Cause of the great depression

History, American History

This was the greatest depression as it severely affected almost all countries in the whole world. The US was the hardest hit by this depression which stated with the collapse of its stock market. The great depression did not spare any country whether rich or poor, devastating the country's revenue from taxation, diminishing the income of individuals and the industrial profits. It led to the reduction of output productivity which in turn saw the rise of unemployment and the deflation of prices. The spread of this depression to other countries was attributed to the fall of the stock market, but the condition of the depression were either made worse or better by the internal strengths and weaknesses of the affected countries. The economic downturn was eminent, and it took hold in 1929 as a result of the collapse of the stock market. The collapse of the stock market contributed much to the collapse of close to half the number of the banks in the US.

The transmission of the depression to other countries was also attributed to the use of gold standards which was linked to all as a medium of exchange (Romer). Thus, economic recovery in many countries was accelerated by the country abandoning the use of gold standards and adaptation of monetary expansion; this resulted to the adaptation of changes of economic theory, macroeconomic policies and the economic institutions.

The end of World War I had seen the expansion of industries in the US, and this lead to the rise of the debt level which had reached about 300% by the time of the great depression. The value of capital was rapidly increasing growing at a rate of7. 7 percent and the standard index bonds were yielding at 4. 9 percent. Before the shock of the great depression, brokerage firms had margin requirement of 10%, which they issued, to the amount invested.

The collapse saw those brokers recalling loans of which was impossible to pay back as the value of prices had reduced and the rise of the interest rates.

The collapse of banks was attributed by the failure of debtors to service their debts, while the depositors were withdrawing their deposits in masses thus, leading to panic in the financial markets. The ineffectiveness of government policies led to loss of billions in the form of assets. Thus, this increased the outstanding debt and the falling of prices while the value of debt remained at the same level. Capital investments and construction industry came to a hold attributed to the fact that the future profitability being unattractive and the conservativeness of banks to lending the banks accumulated their capital reserve lending few loans; thus; intensifying the deflationary pressure that in turn resulted to a vicious cycle. The liquidation of debt was unable to cope with the fall of prices as it much ahead, thus, the increase of the dollar value owed to the declining assets holding; hence individual's efforts to offset their debt increased it rather than reducing (Romer).

The economicboom of 1920s had an impact of unequal distribution of wealth, and this was a contributor to the great depression, due to the massive production that was by far more than the demand. The rate of wage increase was extremely low in comparison to increase in productivity, and hence the benefits that accrued with the increased productivity were converted to profits. These profits were invested in the stock market, which had an effect of reducing the consumer purchasing power. The federal banks had kept the discounting rate low so as to attract investment; this led to increased

productivity making the economy flourish. The resulting was increased capital investment that created a lot of space that was impossible to utilize which increased the supply more than demand, because of the diminishing purchasing power of consumers. The overinvestment of industrial capacities led to the great depression rather than the individual businesses.

Financial institutions were exposed to vulnerability as the medium institutions relied on farmers, while the large institutions invested heavily on the stock market. The fall of the prices to farm output led to the significant increase to the rate of interest on loans due to depression. This led to the inability of the farmers to service loans, as their land had been over-mortgaged as a result of economic boom, and the depression led to increased fall of output prices with the subsequent increase to interest rates. This was the main reason for the collapse of these banks was as a result of over reliance to farmers. Lack of proper management by the large banks of their reserves led to overinvestment in the stock market, and the lending of risky loans made the banks lack the capability of absorbing the shock of depression because of the reserve inadequate (Romer)..

The use of gold standards as a means of fixing the rate of currencies by some countries had adverse effects, as those countries that had lent out were looking on ways that they could recover the same quantity in gold value. Countries were setting the value of their currency using the gold standard and had to defend these prices, and they played a crucial role of limiting the use of monetary policy. This did lead to trade imbalances, which led to, inflow of gold to US.

The restriction of exchange and the creation of currency control, made Britain set prices for its currency in relation to gold prices, which was criticized as being a revolution of wages that did not have equilibrium. Countries that relied on loans to finance their activities were the hardest hit by the impact of deflation, as the price of commodities was eroded by the real value of its debt. Gold standards were attributed to the increase of the depression shock as it deterred the lowering of these effects of depression transmitting the problem allover the world. The high rate of the gold standard required to attract investors made the easing of monetary policies impossible as they ensured the international equilibrate through exchange rate, and only countries thhat had abandoned this standard that suffered lesser (Romer).

Population dynamics had an effect in the depression as the decline led to a decrease in demand for housing, and other commodities as the propensity to growth was dependent of population dynamics. The reduction of population due to World War I and the enactment of migration law had an adverse effect on population growth as it resulted to few families.

The collapse of world trade contributed to the great depression as the allies of the US during the war had been loaned by US banks. These countries sort for reparation as they were heavily indebted to service their loans. The weakening of the US economy resulted to many countries to borrow, and the high tariffs made the selling of their goods to US difficult thus, they defaulted in servicing the loans. The productivity of these countries mainly in agriculture had started to flourish, and the demand for US goods declined,

due to the financial crises that made the purchase of foreign goods difficult. The government protectionism made many countries become beggars as the mode adapted by countries to use gold standards as a means of exchange instead of rate floating did not cut the interest rate. This changed the terms of trade of countries that relied on the gold standards.

Reasons for Prolonged Depression

The New Deal policies are said to slow the recovery of the great depression as some of them benefited the economy by the establishment of social safety, and the financial systems stabilization. However, other deals were responsible for the violation of the basic principles of economics, as they were suppressing the principle of competition, and setting of prices and wages that were beyond the normal level in quite a number of sectors. These policies plunged the economy back to depression as they were the stumbling block to the powerful recovery forces (Sullivan).

The excessive competition had been attributed to price and wages reduction led to the introduction of wages that were above to where they ought to be, which ran contrary to what would have been in an economic state resulting to gains in productivity. This led to the inability of consumers to purchase stalling demand decline in the national Gross National Product (Sullivan). The policies contained in the National Industrial Recovery Act (NIRA) exempted industries from antitrust prosecution by agreeing to enter into collective bargaining agreements that saw the rise in wages, but it ensured higher prices for goods. This saw more industries accounting 80 private and non-agricultural employments. It is contented that the policies prolonged the

depression as the act was later declared to be against the law. The policies are said to have been short lived as they artificially inflated the wages. The NIRA policies were the most damaging as they had permitted the collusion of industries to increase wages and prices above the productivity growth.