ASK AN ECONOMIST

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Q. Does the Fed's regional structure play a role in monetary policy?

A. The regional structure of the Federal Reserve System plays an important role in determining U.S. monetary policy. The Federal Open Market Committee (FOMC), which is the Fed's primary monetary policymaking body, is comprised of all members of the Fed's Board of Governors and five of the 12 Reserve bank presidents. The president of the Federal Reserve Bank of New York is a permanent member of the FOMC, while the presidents of the other Reserve banks serve as members on a rotating basis. However, all 12 Reserve bank presidents participate in the committee's deliberations; those who are not currently voting members contribute as much to the discussion around the FOMC table as those who are. At the meetings, the presidents report on economic conditions in their districts and offer their views and perspectives on appropriate monetary policy.

In addition to helping bring information about economic conditions throughout the country to bear in setting policy, the Fed's regional structure contributes to the deliberative process by giving a voice to diverse views about policy that come from the economic research functions of the Reserve banks. Each Reserve bank has a staff of economists who support their president in his or her role on the FOMC. Having 13 different research divisions throughout the system (including that of the Board of Governors) facilitates a healthy competition of ideas. For example, in the 1960s and 1970s, the president of the Federal Reserve Bank of St. Louis, with supporting research by his staff economists, challenged the conventional wisdom about the cause of inflation. He argued that monetary policy alone is responsible for determining a country's long-term rate of inflation. The Fed's regional structure enabled the St. Louis Fed president's views to be heard at the FOMC table, and eventually his views became the conventional wisdom.

As the example shows, the structure of the Fed promotes a diversity of views and helps to avoid a groupthink mentality. Ultimately, this helps bring about better monetary policymaking.

LETTER TO THE EDITOR

This is in response to the "Ask an Economist" column in the October issue of *The Regional Economist*. The question was: Why doesn't the U.S. return to the gold standard so that the Fed can't "create money out of thin air"? The question was answered by St. Louis Fed economist David Andolfatto.

Dear Editor:
Continuing with the answer given to the gold standard question, here's a follow-up question: Isn't it a fact that all the major currencies of the world are no longer based on the gold standard (since Aug. 15, 1971)? Doesn't this mean that the United States, as a sovereign nation and the sole issuer of the dollar, no longer has to borrow gold in order to create its sovereign currency? Which leads to the fact that the United States cannot ever run out of dollars. The only limit on creating dollars out of thin air is the fear of inflation. The Fed targets this by managing the interest rates and by bond purchases. Isn't this true? Why doesn't the Fed come out and say these in clear terms and in plain English so that the citizens of the United States can understand? By being silent, the Fed is feeding the debt hysteria that is gripping this nation and destroying its productivity and creativity.

Gopinath Pulyankote, IT manager in Santa Clara, Calif.

Author's Response:
Not only is it true that major currencies of the world are no longer tied to the value of gold, I think it is reasonable to assume that this knowledge is widespread. The great peacetime inflation of the 1970s showed U.S. citizens what happens with excessive money growth. Thus, I think you go too far in suggesting that the Fed is somehow keeping this knowledge suppressed. Please go the Fed's web site for more information; see here: http://www.federalreserve.gov/pf/pf.htm

The Fed's main goal, publicly announced, is to keep prices "stable" in the sense of maintaining an inflation target of 2 percent. I am not sure what you mean by suggesting that the Fed's silence along the gold standard dimension is feeding a debt hysteria. The concerns with debt have to do with the fact that Congress continues to approve deficit spending, with the debt-to-GDP ratio rising rapidly to unsustainable levels. The Fed is not promising to monetize this debt, as long as one believes in the 2 percent inflation target. If the Fed were to use its powers to create money out of thin air to monetize the debt forever, then history tells us that holders of U.S. dollar-denominated securities will be subject to a heavy inflation tax. The Fed believes that taxation should be left to an elected Congress, not an unelected body in charge of maintaining a smoothly operating payments system.

We welcome letters to the editor, as well as questions for "Ask an Economist." You can submit them online at www.stlouisfed.org/re/letter or mail them to Subhayu Bandyopadhyay, editor, *The Regional Economist,* Federal Reserve Bank of St. Louis, Box 442, St. Louis, MO 63166. To read other letters to the editor, see www.stlouisfed.org/publications/re/letters/index.cfm