

Econ 2200 study guide

[Business](#)



Chapter 3: Second industrial Revolution: -many believe began with Bessemer steel process -firms grew, with this came market power -rising concern over monopolies led to anti-trust legislation -worried that Malthus's economic prediction might come true-that growth would explode, leading to more thinly spread resources (food) among starving and dying population (appendix 20. 1)-the classical(malthusian) growth model -from 1860-1890: real wages for manufacturing employees increased by 50% or 1.

36% per year -wages in building increased by 60% or 1. 58% per year average real wages in manufacturing grew despite rapid-growth in less-skilled, less-literate immigration from southern to eastern Europe between 1890-1914 -increased supply of labor from immigration depressed manufacturing wages, but the rising factory-driven demand for labor prevailed -these increases in living standards occurred during a period of laissez-faire capitalism, aided by free trade and lack of gov. control - consumers enjoyed a greater selection of goods and services Sources for economic growth and increases in living standards -Appendix 20 Models of Economic Growth physical capital includes the tools, machinery, and other resources workers use to produce goods and services -human capital includes the skills and knowledge, or education, of workers -technological advance occurs when society has discovered a better or more efficient way to produce -most common example of this is the assembly line, where workers specialize in specific tasks -economists agree that physical and human capital face diminishing marginal returns, meaning additional units of them yield smaller increases in output Physical and Human Capital over the Industrial Revolution: during 2nd revolution, industry moved from an

agriculturally based economy to an industrial-based one -factories began employing large numbers of workers, and in 1860, nearly 1 out of 4 Americans worked in manufacturing, while in 1900 this increased to 1 out of 2 workers -in the south, most sharecroppers after the civil war were black, had little opportunity, and continued living on plantation owners' lands in exchange for shares of crop they grew -society became more educated as some state governments increased funding for public schools and levied taxes to fund textbooks Morrill Act of 1862-provides grants of public lands to states to support education, and the Hatch Act of 1887-provided federal funding for state land-grant colleges to create agricultural experiment stations, which researched soil, minerals and plant growth Technological Advance over the Industrial Revolution: -technological advance was the most important factor that contributed to long-run economic growth -include new inventions or innovations that lead to better or more efficient production methods the Bessemer process led to the mass production of steel by blowing cold air on red, hot iron to purify it by burning off carbon deposits -as this process lowered the cost of steel production, railways expanded outward and skyscrapers grew upward -the first skyscraper, the Home Insurance Company built in Chicago in 1884, was 10 stories high and was not possible without the advent of steel Technological Advancement's Effect on Real Wages: -Taylor's ideas flourished in the Second Revolution, as firms hired efficiency experts from across the country experts promoted the use of time clocks and breaks, and tied rewards to productivity -many also found that piece-rate pay increased worker productivity -unmonitored, hourly-rate workers had the incentive to work more slowly, but salaried workers had the incentive to shirk because piece-rate pay paid each worker for only for each

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specific quality item produced—so monitoring workers became less important -Henry Ford perfected Taylor's scientific management principles through his assembly line production of automobiles Technological advances during 2nd revolution increased the marginal productivity of labor for every worker -measure the marginal productivity of labor as the additional output each worker produces -Because more-productive employees generated more revenue for firms, factories increased their demand for labor -therefore, technological advances led to higher manufacturing wages -firms even trained less-skilled, less-literate immigrants to perform simple, specialized tasks.. and increased levels of unskilled immigration lowered the growth rate of real wages, but these wages still rose over time Appendix 7-The Market for Labor) **fall in real manufacturing wages over the Civil War, but wages perpetually increased thereafter -After the civil war, the Fed.

Gov. remained on a de facto (unregulated by law, but still practiced) gold standard -As the money supply was steady, great amounts of technological advancement lowered the cost of producing goods and services, and average prices fell, but the purchasing power of each hour of labor bought more (Appendix 19-The Quantity equation; Appendix 10. 2-The Long-Run Aggregate Supply Curve and Shifters) in short, deflation from the technological advancement caused the cost of living to fall -Charles Dana Gibson created the Gibson girl, which became the romantic ideal of the age for single, young women-she was young, athletic, attractive, independent, and outdoorsy -in reality, marriage usually ended women's factory lives, and most never achieved the Gibson Girl dream -20% of all children were working

by 1890 and states began passing laws regulating child labor; however, states found it difficult to enforce these laws until 1938 during Great Depression

Technological Advancement's Effect on Capital Stock -over time, persistent rising real wages cast doubt on Malthus's prediction that these advances led to only temporary increases in income -Malthus predicted technological advance increased the marginal productivity of every worker in the short run; however, a wealthier population then chose to reproduce, and real wages again fell because capital spread more thinly among workers - reproduction ceased when resources spread so thinly that people started dying of starvation (Appendix 20. 1-The Classical Malthusian Growth Model) in Malthus's long-run equilibrium, the average worker had equal income both before and after the technological advance -he made 2 wrong assumptions: first, he assumed higher levels of income always led to higher levels of reproduction (income and population are inversely related so in other words higher income families have less children) and second, he assumed that physical capital and technology were unrelated; however, technological advances have led to increases in the accumulation of capital by firms - Solow model: as firms accumulate more physical and human capital per worker, each worker's output and real wages rise by even more.

This capital accumulation eventually ends when the cost of diminishing marginal returns from each unit of capital per worker offsets the value of output created (Appendix 20. 1-The Neo-Classical Growth Model) -2nd revolution led to firms accumulating more steel for railroads and skyscrapers, machinery for textile mills, and other physical capital.

The discovery of the Bessemer process led to factories purchasing more Bessemer furnaces. Firms also invested in human capital through training employees because of Fredrick Taylor's ideas of scientific management.

Without these technological advances in steel making or Taylor's ideas, investment among firms would have been much smaller. Attempts to Limit Massive Immigration: -most came from England, Ireland, and Germany in early 1800s -during later 1800s, most came from non-English speaking countries such as eastern Europe, Russia, and Italy-they were poorer and less skilled -increased the supply of available labor, depressing manufacturing wages (Appendix 7-The Market for Labor) -typically worked in factories or mining in the North or West and few migrated to the South, because there was less opportunity there (only sharecropping) native workers became concerned that increased levels of immigration depressed their wages through American manufacturing cities across the U. S-mostly within Cali and New York.

Ellis Island opened in 1892 and required that immigrants underwent physical, psychological, and political testing-and in 1910-the West Coast's version, Angel Island, opened in San Fran -During the mid-1800s, rail companies hired nearly 14, 000 Chinese workers to build the transcontinental railroad, but natives later believed these workers stole American mining jobs after the railroads completion Dennis Kearney convinced many that the Chinese were responsible for depressed wages so fed. gov. passed the Chinese Exclusion Act of 1882 that prohibited any new Chinese from entering the country **most restrictive racial bans on immigration during American history -later passed California Alien Land Law <https://assignbuster.com/econ-2200-study-guide/>

of 1913, which prohibited “ aliens ineligible for citizenship” from owning agricultural land or purchasing long-term leases over it in Cali **this applied to Chinese, Indian, Japanese, Korean farmers Investment Banking Trumps the National Banking Acts: before the civil war, the era of free banking existed, where nearly any state made it easy for an organization to obtain a state bank charter -union hoped to establish a national system to unify all banks -The National Banking Acts of 1863 and 1864 required that all national banks invest a portion of capital into gov. bonds, used to finance the Civil War, and increased the Union’s borrowing power after the Civil war -money could flow between banks to where it had higher-valued uses -these banking acts did not result in a national banking system that fostered economic growth through expanding credit availability for three reasons) the smaller state banks in the South and West suffered when the fed. gov.

increased taxes on their note (money issues) 2) national banks could also not make real estate loans-something commonly done for farmers in the South and West 3) investment banking developed and offered far greater credit expansion than what the national system could offer -therefore, these banking acts were not crucial to the economic development of the U. S. during the 2nd Industrial Revolution -as proprietorships (firms with one owner and sole liability) and partnerships (two or more owners, shared liability) grew larger, corporations began to form corporations acted, and still act, as separate entities where, if sued, the owners share limited liability - investment banking allowed corporations a lower cost to obtain large amounts of capital -because most state or national banks could not provide the required credit these corporations needed, investment banking served

the purpose -investment banks didn't have power to issue bank notes(money) or create deposits, but they did act as financial intermediaries -like banks, they brought together borrowers and lenders to do this, these firms issued corporate stocks (shares of ownership in the corporation) and corporate bonds(loans) that investment banks advertised to potential leaders. The investment banks then charged fees or commissions for their matching services -investment banks also ensured that corporations paid any profit made to stockholders as dividends(payments) or bondholders as interest and principal -the Dutch East India Company of the Netherlands, established in 1602, was the first company to issue stocks -J. P. Morgan was a pioneer in investment banking, setting up J.

P. Morgan and Company in 1871 he earned over \$3 million alone for his services in advertising and selling stocks for Cornelius Vanderbilt's New York City Railroad in 1879 -in 1901, Morgan also financed U. S. Steel, the first billion-dollar corp. in the U. S.

-in 1907, Morgan avoided Panic of 1907 -the New York Stock Exchange went into significant decline, leading to banking runs -banks had no means to obtain enough currency to satisfy withdrawals so instead, they acted quickly to recall loans, but recalling loans put financial pressures on borrowers and started leading to other bankruptcies (Appendix 17. 2-Other Economic Factors Affecting the Money Supply, Appendix 15. -Costs Associated with Deflation) -Morgan acted as a one-man central bank (like the Federal Reserve today) using his own money and \$25 million provided by President Theodore Roosevelt to organize a rescue for banks and trusts -he effectively averted the shutdown of the New York Stock Exchange and bailed out New
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York City -panic of 1907 and Morgan's success as a one-man central bank led to the passage of Federal Reserve Act of 1913, which created the Federal Reserve as the central bank of U. S. to monitor the health of the banking system, conduct monetary policy, and hold bank reserves

The Consolidation of Big Business and the Robber Barons: -During the 2nd Industrial Revolution, investment banking allowed firms to grow to sizes never seen before -the term robber baron came to describe any businessman who allegedly used unfair tactics in business or the stock market to obtain personal fortunes -those who owned and operated large companies were claimed at times to unfairly drive other firms out of business through predatory pricing(pricing below the cost of production to drive others out of business, and then raise prices again to higher-than-competitive ones) (Appendix 6-Monopoly Power in the Goods and Services Market) the most famous robber barons were J.

P. Morgan in investment banking, John D. Rockefeller of Standard Oil, and Andrew Carnegie of U. S. Steel The Example of Standard Oil-Monopoly and Economics of Scale) -Rockefeller believed he could do better by improving both the production and distribution process -by creating standard oil, he could leverage economies of scale (Appendix 21-Economics and Diseconomies of scale) -economies of scale allow firms to lower long-run average costs through increasing production or quantity. -instead of setting up a small refinery like most, Rockefeller invested enough to create the largest refinery in Cleveland-Excelsior Works -he produced 505 barrels a day, compared to the typical 5 others produced -he also chose Cleveland so it was easy to ship by railroad or by water, using competition to his advantage

-Rockefeller immediately vertically inverted Standard Oil with barrel production.

Vertical production occurs when a firm manages its own upstream or downstream production or distribution; a mining company merging with an electric utility company is an example -he increased quantity and lowered production costs of shipping barrels -also purchases forests also mastered horizontal integration of the oil industry through buying up or allying with less-competitive firms in the industry -eventually his firm was compared to a monopoly (one seller of a unique product that reduced quantity to increase price) (Appendix 6-Monopoly Power in the Goods and Services Market) -all else the same, monopolies also pass on cost savings to consumers when marginal costs fall (Appendix 21. 1-Growing Monopoly with Economies of Scale) -therefore, although inherently inefficient, a monopoly may be more efficient if it enjoys economies of scale since cost-savings pass onto customers Standard Oil was compared to a natural monopoly-an industry where it is cheaper for one firm to produce a good or service, enjoying economies of scale, than for two firms to produce separately the same good or service -consumers were better off with Standard Oil than the shoddy, poorly run refineries that existed before -in 1877, the U. S. produced 3.3 million barrels of crude oil, and kept growing -over the period, the price of oil fell -even though deflation persisted during the period, causing all prices to fall from tech.

advances and a de-facto gold standard, the real price of oil still fell (appendix 19) this means that the price of oil fell faster than average prices in the U. S. , and it is without question Rockefeller's hard work paid off for consumers <https://assignbuster.com/econ-2200-study-guide/>

and Standard Oil. The smaller, less competitive were hurt. Why Did Standard Oil Profit by Cutting Costs? : -monopolies that face elastic demand for their good (buyers are price sensitive) greatly gain by reducing cost -when buyers are price sensitive to changes in price, a price reduction loses some revenue per unit sold, but the revenue gained from a much larger quantity sold increases total revenue Appendix 3. 1-Elastic Demand and Industry Expenditure/Revenue) -Therefore, profit greatly increases as total cost falls, but total revenue rises Reasons to believe oil was elastic: 1)The petroleum industry was both new and small 2)Automobiles were not commonplace and Americans were not dependent on oil like today 3)Rockefeller by choice obsessed over cost cutting to lower the price of oil to his customers.

Had he sold gold with inelastic demand, he would have lost revenue by lowering price a. Appendix 3. 20-Inelastic Demand and Industry Expenditure)A rough calculation of the price elasticity of demand suggest that oil was highly price elastic during the late 1800s -Many blamed Rockefeller for predatory pricing, or pricing below the cost to drive competing companies into submission or out of business; however, these people compared Standard Oil's prices to less-efficient refineries that had higher costs Did Other Firms Gain by Cutting Costs? : -Like Rockefeller, Andrew Carnegie of U. S. Steel obsessed over obtaining economies of scale through quickly recognizing the cost-cutting importance of the Bessemer and open-hearth processes.

These processes involved large amounts of capital, and investment banking provided this capital -Carnegie also became a master of horizontal mergers,

expanding in size and lowering long-run average cost -the Gilded Age and Anti-Trust Legislation: -As Standard Oil, U.

S. Steel, and other large manufacturers grew, they perfected the creation of trusts. -state laws previously prohibited companies from owning stocks in others, but it was legal to create a "trust" where stockholders in one company could voluntarily give control of their shares to a board of trustees of another what started as cost-cutting, growing companies eventually grew into companies that attempted to control much legislation in Congress, and political corruption became rampant during the Gilded Age -A term coined by author and humorist Mark Twain, the Gilded Age lasted from 1875 to 1900, and the term implied that society was covered by a thin layer of gold (prosperity) that hid wide-scale political corruption -many became involved in politics -Cornelius Vanderbilt, a railroad tycoon, may have been the most successful in obtaining large amounts of funding from government to build railways that society little used, for example it is not surprising that these large corporations attempted to gain political power-even cost-cutting monopolies with economies of scale cannot lower price forever. Eventually, buyers become price insensitive and a reduction in price loses the firm more revenue than the gain in revenue from selling a few more units -the profit maximizing solution for the firm becomes devoting resources to creating barriers to entry against competition and limiting production -societal unrest led to the Sherman Anti-trust Act of 1890, which forbade any combinations (trusts, pools, holding companies, etc. that restrained trade -at first was ineffective because not well enforced and it was legal for companies to

merge -all until Theodore Roosevelt aka the first trustbuster -in 1902, he announced an antitrust lawsuit against J.

P. Morgan's railroad -dissolved 44 trusts during his term -In 1909, Pres. William Taft followed in Roosevelt's trust-busting and dissolved Standard Oil and the American Tobacco Co. -During Pres. Woodrow Wilson, Congress passed Clayton Act of 1914, which removed ambiguities in existing anti-trust law also ordered courts to take stronger action against large corporations that lessened competition by price discriminating among buyers, offering exclusive selling or tying contracts, or acquiring competitors' stock -also created the Federal Trade Commission (FTC) to enforce anti-trust law

Chapter 4 notes: -1920s were a decade of prosperity for most individuals after a short, but severe recession that occurred following WWI -most of pop.

began living in cities -Taylor's cost-cutting ideas of scientific management gained popularity and became used by most businesses and factories Henry Ford mastered Taylor's philosophy and during 1925, a Model T automobile was produced every 24 seconds -cut costs similar to Rockefeller -first small grocery chains emerged -chains achieved economies of scale through creating larger distribution networks and outselling "mom and pop shops" - automobile allowed for stores to be further away from the city which meant lower real estate costs-these stores could pass on cost-savings to consumers -often 1920s is referred to as the advertising age -many firms began to mass-advertise through radio, newspaper, and magazines standardization of goods allowed for lower-cost production in automobiles. Durable goods, foods, and advertisements -standard of living went up Henry Ford's Efficiency Wages, the Model T, and quest for Riches: -starting in 1914, Ford <https://assignbuster.com/econ-2200-study-guide/>

decided to pay radical \$5 a day wage compared with \$2. 34 other firms were offering -when a firm chooses to pay a higher wage than most market wage, economists call it an efficiency wage -these result in higher levels of unemployment since a larger quantity of individuals seek employment at the higher wage, but the firm hires fewer as the cost per unit of labor is higher despite higher unemployment being inefficient, the firm may obtain efficiency-enhancing benefits -Ford knew by paying a higher wage he would obtain a larger pool of applicants so that he could pick the best -worker turnover decreased and effort increased from paying higher wages -low worker turnover is important to firms that have face high training costs, and firm effort is important to firms that don't monitor employees as much - Shapiro and Stiglitz developed a model of efficient wages showing that higher pay, rather than increasing monitoring, increases worker effort it is when one firm pays higher wages than other firms that the opportunity costs from being fired is higher and shirking decreases -if all firm's paid what Ford did-there would have been stagflation -during 1920's, autos were a luxury good for the rich, and consumers were sensitive to changes in the price -with this elastic demand, a lower price decreases the revenue per unit sold, but the firm sells a much larger quantity of goods, causing overall revenue to rise -when Ford focused on hiring the best, hard-working employees to specialize on specific tasks along the assembly line, he lowered each auto's production cost the lower cost allowed him to charge price-sensitive consumers a lower price, increasing overall revenue (appendix 3. 1) The presidency of Warren G. Harding: -Harding ran a platform of low taxes, high tariffs, farmer's assistance, and opposition to the League of Nations that Pres. Wilson had established after WWI.

-time to promote business -promoted isolation as opposed to future immigration -passed the Emergency Quota Act of 1921, limiting the rate of immigration to only 3 percent of the number of people from each country living in the US in 1910 -immigration fell 40% Charles Forbes, director of the Veteran's Bureau, stole nearly \$250, 000 from the gov. , and Attorney General Harry Daugherty took bribes from businessmen, bootleggers, and others -shows Harding's presidency was full of scandals -largest scandal of Harding administration was the Teapot Dome Scandal, where Secretary of the Interior Albert Fall had two oil deposits put under his department's jurisdiction-one of these oil deposits was the Teapot Dome in Wyoming. These oil deposits were illegally leased to private companies for large sums of money Agriculture suffers: although many enjoyed increased standard of living in the 20s, farmers faced significant decreases -as world supply of food rose, prices fell, reducing domestic agricultural prices and exports -higher foreign tariffs after WWI ended caused a one-two punch to agriculture lowering domestic prices even further -farmers operated in a perfectly competitive market where each farmer was a price taker -each farmer did not individually have an effect on the price of food, but all collectively did -as all adopted technology, they all competed with each other ultimately cost-saving technology benefited only customers. Farmers suffered from lower prices and falling revenue -falling prices can increase or decrease revenue -a lower price reduces the revenue per unit sold, but the lower prices increase the quantity of product sold, increasing revenue -it all depends on how price sensitive consumers are -demand for food is modeled as inelastic b/c it is a necessity -so in this case, falling food prices decrease revenue per unit more

than the increase in revenue from selling slightly more food (Appendix 3. 2)
Harding attempted to help farmers through Capper-Volstead Act of 1922.

This gave farmers protection from anti-trust law and allowed them to cooperatively market -ultimately worthless though since farmers operated in perfectly competitive market Redistributing Taxes toward Foreigners: -tax rates were high because of the First Great War and funded 1/3 of the war - Pres. Harding appointed Andrew Mellon, the “ richest man in America,” Secretary of the Treasury, and Mellon believed that extremely low taxes would encourage investment and ensure prosperity, but tax revenue would change little he also promoted lower gov. spending, believing investment would be crowded out less (appendix 9) -Harding took Mellon’s advice and passed Revenue Act of 1921. This act repealed the wartime excess profit tax-a tax intended to capture any additional profits firms made from the war -more importantly, the top marginal income tax rate fell from 73 to 56 percent -the lowest marginal tax rate remained unchanged at 4 percent - while tax rates for the wealthiest fell at home, Harding increased tariffs on many products from 27 to 35 percent -believed to protect US firms and promote production also, tariffs had been commonly used in the past to fund gov. expenditure -as higher tariffs increased price consumers paid for imports, firms quickly increased prices domestically, in importing industries, did promote jobs in the short run -in the long run, both importing and exporting industries would have suffered -countries obtain income through exporting to purchase goods and services abroad, so any other country’s attempt to limit the first’s income reduces the other country’s exports The presidency of Calvin Coolidge (1923-1929): Coolidge became pres when

Harding died of stroke -did little as president -believed lower tax cuts and gov.

spending would stimulate economic growth -also tried to limit immigration - The National Origins Act of 1924 halted all immigration from Asia, and it nearly stopped all immigration from Italy and Poland-said immigration could grow by no more than 2 percent each year The Coolidge Tax Cuts, Economic Growth, and Budget Surpluses: -Coolidge signed into law Revenue Act of 1924-this act lowered the top marginal tax rate from 58 to 46 percent and lowered bottom rate from 4 to 2 percent income tax revenues as a percent of GDP increased by 4. 26 percent indicating the US was on the right-hand side of the Laffer Curve (appendix 12) -unlike 1921 under Harding, this tax cut greatly lowered tax rates for both the rich and poor -low income individuals increased their incentive to work -this act is one of the few believed to have led to lower inflationary pressure but an even greater increase in output and reduction in unemployment (Appendix 13) -Revenue Act of 1926-this act lowered the top income tax rate from 46 to 25 percent but did not change the bottom rate as with the 1921 act, this act led to a fall in income tax revenue -if wealthier individuals are less sensitive to taxation, then lowering their marginal tax rate leads to lower revenue per hour worked, but a minimal increase in the number of taxable hours worked -SO from 1922-1926 the top income tax rate fell 55% and the bottom fell 50% - the marginal tax rate fell greatly for lower income people -supply side theory states that the lower tax rates on the poor were associated with greater increases in output and reductions in unemployment -budget surplus was maintained over the period

Monetary Policy: -after brief recession from 1920-1921, the economy advanced and real income rose. -The Federal Reserve lowered the discount rate, the rate at which it charged banks to borrow from it, making it easier for banks to borrow and for credit to be provided to growing businesses - prices remained stable -some banks failed due to bad management and automobile increased competition -Fed initially took a hands off approach to economy. -it did allow money supply to grow and credit to be extended through lowering the discount rate (Appendix 17) but it did not actively pursue expansionary policy deliberately to lower unemployment as was done from the 1960s onward -Fed understand on monetary policy was limited, and it may have eventually led to Great Depression through a key decision (discussed in next chapter)

Women and Minorities: -movement toward equal rights started -19th amendment was ratified in 1920 and ensured women the right to vote -Wyoming and Texas were first to have women governors -the flapper emerged as the girl who could partake in traditionally male activities -smoke cigs, drank whiskey, played poker most of this occurred outside of common society's eyes as the 18th amendment made it illegal to drink alcohol -blacks did not share same rights -still violence and lynching in the South and the Ku Klux Klan grew mainly in small towns but existed in the North and South (saw blacks, Catholics, and immigrants as threats to rural ways) -Harlem Renaissance allowed some blacks to celebrate their culture through a movement that started in Harlem -movement grew in the 20s and 30s and was made up of black writers, artists, musicians, and others exploring their heritage Louis Armstrong and Duke Ellington made jazz popular during the movement -Red Scare developed as many feared communism after the war and it blamed all wrongdoing on the " Reds" -in <https://assignbuster.com/econ-2200-study-guide/>

1919 Attorney General Mitchell Palmer carried out raids in homes and places of employment for those suspected to be Reds: Palmer Raids -led to thousands arrested and sent back to home country Chapter 5 Notes: The Great Depression and Hoover's Response: -at its peak, unemployment reached 25%, the economy was shrinking by 10%, and as prices fell, deflation affected both firms and workers as prices for goods and services fell, most firms found it difficult to repay their loans and laid off workers or declared bankruptcy -as consumers lost confidence in banks, many withdrew currency, leading to banking failures in both rural and urban areas Causes for the Great Depression: 1)Agriculture (sharp decline in price of agricultural goods and farmers couldn't repay loans) 2)Uneven Distribution of Wealth (income gap grew, inability to consume led to decrease in firm investment and layoffs of workers) 3)Over-extension of credit and installment buying (many purchased items on credit in 20s and could not afford them))Buying stocks on margin (paid brokers for a small fraction of the cost of a stock, and brokers lent the remaining amount-a stock market crash would bankrupt these individuals) 5)Stock market crash of 1929(many lost entire savings-what led up to the crash was the biggest cause of the depression) Economic Explanations of the Great Depression: The Keynesian Explanation: -states that a collapse in the desire for new capital formation occurs because consumption falls -this causes firms to reduce their demand for loans and investment demand collapses (Appendix 9) interest rates must eventually fall if there is a surplus of saving -deflation increased the value of each dollar over time and encouraged lenders to hoard cash rather than lend it to firms, and this hoarding decreased the amount of funds available to firms (Appendix 15. 2) The Monetarist Explanation: -states that contractionary <https://assignbuster.com/econ-2200-study-guide/>

monetary policy leads to a fall in the supply of saving -in the short run, the Federal Reserve contracted the money supply, and the lower money supply reduced the amount of money available for individuals to purchase goods and services some prices were sticky and did not adjust, consumers had to pay these prices with less money -as these people withdrew money from the financial system to pay old prices, less savings was available for firms, and interest rate rose (Appendix 9) The Fed's attempt to curb speculation in the Stock Market: -over the 1920s, the Federal Reserve lowered the discount rate, leading to expansionary monetary policy, but reversed this policy in 1928 and 1929 (Appendix 17) -the discount rate is the interest rate that the Fed. Reserve charges banks to borrow from it To reduce the speculative boom in the stock market, the Fed raised the discount rate from 5% in 1928 to 6% in 1929 -it also greatly reduced its holdings of gov.

bonds through open-market sales -these actions caused unexpected, severe contractionary monetary policy reducing the money supply, and a reduction in the money supply put deflationary pressure on prices, as individuals had less money available to purchase these goods and services -the stock market began to slow in early October 1929, and panic quickly set in that led to a mass sell-off beginning October 29, 1929 aka Black Tuesday prices dropped over many months and the market bottomed out -had the fed used less severe contractionary policy to slow the speculative boom in the stock market, the market would not have crashed as hard as it did Further Contractionary Policy and Bank Runs: -continued contractionary monetary policy and money supply fell by 30% -severe deflation caused people to hoard cash and prices to fall -firms found it hard to operate with prices

falling, and laid off workers -firms were in dire need of loans and still had existing loans to pay off -many resorted to bankruptcy -consumers withdraw more money during bad economic times.

As consumers withdrew money, some banks did not have sufficient reserves to honor the withdrawals so panic grew quickly, and bank runs occurred as people ran to banks to withdraw life savings -this caused banks to fail and had the fed acted as a lender of last resort and lowered the discount rate, bank failures would have been fewer An Eventual Collapse of Investment Demand: -after the Fed. Reserve caused the stock market crash and deflation caused lenders to hoard cash many firms went out of business -eventually investment demand collapsed as presented by the Keynesian explanation appendix 9) -decrease in investment lead to a decrease in the real interest rate -SO there is strong evidence for the Monetarist explanation for the cause of the Great Depression, but the Keynesian explanation better describes the later period -both explanations lead to a lower quantity of saving and therefore quantity of dollars borrowed by firms for investment purposes -the monetarist explanation focuses on a decrease in the firm's willingness to save money, while the Keynesian explanation focuses on a decrease in firm's willingness to borrow money the Fed's poor management caused the Depression (blame the lower money stock and non-response of Fed) The Presidency of Herbert Hoover: -Herbert Hoover became president as the economy quickly fell in the Great Depression but believed as most classical economists did that the federal government should not tamper with the economy -he also believed in a balanced budget and no unemployment benefits -many people mistakenly label as a " do nothing" president, but he

did take steps during the end of his term that promoted government intervention Promoting Unemployment through Volunteerism and Labor Unions: Hoover first addressed the crisis through promoting volunteerism and urged Americans to donate what they could to charities -Hoover later signed the Norris-La Guardia Act of 1932-this act effectively promoted labor unions through outlawing yellow-dog contracts where employers required employees to sign a contract agreeing not to join a labor union -also outlawed court injunctions against nonviolent labor disputes such as strikes, boycotting and picketing -labor unions collectively bargained for higher wages, and during a period of deflation, these higher wages led to even greater unemployment

Picking Up after the Fed- A Lender of Last Resort: -a more beneficial piece of legislation than Norris-La Guardia was the Emergency Relief and Construction Act of 1932. This created the Reconstruction Finance Corp. , and independent agency of the federal gov.

, which provided nearly \$2 billion in aid to state and local governments - states used this aid to make loans to banks, railroads, mortgage associations and other businesses -nearly all organizations repaid their loans -this act was a major step for Hoover away from classical economist laissez-faire (look at page 99 here) The United States Becomes more Isolationist: as Americans became more worried with problems at home, and the government aimed to increase revenues, the Smoot-Hawley Tariff of 1930 significantly increased tariffs by 60% (highest import tax ever) -while the act promoted business in the U. S. in the short run, foreigners' response of increasing tariffs on US goods resulted in lower US exports, causing a fall in output and deflationary

pressure in the long run (appendix 5 and 10) -some economists think the act prolonged the Depression, but it is unlikely that it was a large factor since exports only accounted for 5 % of national output before the act

Helping Farmers Out: -To help farmers, Hoover passed the Agricultural Marketing Act of 1929 that created a federal farm board. This board gave loans to farmers and purchases various agricultural goods -recall in the 20s farmers suffered from falling agricultural prices, and many could not repay their loans. For a short period, this program worked as the gov. demand for the goods sustained their prices (Appendix 1) -over time though, farmers responded by increasing production, and prices again began to fall -the gov. made no effort to curtail supply, and with a limited budget, the farm board eventually collapsed in 1932