1 The Nation's Sick Economy

TERMS & NAMES
- price support
- credit
- Alfred E. Smith
- speculation
- buying on margin
- Black Tuesday
- Great Depression
- Dow Jones Industrial Average
- Hawley-Smoot Tariff Act

LEARN ABOUT economic problems affecting industries, farmers, and consumers at home and abroad
TO UNDERSTAND the causes of the Great Depression.

ONE AMERICAN'S STORY

Gordon Parks, who would later become a well-known photographer, author, and filmmaker, was 16 years old during the fall of 1929. He attended high school in St. Paul, Minnesota, and supported himself as a bellboy at the exclusive Minnesota Club. Observing the prosperous club members, Parks saw people who were confident in the economy. Parks felt that he, too, could look forward to a bright future. Then came the stock market crash of October 1929, and everything seemed to fall apart. In his autobiography, Parks recalled his feelings at the time.


Gordon Parks

A PERSONAL VOICE

I couldn't imagine such financial disaster touching my small world; it surely concerned only the rich. But by the first week of November I too knew differently; along with millions of others across the nation, I was without a job. All that next week I searched for any kind of work that would prevent my leaving school. Again it was, "We're firing, not hiring." . . . Finally, on the seventh of November I went to school and cleaned out my locker, knowing it was impossible to stay on. A piercing chill was in the air as I walked back to the rooming house. The hawk had come. I could already feel his wings shadowing me.

GORDON PARKS, from *A Choice of Weapons*

The crash of 1929, and the Depression that followed, dealt a crushing blow to the hopes and dreams of millions of Americans. The high-flying prosperity of the 1920s was over. Hard times had begun.

Economic Troubles on the Horizon

As the 1920s advanced, it grew increasingly clear that serious problems threatened economic prosperity. Though some Americans were becoming wealthy, many more could not earn a decent living. Important industries were in trouble. Farmers produced more food than they could sell at a profit. In hopes of finding wealth, Americans gambled on the stock market. When the decade drew to a close, slippages in the economy signaled the end of an era.

INDUSTRIES IN TROUBLE The superficial prosperity of the late 1920s hid troubling weaknesses—weaknesses that would ultimately lead to the Great Depression of the 1930s. A number of key basic industries, such as textiles, steel, and railroads, barely made a profit. Railroads lost business to new forms of transportation (trucks, buses, and private automobiles), while textile mills faced competition from foreign producers in Japan, India, China, and Latin America.

Mining and lumbering, which had expanded to supply wartime needs during World War I, faced diminished demand for their goods in peacetime. Coal mining was especially hard-hit, in part due to stiff competition from new forms of energy, including hydroelectric power, fuel oil, and natural gas. By the early 1930s, these sources supp[illegible] than half the energy that had once [illegible] from [illegible]

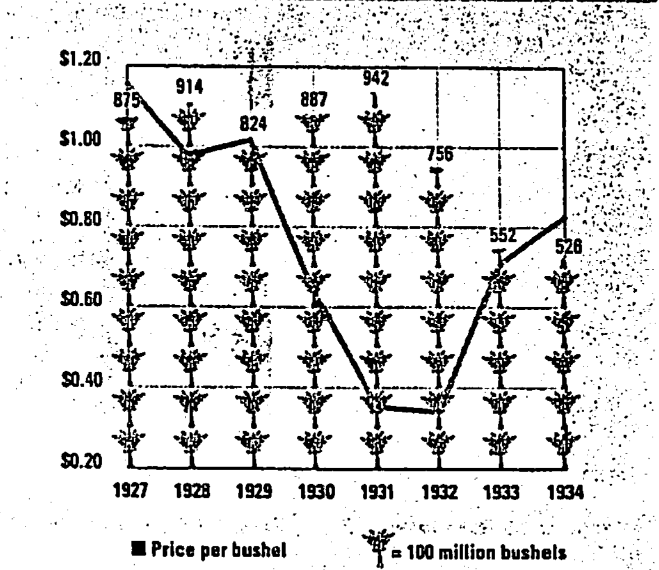
Even the boom industries of the 1920s—automobiles, construction, and consumer goods—began to weaken. The construction of new houses, for example, fell steadily after peaking in 1925. Between 1925 and 1929, applications for new building permits declined by approximately 25 percent. Housing starts were an important economic indicator, because house construction had spinoff effects on other industries. New houses required building materials, new furnishings, new equipment, and new appliances. Construction also created jobs.

UGH HISTORY
Analyzing
Causes What
weakness
declining
economy in
the 1920s?

When housing started to decline, so did other businesses that depended on construction. Furniture companies that had expected an expanding market produced too many goods and cut their labor forces to reduce inventories. A similar story held for makers of household appliances.

FARMERS NEED A LIFT Perhaps more than any other part of the economy, agriculture suffered throughout the 1920s. During World War I, international demand for food crops such as wheat and corn soared, causing prices to rise. Farmers planted more crops and took out loans to buy land and equipment. After the war, demand for farm products fell, and crop prices declined by 50 percent or more.

U.S. Wheat Production and Wheat Prices



Source: *Historical Statistics of the United States*

To compensate for falling prices, farmers boosted production in the hope of selling more crops, but this only depressed prices further. Between 1919 and 1921, annual farm income declined from $10 billion to just over $4 billion. Farmers who had gone into debt had difficulty in paying off their loans. Many lost their farms when banks foreclosed, and seized the property as payment for the debt. As farmers began to default on their loans, many rural banks began to fail.

UGH HISTORY
Analyzing
Causes What
some of the
difficulties
by farmers in
the 1920s?

To prop up the farm sector, members of Congress proposed a complicated piece of legislation called the McNary-Haugen bill. This proposal called for federal **price supports**—the support of certain price levels at or above market values by the government—for key products. The bill had three major provisions.

- The government would buy from farmers surplus crops, such as wheat, corn, cotton, and tobacco, at guaranteed prices that were higher than the market rate.
- The government would then sell these crops on the world market for the lower prevailing prices.
- To make up for losses caused by buying high and selling low, the government would place a tax on domestic food sales, thus passing the cost of the farm program along to consumers.

Congress passed the bill twice, in 1927 and 1928, but each time President Coolidge vetoed it. At one point, the president commented, "Farmers have never made money. I don't believe we can do much about it." Farm prices remained low and farmers continued to struggle.

SKILLBUILDER INTERPRETING GRAPHS ***How far does the price per bushel of wheat drop from the high point on the graph to the low point? How many times bigger than the low price is the high price? What factors do you think contributed to this drop?***

CONSUMERS HAVE LESS MONEY TO SPEND As farmers' incomes fell, they bought fewer goods and services. Without money to spend, rural families could not buy the products of American industry. The same problem was evident among American consumers as a whole

By the late 1920s, Americans were buying less—mainly because of rising prices, stagnant wages, unbalanced distribution of income, and too much credit buying in the preceding years—even as American farms and factories were producing more. Production expanded much faster than wages, resulting in an ever-widening gap between the rich and the poor.

LIVING ON CREDIT Although many Americans appeared prosperous during the 1920s, in fact they were living beyond their means. They often bought goods on **credit**—an arrangement in which consumers agreed to buy now and pay later for purchases, often on an installment plan (usually in monthly payments) that included interest charges.

THINK THROUGH HISTORY
C. Drawing Conclusions *What did the experience of industry, farmers, and consumers at this time suggest about the health of the economy?*

By making credit easily available, businesses encouraged Americans to pile up a large consumer debt. Many people then had trouble paying off their growing debts. Faced with debt, consumers cut back on spending.

UNEVEN DISTRIBUTION OF INCOME Consumers also spent less because their incomes were not rising fast enough. During the 1920s, nearly half the nation's families earned less than $1,500 per year, then considered the minimum amount needed for a decent standard of living. Even families earning twice that much could not afford many of the household products that manufacturers produced. Economists estimate that the average man or woman bought a new outfit of clothes only once a year. Scarcely half the homes in many cities had electric lights or a furnace for heat. Only one city home in ten had an electric refrigerator.

In contrast, rich Americans did very well. Between 1920 and 1929, the income of the wealthiest 1 percent of the population rose by 75 percent, compared with a 9 percent increase for Americans as a whole. In 1929, the wealthiest 5 percent of American families took in nearly a third of the nation's income, while the poorest 40 percent of the population earned just over a tenth of the national income.

This unequal distribution of income meant that most Americans could not participate fully in the economic advances of the 1920s. Many people did not have the money to consume the flood of goods that factories produced. The prosperity of the era rested on a fragile foundation.

A NEW PRESIDENT Although economic disaster was around the corner, the election of 1928 took place amidst a national mood of apparent prosperity. This election pitted Republican candidate Herbert Hoover against Democrat **Alfred E. Smith.** The two men could hardly have been more different. Hoover, the secretary of commerce under Harding and Coolidge, was a mining engineer from Iowa who had never run for public office.

"We in America are nearer to the final triumph over poverty than ever before."
HERBERT HOOVER

Smith, in contrast, was a career politician who had served four terms as governor of New York. Where Hoover was formal and reserved, Smith was witty and outgoing. Both men came from poor families and had worked hard to achieve success. Whereas Hoover felt uncomfortable in the limelight, Smith seemed to relish it.

Hoover had one major advantage: he could point to years of prosperity under Republican administrations since 1920. Many Americans believed Hoover when he declared, "We in America are nearer to the final triumph over poverty than ever before. . . . The poorhouse is vanishing among us."

Although Smith ran a spirited campaign, he could not overcome the Republican advantage. In addition, Smith's heavy Brooklyn accent, his opposition to prohibition, and his religion (Roman Catholic) counted heavily against him. In the election, Hoover captured 58 percent of the popular vote and won 444 electoral votes to Smith's 87. The message was clear: most Americans were happy with the course of the nation and its Republican leadership.

The Stock Market Comes Tumbling Down

By 1929, some economists were warning of serious weaknesses in the economy. Most Americans remained unaware of these problems and continued to have confidence in the nation's economic health. Those who could afford to invest in the stock market did so in increasing numbers. In fact, the stock market had become the most visible symbol of an American economy that seemed to be producing wonderful products almost at will since the end of World War I.

DREAMS OF RICHES IN THE STOCK MARKET Through most of the 1920s, prices on the stock market rose steadily. Eager to take advantage of this "bull market"—rising stock market prices—many Americans rushed to buy stocks and bonds. One observer wrote, "It seemed as if all economic law had been suspended and a new era opened up in which success and prosperity could be had without knowledge or industry." By 1929, about 4 million Americans—or 3 percent of the nation's population—owned stocks. Many of these investors were already wealthy, but others were average Americans who hoped to strike it rich.

As stock market prices rose, several problems became evident. More and more investors engaged in **speculation**—that is, the engagement in risky business transactions (in this case, the buying and selling of stocks) on the chance of quick or considerable profit. Their unrestrained buying and selling fueled the market's upward spiral. As prices rose, wealth was generated on paper, but it bore little relation to the real worth of companies or the goods that they produced. The price of stocks had little relationship to the dividends the stocks paid.

Furthermore, many investors began **buying on margin**—paying a small percentage of a stock's price as a down payment and borrowing the rest. With stockbrokers willing to lend buyers up to 75 percent of a stock's purchase price, buying on margin became the rule. This system worked as long as prices continued to rise, since investors could sell their inflated stocks to make a profit and pay off their debt. If stocks declined, however, there was no way to pay off the loan.

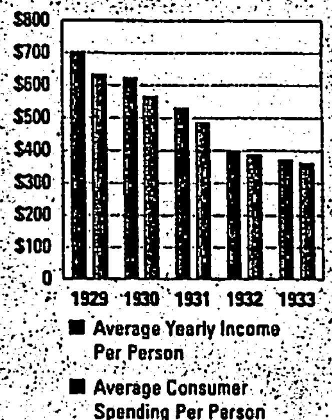
BLACK TUESDAY In early September 1929, stock prices peaked and began to decline. Confidence in the market started to waver and some investors sold their stocks and pulled out. On October 24, the market took a gut-wrenching plunge, as panicked investors unloaded their shares. But the worst was yet to come.

On October 29—known as **Black Tuesday**—the bottom fell out of the market. People and corporations alike frantically tried to sell their stocks before prices plunged even lower. Those individual investors who had bought stocks on credit acquired huge debts when stock prices plunged. Other investors, who had invested most of their savings in the market, lost their investments when prices fell. The number of shares dumped that

ECONOMIC BACKGROUND

AMERICA'S DECLINING WEALTH

As the following chart demonstrates, the yearly income and spending per person declined after 1929, the year of the stock market crash.



Source: *Historical Statistics of the United States*

SKILLBUILDER INTERPRETING GRAPHS ***What happened to the yearly difference between income and consumer spending from 1929 to 1931? What do you think this change meant to Americans?***

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millions of shares could not even find buyers. By mid-November, investors had lost $30 billion, an amount equal to American spending in World War I. The stock market bubble had finally burst. One eyewitness to these events, Frederick Lewis Allen, described the resulting situation.

THINK THROUGH HISTORY
D. Forming Opinions *What role did greed play in the stock market crash?*

A PERSONAL VOICE

The Big Bull Market was dead. Billions of dollars' worth of profits—and paper profits—had disappeared. The grocer, the window cleaner, and the seamstress had lost their capital [savings]. In every town there were families which had suddenly dropped from showy affluence into debt. . . . With the Big Bull Market gone and prosperity going, Americans were soon to find themselves living in an altered world which called for new adjustments, new ideas, new habits of thought, a new order of values.

FREDERICK LEWIS ALLEN, from *Only Yesterday*

"Wall Street Lays an Egg"

HEADLINE, *VARIETY,* OCTOBER 1929

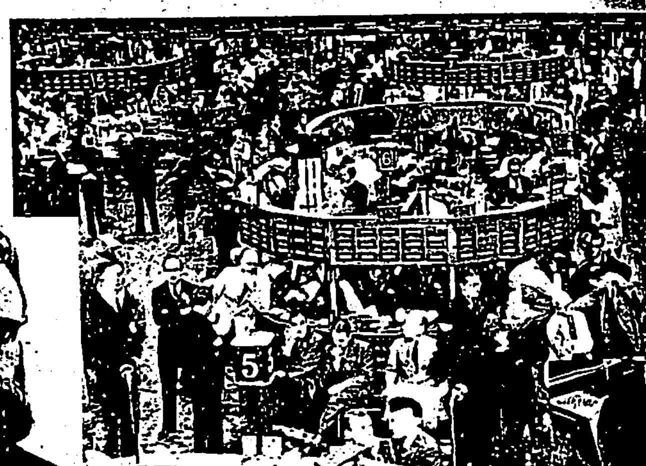
CAUSES OF THE GREAT DEPRESSION The stock market crash signaled the beginning of the **Great Depression**—the period from 1929 to 1941, in which the economy was in severe decline and millions of people were out of work. The crash alone did not cause the Great Depression, but it hastened the collapse of the economy and made the Depression more severe.

Although historians and economists differ on the main causes of the Great Depression, most cite a common set of factors. Among these causes were the following:

NOW THEN

The Dow Jones Averages

Television and radio news programs report the Dow Jones Industrial Average many times during the work week. "The Dow closed 20 points higher today at 5672." "The Dow Jones passed the 6000 mark." What is the Dow Jones Industrial Average?



left, Charles H. Dow; *above,* a trading floor in the 1920s; *right,* a modern trading floor.

1882

Charles H. Dow, Edward Jones, and Charles M. Bergstresser start a company that distributes copies of stock market reports to business customers in New York City. The first reports are handwritten and distributed by messenger boys. In 1889, the reports, plus additional editorials, become known as the *Wall Street Journal.*

1896

Charles H. Dow creates the Dow Jones Industrial Average by choosing 12 major American companies and averaging the price of their stocks. The twelve original companies are:

American Cotton Oil	Laclede Gas
American Sugar	National Lead
American Tobacco	North American
Chicago Gas	Tennessee Coal & Iron
Distilling & Cattle Feeding	U.S. Leather
General Electric	U.S. Rubber

- an old and decaying industrial base—outmoded equipment made some industries less competitive
- a crisis in the farm sector—farmers produced more than they were able to sell, especially with the end of World War I and the disappearance of markets that the war had opened to them
- the availability of easy credit—many people went into debt buying goods on the installment plan
- an unequal distribution of income—there was too little money in the hands of working people, who were the vast majority of consumers.

THROUGH HISTORY
E. Analyzing Causes What are some of the causes of the Great Depression?

These factors in turn led to falling demand for consumer goods, even as newly mechanized factories produced more products. The federal government contributed to the crisis by keeping interest rates low, which in turn allowed companies and individuals to borrow easily and build up large debts. Some of this borrowed money was used to buy stocks, but the government did little to discourage such buying or to regulate the market.

At first people found it hard to believe that economic disaster had struck the country. In November of 1929, Hoover encouraged Americans to remain confident about the future of the economy. Yet despite the comforting words, the most severe depression in American history was well on its way.

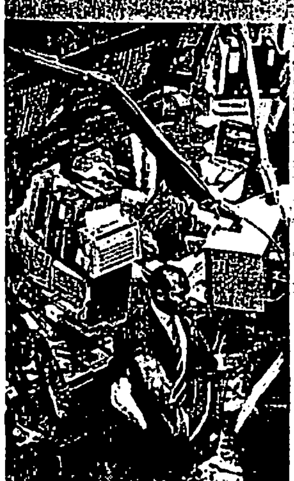
Then, as now, the **Dow Jones Industrial Average** was the most widely used barometer of the stock market's health. The Dow is a measure based on the stock prices of 30 representative large firms trading on the New York Stock Exchange. Just prior to the crash of 1929, the Dow reached a high of 381 points, nearly 300

October 28–29, 1929
The Dow loses nearly one-fourth of its value over a two-day period as the stock market crashes.

1982–1987
During the Reagan presidency, the Dow Jones Industrial Average moves steadily upward from 776.92 in August of 1982 to a peak of 2722.42 in August of 1987.

January 8, 1987
The Dow breaks the 2000 mark for the first time.

October 19, 1987
The Dow falls 508 points to 1738.74, on what has been called Black Monday.



100TH BIRTHDAY

1997
Through the years, the stocks that make up the Dow Jones Industrial Average have changed to reflect the times. The group of 30 stocks includes McDonald's, Walt Disney, and American Express as well as industrial companies, such as Caterpillar Inc. There are also averages of 20 transportation companies, of 15 utility companies, and of the 65 stocks together. In 1997, the Dow Jones Industrial Average exceeds the 7000 mark for the first time.

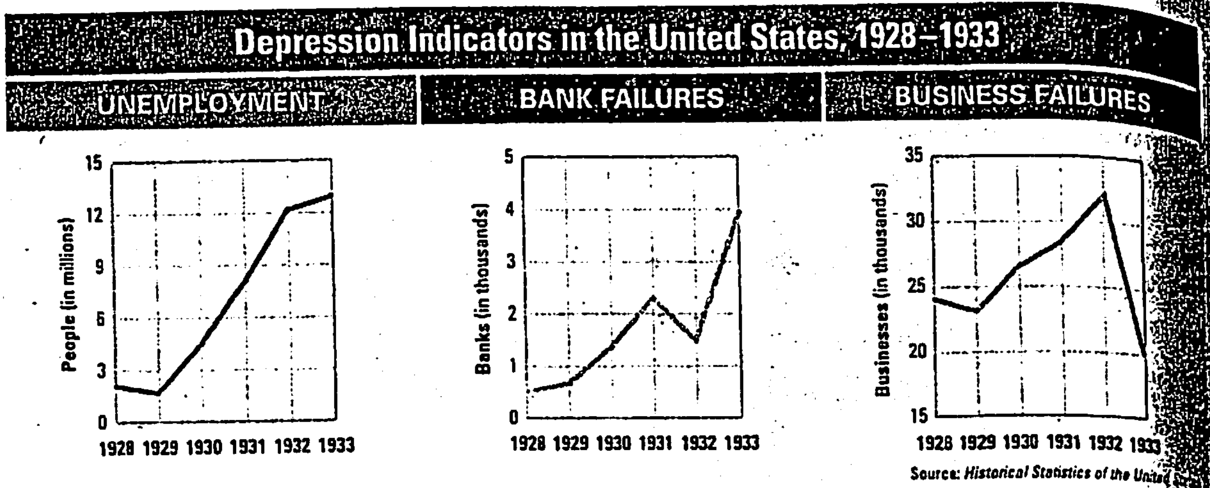
INTERACT WITH HISTORY

1. **ANALYZING ISSUES** Based on what you have read, does the stock market seem like a good investment? If you invested money in 1990, are you more likely to have lost money or made a profit since then?

SEE SKILLBUILDER HANDBOOK, PAGE 1046

2. **STUDYING THE MARKET** Look at a daily newspaper to see what the Dow Jones Industrial Average is on a given day. Was the Dow average up or down for the day?

INTERNET For more about the Dow Jones Industrial Average, click on *Social Studies* at http://www.mcdougallittell.com



Source: *Historical Statistics of the Unit*

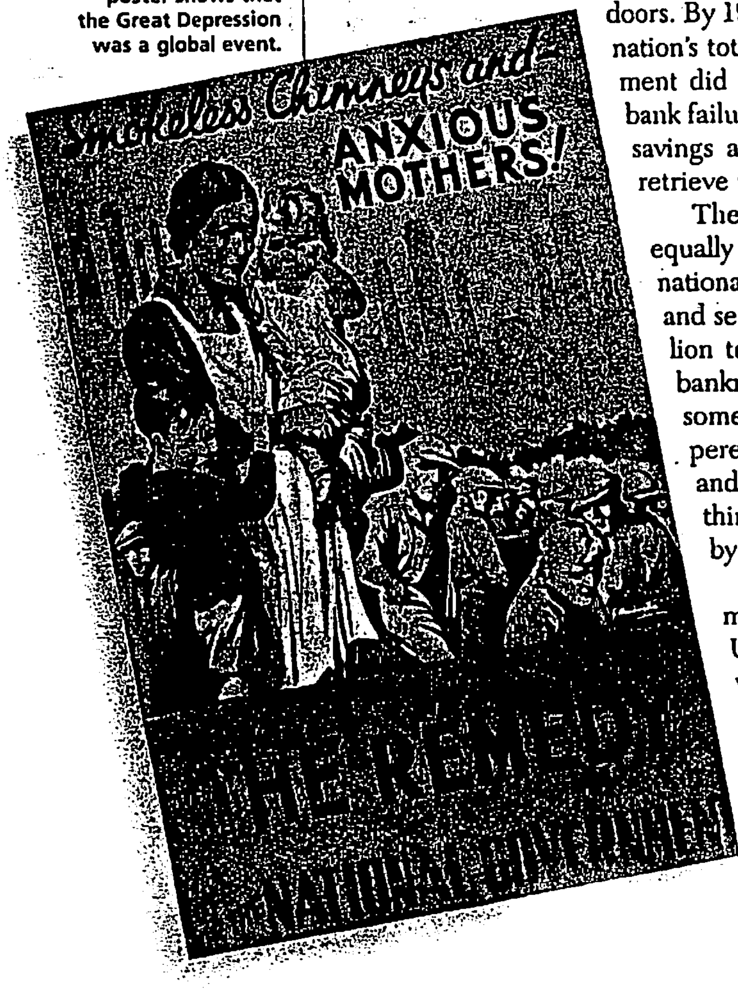
SKILLBUILDER INTERPRETING GRAPHS ***In what year did the biggest jump in bank failures occur? What measure on the graphs seems to indicate an improvement in the U.S. economy during the Depression?***

points higher than it had been five years earlier. On October 28 and 29, Black Monday and Black Tuesday, the Dow fell dramatically and continued to fall until 1932.

Financial Collapse

After the crash, many Americans panicked and withdrew their money from banks, which forced some banks to close. Many banks could not cover their customers' withdrawals because the banks too had invested and lost money in the stock market, just as individuals had. As a result, in 1929, 659 banks shut their doors. By 1933, around 6,000 banks—one-fourth of the nation's total—had failed. Because the federal government did not protect or insure bank accounts, these bank failures wiped out around nine million individual savings accounts. People who went to the bank to retrieve their savings came home with nothing.

This British election poster shows that the Great Depression was a global event.



The Great Depression hit other businesses equally hard. Between 1929 and 1932, the gross national product—the nation's total output of goods and services—was cut nearly in half, from $104 billion to $59 billion. Some 85,000 businesses went bankrupt. Among these failed enterprises were some of the automobile companies that had prospered during the 1920s, including Pierce-Arrow and Bearcat. Railroad companies controlling one-third of the nation's track mileage went bankrupt by the early 1930s.

THINK THROUGH HIST
F. Recognizing Effects *What happened to ordinary worker during the Great Depression?*

As the economy plunged into a tailspin, millions of workers lost their jobs. Unemployment leaped from 3 percent of the work force (1.6 million workers) in 1929 to 25 percent by 1933 (13 million workers). One out of every four workers did not have a job. The workers who managed to hold onto their jobs often had to accept pay cuts

Not everyone fared so badly, of course. In the months before the crash, shrewd stock market speculators began to unload their stocks and take the profits. Bernard Baruch was one who did so. Joseph P. Kennedy, the father of future president John F. Kennedy, was another. Most people, however, were not so lucky or shrewd.

WORLDWIDE SHOCK WAVES The United States was not the only country gripped by the Great Depression. Much of Europe, for example, had suffered throughout the 1920s. European countries trying to recover from the ravages of World War I faced high debt payments. In addition, Germany had to pay war reparations—payments required from defeated nations for the damage they caused. The Great Depression compounded these problems by limiting America's ability to import European goods. This made it difficult to sell American farm products and manufactured goods abroad.

In 1930, Congress made a bad situation worse by passing the **Hawley-Smoot Tariff Act,** which established the highest protective tariff in United States history. This act—designed to help American farmers and manufacturers by protecting their products from foreign competition—backfired and had the opposite effect. By reducing the flow of goods into the United States, the tariff also prevented other countries from earning American currency to buy American exports. In this way, the tariff made unemployment worse by hurting companies that could no longer export goods to Europe. Many countries retaliated against the Hawley-Smoot Tariff Act by raising their own tariffs. Within a few years, world trade had fallen more than 40 percent, which reduced overall economic activity.

ON THE WORLD STAGE

GLOBAL EFFECTS OF THE DEPRESSION

The Great Depression was a worldwide phenomenon, in large part because many industries depend on worldwide sources of raw materials and foreign markets. After World War I, European firms needed capital to rebuild their factories. Suppliers of raw materials in Asia, Africa, and Latin America needed to export their products to the industrialized nations.

As the American economy collapsed, other nations suffered as well. Austria's main bank failed in May of 1931. Germany imposed currency controls in July. Great Britain went off the gold standard in September of the same year. Throughout the world, many banks and businesses failed, and rates of joblessness skyrocketed.

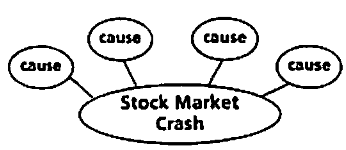
The problem was complicated by the effects of World War I on currency and the gold standard. Not only had vast amounts of property in Europe been destroyed, but European nations also faced heavy debts. This made them reduce their purchases of American goods even more. In order to encourage European nations to purchase American goods, Hoover proposed a moratorium, or postponement of payments, on Allied war debts and German reparations. Before anyone could agree to this plan, however, Britain and other European countries went off the gold standard. That is, their paper money could no longer be exchanged for gold. As a result, gold dropped in value, which meant that Europeans would be buying American goods and repaying American loans in cheaper currency. All these economic troubles caused a tremendous amount of suffering for people throughout the world as they adjusted to the harsh realities of the Depression.

THROUGH HISTORY
Summarizing How did the Great Depression affect the world economy?

Section 1 Assessment

TERMS & NAMES
Identify:
- price support
- credit
- Alfred E. Smith
- speculation
- buying on margin
- Black Tuesday
- Great Depression
- Dow Jones Industrial Average
- Hawley-Smoot Tariff Act

2. SUMMARIZING Using a diagram, record the causes of the 1929 stock market crash.



When you have finished, add effects of the crash to the bottom of the diagram.

3. ANALYZING CAUSES How did the economic trends of the 1920s help cause the Great Depression?

THINK ABOUT
- what happened in industry
- what happened in agriculture
- what happened with consumers

4. DRAWING CONCLUSIONS Judging from the events of the late 1920s and early 1930s, how important do you think public confidence is to the health of the economy? Explain.

THINK ABOUT
- what happened when overconfidence in the stock market led people to speculate and buy on margin
- what happened when lack of confidence caused people to sell stocks and close out bank accounts