

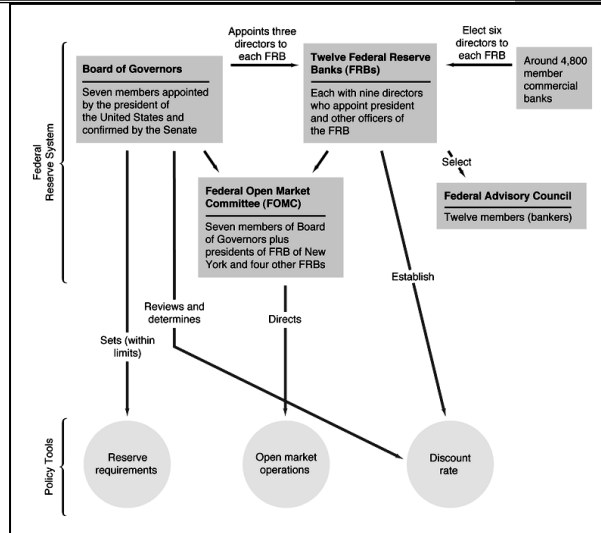
Chapter 14

Structure of Central Banks and the Federal Reserve System

Need for a Central Bank

- Before 1913
 - general resistance against centralization of powers and moneyed 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

Formal Structure of the Fed



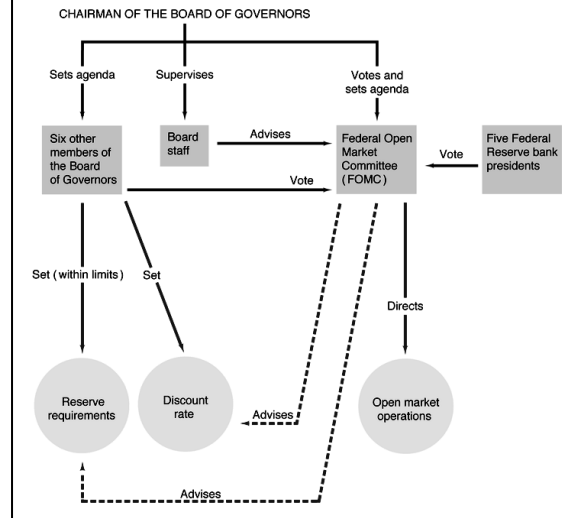
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Federal Reserve Districts



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Informal Structure of the Fed



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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

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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

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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

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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