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Chapter 6
What Caused the Depression

In this chapter, you will read a short history of one single family business, the Connors Toy Company. Then you will be introduced to economic statistics which, in addition to this story, should help you understand what caused the Great Depression of the 1930's.

Blocks for Tots

After he came home from World War I, Mr. Frank Connors went into business for himself. Using money he saved during the War, he started a toy company that made small building blocks for children ages 3-5. He called his company, *Blocks for Tots*. Business was good right from the start. Connors was making substantial profits which he used to buy more efficient machines. This helped him keep labor costs low and profits high. While doubling production, he was able to reduce his work force from 15 workers to 11. Though he gradually increased wages, his profits grew at a much faster pace.

In the later 1920's, Mr. Connors began to buy stock with his business profits. He speculated on stocks that increased in value quickly, and borrowed money (using margin) to buy more stocks. When the stock market crashed in 1929 the value of his stocks decreased by $5,000, and Connors was forced to sell them to supply his broker with more margin. He lost another $2,000 when his bank was forced to close its doors, and what little money he had left went to pay for the labor saving machinery he could no longer use. Losing all the money he made in business was more than a little bit upsetting. After all, he had done what everyone said he should do. He started a business on his own - he built his business up. He put his money in the stock market which everyone else seemed to be doing too. He made sure to keep enough money in a safe bank account in case his business went sour.

As bad as things were in 1929, they kept getting worse for Connors. He learned that workers who don't have jobs do not buy toys for their kids. The toy business became really slow. There were hardly any new orders, even for Christmas. As much as he hated to do it, Connors fired five workers and cut the wages of those who stayed. Even with a smaller work force, *Blocks for Tots* kept losing money.

At home, Mrs. Connors cut back on the expenses. The family no longer ate meat every day. They stopped going to the movies twice a week. The children no longer got their allowances and Mrs. Connors stopped buying new clothes. The children had to wear 'hand-me-downs' from neighbors.

More Trouble in Toyland

Despite all his efforts to cut corners, Connors' business kept losing money., and in August, 1931, he shut it down. Now unemployed, Connors moved to Richmond, Indiana where he could live on his wife's family farm. At least no one would starve. Connors himself was able to get a low paying job on a government project. His children went to school in Richmond, instead of Chicago. That was just as well. Chicago had run out of money to pay its teachers and its schools had closed.

Why this long story about one single family during the Depression? Because the Connors ' story can help us understand one theory about what caused the Depression, and why it got worse.

What Caused the Depression?

We should remember in the chapter on the prosperity of the 1920's that despite many signs of real economic growth - a serious problem remained. The prosperity was not divided evenly among Americans. Some grew very rich while others had trouble making ends meet.

Those who did not make much money, had less to spend. For instance, the poor could not afford to buy cars. The rich, after buying their own cars, started buying stock in such corporations as General Motors. As a result more cars were being made than the poor could buy and the rich wanted. Faced with lagging sales, General Motors, Ford and Chrysler began closing their factories. This threw more people out of work, resulting in even less money for buying cars, radios, washing machines, houses leading to even more unemployment. There is a saying, 'whatever goes around, comes around'. More and more unemployment led to less buying and, as a result, even more unemployment kept coming around.

The main problem in the 1920's, many economists have come to believe, was that wages did not rise as fast as production. We saw the same thing with the Connors' toy business. When Mr. Connors' plant became more efficient and production increased, Mr. Connors only passed a small part of the new earnings on to his workers. Eventually, the Connors' factory closed down because his workers and millions in a similar position weren't being paid enough to afford to buy expensive toys for their children.

Of course we cannot blame the Depression on the way Mr. Connors ran his business. But, his story points to a serious problem in the American economy. Because they were not paid enough, workers all over the country could not afford to buy back what they were producing. The businessmen who made the profits, at first bought necessities, and then luxuries and, finally, stock. With so much money going into the stock market, prices of stocks rose and kept rising. But, when people bought GM stocks instead of Chevrolets, a lot of unsold cars were left sitting around in showrooms. Soon the dealers stopped ordering cars, factories cut production, and automobile workers were laid off. When these workers could not buy anything, there were even fewer orders and more layoffs. Meanwhile, the stock market collapsed, banks (having often 'invested' heavily in speculative stocks) failed, all hope and confidence also went down the drain, and America slowly sank into the worst Depression in its history.

The Flow of Goods and Services

In the chart below you will be asked to learn a new way of looking at our economy. We see that money, work, wages, and goods and services are constantly moving from producers (the businesses, factories, etc.) to consumers (homes of the buying public).

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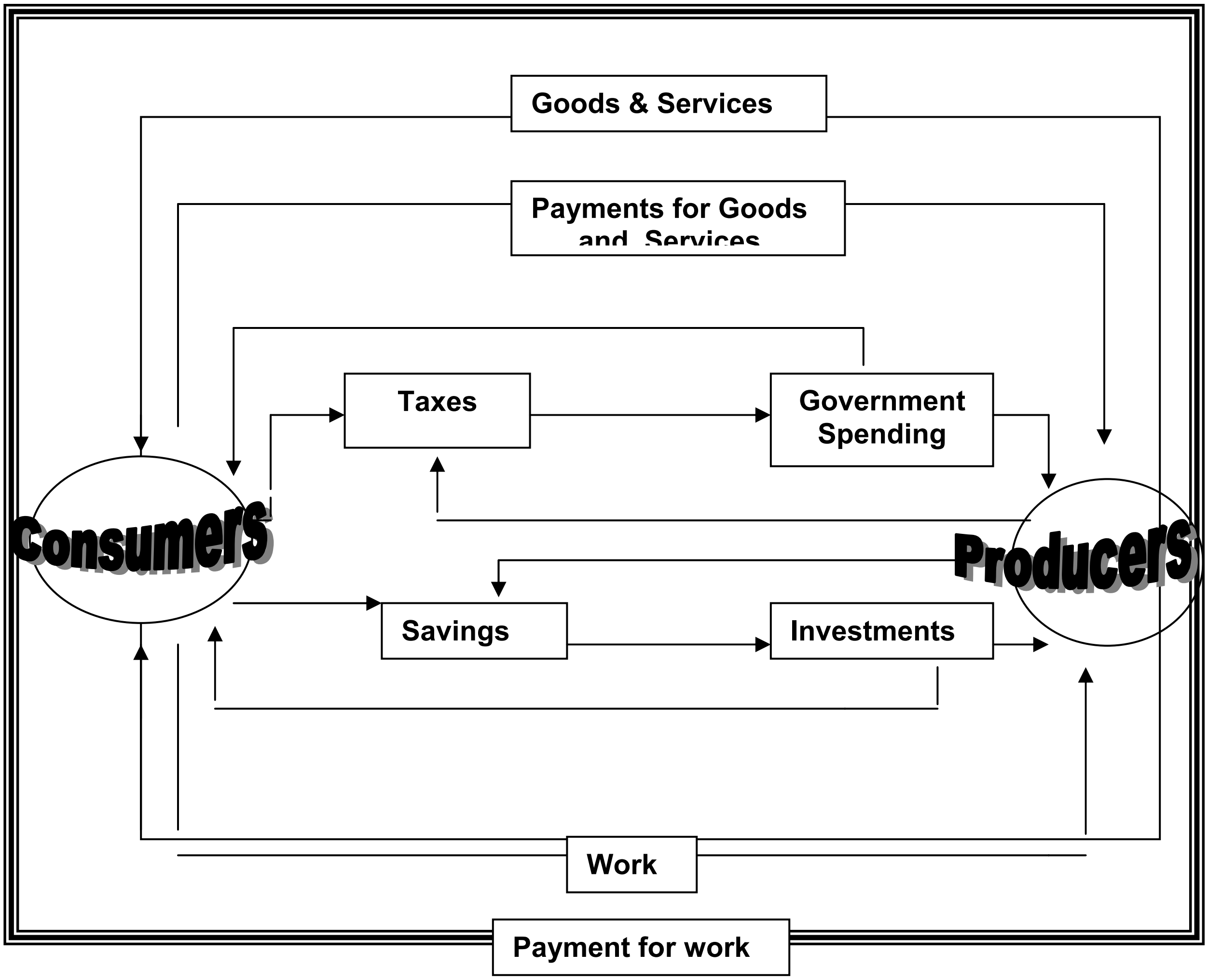

Chart Showing Flow of Goods and Services through an Economy

t any one time money and goods and services circulates through the economic system There is a certain amount of money in the system. When money leaks out into savings or profits, it must be returned to the system. Otherwise, the whole flow of goods and services decreases.

One way of returning the savings is for businessmen to re—invest them back into the economy by buying machines. Another is for the Government to borrow the money and pay people who are out of jobs, or to take the money in form of taxes.

During the late 1920's much money left the cycle of goods and services when it was gambled in the stock market. When the market collapsed, much of this money was taken out of circulation. As people began losing their jobs, they could not buy goods and services, once more slowing down the system's flow.

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Failure of Purchasing Power to Keep Pace with Production

Different economists have different theories about what caused the Depression. Some say it was overproduction (too much being produced). Others say it was under consumption (people did not have enough money to buy). Others say it was due to the stock market crash, and loss of confidence others said it was due to problems in other parts of the world

Without going into great details, we say that the cause of the Depression had something to do with overproduction and under consumption. More was produced than people could buy. That is overproduction. But, it also was under consumption. People did not have enough money to buy what was produced, and people who had money were using it to buy stocks. When the market collapsed and the banks failed, much of the money that had been saved was lost. That is why we say the cause of the Depression was failure of purchasing power to keep up with production.

Suggested student exercises:

1. If the cause of the Depression was really the failure of purchasing power to keep up with production (and that is just one theory) then how did the following contribute to the problem:

a. wages during the '20's not keeping up with production b. the failure of competition in many cases to reduce prices c. the farm depression of the 20's d. some of the economic and political decisions (i.e. tax cut, not helping farmers, & failure to finance TVA,). made during the '20's.	e. the stock market crash f. poverty in Europe and the collapse of foreign markets g. high tariffs on American exports h. Mr. Connors i. the 12 million poor families who did not have as much money in total as the 36,000 wealthiest families.

2. If the cause of the Depression really was the failure of purchasing power, what should be done to end it?

3. If the cause of the Depressions was not failure of purchasing power to keep up with production, what would you say it was? Explain.