International Journal of Social Science and Economic Research

ISSN: 2455-8834

Volume:09, Issue: 12 "December 2024"

The Transmission of The Great Depression Through Globalized Economies

Nicolette Liu

Riverdale Country School, New York

DOI: 10.46609/IJSSER.2024.v09i12.043 URL: https://doi.org/10.46609/IJSSER.2024.v09i12.043

Received: 26 November 2024 / Accepted: 20 December 2024 / Published: 31 December 2024

Introduction

Before World War I, British banks and financial institutions played a significant role in the global economy, spreading British capital across the world through extensive international lending and investment. The price of gold was fixed in Britain, and the "gold standard was accepted as an objective fact, hardly subject to alteration."[1] However, with World War I, most countries abandoned the Gold standard, and America soon assumed the leadership position as most European countries were incapacitated due to their participation in the war. The World War significantly altered America's position in the world as, according to economist Jeffry A. Frieden, "America changed from being the world's biggest debtor to its biggest lender."[2] After World War I, America replaced Britain as the leading power in the world, creating ties with all of the countries that previously relied on British loans through the gold standard, lending, and trade, making all countries dependent on the American economy susceptible to the economic downturn that started well before the 1929 Wall Street Market Crash. Along with economic policy missteps in countries that failed to adjust their currencies after the revival of the gold standard, the American Stock Market Crash served as a catalyst, triggering a domino effect that drastically reduced trade and capital flows worldwide.

Following World War I, governments globally reinstated the gold standard, along with international trade, foreign investment, and international lending, thereby linking all their nations' economies together, which in turn created a more interconnected world. The re-establishment of the gold standard created a network of fixed exchange rates. By the 1920s, the international gold standard had been rebuilt country by country, with approximately 90% of

[1] Charles P. Kindleberger, *The World in Depression 1929-1939* (W. W. Norton & Company, 2007), 293.

[2] Jeffry A. Frieden, *Global Capitalism: Its Fall and Rise in the Twentieth Century* (Berkeley : University of California Press, 1987), 132.

 Copyright © IJSSER 2024, All rights reserved

ISSN: 2455-8834

Volume:09, Issue: 12 "December 2024"

nations adopting it by 1929.[3] This reconstruction facilitated the resurgence of international commerce, with poorer manufacturing regions specializing in commodities and exporting raw materials to industrialized nations, who, therefore, export their manufactured goods throughout the world. The free trade system under which the world operated cultivated global interconnectedness and, more importantly, interdependence. Exports swelled to double pre–World War One levels; even when one accounts for inflation, world trade was 42 percent greater in 1929 than in 1913 and was a larger share of national economies.[4] Moreover, lending played a crucial role in interconnecting the world, especially in the context of post-war reparations. Under the terms of the Versailles Treaty, Germany was obligated to pay thirty-three billion dollars in reparations, predominantly to France and Britain. Consequently, Germany turned to American banks for loans. Meanwhile, Britain and France found themselves heavily indebted to America due to the war, thereby increasing their reliance on Germany's reparation payments to settle their financial commitments. The intricate interplay of lending and reparations forged a complex web of interdependence. Additionally, investment in foreign businesses expanded significantly during this period, further strengthening global ties. As the American economy expanded, "industrialists searched for profitable investment opportunities. Firms invested more than 5 billion dollars over the 1920s, by the end of which American corporations were well established in every major economy and some minor ones as well. In the late 1920s, America had nearly 200 branches abroad." [5] This investment surge re-established global connections and stimulated economic growth worldwide by injecting more capital into the system and increasing the number of transactions. Essentially, the aftermath of World War I saw a revival in global connectivity propelled by the reintroduction of the gold standard and the elaborate network of trade, investment, and lending.

Although the recovery period after WWI formed international ties and stabilized currencies, the recovery process did not go entirely smoothly, as challenges like the Agricultural Depression and, later on, mass speculation in the stock market emerged. The agricultural sector suffered throughout the 1920s. As economic historian Kindleberger observed, farm prices continued to decline for two key reasons: Firstly, the massive expansion of American farms during World War I, aimed at meeting the demand for food supplies, resulted in an oversupply of agricultural products once the war ended. This surplus, coupled with the decreased demand of post-war, led

---

[3] Richard H. Pells, and Christina D. Romer, *Great Depression: Economy*, Encyclopedia Britannica, https://www.britannica.com/event/Great-Depression.

[4] Richard H. Pells, *Great Depression: Economy*, Encyclopedia Britannica.

[5] Jeffry A. Frieden, *Global Capitalism*, 140.

 Copyright © IJSSER 2024, All rights reserved

ISSN: 2455-8834

Volume:09, Issue: 12 "December 2024"

to a sharp price decline. Secondly, the expansion of farms prompted many farmers to adopt mechanized operations through heavy loans from banks, which often resulted in high levels of debt. The combination of overproduction, low prices, and mounting debt placed immense financial strain on farmers, aggravating their economic hardships. Moreover, the phenomenon of debt deflation further compounded the challenges faced by farmers as the increased value of the dollar made it harder to pay off debts, leading to a downward spiral in farm incomes, which exacerbated the Agricultural Depression.[6] The agricultural downturn signifies the economic decline preceding the Great Depression and serves as one of the catalysts for the onset of the crisis.

Furthermore, there were fundamental issues with the re-establishment of the gold standard, which set the stage for subsequent failures as it took countries' ability to adjust their currency. Following the inflationary aftermath of the First World War, nations grappled with restoration or adjustment of exchange rates, aiming to stabilize them at equilibrium levels. "In most countries, economists worked at calculating purchasing power parities, without always making adequate allowance for structural changes, such as the loss of overseas assets by Britain or the large volume of French capital that in 1926 was not returned to France."[7] Notably, Italy's decision regarding exchange rates was largely influenced by considerations of prestige rather than economic fundamentals. Consequently, this collective arrangement of exchange rates imposed strain on the financial system and precipitated instability.

The subsequent 1928 stock market boom in America, while seemingly positive, ultimately bore significant negative repercussions for the American economy. As interest rates rose sharply in the spring of 1928, the investment focus sharply pivoted to the stock market. Early signs were promising, with general stock market growth and increased trading activity. However, the apparent success was largely superficial as it was primarily fueled by over-speculation and inflated stock prices, making this economic condition unsustainable. Although the stock market boom appeared beneficial superficially, it diverted essential funds from productive economic activities, which was detrimental to the economy. As economic historian Charles Kindleberger explains, "intense interest in the stock market is likely to enlarge the number of funds held ready for opportunities to speculate and to shrink those that normally turn over in the production, distribution, and consumption of goods." [8] By fall of 1928, commercial bankers were allocating

[6] Charles P. Kindleberger, *The World in Depression 1929-1939,* 70-73.

[7] Charles P. Kindleberger, "*The World in Depression 1929-1939",* 293.

[8] Ibid., 60.

 Copyright © IJSSER 2024, All rights reserved

ISSN: 2455-8834

Volume:09, Issue: 12 "December 2024"

more funds towards the stock market and real estate investments rather than supporting commercial ventures, a shift that reflects "an economy overly reliant on speculative investments."[9] Additionally, while the stock market saw growth, other sectors were struggling. In January 1929, wages were only 5 percent above January 1925. Commodity prices fell almost 5 percent from 1926 to 1929, rising 5 percent in farm products and falling almost 8 percent in other commodities. Overall, the negative impacts of the stock market boom, fueled by mass speculation and an economy resting on inflated asset prices, heavily outweighed its superficial positive effects.

Due to the world's interconnectedness, the 1928 American stock market boom not only had domestic repercussions but also reverberated globally, adversely affecting nations reliant on America for lending and trade as it dried up the funds from America. The redirection of capital from investments and lending that contribute directly to economic growth and development to investment in the stock market significantly curtailed funds to foreign countries, exacerbating economic strains. This reduction in lending, compounded by the decline in business investments, particularly impacted commodity-producing nations, as noted by historian Jeffry A. Frieden. Commodity-producing nations were especially hard hit by the "combined effect of price declines, the slump in American and European demand for their exports, and the cutoff of American lending."[10] Furthermore, the downturn in business investments further exacerbated the adverse effects, creating a ripple effect of economic hardship throughout the countries that relied on America for funds.

The 1929 stock market crash marked a critical point in the ongoing economic downturn, precipitated by the Federal Reserve's decision to raise interest rates, worsening the decline of the American economy and placing additional strain on European economies. Economist John Garraty identifies a multitude of factors that contributed to the growing instability leading up to the crash, including agricultural overproduction and the oversight of the consequences that an augment of interest rates would bring.[11] After experiencing a bumper crop in 1928, along with a surplus of wheat, the agricultural sector faced plummeting prices and reduced purchasing power, a catalyst for the Great Depression. Additionally, as speculation in the stock market reached unsustainable levels, the Federal Reserve raised interest rates in August as a measure to curb speculation. However, the Federal Reserve did not anticipate that this action would trigger the

[9] Ibid., 59.

[10] Jeffry A. Frieden, *Global Capitalism*, 175.

[11] John A. Garraty, *The Great Depression: An Inquiry into the Cause, Course and Consequences of the Worldwide Depression of the Nineteen-Thirties* (Harcourt Brace Jovanovich, 1986), 19.

Copyright © IJSSER 2024, All rights reserved

ISSN: 2455-8834

Volume:09, Issue: 12 "December 2024"

total collapse of the stock market as "in late October 1929, the frenzy came to an end. In three weeks the market lost all the ground it had gained in the previous year and a half."[12] Furthermore, "an increase in American interest rates sucked capital out of Europe and Latin America, making business conditions more difficult there."[13] As a result of these overlapping and interconnected events, American industrial production fell by 10 percent, imports by 20 percent in three months, and prices of commodities dropped steeply as well. Ultimately, the stock market crash acted as a catalyst to precipitate a vicious cycle in the United States.

The stock market crash instigated widespread panic and chaos in America, causing the American people to lose faith in their government and weak financial institutions. Exacerbated by the effects of debt deflation, the bank runs caused prices, wages, and employment rates to decrease significantly, creating a downward spiral in America as each factor influenced the other.

As economic conditions worsened, many people feared for the safety of their deposits and rushed to withdraw their money from banks. As Jeffry A. Frieden explained, "the vicious circle fed on itself, as expectations of a devaluation could cause a bank panic, while bank panics triggered devaluations."[14] Most of America's banks were small, individual institutions relying on their resources. If the banks did not have enough money in their reserves when depositors rushed to take money out, they would go bankrupt. The sudden and massive withdrawal of funds caused many banks to become insolvent, leading to widespread bank failure throughout America.[15] The collapse of banks not only wiped out individual savings but also severely restricted the availability of credit, further deepening the economic crisis. "Ultimately, this meant that credit froze up, which was what really destroyed the American economy,"[16] argues economic historian Charles Kindleberger. A frozen credit system meant less money was in circulation, leading to deflation. When prices drop, businesses cut costs, mainly by laying off workers. As more workers were laid off, consumer spending declined sharply as people could no longer afford goods, so inventories continued to build up, and prices dropped even further. Furthermore, as deflation forced debtors to reduce consumption and investment due to the higher value of dollars, prices further declined. As banks could not lend any more money, employers could not borrow in

[12]Jeffry A. Frieden, *Global Capitalism*, 175.

[13]Ibid.

[14]Ibid., 183.

[15] Charles P. Kindleberger, "*The World in Depression 1929-1939",* 128.

[16] Ibid,. 291.

 Copyright © IJSSER 2024, All rights reserved

ISSN: 2455-8834

Volume:09, Issue: 12 "December 2024"

order to make payroll to pay their workers. Consequently, an increasing number of businesses went bankrupt, leaving more and more workers unable to purchase the goods and services that would keep other businesses open. Furthermore, the lack of interference from the Federal Reserve exacerbated America's descent further into the depression. Ultimately, the convergence of the previously weak banking systems, debt deflation, and bank runs with little government interference led America into a complete depression.

As the depression spread throughout America, the gold standard transmitted America's downturn globally through its fixed rate exchange, hindering the ability of countries to adjust their currencies to economic shocks. This inflexibility limited the effectiveness of monetary policy and further spread the American dollar deflation throughout the world, making the countries' economies collapse one after another. As Charles Kindleberger explains, "as a result of the fixed exchange rate, other countries tied to the gold standard had to deflate their currencies to maintain parity with the dollar. This deflationary pressure spread globally, as countries adjusted their monetary policies to align with the value of gold and the U.S. dollar, thereby matching their economic conditions with those of the United States."[17] In addition, the gold standard, by forcing countries to deflate along with the United States, "reduced the value of banks' collateral property, such as securities, pledged by a borrower to protect the interests of the lender and made them more vulnerable to runs therefore further depressing prices."[18] The gold standard also hampered any attempts at economic recovery. The reduced value of a currency coupled with unchanged exchange rates would deter investors from buying the country's bonds. Additionally, under the gold standard, a failing nation's exports would become more expensive and, therefore, less attractive to foreign consumers. The inability to adjust the exchange rate weakened currencies and hindered economic recovery efforts, particularly for nations grappling with recessionary conditions.

As international lending and investment dried up, global trade contracted, leading to widespread unemployment and economic hardship spreading throughout the world. Cutbacks in world trade severely affected commodity-producing nations like Argentina, Brazil, Canada, and Australia, which struggled to export their goods amid the downturn. As Jeffry A. Frieden explains, "commodity-producing nations were especially hard hit by the combined effect of price declines, the slump in American and European demand for their exports, and the cutoff of American lending."[19] Industrial economies also faced turmoil as "heavily indebted people and countries

[17] Charles P. Kindleberger, "*The World in Depression 1929-1939",* 292-294

[18] Richard H. Pells, "Great Depression: Economy," *Encyclopedia Britannica*.

[19] Jeffry A. Frieden, *Global Capitalism*, 175.

 Copyright © IJSSER 2024, All rights reserved

ISSN: 2455-8834

Volume:09, Issue: 12 "December 2024"

would cut back on their purchases and investments, therefore reinforcing the vicious debt-deflation cycle, further depressing local and world prices."[20] This halt in world trade hit countries that depended on America for exporting and lending, such as Germany, Argentina, and Brazil, as lending was reduced and eventually halted. The combined effects of "price declines, decreased demand from American and European markets, and the cessation of American lending placed immense strain on commodity-producing nations, worsening the vicious debt-deflation cycle and further depressing local and global prices."[21] Specifically, Latin American countries such as Argentina and Brazil experienced significant downturns due to their close economic ties with the United States, especially as American tariffs made their exports less competitive. As analyzed by economics professor Carlos F .Díaz-Alejandro,"the collapse of the world economy from 1929 to 1933 impacted Latin America primarily through a sharp change in relative prices, with dollar export prices falling more steeply than dollar import prices, causing the price of Latin American goods to drop by 50-60 percent during this period."[22] The reduction in lending and investment from America, combined with the decline in global trade resulting from the American depression, propagated the economic downturn worldwide, particularly affecting commodity-producing countries.

Furthermore, even as the Federal Reserve aimed to alleviate the depression through economic policies, governmental missteps in policy further deepened the Great Depression in every country. The adoption of austerity measures, including tariff hikes, "further worsened the situation as deflation and liquidation failed to stimulate new investment and consumption."[23] Despite the falling prices, the American government's focus on monetary policies to combat inflation only added to the already downturning economy. Moreover, protectionist policies such as the Smoot-Hawley Tariff Act, enacted in response to economic turmoil in Europe in 1930, failed to anticipate the repercussions of other countries raising their tariffs. This led to a further decrease in world trade as many countries followed America in adopting protectionist policies, reducing sales and job opportunities, and deepening the depression. Unfortunately for countries such as Germany, resistance from American investors to protectionist measures increased the challenges for countries struggling to repay debts. Overall, implementing austerity and

---

[20] Ibid,. 182.

[21] Jeffry A. Frieden, *Global Capitalism*, 192.

[22] Carlos F. Díaz-Alejandro, *Latin America in Depression, 1929-1939* (Yale University, Economic Growth Center, 1980), 13, https://www.econstor.eu/bitstream/10419/160270/1/cdp344.pdf.

[23]Jeffry A. Frieden, *Global Capitalism*, 178.

 Copyright © IJSSER 2024, All rights reserved

ISSN: 2455-8834

Volume:09, Issue: 12 "December 2024"

protectionist measures not only exacerbated the depression in America but also intertwined economic difficulties across nations.

Ultimately, while the restoration of the gold standard is blamed and labeled the cause of the Great Depression of the twentieth century and what made it global, it is not the sole cause, though it did, in fact, play an essential role in transmitting the depression. The onset of the Great Depression was ultimately caused by the global economies' reliance on the American economy due a complex interplay of factors including lending practices, trade dynamics, investment activities, in addition to the gold standard. The undeniable ties formed between America and the globe after World War I made countries susceptible to America's economic issues, therefore spreading the American depression throughout the world. The Great Depression officially ended with World War II, leading to a massive increase in industrial production and employment due to the demand for military supplies, which boosted the economy significantly. World War II called for countries to abandon the gold standard completely and each country acted independently, cutting almost all global ties.

The Great Depression, born from the ashes of the First World War, inflicting suffering upon millions worldwide, finally found its conclusion amidst another gruesome global uproar.

References

Diaz-Alejandro, Carlos F. "Latin America in Depression, 1929-1939". Center Discussion Paper, No. 344, Yale University, Economic Growth Center, CT, March, 1980. https://www.econstor.eu/bitstream/10419/160270/1/cdp344.pdf.

Frieden, Jeffry A. *Global Capitalism: Its Fall and Rise in the Twentieth Century*. W. W. Norton & Company, 2007.

Garraty, John A. *The Great Depression: An Inquiry into the Cause, Course and Consequences of the Worldwide Depression of the Nineteen-Thirties*. New York: Harcourt Brace Jovanovich, 1986.

Kindleberger, Charles P. *The World in Depression 1929-1939*. Berkeley : University of California Press, 1987.

Pells, Richard H., and Christina D. Romer. "Great Depression: Economy." Encyclopedia Britannica. https://www.britannica.com/event/Great-Depression.

Copyright © IJSSER 2024, All rights reserved