Myths, tall tales, and urban legends: A lesson on the facts behind the Fed

Interactive Simulation with SMART Board Application

Lesson by

Amy B. Hennessy, economic and financial education specialist, Federal Reserve Bank of Atlanta

---

Lesson Description

The lesson introduces students to common myths about the Federal Reserve and the reality behind the misconceptions. Students are given a card with a statement about the Federal Reserve that is either a myth or reality. Students circulate and survey one another in order to pair the myth cards with the reality cards. The student pairs then identify which statement is the reality versus the myth. Students will analyze statements from primary source materials about the structure and/or functions of the Federal Reserve System.

Grade Level

Grades 11–12

Time Required

55 minutes

Content Standards

National Content Standards in Economics

Standard 11: Students will understand that money makes it easier to trade, borrow, save, invest, and compare the value of goods and services. The amount of money in the economy affects the overall price level. Inflation is an increase in the overall price level that reduces the value of money.

- Benchmark 1, Grade 12: The basic money supply in the United States consists of currency, coins, and checking account deposits.
- Benchmark 2, Grade 12: In many economies, when banks make loans, the money supply increases; when loans are paid off, the money supply decreases.

Standard 20: Students will understand that federal government budgetary policy and the Federal Reserve System's monetary policy influence the overall levels of employment, output, and prices.

- Benchmark 1, Grade 12: In the long run, inflation results from increases in a nation's money supply that exceed increases in its output of goods and services.

- Benchmark 2, Grade 12: Monetary policies are decisions by the Federal Reserve System that lead to changes in the supply of money and the availability of credit. Changes in the money supply can influence overall levels of spending, employment, and prices in the economy by inducing changes in interest rates charged for credit and by affecting the levels of personal and business investment spending.
- Benchmark 3, Grade 12: The major monetary policy tool that the Federal Reserve System uses is open market purchases or sales of government securities. Other policy tools used by the Federal Reserve System include increasing or decreasing the discount rate charged on loans it makes to commercial banks and raising or lowering reserve requirements for commercial banks.

Concepts

Discount rate

Federal Reserve Act

Federal Reserve System

Fiat money

Money

Myth

Open market operations

Reality

Objectives

Students will:

- Categorize and evaluate common statements about the Federal Reserve System as either myth or reality
- Analyze primary source documents related to the Federal Reserve System
- Explain important facts about the Federal Reserve System
- Define discount rate, fiat money, money, myth, reality, and open market operations

Materials

- A copy of Handout 1 on white card stock, laminated and cut apart(10 cards)
- A copy of Handout 2 on white card stock, laminated and cut apart(10 cards)
- A copy of Handout 3 on white card stock, laminated and stacked in order from 1 to 10.
- Transparency of Visual 1 and a copy for each student
- A copy of Handout 4 for each student
- A copy of Handout 5 for each student
- SMART Notebook file "Myth vs. Reality" (This is an extension for educators with SMART Boards. Use the instructions in the SMART file for the procedures.)

Preparation

Mix the cards from Handouts 1 and 2 to create a deck for random distribution.

Procedure

1. Ask the students if they can give you a definition or an example of a myth. (*Answers will vary. Students might suggest a myth is an untrue story and may discuss Greek gods or Santa Claus as examples.*)

2. Tell the students that a **myth** is an unproved or false collective belief. Define **reality** as the state of being a verifiable thing or fact. Explain that, historically, myths explained unexplainable events to people. For example, before a proper understanding of how diseases spread, people may have explained them as punishment from the gods.

3. Ask the students if they have heard of the Federal Reserve System, the central bank of the United States. (*Answers will vary.*) Tell students that there are many myths and misperceptions about the Federal Reserve System, the U.S. central bank. Explain that the creation of the Federal Reserve System was a response to the demands of a complex financial system manifested in a series of money panics in the late 19th and early 20th century. Emphasize that nations have established central banks to address the needs associated with a modern economy.

4. Tell the students that just as people tend to use myths to explain events that they don't have good information about—such as that the stock market crash of October 29, 1929, caused the Great Depression—people might attribute things to the Federal Reserve System that are not factual. Some current attributions to the Fed are misperceptions not based on fact.

5. Explain to the students that they will participate in an inquiry to uncover the truth behind some common myths about the Federal Reserve.

6. Distribute one card to each student from the deck of cards created by mixing Handouts 1 and 2 together (20 cards). For classes with more than 20 students, pair extra students. If there are fewer than 20 students, give a few students more than one card to ensure that all 20 cards have been handed out.

7. Instruct students to read the statements on their cards. Explain that half the cards have factual statements related to the Federal Reserve System while the other half contain common myths associated with the Fed.

8. Ask students to circulate in the room surveying other students to find the statement that is complementary to the statement on their card.

9. Tell the students that when they have found the student with the complementary statement, they should stand together and decide which statement is the reality and which is the myth.

10. When students have found their partners, have each pair of students read their statements aloud and identify which statement is the myth and which is the reality. They should also explain why they reached that conclusion. (Refrain from commenting during this portion of the lesson to foster a nonthreatening environment for student inquiry.)

11. After each group has identified their cards, poll the students by having them raise their hands as you read each myth in the order they appear on Visual 1, the answer key, to determine how many think each myth was correctly paired with its complementary reality.

12. Ask the students how they differentiated the myth card from the reality card. (*Answers will vary. Some may know the answers from prior knowledge. Some groups may guess while other groups may not know the correct answers*.)

13. Display Visual 1. Inform students that this is the answer key for the activity.

14. Distribute the correct statement from Handout 3 to each pair of students who have the corresponding myth from Handout 1. Ask each student to read the myth and its corresponding statement of reality in the order found on Visual 1, the answer key. Tell the students to correct their pairings based on what they hear as other students read the factual statements associated with each myth.

15. Direct the students to return to their seats.

16. Ask the students if they know what a primary source of information is. Define a primary source as a source that is closest to the person, information, period, or idea being studied.

17. Ask students for examples of primary sources. Tell them that first-hand accounts, legal documents, court opinions, and diaries of events expose readers to the original source of the information under review.

18. Ask the students to explain why primary sources are important. Explain that a primary source document allows the reader to interpret the information that the source provides without the biases or authoritative comments of a secondary source. Suggest the following scenario:

    Suppose that you send a text to a friend, Tom. Suppose that Tom reads your text and decides what he thinks you mean. He then texts his interpretation of your thoughts to a second friend, John. John is very upset with you when he reads the text. John does not have access to the primary source—your original comments and thoughts—he only has access to the secondary source—Tom's interpretation of your text.

19. Distribute a copy of Handouts 4 and 5 to each student. Divide the students into groups of four students.

20. Tell the students that the three excerpts on Handout 4 are from primary source documents. Tell them that examining these excerpts will help them to determine myth versus reality as related to the Federal Reserve. Direct students to use the guided discussion questions on Handout 5 to conduct their analysis of each excerpt.

21. Allow enough time for each group to complete its work. When students have finished, ask student volunteers from each group to share their observations from the analysis of the excerpts.

22. Ask the students the questions from Handout 5.

    Answer Key for Handout 5.

    Excerpt 1: Federal Reserve Act

    1. The U.S. Congress passed the Federal Reserve Act and President Wilson signed it.

    2. The Federal Reserve Act was signed on December 23, 1913.

3. *Answers will vary but may include bankers or leaders of financial institutions.*
4. *Answers will vary but key words may include: designated, cities, fixed, geographical limits, every national banking association, required, subscribe, capital stock, Federal Reserve Bank, equal to, paid-up capital stock, surplus. Key ideas may include: an organization committee will designate which cities have Federal Reserve banks; all national banking associations are required to subscribe to the capital stock of the Federal Reserve Bank in their district.*
5. *Answers will vary but may include: to subscribe to the capital stock…; six per centum of the paid-up capital stock and surplus of such bank.*
6. *Answers will vary but may include: the Act was created to establish a national bank, the Act was created to organize national banking associations.*
7. *Answers will vary but may include: an organization committee designated which cities would have a Federal Reserve District Bank; national banks are required to own stock in their District Reserve Bank.*
8. *Answers will vary but may include: national banks own stock in their District Federal Reserve Bank.*

Excerpt 2: McCulloch v. Maryland, 17. U.S. 316 (1819).

1. *Answers will vary but may include: a court of law. Students with prior knowledge of the case will know that it is a landmark U.S. Supreme Court case.*
2. *The decision was handed down in 1819.*
3. *The state of Maryland, the petitioner, McCulloch, and future courts are the intended audiences.*
4. *Answers will vary but may include: deliberate consideration, unanimous, opinion of this Court, incorporate, Bank of the United States, in pursuance of the constitution, supreme law of the land. Key idea: the creation of the Bank of the United States was constitutional.*
5. *Answers will vary but may include: decided opinion, act to incorporate, and made in pursuance of the constitution.*
6. *Answers will vary but may include: the document is part of a court decision to resolve a dispute between two parties.*
7. *Answers will vary but may include: the decision established the constitutionality of the Bank of the United States, the decision establishes the supremacy of the Congress to incorporate the Bank of the United States, the decision was unanimous, Congress was using its constitutional powers to incorporate the Bank of the United States.*
8. *Answers will vary but may include: the decision established the constitutionality of Congress to incorporate a national or central bank as a precedent.*

Excerpt 3: National Banking Act, 1935 Title 12, Chapter 3, Subchapter IV, 263.

1. *The U.S. Congress passed and President Franklin D. Roosevelt signed the National Banking Act of 1935.*

2. *The Act was passed in 1935.*

3. *Answers will vary but may include the Federal Reserve System and banks.*

4. *Answers will vary but may include: Federal Open Market Committee, consist, Board of Governors of the Federal Reserve System, five representatives; open-market operations, in accordance, purchases and sales of paper, accommodating commerce and business, bearing upon the general credit situation in the country. Key ideas: the Act created the Federal Open Market Committee, the Federal Reserve Board of Governors and five representatives of the Federal Reserve Banks will be members of the Committee, Federal Reserve Banks must conduct open-market operations according to specific regulations adopted by the Committee, the goal of open-market operations is to accommodate commerce and business with an eye to U.S. credit conditions.*

5. *Answers will vary but may include: open-market operation and paper.*

6. *Answers will vary but may include: the Act was passed to give a specific power, the power to conduct open-market operations, to the Federal Reserve System; and the Act created the Federal Open Market Committee.*

7. *Answers will vary but may include: the Act gave the Federal Reserve a tool to help promote commerce and business activity while maintaining a stable credit environment in the United States; the composition of the Federal Open Market Committee was established; the Federal Open Market Committee was given the authority to conduct open-market operations in order to promote stability in the economy.*

8. *Answers will vary but may include: the Federal Open Market Committee has the statutory authority to conduct open market operations to accommodate the U.S. economy and credit conditions.*

Closure

23. Ask the following questions to review the lesson.

    a. What is the difference between a myth and reality? *(A myth is an unproved or false collective belief and a reality is the state of being a verifiable thing or fact.)*
    b. What is a primary source? *(A primary source is a source that is closest to the person, information, period, or idea being studied.)*
    c. What primary source documents did you use in this lesson? *(Excerpts from the Federal Reserve Act of 1913, the Supreme Court decision in McCulloch v. Maryland, 1819, and the National Banking Act of 1935.)*
    d. When was the Federal Reserve System created? *(The Federal Reserve Act was signed by President Woodrow Wilson on December 23, 1913.)*
    e. What is the advantage of using primary sources? *(Using primary sources fosters critical thinking and allows the reader to interpret the primary source without the biases or authoritative comments of a secondary source.)*
    f. Based on your review of primary source documents, who owns the Federal Reserve District Banks? *(All nationally chartered banks and state banks that choose to become members of the Federal Reserve System own stock in their district's Federal Reserve Bank [The Federal Reserve Act, 1913].)*

g. Based on your review of primary source documents, is the Federal Reserve System constitutional? *(Yes, it is. The precedent-setting case, McCulloch v. Maryland, 1819 established the constitutionality of a U.S. central bank.)*
h. Based on your review of primary source documents, what is the objective of open market operations conducted by the New York Federal Reserve Bank at the direction of the Federal Open Market Committee (the FOMC)? *("Open-market operations shall be governed with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country." National Banking Act, 1935)*
i. Can the Federal Reserve prevent bank panics from spreading? *(While bank panics can and do still occur, actions by the Federal Reserve can help to control the spread of such panics.)*
j. What gives money its value? *(Money gets its value from its ability to purchase goods and services.)*
k. What is a court precedent? *(A court precedent is a legal principle that becomes an authority for judges to use in deciding future cases of a similar issue.)*

Assessment

24. Ask students to choose two of the four following blog posts to write comments correcting the inaccurate information in the posts. Tell students the blog posts are common misrepresentations of the Federal Reserve System. Ask the students to use primary source references from the Federal Reserve Act, Supreme Court decisions, and/or additional acts of Congress to support their comments.

Blog Post #1: The Federal Reserve System is an illegal organization with no constitutional authority that has no involvement with the lives of ordinary Americans. The Federal Reserve only serves the interests of Wall Street financiers and the most powerful banks in the United States.

Blog Post #2: A gang of the most powerful Wall Street bankers held a clandestine gathering on Jekyll Island, Georgia, in 1910 to protect their interests. As a result of this secret meeting, the Federal Reserve System was created.

Blog Post #3: The Federal Reserve System is owned and controlled by citizens of foreign nations.

Blog Post #4: The United States has not experienced bank panics since the Federal Reserve System was created in 1913. The Federal Reserve System prevents bank panics from occurring.

Handout 1

Bank panics are a thing of the past because of the Federal Reserve System.	U.S. money is backed by gold.
The Federal Reserve is controlled by citizens of foreign nations.	The Federal Reserve was created by Wall Street Bankers, in secret, on Jekyll Island, Georgia.
The Federal Reserve sets interest rates at whatever level it pleases.	The Federal Reserve is unconstitutional.
The Federal Reserve has little to do with the lives of ordinary people.	Unanticipated inflation hurts everyone in the economy.
Most money spent in the economy is transferred by check or cash.	The Federal Reserve profits at taxpayer expense.

Handout 2

Quick responses by the Federal Reserve prevent bank panics from spreading.	Purchasing power is what gives money its value.
Member banks of the Federal Reserve hold stock in the Reserve Bank for their district.	The Federal Reserve Act was signed into law by President Wilson on December 23, 1913.
The Fed, interacting with the marketplace, influences interest rates.	The constitutionality of central banking was established through a U.S. Supreme Court precedent.
People can take care of their day-to-day business because the Federal Reserve fosters a sound banking system.	Some people benefit from unanticipated inflation despite its generally harmful effects.
Most money spent in the economy is transferred electronically.	The Federal Reserve rebates almost all of the interest earned on the securities in its portfolio each year to the U.S. Treasury.

Handout 3

Myth 1: The Federal Reserve is unconstitutional.

Reality: The constitutionality of central banking was established through a U.S. Supreme Court **precedent**. (A precedent is a legal principle that becomes an authority for judges to use in deciding future cases of a similar issue.) The case, McCulloch v. Maryland, 17 U.S. 316 (1819) was a landmark decision by the U.S. Supreme Court. The case established that the Constitution grants to Congress implied powers for implementing the Constitution's expressed powers, and established that federal laws and treaties are supreme over state law. Therefore, when Congress enacted the law to incorporate the Second Bank of the United States, it was a valid exercise of its constitutional powers.

Handout 3 continued

Myth 2: The Federal Reserve was created by Wall Street bankers, in secret, on Jekyll Island, Georgia.

Reality: Parts of a draft legislation known as the Aldrich plan after Senator Nelson W. Aldrich, one of the prominent financiers in attendance at a meeting on Jekyll Island in late November 1910, did make it into the statute that became the **Federal Reserve Act** signed into law by President Woodrow Wilson on December 23, 1913. In 1908, after the Panic of 1907, Congress created the National Monetary Commission to study and propose a solution to address future banking crises. Senator Nelson Aldrich of Rhode Island made recommendations based on his investigation and research about central banks of Europe. However, throughout December 1913 the Glass-Willis proposal, which was the product primarily of Representative Carter Glass of Virginia, was debated and revised until it became the **Federal Reserve Act of 1913**. The Federal Reserve System represents a compromise of ideals. It is a decentralized central bank that incorporated the contentious positions voiced by the populists and private banks of the era.

Handout 3 continued

Myth 3: The Federal Reserve has little to do with the lives of ordinary people.

Reality: People can take care of their day-to-day business because the Federal Reserve fosters a sound banking system by establishing regulations and acting as a supervisor for depository institutions. Commercial bank customers' demands for funds, electronic payments, direct deposit, and trust in their financial institution are all supported through the efforts of the Federal Reserve System. Furthermore, the flow of money and credit in the economy is affected by the monetary policy actions of the Federal Reserve. These actions all contribute to a stable financial system in which people operate day to day.

Handout 3 continued

Myth 4: The Federal Reserve is controlled by citizens of foreign nations.

Reality: Member banks of the Federal Reserve hold stock in the Reserve Bank for their district. Individuals cannot hold stock. Member banks include all nationally chartered banks and any state-chartered banks that choose to become members. Based on provisions in the Federal Reserve Act, each Federal Reserve Bank issues shares of stock to its member banks. The Federal Reserve Banks pay dividends to the member banks for their stock. Member banks cannot sell or trade their stock. More than 8,000 depository institutions representing approximately 38 percent of the nation's banks are members of the system. Although these banks are member owners, they have no control of monetary policy or supervisory authority and make no decisions in these areas.

Handout 3 continued

Myth 5: Bank panics are a thing of the past because of the Federal Reserve System.

Reality: Quick responses by the Federal Reserve prevent bank panics from spreading. Bank panics can and do still occur. However, actions on the part of the Federal Reserve System to provide liquidity and lending facilities to troubled financial institutions ensure that such events are contained and minimized. The Federal Reserve works to limit threats to the financial system.

Handout 3 continued

Myth 6: The Federal Reserve profits at taxpayer expense.

Reality: The Federal Reserve rebates almost all of the interest earned on the securities in its portfolio each year to the U.S. Treasury. As a result of **open market operations**—the buying and selling of U.S. government securities—the Federal Reserve earns interest on the U.S. government securities in its portfolio. In addition, the Federal Reserve earns income from fees that depository institutions pay for check clearing, automatic clearinghouse operations, and funds transfers. It also earns interest income from loans it makes to depository institutions at the **discount rate**, which is the rate of interest depository institutions pay the Fed for overnight loans. Each year, the Federal Reserve returns to the U.S. Treasury what remains from its income after paying its operating expenses. In 2010, the Federal Reserve returned $79.2 billion to the U.S. Treasury.

Handout 3 continued

Myth 7: The Federal Reserve sets interest rates at whatever level it pleases.

Reality: The Fed, acting within the marketplace, indirectly influences interest rates. When the Fed buys and sells U.S. government securities through open market operations, it influences the money supply and short-term interest rates. Traditionally, buying securities from the primary dealers through the open market leads to lower nominal interest rates. Conversely, Fed sales of securities lead to rising nominal interest rates. The Federal Open Market Committee—or the FOMC—directs the New York Federal Reserve Bank to target the federal funds rate by buying or selling U.S. Treasuries in the secondary market to achieve a specific level of bank reserves. The FOMC bases this targeted rate on its reading of the economy and the economic outlook to achieve its dual mandate of price stability and full employment.

Handout 3 continued

Myth 8: U.S. money is backed by gold.

Reality: U.S. money gets its value from its purchasing power. Money is what money does. In other words, the real **value of money** is determined by the goods and services it can buy. As long as people accept money during such transactions, money maintains its ability to purchase. Paper currency represented a claim on a certain amount of gold or silver during much of U.S. history. However, in 1933, President Franklin Delano Roosevelt removed the United States from the gold standard. The Federal Reserve Banks do hold collateral—U.S. government securities—equal to the value of Federal Reserve notes—that is, paper currency—in circulation. Hence, U.S. currency is backed by the full faith and credit of the U.S. government. It is **fiat money**, established through government decree.

Handout 3 continued

Myth 9: Most money spent in the economy is transferred by check or cash.

Reality: Most money spent in the economy is transferred electronically. Since the mid-1990s, check writing has declined while electronic payments have increased. Since 2003, electronic payments have surpassed checks as a form of payment.

Handout 3 continued

Myth 10: Unanticipated inflation hurts everyone in the economy.

Reality: Some people benefit from unanticipated inflation despite its generally harmful effects. For instance, debtors who are paying a fixed rate of interest are helped by unanticipated inflation because the rate they are paying does not provide their creditors a rate of return necessary to maintain future purchasing power. A common phrase associated with this phenomenon is "using cheap dollars to pay back dear dollars." In other words, the money debtors are paying to creditors will not buy today what it could have purchased at the time the borrower took the loan.

Handout 4

1. When the organization committee shall have designated the cities in which Federal reserve banks are to be organized, and fixed the geographical limits of the Federal reserve districts, every national banking association within that district shall be required within thirty days after notice from the organization committee, to subscribe to the capital stock of such Federal reserve bank in a sum equal to six per centum of the paid-up capital stock and surplus of such bank…. **Federal Reserve Act, December 23, 1913**

2. After the most deliberate consideration, it is the unanimous and decided opinion of this Court, that the act to incorporate the Bank of the United States is a law made in pursuance of the constitution, and is a part of the supreme law of the land. **McCulloch v. Maryland, 17 U.S. 316 (1819)**

3. (a) There is hereby created a Federal Open Market Committee (hereinafter referred to as the "Committee"), which shall consist of the members of the Board of Governors of the Federal Reserve System and five representatives of the Federal Reserve banks to be selected as hereinafter provided.

   (b) No Federal Reserve bank shall engage or decline to engage in open-market operations under sections 348a and 353 to 359 of this title except in accordance with the direction of and regulations adopted by the Committee.

   (c) The time, character, and volume of all purchases and sales of paper described in sections 348a and 353 to 359 of this title as eligible for open-market operations shall be governed with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country. **National Banking Act, 1935 Title 12, Chapter 3, Subchapter IV, 263**

Handout 5

Guided Discussion: Each group should assign a student to serve as a recorder to produce one copy of the groups' reflections for each of the excerpts found on Handout 4. Use the following questions to guide the group.

1. Who or what produced this document?
2. When was the document created?
3. Who was the intended audience?
4. What are the key words and ideas?
5. What words and/or phrases are difficult to understand even when using context clues?
6. Why was this document created?
7. What is the significance of this document?
8. What is the lasting value of the document?

Visual 1

Myths	**Realities**
The Federal Reserve is unconstitutional.	The constitutionality of central banking was established through a U.S. Supreme Court precedent.
The Federal Reserve was created by Wall Street Bankers, in secret, on Jekyll Island, Georgia.	The Federal Reserve Act was signed into law by President Wilson on December 23, 1913.
The Federal Reserve has little to do with the lives of ordinary people.	People can take care of their day-to-day business because the Federal Reserve fosters a sound banking system.
The Federal Reserve is controlled by citizens of foreign nations.	Member banks of the Federal Reserve hold stock in the Reserve Bank for their district.
Bank panics are a thing of the past because of the Federal Reserve System.	Quick responses by the Federal Reserve prevent bank panics from spreading.
The Federal Reserve profits at taxpayer expense.	The Federal Reserve rebates almost all of the interest earned on the securities in its portfolio each year to the U.S. Treasury.
The Federal Reserve sets interest rates at whatever level it pleases.	The Fed, interacting with the marketplace, influences interest rates.
U.S. money is backed by gold.	U.S. money gets its value from its purchasing power.
Most money spent in the economy is transferred by check or cash.	Most money spent in the economy is transferred electronically.
Unanticipated inflation hurts everyone in the economy.	Some people benefit from unanticipated inflation despite its generally harmful effects.