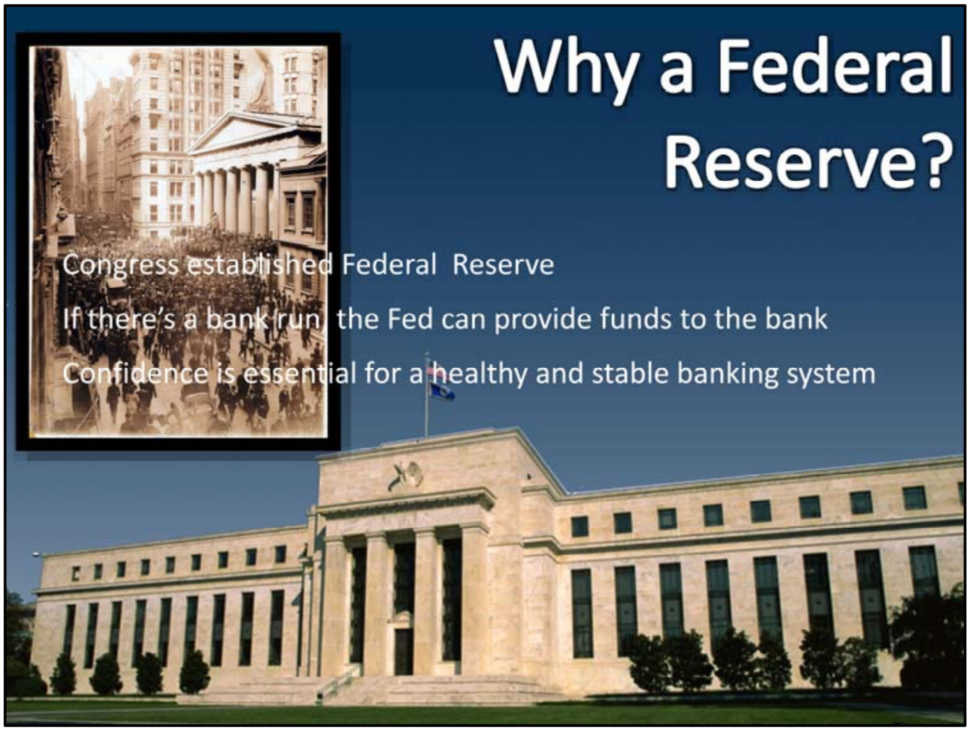


If you've ever seen the movie *It's a Wonderful Life,* you might remember the scene when everyone runs to the bank to withdraw their money because they're worried that the bank is going to run out of money.

This situation happened in real life in the early 20th century when people were in a panic since many banks made bad loans and extended too much credit. People decided to withdraw their deposits because they thought they might lose all of their money. As we just learned, the banks were keeping a fraction of the deposits, and lending out the rest. The banks couldn't pay out all of the deposits at once, so many of them went out of business.

Consequently, Congress established the Federal Reserve Bank to protect against situations like these. If all of the depositors decide to take their funds out of a bank, otherwise known as a bank run, the Federal Reserve can provide money to the bank so that they don't run out of money. When people are confident that their money is safe in the bank, they are much less likely to try and withdraw it all at once. This is essential for the country to maintain a healthy and stable banking system.

It's only one of the roles that the Federal Reserve, or Fed, plays, but it's very important.

The Federal Reserve Act of 1913 created the Federal Reserve System under President Woodrow Wilson. The Federal Reserve bank is public, but regional Federal Reserve Banks have elements of private companies. Private banks own stock in the regional banks, and elect members of the board of directors at their regional Federal Reserve Bank. However, these banks are not for profit businesses and serve the people's interests.

Select the link for more information about how the Fed operates as a public/private entity from the Federal Reserve website.

Before the Fed was created, each of the national banks acted independently. The Fed consolidated these banks into one centralized bank which worked as one entity with the regional banks to help provide consistency among banks and to help prevent banking disasters. How does it do this? For example, the Fed can act as the lender of last resort if there is a run on a bank in order to avoid bank panics. Let's look at some other functions it provides.

We've been talking about how the Fed helps provide stability and sets regulations for banks, for example, the current ten percent reserve requirement it sets for banks that we discussed in the presentation on the history of money. It also supervises banking operations to ensure that your deposits are safe.

The Federal Reserve Banks are considered the “banker's banks” because they provide services to your local banks such as currency, check, and electronic funds processing, which helps assure the safety and efficiency of the payments system.

Since the Fed handles the checking account for the U.S. Treasury, the Fed processes financial transactions for the federal government involving trillions of dollars. The Fed also distributes our paper and coin currency, although the Treasury is actually in charge of producing it.

Finally, as you learned in the Stabilizing the Economy presentation, the Fed is responsible for monetary policy of the country. Its goal is to supply the right amount of money to stabilize the business cycle and promote healthy economic growth.

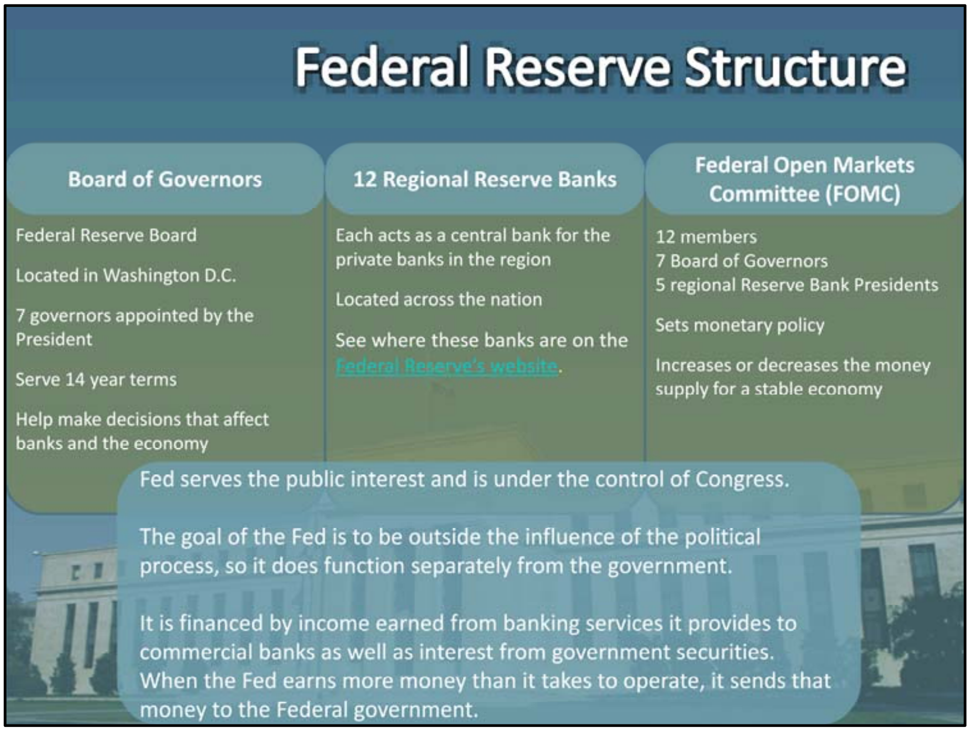
As you learned in the Stabilize the Economy presentation, the Fed uses monetary policy to supply the right amount of money to stabilize the business cycle, achieve stable prices, full employment, and promote healthy economic growth. How does it do this? Primarily loosening or tightening the money supply through setting interest rates and purchasing government securities.

The Fed sets certain interest rates, which have a large impact on the interest rates that consumers and businesses get on any money that they borrow. By setting a low interest rate, loans become cheaper encouraging people and companies borrow and spend more money which helps economic growth. In this scenario, the Fed is loosening the money supply.

When inflation becomes a threat and prices start rising because economic growth is too high, the Fed raises the interest rate. Loans become more expensive and people and companies will borrow and spend less money. the Fed is tightening the money supply.

The Fed seeks to target money growth which promotes stable prices, high employment, and steady economic growth. It's a difficult target to hit, and one that's always changing.

Now imagine if we were back in the late 1800s when each of the regional banks set the money supply according to the needs of the region. Think about how unstable that would make the banking system given how technology has made it possible for banks to operate throughout the country. In fact, the banking panics that were a major feature of the late 1800s and early 1900s led to the centralized Fed.



The Federal Reserve is divided into three parts. The Board of Governors is comprised of members who are all appointed by the President, and approved by the Senate. The best known member of this board is the Chairman of the Federal Reserve. The twelve regional reserve banks are located throughout the country and are owned by the private banks that operate in those regions, however, they are not for profit institutions. Their mission is to serve the public interest. Each of the members on the boards of these banks are appointed by the banks that own stock in the regional bank.

Finally, there is the Federal Open Markets Committee, which is probably the best-known part of the Fed because it's responsible for setting interest rates and monetary policy for the Fed. When you hear news about the Fed, it is most likely from this group which is made up of the Board of Governors and five of the regional reserve bank presidents.

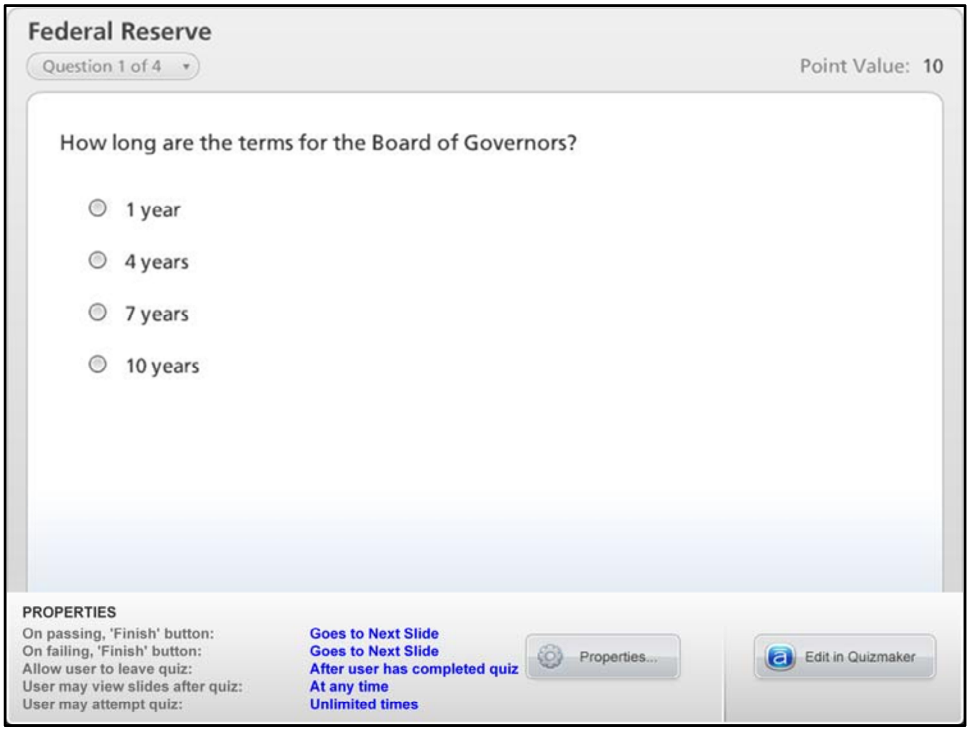
Although the Fed has characteristics of both private companies and government agencies, it serves the public interest and is under the control of Congress. The goal of the Fed is to be outside the influence of the political process, so it does function separately from the government. It is financed by income earned from banking services it provides to commercial banks as well as interest from government securities. When the Fed earns more money than it takes to operate, it sends that money to the federal government.

Source: Federal Reserve Bank of St. Louis.

This graphic from the Federal Reserve Bank of St. Louis website provides you with the different Federal Reserve locations across the country. It also reviews what you just learned regarding the characteristics of money. Last, but not least, it shows the connection on your paper money to the Fed in multiple locations on the bill.

Take a tour of the Federal Reserve System at the Federal Reserve Bank of St. Louis website.

When you get to the Summary page, take the quiz.


Federal Reserve
Question 1 of 4
Point Value: 10
How long are the terms for the Board of Governors?
1 year
4 years
7 years
10 years
PROPERTIES
On passing, 'Finish' button: Goes to Next Slide
On failing, 'Finish' button: Goes to Next Slide
Allow user to leave quiz: After user has completed quiz
User may view slides after quiz: At any time
User may attempt quiz: Unlimited times
Properties...
Edit in Quizmaker