THE GREAT DEPRESSION: CAUSES & CONSEQUENCES

HISTORY STANDARDS

Era8.3.USH.1 Analyze national and international causes of the Great Depression (e.g., political decisions, protectionism, speculation, world gold standard, tariffs, unemployment, environment)

Era8.3.USH.2 Analyze the federal government's fiscal responses to the Great Depression

Era8.3.USH.3 Construct historical arguments and explanations about social, economic, political, geographical, and environmental effects of the Great Depression on various regions from multiple perspectives

Era8.3.USH.4 Evaluate the changing role of the federal government between 1929 and 1945 and the changing views of Americans toward the role of government from multiple perspectives using primary and secondary sources

ECONOMICS STANDARDS

EM.3.E.3 Evaluate intended and unintended consequences of government policies created to improve market outcomes

NE.5.E.1 Analyze economic indicators used to measure economic performance including, but not limited to, unemployment, Gross Domestic Product (GDP), and Consumer Price Index (CPI)

NE.6.E.1 Compare and contrast the roles and functions of financial institutions in the United States including banking practices and regulation of savings and investments

NE.6.E.2 Examine monetary policy tools used by the Federal Reserve System

NE.6.E.3 Examine fiscal policy tools used by the executive and legislative branches of the government (e.g., taxation, spending)

ACRE

MATERIALS INCLUDED:

- *Lesson Plan: From Prosperity to Poverty: Causes of the Great Depression*
- *Lesson Plan: Consequences of Economic Policies During the Great Depression*
- *Pacing Guide(s)*
- *Hands-on Primary Source activities*
- *Video Discussion and Response*
- *Read and Critique activities*

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Editor: Terra Aquia is a program coordinator at the Arkansas Center for Research in Economics. She works with a variety of scholars to create economics-focused educational content for K- 12 teachers in Arkansas.

INTRODUCTION

The stock market crash of October 1929 is synonymous with the Great Depression in the minds of many Americans. Although stories of millionaires jumping from buildings after losing millions in stocks captures the desperation of the era, only two percent of Americans owned stock. In reality, the crash was not the primary cause of the Great Depression. In many ways the stock market crash had more of a psychological effect on the American people than it served as a cause of the Great Depression. But that leaves us with the question: if the stock market crash did not cause the Great Depression, then what did?1

FROM PROSPERITY TO POVERTY: CAUSES OF THE GREAT DEPRESSION

A principal cause of the Great Depression was the Federal Reserve's decision to raise the discount rate from 3.5 percent to 5 percent in less than a year. The discount rate is the interest rate that the Federal Reserve charges member banks to borrow money from it. By raising and lowering the discount rate, the Federal Reserve could influence the rate of interest in the entire economy. When interest rates are low people are more likely to borrow money (because the interest that they have to pay for borrowing is less – in short credit is cheap) whereas when interest rates are higher people are less likely to borrow money (because credit is more expensive). Along with other tools at its disposal, the Federal Reserve can alter the discount rate to engage in what is known as monetary policy. It is widely understood today that if the Federal Reserve lowers interest rates it will encourage economic activity and serve as a stimulus for the economy. When the Federal Reserve raises interest rates it slows economic activity and serves to cool the economy down.

In the 1920s, the Federal Reserve was a young organization. It was founded in 1913 by Woodrow Wilson and the members of the Federal Reserve Board were largely political appointees who had little practical experience and even less theoretical understanding of monetary policy.

ESSENTIAL QUESTIONS:

How did the American economy transition from the successes of the Roaring Twenties to the economic decline of the Great Depression?

What were the causes of the Great Depression?

How did Americans across the U.S react to the Great Depression?

LEARNING OBJECTIVES:

Students will critique policy decisions that impact the U.S economy.

Students will analyze historical data to develop arguments about the causes of the Great Depression.

Students will examine the impacts of the Depression on individuals throughout the U.S.

NOTES:

1. This lesson was written from Marcus Witcher's lecture notes and with reference to his and Joe Horton's article "From Prosperity to Poverty: The Story of American Economic Decline During the 1920s" *Journal of Applied Business and Economics vol. 14(4), 2013.*

THE GOLD STANDARD

The Gold Standard was a way for countries to set the price of their domestic currencies to a specific amount of gold. This system worked well from 1880 to 1914 as most countries on the standard enjoyed economic growth and engaged in free trade. By tying their currencies to gold, countries had a de facto exchange rate and ensured potential trade partners that a dollar was worth a specific amount of gold. As such, the money supply in the United States was tied to the gold supply.

Critics of the Gold Standard argue, especially after World War I when it began to break down, that by connecting the dollar to gold it led to a contracted money supply. Once the Great Depression began, further adherence to the Gold Standard kept central governments from lowering interest rates and using monetary policy to expand the money supply and thus combat the depression.

From 1946 to 1971 countries operated under the Bretton Woods system which continued to use gold to ensure the value of the U.S. dollar. After 1971, the United States decided to no longer redeem currency for gold and the gold standard was abandoned.

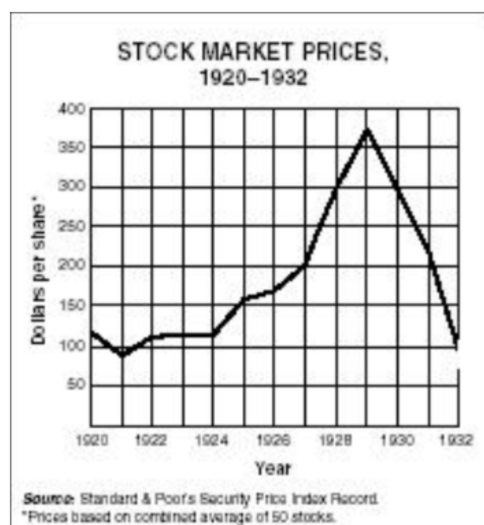
Michael D. Bordo, "Gold Standard" The Library of Economics and Liberty. Accessed at: https://www.econlib.org/library/Enc/GoldStandard.html

The Federal Reserve was created as a decentralized system of banks with 12 Federal Reserve districts each managed by its regional Federal Reserve bank. The system was created this way to ward off opponents of a national bank. To this end, the Federal Reserve was also supposed to be independent of political pressure.2

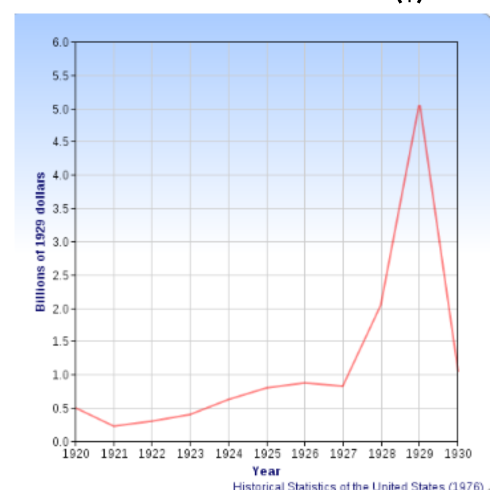
From its creation, the New York branch of the Federal Reserve dominated the system. During the 1920s Benjamin Strong—the Governor of the Federal Reserve bank of New York—made most of the monetary policy decisions for the system. In 1927, Strong decided to lower the discount rate to 3.5 percent to encourage gold to flow to Great Britain to help them get back on the Gold Standard (it was believed at the time that returning to the pre-World War I international Gold Standard would encourage economic stability). Strong's policy worked. Gold flowed from the U.S. to Great Britain and the country was able to rejoin the system at the desired pre-war rate. One of the unintended consequences of lowering the discount rate, however, was to overheat an already booming economy.3

THE 1929 STOCK MARKET CRASH

The stock market had enjoyed steady increases in values throughout the 1920s. The upward trend in the stock market was entirely justified given the economic growth and prosperity of the decade, however, after the discount rate was lowered in 1927 easy credit flowed into the stock market creating a bubble. In 1927 alone, the stock market registered a 39 percent increase.4



CORPORATE COMMON STOCK ISSUED ($)



2. For a history of the creation of the Federal Reserve see Roger Lowenstein, *America's Bank: The Epic Struggle to Create the Federal Reserve* (New York: Penguin, 2015).
3. Lester V. Chandler, *Benjamin Strong: Central Banker* (Washington D.C.: Brookings Institute, 1958), 377.
4. Robert Sobel, *Great Bull Market: Wall Street in the 1920s* (New York: W.W. Norton, 1968), 12; John Kenneth Galbraith, *The Great Crash: 1929* (Boston: Houghton Mifflin, 1954), 14.

In 1928, the Federal Reserve Board—which had taken control of the system after Benjamin Strong resigned to focus on his fight with tuberculosis (he died later that year)—became concerned with the bubble in the stock market. They blamed the lowering of the discount rate in 1927 for encouraging speculation and the board decided to raise the discount rate from 3.5 percent to 5 percent.5 In 1927, the economy had experienced a short recession. As such, the Federal Reserve's decision to increase the discount rate by two-thirds in one year sent shock waves through the economy. The result of the monetary contraction was a substantial economic slowdown in which production declined sharply.

The increase in the discount rate resulted in a significant decline in economic activity which led to the onset of the depression. Economic output began to slow in the summer of 1929 and this reality was reflected in the stock market crash several months later in October when investors recognized that the expectations that had driven up stock prices were no longer realistic. As a result, the stock market crashed. Although only 2 percent of Americans owned stock in the 1920s, the collapse of stock values destroyed the belief that prosperity could last forever.

Economists and economic historians agree that the increase in the discount rate was one of the main causes of the Great Depression.6 Ben Bernanke, who was the Chairman of the Federal Reserve from 2006 to 2014, summed it up in 2004: "The slowdown in economic activity, together with high interest rates, was in all likelihood the most important source of the stock market crash in October. In other words, the market crash, rather than being the cause of the Depression, as popular legend has it, was in fact largely the result of an economic slowdown and inappropriate monetary policies that preceded it."7

THE FEDERAL RESERVE AND BANKING PRACTICES

The creation of the Federal Reserve in 1913 also had some unintended consequences. The banking system in the United States functions on what is called fractional reserve banking. This means that only a small percentage of the money that each customer deposits is kept in the bank. Most of the deposits are loaned back out to the bank's other customers to purchase homes, houses, and other items. Of course, this is how banks make money and how they continue to exist.

ECONOMIC SIGNALS AND INCENTIVES:

In raising interest rates, the Federal Reserve realized that their actions would cause businesses and individuals to change their behavior, they just didn't anticipate how much. In 1928 there were very few people who understood how manipulating interest rates would affect the wider economy. In hindsight we understand that almost doubling interest rates within a one-year period has negative outcomes, but our understanding is largely a result of economists learning from the mistakes that were made in the past.

The economic way of thinking tells us that people respond to incentives and that they respond on the margins. After all, most parents have some form of incentive structure to encourage their children to behave properly – whether it be an allowance or a variety of punishments for poor behavior. In public policy, we recognize this as well. Legislators recognize that if you want more of something you subsidize it and if you want less you tax it.

NOTES:

5. Milton Friedman and Anna J. Schwartz, *A Monetary History of the United States: 1867-1960* (Princeton: Princeton University Press, 1963), 288.
6. Robert Whaples, "Where Is There Consensus Among American Economic Historians? The Results of a Survey on Forty Propositions," *The Journal of Economic History* Vol. 55, No. 1, 1995, 139-154
7. Ben S. Bernanke, "Money, Gold, and the Great Depression," The H. Parker Willis Lecture in Economic Policy, Washington Lee University, Lexington, VA, March 2, 2004. Accessible at https://www.federalreserve.gov/boarddocs/speeches/2004/200403022/default.htm

THINKING ON THE MARGIN:

The second concept, thinking on the margins, can be a bit more difficult to grasp. What it means is that humans make decisions based on the amount of utility (or benefit) doing an additional thing will bring them versus the cost of doing said thing. For example, on a hot summer day the first glass of lemonade that I drink will quench my thirst and provide me with a large amount of utility. If offered a second glass of lemonade, I'd have to think about whether I want to drink it. In doing so, I'd be contemplating the additional (or marginal) benefit the second glass of lemonade will bring me. Actors in an economy do this all the time. A business owner might hire one employee, but that doesn't mean she will hire a second. It would depend on the cost/benefit of that additional employee and if the government was to raise the minimum wage then it would affect her decision.

During the Great Depression, policy makers implemented policies that discouraged additional economic activity. The sum of these policies turned the depression in the Great Depression as millions of Americans decided the marginal benefit of certain economic activity was not worth the cost.

For more on thinking on the margins consult "Margins and Thinking at the Margin" The library of Economics and Liberty.

Accessed at:

https://www.econlib.org/library/Topics/College/margins.html#:~:text=It%20means%20to%20think%20about,additional%20action%20means%20for%20you.

The problem fractional reserve banking presents, however, is that if every person who had deposited money in a bank demanded their deposits at the same time the bank would fail because it would not have enough cash on hand to cover all the deposits.

When the Federal Reserve was created in 1913, the average bank had around 12 percent of the value of their deposits on hand. In 1922-23, those same banks only had a little over 2 percent of the value of their deposits on hand. This meant that if there was a run on the bank (a bank run is where a large number of a bank's customers all demand their deposits at the same time), the banks had very little cash on hand to cover their deposits. If a bank could not fulfill the demands of their customers, they would be forced to close. For reference, think of the scene out of It's a Wonderful Life in which Jimmy Stewart's character was able to beg his depositors to not withdraw all their money—thus saving his bank from failing.

Working Reserves: Cash on Hand in $ and %
Before and after the establishment of Federal Reserve

	1909-1913		1922-1923	
Central Reserve City Banks	$406,059,000	20.4%	$53,374,000	1.4%
Other Reserve City Banks	$250,137,000	11.4%	$83,179,000	1.7%
Country Banks	$272,059,000	7.9%	205,012,000	2.7%
Total	$928,255,000	12.2%	$341,565,000	2.1%

Source: Compiled from charts provided by the Governor of the Richmond Federal Reserve, George J. Seay found in a memo dated December 31, 1923. Small Special Collection Library, University of Virginia, *The Carter Glass Papers*, Box 7.

After the Federal Reserve raised the discount rate, many banks across the US were not as lucky as the bank in the movie. Bank failures became a staple of the Great Depression. From 1929 to 1933, 9,755 banks failed across the United States—roughly 40 percent of all banks. This led to a further contraction of the available credit in the country, which caused further monetary contraction and more stress on the banking system and the economy.

Total Bank Suspensions 1921-1933

Year	Total Number of Banks	Number of Suspended Banks
1921	29,788	505
1922	29,458	366
1923	28,877	646
1924	28,185	775
1925	27,638	618
1926	26,751	976
1927	25,800	669
1928	24,968	498
1929	24,026	659
1930	22,172	1,350
1931	19,375	2,293
1932	17,802	1,453
1933	14,440	4,000

SOURCE: Elmus Wicker, *The Banking Panics of the Great Depression*, 2.

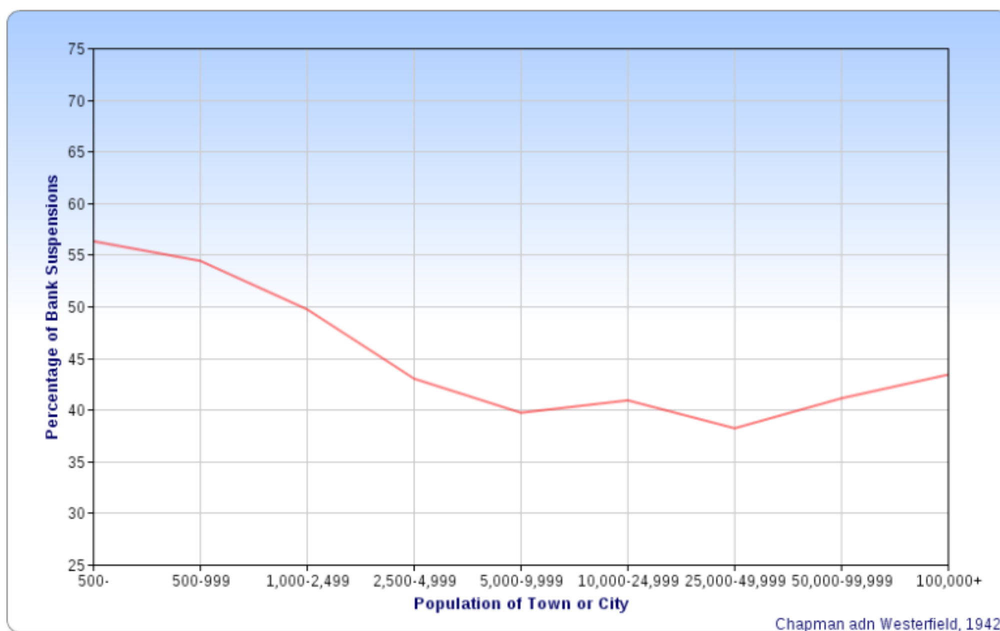
One of the major reasons the United States experienced so many bank failures was because the country prohibited branch banking. Today, banks are allowed to branch (thanks to the Riegle-Neal Interstate Banking and Efficiency Act of 1994), but in the 1920s many states did not allow branching at all and some only allowed a bank to have a second location in special circumstances. Laws that prohibited branching were called unit banking laws because they protected the single unit bank rather than a bank that had multiple units. Laws prohibiting branching were popular because there was a fear that if banks were allowed to branch that large banks would put small banks out of business. As such, advocates of unit banking laws claimed they were opposed to monopoly. The effect of these laws prohibiting branching, however, was to create a large number of small rural banks that had very un-diverse portfolios (meaning that they loaned primarily to one segment of the economy—often farmers). A disproportionate number of these small rural banks ultimately failed. In contrast, Canada had an extensive branch banking system and did not experience a single bank failure during the Great Depression. Once again, the unintended consequence of unit banking laws was to create a large number of banks that were more susceptible to failing.8

UNINTENDED CONSEQUENCES:

Q: Why did laws that were designed to protect local banks from monopoly competition end up harming them during the Great Depression?

A: Laws prohibiting bank branching left banks with weak portfolios that were unable to handle the impact of a depressed economy. These rural banks did not have larger profitable accounts to make up for the losses their clients were experiencing.

Bank Suspensions by Size of Population of Town and City, 1921-1936



NOTES:

8. Elmus Wicker, The Banking Panics of the Great Depression (New York: Cambridge University Press, 1996), 3.

CONCLUSION

The principal cause of the Great Depression was the Federal Reserve's decision to raise interest rates. By increasing the discount rate from 3.5 to 5 percent, they contracted the economy and brought about an economic depression. To compound the problems of monetary contraction, the American banking system was designed to fail by legislation at both the state and federal level that discouraged competition between banks. Combined, the Federal Reserve's policies and the structure of the banking system ensured the United States would endure a depression. However, it was not inevitable that this depression would become known as the "Great Depression." To understand how this economic downturn in 1929 became the greatest economic crisis in American history it is essential that we explore the unintended consequences of President Herbert Hoover's policies, which we will do in the next lesson.

HANDS-ON ACTIVITY OPTIONS:

Both Federal Reserve policies and the structure of the U.S. banking system had impacts that depressed the economy. If additional time is available, guide your students through the role-play activity "Whatdunnit?" included in this module. In this activity students take the roles of working Americans in various sectors of the U.S. economy and demonstrate how they react to economic policy decisions.

NOTES:

9. Liaquat Ahamed, Lords of Finance: The Bankers Who Broke the World (New York: penguin Press, 2009), 226; John Kenneth Galbraith, The Great Crash: 1929 (New York: Mariner, 1954), 178.

PACING GUIDE

INTRODUCTION: GREAT MYTHS OF THE GREAT DEPRESSION

15 MINUTES

Split your students into groups of four. Using the short reading, Great Myths of the Great Depression by Lawrence Reed, have each group read and discuss one of the sections of reading. Have each student write the main idea and interesting points in their classroom journal, and in their groups come up with two to three main ideas to share with the rest of the class.

LESSON

20 MINUTES

Present PowerPoint presentation to your students, stopping and various points for student response to guided questions and discussion questions. Mark student participation and objectives met using a classroom roster. Stop on key image slides for questions and discussions from students. As they are listening, tell students to keep a list of "Causes of the Depression" in their journals as the lesson progresses.

VIDEO: ITS A WONDERFUL LIFE

15 MINUTES

Play the following clip for your students and have them respond to the following questions in their small groups:
https://www.youtube.com/watch?v=iPkJH6BT7dM

Q1 Why were so many customers wanting to withdraw their money from George's bank at the same time? What was their fear?

Q2 From 00:56-1:08 What does George mean when he says that all of the banks customers are "loaning one another money?" How do banks use the money they receive from depositors?

Q3 How does this scene relate to the discussions we had about banking in the United States during the Great Depression?

Q4 Why were some customers so quickly willing to sell their bank loans at a loss to another bank?

ROLE PLAY: WHATDUNNIT? THE GREAT DEPRESSION MYSTERY

ADDITIONAL TIME AS AVAILABLE

The students read a brief passage posing the basic question about the Great Depression: Why did it happen? A brief simulation activity shows how unemployment in one part of the economy can lead to unemployment in other parts of the economy. With the aid of a visual, the teacher compares the simulation to the business cycle. The teacher then uses another visual to introduce the role of bank failures in intensifying the depression, and the students fill out a worksheet that helps them understand how the decisions of foreign and domestic banks, the Federal Reserve System and individual depositors brought about the collapse of the American banking system in 1933.

This activity was developed by the National Council on Economic Education, NYC branch.

HOW THE HOOVER ADMINISTRATION TURNED A DEPRESSION IN THE "GREAT DEPRESSION"

It was not inevitable that the economic decline triggered by the Federal Reserve's poor monetary policies would create the worst economic downturn in American history. It wasn't until after President Hoover (elected in 1928) decided to raise taxes and raise tariffs that a bad economic downturn became the Great Depression. Once again, this lesson will emphasize the unintended consequences of government policy – this time fiscal policy.

It is one of history's great ironies that Herbert Hoover is often thought of as a champion of laissez-faire capitalism. In fact, Hoover was a progressive who believed in cooperation between labor unions, large corporations, and government to create an economy that functioned more efficiently than the free market. Hoover said as much in his 1921 book *American Individualism*.1 Hoover was an engineer who had a long record as a government planner. During World War I he led the American Relief Administration which provided relief supplies to a war-torn Europe. Fresh from his service abroad, Hoover was tapped to be the Secretary of Commerce in the Harding and later Coolidge administrations. In this role he advocated for the cartelization of many major industries in the United States—with goals to decrease waste from competition and get labor, corporate leadership, and government to work together in managing and directing the economy. From 1921 to 1928, Hoover created the intellectual argument that the government should directly respond—in the form of public works and other forms of coordination—to an economic depression. If anyone was qualified to use government to combat an economic downturn it was Herbert Hoover.2

HOOVER'S WAGE STABILIZATION AND TAX INCREASES

When the United States entered a depression in 1929, Hoover was presented with the opportunity to put his ideas about government coordination into action. Hoover embarked on an unprecedented series of government interventions into the economy.3 One of his central beliefs was that wages must not be allowed to decline.

1. Herbert Hoover, *American Individualism* (New York: Doubleday, 1922).
2. Murray Rothbard, "Hoover: The Myth of Laissez-Faire" in *A New History of Leviathan: Essays on the Rise of the American Corporate State* (New York: E.P. Dutton & Co., 1972).
3. David M. Kennedy, *Freedom from Fear* (Oxford: Oxford University Press, 1999), 48; John A. Moore, "The Original Supply Siders: Warren Harding and Calvin Coolidge" *The Independent Review.* 18 (4), 614.

ESSENTIAL QUESTIONS:

How did individuals and groups react to the Great Depression?

How did geography affect how Americans across the country were impacted by the Depression?

What policies were implemented in order to try stimulate the economy? Were those policies effective?

LEARNING OBJECTIVES:

Students will analyze the responses of various political, economic, and social groups to the Great Depression

Students will analyze historical data to critique the impacts of economic policies on the U.S. economy.

Students will examine the impacts of the Depression on individuals throughout the U.S.

NOTES:

THE ROLE OF GOVERNMENT

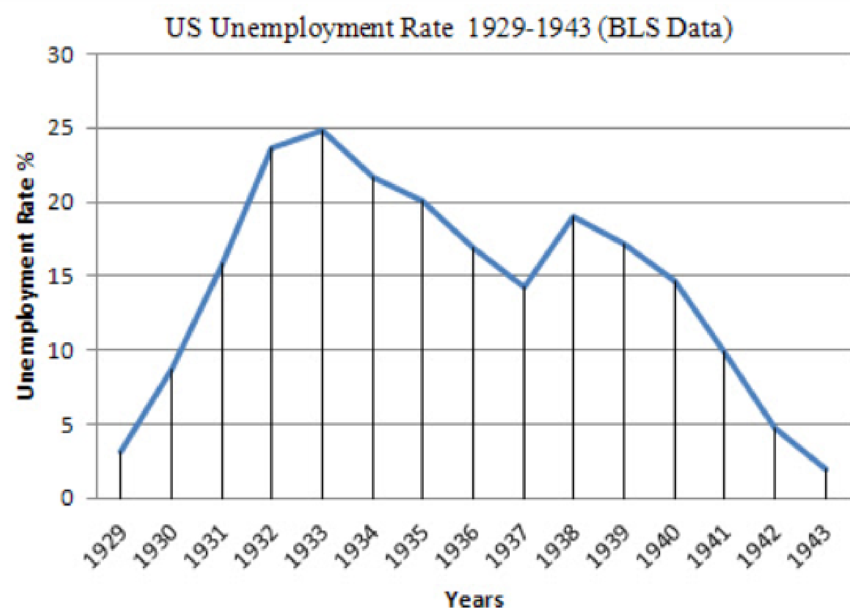
Economists disagree about what the proper government response to a depression should be. For instance, during the Great Depression British economist John Maynard Keynes (1883-1946) argued that the government should use fiscal and monetary policy to boost demand and decrease unemployment. In short, Keynes promoted government stimulus, which can take the form of public works projects, monetary easing, tax cuts, and other spending measures to combat recessions and depressions.6

In contrast to Keynes, Austrian born economists F.A. Hayek argued that recessions and depressions were caused by central banks and other institutions keeping interest rates arbitrarily low. According to Hayek, the easy money during these periods flowed into bad investments and led to economic downturns. The answer, according to Hayek, was not more government spending and manipulation of interest rates but rather a policy of doing less than nothing – allowing the market to purge itself of bad investments and perhaps removing the incentives that led to the initial economic decline.7

A third perspective was offered by University of Chicago economist Milton Friedman. The analysis in this lesson is heavily influenced by Friedman's understanding of the Great Depression. Friedman held that the Great Depression was largely caused by the Federal Reserve's decision to raise interest rates thus sending the economy into contraction.8

If wages fell, Hoover believed that purchasing power would decrease and make the depression worse. As such, he called a series of White House Conferences in which he requested that the nation's preeminent industrialists not lower wages. Hoover, believing that the government working with business could produce better outcomes than the free market, had a tremendous amount of success in enlisting businessmen to keep wages high. From 1929 to 1933, wage rates declined by only 23 percent which was less than the decline in prices. Therefore, the real wage actually increased at the same time that production, consumption, and output were all declining.4

Hoover's wage stabilization policy had unintended consequences. Unfortunately, for millions of Americans, keeping wages artificially high meant that they struggled to find work when the economy declined and people were being let go. Unemployment increased from 3.2 percent in 1928 to 25.2 percent when Hoover left office in 1933.5 This sharp increase in unemployment was the result of the monetary contraction we discussed in lesson three. The economy slowed, production fell, and people lost their jobs. There is little doubt, however, that Hoover's efforts to keep wages high increased the number of unemployed. To what degree is a matter of dispute between economists and economic historians.

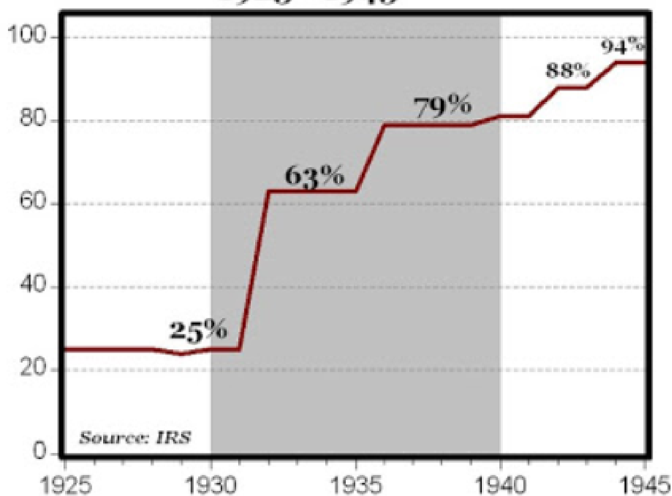


4. Rothbard, "Hoover," 128-130.
5. Elmus Wicker, *The Banking Panics of the Great Depression* (New York: Cambridge University Press, 1996), 4.
6. John Maynard Keynes, *The Means to Prosperity*, 1933 and especially John Maynard Keynes, *The General Theory of Employment, Interest and Money* first published in 1936.
7. F.A. Hayek critiqued John Maynard Keynes in 1930 in his "Reflections on the pure theory of Mr. J.M. Keynes" which he later published as a series of lectures titled *Prices and Production* in 1931. Keynes and Hayek vigorously debated the proper role of government, monetary theory, as well as many other topics in their correspondence. For a good overview of the debate between the two see Nicholas Wapshott's *Keynes vs. Hayek: The Clash That Defined Modern Economics* (New York: Norton, 2012).
8. Milton Friedman, *The Great Contraction*, 1929-1933 (Princeton: Princeton University Press, 2008).

HOOVER'S TAX INCREASES

Hoover's predecessors Harding and Coolidge followed the advice of Treasury Secretary Andrew Mellon, who advised lowering taxes to incentivize economic activity and growth. Hoover did the opposite. This action, combined with the general interventionist policy of the administration, led Mellon to resign his position in 1932.9 Generally speaking—whether they be on personal income, corporations, or capital gains—when taxes are increased, productivity declines.

In 1932, Hoover signed the Revenue Act of 1932, which raised taxes on personal incomes, doubled the estate tax, and increased the corporate tax. The legislation also created the first gasoline tax and gift tax. The top marginal income tax rate was increased from 25 percent to 63 percent. Meaning that after a certain threshold, the wealthiest Americans would pay 63 cents on every dollar they earned. Likewise, corporate taxes were increased from 12 percent to 13.75 percent.10



THE SMOOT-HAWLEY TARIFF

Maybe Hoover's greatest mistake as president was to sign the Smoot-Hawley Tariff into law, crippled international trade in the midst of the depression. Hoover was personally opposed to tariffs and in private called the Smoot-Hawley Tariff "vicious, extortionate and obnoxious." One thousand economists signed a petition asking him to veto the measure.

9. John A. Moore, "The Original Supply Siders: Warren Harding and Calvin Coolidge" *The Independent Review.* 18 (4), 614.
10. Veronique de Rugy, "High Taxes and High Budget Deficits: The Hoover-Roosevelt Tax Increases of the 1930s" Tax and Budget (a publication of the Cato Institute), No. 14, March 2003. Accessed at: https://www.cato.org/sites/cato.org/files/pubs/pdf/tbb-0303-14.pdf

TARIFFS IN ECONOMICS

In 1930, 1,028 economists signed a letter opposing Hoover's trade restrictions. While economic thought has evolved over the past ninety years on many issues, on the issue of tariffs economists have been consistently opposed. Indeed, a poll of American economists in 2014 revealed that 93 percent agreed or strongly agreed that "past major trade deals have benefited most Americans." The other seven percent were uncertain – with exactly zero disagreeing with the statement.1 Another survey reported that 83 percent of economists agreed that the U.S. government should "eliminate remaining tariffs and other barriers."2 It's hard to find that type of unanimity in any academic field, let alone among economics.

Why do economists believe that free trade is good and that tariffs are bad? Well, at the core of this belief is the realization that trade always benefits both parties. If both individuals didn't benefit from the exchange, then the trade wouldn't take place. If there is no coercion involved, trade – by definition – makes everyone better off. Another reason is that tariffs are taxes on imports and every tax that the government imposes has a dead weight loss on society. What this means is that when you put a tax on imports there will be less imports than there otherwise would have been therefore some members of society will not engage in exchange and as a result be worse off.3

1.IGM Forum, "Fast-Track Authority: Polling," November 11, 2014. Accessed at: http://www.igmchicago.org/surveys/fast-track-authority/.

2. Daniel Griswold, "A Super-Majority of Economists Agree: Trade Barriers Should Go," September 18, 2009. Cato Institute. Accessed at: https://www.cato.org/blog/super-majority-economists-agree-trade-barriers-should-go.

3. For more on dead weight loss see https://www.intelligenteconomist.com/dead weight-loss/

ARKANSAS IMPACT:

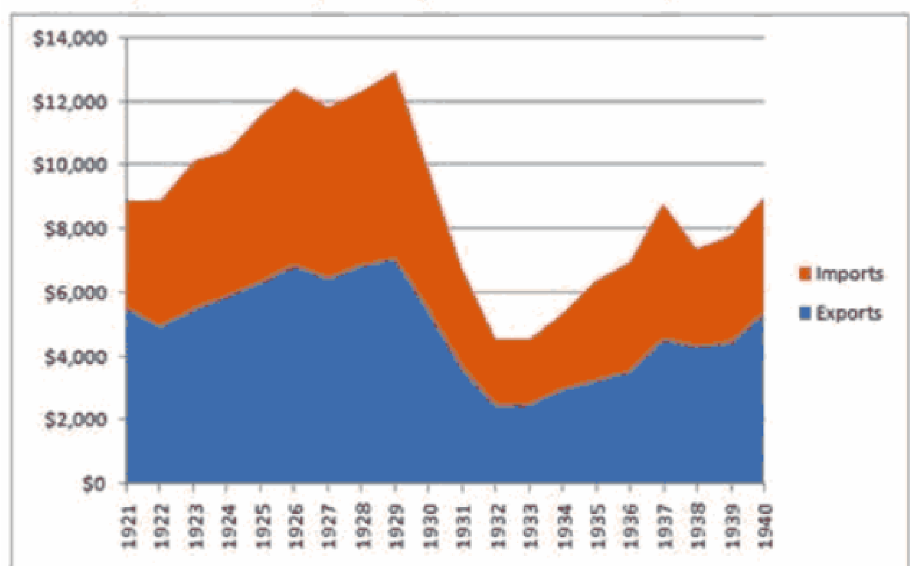
The timing could not be worse for Arkansans living through the Great Depression. In 1927, Arkansans living near the Mississippi River experienced a massive flood that destroyed crops, property, and road systems, leaving thirty-six out of seventy-five Arkansas counties under water up to thirty feet deep in places. In 1930-31, the state experienced a massive drought and Arkansas's food supply greatly declined. Rural Arkansans experienced food shortages and rioting. When the economy started to crumble, the state of Arkansas was already drowning in debt and asking for Federal relief. To learn more about the early 1930s in Arkansas, check out the resources offered online at the Encyclopedia of Arkansas website.

NOTES:

One of Hoover's economic advisors, Thomas Lamont (who was also a partner at J.P. Morgan) recounted that he "almost went down on [his] knees to beg Herbert Hoover to veto the asinine Hawley-Smoot Tariff." Even after all of this, Hoover signed the Smoot-Hawley Tariff into law in 1930. His lack of statesmanship and his inability to stick to his principles resulted in what historian David Kennedy has described as "an economic and political catastrophe."11

As countries around the world turned inward and raised tariffs, global trade grinded to a halt. As Lamont explained, the U.S. passing of the tariff "intensified nationalism all over the world." The great American journalist and political commentator Walter Lippmann complained that Hoover had "surrendered everything for nothing. He gave up the leadership of his party. He let his personal authority be flouted. He accepted a wretched and mischievous product of stupidity and greed."12 These concerns turned out to be well founded as the tariff ultimately decreased U.S. imports and exports by 67 percent.13

The enactment of tariffs across the globe further exacerbated the world-wide economic depression. Trade, by definition, is mutually beneficial—it makes both parties better off. Trading between one another increases the wealth of nations. The collapse of international trade hurt not only the United States but also the rest of the world. While some American manufacturers may have benefited individually, American consumers overall paid higher prices for goods because items from overseas were now taxed before they could be purchased. Likewise, American farmers had a harder time selling their crops abroad. This strained rural communities and the rural banks that made loans primarily to farmers.



11. David M. Kennedy, *Freedom from Fear* (Oxford: Oxford University Press, 1999), 48.
12. David M. Kennedy, *Freedom from Fear* (Oxford: Oxford University Press, 1999), 48.
13. Alfred E. Eckes, Jr, *Opening America's Market: U.S. Foreign Trade Policy Since 1776* (Chapel Hill: University of North Carolina Press, 1995).

CONCLUSION

NOTES:

Far from being a proponent of laissez-faire economics, Hoover believed in using the government to manage the economy. The results of Hoover's interventions were catastrophic. However, the Hoover administration's policy decisions helped turn an economic depression into the Great Depression. Why then do so many people view Hoover as a do-nothing president who believed in the free market? This is mostly because of what came after Hoover left office.

President Franklin Delano Roosevelt was elected in 1932 to usher in a "New Deal" for the American people. Although it was initially unclear what that New Deal would consist of , in time Roosevelt embraced massive interventions by the federal government in an attempt to stabilize the economy. In his First Inaugural Address, FDR condemned free market capitalism for creating the depression and he blamed the belief in outdated economic ideas for not allowing the bold experimentation it would take to combat the crisis. Comparing the economic downturn to a war, Roosevelt promised bold and decisive action by the federal government.14 In reality, he built on many of the failed programs that Hoover had already put into place.FDR magnified the scale of government intervention.

14. Adam Cohen, *Nothing to Fear: FDR's Inner Circle and the Hundred Days that Created Modern America* (New York: Penguin, 2009), 38-40.

PACING GUIDE

INTRODUCTION: FISCAL POLICY

15 MINUTES

Write journal prompt on the board for students to respond to:

List several ways you can think of that the government might work to stimulate the economy during times of economic decline. Which of these methods do you think would lead to the best outcomes? Be prepared to discuss.

LESSON

20 MINUTES

Present PowerPoint presentation to your students, stopping and various points for student response to guided questions and discussion questions. Mark student participation and objectives met using a classroom roster. Stop on key image slides for questions and discussions from students.

VIDEO: SMOOT-HAWLEY TARIFF

15 MINUTES

Play the following clip for your students and have them respond to the following questions in their small groups: https://www.youtube.com/watch?v=C4CvLu8HA7I

Trade restrictions are still being debated today for many of the same reasons mentioned in this video, protecting American businesses and "lowering" the price of American goods. Did tariffs work during this historic economic case study? Lead a discussion with your students, making comparisons to current conversations about global trade.

ACTIVITY: THE GREAT DEPRESSION IN ARKANSAS

ADDITIONAL TIME AS AVAILABLE

In this activity, students will read letters written by Arkansans during the Great Depression to their political legislators and governor as well as newspaper articles providing commentary from Arkansans of the time. These sources help students explore the question "How did the Great Depression help individuals who were living and working in Arkansas?" Have students review the documents using the guided document worksheet included in these materials.

This activity was created by the Arkansas State Archives: http://www.statearchives.us/arkansas.htm