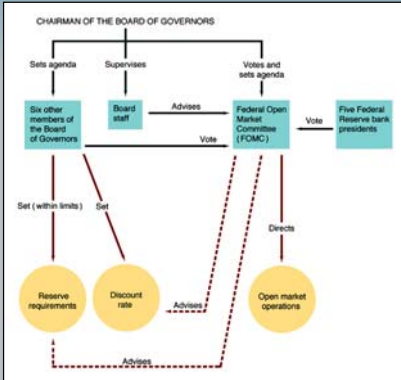




## Informal Structure of the Fed



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## 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

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## 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 independence produces better policy outcomes throughout the whole
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

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