Credit and Consequences

Trace how monetary policy and borrowing shaped the 1920s economy.

USH.C.4.2.D "Examine the role of monetary policy and the expansion of credit in the 1920's including the creation and actions of the Federal Reserve System and their relationship to speculation, investment, and economic instability."

NAME _____ DATE _____

1 READ AND MARK

Read it twice

YOUR JOB Underline Federal Reserve actions that changed access to credit, and circle ways people used borrowed money. Then number three linked events in the passage that show how borrowing could spread instability.

When Credit Fueled the Boom

(1) In 1913, Congress created the Federal Reserve System to make banking more stable and provide an elastic supply of money and credit. Its regional Reserve Banks could lend to member banks, while a central board helped guide policy. By the 1920s, the Fed could also buy or sell government securities, changing how much money banks had available to lend. Buying securities added reserves and tended to ease borrowing; selling them drained reserves and tended to restrain lending. The Fed also set the discount rate, the interest rate it charged member banks for short-term loans. These tools affected borrowing costs, but they did not control every loan.

(2) After a recession in 1923 and 1924, the Fed bought government securities, helping make credit easier to obtain. In 1927, it again eased credit, including a cut in its discount rate. Cheaper loans could help businesses finance equipment and expansion, a form of investment that might raise production. Yet easier credit could also reach buyers of stocks. Some investors bought shares on margin, paying part of the price and borrowing the rest from a broker. Rising share prices made this strategy seem safe, even when prices grew faster than company earnings. Loans made a small initial payment control a much larger, riskier purchase.

(3) By 1928, Fed officials worried that stock speculation was drawing too much credit. The Fed raised its discount rate in 1928 and 1929 and pressed member banks to limit loans used for speculation. Other lenders still supplied money to stock buyers, so tighter policy did not end margin borrowing. When share prices fell sharply in October 1929, borrowers who had used margin could face demands for more cash or forced sales. Those sales could push prices lower and spread losses to lenders. The crash had multiple causes, and Fed policy alone did not cause the Great Depression. Credit could support growth yet amplify instability.

2 ANSWER WITH EVIDENCE

Use the passage

1. How did the Federal Reserve System, created in 1913, give policymakers ways to change access to credit?

2. How could easier credit in the 1920s support investment but also increase speculation?

3. Why did the Fed's efforts in 1928 and 1929 not end borrowing for stock purchases?

4. How could buying shares on margin make a sharp fall in stock prices more damaging?

3 YOUR TURN

Your own words

Imagine advising Fed officials before their 1927 decision. In four or five sentences, recommend whether to ease or tighten credit, explain a likely effect on business investment and on stock speculation, and identify one risk to economic stability. Do not simply describe what officials actually did.

ANSWER KEY

Credit and Consequences

HIGH SCHOOL · USH.C.4.2.D

PART 1 · READ AND MARK

Underline Federal Reserve actions that changed access to credit, and circle ways people used borrowed money. Then number three linked events in the passage that show how borrowing could spread instability. Accept any marking that follows this job and points at the right text.

PART 2 · ANSWERS

#	QUESTION	ANSWER
1	How did the Federal Reserve System, created in 1913, give policymakers ways to change access to credit?	**Its Reserve Banks could lend to member banks. The Fed could also buy or sell government securities and change the discount rate, affecting banks' ability and cost to borrow.**
2	How could easier credit in the 1920s support investment but also increase speculation?	**Businesses could borrow to buy equipment and expand, while stock buyers could borrow on margin to purchase more shares than their own money would allow.**
3	Why did the Fed's efforts in 1928 and 1929 not end borrowing for stock purchases?	**Although the Fed raised its discount rate and pressed member banks to limit speculative loans, other lenders still supplied money to stock buyers.**
4	How could buying shares on margin make a sharp fall in stock prices more damaging?	**Borrowers could face demands for more cash or forced sales. Those sales could drive prices lower and spread losses to lenders.**

PART 3 · YOUR TURN (SAMPLE ANSWER)

I would recommend keeping credit tighter before the 1927 decision to discourage borrowing for stock purchases. Higher borrowing costs might also delay some business equipment purchases, reducing investment in production. Fewer investors might buy shares on margin, lowering the risk that falling prices would trigger forced sales. This choice could reduce one source of instability, though other lenders could still supply credit and tighter policy would not prevent every downturn.

Accept either recommendation in Part 3 if the response accurately connects credit conditions to investment, speculation, and a risk to stability. For the marking job, accept any three correctly ordered events in the passage's chain from falling share prices to forced sales, lower prices, or lender losses.