USII Honors Summer Reading Assignment 2019

Directions:

Please read Chapters 1, 3 and 4 and complete A and B for each chapter. These will be counted as a homework grade. Complete For Further Consideration and note that the instructions are after each reading. These will be counted as a writing assignment.

Common Core Standards: RH.11-12.3, RH11.11-12.5, RH.11-12.9, WHST.11-12.8, WST.11-12.9
Chapter 1
Conservative Policies and Presidents, 1921–1933

Introduction

Throughout American history, major changes in public opinion have occurred roughly every ten to 20 years because people want to make changes in the relationship of the government to the economy. Sometimes they elect liberal (sometimes called progressive) presidents and congresses because they want the government to do more to help lower-income and middle-class people, to regulate business, and to protect the environment. Because liberal leaders sometimes end up doing more than the people who elected them wanted them to do, they get voted out of office and replaced by more conservative politicians, who usually scale back the scope of government spending and regulation. During the Progressive Era (1900–1920), for instance, liberal presidents Theodore Roosevelt and Woodrow Wilson used the national government to protect workers and consumers from unregulated big businesses. It seemed that the U.S. government was on a crusade to reform everything from business practices to tenement houses to the consumption of alcohol. Beginning in 1917, President Wilson extended his crusade into foreign policy to “save the world for democracy,” and advocated his idealistic Fourteen Points as a blueprint to achieve this objective. By the time the fighting ended, the American people had grown tired of liberal crusades, rejected the League of Nations, and returned to a more conservative foreign policy. Most citizens just wanted to take care of their own businesses and have a good time. The presidents and the congresses they elected in that period (1920–1930) expressed this newfound conservative mood. In this chapter, you will learn about the three men who served as U.S. presidents during the 1920s and their ideas on governing the country.

Warren Harding—A Conservative President

Warren Harding was the first conservative president elected in the 1920s. Since Harding came from Ohio, a swing state in presidential elections, party bosses decided to nominate him for president. Another reason he was nominated was that the most respected Republican men in the party had taken unpopular stands on important issues. Harding, with an undistinguished record as a lieutenant governor and senator, had not taken significant stands on any issues. However, his appearance radiated authority and dignity and he had made few enemies. Businessmen liked him because he was a conservative and would do what they wanted. Republican Party political bosses liked him because he did not know enough about politics to run the country without their advice. They nominated him in a closed convention after
a backroom deal and chose Calvin Coolidge of Massachusetts as his running mate because he had taken a strong stand against a policeman’s strike in Boston.

In a speech in Boston in May 1920, Harding said what the country needed was not heroes but healing, not new government experiments but a return to “normalcy,” not “revolutions but restoration; not agitation but adjustment.” It mattered little that the word “normalcy” was not in the dictionary, for American voters longed to return to the “good old days” of the 1890s, when President McKinley promised a “full dinner pail” and neither international responsibilities nor domestic reforms were the orders of the day. Harding’s campaign speeches played on this longing. He plucked a favorite chord by taking a stand for “happiness” as the greatest thing in the world. In his rhapsodies on normalcy, he declared himself in favor of peace, honesty, private enterprise, Americanism, low taxes, and a balanced budget. He campaigned in the traditional manner by remaining in his Ohio home where he received visiting delegations and played horseshoes. He was in the words of his supporters “no world beater,” but he gave voice to a mood most Americans shared; and he was elected over the Democratic ticket of James Cox (also of Ohio) and future President Franklin D. Roosevelt by a landslide with 61 percent of the popular vote.

“The Best Minds”

Warren Harding was aware of the fact that he really did not know enough to run the country. He therefore tried to get the men with the “best minds” in the country to tell him what to do. Some of these minds did make it into the president’s cabinet, including Herbert Hoover, a successful businessman with a distinguished record of public service whom Harding appointed Secretary of Commerce, and Charles Hughes, a former presidential contender and later Chief Justice of the Supreme Court, who became Secretary of State. Andrew Mellon, who had made a fortune with the Aluminum Corporation of America (ALCOA), resigned from 60 corporate directorships to take a position in Harding’s cabinet as Secretary of the Treasury.

Hoover, Mellon, and most other of Harding’s cabinet members were wealthy men who believed what was good for rich Americans was good for the country as a whole. These men gave America a conservative government, which pleased American businessmen from John D. Rockefeller to the corner grocer. In addition to Hoover, Hughes, and Mellon, Harding appointed some of his own friends and political associates who had neither the “best minds” nor the best morals. They included Harry Daugherty, Harding’s campaign manager, as Attorney General and Albert Fall as Secretary of the Interior. Daugherty was later accused of selling pardons and liquor permits, but was acquitted when a jury failed to reach a verdict after deliberating for 62 hours. Fall was later found guilty of receiving “loans” of $400,000 for leasing valuable government oil lands at Teapot Dome, Wyoming without competitive bids.
Presidents Coolidge and Hoover

When Warren Harding died in 1923, Americans were just beginning to realize how much money his friends had taken from the government. However, these scandals were soon forgotten as Harding’s vice-president, Calvin Coolidge, took control of the office that Harding had disgraced. Coolidge had attracted national attention as governor of Massachusetts by standing up to striking Boston police officers in 1919. He called the National Guard and made sure all who disregarded their public duty were fired. Coolidge’s warning that no one had the right to strike against the public good convinced Republican leaders he would help Harding win the election.

As President, Coolidge ran a tight ship. He got rid of the thieves in Harding’s government and replaced them with honest public servants. He asked Congress to reduce taxes and balance the budget. He vetoed attempts to give money to American farmers and helped reduce income taxes. Coolidge summed up his philosophy of government with his famous statements that “the business of America is business,” and the less famous statement that “a man who builds a factory builds a temple.” In keeping with his laissez-faire philosophy, Coolidge aspired to be the “least” president that the U.S. ever had and is said to have succeeded in that regard. He proposed no major legislation, was known for his many veto messages, took long naps in the afternoons, made few appointments, and said little to those who managed to see him.

After Coolidge decided not to run for reelection in 1928, the Republican Party chose Herbert Hoover to round out 12 years of conservative rule. Raised by uncles who could not afford to send him to college, Hoover worked his way through Stanford University. He earned his first million as a mining engineer before he was 40 and then devoted himself to public service. He gained universal fame and respect before and after World War I for heading organizations that provided relief to war victims, and for his service in the Harding-Coolidge cabinet as Secretary of Commerce. During the campaign, Hoover promised to continue the policies of the previous years:

When the Republican Party came into full power [in 1921] it went at once resolutely back to our fundamental conception of the State and the rights and responsibilities of the individual. Therefore it restored confidence and hope in the American people, it freed and stimulated enterprise, it restored the Government to its position as an umpire instead of a player in the economic game. For these reasons the American people have gone forward in progress while
the rest of the world has halted, and some countries have even gone backwards.

By adherence to the principles of decentralized self-government, ordered liberty, equal opportunity, and freedom to the individual, our American experiment in human welfare has yielded a degree of well-being unparalleled in all the world. It has come nearer to the abolition of poverty, to the abolition of fear of want, than humanity has ever reached before. Progress of the past seven years is the proof of it.
Student Activities

A. Student Exercises

In the opinion of American voters at the time, what outstanding qualifications did Harding, Coolidge, and Hoover have that seemed to prepare them to lead the nation? Comment on each man's qualifications.

B. Graphic Organizer

Match each of the statements below this chart with the president to whom it could/should be attributed.

<table>
<thead>
<tr>
<th>Matches Most Closely with Which President?</th>
</tr>
</thead>
<tbody>
<tr>
<td>President Harding</td>
</tr>
<tr>
<td>President Coolidge</td>
</tr>
<tr>
<td>President Hoover</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Claimed prosperity of 20s due to policies he supported</th>
<th>Decided not to run for reelection in 1928</th>
</tr>
</thead>
<tbody>
<tr>
<td>Died in office</td>
<td>Slept a good deal while in office</td>
</tr>
<tr>
<td>Strove to be the &quot;least president&quot; he could be</td>
<td>Known for corruption of people he appointed while in office</td>
</tr>
<tr>
<td>Believed in 'normalcy'</td>
<td>Was a millionaire by the time he was 40</td>
</tr>
<tr>
<td>Known for claiming that &quot;the business of America is business&quot;</td>
<td></td>
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</tbody>
</table>
For Further Consideration:
Conservative Policies of Harding, Coolidge, and Hoover

Only a few important differences existed between the conservative beliefs of presidents Harding, Coolidge, and Hoover. Their ideas and policies therefore are summarized below:

Laissez-Faire Policies

Conservatives believed that government should not interfere with the normal operations of the economy. Wages, prices, recessions, inflation—conservatives thought that all these problems had a way of resolving themselves. In the conservative view, the sum total of every individual looking out for what was best for them or their business would result in the best for everyone. If some businessmen were unsuccessful, or if people ended up in poverty, not to worry—it was the natural order of things for the fittest to survive and government should not interfere with it.

Examples of these ideas as carried out during the 1920s:

Veterans' bonuses—Soldiers who fought in World War I were paid only $16 a month. They would have made much more if they had stayed out of the army and continued their civilian jobs. They asked the government to pay them a bonus of $500 dollars, which they would collect when they retired in 1945 to make up for what they had lost in their years of service. Harding, Coolidge, and Hoover opposed that plan.

Problems on America's farms—During World War I, farmers expanded the size of their farms to produce food to help the Allies. When the war ended in Europe, food production soon returned to prewar levels. Deprived of this market, U.S. farmers were left with wheat, corn, and other products they could not sell. Because they had borrowed heavily during the war to keep up with demand, many farmers could not pay their debts. Banks started to call in farm loans and farmers often had no choice but to sell their farms. Farmers led by Congressmen Charles McNary and Gilbert Haugen asked the federal government to buy the surplus farm products and sell them at a loss to other countries. Liberals supported this plan but conservative presidents Harding, Coolidge, and Hoover opposed it.

Laws regulating competition—Presidents Harding, Coolidge, and Hoover made few attempts to enforce laws against unfair competition, conspiracies to raise prices, and insider trading or similar practices in the stock market. In fact, businessmen were encouraged to plan together in order to avoid waste and unnecessary competition. Despite complaints by liberals, the conservative presidents during the 1920s practiced laissez-faire beliefs regarding business regulation.

Muscle Shoals Project—During World War I, the national government started building a dam at Muscle Shoals on the Tennessee River to power two plants that would make
nitrates. These chemicals, used to manufacture explosives, could also be used to make fertilizers. After the War, liberals thought the government should complete this dam. The power generated by the dam could be used to make inexpensive fertilizers and electricity for the people living in the area. Coolidge and Hoover opposed this plan. They wanted privately owned businesses, not the government, to build the dam and sell the electricity.

**Trickle-Down**

Conservatives also held a fundamental belief in the trickle-down principle. They thought that what was good for the rich and good for business would benefit the entire country because their wealth would “trickle down” to the poor in the form of jobs and opportunities to make money.

**Examples of these ideas as carried out during the 1920s:**

**Tax reduction**—The tax rate under the three conservative presidents was reduced from 73 percent on the part of taxable incomes that exceed $1 million (about 15 million in today’s dollars) to 25 percent on such high incomes. These new rates saved Secretary of Treasury Andrew Mellon and his family about $2 million a year. Not only were taxes for the rich reduced, money was rebated to businesses and people who had already paid their taxes under the old rates. Altogether, the government returned $3.5 billion in this way.

**Raising taxes on imports**—Conservatives raised tariffs shortly after World War I. The Fordney-McCumber Tariff under President Harding reversed the first major tariff reduction since the Civil War. The Hawley-Smoot tariff of 1931 under Herbert Hoover raised tariffs to an all-time high. It protected most businesses from competition from foreign goods. However, it also increased the cost of goods bought by American consumers and led foreign countries to raise tariffs on goods made in the U.S. Liberals strongly opposed these rate hikes.

As we have seen, conservative policies from conservative presidents were based on beliefs in *laissez-faire* and trickle-down. Conservatives thought these policies would help the whole country, not just businesses and the rich.

Write two strong paragraphs explaining why the U.S. should or should not have followed *laissez-faire* and trickle-down policies during the 1920s; be prepared to present your opinion, to listen to the opinions of others, and to either defend your own or change your mind.
Chapter 3
Prosperity: Fact or Myth

Introduction

The so-called “Roaring Twenties” has become known for unrestrained but illegal drinking, the crimes of Al Capone, long home runs blasted by Babe Ruth, the cross-Atlantic flight by Charles Lindbergh, reckless youths dancing the Charleston, a soaring stock market, and seemingly unending prosperity. True, farmers and miners did not share in the good times, and business profits increased much faster than wages, but more Americans owned stocks and enjoyed shiny new gadgets in 1929 than ever before. For the first time in history, most middle-class couples owned a car, a radio, a refrigerator, and a house. These couples probably shared the belief that the United States was about to do the impossible: abolish poverty. Comfortable Americans didn’t really care that farmers weren’t doing well (why not migrate to the city?), that many people were poor (maybe they weren’t working hard enough?), or that the prices paid for stocks were too high (wasn’t the market a reflection of confidence in the future?).

We now know that the prosperity of the Twenties did not last. With the benefit of 20-20 hindsight, one might ask whether the prosperity of the 1920s was only a golden illusion, and whether people were blind to the weak spots in the economy, which should have warned of the depression that followed. This chapter will help you answer that question.

The New Ford

The date was December 2, 1927. The grand event was the first showing of the brand new Model A Ford, which Americans and Europeans had been excitedly awaiting for 18 months. In New York, 1.1 million people waited eagerly outside the 76 Ford showrooms. In Detroit, 100,000 people stormed into dealers’ showrooms, and in Madrid, nearly 150,000 Spaniards attended the showing.

There was good reason for this excitement. Henry Ford had produced the most popular and cheapest car in the world. For 18 years, his Model T dominated the automobile market, and he sold more than 15 million vehicles. The Model T outlasted other cars by an average of nearly two years and undersold its nearest competitor by more than $100. Between 1921 and 1926, it accounted for 40 percent of the automobile market. When Ford suddenly dismissed 100,000 workers to change his assembly lines in order to produce his new model, Americans waited patiently. Many put off buying another car until they could take a look at the new Ford.
The Model A was a definite improvement over the Model T. The new Ford was lower, faster, and more comfortable than the old Model T. It could reach a top speed of 65 miles an hour compared to the 40 miles an hour of the older car. The Model A was the only low-priced car with hydraulic shock absorbers to give it a smooth ride instead of the bone-shaking discomfort of the Model T. While Ford once said, you could have the old “tin lizzy” in any color you wished as long as you wanted black, the new Ford was available in other colors; Gun Blue, Dawn Gray, and Arabian Sand. The price of the new car was almost the same as the old. New Yorkers were so favorably impressed that, on the first day, they ordered 50,000 of them.

**More and Better Cars**

In 1919, 6,771,074 passenger vehicles were registered in the United States. In ten years, this figure leaped to 23,122,100—almost one car per family. The cars of 1929 were cheaper than those of 1919, averaging $621 rather than the previous $888; they were also better, faster, and flashier. Production in 1929 reached more than 4.58 million vehicles, tripling the number produced in 1919. American factories built seven-eighths of the world’s cars and exported 500,000 vehicles each year.

**Impact of the Automobile**

The footwear industry felt the impact of the automobile: people rode rather than walked and wore out tires instead of shoes. Railroads found that they couldn’t compete with cars, buses, and trucks, and thus began a long decline. However, automobiles required replacement parts and services, giving birth to a range of new businesses. Gasoline stations sprang up like mushrooms and were accompanied by billboards, roadside hot dog stands, restaurants, and camp sites. The automobile motorized crime: bootleggers ran whiskey hidden under the seats of old Fords, and bank robbers could attempt their getaways in stolen Pierce Arrows pursued by policemen in hopped-up Chevrolets.

Americans discovered they could live further from the center of cities and began moving into the suburbs. Farmers marketed eggs in the backs of their old Model Ts and trucked vegetables and dairy products to the cities. Even courtship patterns were greatly influenced by the automobile: the car replaced the parlor as the place where pleading suitors “popped the question,” and parents feared for their daughters’ virtue when boyfriends appeared in flashy automobiles.

By 1926, Americans were spending $6 billion yearly on purchases connected with their cars. Production of automobiles alone accounted for 12.7 percent of all manufacturing done in the country. People spent millions on items connected to the automobile. City, state and federal governments spent $1.5 billion each year building roads. Restaurants, resorts, tourist camps, and vacation spots were constructed to serve the customers brought by the automobile from all over the country.

Other products also sparked economic development—especially radios and movies. In 1920, the first radio sets appeared on the market. By 1922, sales totaled $60 million, but the craze had not yet really caught on. Over the next two years, sales more than doubled, and by 1929, Americans had spent $3.4 billion on radios. Moviemakers glamorized their products by introducing the public to stars such as Douglas Fairbanks and Mary Pickford. By 1930, weekly attendance exceeded 50 million. Other industries were also very successful. With the coming of electric power to most homes, people spent their money on telephones, refrigerators, vacuum cleaners, and washing machines.

During the 1920s, the average American’s income went up by 20 percent. This gave them the money to purchase 27 million automobiles and 3.5 million new homes. Nine million homes were wired for electricity, six million phones were installed, and seven million radios were sold. School and college enrollments increased by 75 percent. Of course, not all of this was paid for; mortgages aside, installment purchases increased by $6 billion.

The Stock Market Jumps

The wealth and optimism of the 1920s was reflected in the rise in the price of stocks. Between 1921 and 1925, prices of common stock doubled. However, after 1928 (for reasons explained in the next chapter) the price of stocks increased spectacularly, and this news flashed across the front pages of the country’s leading newspapers. Many people who should have known better invested their life’s savings in stocks, and more than 600,000 people bought them with borrowed money.

More than five million shares of stock were bought and sold every day. Shareholders did not make money on the dividends (profits) corporations earned, but on the rise in the prices of the shares of stocks. The more expensive stocks got, the more people wanted them. Some stocks jumped up by ten and even 20 dollars per share in a single day. By 1928, common stocks sold at an average of three times their 1921 values and were still being bid up. Many insiders thought the price of stocks would never stop rising. Brokers, bankers, and even government officials supported this belief. More than one million Americans became financially committed to the market.

By 1929, common stocks sold for four times their 1921 prices, but few people worried. Stock values, it was thought, reflected the condition of the American economy, and in a way they did.
Is There Anything Worrisome About This Picture?

Statistical analysis should not be limited to mathematics classes. It can offer some important insights for students of history and economics. Take careful note of what the following statistics might reveal:

- Between 1920 and 1929, national income shot up by $22 billion, from $60 billion to $82 billion.
- Productivity (the amount produced in each working hour) increased by 25 percent during the 1920s at a rate of 3.5 percent a year, while real wages increased by 15 percent per person (mostly recorded between 1920 and 1923). Business profits increased 62 percent.
- The richest 36,000 families had incomes equal to the earnings of the poorest 12 million.

About $10 billion of the $15 billion dollars saved in 1929 were used to buy stocks and bonds. Much of this money merely increased the value of stocks that had already been sold.

Many Americans could not help but see what was wrong with this picture of uneven prosperity. Not everyone benefited—certainly not the farmers who were buried under a surplus of wheat, cotton, or corn nor the miners who found the need for coal slackening while unsold surpluses mounted. Textile and leather workers were overproducing and could not command prosperity wages. Most African Americans, Latinos, and Asians lived in abject poverty in America as they had for centuries. Doctors and lawyers in 1929 had average net incomes a bit more than $5000. The best-paid teachers in city schools received $2000, but many teachers in rural schools received as little or less income as workmen who averaged only $1500. Estimates of a family minimum income necessary for "health and decency" ranged between $1820 and $2080.

Fact or Myth?

In 1928, Republican presidential candidate Herbert Hoover predicted that the United States was nearing a time when it would conquer poverty. Hoover pointed proudly to statistics showing that the national income was rising and concluded that more Americans now enjoyed the material rewards of life than ever before. The future looked rosy, and Hoover credited the conservative policies of the past eight years. The nation approved of his judgment with a resounding vote of confidence in the presidential election of 1928.
Student Activities

A. Student Exercises:

1. What evidence supports the argument that many Americans were better off in the 1920s than ever before?

2. What signs existed of real weaknesses in the economy during the 1920s? Do you think that these signs should be viewed as a warning that something was seriously wrong with the economy? Why or why not?
### B. Graphic Organizer:

Place the phrases accompanying the chart under their appropriate headings.

#### Graphic Organizer Chart

<table>
<thead>
<tr>
<th>Signs of real prosperity</th>
<th>Signs that something was seriously wrong with the economy</th>
<th>Irrelevant to the question of whether prosperity was real or false</th>
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</tbody>
</table>

#### Phrases to Place in Graphic Organizer

<table>
<thead>
<tr>
<th>Wages did not keep up with the amount the average worker produced in a day</th>
<th>The price of stocks increased fourfold during the 1920s</th>
<th>More people than ever bought goods on credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>50 million people went to the movies each week</td>
<td>9 million homes were wired for electricity</td>
<td>Prices of stocks were rising much faster than earnings</td>
</tr>
<tr>
<td>Babe Ruth hit 60 home runs in 1927; a record not equaled until 1961</td>
<td>Lots of people were drinking illegally</td>
<td>The new Ford was much better and cheaper than the old one</td>
</tr>
<tr>
<td>Charles Lindbergh became the first pilot to fly from the U.S.A. to France</td>
<td>The total earnings of the 12 million poorest families was less than the total of the richest 36,000 families</td>
<td>Farmers were producing more food than people could afford to buy</td>
</tr>
<tr>
<td>Car sales and ownership tripled during the 20s</td>
<td>More people danced the Charleston</td>
<td>Mary Pickford was a movie star</td>
</tr>
</tbody>
</table>
For Further Consideration: The Causes of the Depression

Assume the role of an economist living during the 1920s and write a strong paragraph warning Americans that the country is heading for a depression. Come to class ready to present your argument, listen to the opinions of others, and either defend yours or change your mind.
Chapter 4
Rise and Crash

Introduction

The period between March 1928 and September 1929 is famous in America's economic history. It was the time of a "bull market" (i.e., one characterized by rising prices). During that time, Americans were obsessed with the idea of buying stocks. Some stocks went up by as much as 700 percent. People invested their life's savings in the stock market. Others borrowed huge sums of money in the hope of getting rich quick, and many thought it a sin not to invest. Average people—cab drivers, housewives, construction workers, and waiters, as well as millionaires and brokers—were totally invested in the stock market.

What made people so interested in buying and selling stocks? Why did the stock market rise so rapidly during that period of time? What caused it to collapse so suddenly 18 months later? These are some of the questions that this chapter will help you answer.

March 3, 1928

The Great Bull Market started on a particular day—March 3, 1928. That was the day Michael J. Meehan and a group of friends decided to make money by fooling a lot of people. They formed a plan to buy and sell shares of RCA (Radio) stock to each other. This arrangement is called a "pool." The idea behind their scheme was to cause the price of the stock to rise, unload it on people who did not know what they were doing, and emerge with a great profit. Here is how it worked:

At the start of the business day, Meehan sold 200 shares of RCA stock at its opening price of $94.50. His friend sold the same 200 shares to another friend at $95 a share1. The next sale of the same stocks was at $96.00, followed by $97.50, before Meehan bought back his original shares at $98.25 each.

For those following the ticker tape, the sales just described were recorded as follows:

R.2.941/2; R.2.95; R.2.96; R.2.971/2; R.2.981/4.

People who read the ticker did not know that all the buying and selling was done by a couple of friends planning to fool the public. However, that is exactly what

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1 Although the numbers given as an illustration are not real, the example is an accurate portrayal of what actually happened.
Meehan and his co-conspirators were doing, and they succeeded. Buyers interested in getting rich quickly saw the price of RCA going up and began to buy large amounts of this stock. On March 12, 1928, RCA went up by $12.00 a share. The next day the price rose by $18.00. By the end of March, RCA was selling for $195.00—a gain of more than $100 from the opening price of March 3rd. Now, Meehan and his friends sold their shares and split a profit of around $10 million between them. Had they held on to their shares of RCA, they would have realized far more profit. Before the Crash of 1929 ended the Great Bull Market, RCA was selling for $505 a share.

Michael Meehan and his friends gained the public's interest in the stock market. As the dramatic gains became front-page news, a speculative fever swept the country. RCA stock, of course, was not the only game in town. Other popular stocks at the time included GM, (General Motors), U.S. Steel, and Goldman Sachs. Some performed as well as RCA, and others did even better but all attracted people who thought they could get rich quickly.

### Buying on Margin

Once people became interested in buying stocks, they wanted to invest as much money as possible. They even wanted to invest money they did not have!

Smart money managers came up with a plan to help people borrow money to invest in the market: buy the stock on credit! In those days it was called "margin." It worked like this: You put a certain amount of money down—usually about 25 percent of the price of the stock, sometimes even less. That was the margin. Your broker would borrow the rest from a bank. Since the bank could "call in" (i.e., ask your broker to repay your loan) at any time, the money was referred to as "call money." If the market went up, this plan could help you increase the money you invested and therefore increase your profits.

Suppose you bought a share of RCA stock for $100 in March 1928. Your margin requirement of 25 percent would mean you invested $25.00 of your own money and your broker borrowed $75.00 in your name. If you kept this stock until September of 1929, you could sell it for $500. Your profit would be $400.00. Since you only invested $25.00 of your own money, your profit would be 15 times your original investment, or 1500 percent!

<table>
<thead>
<tr>
<th>Paid for stock</th>
<th>Sold stock for</th>
<th>Profit on sale</th>
</tr>
</thead>
<tbody>
<tr>
<td>$100</td>
<td>$500</td>
<td>$400</td>
</tr>
<tr>
<td>Money borrowed</td>
<td>Money paid back</td>
<td></td>
</tr>
<tr>
<td>$75</td>
<td>$75</td>
<td></td>
</tr>
<tr>
<td>Own money invested</td>
<td>Profit made</td>
<td>% profit:</td>
</tr>
<tr>
<td>$25</td>
<td>$400 - 25 = $375</td>
<td>$375/25 = 1500%</td>
</tr>
</tbody>
</table>
Margin in Reverse

While margin worked its magic when the market went up, it could do a great deal of damage when the market went down. People who bought stocks during the high point of the stock market would be forced to sell when the market started going down because bankers and brokers would need more money to cover their loans and would call in outstanding debts.

As margin encouraged people to buy stocks while the market was rising, it would also force people to sell their stocks when the market was falling. When people sell their stocks, prices come down. Declining prices cause more people to sell their stocks to cover their loans, and this in turn causes prices to go down even further. Thus, margin was a time bomb waiting to go off if something started the stock market on a downward course.

Imagine buying a stock for $500, with 25 percent of the cost paid out of pocket, and a loan of $375. Should the stock go down to $25, you would have lost $475, almost four times more than you invested.

The Market Heads Down

By September 1929, the stock market was like a sponge full of water. It could not soak up any more stocks. People were no longer buying new stocks—investors were a little jittery. Prices were too high. No new money was coming into the market. The stock market started going down when British investors began selling their stocks. They were having problems in England and needed the money at home.

In October 1929, the banks began to get worried. Too much money had been lent out on margin, and they began to call in loans. People were forced to sell their stocks so they could repay their loans, and prices began to fall. Even people in more secure positions became jittery and began thinking maybe it was time to sell. After all, the good times couldn’t last forever.

On October 23, 1929, so many people tried to sell their stocks that the ticker tape ran two hours late. This caused even more panic sales. Brokers spent long hours in the morning trying to balance their books. In account after account, their clients had used up their margin and needed to raise more money.

October 24th was even worse than the 23rd. Investors were forced to put blocks of stocks on sale, sometimes totaling 10,000 shares at a time. There was absolute chaos on the New York Stock Exchange. Goldman Sachs lost $30 per share in two hours. Other stocks seemed headed for even greater losses.

At this point, a pool of bankers got together to temporarily save the stock market. They bought up thousands of shares of stocks to stop the fall in prices and
restore people’s confidence. However, all they did was to call a short-lived halt to
the approaching crash as they quietly sold their stock before the market collapsed
completely. Too many margin accounts were exhausted by the fall in prices on October
24th. On October 29th, a huge volume of sales orders flooded the stock market. One
writer described the scene on the floor of the Stock Exchange that day:

The big gong had hardly sounded in the great hall of the Exchange at ten o’clock Tuesday
morning before the storm broke in full force. Huge blocks of stock were thrown upon the
market for what they would bring. Five thousand shares; ten thousand shares appeared at a
time on the laboring ticker at fearful recessions in price. Not only were innumerable small
traders being sold out, but big ones, too—who a few weeks before had counted themselves
millionaires. Again and again the specialist in a stock would find himself surrounded by
brokers fighting to sell—and nobody at all even thinking of buying.2

With the near absence of buyers, one stock that had earlier sold for $48 a share
was bought for one dollar. Even the best stocks dropped as much as $60.00 a share.

As to the cause of the collapse, an observer speculated:

It seems probable that the principle cause of the break in prices...was forced selling. It was
the dumping on the market of hundreds of thousands shares of stock held in the name of
miserable traders whose margins were exhausted or about to be exhausted. The gigantic
edifice of prices was honeycombed with speculative credit and was now breaking down
under its own weight. All in all, stocks lost $40 billion of their value. [A comparable loss
today would be far more than 1 trillion dollars.]3

October 29th was a nightmare. Fortunes were lost; people who were rich in the
morning found themselves penniless that night. Dreams and hopes died as life savings
disappeared. Expensive stocks turned into worthless pieces of paper. Some dejected
investors jumped out of their office windows and others went home, put their heads in
their ovens, and turned on the gas.

October 29th was also the end of an era. The stock market crash took the
bloom off the prosperity of the 1920s. In the following years, unemployment jumped
from one to thirteen million. Industrial production was practically cut in half. Millions
lost their businesses, their homes, and their farms. America entered into the greatest
economic crisis it has faced before or since.

Just as the stock market had climbed during the prosperity of the 1920s, it
fell during the depression that followed. The accompanying charts show just how far

3 op. cit.

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prices collapsed. Note, in particular, the average for the 50 leading stocks.

<table>
<thead>
<tr>
<th>Stock</th>
<th>Dividends</th>
<th>Prices in dollars as of:</th>
<th></th>
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<tr>
<td></td>
<td>1927</td>
<td>March 3, 1928</td>
<td>Sept. 3, 1929</td>
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<tr>
<td>U.S. Steel</td>
<td>7</td>
<td>138</td>
<td>261</td>
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<tr>
<td>Goldman Sachs</td>
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<td>American Can</td>
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<tr>
<td>Avg. 50 Leaders</td>
<td>176</td>
<td>307</td>
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Student Activities

A. Student Exercises:

1. How did Michael Meehan and his friends help cause the rise of the Great Bull Market?

2. How did margin cause the price of stocks to rise far beyond what they were worth (according to their P/E ratios)? How did not meeting margin requirements cause the price of stocks to fall?

3. How did the pool of bankers manage to escape being caught in the market crash of 1929?
For Further Consideration: The Sub-Prime Crisis of 2008

We are going through a financial crisis more severe and unpredictable than any in our lifetimes. We have seen the failures, or the equivalent of failures, of Bear Stearns, IndyMac, Lehman Brothers, Washington Mutual, Wachovia, Fannie Mae, Freddie Mac and the American International Group. Each of these failures would be tremendously consequential in its own right. But we faced them in succession, as our financial system seized up and severely damaged the economy.

—Secretary of Treasury Henry Paulson, November 18th, 2008

To understand the cause of this crisis, look at the case of a typical but fictional buyer:

Like most Americans, Mr. Senteris dreamed of owning a home for his wife and three children. He found something that would meet the needs of his family, but at a price he never thought he could afford—$300,000. Senteris’s income was only $54,000 and a 4 percent interest would make his home payments of $12,000 a year consume much of his take-home pay of about $45,000. Never mind, his broker told him, “I can fix you up with an ARM [Adjustable Rate Mortgage] and you won’t even have to come up with a down payment. You’ll start at four percent, and the rate won’t go up for two years. After two years, you can borrow money using your house as collateral because its value is bound to increase."

Two years later, Senteris was sitting in his dream house with a debt of 325,000, and an eight percent mortgage that would cost him over half his yearly take-home earnings to pay. Moreover, in a declining market, the value of his house had decreased. Since he had no equity in it, he could not use it as collateral on another loan; he would have to empty his savings account and face foreclosure in a year or two.

What was a private tragedy for Senteris was a public catastrophe for the investment houses and banks that had contracted what is known as sub-prime (below market rate) loans with adjustable rates (ARMs). Millions of these types of loans were packaged into bundles called Mortgage Backed Securities (MBS). They were bought on

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4 In 2005, the median down payment for first-time homebuyers was 2 percent, with 43 percent of those buyers making no down payment whatsoever.

the assumption that the loans would be paid or the foreclosed properties would be worth more than was owed (in November 2008, 7.5 million homeowners owed more on their houses than they could sell them for.) Because of the unexpected downturn in the housing market, these securities were not worth what investors had paid for them.

In addressing the American people about the problems caused by optimistic and predatory lenders, irresponsible and often misinformed borrowers, and foolish as well as greedy financiers, President George W. Bush explained:

Many mortgage lenders approved loans for borrowers without carefully examining their ability to pay. Many borrowers took out loans larger than they could afford, assuming that they could sell or refinance their homes at a higher price later on. Both individuals and financial institutions increased their debt levels relative to historical norms during the past decade significantly.

Optimism about housing values also led to a boom in home construction. Eventually the number of new houses exceeded the number of people willing to buy them. And with supply exceeding demand, housing prices fell. And this created a problem: Borrowers with adjustable rate mortgages [i.e., those with initially low rates that later rise] who had been planning to sell or refinance their homes before the adjustments occurred were unable to refinance. As a result, many mortgage holders began to default as the adjustments began.

These widespread defaults [and related foreclosures] had effects far beyond the housing market. Home loans are often packaged together, and converted into financial products called “mortgage-backed securities.” These securities were sold to investors around the world. Many investors assumed these securities were trustworthy, and asked few questions about their actual value. Credit rating agencies gave them high-grade, safe ratings...

The decline in the housing market set off a domino effect across the U.S. economy. When home values declined, borrowers defaulted on their mortgages, and investors globally holding mortgage-backed securities...began to incur serious losses. Before long, these securities became so unreliable that they were not being bought or sold. Investment banks such as Bear Stearns [where stock selling for $70 a share had to be sold for $2.00 a share]...found themselves saddled with large amounts of assets they could not sell. They ran out of the money needed to meet their immediate obligations...

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6 Or as Thomas Friedman wrote in the New York Times on the sub-prime mortgage crisis: “So many people were in on it: People who had no business buying a home, with nothing down and nothing to pay for two years; people who had no business pushing such mortgages, but made fortunes doing so; people who had no business bundling those loans into securities and selling them to third parties, as if they were AAA bonds, but made fortunes doing so; people who had no business rating those loans as AAA, but made fortunes doing so; and people who had no business buying those bonds and putting them on their balance sheets so they could earn a little better yield, but made fortunes doing so.” New York Times, November 26, 2008

Write a strong paragraph or two pointing out the essential similarities and the essential differences between the causes of the sub-prime mortgage crisis of the year 2008 and the causes of the stock market crash of 1929. Come to class prepared to explain your views, listen to the opinions of others, and defend or reexamine your beliefs.