**Causes of the Great Depression**

There were many things that occurred during the “Roaring Twenties” that were paving the way for one of the worst economic situations in our nation’s history: The Great Depression. These foundations for failure, along with the fateful **Stock Market Crash of October 29, 1929** would lead the nation into a time period of great hardship and suffering.

*Uneven Prosperity*

During the 1920s, while it appeared that the economy was “roaring” in reality the rich got richer, and the poor got poorer. Between 1920 and 1929, the income of the wealthiest 1 percent of the population rose by 75%, compared with a 9% increase for the rest of Americans as a whole.

More than 70 percent of the nation's families earned less than $2500 per year, then considered the minimum amount needed for a decent standard of living. So while it appeared that the standard of living was improving during the 20s, it wasn’t improving for everyone. Scarcely half the homes in many cities had electrical lights or a furnace for heat. Only one city home in ten had an electric refrigerator.

This **unequal distribution of income** was an important background cause of the Depression as it meant that most Americans could not participate fully in the economic advances of the 1920s. Many people did not have the money to purchase the flood of goods that factories produced. The prosperity of the era was a façade that masked the fragile foundation that it rested upon.

*Overproduction and Under-Consumption*

Another main cause of the Great Depression was **overproduction**. Factories had produced many war time goods during World War I and had to adjust as Americans settled back in to a peace-time economy in the 20s. The factories transitioned to making washing machines, vacuum cleaners and Model T Fords which became the standards in technology during the early twenties.  Unfortunately, factories were mass producing these items faster than consumers were purchasing them.

Farmers faced similar situations.  Called upon during wartime to feed the troops, farmers had increased production rates during World War I.  Again, in a transition to a peace-time economy, farmers struggled to reduce their rates of production and saw a sharp decrease in the need for the food they were growing.  This **under-consumption** of products led to farm prices falling throughout the 20s.  Factories and farms were producing more goods than the people were buying and as a result, prices fell, factories closed and workers were laid off.

*A weak banking system*

Perhaps one of the most important cause of the Great Depression was an unacknowledged **crisis in banking** that was occurring during the 1920s. During the 1920s there was a rapid expansion of credit which inevitably led to a nation of citizens in debt. People who had “bought now” and intended to “pay later” were in a constant state of owing money. A problem of the 20s, in terms of banking, was that many of the lines of credit (loans) were given out whether or not the borrower was known to the lender or had a track record of successfully servicing previous loans. This problem of over-supply of credit was an extreme risk for the banking system of the United States. What would happen if the borrowers didn’t, or couldn’t, pay their loans back?

*An unstable stock market*

Many Americans had also invested in the stock market through on-margin buying during the 20s. As people became comfortable buying stocks, speculation became comfortable, too.  When stories of overnight fortunes were reported in the news, regular folks wondered:  Why not me?

As the bull market continued, people were increasingly willing to buy stocks with borrowed money.  The "buy now, pay later" method of credit was introduced to the stock market as "buying on margin."  The deal was to put some of the money down, then pay for the rest of the shares with profits when the paper was sold.  The concept works, provided that the stock prices keep going up. Recklessness became part of the national consciousness.  "The market takes care of things pretty well," so why not join in?

Buying on margin became so popular that by the late 1920s, "ninety percent of the purchase price of the stock was being made with borrowed money."  Not only that ... the U.S. economy had come to depend on that activity.  Nearly forty cents of every dollar loaned in America was used to buy stocks.

As more people bought stocks with borrowed money, the demand for stocks increased - as did the prices.  In 1928 alone, the stock market doubled.

Applying the formula of the time, a person with $6,000 could buy $60,000 worth of stock because all one had to do was put down 10% of the purchase price.  With a market going ever upward, who would have thought about "paying the piper" - that is, the rest (90%) of the purchase price - in the event the value of the stock "tanked?" To Americans in the 20s, that was unthinkable.

*Black Tuesday: The Stock Market Crashes*

On October 29, 1929, “Black Tuesday” as it would later become known as, the unthinkable happened: the stock market crashed.

Black Tuesday was the fourth and last day of the [stock market crash of 1929](https://www.thebalance.com/stock-market-crash-of-1929-causes-effects-and-facts-3305891). It took place on October 29, 1929. Investors traded a record 16.4 million shares. They lost $14 billion on the [New York Stock Exchange](https://www.thebalance.com/what-is-the-new-york-stock-exchange-3306243), worth $199 billion in 2017 dollars. During the four days of the crash, the Dow dropped 25 percent and investors lost $30 billion. That was ten times more than the 1929 federal budget.

Stock prices began to decline in September and early October 1929, and on October 18 the fall began. Panic set in, and on October 24—Black Thursday—a record 12,894,650 shares were traded. Investment companies and leading bankers attempted to stabilize the market by buying up great blocks of stock, producing a moderate rally on Friday. On Monday, however, the storm broke anew, and the market went into free fall. Black Monday was followed by Black Tuesday, in which stock prices collapsed completely.

After the crash, stock prices continued to fall. They hit their 1929 bottom on November 13. By then, more than $100 billion had disappeared from the American economy. In today's terms, that was worth $1.3 trillion. Buyers roared and screamed. Some collapsed onto the ground when they got bad news about a stock price. Crowds formed outside of the NYSE. The police were called to keep order

Americans were in a state of panic. This was because many American investors had bought on margin. These investors had placed huge [stock orders](https://www.thebalance.com/understanding-stock-orders-3141318) with only 10 percent or 20 percent down. They used the money they borrowed from their brokers. When stock prices fell, the brokers called in the loans. Many people found paying off the loans wiped out their entire life savings. In despair, some even jumped out of windows.

[*The Roaring Twenties*](https://www.thebalance.com/roaring-twenties-4060511)*were over*

Black Tuesday [kicked-off the Great Depression](https://www.thebalance.com/when-did-the-great-depression-start-4060510). What followed was a complete loss of confidence in the U.S. financial system. In those days, people believed the stock market was the economy. What was good for [Wall Street](https://www.thebalance.com/wall-street-how-it-works-history-and-crashes-3306252) was thought to be good for Main Street. The stock market crash caused people to withdraw all their savings, which is called a run on the banks. The banks didn't have enough cash on hand and were forced to close. When they reopened, they only gave savers ten cents for every dollar they had deposited.

Dejected and in economic despair, America entered the Great Depression.