



SECTION  
1

# The Nation's Sick Economy

## MAIN IDEA

As the prosperity of the 1920s ended, severe economic problems gripped the nation.

## WHY IT MATTERS NOW

The Great Depression has had lasting effects on how Americans view themselves and their government.

## Terms & Names

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

## CALIFORNIA STANDARDS

**11.5.1** Discuss the policies of Presidents Warren Harding, Calvin Coolidge, and Herbert Hoover.

**11.6.1** Describe the monetary issues of the late nineteenth and early twentieth centuries that gave rise to the establishment of the Federal Reserve and the weaknesses in key sectors of the economy in the late 1920s.

**11.6.2** Understand the explanations of the principal causes of the Great Depression and the steps taken by the Federal Reserve, Congress, and Presidents Herbert Hoover and Franklin Delano Roosevelt to combat the economic crisis.

**11.6.3** Discuss the human toll of the Depression, natural disasters, and unwisely agricultural practices and their effects on the depopulation of rural regions and on political movements of the left and right, with particular attention to the Dust Bowl refugees and their social and economic impacts in California.

**HI 6** Students conduct cost-benefit analyses and apply basic economic indicators to analyze the aggregate economic behavior of the U.S. economy.

## One American's Story

Gordon Parks, now a well-known photographer, author, and filmmaker, was a 16-year-old high school student in the fall of 1929. He supported himself as a busboy at the exclusive Minnesota Club, where prosperous club members spoke confidently about the economy. Parks, too, looked forward to a bright future. Then came the stock market crash of October 1929. In his autobiography, Parks recalled his feelings at the time.

### A PERSONAL VOICE GORDON PARKS

**“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 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.' . . . 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.”**

—A Choice of Weapons



▲ Gordon Parks, shown here in 1968 discussing the movie version of his autobiographical novel, *The Learning Tree*.

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, serious problems threatened economic prosperity. Though some Americans became wealthy, many more could not earn a decent living. Important industries struggled, and farmers grew more crops and raised more livestock than they could sell at a profit. Both consumers and farmers were steadily going deeper into debt. As the decade drew to a close, these slippages in the economy signaled the end of an era.

**INDUSTRIES IN TROUBLE** The superficial prosperity of the late 1920s shrouded weaknesses that would signal the onset of the Great Depression. Key basic industries, such as railroads, textiles, and steel had barely made a profit. Railroads lost business to new forms of transportation (trucks, buses, and private automobiles, for instance).

Mining and lumbering, which had expanded during wartime, were no longer in high demand. 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 supplied more than half the energy that had once come from coal. Even the boom industries of the 1920s—automobiles, construction, and consumer goods—were weakened. One important economic indicator that declined during this time was housing starts—the number of new dwellings being built. When housing starts fall, so do jobs in many related industries, such as furniture manufacturing and lumbering. **A**

**MAIN IDEA**

**Identifying Problems**

**A** What industrial weakness signaled a declining economy in the 1920s?

**FARMERS NEED A LIFT** Perhaps agriculture suffered the most. During World War I, prices rose and international demand for crops such as wheat and corn soared. Farmers had planted more and taken out loans for land and equipment. However, demand fell after the war, and crop prices declined by 40 percent or more.

Farmers boosted production in the hopes 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. Auctions were held to recoup some of the banks' losses.

Congress tried to help out farmers with a piece of legislation called the McNary-Haugen bill. This called for federal **price-supports** for key products such as wheat, corn, cotton, and tobacco. The government would buy surplus crops at guaranteed prices and sell them on the world market.

President Coolidge vetoed the bill twice. He commented, "Farmers have never made money. I don't believe we can do much about it."

**CONSUMERS HAVE LESS MONEY TO SPEND** As farmers' incomes fell, they bought fewer goods and services, but the problem was larger. By the late 1920s,

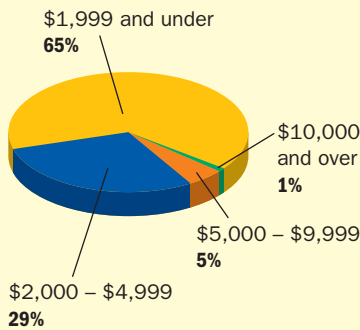


Farm equipment is auctioned off in Hastings, Nebraska.

## ECONOMIC BACKGROUND

### UNEVEN INCOME DISTRIBUTION, 1929

The 1920s were an era that favored big business. Life was good for the rich. They made up just 0.1 percent of the population and had yearly incomes of more than \$100,000. Conversely, much of the population had to scrape to get by. Many earned so little that everyone in the family, including children, had to work. Nearly 80 percent of all families had no savings.



Source: Historical Statistics of the United States, Colonial Times to 1970

Americans were buying less—mainly because of rising prices, stagnant wages, unbalanced distribution of income, and overbuying on credit in the preceding years. Production had also expanded much faster than wages, resulting in an ever-widening gap between the rich and the poor.

**LIVING ON CREDIT** Although many Americans appeared to be 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. This was often in the form of an installment plan (usually in monthly payments) that included interest charges.

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** During the 1920s, the rich got richer, and the poor got poorer. 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.

More than 70 percent of the nation's families earned less than \$2,500 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.

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 purchase the flood of goods that factories produced. The prosperity of the era rested on a fragile foundation. **B**

### MAIN IDEA

### Forming Generalizations

**B** What did the experience of farmers and consumers at this time suggest about the health of the economy?

## Hoover Takes the Nation

Although economic disaster was around the corner, the election of 1928 took place in a mood of apparent national prosperity. This election pitted Republican candidate Herbert Hoover against Democrat **Alfred E. Smith**.

**THE ELECTION OF 1928** Hoover, the secretary of commerce under Harding and Coolidge, was a mining engineer from Iowa who had never run for public office. Smith was a career politician who had served four terms as governor of New York. He was personable and enjoyed being in the limelight, unlike the quiet and reserved Hoover. Still, Hoover had one major advantage: he could point to years of prosperity under Republican administrations since 1920. Many Americans believed him when he declared, "We in America are nearer to the final triumph over poverty than ever before."

It was an overwhelming victory for Hoover. The message was clear: most Americans were happy with Republican leadership.

**DREAMS OF RICHES IN THE STOCK MARKET** By 1929, some economists had warned of weaknesses in the economy, but most Americans



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

HERBERT HOOVER



## Vocabulary

**stock:** a share of ownership in a company

maintained the utmost confidence in the nation's economic health. In increasing numbers, those who could afford to invested in the stock market. The stock market had become the most visible symbol of a prosperous American economy. 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.

Through most of the 1920s, stock prices rose steadily. The Dow had reached a high of 381 points, nearly 300 points higher than it had been five years earlier. Eager to take advantage of this "bull market"—a period of rising stock prices—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.

However, the seeds of trouble were taking root. People were engaging in **speculation**—that is, they bought stocks and bonds on the chance of a quick profit, while ignoring the risks. Many began **buying on margin**—paying a small percentage of a stock's price as a down payment and borrowing the rest. With easy money available to investors, the unrestrained buying and selling fueled the market's upward spiral. The government did little to discourage such buying or to regulate the market. In reality, these rising prices did not reflect companies' worth. Worse, if the value of stocks declined, people who had bought on margin had no way to pay off the loans. **C**

### MAIN IDEA

## Analyzing Events

**C** How did speculation and margin buying cause stock prices to rise?

## The Stock Market Crashes

In early September 1929, stock prices peaked and then fell. Confidence in the market started to waver, and some investors quickly sold their stocks and pulled out. On October 24, the market took a plunge. Panicked investors unloaded their shares. But the worst was yet to come.

## Analyzing

## Political Cartoons

### DAY OF WRATH

After the apparent prosperity of the 1920s, virtually few were prepared for the devastating effects of the stock market crash. This cartoon by James N. Rosenberg, which shows Wall Street crumbling on October 29, 1929, is titled *Dies Irae*, Latin for "day of wrath."

### SKILLBUILDER Analyzing Political Cartoons

1. What does the cartoonist suggest will happen to individuals because of the crash?
2. How does the cartoonist convey the sense of fear and shock?
3. What do the looks on people's faces indicate about the impact of the crash?

 SEE SKILLBUILDER HANDBOOK, PAGE R24.



**BLACK TUESDAY** On October 29—now known as **Black Tuesday**—the bottom fell out of the market and the nation’s confidence. Shareholders frantically tried to sell before prices plunged even lower. The number of shares dumped that day was a record 16.4 million. Additional millions of shares could not find buyers. People who had bought stocks on credit were stuck with huge debts as the prices plummeted, while others lost most of their savings.

## NOW & THEN

### NEW YORK STOCK EXCHANGE

In the twenty-first century, the New York Stock Exchange (NYSE) remains at its core what it has been since it opened its doors in 1792: the nation’s premier marketplace for the buying and selling of stocks. There, stockbrokers known as “members” take orders from their customers to buy and sell shares of stock in any one of more than 3,000 companies.

To execute their customers’ orders, the members offer and receive bids in what resembles a loud and fast-paced auction. In general, customers submit two types of orders. A limit order tells the broker to buy or sell only if the stock reaches a certain price. A market order tells the broker to execute a transaction immediately, no matter what the price.

Despite remaining close to its roots, the NYSE is today undergoing perhaps the most significant changes in its long history, in large part due to the growth of computers and the Internet.

### A Pen and Paper Operation

In the 1920s, orders to buy or sell a stock arrived at brokers’ telephone booths located around the edge of the trading floor. They were then carried by hand or sent by pneumatic tube to the trading post where that stock would be traded.

NYSE employees called reporters had to record every transaction. For each new sale, they wrote out a slip of paper containing the stock’s abbreviation, the number of shares, and the price, and then transmitted it to the ticker room. Market information was typed into a keyboard that converted the keystrokes into electrical impulses that drove the clattering print wheels in ticker machines along the network. People would read the current display at the trading posts.



The trading floor in 1914. ▲

### Technological Changes

While still centered around human interaction, the exchange has incorporated a number of computer technologies to keep up with the times. For example, members now receive stock bids and offers through an electronic delivery system known as SuperDot, which enables them to make a trade in less than 12 seconds. Electronic communications networks now allow individuals to buy and sell stocks themselves over the Internet at a fraction of what it would cost to use a specialist. Such innovation has prompted some to insist that all future trading will be done via computers, thus eliminating the need for physical exchanges such as the NYSE.

### SKILLBUILDER

1. **Hypothesizing** What scenarios can you imagine that might prompt someone to submit a market order on a certain stock?
2. **Comparing** How has technology on the trading floor changed since the 1920s?

The trading floor in 2000. ▼



By mid-November, investors had lost about \$30 billion, an amount equal to how much America spent in World War I. The stock market bubble had finally burst. One eyewitness to these events, Frederick Lewis Allen, described the resulting situation.

### **A PERSONAL VOICE** FREDERICK LEWIS ALLEN

**“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, and a new order of values.”**

—*Only Yesterday*

## Financial Collapse

The stock market crash signaled the beginning of the **Great Depression**—the period from 1929 to 1940 in which the economy plummeted and unemployment skyrocketed. The crash alone did not cause the Great Depression, but it hastened the collapse of the economy and made the depression more severe.

**BANK AND BUSINESS FAILURES** After the crash, many people panicked and withdrew their money from banks. But some couldn’t get their money because the banks had invested it in the stock market. In 1929, 600 banks closed. By 1933, 11,000 of the nation’s 25,000 banks had failed. Because the government did not protect or insure bank accounts, millions of people lost their savings accounts.

The Great Depression hit other businesses, too. 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. Approximately 90,000 businesses went bankrupt. Among these failed enterprises were once-prosperous automobile and railroad companies.

As the economy plunged into a tailspin, millions of workers lost their jobs. Unemployment leaped from 3 percent (1.6 million workers) in 1929 to 25 percent (13 million workers) in 1933. One out of every four workers was out of a job. Those who kept their jobs faced pay cuts and reduced hours.

Not everyone fared so badly, of course. Before the crash, some speculators had sold off their stocks and made money. Joseph P. Kennedy, the father of future president John F. Kennedy, was one who did. Most, however, were not so lucky or shrewd. **D**

**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 war debts. In addition, Germany had to pay war reparations—payments to compensate the Allies for the damages Germany had 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.

Image not available for use on this CD-ROM. Please refer to the image in the textbook.

#### MAIN IDEA

#### Analyzing Effects

**D** What happened to ordinary workers during the Great Depression?

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

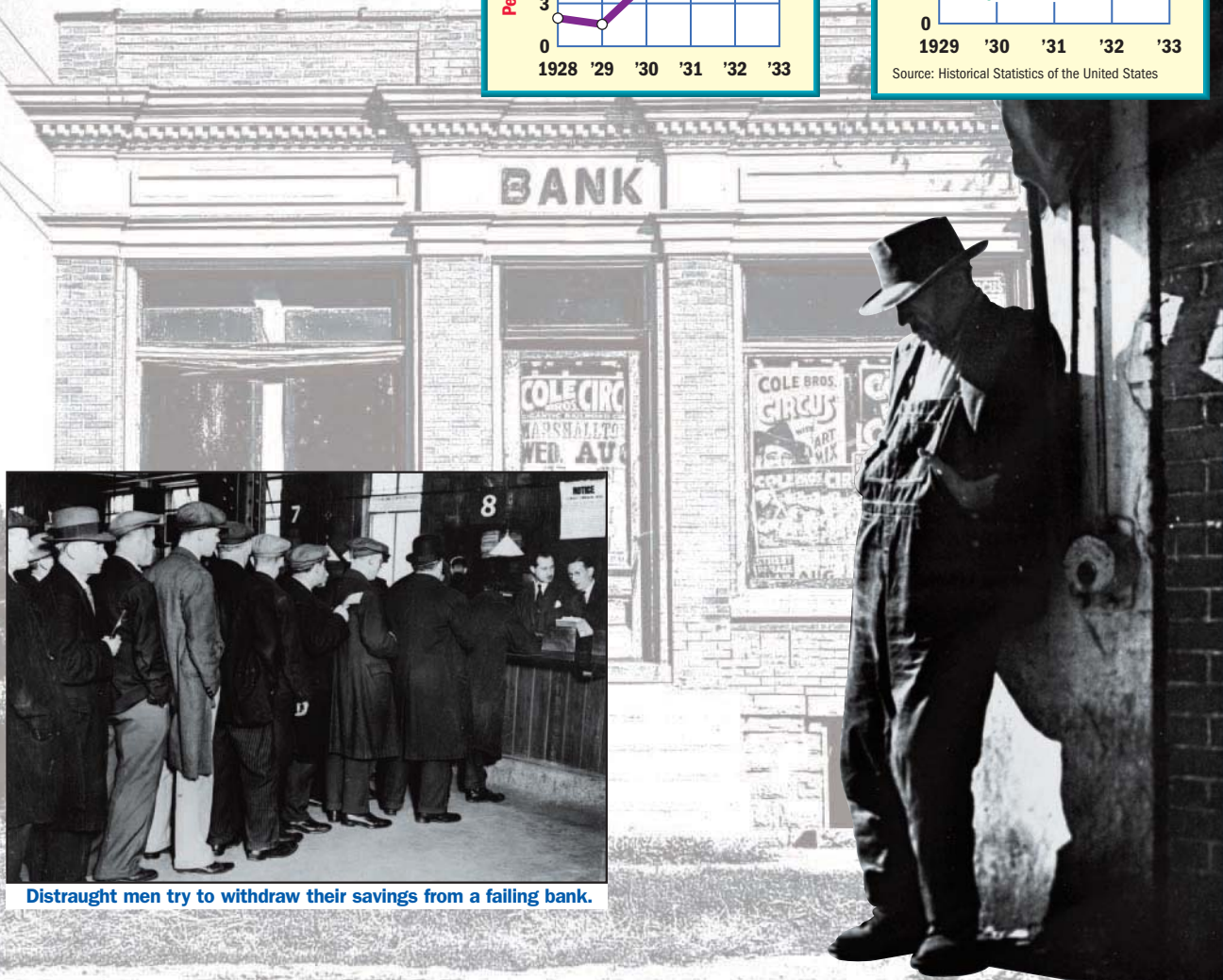
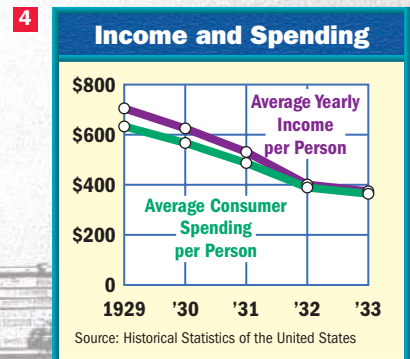
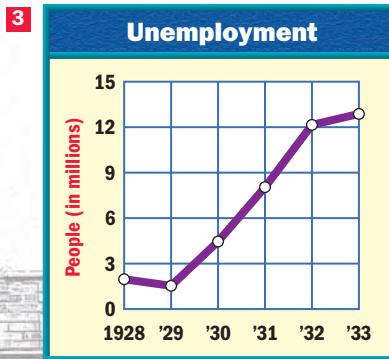
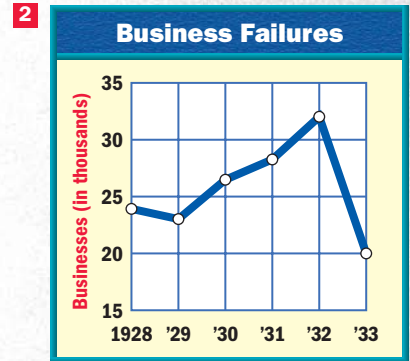
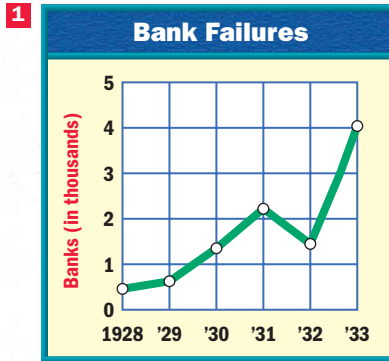


# Depression Indicators

Economic indicators are measures that signal trends in a nation's economy. During the Great Depression several trends were apparent. Those indicated at the right are linked—the conditions of one can affect another. For instance, when banks fail **1**, some businesses may have to close down **2**, which can cause unemployment to rise **3**. Thus, people have less money and spending declines **4**.

## SKILLBUILDER Interpreting Graphs

1. In what year did the biggest jump in bank failures occur?
2. What measure on the graphs seems to indicate an improvement in the U.S. economy during the Depression? What might explain this?



**Distraught men try to withdraw their savings from a failing bank.**

In 1930, Congress passed the **Hawley-Smoot Tariff Act**, which established the highest protective tariff in United States history. It was designed to protect American farmers and manufacturers from foreign competition. Yet it had the opposite effect. By reducing the flow of goods into the United States, the tariff prevented other countries from earning American currency to buy American goods. The tariff made unemployment worse in industries that could no longer export goods to Europe. Many countries retaliated by raising their own tariffs. Within a few years, world trade had fallen more than 40 percent. **E**

**MAIN IDEA**

**Summarizing**

**E** How did the Great Depression affect the world economy?

**CAUSES OF THE GREAT DEPRESSION** Although historians and economists differ on the main causes of the Great Depression, most cite a common set of factors, among them:

- tariffs and war debt policies that cut down the foreign market for American goods
- a crisis in the farm sector
- the availability of easy credit
- an unequal distribution of income

These factors 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, thereby allowing companies and individuals to borrow easily and build up large debts. Some of this borrowed money was used to buy the stocks that later led to the crash.

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

**WORLD STAGE**

**GLOBAL EFFECTS OF THE DEPRESSION**

As the American economy collapsed, so too did Europe's. The world's nations had become interdependent; international trade was important to most countries. However, when the U.S. economy failed, American investors withdrew their money from European markets.

To keep U.S. dollars in America, the government raised tariffs on goods imported from other countries. World trade dropped. Unemployment rates around the world soared. Germany and Austria were particularly hard hit. In 1931 Austria's largest bank failed. In Asia, both farmers and urban workers suffered as the value of exports fell by half between 1929 and 1931. The crash was felt in Latin America as well. As U.S. and European demand for Latin American products like sugar, beef, and copper dropped, prices collapsed.



**ASSESSMENT**

**1. TERMS & NAMES** For each term or name, write a sentence explaining its significance.

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

**MAIN IDEA**

**2. TAKING NOTES** (HI 6)

In a diagram like this, record the causes of the 1929 stock market crash.



Which do you see as the biggest cause? Why?

**CRITICAL THINKING**

**3. MAKING INFERENCES** (11.6.1)

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** (11.6.3)

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
- how confidence affects consumer borrowing