

Causes of the Great Depression

Cause#1: Reparations Payments and War Debts

The Treaty of Versailles of 1919 put an official end to World I. Included in the Treaty were two very controversial clauses (Articles 231 and 232) that forced Germany to pay the Allied nations in Europe nearly \$32 billion over the following thirty years. In large part owing to this settlement, Germany experienced serious economic problems during the 1920s. After Germany failed to make payments in 1923 and the French occupied the Ruhr region in retaliation, the United States decided to step in and loan Germany the funds to pay reparations. Known as the Dawes Plan, this American policy enabled Germany to meet its obligations for the next five years. But it was a brief respite. When the Great Depression hit, the American loans dried up and Germany soon defaulted on the payments again. Meanwhile the Allied nations in Europe owed \$12 billion in war debts to the United States. This was one reason why they demanded reparations payments from Germany. The reparations gave them the funds to pay off their own debts. Soon, the Dawes Plan led to an absurd situation: the Americans loaned money to the Germans; the Germans used those loans to pay reparations to the French and British; and the French and British used the reparations to pay off their debt to the Americans. Despite many requests, the United States refused to show any leniency to the Allied nations. When American loans to Germany shrank in the late twenties, it was only a matter of time before the Allies defaulted on their war debts. In short, the most powerful nations in Europe were economically vulnerable to disaster.

Cause#2: Overproduction in Agriculture

Between 1925 and 1929, nearly every export crop in the world fell in price. Millions of farmers suffered losses as cash commodities like coffee fell from 24 cents to 10 cents a pound or rice depreciated 30-50 percent in value. The problem was simple. There was too much agricultural production in the 1920s—supply far outweighed demand. Declining populations and more efficient farm machinery were mainly responsible for the glut. But people seemed to make a determined effort to ignore the problem. Rather than curtail production, farmers further expanded their operations. Cotton production increased by 30 per cent; rubber production increased by more than 80 percent. The farming of wheat, beets, sugar cane, tea, and cocoa was also amplified. Meanwhile governments placed tariffs on imported foodstuffs to protect their own farmers. Germany, for example, more than tripled its wheat tariff between 1925 and 1930. The sharp reduction in exports devastated agriculture worldwide. Heavily in debt for land and machinery, farmers around the globe were in trouble well before the Great Depression started. The agricultural industry was still the backbone of the economies of many countries, including the United States. In numerous countries, however, profound structural weaknesses plagued economic life in the 1920s

Cause#3: Stock Market Crash

Most people associate the Great Depression with the Wall Street stock market crash of 1929. One scholar described the start of the crash on October 24 as “the most devastating day in the history of the New York stock market.” Throughout the 1920s a long boom took stock prices to peaks never before seen. From 1920 to 1929, stocks more than quadrupled in value. Many investors became convinced that stocks were a sure thing and borrowed heavily to invest more money in the market. This was called “buying on the margin” and was very risky financially. It was possible to make nine dollars for every dollar invested, but it was also possible to lose nine dollars for every dollar invested. Still Americans remained confident that they could become rich from “playing the market.” The collapse began on October 24, now known as “Black Thursday.” Prices plummeted when people realized that the stock market boom was over. With no one buying stocks, millionaires became bankrupt almost overnight. In just three days, stocks lost \$5 billion in value. The banking system fell into chaos as banks tried to collect on loans made to stock market investors whose holdings were now worth little or nothing. Worse, many banks had themselves invested depositors’ money in the stock market. When word spread that banks’ assets contained huge loans and almost worthless stock certificates, depositors rushed to withdraw their savings. Unable to raise fresh funds, banks began failing by the hundreds. When American loans to other countries dried up, the fragile world economy felt the full impact of the crash.

Cause#4: Inequitable Income Distribution

The 1920s in the United States are often linked in our historical memories to prosperity and good times. But 40 per cent of the country shared just 12 per cent of the national income by the end of the decade. In contrast, the well-to-do who made up 5 per cent of the population enjoyed 30 per cent of the national income. The economy did grow at a spectacular rate, with American industry churning out cars, refrigerators, and radios. But wages did not keep pace with productivity in the 1920s and many Americans were too poor to buy the glut of consumer goods. The introduction of installment plans or buying on credit helped. Most cars and radios were bought with a “buy now and pay later” plan. Still, there was too much money in too few hands. And installment debt decreased the incomes of the less privileged even further. The rich were only able to buy so many goods for themselves; their consumption was not enough to offset the overproduction of goods. Finally, in the summer of 1929 (just before the stock market crash), business people realized that supply far exceeded demand, and they made severe cutbacks in many industries. Unemployment rose so less money existed to buy goods. This resulted in more layoffs, and so on. Ultimately the United States government passed the Hawley-Smoot Tariff Act, which slapped heavy taxes on thousands of imported goods from other countries in order to help American industries recover. It dealt a crushing blow to international trade and greatly contributed to the spread of the Great Depression around the world. In short, what began as an uneven distribution of wealth in one country, ended in a global crisis.

Cause#5: Protectionism

In 1927, at an earlier World Economic Conference in Geneva, delegates recognized that a thriving world economy was dependent upon free trade. The benefits of international trade would not be realized unless all nations decreased their tariffs or taxes on imported goods so that they could compete fairly with commodities made at home for a share of the market. In 1930, however, the United States passed the Hawley-Smoot Tariff Act which levied duties on thousands of imported goods to protect American-made products from foreign competition. Over thirty countries filed formal protests, but just as quickly sixty countries followed suit. In the words of one historian, Hawley-Smoot “gave rise to a headlong stampede to protection and restrictions on imports” around the world. It came to stand as a symbol for the beggar-thy neighbor policies—policies designed to improve one’s own lot at the expense of that of others—implemented in the 1930s. It was a lose-lose situation. United States imports from Europe declined from a 1929 high of \$1,334 million to just \$390 million in 1932, while United States exports to Europe fell from \$2,341 million in 1929 to \$784 million in 1932. Overall, world trade declined by some 66 percent between 1929 and 1934. Meanwhile unemployment continued to increase in the United States, while European countries found it difficult to pay off reparations and war debts. Protectionism proved even worse for less developed countries that depended heavily on the export of raw materials and cash crops for revenues. Malaysia, for example, experienced an 80 percent drop in export revenues between 1929 and 1932. Efforts to protect domestic industries had a disastrous impact on the world economy and contributed greatly to the length and depth of the Great Depression.