13.4: The Federal Reserve System and Central Banks

Learning Objectives

- Explain the structure and organization of the U.S. Federal Reserve
- Discuss how central banks impact monetary policy, promote financial stability, and provide banking services

Structure and Organization of the Federal Reserve

In order to help financial systems operate smoothly and to reduce the likelihood of financial crises, most modern nations have a **central bank**. The oldest central bank is the Bank of England. Other prominent central banks include the Bank of Japan, and the European Central Bank, which is the central bank for the member countries of the European monetary system. In the United States, the central bank is called the Federal Reserve—often abbreviated as "the Fed." This section explains the organization of the U.S. Federal Reserve System and identifies the major responsibilities of a central bank.

The **Federal Reserve**, unlike most central banks, is semi-decentralized. At the national level, it is run by a Board of Governors, consisting of seven members appointed by the President of the United States and confirmed by the Senate. Appointments are for 14-year terms and they are arranged so that one term expires January 31 of every even-numbered year. The purpose of the long and staggered terms is to insulate the Board of Governors as much as possible from political pressure so that policy decisions can be made based only on their economic merits. Additionally, except when filling an unfinished term, each member only serves one term, further insulating decision-making from politics. Policy decisions of the Fed do not require congressional approval, and the President cannot ask for the resignation of a Federal Reserve Governor as the President can with cabinet positions.

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The Federal Reserve is more than the Board of Governors. The Fed also includes 12 regional Federal Reserve banks, each of which is responsible for supporting the commercial banks and economy generally in its district. The Federal Reserve districts and the cities where their regional headquarters are located are shown in Figure 2. The commercial banks in each district elect a Board of Directors for each regional Federal Reserve bank, and that board chooses a president for each regional Federal Reserve district. Thus, the Federal Reserve System includes both federally and private-sector appointed leaders.

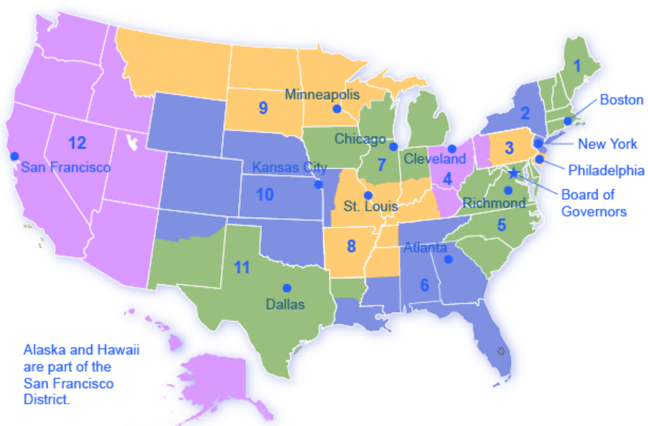

Figure 1. The Twelve Federal Reserve Districts. There are twelve regional Federal Reserve banks, each with its district.

One member of the Fed's Board of Governors is designated as the Chair. For example, from 1987 until early 2006, the Chair was Alan Greenspan. From 2006 until 2014, Ben Bernanke held the post. The next Chair, Janet Yellen, held the position from 2014 to 2018, and now Jerome Powell heads the organization.

WHO HAS THE MOST IMMEDIATE ECONOMIC POWER IN THE WORLD?

Figure 2. Janet L. Yellen was the first woman to hold the position of Chair of the Federal Reserve Board of Governors.

(Credit: Board of Governors of the Federal Reserve System)

What individual can make financial market crash or soar just by making a public statement? It is not Bill Gates or Warren Buffett. It is not even the President of the United States.

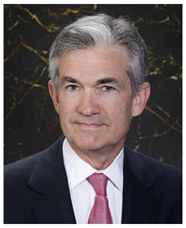

Figure 3. Chair of the Federal Reserve Board, Jerome Powell.

The answer is the Chair of the Federal Reserve Board of Governors. In early 2014, Janet L. Yellen, shown in Figure 1, became the first woman to hold this post. Yellen has been described in the media as "perhaps the most qualified Fed chair in history." With a Ph.D. in economics from Yale University, Yellen taught macroeconomics at Harvard, the London School of Economics, and at the University of California at Berkeley before becoming the President of the Federal Reserve Bank of San Francisco between 2004–2010.

In February 2018, Yellen was succeeded as Fed Chair by Jerome Powell, a lawyer and investment banker.

The Fed Chair is first among equals on the Board of Governors. While he or she has only one vote, the Chair controls the agenda, and is the public voice of the Fed, so he or she has more power and influence than one might expect.

Visit the Federal Reserve Board website to learn more about the current members of the Federal Reserve Board of Governors. You can follow the links provided for each board member to learn more about their backgrounds, experiences, and when their terms on the board will end.

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What Does a Central Bank Do?

The Federal Reserve, like most central banks, is designed to perform three important functions:

1. To provide banking services to commercial banks and other depository institutions, and to provide banking services to the federal government.
2. To promote stability of the financial system
3. To conduct monetary policy

We will discuss the first function here. The other two functions are sufficiently important that we will explain them on their own pages.

The Federal Reserve is sometimes called a "banker's bank." The reason for this is that the Fed provides many of the same services to banks as banks provide to their customers. For example, all commercial banks have an account at the Fed where they deposit reserves. In fact, most of a commercial bank's reserves are not held on the premises; rather, they are held at their regional Federal Reserve bank. Banks can also obtain loans from the Fed through the "discount window" facility, which will be discussed in more detail later. Additionally, the Fed is responsible for check processing. When you write a check, for example, to buy groceries, the grocery store deposits the check in its bank account. Then, the physical check (or an image of that actual check) is returned to your bank, after which funds are transferred from your bank account to the account of the grocery store. The Fed is responsible for each of these actions.

On a more mundane level, the Federal Reserve ensures that enough currency and coins are circulating through the financial system to meet public demands. For example, each year the Fed increases the amount of currency available in banks around the Christmas shopping season and reduces it again in January.

Finally, the Fed is responsible for assuring that banks are in compliance with a wide variety of consumer protection laws. For example, banks are forbidden from discriminating on the basis of age, race, sex, or marital status. Banks are also required to disclose publicly information about the loans they make for buying houses and how those loans are distributed geographically, as well as by sex and race of the loan applicants.

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Watch It

Watch Mr. Clifford at the Federal Reserve building in Washington D.C. as he gives an overview of the Federal Reserve System and how it works.

An interactive or media element has been excluded from this version of the text. You can view it online here: http://pb.libretexts.org/mlum/?p=553

Glossary

[glossary-page][glossary-term]central bank:[/glossary-term]
[glossary-definition]institution which conducts a nation's monetary policy and regulates its banking system[/glossary-definition][glossary-term]Federal Reserve: [/glossary-term]
[glossary-definition]the central bank of the United States run by a 7-member Board of Governors in conjunction with 12 regional Federal Reserve banks[/glossary-definition] [/glossary-page]