SS.912.A.5.11 – Great Depression and New Deal – Example 1 Answer

Which economic factor contributed most directly to the start of the Great Depression?

a. low worker productivity  
b. high income taxes  
c. decreasing tariff rates  
d. buying stocks on margin

Answer

d. buying stocks on margin

Buying stocks on margin had become very popular during the 1920s. In margin buying, an individual could purchase a share of a company's stock and use the promise of that share's future earnings to buy more shares. Unfortunately, many people abused this system to invest huge sums of imaginary money that existed only on paper. In the 1920s, more people invested in the stock market than ever before. Stock prices rose so fast that by the end of the decade, people could become rich overnight just by selling or buying stocks. The buyer would hold the stock until the price rose and sell it for a profit. As long as the prices of stocks kept on increasing, the system worked. In 1928 and 1929, the value of stocks went up faster than the value of the companies the stocks represented. Some experts warned that this bull market would end. In 1929, a few stock investors began to sell their stocks, seeing these few investors begin to sell, others soon followed creating a domino effect. The sudden selling caused the stock prices to fall. Nervous brokers asked investors to pay their debts, but when they couldn't repay, they were forced to sell, causing the prices of stocks to fall even more. Eventually, stocks lost more than 50% of their value and 16 million shares were sold at a lost.