Why did the Federal Reserve Fail?

• Why did the Federal Reserve System allow the money supply to fall?

The Failure of the Federal Reserve System

• Set up after 1908 Panic to be Bank of Last Resort to provide liquidity in *exactly* the conditions of 1929-1933.

\[ M_2 \times \text{Multiplier} = \frac{M_2}{M_B} \]

\[ M_2 = M_2 \times \text{Multiplier} \times M_B \]
**Why Did the Federal Reserve Fail?**

- Concerned about defending Gold Standard
- Failure of Leadership
- Bank of England abandoned Gold Standard and provided liquidity. Decline was milder.

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**Benjamin Strong**

Powerful leader of Federal Reserve Bank of New York, who died just before crash. Left a power vacuum.

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**British Influence**

Walter Bagehot left rule about expanding Monetary Base.

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**British Influence**

A bank lives on credit. Till it is trusted it is nothing; and when it ceases to be trusted it turns to nothing.

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**Phase III-The Collapse of 1933**

- In early 1933, bank after bank collapsed in the United States. Real implosion of economic conditions.
- FDR took over as President in March 1933.
  - Proclaimed bank holiday, restructured banks
  - Started New Deal
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Phase IV - 1933-1940

- Recovery was long in coming and economists still debate why.
  - Next Lecture

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