Specific Objective: Describe the monetary issues of the late nineteenth and early twentieth centuries that gave rise to the establishment of the Federal Reserve and the weaknesses in key sectors of the economy in the late 1920s.

Read the summary to answer questions on the next page.

Establishing the Federal Reserve System
- Through the late 1800s, banks often closed during economic crises. The federal government or the banking system could not increase the supply of money or credit. People lost what they deposited, and paper money could not be exchanged for gold.
- Crises in 1873, 1883, and 1893 caused many banks to fail and businesses to go bankrupt. After a huge bank failed in 1907, Congress came up with a plan.
- The Federal Reserve System was established in 1913 under President Wilson.
- The Federal Reserve System still functions today to prevent bank failures and regulate the supply of money.

A Weak Economy That Seemed Strong
From the beginning of World War I in 1914 until 1929, everyone believed the U.S. economy was stronger than it had ever been. But during the late 1920s, problems in the economy began to build up. Before the stock market crashed in 1929, the U.S. economy had the following problems:

Uneven distribution of wealth—The richest people got richer while workers’ wages increased only slightly. With only a small increase in their income, most people couldn’t afford to buy all of the products of U.S. industry.

Too much production with too little demand—Factories continued to produce more and more goods, but people could not afford them. Warehouses were filled with unsold goods. Most major industries had slowed down by the middle of 1929.

Widespread use of credit—People began to buy goods on credit. Many owed more money than they could pay back. By the end of the 1920s, buying slowed.

Stock speculation—Because it seemed the stock market would always keep rising, many people borrowed money to buy stocks. If the stocks did not rise, those who had borrowed would not have the money to pay for them.

Farm problems—Farmers had problems as soon as the war ended. Many had borrowed money to buy more land and grow more crops. After the war, European farmers started producing again, and prices dropped for American farm products. The government did not help farmers, and many lost their farms.

Weak industries—Older industries such as iron, railroads, mining, and textiles did not share in the general prosperity.

International economic problems—The United States kept tariffs high on foreign goods to protect U.S. industries. However, if foreign countries could not sell goods in the United States, they could not afford to buy U.S. exports or to pay back loans.
Directions: Choose the letter of the best answer.

1 Why did banks often close in economic crises through the late 1800s?
   A Banks did not loan out enough money, so they did not make much on interest.
   B Gold mines closed down and there was not enough gold to exchange for paper money.
   C There was no national system to increase the supply of money or credit.
   D Banks and railroads were commonly owned, and when railroads had trouble, banks closed.

2 Which statement best describes the Federal Reserve System?
   A It was established in 1913 and lasted until the stock market crash of 1929.
   B It let private bankers control the economy through the interest rates on loans.
   C It was established in 1913 and continues to regulate the money supply today.
   D It was established in 1913 and backed U.S. currency with silver.

3 By the end of the 1920s, buying slowed because
   A most people refused to borrow so they could buy more.
   B most people owed more money than they could afford to pay back.
   C most people preferred to save money, rather than spend it.
   D most people believed there would be another world war.

4 During the 1920s, U.S. farmers
   A got help from the federal government to repay their debts.
   B enjoyed the booming economy like many others.
   C continued to find a good market in Europe for their products.
   D suffered from low prices and too much debt.

5 How did high U.S. tariffs affect the economy during the 1920s?
   A Factories increased production to keep up with the demand for U.S. exports.
   B Foreign countries could not afford to buy U.S. exports or repay U.S. loans.
   C Prices for U.S. goods were kept high, so fewer people could afford to buy them.
   D U.S. companies fought tariffs because they believed in open markets.

6 Which statement describes the way wealth was distributed during the 1920s?
   A Workers gained at a much higher rate than owners or the middle class.
   B The middle class gained much more than the owners or workers.
   C The richest people got much richer while working wages rose only slightly.
   D Owners did not have enough to invest in new businesses.