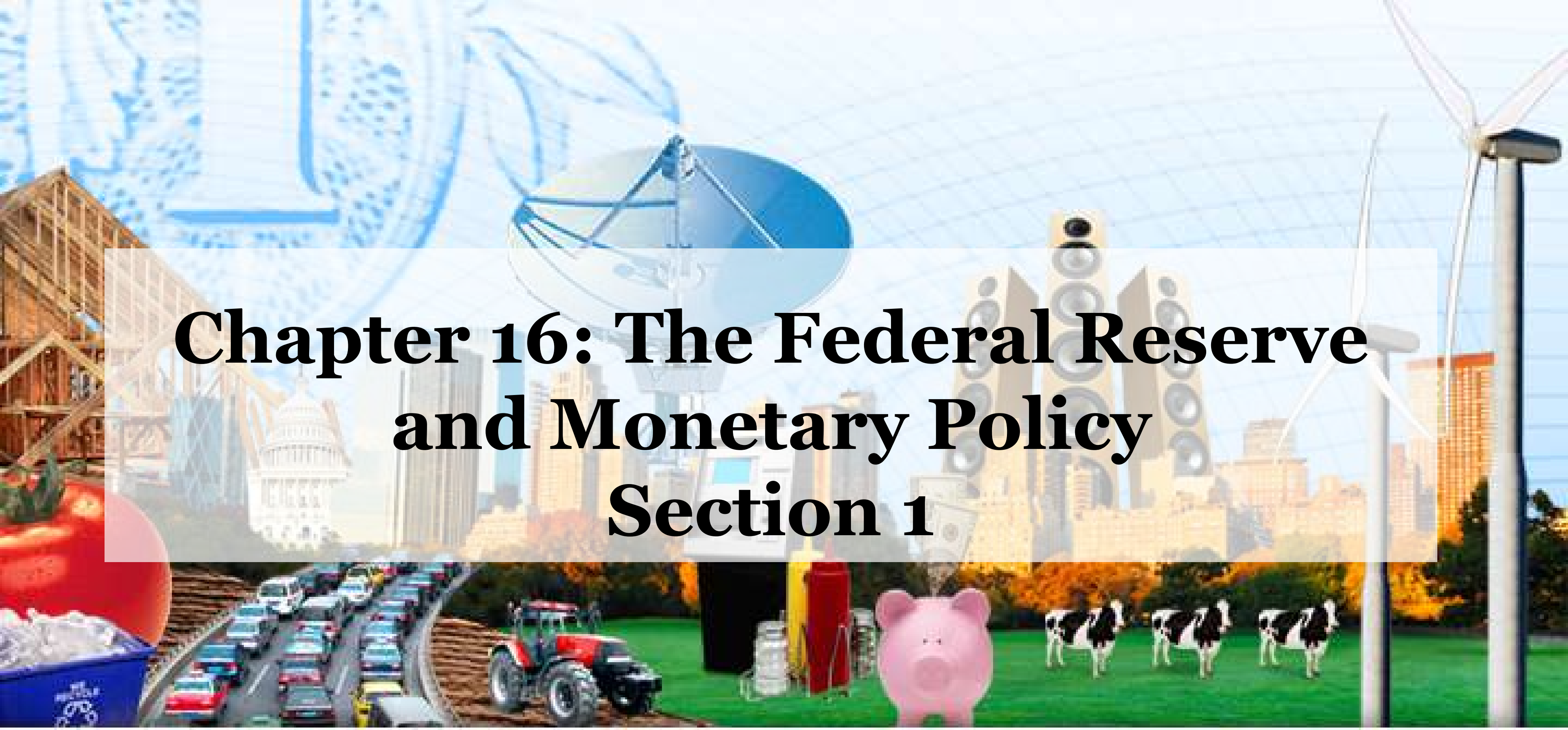
Chapter 16: The Federal Reserve and Monetary Policy
Section 1



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ECONOMICS

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Objectives

1. **Describe** banking history in the United States.
2. **Explain** why the Federal Reserve Act of 1913 led to further reform.
3. **Describe** the structure of the Federal Reserve System.

Key Terms

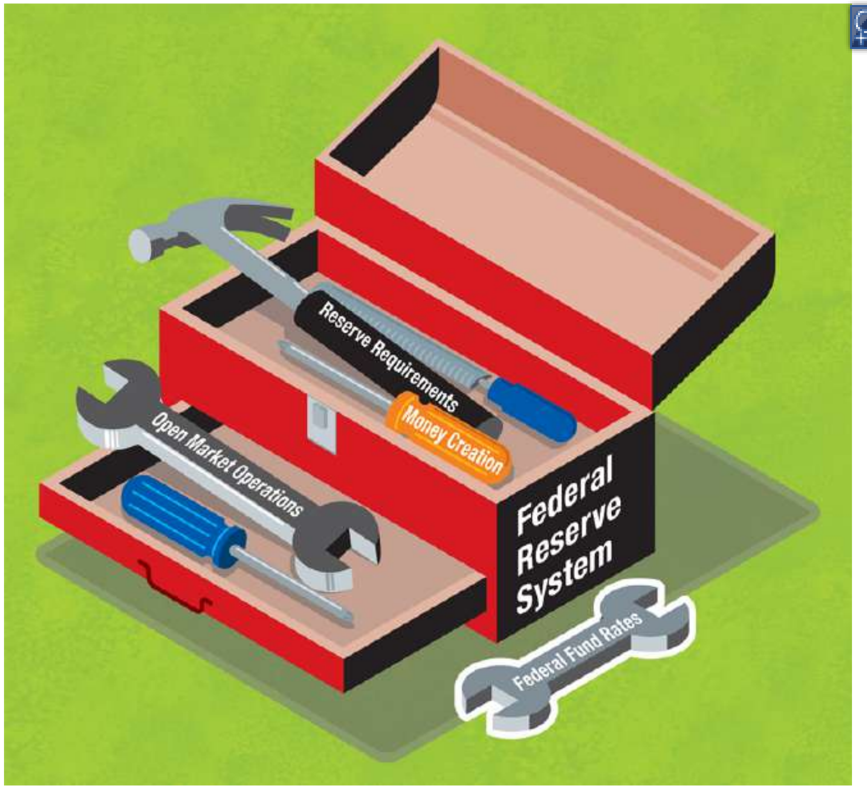
- **monetary policy**: the actions that the Federal Reserve System takes to influence the level of real GDP and the rate of inflation in the economy
- **reserves:** deposits that a bank keeps readily available as opposed to lending them out
- **reserve requirements**: the amount of reserves that banks are required to keep on hand

Introduction

- How is the Federal Reserve System organized?
  - The Federal Reserve System has:
    - A seven-member Board of Governors with one governor acting as the chair
    - 12 District Reserve Banks
    - 4,000 member banks and 25,000 other depository institutions across the country

What is Monetary Policy?

- Monetary policy refers to the actions that the Fed takes to influence the level of real GDP and the rate of inflation in the economy.



Banking History

- The First Bank of the United States, which issued a single currency and reviewed banking practices, only lasted until 1811, when Congress refused to extend its charter.
- The Second Bank of the United States was established in 1816 to restore order to the monetary system.
  - It lasted until 1836, when Andrew Jackson allowed its charter to expire. People feared a central bank would increase the power of the Federal government too much.

Banking History, cont.

- A period of chaos and confusion followed.
  - Reserve requirements were difficult to enforce among the various state and federal chartered banks.
  - The Panic of 1907 finally convinced Congress to act.

- The nation’s banking system needed to address two issues:
  - Greater access to funds
  - A source of emergency cash to prevent bank runs

Federal Reserve Act of 1913

- The Federal Reserve Act of 1913 attempted to solve these problems.

  - This Act created the Federal Reserve System, which consists of 12 banks that can lend money to other banks in times of need.

The Fed and the Depression

- Checkpoint: Why did the Fed fail to prevent the financial crisis that led to the Great Depression?
  - Congress hoped to avoid a situation like the Great Depression by creating the Fed, but it was unable to.
    - The system did not work well because the regional banks each acted independently.
    - By the time Congress forced the Fed to take strong action in 1932, it was too little, too late.

A Stronger Fed

- In 1935, Congress adjusted the Federal Reserve so that it could respond more effectively to future crises.
- The new Fed enjoyed a more centralized power so that the regional banks were able to act consistently with one another while still representing their own district's banking concerns.

Structure of the Fed

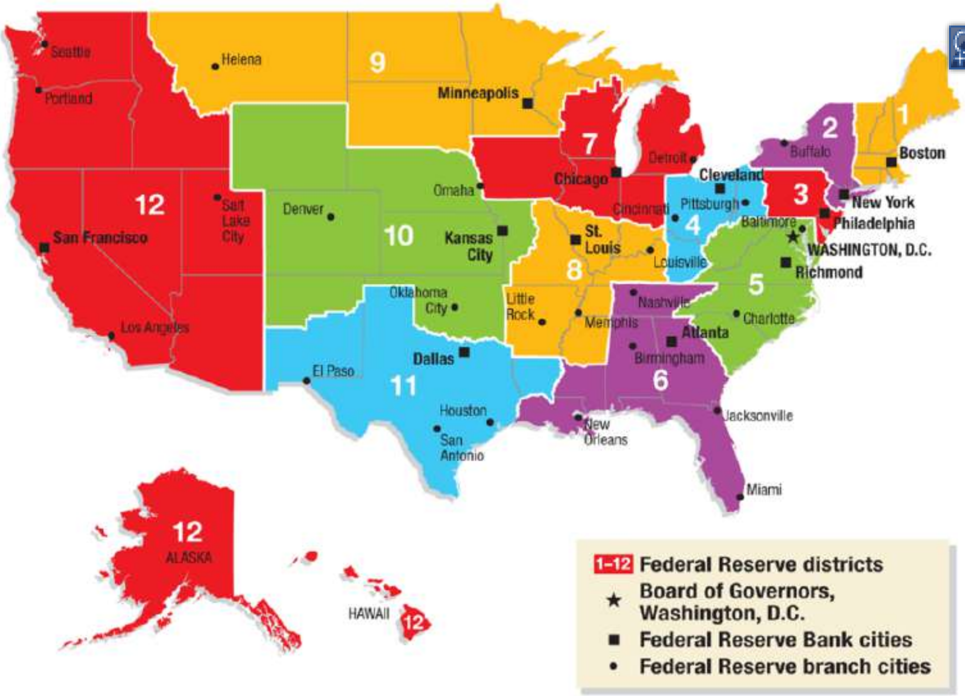
- The Federal Reserve System is overseen by the Board of Governors of the Federal Reserve.
  - This **seven-member board** is appointed by the President with the advice and consent of the Senate.
  - The President also appoints the chair of the Board of Governors from among these seven members.

Former and Current Fed Chairs

- **Paul Volcker** oversaw the tightening of interest rates which crushed the inflation of the 1970's, but causing much unemployment in the early 1980's. He used "tight/hard money policy."
- **Alan Greenspan**, a former economics professor and head of the President's Council of Economic Advisors has been the most notable chair of modern times.
- **Ben Bernanke**, the head of the CEA and former economics professor as well, became chair in 2006, when Greenspan stepped down.
- **Janet Yellen** is the new Fed Chair, the first female to hold this position. She follows "loose/easy money policy".

Twelve Federal Reserve Banks

- The Federal Reserve Act divided the United States into **12 Federal Districts** - one Federal Reserve Banks is located in each district.
- Each district is made up of more than one state and **Congress regulates the makeup of each Reserve Banks' board of nine directors** to make sure it represents many interests.

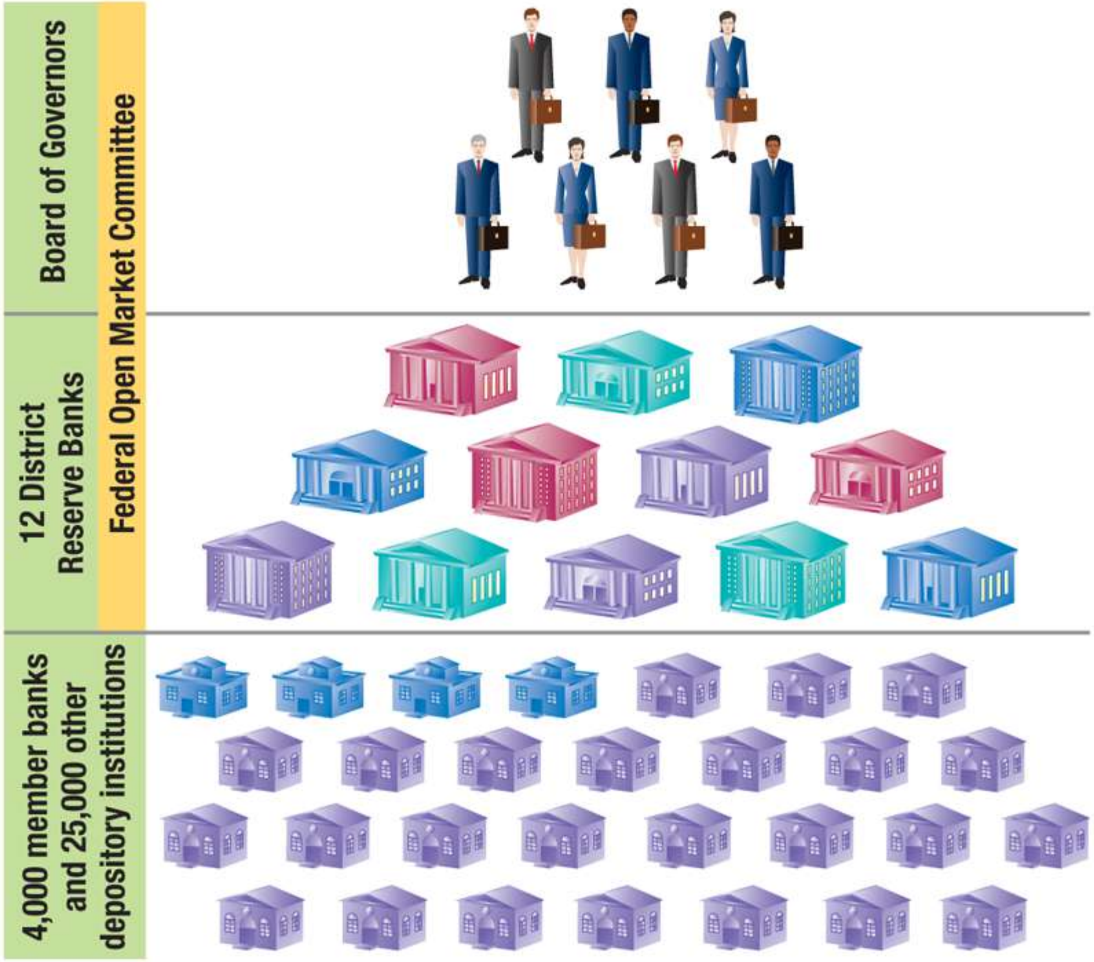


Member Banks

- All nationally chartered banks are required to join the Federal Reserve System.
- State-chartered banks join voluntarily.
  - All banks have equal access to Fed services whether or not they are Fed members.
- Each of the 2,600 member banks contributes a small amount of money to join the system, which means the banks themselves own the Fed, keeping the system politically independent.

The Federal Reserve System

- About 40 percent of all United States banks belong to the Federal Reserve.
  - At which of the three levels of this Fed structure would a nationally chartered bank in your community fit?



FOMC

- The Federal Open Market Committee (FOMC) makes key monetary policy decisions about interest rates and the growth of the United States money supply.
- FOMC's decisions can affect financial markets and rates for mortgages as well as many economic institutions around the world.
- FOMC members include:
  - All 7 members of the Board of Governors
  - 5 of the 12 district bank presidents
  - President of the New York Federal Reserve Bank
  - The six other district bank presidents who serve one-year terms on a rotating basis

Review

- Now that you have learned about how the Federal Reserve System is organized, go back and answer the Chapter Essential Question.
  - How effective is monetary policy as an economic tool?
  - View video about Federal reserve: View the last 10 minutes [start at 20:09]
  - COPY AND PASTE THIS LINK:
  - http://www.learner.org/series/econusa/unit21/