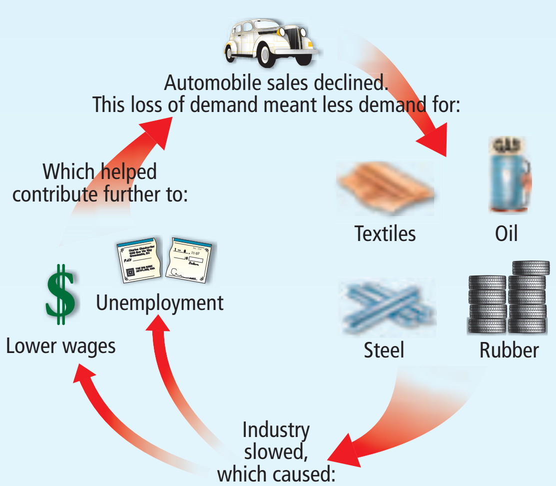
INFOGRAPHIC

Causes of the Great Depression

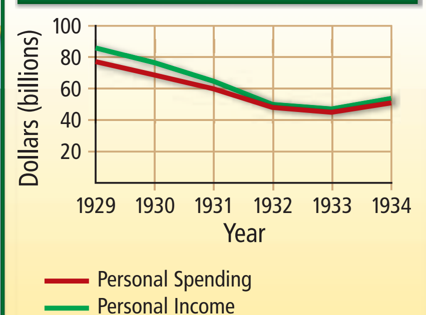
What Caused the Economy to Collapse?

- **Low Interest Rates** Federal Reserve kept interest rates low; companies borrowed money and expanded more than necessary.
- **Overproduction** Companies made more goods than could be sold.
- **Uneven Distribution of Wealth** Not everyone who wanted consumer goods could afford them.
- **High Tariffs** restricted foreign demand for American goods.
- **Falling Demand** With too many goods unsold, production was cut back and employees were laid off.
- **Stock Market Speculation** Low interest rates encouraged borrowing money to speculate, endangering bank solvency.

Cyclical Effect

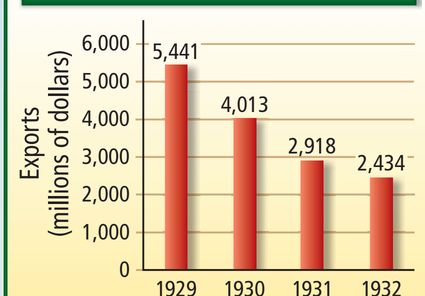


Income and Spending



Source: *Historical Statistics of the United States.*

Value of Exports, 1929–1932



Source: *Historical Statistics of the United States.*

Analyzing VISUALS DBQ

1. **Analyzing** What effect did the decline in automobile sales have on the steel industry?
2. **Calculating** Between what two years was the decrease in the value of exports the greatest?

During the 1920s many Americans had purchased high-cost items, such as refrigerators and cars, on the **installment** plan. Purchasers could make small down payments and pay the remainder of the item's price in monthly installments. Paying off such debts eventually forced some buyers to stop making new purchases. Because of the decrease in sales, manufacturers in turn cut production and laid off employees.

The slowdown in retail sales reverberated throughout the economy. When radio sales slumped, for example, makers cut back on 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 cut back on purchases, further cutting sales. This kind of chain reaction put more and more Americans out of work. Many families had little or no savings. They had nothing to support themselves when they lost their jobs. In 1930 alone, about 26,000 businesses collapsed.

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 sped up, U.S. banks made loans to speculators rather than loans to foreign companies. Foreign countries were also facing a recession after World War I. Many nations did not have the money to buy American-manufactured goods or crops.

In 1929 Hoover wanted to encourage overseas trade by lowering tariffs. Most Republicans, however, wanted to protect American industry from foreign competition by raising tariffs. The resulting legislation, the **Hawley-Smoot Tariff,** raised the average tariff rate to the highest level in American history. In the end, it failed to help American businesses, because foreign countries responded by raising their own tariffs. This meant fewer American products were sold overseas. By 1932 exports were 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 throughout the 1920s.

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

Reading Check **Listing** What were three factors that contributed to the Great Depression?

Section 1 REVIEW

Vocabulary

1. **Explain** the significance of: Alfred E. Smith, stock market, bull market, margin, margin call, speculation, Black Tuesday, bank run, installment, Hawley-Smoot Tariff.

Main Ideas

2. **Identifying** What factors contributed to Herbert Hoover's election in 1928?

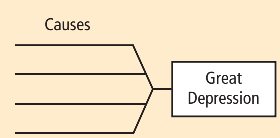
3. **Examining** How did the stock market collapse affect banks?

4. **Explaining** What effect did tariff policies have on the Great Depression?

Critical Thinking

5. **Big Ideas** How did the practice of buying on margin and speculation cause the stock market to rise?

6. **Organizing** Use a graphic organizer similar to the one below to list the causes of the Great Depression.



7. **Analyzing Visuals** Look at the graph on page 630. What generalization can you make about the variation in highs and lows of the stock market from 1920 to 1932?

Writing About History

8. **Expository Writing** Write an article for a financial magazine explaining the stock market's rapid decline in 1929 and the reasons for the crash on Black Tuesday.

History ONLINE

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