Causes and Consequences

The Depression

By September of 1929, nervous investors began selling stocks in order to get out of the market while prices were still high. As the volume of selling increased, stock prices began to fall in October. On October 24 (Black Thursday) and October 29 (Black Tuesday), prices fell drastically as sellers panicked. By December, a staggering $40 billion in stock value had been lost. Hoover and business leaders attempted to calm Americans by assuring them that the country's economy was fundamentally sound. J.P. Morgan and other bankers bought $20 million of U.S. Steel to try to restore confidence, but to no avail. The Stock Market Crash of 1929 did not by itself cause the American economy to collapse. Many factors contributed to a situation so precarious that this event was but the first of a cascade of collapses on many different fronts around the entire world.

One weakness in the American economy was lack of diversification. Prosperity of the 1920s was largely a result of expansion of construction and automobile industries and their corollary industries such as the petroleum industry. Older businesses, such as coal, declined.

Poor distribution of income and purchasing power among consumers also contributed. By 1929, the top 10 percent of the nation's population received 40 percent of the nation's disposable income, but this 10 percent did not purchase the mass quantities of food and goods that were being turned out in the nation's farms and factories. Many farmers and factory workers, on the other hand, were unable to make the purchases of cars and houses that would have sustained economic growth. Farm income actually declined 66 percent from 1920 to 1929.

Overproduction of goods and farm products compared to the public's ability to pay for them dragged the economy down. Panicked farm and business owners plowed what profits they made not into wages of workers who would have been customers, but into ever-less-profitable plants and acreage. Industrialists, rather than increase wages, put their money into new production capacity. Massive business inventories (up 300 percent from 1928 to 1929) and food surpluses drove prices ever downward. As farms and businesses faltered, unemployment rose cutting the nation's purchasing power even more. Overproduction drove down prices, and things were cheap, but farmers and workers were too strapped to buy goods at any price.

While they seemed like wonderful innovations, new laborsaving machines for home, farm, and factory eliminated whole classes of jobs. Mass production of automobiles brought the price of cars to within the reach of the average person. By 1929, 26 million autos rumbled over American roads. But as the auto business thrived, the railroads, which had been a major pre-war employer, declined. The impact of technology caused newer businesses to supplant older ones, resulting in worker and resource dislocations. This pattern was repeated throughout the economy, such as synthetic rayon making inroads into the cotton and wool markets.

Credit problems mounted through the twenties as businesses began offering installment buying options and easy credit to stimulate sales, and wage earners turned to time payments as a means to stretch their income. Both consumers and companies found it all too easy borrow more than they could pay back. As individuals and businesses became interdependent in their credit/debt dealings, default at any one point could ripple through the economy and cause other defaults.

Stock market speculation proved the weakest point in the credit/debt web. The New York Stock Exchange seemed to provide investors with yet another way to get rich quick. Stocks could be bought on a very small margin. An investor could purchase stock with a small amount of his or her own money and borrow the rest. The theory was that when the stock went up, it could be sold, the borrowed money paid back, and the remainder kept by the investor. Buying on margin enabled investors to leverage their own money into huge profits. But if the stock went down, the lenders still wanted their money at the close of the sale, and the investor would lose the margin. If the stock crashed altogether, the lenders as well as the investors lost everything.

Banking problems sounded another alarm that the economy was faltering. A string of banks failed in the late 1920s as customers, many of them farmers, were unable to pay their mortgages. Foreclosures dispossessed thousands, and banks turned from mortgages and loans to stock market speculation as a means to profitably invest their deposits. Low margins encouraged speculative investment on the part of banks both as investors and as lenders. Many bankers held small reserves as they attempted to capitalize on stock market growth. The crash wiped out not only their profit potential, but

also the investment money the bank had sunk in the market. A run on the bank would then soon exhaust its reserves and cause it to close its doors.

Though the crash of the stock market did not cause the Great Depression, its magnitude accelerated the nation's economic downturn. Between 1929 and 1933, 100,000 businesses failed, corporate profits fell from $10 billion to $1 billion, and some 6,000 banks failed taking with them over nine million savings accounts amounting to a $2.5 billion loss to families and individuals. By 1933, 13 million workers were unemployed, which accounted for 25 percent of the workforce. Thousands of families lost their homes and farms in foreclosures. Tent cities and shantytowns sprang up and large numbers of homeless roamed the U.S. seeking work. Peoples' health suffered as a consequence of these hardships. Malnutrition increased, as did tuberculosis, typhoid, and dysentery. Many people had no other alternative than to turn to soup kitchens and breadlines for food. Even so, 95 people died in New York City from starvation in 1932.