Chapter 14
STRUCTURE OF CENTRAL BANKS AND THE FEDERAL RESERVE SYSTEM

Formal Structure of the Fed

Central Bank Independence

Factors making Fed independent
1. Members of Board have long terms
2. Fed is financially independent: This is most important

Factors making Fed dependent
1. Congress can amend Fed legislation
2. President appoints Chairmen and Board members and can influence legislation

Overall: Fed is quite independent

Other Central Banks
1. Bank of England least independent: Govt. makes policy decisions
2. European Central Bank: most independent—price stability primary goal
3. Bank of Canada and Japan: fair degree of independence, but not all on paper
4. Trend to greater independence: New Zealand, European nations
Explaining Central Bank behavior

Theory of bureaucratic behavior
1. Is an example of principal-agent problem
2. Bureaucracy often acts in own interest

Implications for Central Banks:
1. Act to preserve independence
2. Try to avoid controversy: often plays games
3. Seek additional power over banks

Should Fed be Independent?
Case For:
1. Independent Fed likely has longer-run objectives, politicians don't: evidence is better policy outcomes
2. Avoids political business cycle
3. Less likely deficits will be inflationary

Case Against:
1. Fed may not be accountable
2. Hinders coordination of monetary and fiscal policy
3. Fed has often performed badly