Proceedings of 3rd International Conference on Interdisciplinary Humanities and Communication Studies
DOI: 10.54254/2753-7064/51/20242533

Analysis of the Impact of Major Economic Crises on Political Stability: Taking the World Economic Crisis in 1930 as an Example

Chengzu Ge[1,a,*]

[1]Hangzhou Senior High School, Hangzhou, 310000, China
a. ggbao0572@gmail.com
**corresponding author*

Abstract: Since the first general economic crisis in Britain in 1825, the world has repeatedly faced economic shocks. The growing interconnectedness of the global economy has amplified both the intensity and scope of these crises. Following World War II, the rapid expansion of the financial sector stimulated global economic growth. However, its complexity also introduced significant uncertainties and instabilities. Asset securitization implies that capital value is not solely determined by productive forces it supports, but is also subject to unpredictable behavior of market participants. Insufficient information can trigger stock market crashes and asset devaluation, causing widespread panic that ultimately affects the real economy. Despite efforts by major economies to stabilize markets through fiscal and monetary policies, policymakers are human beings who possess inherent uncertainties and often adopt short-term approaches with unintended consequences. Efforts aimed at addressing current challenges may inadvertently lay the foundations for future problems due to their butterfly effect nature. Moreover, economic globalization can exacerbate these issues, highlighting a fundamental aspect of modern economic challenges. Using the Great Depression of 1930 as an example, this paper focuses on exploring political and economic factors contributing to outbreaks of economic crises and government measures taken to address them. Studying the Great Depression provides important historical lessons for today's policymakers, enabling them to better assess potential risks and formulate appropriate policies when facing economic crises. It also analyzes banking system fragility and financial markets susceptibility to failure without government regulation, aiding prevention of similar crises.

Keywords: Major economic crisis, political stability, impact analysis.

1. Introduction

In the context of globalization, economic crises have become a major concern for governments and academia worldwide. The rapid development of social economies and interconnected financial markets have amplified the impact of economic crises in terms of both scope and depth. Following the global financial crisis in 2008 and the pandemic in 2020, many countries still face severe challenges such as sluggish economic recovery, high unemployment rates, and increasing social inequality. These issues not only hinder stable economic development but also pose threats to political

DOI: 10.54254/2753-7064/51/20242533

stability and social harmony. Against this backdrop, this research focuses on exploring the political and economic factors behind the Great Depression of 1930, as well as evaluating government responses. By conducting an in-depth analysis of this historical event, this paper is expected to provide new perspectives on addressing current economic crises. Although there has been extensive research on the Great Depression, there are still certain limitations in analyzing its deeper causes and its influence on subsequent policy-making. In particular, there is a lack of systematic assessment regarding the timeliness and effectiveness of government policy responses. Therefore, this paper will approach the topic from a new angle, integrating modern economic theory to explore the implications of the Great Depression for today's economic policies.

This research holds significance not only in terms of theoretical contributions but also provides practical guidance by enhancing the understanding of complex economic crises' impact on political stability, offering valuable insights for contemporary policymakers.

2. Overview of Economic Crisis

2.1. Definition and Characteristics

An economic crisis, in broad terms, refers to a prolonged period of contraction in one or more national economies or the global economy, typically accompanied by several characteristics: slowing or negative economic growth, high unemployment rates, increasing corporate bankruptcies, and reduced investment and consumption. According to Adam Smith's conception in "The Wealth of Nations," in a free economy with market self-regulation, individual self-interest translates into factors that promote vigorous economic development, making everyone wealthier [1]. However, a perfect competition market is only ideal; those who have perfect information or have inherent advantages will be much more competitive. As a result, the market does not distribute resources fairly, leading to a winner-takes-all phenomenon and worsening wealth inequality, with wealth inevitably flowing to the elite. As productivity continues to rise, capitalists as individuals cannot consume all the goods produced, while ordinary consumers with genuine demand increasingly find it difficult to afford these goods, resulting in market imbalance.

2.2. Types

Economic crises can be categorized into various types, including financial crises, recessions, depressions, debt crises, inflation crises, deflation crises, asset bubble collapses, structural crises, and global economic crises. The economic crisis of 1930 primarily belongs to the type of depression. It was a severe economic downturn that occurred globally, particularly with the United States facing significant economic difficulties, including mass unemployment, a decline in production capacity, and a persistent drop in prices.

3. Classic Case Analysis of Economic Crisis: the Great Depression of 1930

3.1. Background

After World War I, the global landscape underwent a significant transformation, with economic and financial centers shifting from Europe to the United States. The U.S. gradually took the lead in various fields such as economy, technology, trade, and finance, becoming the central player on the world stage. In the aftermath of the war, the U.S. GDP became undisputedly the largest in history, surpassing the combined total of the British Commonwealth and all its colonies. Technologically, essential infrastructures like oil and electricity became more mature, and wartime technological advancements were gradually redirected for civilian use. New energy sources and technologies, coupled with strong

DOI: 10.54254/2753-7064/51/20242533

consumer demand, led to economic prosperity. The development of businesses helped a large number of ordinary people rise into the middle class, and the robust consumption by this middle class, in turn, stimulated the growth of various industries, creating a positive cycle.

In contrast, Europe's situation was far more complex. After the war, the economies of various nations and global trade began to recover, but the warring nations were burdened with massive war debts. In an effort to repay these debts, Britain temporarily abandoned the gold standard and began printing money recklessly, leading to the collapse of the British pound's credibility. The status of the pound as the dominant currency in international trade gave way to the U.S. dollar. During the war, the U.S. became the world's largest trade surplus nation, and gold flowed from Europe into the U.S., with American gold reserves at one point accounting for a third of the world's total. Capital also began to flee war-torn Europe and flow into the United States. The large amounts of European war debt underwritten by American banks led to the rapid development of the U.S. financial industry, and New York became the world's largest capital market.

3.2. Factors

The Great Depression, which began in 1929 and lasted through much of the 1930s, was the most severe economic downturn in modern history. One major factor was the rampant stock market speculation in the 1920s. In response to European banks cutting interest rates, the Federal Reserve lowered its own rates from 4.0% to 2.7% within a few months [2]. After this, the U.S. stock market predictably surged, with the bubble expanding wildly. Large amounts of foreign hot money flowed into U.S. stocks through wealth management trusts and other unregulated shadow banking institutions. Many Americans and financial institutions are heavily invested in the stock market, often borrowing money to buy stocks, known as buying on margin. At its peak, 90% of new capital entering the market was leveraged. This created an unsustainable financial bubble, with stock prices far exceeding the actual value of companies. The Dow Jones Industrial Average surged from 160 points to 300 points within a year [3]. Many investors believed that stock prices would continue to rise, leading many to use borrowed funds for stock investments, often leveraging up to 20 times. When stock prices plummeted, they were unable to repay their debts, resulting in banks tightening credit and further suppressing economic growth. The collapse of financial institutions exacerbated the crisis, as the loss of wealth not only reduced spending by consumers and businesses but also undermined investor confidence, creating a vicious cycle of economic decline. A drop in confidence among investors and consumers severely curbed economic growth, leading to reduced investments and lower consumption, which further worsened the economic situation. Additionally, the government and the central bank failed to implement timely and effective policies to stabilize the situation. President Hoover firmly believed that the market would self-correct, which further deteriorated the economic condition. Together, these factors contributed to the ensuing severe economic crisis.

Another important factor was the underlying weakness in the U.S. economy, especially in key sectors like agriculture and manufacturing. Despite the surface prosperity of the 1920s, advancements in mechanized production also led to overproduction, laying the groundwork for a future crisis. After World War I, European agriculture began to recover, reducing demand for U.S. agricultural exports, which hit American farmers hard. Farmers started seeking ways to cut costs and improve efficiency, and by the 1920s, agricultural mechanization was at its peak. Machines like seeders and tractors became widely used, and small farms were consolidated into larger plantations to increase efficiency. In this wave of productivity transformation, many farmers became surplus labor. By the time of the 1929 crisis, this was already a widespread problem in the South. Many farmers were struggling due to falling crop prices and mounting debt. Similarly, the steel-based heavy industry in towns expanded massively after World War I to supply both domestic needs and the rebuilding of Europe. However, as Europe's reconstruction neared completion, the U.S. steel industry began to decline in 1927,

DOI: 10.54254/2753-7064/51/20242533

leading to overcapacity by 1929. Overproduction in both agriculture and industry resulted in supply far exceeding demand, leading to falling profits and layoffs. In addition, growing income inequality concentrated wealth in the hands of a small minority, limiting the broader population's ability to sustain consumer demand.

The collapse of banks was also a significant cause of the Great Depression. Many banks engaged in risky lending practices, providing loans not only to individuals speculating in the stock market but also to companies that had already overextended themselves. When the market crashed, many banks chose to reduce new lending and tighten the collection of existing loans, which left consumers unable to repay their debts and decreased their spending. This, in turn, led to a reduction in corporate profits, causing companies to default on their loans, resulting in widespread bank failures. The Federal Reserve decided to raise interest rates in the early 1930s to prevent gold from flowing out to Europe and to defend the gold standard, further tightening credit and deepening the crisis. These factors combined to create a vicious cycle that resulted in an increasing number of unemployments, widespread poverty, and the collapse of global trade, exacerbating the severity and duration of the Great Depression.

Due to the high dependence on international trade, many countries experienced rapid economic growth during the 1920s, particularly European nations that relied on American steel and agricultural products for their post-war reconstruction. As a result, the American economic depression had a direct and profound impact on these countries, especially those dependent on exports. Following the stock market crash in the United States, consumer and investor confidence plummeted, leading to a decreased demand for imported goods, which in turn affected the economies of other nations. In 1930, the U.S. enacted the Smoot-Hawley Tariff Act, which significantly raised import tariffs with the intention of protecting domestic industries during the economic downturn. However, this measure triggered retaliatory tariff policies from other countries, which also increased tariffs, sparking a trade war and causing global trade volumes to plummet. At the same time, the instability of the financial system contributed to the transformation of this economic crisis into a global one. The collapse of the American banking system placed enormous pressure on financial institutions in other countries, leading many banks to face insolvency due to liquidity crises [4]. This resulted in a contraction of credit markets, increasing borrowing costs for businesses and consumers, which further suppressed economic activity. The turbulence in global financial markets hindered the flow of capital, causing a significant reduction in economic activity. In this context, unemployment rates surged in many countries, with businesses laying off workers or shutting down, creating a vicious cycle. Overall economic growth turned negative. Ultimately, this series of cascading effects caused what initially was a crisis confined to the United States to rapidly expand into a global economic crisis, profoundly impacting the economic development and social stability of countries worldwide.

3.3. Countermeasures and their Impacts

During the period of Hoover's Presidency, he signed the Smoot-Hawley Tariff Act into law in 1930, fulfilling his campaign promise [5]. The act significantly raised tariffs on more than 20,000 imported goods, making it one of the most stringent tariff laws in U.S. history. Its initial aim was to protect American farmers and businesses from foreign competition and alleviate the economic distress caused by the 1929 Great Depression. However, the implementation of the Smoot-Hawley Tariff Act worsened the international trade environment, triggering retaliatory tariffs from other countries. Global trade volume plummeted, exacerbating the severity of the Great Depression. According to U.S. government statistics, after the act was passed, the total trade between the U.S. and Europe dropped by 50%. In the three years following its enactment, U.S. trade fell from approximately $1.3 billion in 1929 to $390 million in 1932 [6].

DOI: 10.54254/2753-7064/51/20242533

Following Britain's abandonment of the gold standard, President Herbert Hoover established the Reconstruction Finance Corporation (RFC) in 1932 to address the banking crisis [7]. The RFC was designed to provide emergency loans to banks, railroads, insurance companies, and large corporations facing financial distress, with the goal of preventing the complete collapse of the financial system. Hoover relied on various financial consortia to fund the sale of distressed banks' bad debts and inject liquidity into the economy. However, capital is profit-driven, and the major consortia deemed this endeavor unprofitable due to a lack of collateral. Moreover, many small banks were reluctant to borrow from the RFC, as doing so was seen as an admission of financial trouble, which could trigger bank runs. Initially, the RFC received $500 million in funding, later increased to over $2 billion, to support financial institutions and key industries. Nevertheless, most of the RFC's assistance focused on large corporations, and its loan terms were relatively strict. The RFC made numerous empty promises to small and medium-sized banks, and only about 15% of the $300 million pledged was actually disbursed. This left the needs of small businesses and ordinary citizens unmet. Although the RFC succeeded in preventing some banks and large corporations from failing, its relief measures were criticized for being too conservative and lacking in focus. The public generally believed that the government was more concerned with big businesses than with the struggles of ordinary people. The RFC's efforts failed to adequately address the widespread economic crisis.

Overall, President Herbert Hoover's response to the economic crisis revealed a deep-seated resistance to government intervention in many aspects. He was overly reliant on the self-regulating mechanisms and cooperation between local governments and private institutions. This ideology resulted in delayed and ineffective policy implementation. Although Hoover later introduced certain public works and financial relief measures, such as the Reconstruction Finance Corporation and the Hoover Dam, these efforts were insufficient in scale and sluggish in execution to effectively mitigate the impact of the Great Depression. Ultimately, Hoover's policies were widely seen as failures, paving the way for Franklin D. Roosevelt's New Deal.

In 1932, frequent large-scale protests and rampant social violence were prevalent, while the government's credit was on the verge of bankruptcy. The adverse effects of the trade war were gradually becoming apparent, exacerbating the banking crisis that spiraled out of control. The collapse of the gold standard further exacerbated the dire situation. At this critical juncture, with society teetering on the brink of chaos, Franklin D. Roosevelt assumed office after reflecting upon the failures of laissez-faire policies. While Western countries grappled with economic crises, per capita GDP in the Soviet Union steadily rose. Against this backdrop, a comprehensive reassessment of America's system took place under Roosevelt's leadership to address its deep-rooted issues. The absence of safety nets for banks and society at large had allowed the crisis to spread rapidly; thus, building barriers for both the economy and society through various insurance systems emerged as a viable solution. In 1933, after Roosevelt was inaugurated, he began to implement moderate regulation to end laissez-faire policies, inspired by the Soviet model [8]. He started addressing various social issues one by one, marking the beginning of Roosevelt's First Hundred Days. On March 9, 1933, the Emergency Banking Act was swiftly approved on the same day it was submitted. This act allowed the 12 Federal Reserve Banks to lend to banks based on their sound assets and to provide unlimited liquidity to the entire society, ensuring the safety of liquidity when banks reopened. Utilizing the cutting-edge media of the time—radio—Roosevelt initiated the famous "fireside chats," explaining the principles of bank operations to the public and rebuilding their confidence in the banking system. By the end of March, two-thirds of the currency had returned to circulation within the banking system.

By 1935, during the second phase of the New Deal, the Banking Act was formally introduced, establishing a deposit insurance system through legislation to address the issue of bank failures from a structural standpoint. The gold standard was also abandoned, allowing the government some flexibility to print money within limits. As gold returned to the Federal Reserve and the Treasury,

DOI: 10.54254/2753-7064/51/20242533

confidence in the U.S. dollar was restored. Following the stabilization of the banking sector, monetary order also gradually returned. Roosevelt simultaneously investigated various illegal activities on Wall Street during the Great Depression, uncovering widespread fraud and insider trading. In response, the Securities Act was passed in 1934, and the Securities and Exchange Commission (SEC) was established to regulate the securities industry.

In 1935, the Social Security Act was enacted. At that time, the United States was the only developed country without a social security system. Subsequently, the U.S. government implemented social security, unemployment insurance, and pension systems. Following this, the National Labor Relations Act was introduced to ensure minimum wages, enforce an eight-hour workday, and protect workers' rights. These policies marked a significant shift from Hoover's hands-off approach and helped stabilize the economy, although the full recovery did not occur until the onset of World War II.

4. Conclusion

This paper primarily examines the background, causes, and impact of the 1930 Great Depression on political stability, delving into the implementation and effectiveness of President Roosevelt's New Deal. The Great Depression revealed the fragility of the American economic system, particularly in agriculture and heavy industry, where overproduction and market imbalances were prevalent. The New Deal stabilized the economy through economic reforms and social security measures, improving labor rights and strengthening financial market regulation. The conclusion emphasizes that historical experiences provide important insights for contemporary policy-making and highlight the critical role of government during economic crises. However, the article also has some shortcomings, such as a lack of in-depth analysis of the specific effects of certain economic policies and insufficient exploration of the interactions between various policies. Additionally, the literature review could be more comprehensive, covering more studies on the subsequent impacts of the Great Depression. Due to space constraints, the article only discusses one economic crisis. Future research could focus on several areas: first, a deeper exploration of the relationship between economic crises and social inequality, analyzing how different classes benefit from economic policies; second, studying the mechanisms of crisis transmission in the context of globalization and examining how international markets affect domestic economic stability; finally, paying more attention to several major economic crises that have occurred since 1930. By studying different types and causes of economic crises, we can better inform policies or legislation. Through this research, a more comprehensive understanding of the complexity of economic crises and their long-term impacts on society can be achieved.

References

[1] Smith, A. (2023). The wealth of nations. Beijing: Commercial Press.

[2] Calomiris, C. W. (1993). Financial factors in the Great Depression. Journal of Economic Perspectives, 7(2), 61–85. https://doi.org/10.1257/jep.7.2.61

[3] China Economic Net. (2013). Data brief: The Dow Jones Industrial Average over the past 100 years - Chart and historical events. http://intl.ce.cn/specials/zxxx/201307/29/t20130729_24614475.shtml

[4] Federal Reserve History. (n.d.). Banking panics of 1930-31. https://www.federalreservehistory.org/essays/banking-panics-of-1930-31

[5] CFI team Smoot-Hawley tariff act https://corporatefinanceinstitute.com/resources/economics/smoot-hawley-tariff-act/

[6] Bao, J. (2010). The international political economy analysis of trade protectionism: Theoretical model, empirical testing, and policy choices. Beijing: Economic Science Press.

[7] Federal Reserve History. (1932, January 22). Reconstruction Finance Corporation Act. https://www.federalreservehistory.org/essays/reconstruction-finance-corporation

[8] Federal Reserve History. (1933, March 9). Emergency banking act of 1933. Retrieved from https://www.federalreservehistory.org/essays/emergency-banking-act-of-1933