Under Pressure

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This book examines the role of politics on the Federal Open Market Committee at that time and highlights the importance of the Fed's independence and decentralized structure.

During the U.S. recession of 1990-91, the Federal Reserve came under intense pressure from political forces seeking to influence monetary policy. This book examines the role of politics on the Federal Open Market Committee at that time and highlights the importance of the Fed's independence and decentralized structure.

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Preface

The Federal Reserve, the Federal Open Market Committee and Monetary Policy

Congress designed the Federal Reserve's structure to carefully balance public and private interests in the oversight of the nation's central bank. The goal was to ensure broad representation in the bank's important policy deliberations with ample opportunity for discussion and disagreement while also providing insulation from those who might seek to influence policy decisions for short-term political gain. Under this structure, the Board of Governors in Washington, D.C., has broad oversight responsibility for the Federal Reserve. The Board is the government component of the Federal Reserve and comprises seven governors who are appointed by the president of the United States and confirmed by the Senate. Meanwhile, the regional Federal Reserve Banks operate under the leadership of local Boards of Directors. These boards are filled by individuals from throughout the respective Federal Reserve Districts and, among other responsibilities, select the president of their respective Federal Reserve Banks.

This blending of public and private is mirrored in the Federal Open Market Committee, (FOMC) which is responsible for setting the nation's monetary policy.

All seven governors are voting members of the FOMC, as is the president of the Federal Reserve Bank of New York. The other Federal Reserve Bank presidents vote on a rotating basis. All governors and Bank presidents participate in the FOMC policy deliberations and offer their views on current economic conditions, the outlook and the path they would recommend for monetary policy.

The Federal Reserve primarily conducts monetary policy through adjustments in a short-term interest rate known as the federal funds rate. Depository institutions, such as commercial banks, have accounts, called reserve accounts, at their respective regional Federal Reserve Bank. These funds are held to meet demand for loans or withdrawls and can be loaned to another institution needing cash. The interest rate on these short-term loans is the fed funds rate. Changes in the rate can set off a chain of events that influence other interest rates. The entire FOMC is responsible for setting a target for the fed funds rate.

The Federal Reserve, the Federal Open Market Committee and Monetary Policy Preface • xi The Federal Reserve Banks can also loan balances directly to sound financial institutions through what is known as the Fed's discount window. This is where the central bank meets its responsibility for acting as a lender of last resort. For these loans, the Fed charges borrowers an interest rate known as the discount rate. The discount rate is set by the Boards of Directors of the Federal Reserve Banks, subject to the review and determination of the Federal Reserve's Board of Governors. The rate is the same across the nation, and the Federal Reserve's governors vote on changes to the discount rate, not the entire FOMC. Because both rates involve bank borrowing, and the Fed lends at a higher rate than what is available on the market, the fed funds rate and the discount rate almost always move in tandem today. In recent years, discount window lending has changed and now includes both primary and secondary credit, which is available to financial institutions at different rates. In this environment, primary credit is the discount rate while secondary credit is a higher rate.

Current media coverage of Federal Reserve interest rate changes focuses almost exclusively on the fed funds rate. Previously, changes in the discount rate also received significant media attention, but even then, it was recognized that discount rate moves were seen as largely symbolic, and their actual influence on monetary policy was nominal.
