The Federal Reserve System

**A Brief History**
- Several bank panics in the 19th century, especially 1893 and 1907.
- National Banking Commission established in 1907. After five years of study, recommended Federal Reserve System.
- President Wilson signed law establishing Federal Reserve System in 1913.

**The Basics of the System**
- This is a “bank’s bank”.
- Only banks have accounts at Fed.
- Bank of England
- European Central Bank
- Bank of Japan

- Twelve District Banks
  - Atlanta
  - Boston
  - Cleveland
  - Dallas
  - Denver
  - Kansas City
  - Minneapolis
  - New York
  - Philadelphia
  - Richmond
  - St. Louis
  - San Francisco

- Twelve District Banks
  - Board is one-third appointed by Board of Governors and two thirds elected by banks in district.
  - Bank board elects its own president, subject to approval by Board of Governors.

- Seven members, elected for 14 years terms (cannot repeat).
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  - All appointed by President, subject to Senate confirmation.

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  - **Federal Open Market Committee (FOMC)**
    - Seven members of Board of Governors
    - President of NY District Bank and four other district presidents on rotating basis.
    - This group sets monetary policy.

Independence of Fed

- 14 year terms
- District Banks have real independence and appoint 5 of 12 members of FOMC.
- President and Congress have little day-to-day control.
Independence of Fed

• The designers of the Federal Reserve System were worried that political control of the monetary policy would cause wild swings in the money supply and macro instability.

• Most economists approve of this degree of independence.

• Some argue that the independence of the Federal Reserve System makes it unresponsive to the will of the majority.

Factoid:
Nations with independent central banks have lower inflation rates than nations where the central bank is subject to political control.