

The Beginnings of the Great Depression

by Sophia



WHAT'S COVERED

The stock market crash of 1929, also known as the Great Crash, was one of the most significant events in American history. It marked the abrupt end of one era—the “Roaring 20s”—and the beginning of another—the Great Depression.

This tutorial examines the beginnings of the Great Depression in four parts:

1. Herbert Hoover

The landslide victory of Herbert Hoover (image on the right) over Democrat Al Smith in the presidential election of 1928 was the culmination of the “Republican ascendancy” of the 1920s. The decade witnessed the return of a pro-business federal government, led by Republican Presidents Warren G. Harding, Calvin Coolidge, and, beginning in March 1929, Herbert Hoover. Republicans also dominated both houses of Congress during the 1920s.

President **Herbert Hoover** set an agenda that he believed would continue the prosperity of the 1920s. In his view, the government should partner with the American people, but individual citizens should rise (or fall) according to their abilities. With this in mind, he planned an immediate overhaul of federal regulations so that excessive government control would not hinder the growth of the nation’s economy.



PEOPLE TO KNOW

Herbert Hoover

Republican president from 1929 to 1933, who oversaw the first years of the Great Depression after the stock market crash of 1929; his philosophy of individualism and



limited government was challenged by the scale of the economic crisis.

Hoover was also known as a humanitarian and a reformer, based on his accomplishments as a public servant before he became president.

➔ **EXAMPLE** When World War I began in Europe, Hoover led food relief efforts that prevented the starvation of millions of Belgians during the German occupation. When the United States entered the war, President Wilson appointed Hoover as head of the U.S. Food Administration, which coordinated rationing efforts in America and secured essential food items for Allied forces and civilians in Europe. Hoover's first months in the White House provided additional evidence of his reformist, humanitarian spirit:

- Hoover authorized the creation of the Federal Farm Board, which assisted farmers by implementing government price supports.
- Hoover created the Veterans Administration and increased the number and quality of veterans' hospitals.
- Hoover proposed the creation of an old-age pension program that would provide \$50 per month to all Americans over the age of 65.

As the autumn of 1929 arrived, Hoover was a popular president. All signs pointed to a successful administration.

2. Causes of the Great Crash

Much of the optimism that surrounded Hoover's administration was based on confidence in the economy among middle-class and wealthy Americans. As the Great Crash unfolded, it became evident that their confidence was misplaced and that underlying weaknesses in the economy had been overlooked.

Rising incomes during the 1920s had much to do with the widespread optimism regarding the economy. In 1922, almost 600,000 Americans had annual incomes that exceeded \$5,000. By 1929, over 1 million had an annual income that exceeded that amount.

Increasing incomes enabled many Americans to purchase homes, automobiles, and electric appliances. Many of them also invested their money. Traditional options, including savings accounts and life insurance, continued to be available to them, but some chose to **speculate** on riskier investments, hoping for larger returns.



TERM TO KNOW

Speculation

The practice of investing in risky financial opportunities in the hopes of a fast payout due to market fluctuations.

The federal government, most notably Treasury Secretary Andrew Mellon and the Federal Reserve, encouraged the increase in speculation during the 1920s. Following a brief postwar recession (1920–1921), the Fed lowered interest rates and eased the reserve requirements on the nation's largest banks. As a result, the money supply in the United States increased by almost 60% during the decade. This convinced many middle- and upper-class Americans that investing—including speculation—was safe.

The abundant supply of money, along with low interest rates (which made borrowing easier), led to the rise of several questionable investment schemes during the 1920s.

➔ EXAMPLE “Ponzi schemes,” named for vegetable-seller-turned-Wall-Street-trader Charles Ponzi, encouraged novice investors to back unfounded ventures. Speculators used the funds provided by those investors to pay off older investments, which enabled the venture to grow, enticing more people to invest in it.

Commercial banks, as well as deposit institutions that originally avoided investment loans, began to offer easy credit, which enabled people to invest—even if they lacked the money to do so.

Before the stock market crash of 1929, there was evidence that ongoing speculation was not sustainable. One example was the Florida land boom of the 1920s.

Beginning in the early 1920s, real estate developers promoted South Florida as a tropical paradise. They convinced a number of investors to go “all in,” buying land they had never seen with money they did not have. Many of them then sold the land to other investors at higher prices.

The land boom went bust in 1926. Negative press reports regarding the speculative nature of the boom, along with federal investigations into the practices of several land brokers and a railroad embargo that limited the delivery of construction supplies to South Florida, reduced investor interest. A hurricane in 1926 drove many of the developers to bankruptcy.

Like the advertisers of domestic appliances who targeted women (and reinforced gender stereotypes), advertisers of real estate in Florida (and elsewhere in the United States) preyed upon the hopes and aspirations of potential investors.

Another Ratterree Tract—
ADAMS SQUARE
Los Angeles, the Fastest Growing City in the U. S. A.
BUY NOW!!
Put Your Money in Real Estate—It Will Grow With the City
We believe Adams Square is the biggest realty bargain ever offered in Los Angeles.
Adams Square fronts on Adams boulevard, one of the most vital connecting arteries between Los Angeles and the beach cities, and is in the direct trend of expansion from the city to the sea.
Adams Square is close in, with five cent yellow car—besides the fortunate location as to boulevards.
There is no better place in Los Angeles than Adams Square from every point of view, for homes, business or investment.
Adams Square is exceptionally beautiful, commanding views such that cannot be bought in but few places. In no other location can you buy at such attractive prices.
The reason we can sell you this property, which is within the reach of all, is we are the owners, backed by unlimited capital and with an enormous business that our overhead is low.
“Procrastination is the Thief of Time”
Come Out Tomorrow
By Motor—West on Adams to Ringier Ave.
West Adams “Third” Car to Ringier Ave.
The RATTERREE BROTHERS Co.
Close In—Not Away Out in the Country
60 FOOT BUNGALOW LOTS \$749 \$50 DOWN 15 A MONTH
ADAMS ST. BUSINESS LOTS \$1499 250 DOWN 25 MONTHLY
INTEREST AND IMPROVEMENTS INCLUDED—
You Are Sure to Make Money on These

This real estate ad (from Los Angeles) illustrates commonly used techniques. “Buy now!!” the ad proclaims. “You are sure to make money on these.” “Bungalow Lots” were available for as low as \$50 down and only \$15 a month.



THINK ABOUT IT

How does the advertisement above reflect the growing interest in investment and speculation during the

1920s?

Despite the publicity surrounding the boom and bust of Florida real estate, speculation continued, especially in the stock market.

By the late 1920s, some investors were buying stock “on margin”—for a small down payment, made with borrowed money, and with the intention of selling it quickly for a much higher price before the remaining payment was due. This strategy could work, as long as stock prices continued to increase. Furthermore, the opportunity to buy stock for a small down payment encouraged many Americans (who might not have done so otherwise) to invest in the stock market.

These tactics were developed in the absence of federal regulation of the stock market. They were used by retail stock brokerage firms, which catered to average investors who wanted to get into the market but lacked ties to investment banking houses or large brokerage firms.

➔ **EXAMPLE** As many as 1,600 brokerage firms were in business in the United States by 1929. Most Americans did not have to go to Wall Street or follow the stock market to invest.

In September 1929, the Dow Jones Industrial Average peaked at 381 points, roughly 10 times the market’s value at the beginning of the 1920s.

3. The Great Crash

Amid these waves of speculation, several warning signs indicated that a crash was coming.

➔ **EXAMPLE** A brief downturn in the market on September 18, 1929, raised questions among investment bankers and led some of them to predict an end to high stock values.

➔ **EXAMPLE** A steep sell-off of automobile stocks on October 23, 1929, decreased stock values and threatened the accounts of thousands of investors who had purchased stock “on margin.” Overnight, brokerage firms issued “margin calls” to their clients, which required investors to increase their down payment on their stocks or sell their stocks if they could not do so.

Nothing could have prepared traders for October 24, often referred to as “Black Thursday.” On that day, the New York Stock Exchange lost 11% of its value as thousands of investors, unable to meet their margin calls, attempted to sell their shares but found few buyers. To prevent a panic, leading investment banks, including Chase National, National City, and J. P. Morgan, purchased large amounts of stock to prevent prices from collapsing.

Market fluctuations continued into the next week. The Dow Jones Industrial Average lost another 13% of its value on Monday, October 28. The situation worsened the next day, October 29, also known as **Black Tuesday**.



TERM TO KNOW

Black Tuesday

October 29, 1929, when stockholders sold over 16 million shares and caused the value of the stock market to decline significantly.

No one heard the New York Stock Exchange’s opening bell on October 29; shouts of “Sell! Sell!” drowned it out. In the first 3 min after it rang, nearly 3 million shares of stock, worth \$2 million, changed hands. Banks, facing debt and seeking to protect their assets, demanded payment for the loans they had made to individual investors. Stock belonging to investors who could not pay was sold immediately. In some instances, their life

savings were wiped out in minutes.



On October 29, 1929 (Black Tuesday), thousands of people raced to Wall Street discount brokerages and markets to sell their stocks.

Stockholders traded over 16 million shares—and lost over \$14 billion—on Black Tuesday. To put this in context, a day when 3 million shares were traded was considered a busy day on the stock market.

The financial outcome of the Great Crash was devastating. Between September 1 and November 30, 1929, the stock market lost over half its value, dropping from \$64 billion to approximately \$30 billion. What distinguished this crash from previous panics was its impact on millions of Americans, not just a small number of stock market investors.

➔ **EXAMPLE** While only 10% of American households owned investments, over 90% of all U.S. banks invested in the stock market.

4. The Coming of the Great Depression

The Great Crash was not the sole cause of the Great Depression, nor did the crash occur in a vacuum. Rather, the crash exposed underlying weaknesses in the economy, specifically in the nation's banking system.

An uneven distribution of wealth among Americans compounded the structural flaws in U.S. banks.

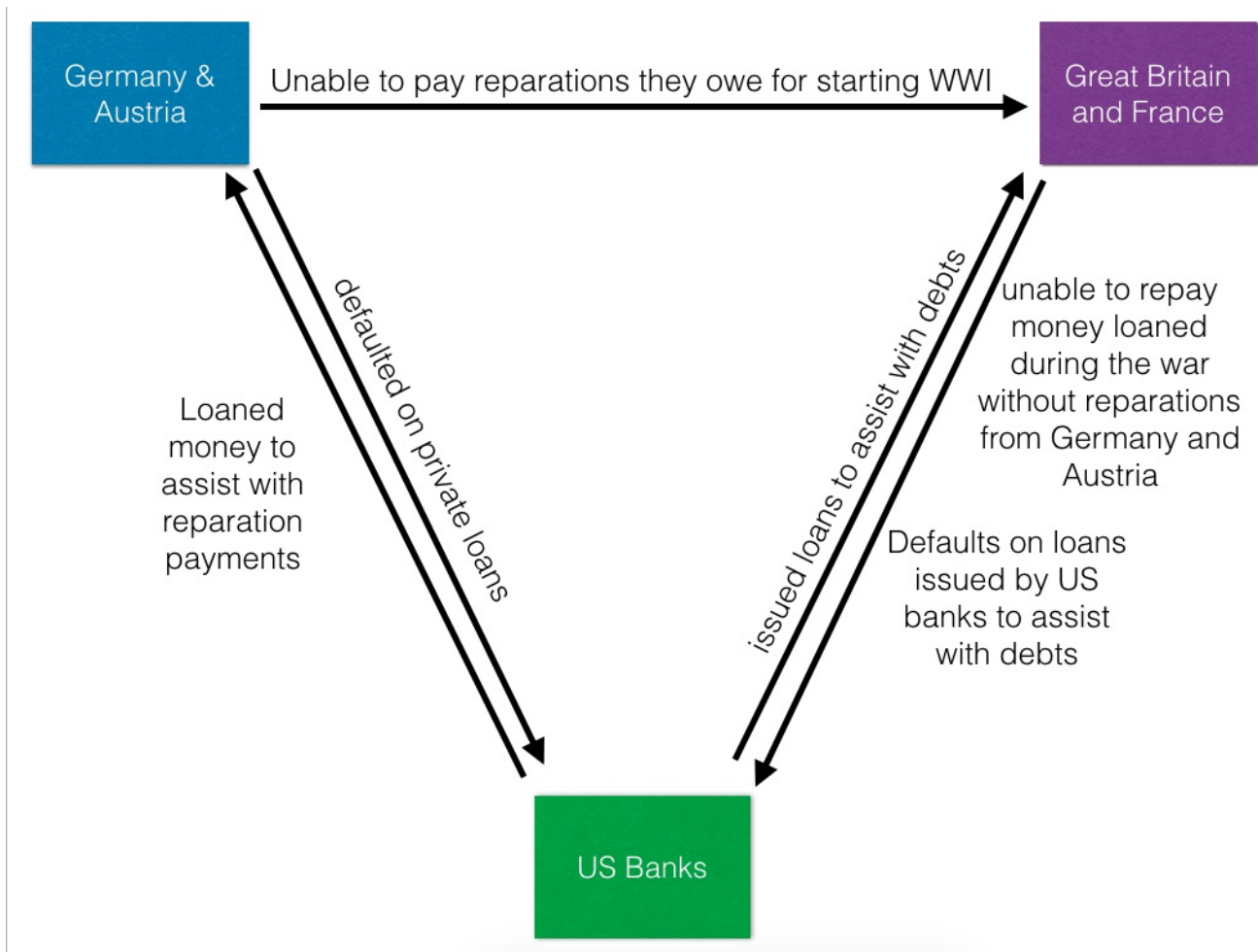
➡ **EXAMPLE** In the 1920s, 80% of American families had almost no savings, and approximately 1% of Americans controlled over a third of the nation's wealth.

This meant that few new investors were entering the market by 1929; there was no one to purchase stock from sellers when the speculative boom crashed in October. Americans who had savings often lost everything in their accounts, since banks had invested their money in the stock market.

There was also an important international contribution to the Depression, one linked to the Treaty of Versailles and the reparations that Germany and Austria owed to Great Britain and France for starting World War I:

- According to the Treaty of Versailles, Germany and Austria owed reparations to Great Britain and France for starting WWI.
- Great Britain and France owed a large amount of money to U.S. banks, which had made loans to them during the war.
- Great Britain and France were unable to pay their debts to U.S. banks and sought to use German and Austrian reparations to do so.
- The German and Austrian economies were struggling after the war, and, despite loans provided by the United States, they were unable to pay reparations.
- The U.S. government refused to forgive the loans it had made to Great Britain and France, so American banks made private loans to these countries, enabling them to repay their debts to the United States.
- Britain and France defaulted on the private loans, which placed additional strains on American banks.
- American banks sought to liquidate those loans as the stock market collapsed.

This cascade of events is illustrated in the image below:



Given the financial situation in the United States and Europe, large numbers of investors and the general public withdrew their money from banks. They feared that the banks would fail. As more people withdrew their money in **bank runs**, the banks were driven to insolvency.



TERM TO KNOW

Bank Runs

The withdrawal of money from a bank by a large number of individuals or investors due to fears of the bank's instability.



The photograph above shows a bank run that occurred at a branch of National City Bank in February 1933.

The bank runs indicate that a loss of confidence in the U.S. economy and financial institutions was an important cause of the depression. For much of the 1920s, Americans believed that prosperity would continue and that markets would keep growing. Following the Great Crash, the market was stagnant and the foundations of the banking system were shaky. Americans wondered whether the country's economic structures would be able to weather continued market volatility.

Panic and pessimism were prevalent in the aftermath of the Great Crash. Banks closed their doors or restricted operations, leaving many customers penniless. There was little investment in industries such as automobiles and construction.

➤ **EXAMPLE** In November 1929, fewer cars were built in the United States than in any other month since November 1919.

The downturn experienced by major industries led to and reflected the limited purchasing of consumers and businesses. As the U.S. economy descended into depression, Americans lost the drive for the conspicuous consumption that they had exhibited during the 1920s. Businesses, with no market for their products, had little incentive to hire workers or purchase raw materials.

☆ BIG IDEA

While the Great Crash was a significant trigger, a combination of other factors caused the stock market

crash to force the U.S. economy into the Great Depression. President Hoover, like many others at the time, hoped (and believed) that the economy would right itself with limited government intervention. In the meantime, millions of Americans sank into poverty.



SUMMARY

Easy access to credit and the lure of wealth through speculation during the prosperous decade that preceded the stock market crash of 1929 created the conditions that led to depression. The stock market, which had grown for years, began to decline during the fall of 1929, descending into a panic in late October. Although relatively few Americans had invested in stock, the Great Crash affected everyone. The underlying weaknesses in the economy, including an unsound banking structure and the unequal distribution of wealth, exacerbated the impact of the crash. An unstable international economy also contributed to panic and pessimism among consumers and decreased production in automobile, construction, and other key industries.

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