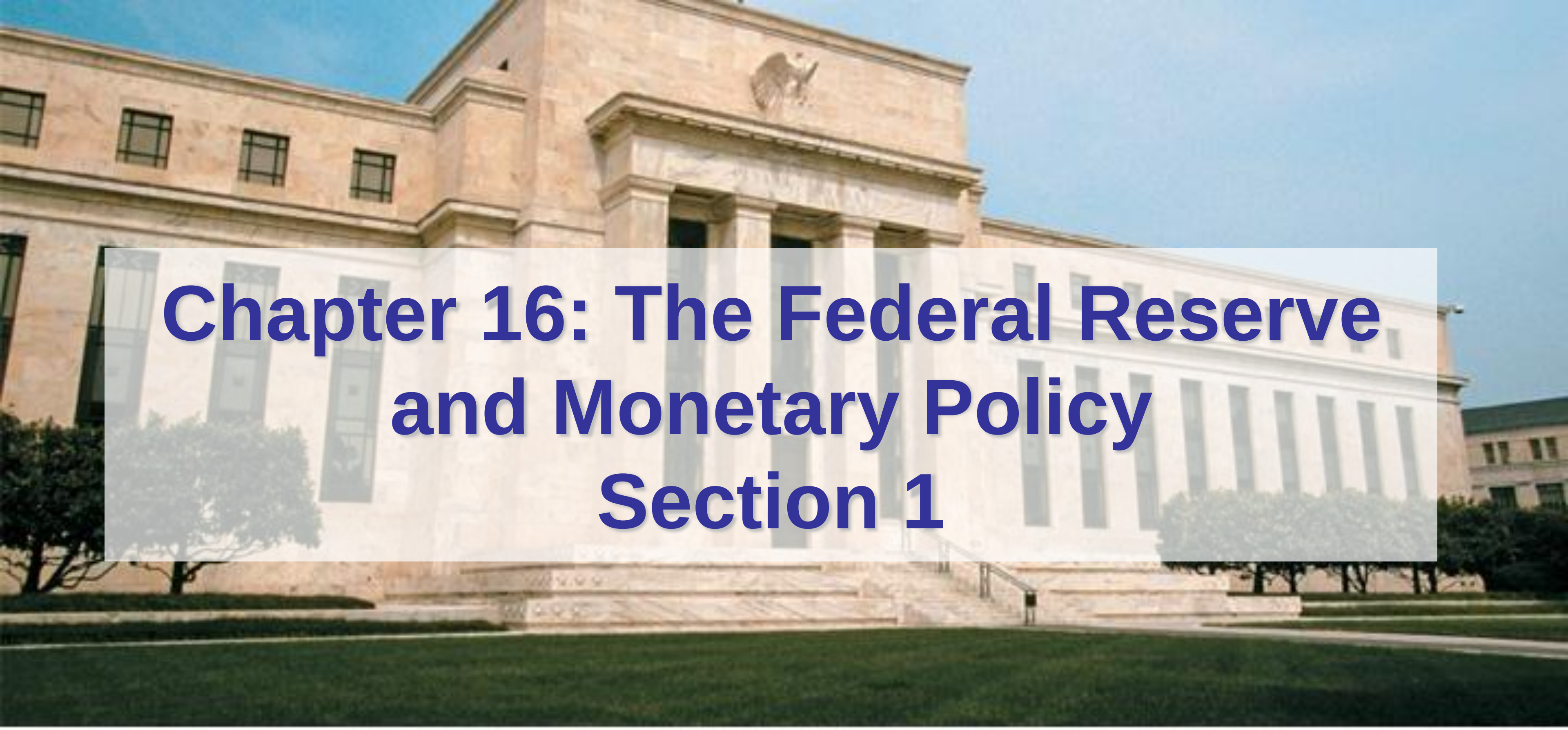
Chapter 16: The Federal Reserve and Monetary Policy
Section 1



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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

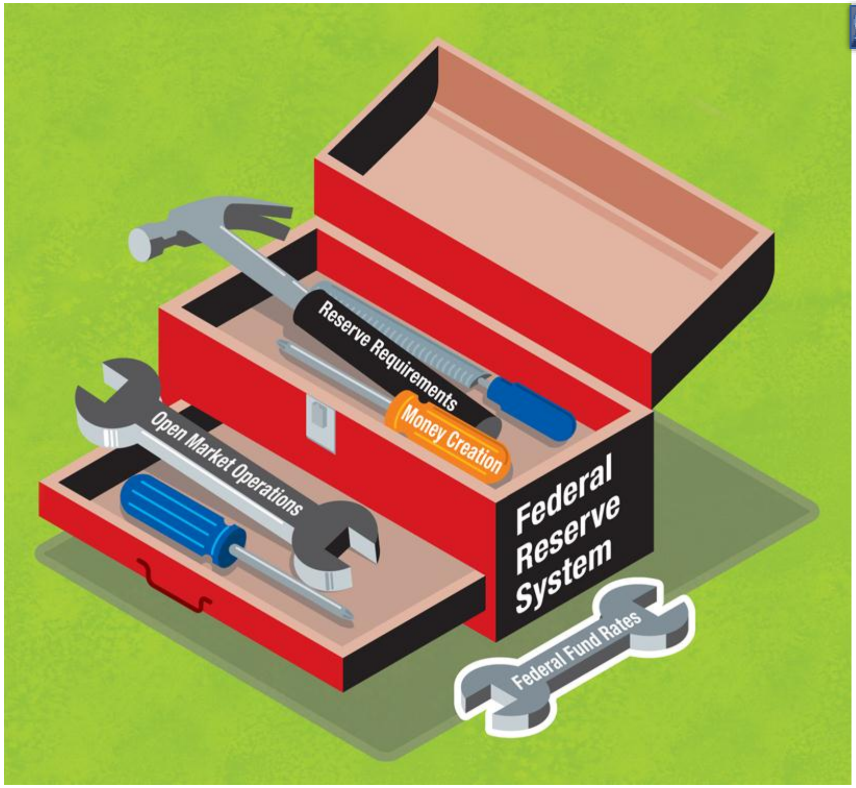
- **monetary policy**: the actions that the Federal Reserve System takes to influence the level of real GDP and the rate of inflation in the economy
- **reserves:** deposits that a bank keeps readily available as opposed to lending them out
- **reserve requirements**: the amount of reserves that banks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

- The Federal Reserve System's most prominent task is to act as the main spokesperson for the country's 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 role of a central bank in the U.S. economy has been hotly debated for many centuries.
- 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 its charter expired.

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

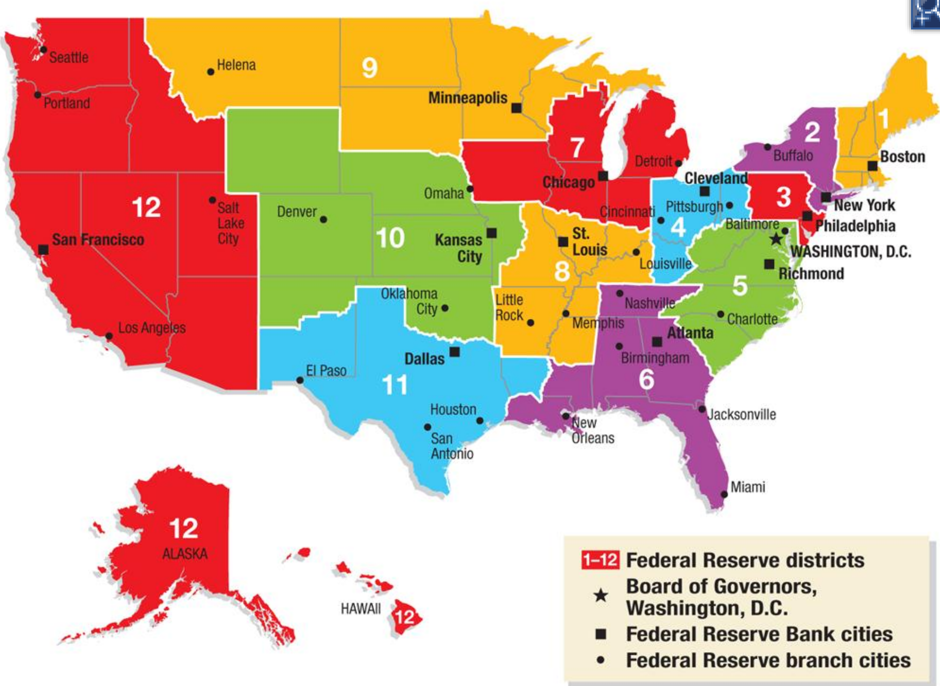
- The Federal Reserve System is overseen by the Board of Governors of the Federal Reserve.
  – This seven-member board is appointed by the President with the advice and consent of the Senate.
  – The President also appoints the chair of the Board of Governors from among these seven members.
  – Recent chairs have been economists from business, the academic world, or government.

Former Fed Chairs

- 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.

Twelve Federal Reserve Banks

- The Federal Reserve Act divided the United States into 12 Federal District - 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.

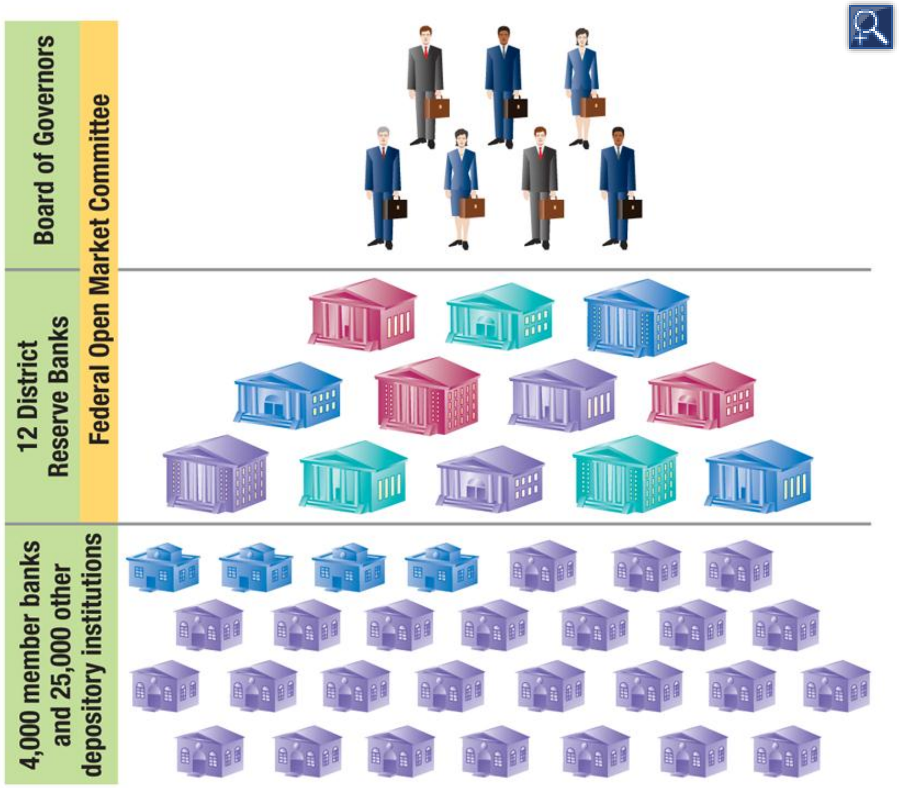


Member Banks

- 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?