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[Economics](#), [Budget](#)



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0px; text-indent: 27. 0px; font: 12. 0px Baskerville; color: #000000; -webkit-text-stroke: #000000}p. p2 {margin: 0. 0px 0. 0px 0. 0px 0. 0px; text-indent: 27.

0px; font: 12. 0px Baskerville; color: #000000; -webkit-text-stroke: #000000; min-height: 14. 0px}span. s1 {font-kerning: none}span. s2 {text-decoration: underline ; font-kerning: none}In 1920s, there was a very good time in America. It could be said that the American economy was in its optimum level. Since there was a slight economic recession at the beginning of the twenties, but the economy had recovered by time and started booming from 1921 (i. e.

Roaring Twenties). Production and employment were high and kept rising. Wages were not increasing much, but the prices were stable (i. e. stable inflation). The American capitalism was undoubtedly in a lively phase. “ The number of manufacturing firms inclined from 183, 900 to 206, 700 between 1925 and 1929; the output value increased from \$60. 0 billions to \$68.

0 billions. The Federal Reserve index of industrial production which had averaged only 67 in 1921 (1923-5= 100) had risen to 110 by July 1928, and it reached 126 in June 1929. In 1926, 4, 301, 000 automobiles were produced. Three years later, in 1929, production had increased by over a million to 5, 358, 000, a figure which compares very decently with the 5, 700, 000 new car registrations of the opulent year of 1953.

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Business earnings were rising rapidly, and it was a good time to be in business.” (Galbraith, *The Great Crash 1929* 2009, Ch. 2, p. 31)

Subsequently, there was a collapse of the stock market in 1929 due to a great speculative orgy occurred and the stock trading was at a speedy pace. In order to make huge profits or returns from the bull market, investors ignored the risks of speculation which means more money was put and rising the stock prices, then led to a speculative bubble. An American economist, Irving Fisher (1929) even noticed that “ stock prices has reached what looks like a permanently high plateau.” The collapse of the stock market triggered the Great Depression over 20 years.

In fact, is there any correlation between the Great Crash and the Great Depression? Yes, there is. To some extent, the collapse of the stock market in 1929 was responsible for the Great Depression. The Great Depression refers to a severe global economic recession between 1929 and 1933. By most contemporary accounts, it started with the U. S.

stock market crash of 1929 and even not finished until the Second World War in 1946. The Great Depression can be indicated as one of the most catastrophic economic events in twentieth century. (Great Depression.

Investopedia, Paragraph 1) In 1933, it resulted in approximately a third drop of the US Gross National Product in 1929. The physical volume of production was in an unsatisfying level. Until 1941, the dollar value of production was kept below 1929. In 1933 nearly 13 million workers were being unemployed which was about a quarter of the labour force. (Galbraith, *The Great Crash*

19292009, Ch 10 p. 186) The Great Depression was caused by an array of reasons such as economic and political factors. In economic factors, many economists have their own stance and opinion on the Great Depression. In Keynes's Theory, Keynes (1997) points out a market economy would be in a long term depression.

According to the General Theory, the chronic condition of depression of an economy and the definition of " subnormal activity" are explained. It is because of excess in saving and lack of consumption and investment in which " the propensity to consume and the rate of new investment cause a deficient effective demand, the actual level of employment will fall short of the supply of labour potentially available..." (Keynes, The General Theory, 1997, p. 30) He believes that economies are naturally volatile if they are not managed, with a trend to subnormal activity. Therefore, the government plays an important role to stabilise the performance of an economy such as introducing policies (Robert Skidelsky, Keynes: A Very Short Introduction, ch. 4). Keynes (1997) also argues a huge decline in income and the employment is way below the average are contributed by inadequate aggregate demand.

In fact, the aggregate demand shrunk (i. e. the consumer expenditure and investment were relatively low) after the stock market crash, so government expenditure became a relatively significant component of its total spending.

Since the economy slowed down, consumer confidence was lost due to an increase in unemployment. Consumers tended to save more and spend less, so consumer expenditure would be decreased. Saving is destruction in

depression. In other words, during the Great Depression the propensity to save rose significantly as income fell drastically (K Dadkhah, The Evolution of Macroeconomic Theory and Policy, 2009, p. 64).

Based on “ The Paradox of Thrift” raised by Keynes, he suggests that if an individual increases his/her saving, that will fall the aggregate demand and decrease the total output which will lead to have a lower total saving. On the investment side, business confidence was shaken by the stock market crash of 1929, plus decreasing investments. From 1929 to 1932, real gross private domestic investment descended nearly 80%. (17. 1 The Great Depression and Keynesian Economics online. Available from: <http://open.lib.umn.edu/macroeconomics/chapter/17-1-the-great-depression-and-keynesian-economics/>)

Keynes claimed that investment is inherently unstable as businesses are driven by the “ animal spirits”. Capitalists are irrational and easy to become an “ irrational exuberance” . Additionally, the marginal efficiency of capital (MEC) also contributes to investment inactivity because of business pessimism and fall in demand for goods and services. So, the aggregate demand exacerbated. To sum up, the collapse of the stock market influenced the Great Depression as the stock market crash caused low consumption and investment.

As aggregate demand is ($Y = C + I + G$), so in order to boost aggregate demand during the depression, government have to increase their spending to stimulate the economy and the multiplier driving higher the economy's

health. (“ Fear the Boom and Bust” Rap online. Available from:
<http://econstories>.

[tv/video/fear-the-boom-and-bust/](http://econstories.tv/video/fear-the-boom-and-bust/)) In Hayek’s view, his thought appears to contradict Keynes’ claim on the Great Depression which Keynes is to encourage government to stimulate investments and discourage savings such that increase its aggregate demand. However, Hayek believes that savings and investments are mutually exclusive. It is difficult to stimulate investments and discourage savings or vice versa. (Rothbard, America’s Great Depression (2000), p.

38) In addition, Hayek identifies the capital structure is key, malinvestments would wreck the economy (“ Fear the Boom and Bust” Rap online. Available from: <http://econstories.tv/video/fear-the-boom-and-bust/>).

According to Austrian Business Cycle Theory by von Mises and Hayek, the result of excessive growth in bank credit during the depression because of artificial low interest rates set by Fed can be implied by the theory.

Nevertheless, Hayek concluded the slump of the 1930s (i. e. the Great Depression) stemmed from the inflation of the 1920s.

The downturn would correct for the past mistakes and inefficiencies created in the growth were removed, and will lead the economy back to full employment equilibrium. So, injecting money and increasing the bank credit made the depression more serious (MWE Economy 3 2016 slide). Hayek did not blame on the stock market crash in 1929 at all. The fundamental cause

was the expansion of money supply over the twenties and the Fed should take responsible for it.

On the monetary side, monetarists such as Friedman and Schwartz were focusing on the depression due to banking crisis, which was not directly correlated and determined by the stock market crash of October 1929. The banking crisis was attributed by a speculative investment bubble, as the Fed increasing of the discount rate to 6% of borrowing to commercial banks in August 1929. But what factors have driven the bubble into the crash? Monetarists (Friedman and Schwartz) agreed that it was generated by investors based on the similar explanation of “ animal spirits”. Friedman and Schwartz suggested the Fed could be the only remedy to bring the economy out of depression swiftly by engaging in a various of disastrous policies after the crash. (Pongracic Jr, *The Great Depression According to Milton Friedman*, 2007, paragraph 14) For example, the Fed allowed large bank failures but did not provide emergency aid (i.

e. bank bailout) to these banks, so the panic to public was produced and widely spread, then the money supply was dropped rapidly. On the other hand, poor governance of the Fed has contributed to the depression. The Fed had unclear statutory objective and conflicts between discretionary targets of monetary policy — the re-establishment of the gold standard abroad and the emergence of the bull market in stocks. In order to promote global monetary stability, the dominant country has to allow movements of gold to influence the money stock and prices through the gold standard rules.

In 1920s, the US was one of the biggest creditors in the world (i. e. exports > imports) and led to expansion of the domestic money supply. (MWE Lecture 1 slide) In Galbraith's opinion, Galbraith stated the importance of how the stock market crash in 1929 had contributed to the Great Depression as it was caused by inadequacy of demand for goods and services, depression on investments and borrowing, economic growth drag and cause of financial hardship.

Subsequently, Galbraith summarised the Great Depression was constituted of five core weaknesses:-1. The bad distribution of income. He argues that the 5% of the population with the highest incomes in that year received nearly 1/3 of all personal income. 2. The bad corporate structure. The vital important firm weakness was inherent in a various new structure of holding companies and investment trusts.

Large segments of the utility was controlled by the holding companies. 3. The poor banking structure. The domino effect shows when one bank failed, it cannot stop the others; one failure led to other failures. An increase in unemployment and lower incomes would be a catalyst for this effect. 4. The imbalance of foreign trade. Since the World War I, the US became one of the international creditor, making a trade surplus (exports > imports) in the following ten years.

High tariffs restricted imported goods and encourage more exports, both contributing the trade account imbalance. 5. The poor state of economic

intelligence. He believes “ the economists who offered economic counsel in the late 20s and early 30s were almost uniquely perverse.

” and “ the burden of reputable economic advice was invariably on the side of measures that would make things worse.” (p. 199, 200)(Galbraith, The Great Crash 1929 2009, p. 194-200)In conclusion, the Great Depression was a grim time in the chronicle. The stock market crash of October 24, 1929 was not the only event or the main reason that caused the Great Depression.

Not only the economic factors have driven the depression, but also the political reasons and environmental problem. For example, political decisions as war reparations post-World War I are associated with the depression such as European imports were imposed by congressional tariffs. In addition, higher tariffs were designed by Hoover for protecting farmers from the competition in Europe in 1928 and the Smoot-Hawley Act in 1930 was passed although economists disapproved. It encouraged international protectionism, world trade exacerbated by 66% between 1929 and 1934.

(K Gill, March 2017, What caused the Great Depression) The economic downturn was made even worse by environmental disaster. A drought and poor harvest affected from southeast of America to the Texas; crops and livestock were killed, untold millions in damage was caused by the dust storms. (M Kelly, August 2017, Top 5 causes of the Great Depression)However, in my opinion on economic view, if the economy was exactly in a turmoil after a stock market crash, could “ invisible hand” guide the economy out of recession? Then we can think of who should take the

responsibility for the Great Depression. The Great Crash? Mismanagement by the immature Federal Reserve? The monetary policy (low interest rate)? Bank failure? or the government? For me, there is no “invisible hand” in a free market economy, especially if an economy was in a recession which is more or less of Keynes’ view. Individual rational market is maximising self-interest such as utility, profits and revenue based on their (budget) constraints and through market exchange, thus leads to desirable outcomes for everyone. But if the individual was in a depression, he/she may easily become irrational.

Ideal decisions in a free market could not be made effectively by “invisible hand”. Also, there are relative high unemployment during the depression, for example, the percentage of unemployed was 24. 75% of the labour force in the US. (Unemployment Statistics during the Great Depression online.

Available from: [http://www.](http://www.u-s-history.com/pages/h1528.html)

[u-s-history.com/pages/h1528.html](http://www.u-s-history.com/pages/h1528.html)) The economy would not be returned to the state of full employment in a short term. Moreover, even the interest rate was low but the real income was low either, there were not a massive boost in consumer spending; investments were depend upon the preference of businesses and individuals.

So, I believe government intervention is needed during the depression. All in all, the stock market crash was responsible for the depression to some extent and the government plays an important role during depression of an economy.