

Bill of Rights in Action



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THE GREAT RECESSION: WHAT WERE THE CAUSES?

The Great Recession began in 2007 after many homeowners with risky mortgage loans were unable to make their house payments to the banks. Millions lost their homes, the banking system collapsed, consumer spending plunged, and unemployment soared. The federal government acted to try to prevent a repeat of the Great Depression of the 1930s.

The Borrowers

John and Maria had been renting an apartment. John worked as a waiter at a restaurant, and Maria was a nurse's aide. Like most Americans, they dreamed of owning a house.

The problem was that their modest income and multiple credit card debts prevented them from qualifying for a traditional, **prime** mortgage loan to help them afford a house. Prime mortgage loans typically require the borrower to provide a down payment equal to around 20 percent of the cost of the house. Borrowers also need to show proof that they could afford to make monthly payments to pay back the amount of the loan they received.

For John and Maria, the customary down payment was beyond their savings. And they would not be able to make the standard monthly house payments.

In 2004, however, a local bank loan officer persuaded John and Maria to get a certain kind of **subprime** mortgage loan. Subprime loans were for people with low-to-moderate incomes and who were often in debt.

The subprime loan that John and Maria got had a higher interest rate than a prime mortgage loan, but had advantages for them. They did not have to provide a down payment. And they did not have to show proof of their income.



This photo of a closed business in New York City in February 2009 shows what happened when businesses had to declare bankruptcy during the Great Recession.

The bank loan officer did not explain everything to the couple, but they were happy with the terms of the loan. For the first two years, they would make monthly payments that they could manage. After that period, payments would be **reset** to a higher rate.

In 2006, when their monthly payment reset date came due, John and Maria planned to **refinance** their loan to reduce the payments. They were confident they could do this because their house would be worth much more. House prices had only been going up. They also felt confident that they could sell their house, pay off the mortgage, and even make a profit, which they could use for a prime loan down payment on another house. However, house prices suddenly had dropped across much of the nation.

ECONOMIC CRISES

This edition of *Bill of Rights in Action* looks at major economic crises and their impact on history. The first article examines the recent Great Recession in the United States and its causes. The second article examines the roles of economic and political causes of the French Revolution and the significance of an unlikely revolutionary. The third article looks at the Great Depression of the 1930s and how the U.S. government responded.

U.S. Government/Economics: *The Great Recession: What Were the Causes?* by longtime contributor Carlton Martz

World History: *The Marquis de Lafayette: A Noble Revolutionary* by guest writer Patrick Jennings

U.S. History: *What Caused the Great Depression and Why Did Recovery Take So Long?* by Carlton Martz

Now they owed more on their mortgage than their house was worth. This is called being “underwater.” No bank would refinance their loan. If they sold their house, they would not get enough to pay off what they owed on their mortgage. They no longer could afford their new monthly house payment, which had been reset several hundred dollars higher. They were trapped.

Worse, they could not renegotiate their loan with the local bank. The bank no longer owned the couple’s mortgage. The bank had long ago sold it to another bank in a bundle of similar subprime loans. This bundle was then resold to a large New York investment bank that, in turn, sold it to a private investor. The banks profited with each sale by charging a fee. They then often used these profits to purchase the subprime loans of more borrowers like John and Maria.

Finally, the current owner of their loan took possession of their home through a process called **foreclosure**. This happened because they were in **default**, unable to make their reset house payments. They lost their house and acquired a ruined credit rating.

* * * * *

John and Maria are fictional, but many real subprime mortgage loan homebuyers like them were caught up in a massive housing **bubble** in the early to mid-2000s. This occurred when home prices rapidly increased because many people wanted to buy homes, and mortgage interest rates remained low.

Starting in 2004, the **Federal Reserve** (the **Fed**), which sets interest rates that influence the cost of mortgage and other consumer loans, began to raise interest rates to slow the out-of-control housing prices. Fewer people bought houses, and prices began to drop. Millions of borrowers like John and Maria found themselves in the subprime loan trap and lost their homes.

The Banks

There are basically two types of banks: commercial banks and investment banks. Commercial banks take in deposits from customers and then earn profits by making loans to people and businesses. Investment banks try to earn profits by investing in financial securities such as stocks and bonds. During the Great Depression of the 1930s, Congress passed the Glass-Steagall Act that prohibited commercial banks from using their funds to invest in financial securities.

In 1999, Congress repealed Glass-Steagall. Both commercial and investment banks alike in the U.S. and around the world invested trillions of dollars in bundles of subprime loans. These bundles were special bonds called mortgage-backed securities (**MBSs**). By 2007, many MBSs had lost value because they no longer produced a steady stream of mortgage payments from the foreclosed homeowners. The banks could only sell the MBSs they owned at a loss, if they could sell them at all.



Wikimedia Commons

This picture from May 2008 is entitled “Sign of the times – Foreclosure.” What does the title tell you about the housing crisis that brought on the Great Recession?

The MBSs became increasingly worthless, and they were not covered by the Federal Deposit Insurance Corporation (**FDIC**). This government agency was established during the Great Depression to insure up to \$100,000 (later \$250,000) of the checking and savings deposits of commercial bank customers. However, the FDIC did not insure bank investments like MBSs. Private companies that insured them were going bankrupt because so many subprime-loan MBSs had gone bad.

In July 2007, an investment firm became the first Wall Street bank to fail because of its large MBS losses. The banking systems in the U. S. and Europe panicked as more commercial and investment banks faced bankruptcy due to their MBS losses.

Most lending to individuals and businesses stopped. Consumer spending dropped, heavily influenced by the falling value of houses, subprime-mortgage foreclosures, and the large debt burden of many Americans. As consumer demand fell, companies laid off workers. Many feared another Great Depression.

The **GDP** (Gross Domestic Product) is the value of total goods and services produced in the economy. When the level of the GDP fell below zero in the last two quarters of 2007, the U. S. was technically in a recession. December 2007 was the official beginning of the Great Recession.

The Government

Ben Bernanke, then-chairman of the Federal Reserve and an expert on the Great Depression, along with Henry Paulson, then-President George W. Bush’s Secretary of the Treasury, decided to ask Congress to bail out Wall Street banks that were “too big to fail.” They believed the entire economic system depended on these large-scale banks to increase lending and prevent the economy from collapsing.

Congress passed the Troubled Asset Relief Program (TARP) in October 2008. Originally, TARP was to use

\$700 billion in taxpayer money to buy the “toxic mortgages” bundled in subprime MBSs. But, Bernanke and Paulson changed their strategy to purchase non-voting shares of stock in major banks to provide banks with more capital (money) to survive. TARP money was also used to bail out auto companies whose sales had plummeted.

Meanwhile, the Federal Reserve acted to use **monetary stimulus** to combat the rapidly increasing number of business failures and unemployment. The Fed used several ways to inject money into the economy, which included reducing interest rates that banks charge one another to near zero. This had the effect of reducing interest rates on bank loans to consumers and businesses in order to spur spending.

But banks were still reluctant to lend because of their losses. Consumers, struggling with foreclosures and debt, were reluctant to borrow and spend. Businesses, suffering from a drastic drop in consumer demand, were reluctant to take out new loans.

By the time Barack Obama became president in January 2009, about 800,000 workers were losing their jobs each month. The unemployment rate reached its highest point at 10 percent (compared to 25 percent in the Great Depression).

In response, Obama proposed the American Recovery and Reinvestment Act, which Congress passed in February 2009. It was a **fiscal stimulus** program, using government spending and tax cuts to get the economy moving again.

This mammoth program, costing \$1.4 trillion, had several parts:

- tax cuts and credits to taxpayers, workers, first-time homebuyers, and businesses;
- financial aid to school districts, colleges, college students, state and local governments;
- extension of unemployment benefits and the food stamp program; and
- direct government spending and grants for infrastructure projects to build, repair, or modernize such things as roads, bridges, and hospitals.

The fiscal stimulus started the economic recovery by giving an important boost to economic growth and reducing unemployment, but at a slow pace. Critics said it was ineffective, too costly, and inflated the national debt. Supporters simply argued the stimulus was not enough. Congress, however, refused to spend more and even made major cuts in government spending that some economists said put a drag on the recovery.

The Causes

There were several causes that contributed to the Great Recession. The large number of subprime borrowers like John and Maria set the stage for the economic crisis when they took advantage of the easy loans.

They did not have to provide proof of income or a down payment and ended up buying houses they simply could not afford. When those borrowers could not make their mortgage reset payments, the crisis was triggered.

Most buyers mistakenly believed that houses were sure investments whose prices would only continue to rise. Testifying about the crisis before Congress in 2010, billionaire investor Warren Buffett said, “The whole American public was caught up in a belief that American housing couldn’t fall dramatically. Very, very few people could appreciate the bubble. That’s the nature of bubbles - they’re mass delusions.”

Most buyers mistakenly believed that houses were sure investments.

The federal government was another cause. For decades, the government pushed policies to make it easier for everyone, even those with low incomes and heavy debts, to buy a house. Congress stripped away certain regulations of the banking system like the Glass-Steagall Act that enabled commercial banks to take higher risks. Evidence later revealed that the Fed and other regulators failed to stop risky bank practices when they had the duty and authority to do so.

Starting in the late 1990s, the Fed kept interest rates too low for too long despite a rapidly inflating housing price bubble. The Fed was mistakenly convinced that the banking system itself would resist risky mortgages.

Some local bank lenders were far more interested in collecting fees for subprime loans than making sure borrowers could afford them. These lenders increasingly targeted unqualified lower income and indebted borrowers. These original lenders never had to worry about the borrowers defaulting because the banks quickly bundled the mortgages into MBSs and sold them to other banks and investors.

The MBSs and other mortgage-related securities became so complex that even the bankers had trouble understanding them. Nevertheless, the big Wall Street banks kept encouraging local lenders to approve more subprime mortgages so the bankers could take their cut of fees and bonuses in buying and selling the MBSs.

Private financial rating agencies were supposed to determine the risk of financial products like MBSs. But they carelessly assigned top ratings to most subprime MBS bundles, dangerously misleading investors who purchased them.

The Consequences

How serious was the Great Recession? Here are some consequences:

- Ten million families lost their homes. Even those not caught in the subprime trap, but heavily in debt, were at risk because [they lost their jobs due to the effects on the economic climate].
- Households lost \$17 trillion in net wealth, including the value of their homes, savings, and retirement accounts. Hardest hit were lower income and minority households.

- In 2011, nearly 25 percent of all properties with mortgages, both prime and subprime, were underwater.
- The median annual income of Americans dropped by nearly \$4,000.
- About 15 million workers lost their jobs between 2007 and 2010. Especially affected were men, the young, those with less education, and African-Americans.
- Workers 55 and older suffered fewer layoffs than younger workers, but had a tougher time finding work when they did become unemployed. Wages of replacement jobs were often significantly less than the original ones, causing many to delay retirement.
- The number of business bankruptcies rose from 20,000 (2006) to 61,000 (2009).
- Losses to banks and other mortgage lenders because of their risky lending and investment practices cost them \$2.6 trillion.
- The cost to the taxpayers for government spending and reduced tax revenue was an estimated \$1.8 trillion after paybacks with interest from the bailed out banks and auto companies.

In June of 2009, after two quarters of economic growth, the Great Recession technically ended. The banks recovered fairly quickly and recovery began. In 2016, GDP growth strengthened, unemployment declined from a high of 10 to 4.6 percent, and wages improved. Americans did drastically reduce their debt. But that had a downside by holding back consumer spending.

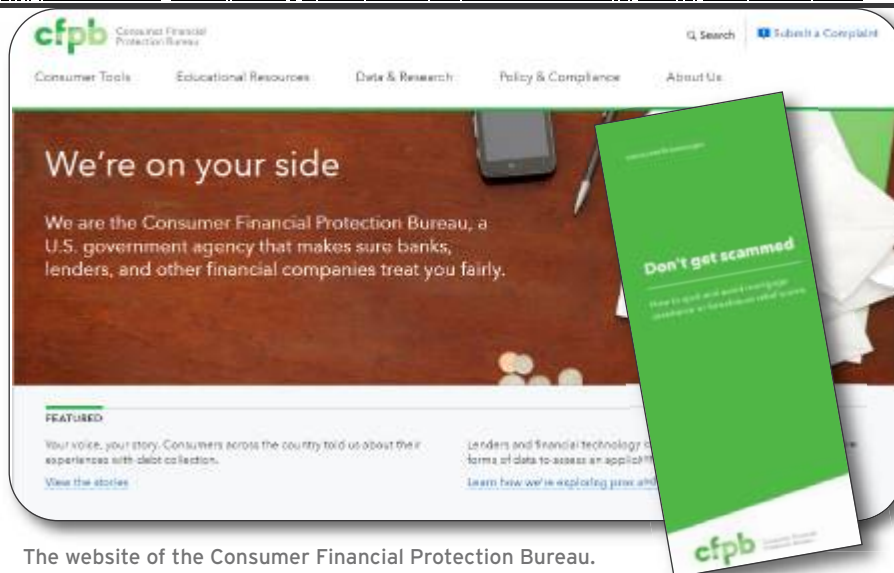
The Fixes

Attempts to fix or reform the financial system began in 2010 when Congress and President Obama enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”). (Senators Christopher Dodd and Barney Frank were the chief sponsors of the bill.) This act strengthened banking regulations and required banks to hold much larger reserves to cover losses.

Dodd-Frank created the Consumer Financial Protection Bureau. Its job was to root out bad financial practices like those that steered unqualified homebuyers into loans they could never pay off.

But Dodd-Frank stopped short of breaking up the big banks, as some wanted. Others criticized the law’s regulations for going too far in restricting banking operations.

Some economists say that just saving the banks was not enough. Too many people, they argue, had lost or were at risk of losing their homes and stopped spending,



The website of the Consumer Financial Protection Bureau.

which was a major drag on the economy. These economists propose a taxpayer-funded government bank to buy the mortgages of those in trouble and help them save their homes by reducing the interest or even the principal (original amount) of their loans.

Companies that survived the Great Recession often did so by replacing workers, especially in manufacturing, with automation, industrial robots, and other technology. Today, economists generally agree many of the old jobs will not come back. Thus, workers of all ages will need more technical training and education beyond high school to get good-paying jobs and lessen their chances of losing them in a future recession.

WRITING & DISCUSSION

1. Why did the government decide to bail out the banks? Do you agree with this decision? Why?
2. Explain the housing bubble and its role in causing the Great Recession.
3. In 2008, Senator John McCain (R-AZ) proposed that \$300 billion of the \$700 billion TARP funds should have gone to bail out individual borrowers like John and Maria. Would McCain’s proposal have prevented all the consequences of the Great Recession listed in the article? Why or why not?
4. Describe the strengths and weaknesses of the Dodd-Frank law. Do you agree with critics that the government should have broken up the big banks? Why or why not?

ACTIVITY: Who Was Responsible?

Who was most responsible for the Great Recession: the subprime borrowers, the banking system, or the government? In groups, make a list of reasons why each of the three had some responsibility. Then, rank the three from most to least responsible. Be prepared to defend your ranking with evidence and information from the article.

THE MARQUIS DE LAFAYETTE: A NOBLE REVOLUTIONARY

In the late 18th century, two great political revolutions, the American and French, changed the world forever. Although each arose from different environments, both reflected ideas developed by French and British thinkers of the time and had an important economic dimension. One man was central to both.



Wikimedia Commons/Currier & Ives, 1876

On August 3, 1777, George Washington first met the Marquis de Lafayette.

A Frenchman in America

Born in 1757, Marie Joseph Paul, the Marquis de Lafayette, came from a family long associated with French military heroes. His ancestor, Gilbert de Lafayette III, fought alongside Joan of Arc. His father was a colonel killed in battle against the British. Marie Joseph Paul (Lafayette) became a lieutenant in the French Army when he was only 13 years old.

When he was 19, he heard an English duke describe the rebellion of colonists in North America against the rule of King George III of Great Britain. He later wrote in his memoirs, “When I first learnt of the subject of the quarrel, my heart espoused warmly the cause of liberty.” He soon left France in 1777 to help the American revolutionary cause.

Lafayette’s eagerness for the American cause appealed to revolutionary leaders. George Washington immediately placed him on his staff. Lafayette fought bravely in several battles and endured the terrible winter at Valley Forge.

In 1779, he returned to France to plead for French support. He returned the next year, having secured a French army and naval fleet to help Washington’s Continental Army. In 1780, Washington called him “an essential friend to America.”

In early May 1780, Washington placed Lafayette in charge of a small army with orders to harass the British in Virginia. For months, he played a cat-and-mouse game

with the British. Sometimes he shadowed them as they moved through the countryside, other times he fought small skirmishes. More often, he withdrew when the British threatened to turn on him.

The British general, the experienced Lord Cornwallis, began to camp his army at the small port city of Yorktown, Virginia, in late spring 1781. In late summer, Washington ordered Lafayette to move his small army into a semi-circle around Yorktown. With Lafayette blocking his escape, Cornwallis seemed unaware that a powerful French fleet was also just off the coast, ready to block any rescue efforts by the British Navy. He was trapped.

After trapping Cornwallis’s army, Lafayette’s small force waited for several weeks for General Washington and French General Rochambeau to arrive. After a successful siege (attack upon a city), Cornwallis finally surrendered in October.

The Battle of Yorktown ended almost all fighting in the American colonies. The Americans and the British began peace negotiations in Paris, France, in 1782 and signed a final peace treaty there in 1783. Great Britain formally recognized the independent United States of America.

Lafayette did not fight in the war for the glory of the Kingdom of France against her despised enemy, Great Britain. Instead, he fought for what was a renegade group of colonies representing political ideas that would soon prove distasteful to his own French King.

Inequity and Revolution

Lafayette crossed the ocean back to his family and native France a few months after the end of the American Revolution. He was inspired by the political ideals of Enlightenment philosophers such as Voltaire, Rousseau, Montesquieu, and Locke, as well as American patriots such as Paine, Jefferson, and Washington. He returned to a nation still governed by a king and aristocrats (elite nobles) like himself.

The common people of France had little voice in the affairs of the nation. Because the nobility and the clergy did not have to pay most taxes, commoners and small-business owners provided the tax revenue for King Louis XVI and his wars. They had to pay internal tariffs, or taxes on goods traded within France. The government also used private tax collectors, called “tax farmers,” who routinely took in far more than the government needed, and they pocketed the difference. It was a complicated, inefficient, and unjust system.

Heavy taxes, internal tariffs, and requirements that peasants provide free labor for the nobility led to poverty and hunger. Bad weather turned hunger into famine. Beginning in 1769, France experienced a series of meagre harvests. In some years, there was excessive rain and floods, in others, no rain at all.

The government’s removal of traditional price controls on grain led to speculation (risky investments), price gouging (charging more than what is fair for goods), and ultimately civil disorder. Hungry peasants forced merchants to lower prices. The French government’s response to the crises was inadequate at best; at worst, commoners suspected that the king had deliberately provoked the crises.

While harvests improved in the next few years, wet weather followed by cooler temperatures in 1784 led to reduced harvests throughout Europe. In July 1788, hailstorms followed by severe cold in winter led to huge food shortages and the threat of mass starvation in France.

Despite the heavy tax burden imposed on its poorest citizens, France was also in debt. For over a century, the monarchy had spent lavishly on luxuries, including the magnificent palace at Versailles. An expensive and unsuccessful war with Great Britain from 1756 to 1763, an aggressive ship-building program to restore the navy, and support for the American Revolution aggravated financial matters.



Wikimedia Commons

In October 1789, women marched on Versailles. What do you notice in the image? Based on the article, what do you think they were marching for?

Unable to raise taxes anymore on the common people, Louis XVI’s ministers had no choice but to turn to international money-lenders for help. The high interest rate France was charged quickly consumed much of the government’s income. To address the financial crises, Louis XVI convened the Council of Notables: a meeting of nobles, French Catholic Church leaders, and state functionaries. When this council could not resolve the crises, Louis took the even more extraordinary step of convening The Estates General at Versailles in May 1789.

The Estates General was an assembly that consisted of representatives of the three traditional classes, or estates, of French society. It had not met since 1614. The First Estate was the clergy, which numbered 10,000 persons and owned from 5 to 10 percent of French land. The Second Estate, the nobility, numbered some 400,000 persons. The Third Estate was the common people, businessmen, peasants, and everybody else in the French nation. It numbered 22 million persons, over 98 percent of the nation’s population.

Although Louis XVI had called the Estates General to initiate financial and tax reforms to meet the debt crises, events quickly took a radical turn. Members spent six weeks wrangling over whether the three estates should vote by estate, which would give a majority to the First and Second Estates, or as a single body, which would give the common people a majority. In the meantime, bread prices spiked across France causing civil unrest.

Out of frustration, the Third Estate broke away to deal with the crises. Some members of the First Estate joined, too. On June 17, this new body called itself the National Assembly. It cancelled and then re-imposed all taxes. This act was a bold seizure of government authority. The French Revolution had begun.

Meeting on Versailles’ indoor tennis court, the assembly members then took an oath not to disband until

they drafted a new constitution for France. The confrontation that followed between Louis and the National Assembly reached a crisis point when Louis brought regiments of Swiss and German mercenaries (paid soldiers) to Paris. For two days, the people of Paris fought the mercenaries. On the third day, July 14, Parisians with the help of deserters from the army stormed the medieval fortress of the Bastille in search of gunpowder, freeing its few prisoners and killing the commander of the tower.

Lafayette and the French Revolution

Lafayette had attended both the Council of Notables and the Estates General, where he was a representative of the nobility of Auvergne. As a *marquis* (pronounced mar-KEE), he was of the second highest order of nobility. His service in the American Revolution had also made him a popular hero in France. Working with Thomas Jefferson and revolutionary leader Honoré Mirabeau, he authored the *Declaration of the Rights of Man*, which the National Assembly adopted in August 1789.

In the radical politics of revolutionary France, Lafayette was a moderate. He hoped to restructure the nation as a constitutional monarchy, with limited authority given to the king. But his hope was impossible after years of anti-monarchy propaganda throughout the nation, worsening economic conditions, and frequent high prices for basic foodstuffs. Outside Paris, mobs of hungry peasants ransacked the estates of nobles, many of whom fled France with their lives and wealth.

For over a year, Lafayette served as commander of the National Guard and the army in and around Paris. His military experience in America, however, was not always useful in the streets. There he dealt with angry mobs who needed food and who believed that royalists (supporters of the king) plotted to keep food supplies low.

In October 1789, he rescued the royal family after a mob stormed Versailles. The king and queen were required to move to their Parisian palace of the Louvre, where they became virtual prisoners.

During the next few years, Lafayette tried to follow a middle ground between supporters of the royalty and the increasingly fanatical revolutionary groups who wanted the king deposed and even executed. Meanwhile, Louis and Queen Marie Antoinette secretly sought aid from the kings of Prussia and Austria. Afraid the revolutionary fever in France might spread to their lands, other European nations began to muster their troops to support the French king.

In June 1791, Louis and his family attempted to flee Paris in disguise for a town on the Belgian border guarded by troops loyal to the Crown (monarchy). They were recognized and captured, however, and returned to Paris.

Radical politicians accused Lafayette of conspiring to help the royals escape. He was defeated in an election for mayor of Paris in November 1791 but accepted command of part of the army defending France from an invasion by Prussian and Austrian forces.

Increasingly, he came into conflict with radical revolutionaries. In August 1792, he was unable to persuade the legislature to suppress the radicals or to convince his soldiers to march on Paris to rescue the royal family. He fled France.

He wished to go to the United States, and sneaked

into the Austrian Netherlands. Unfortunately, the Austrians identified and imprisoned him. During the next four years, Lafayette languished in foreign prisons in Prussia and Austria.

As the French Revolution continued, France experienced political murders on a scale unmatched until the Russian Revolution over a hundred years later. Over 40,000 persons were decapitated by the *guillotine* (pronounced GEE-yo-teen) device, and many more were executed by drowning, gunfire, axes, and knives. Revolutionaries stormed the prisons and murdered thousands of inmates suspected of royalist leanings as well as some children arrested for petty crimes.

Louis XVI and Marie Antoinette were guillotined in 1793. Their son died in ►

The Declaration of the Rights of Man (1789)

Read the excerpt from the Declaration below. In what ways was the National Assembly attempting to address the economic and political problems that caused the French Revolution?

Articles:

1. Men are born and remain free and equal in rights. Social distinctions may be founded only upon the general good.
2. The aim of all political association is the preservation of the natural and imprescriptible rights of man. These rights are liberty, property, security, and resistance to oppression.
3. The principle of all sovereignty resides essentially in the nation. No body nor individual may exercise any authority which does not proceed directly from the nation.
4. Liberty consists in the freedom to do everything which injures no one else; hence the exercise of the natural rights of each man has no limits except those which assure to the other members of the society the enjoyment of the same rights. These limits can only be determined by law.
- ...
13. A common contribution is essential for the maintenance of the public forces and for the cost of administration. This should be equitably distributed among all the citizens in proportion to their means.
14. All the citizens have a right to decide, either personally or by their representatives, as to the necessity of the public contribution; to grant this freely; to know to what uses it is put; and to fix the proportion, the mode of assessment and of collection and the duration of the taxes.



A monument to Lafayette in Lafayette Square, Washington, D.C., sculpted by Alexandre Falguiere. Why would Lafayette be so honored in our nation's capital?

prison at the age of ten after years of solitary confinement. Many of the French officers who had fought in the American Revolution along with Lafayette were also executed.

In October 1795, Lafayette's wife and two daughters were allowed to join him in prison. His son Georges was then living at the Mount Vernon home of his namesake, President George Washington. For 18 months the family lived in two small cells while Washington and Napoleon Bonaparte, then a general and French national hero, among others, lobbied for Lafayette's release.

When he was released in 1796, Lafayette was barred from returning to France until Bonaparte seized control in 1799. He refused to serve in Bonaparte's government, however. Bonaparte crowned himself Napoleon I, emperor, in 1804 as France redirected its revolutionary fervor to the conquest of other European nations.

Lafayette, however, lived a quiet, retired life, corresponding with Thomas Jefferson and entertaining American visitors to France. Following Napoleon's downfall in 1815, Lafayette secretly supported unsuccessful conspiracies against the restored monarchy.

'Hero of Two Worlds'

In 1824, Lafayette returned to the United States. He visited all twenty-four states. Crowds welcomed him everywhere as one of the last great leaders of the American Revolution. While at Bunker Hill in Boston, where an important battle of the American Revolution had been fought, he laid the cornerstone of a monument there.

When he returned to France in 1825, he found a nation under a new ambitious king, Charles X. For five years, as a member of the Chamber of Deputies, Lafayette opposed the king's efforts to restore absolute monarchy.

Finally, in 1830, revolution once again broke out in France. The 73-year-old Lafayette became its leader, joining the young revolutionaries at the barricades in the streets of Paris against royalist troops. After forcing Charles X to abdicate (give up power), Lafayette, fearing the outbreak of another civil war, engineered the rise of a new, more moderate king, Louis-Phillipe.

Four years later, acclaimed in France and the United States as the "Hero of Two Worlds," he died in Paris on May 20, 1834. Fulfilling his request to be buried under American and French soil, his son covered his coffin with soil brought from Bunker Hill.

WRITING & DISCUSSION

1. In what ways did the French Revolution have economic causes? In what ways did it have political causes?
2. The motto "Equality, Liberty, and Fraternity" is associated with the French Revolution. Does this motto accurately reflect the causes and outcome of the revolution? Explain.
3. What did it mean for Lafayette to be a "moderate revolutionary"? Use evidence from the article.
4. President John F. Kennedy gave a speech in which he said, "Those who would make peaceful revolution impossible make violent revolution inevitable." Does the history of the French Revolution support his statement? Why or why not?

ACTIVITY: Lafayette's Speech

The French government established the *Institut de France* in 1795. The Institut (meaning "institution" in English) aimed to promote the study of French literature, history, and the sciences.

1. Students form groups of three. One person in each group will be Lafayette. The other two will be his research assistants.
2. With the help of his research assistants, Lafayette must prepare a short speech about his life experiences, especially with regard to the revolutions he participated in.
3. Each group should use the article to prepare the short speech. If time allows, each group can conduct additional research.
4. Once ready, each group's Lafayette will deliver his speech to the whole Institut (the class). All other groups should take notes while listening to the speeches.
5. Debrief with the students by asking them how important was Lafayette's role in the revolutions that changed the world in the 18th century.

WHAT CAUSED THE GREAT DEPRESSION AND WHY DID RECOVERY TAKE SO LONG?

Economists still debate the causes of the Great Depression, especially why recovery took so long. One thing is clear. Few economists and political leaders at the time understood what was happening and what to do about it.



Wikimedia Commons/National Archives

A crowd gathers outside the New York Stock Exchange after the Crash of 1929.

Boom and Crash

The decade after World War I was generally a boom time for the United States. Business was good, many Americans enjoyed fair wages, and unemployment was low. Americans could buy houses, automobiles, and electric household appliances by making regular payments.

After World War I, countries in Europe and the United States restored the pre-war **gold standard** to stabilize their economies. Under this standard, all paper money in circulation had to be backed by its value in gold. For example, a \$20 bill was backed by one ounce of gold in 1929.

The gold standard regulated the amount of money governments and consumers could spend, which prevented runaway **inflation** (rapidly rising prices).

Established in 1913, the **U. S. Federal Reserve** is a central bank that sets interest rates that member banks charge when they borrow from each other. These rates influence the amount of interest consumers and businesses have to pay when they borrow money from the banks. The Federal Reserve's low interest rates in the 1920s encouraged consumer and business borrowing.

The Federal Reserve has the power to print money to expand the supply in circulation. But the gold standard limited this power at the time. Paper currency could not exceed the value of the amount of gold held by the United States. Actions by the Federal Reserve relating to interest rates and the money supply are called **monetary policy**.

In the later 1920s, investing in the stock market as a way to increase wealth became very popular. Speculators

borrowed heavily from banks to buy stocks in companies. As they poured money into the stock market, stock prices soared. In 1928, the Federal Reserve finally tightened its monetary policy by raising interest rates on borrowing. The Federal Reserve took this action to discourage loans to speculators who were riding a wild Wall Street stock market boom.

The Federal Reserve's higher interest rates succeeded in calming speculation on Wall Street. But, during the summer of 1929, uncertainty about future company earnings led investors to sell stocks. Panic hit Wall Street in October, and the stock market crashed when stock prices plunged sharply and continued to fall.

From Recession to Depression

From the end of 1929 into 1930, the boom of the 1920s turned into an economic slowdown called a **recession**. The stock market crash seemed to spook many consumers into holding back on their spending and borrowing. This drop in consumer **demand** for goods and services forced businesses to reduce their prices, an economic condition called **deflation**. Lower consumer demand also caused industries to reduce their production **output**, cut wages, and lay off workers.

Jobless workers drastically cut back their spending and often **defaulted** (stopped making payments) on their bank loans. Loan defaults prompted banks to make **credit** harder to get for those who wanted to borrow money.



Herbert Hoover (left) and Franklin D. Roosevelt (right) in Washington, D.C. (1933). What did both men do as president to try to stop the Great Depression?

As the recession worsened, President Herbert Hoover put his faith in the capitalist economy to repair itself. Hoover's secretary of the treasury, Andrew Mellon, declared that the recession should be allowed to follow its natural course.

Hoover's priority was to balance the federal budget by raising taxes and cutting government spending. Matters that involve government taxes and spending are called **fiscal policy**.

In 1930, Hoover signed a tariff act to protect farmers and manufacturers from foreign competition. But the higher tariffs (taxes on imports) provoked a trade war with other countries that harmed U. S. export companies. More unemployment resulted.

In 1931, a financial crisis hit. Panicked depositors demanded to withdraw their money from banks. These "bank runs" put stress on the many banks that did not have the cash to pay their depositors. These banks had to close.

The Federal Reserve was the "lender of last resort" for the nation's banks when they got into trouble. But, sticking by the gold standard, the Federal Reserve refused to inject more money into the banking system even though more cash was needed to stop the bank runs.

Rather than lowering interest rates to stimulate borrowing and spending, the Federal Reserve in 1931 increased interest rates to persuade foreign investors to keep their money in the United States.

Hoover resisted intervening in the banking system. But late in his term he established a federal program to

loan money to the banks, which the Federal Reserve had refused to do. This action was too little and too late to save many of the banks.

The recession worsened into a much more severe economic crisis called a **depression**. By early 1933, unemployment reached about 25 percent. Industrial output was down by more than 50 percent. A third of the nation's banks were closed or taken over by other banks. Consumer spending and business investment collapsed.

The period from 1929 to 1933 was the depth of the Great Depression. In 1933, President Franklin D. Roosevelt took office, stabilized the banking system, and abandoned the gold standard. These actions freed the Federal Reserve to expand the money supply, which slowed the downward spiral of price deflation and began a long slow crawl to economic recovery. The Great Depression finally ended in the early 1940s.

What Caused the Great Depression?

Surprisingly, economists are still debating today about what caused the Great Depression. Below are some theories by leading economists:

Household Debt

Low-interest borrowing rates and installment credit in the 1920s led to higher household debt. The prosperity of this time was largely built upon household debt as spending rose faster than income.

When the recession worsened, many Americans found themselves in a financial trap caused by "debt deflation." This means that the more wages fall, the fewer dollars the person has to make debt payments that always remain constant.

Economist Irving Fisher explained in 1933 that to keep up with their house, auto, and other debt payments, people cut back on their spending. This, he said, was the major reason consumer demand dropped, which caused more price and wage deflation, less investment, falling output by companies, and layoffs. Many eventually stopped making payments on their loans, which helped to cause the banks to fail. Thus, household debt and debt deflation, according to Fisher, pushed a recession into a depression.

Failure of the Federal Reserve

In 1963, University of Chicago economist Milton Friedman and economic researcher Anna Schwartz found that the money supply in circulation between

The Difference Between a Recession and a Depression

A **recession** is a general slowing down of economic activity, such as investment spending by businesses and household income, with a decrease in gross domestic product (GDP). GDP is a measure of the total monetary value of all goods and services a nation produces in any given quarter (three-month period) or year. A recession is accompanied by an increase in unemployment and bankruptcies. Economic journalists typically define a recession as an economic slowdown that lasts more than two quarters.

A **depression** is a longer-lasting and more severe form of a recession. According to *The Economist* magazine, a depression occurs when GDP declines more than 10 percent, or when a recession lasts more than three years. The Great Depression qualifies using both measures.

President Harry Truman had a humorous rule to distinguish recessions and depressions: "It's a recession when your neighbor loses his job; it's a depression when you lose yours."

1929 and 1933 fell by a third. This was due mainly to hoarding of cash by frightened households and businesses.

Friedman and Schwartz blamed the Federal Reserve for failing to increase the money supply to the banks, causing banks to fail and freezing credit for consumers. The two economists argued this was the chief cause of the drop in consumer demand that crippled the economy.

Friedman and Schwartz said the Federal Reserve made a bad recession into a depression when its leaders called for more money in the economy only when business was good, even when the banks were desperate for more cash. When panicked depositors withdrew their money, the banks failed, lending stopped, and the economy fell into a depression.

The Gold Standard

For two decades, most economists accepted the Friedman and Schwartz theory that the Federal Reserve's monetary policy caused the Great Depression. But, in 1983, Stanford economist Ben Bernanke proposed that several other causes, especially the gold standard, played a part, too.

Bernanke accepted the analysis of Friedman and Schwartz about the inadequate money supply but blamed the gold standard as the major cause. He noted that countries that abandoned it early, like Britain in 1931, had more freedom to get money circulating in the economy. Those countries that stayed on the gold standard longer, as the U. S. did until 1933, sank deeper into depression.

Bernanke explained that because of the restrictions the gold standard put on the money supply, the Federal Reserve did not act, and banks failed. The resulting interruption of lending depressed demand, which sent into motion the chain of events that led to mass unemployment.

Why Did the Recovery Take So Long?

When he entered office in 1933, President Roosevelt got the banking system working again. But Bernanke argues that the banks tended to be too cautious about lending too long into the recovery. This held down consumer borrowing and spending necessary to get the nation's factories humming again.

FDR had no recovery plan in place for the damage already done to the economy. At first he adopted Hoover's policy of reducing government spending. But spending by consumers and business did not revive and the demand for goods and service remained down.

FDR soon increased government spending with numerous New Deal programs and agencies. These generally improved the economy and reduced unemployment, but very slowly.

Some New Deal programs did not work well. The National Industrial Recovery Act (NIRA) of 1933



First Lady Eleanor Roosevelt at a Works Project Administration (WPA) site in Iowa (1936). The WPA was the largest New Deal program, employing millions of people in public works projects.

attempted to restructure the economy. The NIRA created over 500 industrial groups that set limits on production to raise prices and negotiated higher wages. This program did not speed up the recovery and was declared unconstitutional by the Supreme Court in 1935.

Shortly after the creation of the NIRA, British economist John Maynard Keynes advised Roosevelt in a letter to boost government spending, financed by borrowing rather than taxes, for "a program of public works" to reduce unemployment.

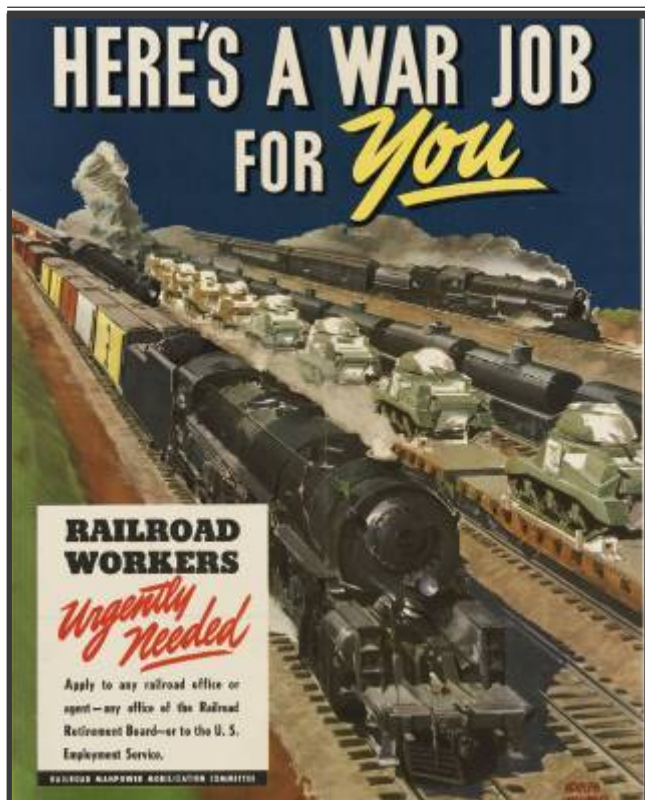
Roosevelt eventually created several public works programs to build roads, dams, and public buildings. These and other New Deal programs helped increase economic output and reduce the unemployment rate from nearly 25 to 17 percent by 1936.

When Roosevelt saw that the recovery was improving, he decided to balance the federal budget by cutting public works spending. But, following Roosevelt's landslide re-election in 1936, business investment stalled, economic output dropped, stock prices fell, farms in the Midwest closed due to droughts and dust storms, and the jobless rate rose again. The 1937-38 economic downturn, is often called the "Roosevelt Recession."

The recession stirred a debate among FDR's advisors. Some argued that FDR should follow the advice of Keynes and borrow to fund large-scale public works. Others argued that FDR should continue to reduce spending and balance the budget to reduce the large national debt. FDR finally decided on a moderate increase in spending for public works. The economy gradually improved.

Theories About the Recovery

Some today argue that government interference in the U. S. free market economy held back the recovery. Conservative economists sharply criticize the NIRA as a social reform disaster that purposely cut production and raised wages that discouraged hiring.



"Here's a War Job For You" by artist Adolph Triedler (ca. 1941-1945). How did wartime spending help to end the Great Depression?

The "Roosevelt Recession," conservative economists say, was in large part caused by higher employer labor costs brought on by a new law requiring union collective bargaining for higher wages and Social Security taxes. Employers responded by cutting hiring and investment.

While the economy began to grow again by 1939, the conservative critics argue that the New Deal was hostile to business, which caused a decline in investment in the economy. They point out that economic output and employment remained below 1929 levels. The unemployment rate in 1940 was still at a depression level of about 15 percent.

By contrast, liberal economists today often claim that the reason the recovery struggled so long was that the government did not go far enough. In 1936, John Maynard Keynes wrote an influential book, arguing for a fiscal stimulus policy. This meant the government should borrow and spend when consumers and businesses did not. This was necessary, Keynes wrote, not only to put more people back to work, but to stimulate demand for goods and services.

Keynes proposed that government projects should hire many more of the unemployed. They would then

spend and increase demand, which would boost sales, get factories busy, and spur more hiring until the free market economy could function on its own. To get this "multiplier effect" started, Keynes said, the government needed to borrow and spend a lot more.

But Roosevelt never fully adopted Keynes's views. Many liberal economists today say Keynes's fiscal stimulus idea contributed little to speeding up the recovery, but could have done much more if FDR had enthusiastically adopted it.

What Finally Ended the Great Depression?

In 1939, war broke out in Europe. When U. S. neutrality ended, Britain and France purchased massive quantities of war materials. This and war-readiness spending by Congress had a dramatic effect on the U. S. economy as factories reopened and hiring jumped.

Helped by the military draft after the Pearl Harbor attack in 1941, the unemployment rate plunged from 14.6 percent in 1940 to 4.7 percent two years later. By 1945, the U. S. was spending \$90 billion a year on the war. When World War II ended, the U. S. was the economic powerhouse of the world.

WRITING & DISCUSSION

1. What do you think was the most important cause of the Great Depression? Why?
2. What do you think is the best explanation for the long, slow recovery of the Great Depression? Explain.
3. Based on your study of the causes and long recovery of the Great Depression, what do you think is the most important lesson we should draw from it today? Explain.

ACTIVITY: A Plan for the Recovery

When he took office in 1933, President Franklin D. Roosevelt really had no plan for a recovery from the Great Depression. Meet in small groups to develop a plan of policies you think he should have adopted in these areas:

1. interest rates on borrowing by individuals and businesses
2. government borrowing and spending
3. taxes
4. wages
5. unemployment

Be prepared to defend your plan by gathering arguments and evidence from the article.



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Standards Addressed

GREAT RECESSION

National Civics Standard 25: Understands issues regarding personal, political, and economic rights. **High:** (3) Understands issues regarding personal, political, and economic rights.

National Civics Standard 26: Understands issues regarding the proper scope and limits of rights and the relationships among personal, political, and economic rights. **High:** (6) Understands the relationship between political rights and the economic right to acquire, use, transfer, and dispose of property.

National Economics Standard 6: Understands the roles government plays in the United States economy. **High:** (1) Understands that because citizens, government employees, and elected officials do not always directly bear the costs of their political decisions, sometimes policies have costs that outweigh their benefits for society.

National Economics Standard 9: Understands how Gross Domestic Product and inflation and deflation provide indications of the state of the economy.

California Principles of Economics HSS Standard 12.3: Students analyze the influence of the federal government on the American economy. (3) Describe the aims of government fiscal policies (taxation, borrowing, spending) and their influence on production, employment, and price levels. (4) Understand the aims and tools of monetary policy and their influence on economic activity (e.g., the Federal Reserve).

Common Core State Standards: SL.1, SL.3, RH.1, RH.2, RH.3, RH.4, RH.7, RH.10, WHST.1, WHST.2, WHST.9, WHST.10.

MARQUIS DE LAFAYETTE

National World History Standard 32: Understands the causes and consequences of political revolutions in the late 18th and early 19th centuries. **Elementary:** (1) Understands the ideas and events that shaped the Revolution in France. **Middle:** (2) Understands events and ideas that influenced the course of the French Revolution (e.g., how the revolution developed from constitutional monarchy to democratic despotism to the Napoleonic empire; the organization of the Estates-General and its merits and limitations; central ideas and origins of the Declaration of Rights of Man and Citizen). **High:** (4) Understands the political beliefs and writings that emerged during the French Revolution.

California HSS Standard 5.3: Students understand the course and consequences of the American Revolution. (2) Describe the contributions of France and other nations and of individuals to the outcome of the Revolution (e.g., the Marquis Marie Joseph de Lafayette).

California HSS Standard 10.2: Students compare and contrast the Glorious Revolution of England, the American Revolution, and the French Revolution and their enduring effects worldwide on the political expectations for self-government and individual liberty. (2) List the principles of . . . the French Declaration of the Rights of

Man and the Citizen (1789). (4) Explain how the ideology of the French Revolution led France to develop from constitutional monarchy to democratic despotism to the Napoleonic empire.

Common Core State Standards: SL.1, SL.3, RH.1, RH.2, RH.3, RH.4, RH.10, WHST.1, WHST.2, WHST.9, WHST.10.

THE GREAT DEPRESSION

National U.S. History Standard 23: Understands the causes of the Great Depression and how it affected American society. **Elementary:** (1) Understands economic aspects of the Great Depression. **Middle:** (1) Understands various political influences on the Great Depression.

National U.S. History Standard 24: Understands how the New Deal addressed the Great Depression, transformed American federalism, and initiated the welfare state. **High:** (3) Understands how the New Deal influenced labor and employment . . . (5) Understands the significance and ideology of FDR and the New Deal.

National Economics Standard 8: Understands basic concepts of United States fiscal policy and monetary policy. **High:** (1) Knows that fiscal policy involves the use of national government spending and taxation programs to affect the level of economic activity in order to promote price stability, maximum employment, and reasonable economic growth. (5) Knows that monetary policy refers to actions by the Federal Reserve System that lead to changes in the amount of money in circulation and the availability of credit in the financial system.

National Economics Standard 9: Understands how Gross Domestic Product and inflation and deflation provide indications of the state of the economy.

California HSS Standard 11.6: Students analyze the different explanations for the Great Depression and how the New Deal fundamentally changed the role of the federal government. (2) Understand the explanations of the principal causes of the Great Depression and the steps taken by the Federal Reserve, Congress, and Presidents Herbert Hoover and Franklin Delano Roosevelt to combat the economic crisis. (4) Analyze the effects of and the controversies arising from New Deal economic policies and the expanded role of the federal government in society and the economy since the 1930s.

Common Core State Standards: SL.1, SL.3, RH.1, RH.2, RH.3, RH.4, RH.10, WHST.1, WHST.2, WHST.9, WHST.10.

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Constitutional Rights Foundation (CRF) has been awarded a new grant from the Center for the Future of Teaching & Learning at WestEd to work with teacher leaders to enhance instructional practices that engage students in critical thinking and improve reading, writing, and discussion skills.

We have fabulous partners: Los Angeles County Office of Education, Carolina K-12 at University of North Carolina-Chapel Hill, and the Florida Joint Center for Citizenship at the Lou Frey Institute housed at University of Central Florida.

CRF and our partners are working with 20 teacher leaders who will be featured in upcoming issues of *Bill of Rights in Action*. We will share tips, lessons, and resources on CRF's and partner websites throughout the year! Look for the  icon!

There are two ways for you to participate in the T2T Collab:

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This project is part of the Center for Teaching & Learning's Teacher Practice Network and is funded by the Bill & Melinda Gates Foundation.

About Constitutional Rights Foundation

Constitutional Rights Foundation is a non-profit, non-partisan educational organization committed to helping our nation's young people to become active citizens and to understand the rule of law, the legal process, and their constitutional heritage. Established in 1962, CRF is guided by a dedicated board of directors drawn from the worlds of law, business, government, education, and the media. CRF's program areas include the California State Mock Trial, youth internship programs, youth leadership and civic participation programs, youth conferences, teacher professional development, and publications and curriculum materials.

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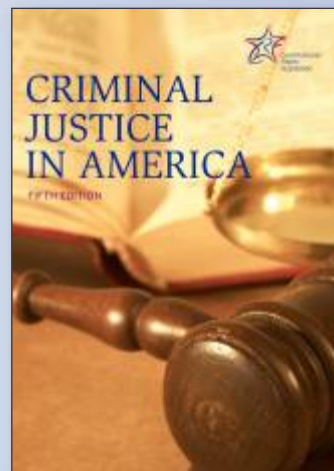
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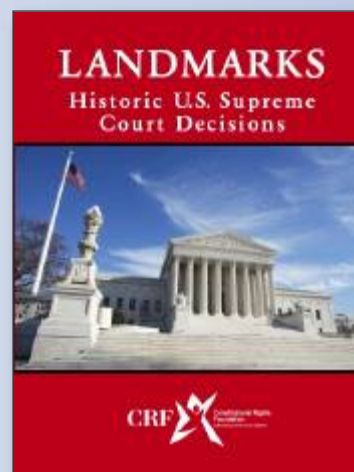
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Teacher Leaders, Collaboration, and Implementation of New State Standards

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