

# Fed Challenge Brief:

## *The Federal Reserve System*

### The Nation's Central Bank

#### What is the Role of a Central Bank?

- Influence the supply of money and credit
- Regulate and supervise the financial industry
- Serve as the fiscal agent for the government
- Provide public payment systems through depository institutions
- Responsible for supply and circulation of coin and currency
- Throughout its history, the Fed has helped other nations to create reliable and secure central banks by serving as a model, providing advice, and offering assistance.

#### Independence of the Federal Reserve

- The Board of Governors is an agency of the federal government; the Regional Banks are private corporations
- Because of its hybrid ownership structure, the Fed is described as "quasi-governmental."
- The Fed's structure plays an important role in separating monetary policy from day-to-day political pressure
  - Political pressure can cause a central banker to sacrifice long-term stability for short-term economic gains

### Structure

#### Structure of the Federal Reserve

- 12 Regional Banks
- Board of Governors
- Regional Bank Branches

#### Board of Governors of the Federal Reserve System

- 7-Member Board, 14-year terms
- Members appointed by President, confirmed by Congress
- Chairman and Vice Chairman serve 4-year terms
- Minimum of 5 members to conduct certain business
- Supervises the Reserve Banks

#### Reserve Banks

- President, chosen by the Board of Directors
- Board of Directors – representing banking and financial institutions and the community

#### Member banks

- National banks and state-chartered banks that meet certain requirements
- Required to hold 3% of capital as stock in the Fed

#### Other Depository Institutions

- Non-member commercial banks / savings banks
- Savings and loan associations
- Credit unions

### On the Web

#### Board of Governors

[www.federalreserve.gov](http://www.federalreserve.gov)

#### Economic Education

[www.federalreserveeducation.org](http://www.federalreserveeducation.org)

#### Reserve Banks:

[www.bos.frb.org](http://www.bos.frb.org)  
[www.ny.frb.org](http://www.ny.frb.org)  
[www.phil.frb.org](http://www.phil.frb.org)  
[www.clevelandfed.org](http://www.clevelandfed.org)  
[www.rich.frb.org](http://www.rich.frb.org)  
[www.frbatlanta.org](http://www.frbatlanta.org)  
[www.chicagofed.org](http://www.chicagofed.org)  
[www.stlouisfed.org](http://www.stlouisfed.org)  
[www.minneapolisfed.org](http://www.minneapolisfed.org)  
[www.kc.frb.org](http://www.kc.frb.org)  
[www.dallasfed.org](http://www.dallasfed.org)  
[www.frbsf.org](http://www.frbsf.org)

### Monetary Policy Tools

#### Monetary Policy Instruments:

***Open Market Operations*** - The Federal Reserve buys and sells U.S. Treasury securities on the open market in an effort to meet its target for the federal funds rate. This is the **Fed's primary policy tool**.

***Discount Rate*** – The rate at which banks borrow from the Federal Reserve. Changes in the discount rate have become largely symbolic and are typically considered less important than the federal funds rate target.

***Reserve Requirements*** – Very rarely changed, the reserve requirement is a mandatory deposit that Federal Reserve member banks must maintain in the form of reserves (vault cash and reserve accounts with the Fed).

***Margin Requirements*** - Although not changed regularly, the Board of Governors has the power to set margin requirements, which set the amount of principal a borrower must contribute toward securities purchases.

***Foreign Exchange Operations*** – The Federal Reserve, through the FOMC, can join with the U.S. Treasury to influence international exchange rates.

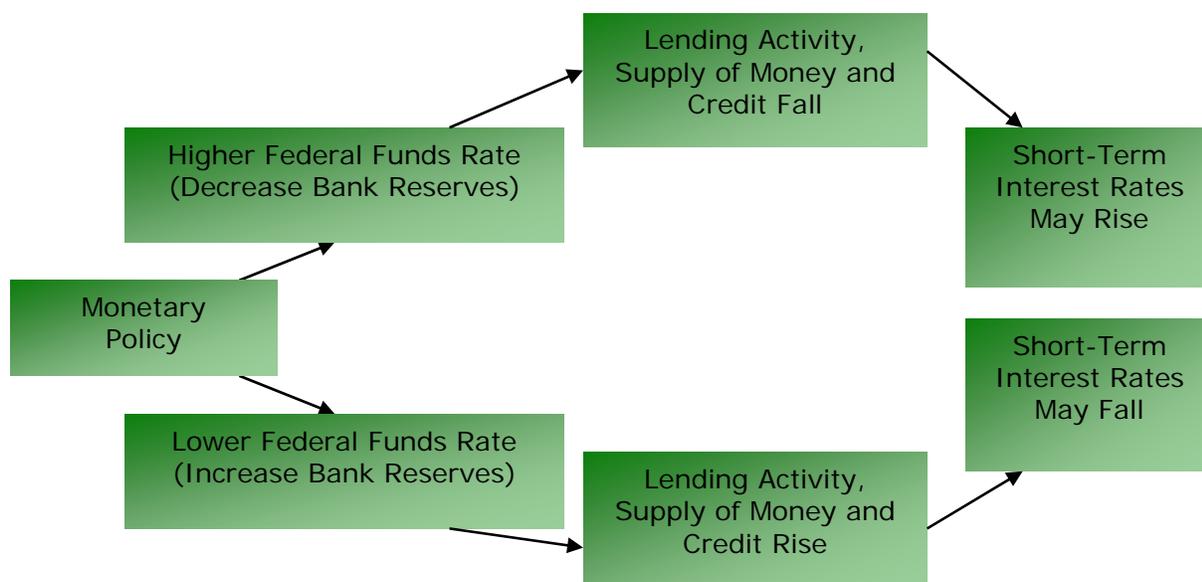
# The FOMC

- Responsible for monetary policy.
- Evaluates economic conditions and sets the federal funds rate target.
- Has the explicit ability to perform open market operations and foreign currency exchange transactions.
- Voting members include all seven members of the Board of Governors and five of the twelve regional Reserve Bank Presidents. Eleven regional Bank presidents serve on a rotating basis in one-year terms; the President of the New York Bank is a permanent voting member.
- The FOMC meets approximately every six weeks (eight times per year) in Washington, D.C.

## The Economy's Performance

The FOMC focuses on the dual criteria of low inflation and low unemployment. The Full Employment and Balanced Growth Act of 1978 (commonly known as the Humphrey-Hawkins Act) directs the Federal Reserve "to promote effectively the goals of maximum employment, stable prices, and moderate long term interest rates." Members who are more concerned about inflation are sometimes referred to as "hawks," while those more concerned with unemployment are referred to as "doves."

Historically, many economists believed that there was a tradeoff between inflation and unemployment – which came to be known as the Phillips Curve. More recent experience, such as the stagflation of the 1970s and the strong growth and low inflation of the 1990s, have led many to believe that it is possible to maintain non-inflationary growth and that no Phillips Curve tradeoff exists.



## Additional Resources

The Federal Open Market Committee  
<http://www.federalreserve.gov/FOMC/default.htm> and  
<http://www.minneapolisfed.org/info/policy/fomc.cfm>

The Federal Reserve Today  
<http://www.rich.frb.org/pubs/frtoday/> - Available free from:  
Public Affairs, Federal Reserve Bank of Richmond, P.O.  
Box 27622, Richmond, VA 23261

The Federal Reserve System: A starting point  
<http://www.minneapolisfed.org/info/sys/> - A good place to  
begin looking for more information about the Fed.

The Federal Reserve System: Purposes and Functions  
December 1994 Available from: Publications Services,  
Division of Support Services, Board of Governors of the  
Federal Reserve System, Washington, DC 20551

Federal Reserve: Special Report – Washington Post Online  
<http://washingtonpost.com/wp-dyn/business/specials/federalreserve/index.html>

An up-to-date web site covering Federal Reserve developments

Special Report: Eyes on the Fed – CNN Online  
[http://cnfn.cnn.com/news/specials/eyes\\_on\\_fed/](http://cnfn.cnn.com/news/specials/eyes_on_fed/)  
Similar to the *Washington Post Online*.

Yahoo: Federal Reserve News from Reuters & AP  
[http://dailynews.yahoo.com/fc/Business/Federal\\_Reserve](http://dailynews.yahoo.com/fc/Business/Federal_Reserve)  
Comprehensive display of recent news on the Federal Reserve

FED 101: The Fed Today  
<http://www.federalreserveeducation.org/>  
Multimedia introduction to the Federal Reserve System.