The Causes of the Great Depression: A Retrospective

By Kenneth Matziorinis

Introduction

During the 1930s the world experienced a cataclysmic economic collapse, the likes of which that had never been seen before. It was unlike previous “depressions” when economic activity would always recover following few years of economic decline. The one that unfolded in the 1930s was greater in magnitude, a 25% – 50% drop in total production; was longer in duration, lasted roughly ten years from 1929 to 1939 and was wider in scale, engulfed the whole of the global economy. With unemployment rates climbing to 25% in the United States and Britain and 40% in Germany, governments became ineffectual and people were driven to despair and to extremes. Liberal democracies lost credibility as did the liberal market economic system. This is why it came to be known as the “Great” depression. It is commonly recognized by historians today that the Great depression set the stage and was one of the major causes of World War II. This paper looks at the factors that caused the depression and examines the impact they had on three major economies of Europe, those of Britain, France and Germany.

2. Causes of the Great Depression of 1929-1939

There is no single cause or obvious set of factors that can explain why the depression occurred. Historians, economists and political scientists have come up with various explanations that place different emphasis on different factors and events. One thing seems clear, however, that the depression was the result of the interaction of a complex set of factors, some economical, some political and some social. This paper will concentrate on the most obvious ones which are organized under the following headings: 1) the economic impact of the Great War; 2) the economic and geo-political dislocation caused by the war particularly in Central and South Eastern Europe; 3) the collapse of the gold standard; 4) the global financial imbalances and the German war reparations; 5) the U.S. stock market bubble and the stock market crash of 1929 and 6) lack of global financial leadership and the application of mistaken economic policies.
2.1 The Economic Impact of the Great War

When the First World War broke out in August 1914, nobody expected that it would last four years, involve so many nations, involve technology and mechanization so much, cost so many lives and do so much destruction and yes, cost so much money. The war caused widespread destruction of industry, transportation and infrastructure in Europe from Belgium and France in Western Europe to Russia in the East and Turkey in the South East of the continent while it caused an economic boom in other countries that were removed from the European theatre of war such as Canada, the United States, Argentina, Brazil and Australia. To win the war each side was forced to spend its gold reserves, to borrow and when all else failed, to print money to pay the bills. France and Belgium borrowed from Britain, all three of them borrowed from the United States. The war not only disrupted the normal patterns of domestic and international trade, but it also undermined the economic and financial strength of the old world and Britain in particular. The European powers incurred huge debts in order to pay for the expenses of the war. Yet, the worse economic legacy of the war was that it forced governments to “go off” the gold standard, that through its linkage of paper money to gold had maintained monetary discipline and price stability for almost a century before. As countries printed paper money in excess of what their shrinking gold reserves would allow, it led to inflation, high inflation and rising prices and falling purchasing power. The consequence of this inflation for the post war Europe was that a) the exchange value of each country’s currency had become misaligned so after the war they could not return to the same parities and b) to return to pre-war parities, governments had to engineer deflation in order to bring prices back to pre-war levels. This was one of the major destabilizing influences of the war, which undermined the foundations of the international monetary system and made the world financial system more vulnerable to a collapse.

2.2 The Dissolution of Empires, the Creation of New Smaller States and Geopolitical Instability that Followed

Another of the major legacies of the “Great” war is that it helped destroy the old order of European geo-political supremacy and economic hegemony in the world. Starting with the Russian Revolution of March 1917, internal strife, economic collapse and civil war, Russia, the world’s fifth largest economy in 1913, collapsed and dropped off the global economic structure. Czarist debts to the west were repudiated by the new Communist regime, the economy of Eastern Europe melted down. Then came the collapse of the Ottoman Empire, out of which new or enlarged countries of the Balkan Peninsula and the Middle East emerged. All these new or reconstituted countries needed to establish new treasuries, issue new currencies, pay their war debts, build new economies, re-build their populations and establish new economic relationships with each other. Worse of all is what happened to the old and established Austro-Hungarian
Empire that occupied the middle ground of Central Europe. Following the Treaty of Versailles, the empire was split into three new and smaller countries, those of Austria, Czechoslovakia and Hungary, not to mention a reconstituted Poland, Romania and Yugoslavia. All these geo-political changes along with the shrinkage of Germany’s borders caused major economic dislocation and political instability in the continent, they also created a huge power vacuum in Central Europe and they imposed huge strains on the international monetary system, as these new countries were in need of financing, in need of export markets and financial assistance to rebuild their war-torn economies. While these empires existed, all trade within their borders could move freely without customs or trade restrictions and could be viewed as free-trade zones, the new countries started setting up barriers to trade with each other, thus reducing trade and the means that trade provides to create wealth and jobs to feed their populations.

2.3 The Collapse of the Gold Standard

When the war broke out, countries suspended the movement of gold in settlement of international trade. Moreover, the pressing needs of financing the war required the suspension of the gold standard so that governments could print money to pay for the war effort. Going back to the gold standard was not as easy as going off it. The new post-war environment had resulted in the creation of many new but weak countries. Each country had to set the value of their currency against gold and to back it up with gold reserves. But to do so, it had to acquire gold by exporting more than it imported and by attracting financing from other countries. This proved very hard to do in the harsh post-Paris 1919 environment. Fixing currency rates to gold meant that each government would have to balance its budget and this limited the amount it could spend. As the population’s needs were great this required sacrifices that populations were not as willing to undertake.

Moreover, to go back to the gold standard at the pre-war rates of exchange required that prices were brought down to pre-war levels in order to restore the value of the currencies. In other words, to re-establish the pre-war stability of the international monetary and trading system required the return to a globally accepted regime, that of the gold standard. To return to the gold standard, it meant that countries had to deflate their price levels by lowering prices. To lower prices governments had to cut spending, cut salaries, cut subsidies and force market prices for commodities and products lower. This amounted to a deflationary set of economic policies, which placed a great deal of downward economic pressure on economies. No economy faced these pressures more than the British economy, where the government went on a starvation diet that resulted in high unemployment and labour strife especially in the coalmines. On May 14, 1925 Britain went back to the gold standard at the pre-war parity of US $4.86 to the pound under the chancellor of the Exchequer Winston Churchill.
The deflationary policies required to restore and subsequently maintain the gold standard reduced not only reduced demand in Britain, but also in other countries and domains of the British empire and the world that relied on the pound and British capital markets for their financing, thus ensuring the spread of these deflationary forces to the rest of the world economy. But the restoration of the gold standard was not to last for very long. On September 19, 1931, the British government decided to go off the gold standard and the pound sterling declined by a third of its value on the foreign exchange market. Lionel Robins (1934) has attributed most of the blame for the Great depression on the collapse of the gold standard. Although restoration of the gold standard may have had deflationary consequences on the global economy and accentuated the depression, it also provided a monetary discipline, a compass, an anchor for all other countries to follow and to coordinate their policies. The demise of the gold standard meant that there was no more standard, no more foundation to pursue coordinated economic policies internationally. Now it was up to each country to do what it believed was the most expedient thing to do, each country was no longer obliged to think of the common good but what is best for its narrow national economic interest. It opened the door to international economic anarchy, it was “devil take the hindmost” or *sauve qui peut.*  

2.4 **Global Financial Imbalances and German War Reparations**

In the aftermath of the war when the various parties gathered together at the Palace of Versailles in Paris in 1919 to discuss the terms of the armstice politically you had two groups, the victors of the Entente and the losers of the Austro-German alliance. Economically, however, they were all losers. They had all suffered from the war. They came out of the war with shattered economies, devalued and depreciated currencies, high unemployment, high inflation and huge debts to each other. Russia owed money to France and Britain that was only paid off 75 years later in the 1980s under Gorbachev. Greece and Serbia owed money to Britain and France, France and Belgium owed money to Britain. Both Britain and France owed money to the United States. The few winners of the war were Canada, Australia, Argentina, and of course, the United States of America that emerged from the war as the world’s real superpower.

The main pressing concern of the victors after the war was how to pay the debts that they incurred during the war. To Clemenceau, the French Prime Minister, it was more than economics. He wanted to exact revenge from the defeated Germany by making her and its Autro-Hungarian ally pay for the damages incurred by the war. The solution was to extract war reparations payments from Germany. This way Germany and Austria would pay France, Belgium and Britain who in turn would pay Britain and all together the U.S.A.. The problem however, was that Germany and Austria had seen their own share

---

of war destruction, they had seen their own treasuries depleted and were reduced in size and economic capacity. You could not expect the losers to pay, especially when the size of reparations imposed on them where so disproportional to their ability to repay. Nobody could see the problem more clearly and succinctly than John Maynard Keynes, the Economic Advisor to Lloyd George, and the British Prime Minister at the negotiations in Paris. When it became clear that Lloyd George would not listen to pragmatic advice but sided with Clemenceau, Keynes resigned his post and went public by writing his famous polemic the Economic Consequences of the Peace (1920). In this book Keynes made his case very succinctly and prophetically, to quote:  

“There are therefore three separate obstacles to the revival of trade: a maladjustment between internal prices and international prices, a lack of individual credit abroad wherewith to buy the raw materials needed to secure the working capital and to re-start the circle of exchange, and a disordered currency system which renders credit operations hazardous or impossible quite apart from the ordinary risks of commerce. The note circulation in France is more than six times its pre-war level. The exchange value of the franc in terms of gold is a little less than two-thirds its former value... The situation in Italy is not very different. ... But if this is the budgetary position of France and Italy, that of the rest of belligerent Europe is yet more desperate. In Germany the total expenditure of the Empire in 1919 is estimated at 25 milliards of marks, of which not above 10 milliards are covered by previously existing taxation. This is without allowing anything for the payment of the indemnity. In Russia, Poland, Hungary, or Austria such a thing as a budget cannot be seriously considered to exist at all.

“Thus the menace of inflationism described above is not merely a product of the war, of which peace begins the cure. It is a continuing phenomenon of which the end is not yet in sight.”

“All these influences combine not merely to prevent Europe from supplying immediately a sufficient stream of exports to pay for the goods she needs to import, but they impair her credit for securing the working capital required to re-start the circle of exchange and also, by swinging the forces of economic law yet further from equilibrium rather than towards it, they favor the continuance of the present conditions instead of a recovery from them. An inefficient, unemployed, disorganized Europe faces us, torn by internal strife and international hate, fighting, starving, pillaging, and lying.”

And then goes on to utter the following prophetic sentence which presages the rise of fascism and the rise of Hitler:

---

“Economic privation proceeds by easy stages, and so long as men suffer it patiently the outside world cares little. Physical efficiency and resistance to disease slowly diminish, but life proceeds somehow, until the limit of human endurance is reached at last and counsels of despair and madness stir the sufferers from the lethargy which precedes the crisis. Then man shakes himself, and the bonds of custom are loosed. The power of ideas is sovereign, and he listens to whatever instruction of hope, illusion, or revenge is carried on the air. …But who can say how much is endurable, or in what direction men will seek at last to escape from their misfortunes?”

Not only the reparations imposed on Germany should have been much lighter, if any at all, but the winning powers should have put in place a mechanism to restore balance on the continent by supporting economic reconstruction and cooperation for the general good of all. This is exactly what the allied powers did following the Second World War, they ensured not to repeat the same grave mistakes they made after the First World War through the Bretton Woods system, the Marshall Plan and NATO. Thus in the years following the Armistice, Germany and Central Europe where starved of capital to restart their economies and whatever little capital and resources they could raise had to go to France and Britain to make reparations so that they could both in turn pay off the U.S.A. If Germany could not have a means to finance its way out then the whole process was doomed for catastrophe. Does one need to search any further for the causes of the Great Depression?

2.5 The U.S. Market Bubble and the Stock Market Crash of 1929

While Europe was suffering and trying to get back on its feet, the United States was experiencing the Roaring Twenties. If there was a real winner from the First World War, it was the U.S.A. Its economy grew tremendously during the war as the warring factions in Europe purchased more goods from the U.S. while new technological innovations in the automobile, electricity, electrical appliance and radio where revolutionizing industry, generating profits and pushing up stock prices. Gold reserves had risen as the United States emerged as the world’s biggest creditor nation. American investment started flowing into Europe and Germany in particular in the form of foreign direct investments in German industry as well as in the form of financing to purchase European sovereign bonds. During the 1920s, the war inflation ended and turned to mild deflation, which restored buying power and created new confidence in the economy. Thanks to American loans and financing to German and Austrian banks, Germany and central Europe embarked on a precarious recovery. The United States had unknowingly become the financial pillar upon which the whole world depended.
But the economic situation was too good to be good. Every simple American wanted to participate in the wave of prosperity and the best way to do so, it seemed, was to participate through the stock market. With low credit margins, i.e. with ten cents an investor could buy a dollar’s worth of stock, the difference being provided as credit from the stock brokerage firms and the banks that financed them. As stock prices went up, everybody was a winner and that attracted more investors to the market. As more investors piled in, stock prices made new highs and the market turned into a bubble. Investors were no longer investing on the merits of corporations but where betting on the continued rise in the market. It was a situation that could not last forever. To cool down the mania and deflate the bubble, the newly created monetary authority known as the Federal Reserve started raising interest rates to cool down the market.

But in a fragile world economy that was dependent on US capital, it also raised the cost of credit to them as well and worse of all prompted Americans to repatriate some of their capital so they can make higher returns in the USA. Then one morning on Thursday, October 24th, 1929, the Dow Jones Industrial Index plunged, falling further the next day losing over 20% of its value in two days. This created a panic on Wall Street as brokers were caught short and as investors lost more than their margin. Unable to repay, brokers were forced to unload their stock pushing prices lower and forcing many firms into insolvency. International capital instead of flowing into Europe to prop up the capital starved economies started to flow out, resulting in a string of bank defaults on European soil starting with the Vienna-based Credit-Anstalt, Austria’s largest deposit bank. The damage had already been done, with the financial pillar of the world now in financial distress there was no hope for anyone. As capital was being pulled out of Europe to cover losses in the USA, the situation worsened, triggering a string of bank failures through continental Europe and then on shore in the United States. The collapse in confidence and the inability of banks to provide credit, led to a slowdown that in the course of 1930 and 1931 accelerated fast. In no time, the economic panic and slowdown spread from one country to the next until the whole world was engulfed in the crisis. The only countries that were spared the worse of the economic consequences of the crash where those like the Soviet Union that had turned to autarchy and had become completely disconnected from the global economy and world financial system. By 1932 production in the United States had fallen by 47%, 44% in Germany and by 37% in the world, excluding the Soviet Union.³

2.6.1 Lack of Global Financial Leadership and the Application of Erroneous Economic Policies

During this period known by historians as the “interwar period” many policy mistakes were made, which to make things worse, were compounded by a

lack of leadership and vision. Two major defining episodes of the period were first what was not done by the victors at the Armistice and second what was not done by Britain and the United States when the stock market crash occurred and economic activity started to fall.

The first wrong turn is best described by Keynes himself: 4 “The Treaty includes no provision for the economic rehabilitation of Europe, -nothing to make the defeated Central Empires into good neighbors, nothing to stabilize the new States of Europe, nothing to reclaim Russia; nor does it promote in any way the compact of economic solidarity amongst Allies themselves; no arrangement was reached at Paris for restoring the disordered finances of France and Italy, or to adjust the system of the Old World and the New.” Lack of vision, good will and leadership set the stage for a fall in 1919-1920.

The second wrong turn was that when the crash occurred in 1929, both Britain and especially the United States -that by now had become the defacto economic leader of the world- failed to act in a decisive and meaningful way as lender of last resort and as guarantor of the international monetary system. Not only was the US Federal Reserve too hasty and aggressive in raising interest rates at a time of financial fragility in Europe but when the fall out from the crash occurred it failed to act as a lender of last resort to bail the banks and shore up the financial system. A leadership vacuum and the wrong choices by the USA dealt the final blow in 1929-1930. Kindleberger (1986) puts it best 5 when he states that, “In 1929, 1930, and 1931 Britain could not act as a stabilizer, and the United States would not. When every country turned to protect its national private interest, the world public interest went down the drain, and with it the private interests of all.” Failure of the United States to act in a decisive market in 1929 and 1930 forced Britain to abandon the gold standard in May of 1931, which started the cycle of competitive devaluations and “beggar-thy-neighbor” policies that are such a defining feature of this period. By 1932, the British pound sterling had not only depreciated by 33%, but Britain also abandons it’s long standing policy of free-trade and introduces a 10% import tariff.

Another part of America’s leadership failure was the Smoot-Hawley Tariff of 1930. To protect domestic farm and manufacturing interests and jobs, the US Congress raised tariffs on world exports to America from an average rate of 15% in 1929 to an average rate of 60% in 1930. By 1934, four years after the crash, the volume of world trade had shrunk to 1/6th of its pre-crash level. The introduction of the tariff by the United States so early in the process was tantamount to an economic declaration of trade war against the rest of the world. Instead of keeping its markets open and allowing other countries to support their economies by exporting goods to the US market it failed miserably to provide the support the world needed to maintain stability. This action then started a period

---

4 Keynes, Economic Consequences of the Peace, 1920, p.226
of global trade war, as other countries raised their tariffs in retaliation to the United States which started the descent to the abyss. Thus, the United States not only failed to come up with the financing the world needed to survive the economic crisis, but it shut its markets tight as well, dealing a double blow to a struggling and weak global economy.

But this is not all that went wrong. Compounding the failure of economic leadership in the world at the time was a failure in intellectual leadership and guidance that mattered the most for sound economic policy. What we know today about macroeconomic theory and policy was unknown at the time. Macroeconomics had yet to be discovered. Any student with a basic full course in micro and macro economics today will tell you that to deal with an economic slowdown governments need to spend more, tax less, cut interest rates and reduce tariffs and barriers to trade. Balancing the budget is not a priority in the short-run. When the economy falters, the proper role of government is to “spend against the wind” to restore balance in the economy and budget balance would be achieved in the long-run as the economy would recover and prosper again. It took a “Great” depression for humanity to discover what the forces at work were which governed their economies and how to manage them to maintain full-employment and price stability. The individual that played the central role in coming up with a new theory and a new set of policy tools to deal with crises of this sort was none other than John Maynard Keynes himself, when in 1936 he came up with his famous book The General Theory of Employment, Interest and Money.

Thus as desperate governments following misguided economic principles tried to deal with the crisis, they cut government spending and raised taxes in order to balance their budgets. Doing so however, had the contrary effect. By reducing spending power, it made the decline worse, which reduced tax revenues further and made it impossible to balance budgets. It turned into a vicious circle. The more they cut, the further the economy declined, the more the economy declined, the more they needed to cut. In the end they flattened what was left of the fragile and weak economies of Europe and world unemployment rates soared, poverty, hunger, sickness and desperation ensued. By the mid-1930s, the prophetic words of Keynes (1920) stood out:  

“Men will not always die quietly. For starvation, which brings to some lethargy and a helpless despair, drives other temperaments to the nervous instability of hysteria and to a mad despair. And these in their distress may overturn the remnants of organization, and submerge civilization itself in their attempts to satisfy desperately the overwhelming needs of the individual. This is the danger against which all our resources and courage and idealism must now co-operate.” Then he goes on to say:  “If we aim

---

6 Keynes, Economic Consequences of the Peace, 1920, p.228
7 ibid, p.268
deliberately at the impoverishment of Central Europe, vengeance, I dare predict, will not limp. Nothing can then delay for very long that final civil war between the forces of Reaction and the despairing convulsions of Revolution, before which the horrors of the late German war will fade into nothing, and which will destroy, whoever is victor, the civilization and the progress of our generation”.

Even Milton Freedman in his seminar work on the monetary history of the United States with Anna Schwartz (1963) concludes that the Great depression was not the result of the stock market crash of 1929 but the result of the wrong economic policies pursued by nations and the United States in particular. He stated: 

“The stock market crash in 1929 was a momentous event, but it did not produce the Great Depression and it was not a major factor in the Depression’s severity. A sharp but not unprecedented contraction was concerted into a catastrophe by bad monetary policy … Whatever happens in a stock market, it cannot lead to a great depression unless it produces or is accompanied by a monetary collapse”

He was proven right when in October 1987 the Dow Jones lost 22% of its value in just two days, a bigger drop than the one that occurred in 1929. Did the world go into a great depression? Rather, the macroeconomic theory that Keynes put together in the 1930s provided governments with the intellectual guidance, and economic tools to prevent a catastrophe from happening again.

3. **The Impact of the Depression on Britain, France and Germany**

The above discussion didn’t just list the causes of the Great Depression, but analyzed and discussed their economic consequences on the large European powers as well. What followed “is history” as they say. What is important to understand, that had it not been for the disruption caused by the First World War, the depression may have not occurred on its own. Had Britain been more able to shoulder the weight of the international financial system on its shoulders a much different outcome is equally possible. But Britain was courageous and responsible enough to at least try. Had the United States been less hampered by its isolationist past and been more eager and willing to embrace the responsibility thrust upon it, a smooth transition of world economic hegemony could have occurred and the world spared of the worse effects of the depression and subsequent conflict. In full fairness to the United States, it is also true that although it had risen to global economic prominence, the United States still didn’t realize it and was not aware of its new-found importance to the world economy. Kindleberger (1986) puts it well in his book: 

---

8 Kindleberger, The World in Depression, 1929-1939, p.106  
9 ibid, p.299
“The notion of the instability of a financial system with two centers, or of one where leadership is in the process of being dropped by one and picked up by another, is cited by Edward Nevin as crucial to the collapse of the gold standard in 1931. He quotes Sir Ernest Harvey’s testimony before the Macmillan Committee: “Better that a motorcar should be in charge of a poor driver than two quite excellent drivers who are perpetually fighting to gain control of the vehicle.”

Then Kindleberger adds: “The instability seems rather to have come from the growing weakness of one driver and the lack of sufficient interest in the other.”

Whatever alternative course the events of the period could have taken, one must also realize that matters were made much worse by the narrow-minded and vengeful attitudes of the allies and the French in particular. Hell-bent on punishing, isolating and diminishing Germany, they created a highly poisonous and counterproductive psychological climate that no matter what else could have been done ensured that the conflict would fester and in time lead to its final outcome, that of renewed conflict and war on the continent. As Keynes predicted with such prescience, it came to happen. Driven by hunger, starvation, unemployment and humiliation, the German nation turned to the words of any madman who could offer a way out of their desperation. That mad man we all know is Adolf Hitler. Within six years from taking power, he performed economic miracles and transformed Germany into a powerhouse, to be respected and feared by everyone. Had Hitler, not gone as far as attacking Poland and Russia and remained content on leveraging his military power to economic power and world influence we would have also seen a much different outcome as well.
References:

Friedman, Milton and Anna J. Schwartz (1963) Monetary History of the United States, 1867-1960


Keynes, John M. (1920) The Economic Consequences of the Peace, Harper Torchbooks


Mackintosh, W.A. (1967) The Economic Background of Dominion-Provincial Relations, Carleton Library


Robbins, Lionel (1934) The Great Depression, Macmillan


Montreal, April, 2007

© Kenneth N. Matziorinis, 2007. All rights reserved. No part of this document may be reproduced or distributed without the express permission of the author.

Comments, feedback and discussion on this paper are welcomed and would be much appreciated by the author.

Dr. Kenneth Matziorinis
Professor of Economics,
Department of History, Economics & Political Science
John Abbott College, and
Adjunct Professor of Economics
Department of Career and Management Studies
Centre for Continuing Education
McGill University
Montreal, QC, Canada
E-Mail: ken.matziorinis@mcgill.ca
The Great Depression was a period of unprecedented decline in economic activity. It is generally agreed to have occurred between 1929 and 1939. Although parts of the economy had begun to recover by 1936, high unemployment persisted until the Second World War.

Background To Great Depression: The 1920s witnessed an economic boom in the US (typified by Ford Motor cars, which made a car within the grasp of ordinary workers for the first time). Industrial output expanded very rapidly. Sales were often promoted through buying on credit. However, by early 1929, the steam had gone out of the economy. There is no single cause or obvious set of factors that can explain why the depression occurred. Historians, economists and political scientists have come up with various explanations that place different emphasis on different factors and events. One thing seems clear, however, that the depression was the result of the interaction of a complex set of factors, some economical, some political and some social.

Another of the major legacies of the "Great War is that it helped destroy the old order of European geo-political supremacy and economic hegemony in the world. Starting with the Russian Revolution of March 1917, internal strife, economic collapse and civil war, Russia, the world’s fifth largest economy in 1913, collapsed and dropped off the global economic structure.

What Caused the Great Depression? As a massive recession that devastated the country (and subsequently the entire world), it's hard to pin down one single fault for the Great Depression. It was a number of factors all coalescing into more than a decade economic misery. There are several theories as to how the economy was able to collapse, but the most obvious occurrence that portended doom and started the depression was the stock market crash that happened in October of 1929. The years of the Great Depression presented great turmoil for the country and the world. After that struggle, lessons had to be learned by the government and the Federal Reserve on how to avoid letting a recession turning into a depression of that magnitude ever again. The Great Depression lasted for a dozen years because the government compounded its monetary errors with a series of harmful interventions. But how exactly did the government inflate the economy, and how did that cause the boom and inevitable bust?

Monetary Policy, Interest Rates, and the Business Cycle. The key to understanding how the government’s policies caused the initial boom and bust of the Great Depression lies in understanding how businessmen and investors use interest rates to decide how and when to spend their money. Investors rely on interest rates to gauge the level of risk. Learn about the causes of the Great Depression in America and the staggering consequences, like the bread lines that kept American citizens from starving. America had gone through hard times before: a bank panic and depression in the early 1820s, and other economic hard times in the late 1830s, the mid-1870s, and the early and mid-1890s. But never did it suffer an economic illness so deep and so long as the Great Depression of the 1930s. Economists have argued ever since as to just what caused it. But it’s safe to say that a bunch of intertwined factors contributed. Among them were: The stock market crash. The stock market soared throughout most of the 1920s, and the more it grew, the more people were eager to pour money into it.