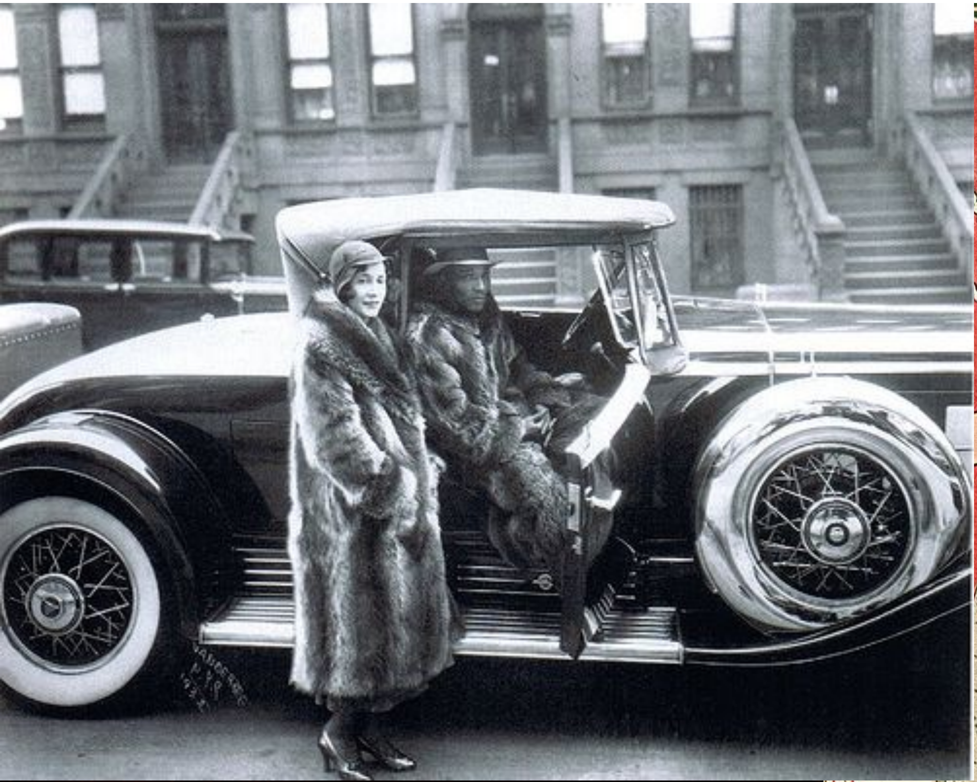
Causes of
The Great Depression

A Mystery:
Unprecedented Prosperity
to Unprecedented Failure




Life
TEACHING OLD DOGS NEW TRICKS


FREE
SOUP COFFEE & DOUGHNUTS
FOR THE UNEMPLOYED
FREE SOUP


-ICE-
WE WANT TO BE
CITIZENS
Not
TRANSIENTS
FOR-JOBS
AND
FUTURE

Before the Great Depression…

- Between 1920 and 1929:
  - Homeownership doubled
  - Home-owners have electric lights, flush toilets (once regarded as luxuries)
  - 60% of households had automobiles (only 20% in 1920)
  - More teenagers attended high school, fewer were working full time

BUT…

- **By 1933:**
- At least 1/4 of the U.S. labor force was unemployed
- 1/4th of the U.S. had their work hours severely cut
- Families lost their homes
- People were starving

"Three or four million heads of households don't turn into tramps and cheats overnight, nor do they lose the habits and standards of a lifetime. They don't drink any more than the rest of us, they don't lie any more, and they're no lazier than the rest of us. An eighth or a tenth of the earning population does not change its character which has been generations in the molding, or, if such a change actually occurs, we can scarcely charge it up to personal sin."

~ Harry Hopkins, Federal relief administrator under Franklin D. Roosevelt (1933)

So, what happened?

- The U.S. had the same productive resources in the 1930s as it had in the 1920s
- Factories and productive machinery were still present
- Workers had the same skills and were willing to work just as hard

<u>So, what caused the Great Depression and what made it last for so long?</u>

The Multiplier Effect

- 1920s: prosperity largely based on sale of houses and automobiles
  - (Buyers could buy these on an installment plans for the first time!)
- Purchases of cars and homes created **jobs** for:
  - Workers who built homes and cars;
  - Workers who built the furniture and appliances that went into the new homes
  - Workers who provided the steel and other materials to make cars
- MORE Jobs are created as business firms built new plants and bought new equipment to produce what consumers wanted
- Government provided MORE jobs to build paved roads for cars, and electric plants, and water/sewage facilities to service new households
- These workers spent money, thus providing income to other workers➔
- **Multiplier Effect**: one person's spending becomes income to another person, who in turn can spend more and add to the income of others

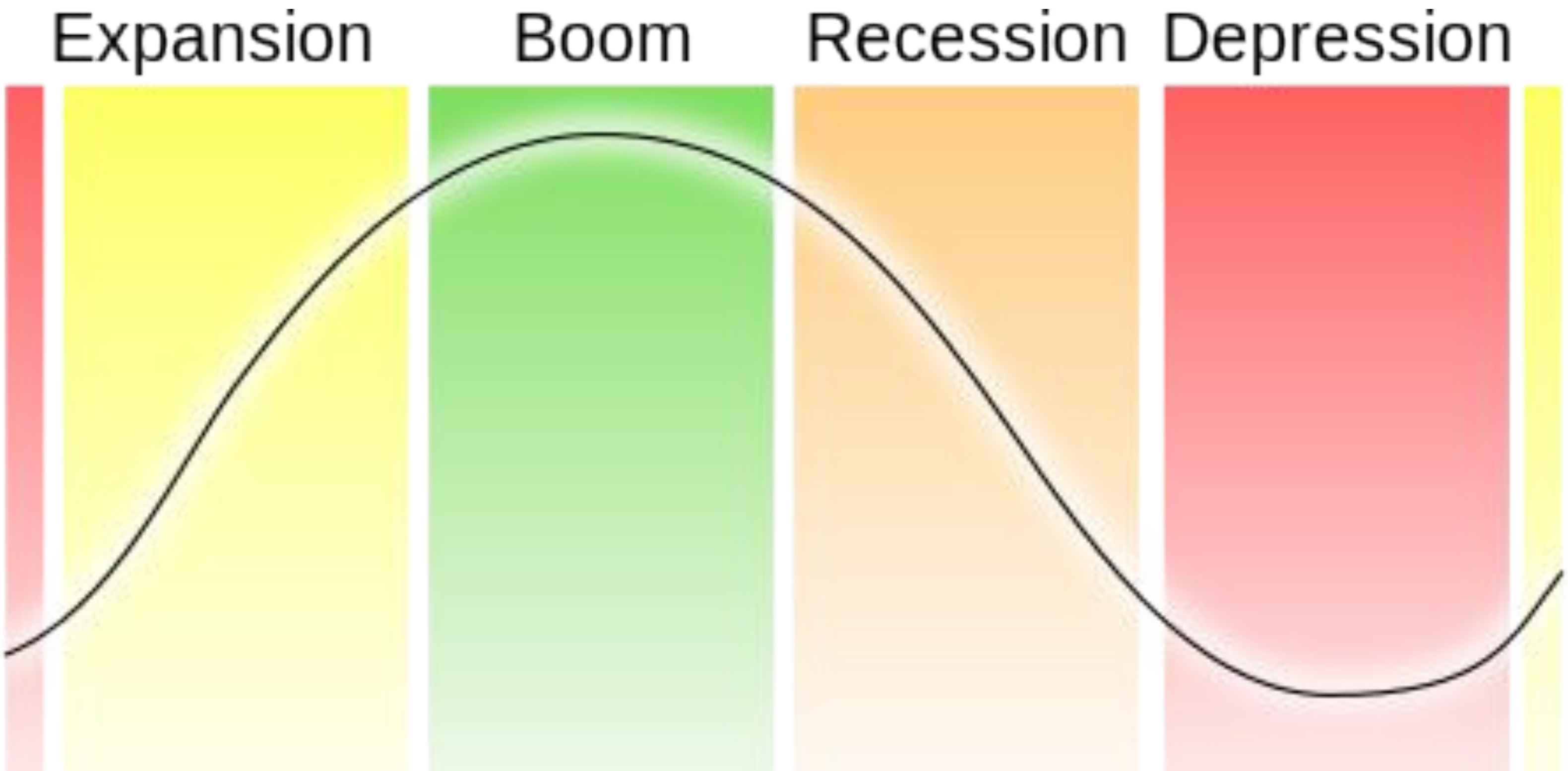
But the multiplier effect can work in reverse…

- By late 1920s, U.S. business activity begins to slow down
  - Sales of homes and new automobiles began to fall
  - Business firms slowed expansion of new plants, causing workers to lose jobs

There is hope!

- If people start buying again, unemployment will fall.
- When automobiles wear out, people buy new ones…
- As more and more people gain employment, some feel they can afford new homes…

The Business Cycle



The Business Cycle

- Demand for durable goods falls
- Demand for investment falls
- Workers who make those goods are laid off
- Because these workers now have less income, they spend less—and demand falls further
- Demand for durable goods revives
- Demand for investment goods revives
- Workers are rehired

But why did the Great Depression last for so long?

- The Stock Market Crash of 1929: investors lose $$
  - “Buying on the Margin”, Margin Call
- Banks began to close in record numbers
  - Many businesses that had borrowed money during the 1920s were unable to repay the loans
  - When banks fail, depositors lose the money they have in their accounts...
  - From 1929 to 1933: U.S. money supply was reduced by 1/3

When there is less money circulating in the economy, fewer goods and services are purchased and fewer workers are employed.


SAFE DEPOSIT VAULTS
AMERICAN UNION BANK
4 % PAID ON THRIFT ACCOUNTS
AMERICAN UNION BANK
W. 37 ST.

Number of U.S. Banks Closing Temporarily or Permanently, 1920-1933

Year	# Banks Closing
1920	168
1921	505
1922	367
1923	646
1924	775
1925	618
1926	976
1927	669
1928	499
1929	659
1930	1,352
1931	2,294
1932	1,456
1933	4,004

Federal Reserve Act of 1913

- Act stated that regional Federal Reserve Banks were supposed to lend reserves to banks in trouble
- **BUT**, they would often only lend to banks that were in no danger of failing and let other banks collapse
- Many blame the Federal Reserve for the Great Depression lasting for so long

Plus:

- The American banking disaster was only part of a worldwide financial collapse.
- Also, people began to stop trusting banks which meant their money couldn't be used as reserves for bank loans.
- Banks reluctant to make loans because they couldn't trust the Federal Reserve System to help