

Chapter 14

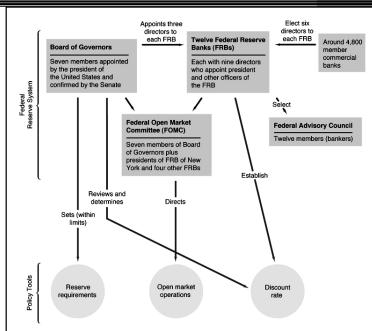
Structure of Central Banks and the Federal Reserve System

Need for a Central Bank

- Before 1913
 - general resistance against centralization of powers and money interests
 - no lender of last resort ⇒ regular bank panics
- Case against a central bank
 - Wall Street interests could gain control over the economy
 - federally operated, so too much government intervention
- Debate on whether the central bank should be privately run or a government institution ⇒ current form is a compromise

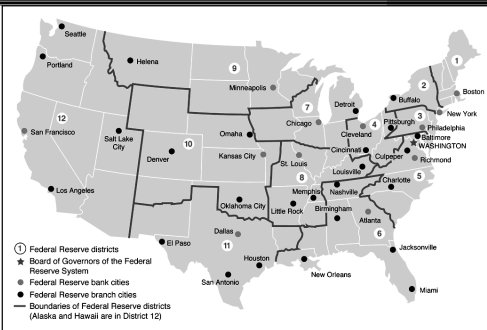
14-2

Formal Structure of the Fed



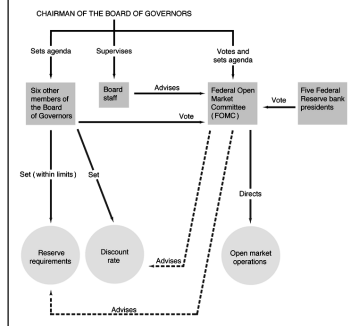
14-3

Federal Reserve Districts



14-4

Informal Structure of the Fed



14-5

Central Bank Independence

- Factors making Fed independent
 - members of the Board have long (non-renewable) terms
 - financially independent (most important)
 - ⇒ Fed is *instrument-independent* (can set monetary policy instruments) and *goal-independent* (can set goals of monetary policy)
- Factors making Fed dependent
 - Congress can amend Fed legislation
 - President appoints Chairmen and Board members and can influence legislation
- Overall: Fed is quite independent

14-6

Independence of Other Central Banks

- Bank of England is least independent: government makes policy decisions
- European Central Bank: most independent—price stability is its primary goal
- Bank of Canada and of Japan: fair degree of independence, but not all on paper
- trend to greater independence: New Zealand, other European nations

14-7

Explaining Central Bank Behavior

- Theory of bureaucratic behavior
 - is an example of the principal-agent problem
 - bureaucracy often acts in own interest
- Implications for Central Banks:
 - act to preserve independence
 - try to avoid controversy: often plays games
 - seek additional power over banks

14-8

Should the Fed be Independent?

- Case “for”
 - an independent Fed likely has longer-run objectives, politicians don't: evidence is independence produces better policy outcomes
 - avoids political business cycle
 - less likely that deficits will be inflationary
- Case “against”
 - Fed may not be accountable
 - hinders coordination of monetary and fiscal policy
 - Fed has often performed badly

14-9
