

**Central Banks and the Federal Reserve System**  
ECON 4673  
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**Answers**

1. *Why was the Federal Reserve System set up with twelve regional Federal Reserve Banks rather than one central bank as in most other countries?*

Since Americans historically have had a distrust of both a central/national bank and centralized authority, the Federal Reserve Act of 1913 set up a system of twelve regional banks to diffuse power across the country.

2. *How many Federal Reserve Banks are there? Briefly discuss the main functions of the Federal Reserve Banks.*

There are twelve Federal Reserve Banks. The Board of Directors of each Bank legally “establishes” the discount rate. One banker from each Federal Reserve Bank is elected by that Bank to serve on the Federal Advisory Council, which consults with the Board of Governors on the conduct of monetary policy. Each Federal Reserve Bank decides which banks can obtain discount window loans and then administers those loans. Each Bank also clears checks, issues new currency, collects and reports data on local business conditions, and acts as a liaison between the business community and the Federal Reserve System.

3. *How many governors are there on the Board of Governors of the Federal Reserve System? How long are the terms for the Governors and the Chair of the Federal Reserve Board? Name the person or entity who nominates the Governors and Chair and who confirms their nominations. What are the main monetary policy functions of the Board of Governors?*

There are seven governors on the Federal Reserve Board who serve 14-year terms. One of those Governors is also appointed the Chair of the Federal Reserve Board and serves a 4-year term in that position. Both the Governors and Chair are nominated by the President and are confirmed by the Senate. The Board of Governors is involved in monetary policy in several ways: 1) All seven governors are members of the Federal Open Market Committee and vote on the conduct of monetary policy; 2) The Board of Governors sets the reserve requirements and; 3) The Board approves or disapproves the discount rate “established” by the Federal Reserve Banks.

4. *The Fed is the most independent of all U.S. government agencies. What is the main reason the Fed is more independent than other government agencies? What is the primary tool that Congress uses to exercise some control over the Fed?*

The Federal Reserve completely funds its operations using resources obtained from its substantial security holdings and interest received on loans from the discount window. The Fed, unlike other government agencies, does not receive any funds from Congressional appropriations. Congress’ primary tool to exercise control over the Fed is to threatening to take back power from the Federal Reserve through its legislative power.

5. *Which is more independent, the Federal Reserve or the European Central Bank and why?*

The European Central Bank (ECB) is more independent than the Fed because its charter can only be changed by revision of the Maastricht Treaty which a very difficult process because all signatories to the treaty must agree to accept any proposed change. The Federal Reserve charter, however, can be changed by Congressional legislation, which is much easier to do.