

The History and Structure of the Federal Reserve System

Jerome Powell

The Federal Reserve's structure reflects a long-standing desire in America to ensure that power over our nation's monetary policy and financial system is not concentrated in a few hands, whether in Washington or in high finance or in any single group or constituency. Rather, Americans have long wanted decisions about these matters to be influenced by diverse voices from all parts of the country and the economy.

In 1791, Congress created the Bank of the United States, a forerunner of the Federal Reserve. It was created in part to conduct financial transactions by the federal government, a typical responsibility of central banks then and today. It was also designed to help America's financial system meet the needs of a growing economy—the same purpose behind the founding of the Federal Reserve more than 100 years later.

Like other early central banks, the Bank of the United States was privately owned, and that fed suspicions that it favored certain interests over others. Interest rates and credit conditions continued to vary by region, and that led to allegations that the Bank was not allocating credit fairly. After 20 years, Congress did not renew the Bank's charter. A second Bank of the United States met a similar fate in 1836.

Over time, the lack of a central bank contributed to financial instability and interfered with the creation of a truly national economy and financial system. The United States expe-



Jerome Powell, chair of the Board of Governors of the Federal Reserve System, listens to a reporter's question at a January 30, 2019, press conference.

Courtesy of the Federal Reserve.

rienced one serious financial crisis after another, with major crises in 1839, 1857, 1873, 1893, and in 1907. The last of these, dubbed the Panic of 1907, caused inflation-adjusted gross national product to decline by 12 percent—more than twice the decline recorded during the Great Recession of 2007 to 2009—and was a catalyst leading to the creation of the Federal Reserve.

After the panic ended, there was a broad sense that reform was needed, although consensus on the nature of that reform was elusive. Some called for an institution similar in structure to the Bank of England at the time, with centralized power, owned and operated by private banks. Some wanted control to be lodged with the

federal government. Others proposed that power be distributed to regional bodies with no central or coordinating board. Still others resisted any sort of central bank.

The resulting institution was a compromise, created by the Federal Reserve Act in 1913. The Federal Reserve was *not* structured to be entirely private in its ownership and operation. Instead, a more *federated* system was created, establishing the Federal Reserve Board in Washington, D.C., and the 12 Reserve Banks located around the country.

The seven-member Board is the part of the System intended to be most directly accountable to the public. The Board is an independent agency within the federal government, and members of the Board—now called governors—

are appointed by the president and confirmed by the Senate. Governors are appointed to 14-year terms that expire at 2-year intervals not linked to election cycles. The Federal Reserve Board is charged with overseeing the Reserve Banks.

The Reserve Banks combine both public and private elements in their makeup and organization. Like the Board of Governors, the Reserve Banks operate with the public interest in mind. In the System's early years, the decentralized structure gave the Reserve Banks considerable scope to make independent decisions that applied to their own districts, which made it difficult to effect policy for the benefit of the country as a whole. For example, as the market for securities became more national in scope, one Reserve Bank's purchases of securities, in order to influence local credit conditions, could be offset by another Bank's sale. As a result, the Reserve Banks created a committee to coordinate these "open market operations." But in these early years, the Reserve Banks were not bound by that committee's decisions and could derail any attempt at coordinated action.

This decentralization was thought by some to have undermined the Federal Reserve's response to the Great Depression. With that experience in mind, the Banking Act of 1935 modified the distribution of power within the Federal Reserve System, giving the Board of Governors seven of the twelve votes on the Federal Open Market Committee (FOMC). The other five votes are held by Reserve Bank presidents—the president of the Federal Reserve Bank of New York and a group of four others that rotates annually. While individual FOMC members are free to dissent from the majority decision about open market operations, all Reserve Banks are nevertheless required to adhere to that decision.

The organizational structure set out in 1935 has been essentially unchanged to this day and has served the country well. As intended by the Fed's framers, the federated nature of the system

has ensured a diversity of views and promotes a healthy debate over policy. Members of the Board of Governors and presidents of the Reserve Banks arrive at their own independent conclusions about the economy and the appropriate path for monetary policy.

Congress has assigned the FOMC the task of achieving maximum employment and stable prices; however, policymakers may disagree on the best way to achieve those goals. The FOMC works to achieve a consensus policy by blending the perspectives of the members of the Board of Governors and the Reserve Bank presidents under the leadership of the Chair. By tradition, the Chair of the Board has been chosen as the Chair of the FOMC and has had a central role in setting the agenda for the FOMC and developing consensus among the Committee's members. In addition, the Chair is the most visible public face of the Federal Reserve System.

The Fed is accountable to Congress and the public for its activities and decisions. Historically, the activities of central banks were shrouded in mystery. In the modern era, all that has changed, as central banks have come to see transparency both as a requirement of democratic accountability and as a way of supporting the efficacy of their policies.

Over recent decades, the Fed has significantly augmented its public communications, as have other major central banks. Twice a year, the Federal Reserve Board prepares a Monetary

Policy Report and the Chair testifies to Congress on those occasions. In 2018, I announced an increase in the number of the Chair's regular press conferences, from four to eight per year, after each FOMC meeting, effective in January 2019. The FOMC releases statements after its meetings that explain the economic outlook and the rationale for its policy decisions. Detailed minutes of the Committee's meetings are published three weeks later. Since 2007, FOMC participants have submitted quarterly macroeconomic projections that are published in the Summary of Economic Projections. Since 2012, the FOMC has laid out the goals and strategy for monetary policy in a detailed statement. Transcripts of FOMC meetings are released to the public after about five years. Federal Reserve Board Governors and Reserve Bank presidents contribute to the Federal Reserve's transparency with frequent public speeches and other communications. I believe that support for the Federal Reserve as a public institution is sustained by the public expression of our diverse views.

These communications with Congress and the public are critical parts of the Federal Reserve's institutional accountability and transparency, and are essential complements to its independence. It is important that Federal Reserve officials regularly demonstrate that the Fed has been appropriately pursuing its mandated goals. Transparency can also make monetary policy more effective by

Federal Reserve Education Resources

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helping to guide the public's expectations and clarify the Committee's policy intentions.

Throughout our history, Americans have debated the structure and even, at times, the need for a central bank. But it is important to understand that history in both advanced and emerging economies across the world has consistently demonstrated the need for a central bank,

and both the existence and the structure of the Federal Reserve are products of that historical experience. Our structure is fundamentally a compromise, shaped by experience stretching back to the first Bank of the United States and, later, by the lessons of the Great Depression. The balance between national and regional interests is critical to the spirit of the original compromise that created the

Federal Reserve, and to its democratic legitimacy. The structure continues to serve our country well and achieves a practical balance that should not be changed lightly. 🌐

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Federal Reserve Banks

The 12 Federal Reserve Banks and their 24 branches are the operating arms of the Federal Reserve System. Reserve Banks examine and supervise financial institutions, act as lenders of last resort, and provide U.S. payment system services, among other things. In addition, each Reserve Bank gathers data and information to report on economic conditions within its district. That information is factored into monetary policy decisions made by the Federal Open Market Committee (FOMC). The presidents of the Federal Reserve Banks also contribute to monetary policy decisions by serving on the FOMC.

- District 1: Federal Reserve Bank of Boston
- District 2: Federal Reserve Bank of New York
- District 3: Federal Reserve Bank of Philadelphia
- District 4: Federal Reserve Bank of Cleveland
- District 5: Federal Reserve Bank of Richmond
- District 6: Federal Reserve Bank of Atlanta

- District 7: Federal Reserve Bank of Chicago
- District 8: Federal Reserve Bank of St. Louis
- District 9: Federal Reserve Bank of Minneapolis
- District 10: Federal Reserve Bank of Kansas City
- District 11: Federal Reserve Bank of Dallas
- District 12: Federal Reserve Bank of San Francisco

