Name ____________________ Date ____________________

The Great Depression

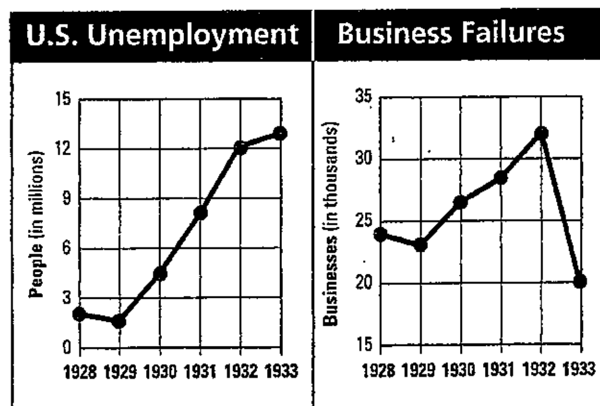
The Great Depression that began in 1929 was the longest, deepest period of hard times in American history. The two graphs below show how much unemployment and business failures rose during the Depression. Six factors helped make this depression the worst of all.

- **The gold standard:** In the 1920s, paper money was backed by gold. Governments pledged to exchange gold for paper money if a person wanted it. This meant that a government could only print as much money as equaled the value of the gold it held. Several years after the Great Depression began, nations—including the United States—dropped the gold standard.
- **The business cycle:** Government and business leaders saw depressions as natural parts of the business cycle. They knew that people would lose their jobs and wages would fall in a depression. However, they believed that eventually businesses would hire more workers because labor was cheaper. Then production would increase, and the economy would grow again.
- **The makeup of the economy:** In 1929, farm products and raw materials formed a big share of the American economy. When prices on these goods fell, trade around the world slowed down. The slowdown in trade spread the Great Depression worldwide.
- **Economic weakness in Europe:** Several nations in Europe had shaky economies in the 1920s. The collapse of American demand for their goods hit these countries hard. Later, the United States raised tariff rates. The aim was to protect the nation's hard-hit industries from cheap imports. But several other nations raised their own tariffs. The result was to further weaken world trade.
- **A drop in consumer spending:** As crop prices fell, farmers had to cut back on spending. They simply didn't have the money to buy goods. Investors who had lost money in the Great Crash also did not have money to spend. As unemployment rose and wages dropped, factory and office workers faced the same problems. Consumers had to cut back to buying just essential items—food and clothing.
- **A credit crunch:** Consumers feared the future. They stopped buying goods on credit (borrowed money). This caused problems for automakers and other businesses that made expensive products. At the same time, falling incomes and failing businesses hurt banks. Consumers and companies were unable to repay their loans. Banks became more cautious about issuing new loans.

The nation did not recover from the Great Depression until World War II. When the United States entered World War II, the federal government greatly increased its spending for arms. American companies hired more workers, and the economy finally improved.

Activity

The Great Depression was a worldwide economic crisis. Choose one other country in the world. Find out what impact the Depression had on that country. Report your findings to the class.



Source: *Historical Statistics of the United States, Colonial Times to 1970*

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Name ______________________ Date ______________________

Deficit Spending

Deficit spending is the act by which the federal government spends more money than it receives in revenue. In general the government engages in deficit spending during economic slowdowns as a way of pumping money into the economy to stimulate business activity and job growth.

Before the 1930s, most presidential administrations were reluctant to engage in deficit spending. The reasons were twofold. First, deficit spending increases the national debt, or the overall amount of money the United States owes to its creditors such as banks, corporations, as well as foreign governments and even private individuals. Too large a debt can become a great burden by making it difficult for the government to borrow money. It also requires the government to divert funds away from various programs each year in order to pay back the money it owes.

Secondly, most economic and political leaders believed that the best way to manage the economy was through a laissez-faire, or "hands off" approach. Conventional wisdom taught that there was no need for the government to try to spur economic growth—when left alone, a capitalist system naturally created a thriving economy and near full employment.

The Great Depression, of course, changed all this. As the financial catastrophe of the 1930s worsened with each passing year, leading economists were at a loss to explain why the nation's economy could not right itself.

It was during this time that British economist John Maynard Keynes stepped forward and claimed that the classical economists had it all wrong. In what became his landmark book, *The General Theory of Employment, Interest, and Money* (1936), Keynes argued that the normal workings of an economy did not necessarily bring full employment and stability and that government intervention, in the form of deficit spending and other measures, was the key to alleviating economic downturns.

President Franklin Roosevelt practiced deficit spending in an effort to stimulate job growth. The benefits of deficit spending, however, did not become apparent—and the Great Depression did not end—until the onset of World War II, when the government greatly increased its expenditures and unemployment all but disappeared.

In the years that followed, the nation's political leaders became strong proponents of deficit spending—and not just during times of financial or military crisis. Keynesian philosophy became official policy with the Employment Act of 1946, which gave the federal government greater authority in trying to maintain full employment and economic growth.

The Keynesian technique reached a peak in the 1960s, when a large tax cut coupled with great amounts of government spending spurred a decade-long economic boom. The situation turned dramatically, however, in the 1970s when a new phenomenon known as "stagflation"—high inflation coupled with high unemployment—crippled the U.S. economy. This time it was the Keynesians who were stumped, as government intervention seemed to provide little help. When Washington, D.C. pumped money into the economy to create jobs, inflation increased; when it tightened the money supply to curb inflation, unemployment rose.

It was during the 1970s that a number of leading economists began to voice opposition to Keynesian economics and called for less government influence in the economy. Thirty years later, the debate seems far from settled. The merits of deficit spending as well as the larger issue of how much the federal government should intervene in the economy continue to prompt disagreement in economic and political circles—and probably will for years to come.

Activity

Work with a partner to track the nation's deficits and debt from 1990 through today. Based on your research, write a brief report on the subject or draw a detailed graph or chart depicting the information you found.

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