JEB HENSARLING, TX, CHAIRMAN

United States House of Representatives
Committee on Financial Services
Washington, D.C. 20515

MAXINE WATERS, CA, RANKING MEMBER

M E M O R A N D U M

To: Members of the Committee on Financial Services

From: FSC Majority Staff

Date: December 9, 2013

Subject: December 12, 2013, Full Committee Hearing Entitled "Re-Examining the Federal Reserve's Many Mandates on its 100-Year Anniversary"

The Committee on Financial Services will hold a hearing at 9:30 a.m. on Thursday, December 12, 2013, in room 2128 of the Rayburn House Office Building, entitled "Re-Examining the Federal Reserve's Many Mandates on its 100-Year Anniversary." The witnesses will be Dr. Douglas Holtz-Eakin of the American Action Forum, Dr. Alice Rivlin of the Brookings Institution, Professor Marvin Goodfriend of Carnegie-Mellon University, and Mr. Alex Pollock of the American Enterprise Institute.

The Federal Reserve's Dual Mandate In Monetary Policy

The Federal Reserve operates under a requirement to focus on both price stability and maximum employment in setting monetary policy, a mandate that originates from the Humphrey-Hawkins Act of 1978.

The Federal Reserve consists of a Board of Governors and twelve regional Federal Reserve Banks. The Board of Governors consists of seven members who are appointed by the President and confirmed by the Senate and who serve staggered 14-year terms. Each Reserve Bank is responsible for a particular geographic area of the United States and has its own board of nine directors. The Reserve Banks are responsible for a variety of functions, including operating a nationwide payments system and distributing the nation's currency and coins. Collectively, the Board of Governors and the Reserve Banks are responsible for supervising and regulating bank holding companies and for providing banking services to depository institutions and the federal government.

Depository institutions maintain accounts at Reserve Banks and use the funds held in these accounts to meet end-of-day reserve and other balance requirements. If a depository institution anticipates that it will have a surplus federal funds balance, it can lend these surplus funds to other institutions, usually through overnight, unsecured loans. The federal funds rate—the interest rate charged for these transactions—is an important benchmark in financial transactions. The Federal Open Market Committee (FOMC)—whose members are the seven Federal Reserve Board Governors, the president of the Federal Reserve Bank of New York, and four presidents selected from the other Reserve Banks—sets a "target" federal funds rate at a level it believes will foster financial and monetary conditions consistent with achieving its monetary policy objectives of stable prices and maximum employment. It regularly adjusts that target in response to economic developments.

To meet its target rate, the FOMC conducts open market operations (the buying and selling of securities, usually U.S. Treasuries), imposes reserve requirements on depository institutions, permits depository institutions to hold contractual clearing balances, and extends secured credit through its discount window facility. Adjusting the federal funds rate or changes in expectations about future federal funds rates in turn can affect other short-term interest rates, longer-term interest rates, the foreign exchange value of the dollar, and stock prices.

If the economy slows and employment softens, the Federal Reserve will be inclined to ease monetary policy to stimulate aggregate demand. When growth in aggregate demand grows to a level commensurate with the economy's ability to produce goods and services, slack in the economy will be absorbed and employment will return to a more sustainable path. By contrast, if the economy shows signs of overheating and inflation pressures are building, the Federal Reserve will be inclined to counter these pressures by tightening monetary policy, reducing the growth in aggregate demand below the economy's potential to produce goods and services in order to defuse inflationary pressures and put the economy on a path to sustainable expansion. As William McChesney Martin, a former Chairman of the Federal Reserve, famously put it, the job of the Federal Reserve is "is in the position of the chaperone who has ordered the punch bowl removed just when the party was really warming up"—that is, to raise interest rates when economy reaches peak activity after a recession.

Additional Mandates for the Federal Reserve

The Federal Reserve has also undertaken additional mandates, or roles, both as a function of law and as a function of tradition. The Federal Reserve serves as a lender of last resort to financial institutions during times of market panic. The Federal Reserve has also served as a regulator of bank holding companies and more recently has undertaken additional regulatory oversight responsibilities as a result of the Wall Street Reform and Consumer Protection Act of 2010.

This hearing will provide an opportunity for the witnesses to examine the many mandates under which the Federal Reserve operates and explore whether those mandates are appropriate for a central banking system. Witnesses will provide their views on how the Federal Reserve has fulfilled or failed to fulfill its mandates over the past few decades and explain whether the Federal Reserve ought to have the mandates that it does as a matter of good government and why. They may provide ideas for reforming the role, structure, powers, or statutory mandates of the Federal Reserve Board of Governors and the Federal Reserve System.

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