Podcasting the Past

European and world history

Part G: USA, 1918-1968

This document is part of a series that summarises recent research published on the key issues outlined in Section G of the [Higher History Course Specification](). Although the summaries are wide-ranging, they do not cover all the literature ever published on the key issues. Instead, the summaries highlight some new research findings and directions, and illustrate how new historical research informs old historical debates, broadening our understanding of the past. This document is intended to supplement, not replace, pre-existing guidance on this topic.

3. An evaluation of the reasons for the economic crisis of 1929-33

A) Republican government policies in the 1920s

- Conventional wisdom holds that artificially high wages deepened and prolonged the Great Depression. The federal government asked failing companies, caught in a downward spiral of falling prices, not to cut wages, even though the normal forces of supply and demand would have lowered wages, cut labour costs, increased employment, and boosted output **(Rothbard, 2000)**. Recent research by **Rose (2010)** has associated the policy of 'wage rigidity' with President Hoover personally. Between November and December 1929, Hoover met with business leaders at the White House to encourage them to maintain high wages – a policy that most economic historians believe made matters much worse. **Mackenzie (2010)** endorses Rose's conclusion: 'Hoover's activist high wage policy prolonged and intensified unemployment during the early years of the Great Depression.'

- **Beaudreau (2017)** argues that the manufacturing sector in the late 1920s found itself with excess capacity, due in large part to electrification. This state of affairs led the Republicans to propose a tariff increase (to raise the cost and lower the supply of foreign-made goods). According to Beaudreau, this failure to make good on this promise led to the Crash and the subsequent decline in investment expenditure, the cumulative effect of which led to the Great Depression.

- **Wisman (2014)** makes the case that it was pre-existing inequality that caused the Great Depression. According to him, prior to 1929, relatively low wages, the availability of credit from the capital-owning classes, low interest rates, new credit facilities, liberal lending practices, lower household savings, higher household debts, longer working hours, and a laissez-faire attitude to taxation and regulation all caused the Great Depression.

B) Overproduction of goods and underconsumption

- The Great Depression was marked by a severe outbreak of protectionist trade policies (tariffs). Countries, like the United States, which stayed on the gold standard - and, therefore, had less autonomy over their money supply – had to introduce tariffs to stabilise prices **(Eichengreen and Irwin, 2010).** To stabilise prices at home (i.e., to stop prices falling) due to overproduction and underconsumption, it became more expensive for other countries to trade with the U.S. Theoretically, tariffs limited the supply of foreign goods and drove up the price of domestic goods. The orthodoxy is that protectionist trade policies made the Great Depression worse **(e.g., O'Rourke, 2018)**, although **Siles-Brügge (2014)** disputes this view.

C) Weaknesses of the U.S. banking system

- One of the key questions on the banking system is: why did so many banks fail during the Great Depression? One view **(e.g., Friedman and Schwartz, 1963)** is that banking panics reflected liquidity crises. As fear spread throughout the country, deposit withdrawals accelerated and bank runs became self-fulfilling panics, causing many viable banks to fail. A second view **(Temin, 1976)** is that bank runs were crises of fundamental solvency. Mounting defaults and a downward trend in the value of bank assets contributed to a decline in the strength of banks. According to this view, banks failed because they were insolvent, rather than merely illiquid.

- Historians disagree on whether the Federal Reserve did enough to alleviate the Great Depression. The orthodox view is that the Federal Reserve was a passive actor in the events of 1929-33. According to **Thompson (2017)** the Federal Reserve System (FRS) was a site of 'policy gridlock'. Some members of the Board wanted the FRS to 'promote international monetary stability.' Other members (an 'aggrieved rural faction') did not agree and vetoed attempts to implement a more interventionist monetary policy in 1929, causing investments to fall and credit to contract. **Richardson and Troost (2009)** and **Jalil (2014)** endorse this view: the Federal Reserve System could have mitigated the banking panics had it been more interventionist and, for example, acted as a lender of last resort for struggling banks. **Damette and Parent (2018)** posit a revisionist view: as early as 1930, the Fed was reacting to economic conditions by adjusting its monetary policy to alleviate the crisis. **Carlson, Mitchener and Richardson (2011)** suggest that, in 1929, a bank run in Tampa, Florida and surrounding cities was stemmed by quick intervention by the Fed.

- **Postel-Vinay (2016)** argues that Chicago banks failed during the Great Depression because they had sold so many mortgages in the 1920s and, therefore, did not have enough money to sustain large-scale customer withdrawals after the crisis hit in 1929. Overexposure to 'illiquid investment' was the reason why so many Chicago banks failed.

- **According to Mitchener and Richardson (2019),** the credit crunch was exacerbated when commercial banks stopped lending money to each other. Once they started to withdraw their deposits from the Federal Reserve banks, other commercial banks could not so easily lend to businesses. This contraction in interbank lending led to a corresponding contraction in total commercial bank lending by approximately 15% between 1929 and 1933.

- **Fishback, Fleitas, Rose and Snowden (2020)** contend that the Great Depression 'involved a severe disruption in the supply of home mortgage credit.' Their research shows that mortgage foreclosures explain 'about 30 percent of the drop in new lending between 1930 and 1935.' The Depression led to a tightening of mortgage credit that, paradoxically, made it harder for the housing market to recover from the crisis. A recent wave of literature argues that the collapse of the housing market in the late 1920s and early 1930s played an important role in the onset and severity of the Great Depression **(Goetzmann and Newman, 2010; Brocker and Hanes, 2014; Gjerstad and Smith 2014; Goetzmann 2016).**

D) International economic problems

- The orthodox view is that **the Gold Standard** – an inflexible monetary system that values currency in terms of a fixed quantity of gold – overvalued some currencies and undervalued others. The orthodoxy is that 'incorrect' exchange rates put the international economy under huge pressure **(Cooper, 1982). Dąbrowski (2015)** argues that the primacy of national economic interests, a failure of central bankers to cooperate with each other, suspicions of a the new, more flexible gold-exchange standard system, and an inflexible monetary policy in France (a preoccupation with keeping prices low) exacerbated 'the Great Deflation' of prices. **Moessner and Allen (2011)** find that the gold standard also limited the amount of money the Federal Reserve could make available to struggling commercial banks. **As Mazumder and Wood (2013)** put it: 'the Great Deflation of 1929-33 was inherent in the operation of the gold standard once a country decided to return to prewar parity following its suspension and wartime inflation.'

- **Mathy (2020)** contends that continued uncertainty (the 'wait-and-see' approach to business investment) reduced investment in the U.S. economy and prolonged the Great Depression. According to Mathy, 'roughly 40–70% of the simulated decline in output' can be attributed to 'uncertainty shocks' that deterred business investment.

E) The Wall Street Crash

- Economists and historians debate how much responsibility to assign the Wall Street Crash of 1929. The orthodox view is that the stock market in 1928–29 was 'a bubble' waiting to burst (share prices were far higher than they should have been and, eventually, investors realised that). Monetarists **Friedman and Schwartz (1963)** conclude that the Crash was a shock that played a role in the onset of the initial recession, but it did not cause the Great Depression.