

ECON 2110 – FALL 2021

Federal Reserve Signature Assignment

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Summary:

The Federal Reserve, or Fed, was created in 1913 and was designed to be a central banking institution for the United States. The article “How Bank Failures Contributed to the Great Depression” by Suzanne McGee explains the Fed’s role in the decade-long Great Depression. McGee breaks it down into three main ways the banks are somewhat “at fault” for the Great Depression. The first being that banks extended too much credit. New businesses – ones making refrigerators or radios were borrowing non-stop from banks in order to increase output. They continued to borrow and spend even as inventories soared causing the American wages to stagnate. The next issue was that banks ignored the Federal Reserve. The Fed did try to slow things down but it was too little too late as banks continued to ignore warning signs that there was the potential for a crash. Even when the Fed did try to relay these messages, banks paid little attention as they were more focused on the “easy” profits. The third part of the Fed’s role was that the banks didn’t maintain adequate reserves. Because many of the banks had not yet joined the Federal Reserve System, they were unable to use the reserves that would help avoid collapse. This means that when Americans flooded banks across the country to collect their savings as the stock market crashed, the banks were unable to meet those needs. In order to try to fix all these problems caused by the banks, President Franklin D. Roosevelt passed the Emergency Banking Act in 1933 which required banks to join the Federal Reserve System and approved the creation of deposit insurance, so in the future, bank failures couldn't destroy family

savings. Eventually this progress helped save the banking system to become strong enough to get out of the hole that was the Great Depression.

Connection:

As I explained in the summary above, one of the main reasons the banks had a role in the Great Depression was because of their inadequate savings in reserves. In class, we discussed that reserves are a small percentage of money deposits that banks collect to entrust to them and lend out the rest in the form of loans. We use the reserve ratio (the equation being: $\frac{\text{reserves}}{\text{deposits}}$) in order to ensure that there is a sufficient amount of reserves on hand in case of emergency. The mistake that the banks made back in 1929, was the lack of reserves they had on hand. So when Americans rushed to their banks in a panic for their savings, banks did not have the funds to address these issues. Since businesses could not get access to this capital, many had to close their doors leaving millions of Americans unemployed. This is partially why President Roosevelt passed the Emergency Banking Act which required banks to join the Federal Reserve System to prevent issues like this from reoccurring.

Works Cited

McGee, Suzanne. "How Bank Failures Contributed to the Great Depression." *History.com*, A&E Television Networks, 13 May 2021,
<https://www.history.com/news/bank-failures-great-depression-1929-crash>.