

100 YEARS OF THE FEDERAL RESERVE SYSTEM

Defining Moments in
Federal Reserve System History: 1907-1935

FRS Centennial Lesson Plan



Lesson authors

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Lesson Description

This lesson presents a history of Federal Reserve events and milestones from 1907 to 1935. Defining events are highlighted by a readers' theater to help students better understand the time period. After each reader's theater scene, students write key information in a Centennial Journal to track the events and their historical impact. Students then complete a handout requiring them to explain the Federal Reserve's role in the key events during this period and how the Federal Reserve has changed over time. Students learning is assessed by their completion of an essay on the Federal Reserve System's ability to promote stable prices and economic growth over time.

Grade Level

9–12

Standards and Benchmarks

See page 25

Concepts

Advice and consent
Commercial banks
Economic growth
Federal Open Market Committee (FOMC)
Governor
Independent central bank
Investment banks
Lender of last resort
Liquidity
Monetary policy
Money supply
Open market operations
Price stability
Reserves
Reserve requirement
Securities (Treasury)
Speculator
Unemployment

Objectives

Students will be able to:

- identify how the Federal Reserve’s role, functions, and tools have remained consistent and/or changed over time using a readers’ theater and Federal Reserve System concept bank;
- discuss the impact of innovation in the banking industry; and
- examine the relevance and evolution of the Federal Reserve System as an independent central bank.

Time Required

Two 45-minute class periods

Materials

- Handouts 1, 2, 4, and 5, one copy of each for each student
- Handout 3 cut into cards
- Name tags for reader’s theater characters
- Microphone for Econ Ed (optional)

Procedures

1. Ask students if they know how banks get their currency and coin. Explain that banks get their currency and coin from the Federal Reserve, also called the Fed, which is the central bank of the United States. The Federal Reserve has this function and several others that make it important to the U.S. economy. Explain the following:
 - The Federal Reserve operates the country’s payment system. The Federal Reserve includes 12 regional Reserve Banks that maintain accounts for **commercial banks**, process checks, and operate a system for electronic transfers of money between accounts, which allows bank customers to use electronic tools, such as debit cards, to make purchases and withdraw money from their accounts.
 - The Federal Reserve supervises state-chartered member banks to ensure that they operate in a safe and sound manner. National banks, all of which are also Fed members, are supervised by the Office of the Comptroller of the Currency, which is part of the U.S. Department of the Treasury. State-chartered banks that are not members of the Federal Reserve System are supervised by the Federal Deposit Insurance Corporation (FDIC) and state banking authorities.
 - The Federal Reserve serves as banker for the U.S. Treasury. The Federal Government has accounts with the Federal Reserve, which are used to pay the government’s bills.

2. Explain that the Federal Reserve Act that established the Federal Reserve System was passed by Congress in 1913 and signed into law by President Woodrow Wilson. The Reserve Banks opened for business in 1914. In 2013-14, the Federal Reserve is celebrating its centennial—100 years of service to Americans.
3. Explain that there have been many defining moments in Federal Reserve history over the past 100 years and that students will participate in a readers' theater to better understand the importance of some key events that took place in the early history of the Fed.
4. Distribute *Handout 1: Federal Reserve System Concept Bank* and explain that this lesson introduces terms with which the students may not be familiar. Have students take turns reading definitions out loud and provide the additional explanations below for some of the terms.
 - **Advice and consent – (Part of the process for nominating people to executive and judicial posts)** Under the Constitution, presidential nominations for executive and judicial posts take effect only when confirmed by the senate.
 - **Commercial banks – Financial institutions that accept deposits and make loans to individuals and businesses.**
 - **Economic growth – A sustained rise over time in a nation's production of goods and services.**

Explain that economic growth is a key indicator of the health of an economy. When economic growth is positive, the economy is producing more goods and services than it did in the preceding period. This growth means there are more goods and services available for consumers to enjoy. If economic growth is negative, the economy is producing fewer goods and services than it did in the preceding period.
 - **Federal Open Market Committee (FOMC) – The Federal Reserve's chief body for conducting monetary policy.**

Explain that the FOMC consists of the Board of Governors and 5 of the 12 Federal Reserve Bank presidents. Fed presidents rotate on and off the Committee at regular intervals. All 12 Reserve Bank presidents attend every meeting of the FOMC and participate in the deliberations, whether they are currently voting members or not.
 - **Independent central bank – A central bank enacting monetary policy, free from the dictates of legislators.**

Explain that the Federal Reserve is the central bank of the United States. One of its responsibilities is to conduct monetary policy for the purpose of keeping prices stable and maximizing employment, which are objectives given to the Fed by Congress. However, the Fed has the independence to determine how best to achieve these objectives without political interference. Central bank independence enables the Fed to focus on the long-run performance of the economy.

- **Investment banks – Financial intermediaries that help corporations raise money by assisting those corporations in selling stock or debt securities (bonds) to investors.**

Explain that when a company wants to raise money to expand its operations, it might decide to let other people become part owners by selling stock. It is difficult for companies to do this on their own because the prospective buyers of the stock may not trust that the company is stable and a sound investment. Investment banks research the company and provide reports that describe everything about the company so that potential owners have the information needed to make a sound decision. Investment banks also help businesses borrow money by issuing bonds. Bonds are like IOUs that people purchase and hold for a certain amount of time. When that time is up and the bond has matured, the bond holder is paid back. Investment banks receive a fee for these services.

- **Lender of last resort – The Federal Reserve’s role in providing short-term loans to financial institutions or markets to help calm financial panics.**

Explain, when banks want to borrow money, they usually borrow from other banks. However, when there is a financial panic, banks may be unwilling to lend to one another. The Federal Reserve makes loans available to banks to ensure that banks have enough liquidity to operate until the crisis is over.

- **Liquidity – The quality that makes an asset easily convertible into cash with relatively little loss of value in the conversion process.**

Explain that many things have monetary value, such as a house, a car, stocks, a checking account, and baseball cards. Some of these items of value can be used right away to make a purchase. For example, a checking account can be used immediately to buy anything from a cup of coffee to a car (provided the balance in the account is sufficient). However, even though a house may have a large monetary value, it cannot be used immediately to buy coffee or a car. It takes time to find a buyer for a house and to transfer ownership. Only then can someone use the house to make purchases. A checking account is easily converted into cash, so it has high liquidity. A house is not easily converted into cash, so it has low liquidity.

- **Monetary policy – Central bank actions involving the use of the interest rate or money supply tools to achieve such goals as maximum employment and stable prices.**

Explain that one problem in an economy could be an increase in the average level of prices. This happens when, for a given stock of goods and services, an increase in the amount of money in circulation causes prices to be bid up as firms raise prices to maximize their profits. A sustained increase in the average price level for goods and services is referred to as “inflation.” Because inflation imposes costs on society, the Fed responds to it by tightening monetary policy to raise interest rates and slow the growth of the money supply in an effort to reduce the demand for goods and services and slow the increase in the price level.

- **Money supply – The quantity of money available in an economy.**
The basic money supply in the United States consists of currency, coins and checking account (demand) deposits. Also known as money stock.
- **Open market operations – The buying and selling of government securities by the Federal Reserve to control the money supply.**
Explain that one way the Fed enacts monetary policy is through open market operations. If the Fed sells a government security, the buyer pays for the security with money. That means the person or institution that bought the security now has less money, so there is less money in the economy to buy goods and services. The Fed might sell government securities when it sees the average level of prices increasing.
- **Reserve requirement – The percentage of a bank’s deposits it is required by law to hold, either as cash in its vault or on deposit with the Federal Reserve.**
Explain that bank deposits in excess of those held as required reserves, termed excess reserves, may be lent to customers.
- **Reserves – The sum of cash that banks hold in their vaults and the deposits they maintain with Federal Reserve Banks.**
Explain that some of the students in the class may have checking accounts, as well as some money tucked away in a bank in their bedroom or kept as cash in their wallets. Reserves are banks’ version of the checking account and the money kept in a bank in a bedroom. Just as people have accounts at a local bank, the local bank may keep an account at a Federal Reserve Bank.
- **Securities (Treasury) – Certificates of indebtedness issued by the Department of the Treasury on behalf of the U.S. government.**
Explain that in more general financial terms, securities include corporate bonds, which are issued to people who lend the corporation money. The term can also mean stocks, which are issued to people and institutions who buy part ownership in a company.
- **Speculators – People who take large financial risks in search of large rewards.**
- **Unemployment – A condition where people are without jobs and actively seeking work.**
Explain that only people who are not working but are seeking work are considered unemployed. People who are retired or choose to stay home with children are not considered unemployed (similarly, students are not considered unemployed).

5. Distribute a copy of *Handout 2: Reader’s Theater* to each student. Assign roles as follows: Econ Ed (assign a different Ed for each of the five scenes); Mr./Ms. Moneybucks; Senator Politico; Mr./Ms. Educator; Mr./Ms. Farmer; Mr./Ms. Director. Give name tags to the characters and designate an area of the classroom as the stage. Direct students to remain seated and take the stage only for their character’s scene.

6. Distribute cards cut from *Handout 3: Concept Cards* to 14 students. Point out that the scenes in which these concepts appear are shown on the card. Students should take the stage only for scenes in which their concepts are discussed. Tell students when they hear their concept mentioned during the reader's theater, they are to move to the front of the readers, state their term, and read the definition aloud. When finished, the student holding the concept card is to move to the rear and all action can resume. Direct the readers to freeze the action whenever they arrive at a word in bold text to allow the definition of that word to be read.
7. Distribute *Handout 4: Centennial Journal* to each student. Tell students to follow each scene carefully because they will be summarizing four historic events and their importance in Fed history. Begin the reader's theater, stopping at the end of each scene so that students can complete their Centennial Journal. Read through as many scenes as possible on Day 1. On Day 2, continue the reader's theater until all scenes and journal entries are completed.
8. Distribute *Handout 5: Key Moments in Federal Reserve History* to each student, directing them to use their scripts and journals to assist them in completing the handout.
9. Distribute *Handout 6: Assessment Essay*. Review the instructions:
Use the information from the lesson to write a short essay as directed in the prompt. Your essay should be five paragraphs long, include an introduction and conclusion, and contain specific examples to support your arguments.

Prompt: How did the structure and responsibilities of the Federal Reserve evolve over time to promote the following?

- Stable prices
- Economic growth
- An independent central bank, free from the dictates of legislators

Handout 1: Federal Reserve System Concept Bank

Advice and Consent – Part of the process for nominating people to executive and judicial posts

Commercial banks – Financial institutions that accept deposits and make loans to individuals and businesses.

Economic growth – A sustained rise over time in a nation’s production of goods and services.

Federal Open Market Committee (FOMC) – The Federal Reserve’s chief body for conducting monetary policy.

Governor – The head of the Federal Reserve Regional Banks, later titled president. Currently, members of the Federal Reserve System Board are referred to as Governors.

Independent central bank – A central bank enacting monetary policy, free from the dictates of legislators.

Investment banks – Financial intermediaries that help corporations raise money by assisting those corporations in selling stock or debt securities (bonds) to investors.

Lender of last resort – The Federal Reserve’s role in providing short-term loans to financial institutions or markets to help calm financial panics.

Liquidity – The quality that makes an asset easily convertible into cash with relatively little loss of value in the conversion process.

Monetary policy – Central bank actions involving the use of the interest rate or money supply tools to achieve such goals as maximum employment and stable prices.

Money supply – The quantity of money available in an economy.

Open market operations – The buying and selling of government securities by the Federal Reserve to control the money supply.

Reserve requirement – The percentage of a bank’s deposits it is required by law to hold, either as cash in its vault or on deposit with the Federal Reserve.

Reserves – The sum of cash that banks hold in their vaults and the deposits they maintain with Federal Reserve Banks.

Securities (Treasury) – Certificates of indebtedness issued by the Department of the Treasury on behalf of the U.S. government.

Speculators – People who take large financial risks in search of large rewards.

Unemployment – A condition where people are without jobs and actively seeking work.

Handout 2: Reader's Theater

Defining Moments in Federal Reserve History:

Act 1: 1907-1935

Scene 1: Outside the Federal Reserve Board of Governors Building in Washington, D.C.

Characters: Econ Ed, economics newscaster; Mr./Ms. Moneybucks, retired banker

Econ Ed: Hello, America! This is Econ Ed, your favorite economic newscaster, reporting live from our nation's capital, Washington, D.C. Welcome to tonight's broadcast, "The Centennial of the Federal Reserve: Not Just Your Average Bank!" Join us as we celebrate 100 years of Fed history in a unique and exciting way. Through NASA's latest initiative, the Time Travel Trekker, we'll journey back to earlier days and learn firsthand about the Fed's impact on our country. I'll interview folks who lived through those historic times to get up-close-and-personal accounts of defining moments in Fed history. Ready to trek? Our first interview takes us to 1914 to meet Mr./Ms. Moneybucks, a retired banker with insight on the early days of the Federal Reserve. Greetings, Mr./Mrs. Moneybucks.

Moneybucks: Hello there, Ed! I hope I can help your viewers better understand the founding and early development of the Federal Reserve System.

Econ Ed: Mr./Ms. Moneybucks, let's go back several years to the Bank Panic of 1907. Do you remember what happened during that time period to **commercial banks**?

Moneybucks: You bet I do! I was a bank officer at the Mercantile Bank in New York at the time. We got news that poor investments were made by stock market **speculators**. For example, some of these speculators were the Heinze brothers, who had tried and failed to capture a corner of the copper market. Some banks, such as the Knickerbocker Trust Company, had lent lots of money to speculators. And, because of huge speculator losses, depositors feared that that bank was on the verge of collapse. This fear spread and there were runs on many other U.S. banks as well. See, banks keep only a certain percentage of their deposits on hand; the rest is lent out or invested to turn a profit. Knowing this, folks flocked to the banks to get their own money before it could be lost too. There were lines of angry customers for days!

Econ Ed: That must have been rough! Did anyone come forward to help depositors during the turmoil?

Moneybucks: That wealthy banker, J. P. Morgan, and his banking committee agreed to bail out certain banks if an audit showed the banks to be solvent—that is, financially sound. Also that oil tycoon, J. D. Rockefeller, was willing to lend \$10 million to try to stabilize the banking system. Still, banks were hurting. See, even though some of the banks were healthy institutions, they had problems with **liquidity**. Because of the low liquidity of banks' investment and loans, they couldn't immediately convert them into cash to satisfy depositors' demands, especially during a bank run.

Econ Ed: What about the U.S. Treasury? Didn't the government care about depositors who were losing their money?

Moneybucks: Well, the Treasury eventually did take action to shore up bank finances. Secretary Cortelyou pledged \$25 million to lend to banks in trouble.

Econ Ed: Wow! How did it all end?

Moneybucks: Morgan and his crew arranged for additional bailout funds, and the banking crisis finally subsided. But everyone was still upset over their bank losses and the lack of supervision in our financial system that allowed such losses to happen. Soon after, legislation was passed so the Treasury could issue emergency currency when banks experienced a short-term liquidity problem. That is, the Treasury could lend banks money when banks needed more cash on hand during an emergency. The legislation also established the National Monetary Commission, which researched the problems in the U.S. banking system and compared our system with those in other countries.

Econ Ed: Ahh! The start of the Federal Reserve!

Moneybucks: Not quite! But it did set the stage for the Federal Reserve Act, which followed in 1913. To get the inside story on that event, you need to interview my friend, Senator Politico.

Econ Ed: Will do! Well time travelers, let's trek on to meet the good senator and further our knowledge of defining Fed moments. On to Capitol Hill...

Scene 2: Outside the Capitol Building in Washington, D.C.

Characters: Econ Ed, economics newscaster; Senator Politico, member of congress

Econ Ed: Whoosh! Gotta love that time travel! It's now 1920 and here comes the senator now. Hello, Senator Politico! Would you be willing to share your insights on the development and signing of the Federal Reserve Act?

Senator: Hello! I'm on my way to an important congressional vote, but I have a few minutes to explain how the act came to be. It was quite a battle!

Econ Ed: Really? I didn't know combat was involved.

Senator: Verbal combat, my man, between the Republicans and Democrats! They argued about the number of regional Reserve Banks, the makeup of the Federal Reserve Board, the amount of influence bankers should have. You name it, they fought about it!

Econ Ed: So, which congressional members were the key players in this battle?

Senator: Well, let's see. Once President Wilson was elected, Representative Carter Glass from Virginia got the ball rolling. We also elicited expert advice from H. Parker Willis, an economics professor from Washington and Lee University. They favored regional control with up to 20 banks because they believed that regional bankers should have more power than the government.

Econ Ed: What did President Wilson think of that?

Senator: Wilson was wise enough to know that Congress and the public wouldn't like a plan that gave the government little control. So he added the idea of a centralized government board made up of presidential appointees to oversee the Federal Reserve.

Econ Ed: That change should have pleased those who wanted more government input. So was it a done deal after that addition?

Senator: There was still debate—you know politicians, it's never easy to compromise! Then Senator Robert Owen from Oklahoma submitted a revised bill suggesting 8 to 12 regional Reserve Banks. Other differences were slowly hammered out and the final bill was signed by President Wilson on December 23, 1913.

Econ Ed: So, Senator, can you fill us in on just how this bill represents a compromise?

Senator: Sure. This compromise structured a seven-member Federal Reserve Board, which is a government board charged with overseeing regional Banks. Board members are appointed by the president with the **advice and consent** of the Senate and serve 10-year staggered terms. That way, members' terms are not all up at once, which adds both continuity and variety in political and economic viewpoints.

Econ Ed: What about the regional Banks? Where do they fit into the bill?

Senator: Excellent question. The central authority of the board is balanced by regional authority through the establishment of 12 regional Reserve Banks. Each regional Bank has its own board of directors composed of bankers and business leaders from within that Federal Reserve region. These regions are also known as districts. Each board of directors chooses its own leader to head its Bank, and this leader is called a **governor**. The role of these regional Banks is to provide **liquidity** to foster confidence in the banking system. Because of this role, the Federal Reserve is considered the **lender of last resort**. So, the Federal Reserve is a blend of public and private interests.

- Econ Ed:** So the central government doesn't have total control, and the regional Banks don't have total control either. Interesting!
- Senator:** The bill provided another essential role for the Fed by allowing it to house the U.S. government's money and act as the nation's banker.
- Econ Ed:** So the Federal Reserve was up and running!
- Senator:** Not yet. The bill laid the foundation, but there were many hurdles to face. We had to decide which cities should have regional Banks. Talk about controversy! Seems every city wanted a Federal Reserve Bank. It took another year for the 12 cities to finally be chosen. The Fed was officially open for business as the next hurdle presented itself—World War I.
- Econ Ed:** Ah, yes! Can you tell us how the Fed responded to that challenge?
- Senator:** Sorry, I'm overdue for the congressional vote! I recommend talking to Mr./Ms. Educator, my former history teacher, to shed some light on the subject.
- Econ Ed:** Thanks, Senator! Okay, fellow historians, let's time travel to 1928 to see if we can catch Mr./Ms. Educator for a look at the Fed's support in funding U.S. involvement in World War I. Hang on to your hats...

Scene 3: Outside Thomas Jefferson High School

Characters: Econ Ed, economic newscaster; Mr./Ms. Educator, history teacher

- Econ Ed:** Hello, Mr./Ms. Educator. Do you have time to share your thoughts about World War I from the Fed's perspective?
- Educator:** Certainly. Teaching history is my job, so I'd love to share what I know.
- Econ Ed:** What role did the Fed play during the war?
- Educator:** Well, once the U.S. entered WWI in 1917, the government needed a way to finance U.S. participation. The Treasury decided to sell Liberty Bonds to citizens as a way to support the war effort. Americans felt it was their patriotic duty to invest in bonds to help U.S. soldiers overseas. I personally bought bonds during each of the four government-issue periods. I wanted to do my part!
- Econ Ed:** Of course. And where does the Fed come into this story?
- Educator:** The Fed kept interest rates low to help banks keep the cost of borrowing low. Low rates encouraged people to borrow money and increased the amount of cash circulating in the economy and provided an incentive to invest in Liberty Bonds. This was the first introduction to bonds for many people. I think this also helped people accept the idea of the Fed's later use of **open market operations**, which is purchasing or selling government **securities**, as a **monetary policy** tool.

Econ Ed: Would you share the skinny version of exactly what monetary policy is?

Educator: Well, in short, monetary policy is essentially the actions a central bank takes to try to influence the cost of credit, that is, interest rates on loans, by affecting the **money supply**. To affect the money supply, the Fed buys and sells government securities, which changes the amount of money banks have available for lending. This money is called **reserves**. When banks have more money for lending—more reserves—interest rates fall and they tend to offer more loans. Here’s how it works: When the Fed buys government securities, the money they pay to sellers is deposited into the sellers’ bank accounts, providing more money for banks to lend—more reserves. The opposite occurs when the Fed sells securities. When it sells government securities, buyers take money from their banking accounts to pay the Fed, making less money available for lending. In this case, interest rates rise and banks tend to offer fewer loans.

Econ Ed: Okay, thanks! Now that we have that straight, please tell us how monetary policy became one of the key responsibilities of the Fed.

Educator: Well, Benjamin Strong, head of the Federal Reserve Bank of New York, helped combat a weak economy in 1922 by purchasing Treasury securities. As you just learned, these purchases increase bank reserves, which banks want to lend to their customers. Competition among banks to make loans tends to lower interest rates. This policy approach helped to encourage economic recovery. Treasury securities are U.S. government debt, or in other words, loans to the government. Since open market operations were successful, the Fed added this new monetary tool to its toolbox to help moderate the bust-and-boom business cycles. The Fed had arrived and added new duties far beyond being the emergency **lender of last resort**. Not to mention our status overseas.

Econ Ed: So the Fed became well known internationally?

Educator: You bet your boots! Strong visited the European central banks to offer Fed assistance. The Fed then cooperated with foreign central banks to promote international financial stability during this period.

Econ Ed: Wow! The Fed was proving its worth. Good news for sure!

Educator: To sum it up, the 1920s have been a roaring success so far. We’ve had steady **economic growth**. And we’ve had fairly stable prices, too. It’s been great chatting with you, but I need to go—my tests won’t grade themselves, you know!

Econ Ed: Take care, Mr./Ms. Educator! Thanks for the Fed history highlights. Well, viewers, we have one more time travel stop to make—and this scene won’t be pretty. We are about to look firsthand at the Great Depression and the Fed’s response to this monumental event. Take a deep breath, here we go...

Scene 4: An Oklahoma Farm in the 1930s

Characters: Econ Ed, economics newscaster; Mr./Ms. Farmer, owner of an Oklahoma farm

Econ Ed: Hello, my name is Econ Ed and I'm here to find out about the problems our nation has been experiencing during the '30s. Do you have time to answer a few questions?

Farmer: Well, if you want to talk about problems, you've come to the right place! There's been nothing but problems on this farm since 1930. And now I may lose my land.

Econ Ed: Could you tell us how this all came about?

Farmer: Well, in 1930, we started hearing rumors that our money wasn't safe in the bank. I was nervous about having enough cash on hand to pay my bills, so I went down to the bank to take my money out. Problem was, everybody else had the same idea and our bank ran out of money and closed its doors. Then a banker came to visit and demanded I repay my farm equipment loan. There's no way I had the funds to do that...and I wasn't the only one!

Econ Ed: So financial difficulties hit people hard?

Farmer: Something really hurting our country right now is **unemployment**. I've heard the unemployment rate is close to 25 percent! Since so many people are out of work, they can't make their payments and many are losing their homes and property. Of course, they also have to cut back on food purchases. So now my pigs and corn are selling for almost nothing. And this means I can't make my payments! When the prices of a country's goods and services fall as much as 10 percent a year, like they are now, it's unbearable for most businesses.

Econ Ed: What other problems have you faced?

Farmer: Well, it seems Mother Nature has become our enemy. They call this area the Dust Bowl because of our extreme drought. When the wind picks up my dry soil and whips it around, you can't see more than a few feet in front of you!

Econ Ed: Wow, you can't get a break! How has the government helped in this awful situation?

Farmer: Well, at first, President Hoover said he thought federal relief was unnecessary. Instead, he favored relief provided by the state and local governments and private agencies. He also tried to persuade big business not to cut wages. And when the unemployment rate increased and so many banks and businesses failed, he tried to step in to help. But by then, too much damage had already been done.

Econ Ed: I'd like to focus on the Federal Reserve's role in all of this. Do you know if the Fed has aided the country during this troubled time?

Farmer: What I've heard is that the Fed has kept interest rates high when they should have kept them low to help businesses and consumers borrow money to stay afloat. They started this policy in 1928 to help stop bank lending to stock market **speculators**. This, as they say, only "gummed up the works." If the Fed would have increased the money supply, banks would have had more money to lend and interest rates would have come down. People would have borrowed more money and demanded more goods and services. Prices would have stopped falling. But, instead, the Fed let the amount of money in circulation fall. This only caused more banks to fail.

Econ Ed: What was the response to the Fed's inaction?

Farmer: Newspapers say that Fed officials are simply "bumping gums"—offering plenty of talk but no action. It seems the Fed thinks that by letting weak banks fail and discouraging unhealthy stock market speculation, the economy will eventually fix itself. But in my opinion, the Fed hasn't been much help at all. I hope they "shake a leg" and figure this mess out real soon!

Econ Ed: It sounds like the Fed has missed a real opportunity to stabilize the nation's economy. I hope the Fed has learned a few lessons based on this experience. Thanks so much for your time today, Mr./Ms. Farmer. Hopefully your luck will change soon! Okay, time trekkers, it's time to learn about another Fed-defining moment. We're off to 1935 to learn about the positive impact of banking legislation in the 1930s.

Scene 5: Outside the Federal Deposit Insurance Corporation (FDIC) Headquarters in Washington, D.C.

Characters: Econ Ed, economics newscaster; Mr./Ms. Director, member of the FDIC Board of Directors

Econ Ed: We've just landed in the perfect location for our final interview of the day. We're outside the FDIC building, a prime spot for discussing the Banking Acts of 1933 and 1935, laws that further enhanced Fed authority and independence. In fact, here comes the person we're looking for. Excuse me, Mr./Ms. Director, could you spare a few moments to explain the importance of the Banking Acts of 1933 and '35?

Director: Your timing is excellent. I've just come from an FDIC meeting where we've been discussing this very topic! We're very excited that the Banking Act of 1935 has made the FDIC a permanent organization. The 1933 Act created the FDIC and the 1935 Act decided to keep us around. Now we can continue to insure customers' deposits, giving them the confidence to leave their money in their bank. Bank customers can be assured that if their bank fails, their deposits will be returned by the FDIC. This will help prevent the terrible bank runs of the past. People who have deposited their money in banks can depend on the FDIC now and well into the future.

Econ Ed: Good to know! But let's start with the Banking Act of 1933, so that our listeners can gain a better appreciation for how these two laws changed the banking system and helped improve the economic well-being of U.S. households and businesses.

Director: Well, shortly after President Roosevelt took office, the president and Congress worked together to write and pass the Banking Act of 1933, also known as the Glass-Steagall Act. Up until the early 1900s, **commercial banks** accepted deposits and made direct loans to individuals and businesses. But in the early 1900s, commercial banks began to establish subsidiaries that financed bonds and provided financial backing for the stocks that companies issued. These were services similar to those offered by **investment banks**. Helping companies issue bonds and new stocks was risky and exposed commercial banks to greater risk of failure. After 1933, with the passage of the Glass-Steagall Act, a clear distinction was drawn between the types of services that commercial banks and investment banks could offer. This eased Americans' fear that banks were unsafe.

Econ Ed: Sounds like FDR and Congress were working to get banks back on track.

Director: It was a great improvement! As I stated earlier, the act created the FDIC as a temporary agency and it also created the **Federal Open Market Committee (FOMC)**. Yes, indeed, the FOMC was a great addition for formulating **monetary policy**.

Econ Ed: Wow, things were happening fast!

Director: That's not all! The changes made through this act and the Banking Act of 1935 further defined the Fed's role. Congress decided in the Banking Act of 1935 to establish a new voting process for the FOMC to balance regional and national perspectives when deciding on monetary policy. With the change, only 5 regional Reserve Bank presidents, not all 12, were allowed to vote at one time, along with all 7 members of Board of Governors. The Board was also legally charged with setting **reserve requirements** for member banks. Prior to this, the regional Banks acted somewhat autonomously, but decisions on monetary and credit policy had always been subject to Federal Reserve Board approval.

Econ Ed: Holy cow! That's a lot of changes.

Director: Hold on a second there, Ed! I haven't finished giving you the "low down." The Comptroller of the Currency and the Treasury Secretary were then removed from the Federal Reserve Board, or Board of Governors as it was now called. The terms of office for Board members were also extended to 14 years.

Econ Ed: That's just swell! The Fed was evolving with the times. Thank you for your insight! Well, listeners, it's time to end our broadcast and trek back to the present. This is Econ Ed, signing off until our next adventure in history.

SOURCE:

The Balance of Power: The Political Fight for an Independent Central Bank, 1790-Present by Tim Todd, Federal Reserve Bank of Kansas City, 2009; <http://www.kansascityfed.org/publicat/balanceofpower/balanceofpower.pdf>

"Money, Gold, and the Great Depression," remarks by Governor Ben S. Bernanke at the H. Parker Willis Lecture in Economic Policy, Washington and Lee University, Lexington, Virginia, March 2, 2004; <http://www.federalreserve.gov/boarddocs/speeches/2004/200403022/default.htm>.

Handout 3: Concept Cards

<p>Advice and Consent – Part of the process for nominating people to executive and judicial posts.</p> <p>Appears in Scene 2.</p>	<p>Commercial banks – Financial institutions that accept deposits and make loans to individuals and businesses.</p> <p>Appears in Scenes 1 and 5.</p>
<p>Economic growth – A sustained rise over time in a nation’s production of goods and services.</p> <p>Appears in Scene 3</p>	<p>Federal Open Market Committee (FOMC) – The Federal Reserve’s chief body for conducting monetary policy.</p> <p>Appears in Scene 5.</p>
<p>Governor – The head of the Federal Reserve Regional Banks, later titled president. Currently, members of the Federal Reserve System Board are referred to as Governors.</p> <p>Appears in Scene 2.</p>	<p>Investment banks – Financial intermediaries that help corporations raise money by assisting those corporations in selling stock or debt securities (bonds) to investors.</p> <p>Appears in Scene 5.</p>
<p>Lender of last resort – The Federal Reserve’s role in providing short-term loans to financial institutions or markets to help calm financial panics.</p> <p>Appears in Scenes 2 and 3.</p>	<p>Liquidity – The quality that makes an asset easily convertible into cash with relatively little loss of value in the conversion process.</p> <p>Appears in Scenes 1 and 2.</p>

Handout 3: Concept Cards, cont.

<p>Monetary policy – Central bank actions involving the use of the interest rate or money supply tools to achieve such goals as maximum employment and stable prices.</p> <p>Appears in Scenes 3 and 5.</p>	<p>Money supply - The quantity of money available in an economy.</p> <p>Appears in Scene 3.</p>
<p>Open market operations – The buying and selling of government securities by the Federal Reserve to control the money supply.</p> <p>Appears in Scene 3.</p>	<p>Reserve requirement – The percentage of a bank’s deposits it is required by law to hold, either as cash in its vault or on deposit with the Federal Reserve.</p> <p>Appears in Scene 5.</p>
<p>Reserves – The sum of cash that banks hold in their vaults and the deposits they maintain with Federal Reserve Banks.</p> <p>Appears in Scene 3.</p>	<p>Securities (Treasury) – Certificates of indebtedness issued by the Department of the Treasury on behalf of the U.S. government.</p> <p>Appears in Scene 3.</p>
<p>Speculators – People who take large financial risks in search of large rewards.</p> <p>Appears in Scenes 1 and 4.</p>	<p>Unemployment – A condition where people 16 years of age or older are without jobs and actively seeking work.</p> <p>Appears in Scene 4.</p>

Handout 4: Centennial Journal

Event: Panic of 1907

Summary of event:

Event's importance in Fed history:

Event: Federal Reserve Act (1913)

Summary of event:

Event's importance in Fed history:

Handout 4: Centennial Journal, continued

Event: Banking Act of 1933 (The Glass-Steagall Act)

Summary of event:

Event's importance in Fed history:

Event: Banking Act of 1935

Summary of event:

Event's importance in Fed history:

Handout 5: Key Moments in Federal Reserve History—Answer Key

Directions: Answer the following questions, using your journal entries for information on key Federal Reserve events.

1. How did the Panic of 1907 encourage the establishment of the Federal Reserve System?

Poor investments made by speculators such as the Heinze brothers, who tried and failed to capture a corner of the copper market, prompted runs on banks, first the Knickerbocker Trust Company and then others. Depositors feared they would lose their money so demanded their deposits in full. The bank runs caused widespread liquidity problems; that is, banks were short on cash and unable to satisfy the level of demand. Because some banks had taken an unacceptable level of risk, the Panic showed the need for a government regulator to protect the public's interest and ensure the safety and stability of the banking system. The Panic also showed the need for a lender of last resort to lend money to the banks in times of crises. At the time, banks had to turn to private investors such as J.P. Morgan and his banking committee.

2. How is the Federal Reserve System structured to balance regional and centralized authority? What about private and public interests?

The Federal Reserve System is composed of the Board of Governors and 12 regional Reserve Banks. The seven-member Board of Governors is appointed by the president of the United States and confirmed by the Senate. It oversees the regional Reserve Banks. Board members serve 14-year staggered terms. Central authority is balanced with the regional authority of the 12 Reserve Banks. Bank presidents are chosen by a board of directors composed of people bankers and business leaders.

3. How did the Bank Panic of 1907, the Federal Reserve Act, and the Banking Acts of 1933 and 1935 affect the Fed's role, functions, and/or operations?

- *The Bank Panic of 1907 prompted interest in establishing a central bank to supervise and regulate banks to promote public confidence and stability in the nation's banking system.*
- *The Federal Reserve Act structured a seven-member Federal Reserve Board, which is a government board charged with overseeing the 12 regional Reserve Banks. Board members are appointed by the president with the advice and consent of the Senate and serve 10-year staggered terms. That way, members' terms are not all up at once, which adds both continuity and variety in political and economic viewpoints. The central authority of the Board is balanced by regional authority through the establishment of 12 regional Reserve Banks. Each regional Bank has its own board of directors composed of bankers and business leaders from within that Federal Reserve region. These regions are also known as districts. Each Board of Directors chooses its own governor to head its Bank. The purpose of these regional banks is to serve as a lender of last resort—to provide liquidity to foster confidence in the banking system. So, the Federal Reserve is a blend of public and private interests. The bill provided another essential role for the Fed by allowing it to house the U. S. government's money and act as the nation's banker.*

Handout 5: Key Moments in Federal Reserve History—Answer Key, cont.

- *To strengthen the Fed's authority and independence, Congress passed the Banking Acts of 1933 and 1935. The Banking Act of 1933 separated commercial banking from investment banking and established the Federal Deposit Insurance Corporation (FDIC) as a temporary agency to guarantee deposits. The term of office for Federal Reserve Governors was extended to 12 years, and the Federal Open Market Committee (FOMC) was established to formulate and implement monetary policy. The FOMC consists of all 12 Bank presidents and the 7 governors of the Federal Reserve Board.*
 - *The Banking Act of 1935 narrowed the number of voting members on the FOMC to five Bank presidents and all seven members of the Board of Governors. It also removed the Secretary of Treasurer and the Comptroller of the Currency from the Federal Reserve Board, a move that helped to strengthen Federal Reserve independence from the U.S. Treasury. It also extended the terms of office for Federal Reserve Board of Governors to 14 years. It is at this point that the Fed was formally considered the nation's central bank.*
4. How did commercial bank services change in the early 1900s and how did this innovation contribute to the Banking Act of 1933?
- *In the early 1900s, commercial banks began to establish related business divisions that provided services similar to investment banks. Commercial banks, for example, helped businesses issue bonds and stocks. These were services similar to those offered by investment banks. Helping companies issue bonds and new stocks was risky and exposed commercial banks to greater risk of failure. After 1933, with the passage of the Glass-Steagall Act, a clear distinction was drawn between the types of services that commercial banks and investment banks could offer.*
5. Based on what you have learned, do you think the Fed was set up to act independently of Congress and the president or to be controlled by them? Why or why not?
- *In 1913, Congress designed the Federal Reserve System to represent both private and public interests. The Federal Reserve Board is a government agency balanced by a system of 12 regional Banks. The system balances central and regional authority. The terms of the Board's Governors were designed to be staggered, and from 1913 to 1935, terms of office were increased from 10 to 14 years. By 1935, the Comptroller of the Currency and the Secretary of Treasury were removed from the Board of Governors, and the FOMC had been created (1933) to formulate and influence monetary policy.*

Handout 6: Assessment Essay

Directions: Use the information from the lesson to write a short essay as directed in the prompt. Your essay should be five paragraphs long, include an introduction and conclusion, and contain specific examples to support your arguments.

Prompt: How did the structure and responsibilities of the Federal Reserve evolve over time to promote the following?

- Stable prices
- Economic growth
- An independent central bank, free from U.S. governmental authority

Standards and Benchmarks

Common Core State Standards: Grades 9-12 English Language Arts Standards

In Writing: Text Types and Purposes CCSS.ELA-Literacy.W.9-10.1; W.11-12.1
Production and Distribution of Writing CCSS.ELA-Literacy.W.9-10.4; W.11-12.4

In History/Social Studies: Key Ideas and Details CCSS.ELA-Literacy.RH.9-10.1; RH.11-12.1
Key Ideas and Details CCSS.ELA-Literacy.RH.9-10.2; RH.11-12.2
Craft and Structure CCSS.ELA-Literacy.RH.9-10.4; RH.11-12.4
Range of Reading CCSS.ELA-Literacy.RH.9-10.10; RH.11-12.10

National Curriculum Standards for the Social Studies

NCSS Strand 2: Time, Continuity and Change
NCSS Strand 5: Individuals, Groups & Institutions
NCSS Strand 7: Production, Distribution & Consumption

National Content Standards in Economics

CEE Standard 18: Economic Fluctuations
CEE Standard 19: Unemployment and Inflation
CEE Standard 20: Fiscal & Monetary Policy