

THE FEDERAL RESERVE:

Adapting, Evolving, Learning



The Federal Reserve has adapted to new information and experience over its first 100 years, always with the public interest at heart.

The Federal Reserve System is the nation's central bank, but what does that mean? Central banks are public institutions that are responsible for ensuring that a nation's financial system supports its commercial needs. Today, central banks typically structure their monetary policy in pursuit of specific goals, such as low inflation, full employment, financial stability, and acting as the government's bank.

The mission, goals, and specific practices of the Federal Reserve have been contentious, in varying degrees, from its creation. And parts of the Federal Reserve's mission, goals, and specific practices have changed since then as well. Americans have an understandably hazy notion of what the Federal Reserve is responsible for, how it goes about its business, and to whom it is accountable for its actions. This essay does not address all of these important matters, but it does seek to explain how today's Federal Reserve is addressing the same basic issues it was designed to address at its founding in 1913, even as its mission and policy tools have evolved in response to experience and the country's needs and economic goals.

Broadly speaking, the Federal Reserve's purpose has always been the same—to support the economy. But as the United States expanded, diversified, innovated, and globalized, so too did its economic and financial system. To fulfill its goals, the Federal Reserve has adapted. Sometimes, these changes have come about through Congressional directives. At other times, ongoing developments in economic theory and practical experience have led the Federal Reserve to alter the way it defines its objectives and implements its policies.

Today, the Federal Reserve is engaged in a range of unprecedented actions as it continues to address fallout from the 2008 financial crisis. Critics claim that the Federal Reserve now wields too much power and is trying to do too many things, but to a large extent, these discussions are not new. The Federal Reserve has been changing how and what it does since its creation 100 years ago. In each era, the changes have depended on what was considered appropriate and sensible. In each case, the Federal Reserve has shown its willingness to learn from experience and its resolve to act in the public interest.

Understanding the evolution of Federal Reserve policy requires that we understand the evolution in economic thinking about what central banks can do and how they can do it, as well as understanding changes in the economic and financial environment in which it operates. In this essay, we describe four episodes in the Federal Reserve's evolution to illustrate how we got here and where we are going:

1. Leaving the gold standard
2. Adding countercyclical stabilization policy to our objectives, eventually as directed by the dual mandate
3. Introducing systematic behavior and communications policy tools
4. Establishing bank regulation and enhanced financial stability objectives

These episodes did not unfold exactly in chronological order, and they overlapped considerably, so it is best to think of them thematically rather than sequentially.