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Analysis on the Impact of the Gold Standard on the Great Depression

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ABSTRACT

The great depression that happened during the 1920s had a huge impact on the whole social and economic process. It is also one of the most well-known crises in the world. This paper, through a method of literature review, will focus on the impact of the gold standard on the Great Depression. Besides, it will also discuss what happened before the Great Depression and what caused it, including its major impact on the world. The paper finds that the Great Depression happened during the stock market crash of 1929, the global trade collapse caused by the Smoot-Hawley Tariff, government actions, bank failures and panics, and the money supply collapse. The gold standard during the great depression made its export demand in the United States smaller than before. Besides, deflation was crippled by a sluggish economy, the stock market crisis of 1929, and a subsequent wave of bank bankruptcies in 1930 and 1931.

Keywords: *Great Depression, gold standard, stock market, Smoot-Hawley Tarriff*

1. INTRODUCTION

The Great Depression, which lasted from 1929 to 1939, was the worst economic downturn in the history of the industrialized world. It plunged Wall Street into a frenzy and wiped out millions of investors. Consumer spending and investment fell sharply during the next few years, resulting in significant drops in industrial output and employment as failing businesses laid off workers. In international studies, the economic crisis has been widely linked to stock market crashes. The author will not only focus on the crash of the stock market but also on the effect caused by the gold standard [1]. The US is a gold standard country, which means in the US, a specific amount of paper money can be transformed into a fixed amount of gold in a gold standard regime. Countries on the gold standard cannot increase the amount of paper money in circulation without increasing their gold holdings.Then, due to the construction and vehicles that drove the postwar rebound in the United States during the first half of the 1920s (known as the Roaring Twenties), the Federal Reserve boosted interest rates in order to battle inflation[2]. This series of behaviors, coupled with the subsequent stock market crash, led to the fall of the gold standard, which turned the great depression into an international financial problem. As there is not that much research focused on this aspect of the gold standard, this paper, through a method of literature review, will focus on the impact of the gold standard on the Great Depression. Besides, it will also discuss what happened before the Great Depression and what caused it, including its major impact on the world[3]. This research not only provides an explanation of previous problems, but it is also connected to current problems to varying degrees. The results of this research can also be used to prevent the impact of future economic crises and to better understand the gold standard.

2. FACTORS FORMED THE 1930S GREAT DEPRESSION

First, the Great Crisis was a significant global economic depression that began in the United States in the 1930s and lasted through 1933. The Great Depression occurred at different times all throughout the world. It began in most nations in 1929 and continued until the late 1930s, making it the 20th century's longest, deepest, and most widespread depression. It was a relatively prosperous time for many middle-and working-class families. As the economy expanded, new jobs were created. Technology and consumer society advancements enabled more free time and the formation of a consumer society. However, the economic downturn that followed the boom has had a significant impact on the daily lives of thousands of families[4].

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2.1 Greater market demand than the stock's actual value

Between 1920 and 1929, the United States' industry increased rapidly, and the country's overall wealth more than doubled. This period is known as the "Roaring Twenties." The stock market's nerve center is the New York Stock Exchange, which is located on Wall Street in New York City. At the time, there was a flurry of desperate speculation, and everyone put their money into stocks. As a result, the stock market skyrocketed, reaching record highs in August 1929 [5].

According to research, production declined, unemployment grew, and stock prices were far more than they were worth at the time. Furthermore, wages were low at the time, consumer debt was skyrocketing, the agriculture sector was suffering from drought and declining food prices, and banks had too many huge debts to sell.

The US economy experienced a moderate recession in the summer of 1929, as consumer spending slowed and the storage of goods began to pile up, hampering factory production. Still, stock prices continued to rise, reaching levels of decline that expected future earnings could not justify. In October of the same year, millions of overextended shareholders panicked and scrambled to unwind their positions, exacerbating the decline and sparking further panic. Shares fell 33% from September to November[6]. As a result, consumers and businesses lose faith in the economy, resulting in a severe psychological shock.The result is that consumer expenditure, particularly for durable items, and corporate investment fell substantially, resulting in a decline in industrial output and job losses, further lowering consumer spending and investment. According to research, the stock market disaster that some predicted occurred on October 24, 1929, when concerned investors began dumping large-cap stocks. On the day, 12.9 million shares were traded, which was a new high[6]. Another 16 million shares moved after another wave of panic rocked Wall Street five days later, on Oct. 29, or "Black Tuesday." Millions of shares finally became worthless, wiping out investors who purchased shares "on margin" (with borrowed funds).

Table 1 Data of U.S. stock market disaster in 1929

	1929 September	1929 October	1929 November
Total 33%	Drop 15%	Drop 10%	Drop 8%
Highest amount of trade (one day)	16 Millions	8.4 Millions	4.3 Millions

To sum up, the main reasons for the collapse of the US stock market are that market demand is far greater than the actual value of the stock, coupled with people's blindly following unstable investments, resulting in a large number of people being unable to pay off their stocks. Banks go bankrupt, stock markets crash. All of these factors combined reached their apex in late 1929.As a result, the U.S. stock market crashed, leading to a future global depression.

2.2 Joblessness and a banking panic

Around a quarter of the American workforce was unemployed during the Great Recession. Those who are fortunate enough to have steady employment often have their earnings decreased or their hours reduced to part-time work. By 1930, there were 4 million unemployed Americans; by 1931, the number had climbed to 6 million. At the same time, the country's industrial production fell by half. In American cities, bread lines, soup kitchens, and an increase in the number of homeless people are becoming more common. Farmers were unable to harvest their crops and were forced to leave them to decay in the fields while the rest of the world went hungry.

In 1930, a severe "dust storm" inspired a mass migration of people from farmland to the cities in search of work. Meanwhile, even the wealthy face serious belt-tightening. Research shows that the incomes of middle and high-level professionals such as doctors and lawyers have fallen by as much as 40%. Families that were previously financially secure are suddenly facing financial instability or, in some cases, bankruptcy[7].

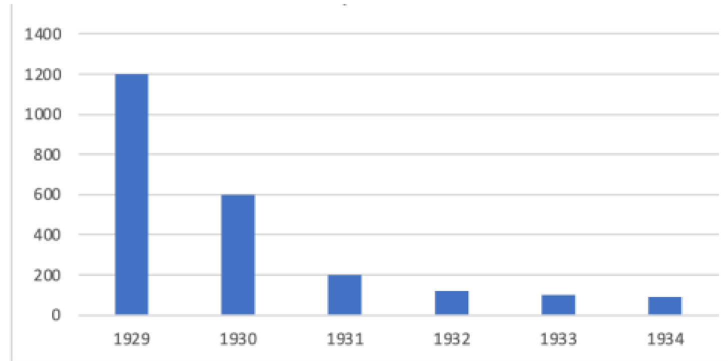

Figure 1 Population of employment during the Great Depression

As a result, many Americans who were obliged to try to obtain scarce jobs on credit became in debt, and the number of foreclosures increased gradually. The first of four waves of banking panics began in the fall of 1930, when a large number of investors lost a lot of faith in banks' viability and demanded cash deposits, pushing banks to liquidate loans to make up for cash reserve deficiencies. Bank runs severely damaged the United States again in the spring and fall of 1932, and by early 1933, many more institutions had closed their doors. Deflation (and the gold standard's restrictions on central bank policy) was the main cause of the banking panic in many countries in the early 1930s. As discussed by Bernanke (1983) in the US case, banking panics disrupt the normal flow of credit to some extent and may affect the performance of the real economy; indeed, if the banking system is sufficiently weakened, even in the absence of a major panic, economic performance would suffer. Bank failures caused ordinary people to hoard gold, affecting the gold standard and triggering an international financial crisis.

2.3 Inefficient policies

The global financial crisis happened because economic policies had no positive effect on the Great Depression of the early 1930s; they acted to strengthen it. Policies are unjust because they are designed to preserve the gold standard, not employment. Maintaining the gold standard would restore employment in time. Central bank officials believe that attempts to directly increase employment will fail. The gold standard was claimed to prevent output and price collapses, as well as the loss of savings when banks collapsed. International gold flows have been hedged by the Federal Reserve and the Bank of England from their normal stabilizing effect on credit conditions. This eliminates the need for price and cost modifications.

A specific amount of paper money can be exchanged for a particular amount of gold under the gold standard, which is a monetary system that links the national currency to the value of gold. Countries on the gold standard cannot increase their paper money circulation without increasing their gold holdings.In fact, the gold standard was already in effect in these European countries before the Great Depression. For example, when the gold standard was back in vogue in Germany, Mussolini was using domestic strains to achieve this result. The Germans were caught in a policy of financial excess that eventually led to hyperinflation. Their experience is considered one of the practical ones that demonstrate the value of the gold standard. When stability was restored through the Dawes Plan in 1924, Mark restored pre-war parity. Germany's adherence to the gold standard and its post-hyperinflation mentality are very strong.

From the late 1800s to the 1930s, several countries, including the United States[7], adhered to the worldwide gold standard. (Many European governments temporarily abandoned the gold standard during World War I in order to print additional money to help the war effort.) The gold standard's global adoption resulted in a fixed currency exchange rate, which helped to spread economic troubles. The United States of America is well known around the world, notably in Europe. Regardless of its impact on the US money supply, the gold standard most likely contributed to the spread of the economic crisis from the US to other countries.When output and inflation fall, Americans tend to buy fewer imports and exports, which are comparatively inexpensive, resulting in trade deficits with other countries. As a result of this mismatch, the United States has seen large outflows of foreign gold, putting pressure on the currencies of countries with depleted gold reserves.

As a result, overseas financial institutions strive to balance trade imbalances by hiking interest rates, which lowers domestic output and prices while also raising unemployment. The ensuing global recession, particularly in Europe, was virtually as bad as the one in the United States. Foreign loans as well as tariffs will be reduced. As the US economy was still growing in the late 1920s, bank lending to foreign countries decreased, owing in part to the relatively high interest rates in the US. Some borrowing countries, notably Germany, Brazil, and Argentina, have had to implement austerity measures as a result of the fall, despite the fact that their

economies were in recession even before the situation in the United States.

2.4 Similar views prevail in other countries as well

Overall, the crisis was so severe in part because the last major peacetime financial crisis was an obvious response, but in 1931, that support was harder to come by interdependently. Under the pressure of the economic collapse, the otherwise interconnected world of markets began to unravel. The destruction of trade relations by the First World War, new tariffs by income-starved successors of Austria-Hungary and industrially minded Latin American governments, and higher tariffs by countries whose domestic industries had been hit by recession, all contributed to the international system structure [8]. But not all Great Depressions started at the same time, and in some countries, the Great Depression came later. Because of the strength and stability of the franc, the Bank of France's desire to keep to the gold standard, and its supposedly indestructible gold reserves, France was initially spared the worst of the recession. When gold convertibility was suspended in the first half of the 1920s, France experienced socially divisive inflation. The budget didn't get out of hand until the government was once again subject to the discipline of the gold standard. Critics argue that ignoring the gold standard would lead to financial excess, economic chaos, and social unrest. Similar views prevail in other countries suffering from high inflation.

3. DISCUSSION

It is widely believed that the gold standard provided a hegemonic ideology and was based on the rhetoric of morality and integrity. In the years before the Great Recession, its discourse dominated public policy debates, and it backed central bankers and politicians as they imposed ever-increasing fees on the general public. Even in the most dire economic conditions, the gold standard mentality has proven impossible to overcome. In 1932, Basil Blackett remarked, "What is astounding is an incredible understanding of the so-called gold mentality," especially among the senior managers of central banks around the world [8]. The gold standard has become one of the board's beliefs, which they believe with great enthusiasm, prevents them from conducting a fair and objective review of possible alternatives.

4. CONCLUSION

In conclusion, the paper finds that the Great Depression happened during the stock market crash of 1929, the global trade collapse caused by the Smoot-Hawley Tariff, government actions, bank failures and panics, and the money supply collapse. The gold standard during the great depression caused export demand in the United States to slow. Deflation was crippled by a sluggish economy, the stock market crisis of 1929, and a subsequent wave of bank bankruptcies in 1930 and 1931.

Besides, historical information shows that the gold standard had a great impact on the Great Depression because of its international mobility and its high recognition. In addition, some factors, like the stock market crash, people who invest only follow the trend, and the recovery after the war, the economic decline also caused the great depression. The shortcoming of this paper may be that the author did not find much substantial historical data or documents left at that time. In the future, the author will focus more on the formation of the economic crisis and the role of the gold standard in it.

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In today's competitive world, those who have the desire to succeed win. A project bridges the gap between the theoretical and practical parts of work. With this eagerness, I decided to participate in this initiative. First and foremost, I'd like to express my gratitude to my parents, to whom I owe a debt of gratitude for raising me with love and encouragement to this point. I feel obligated to take this occasion to express my gratitude to Professor Paul, who first introduced me to economics, and to my deserving instructor, who inspired me to write this paper. Finally, but certainly not least, I am grateful to all of my professors and friends who have consistently assisted and encouraged me throughout the year. I don't have any meaningful words to express my gratitude, but my heart is still overflowing with gratitude for the kindness shown to me by everyone.

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