Inside the Fed

How one system serves three economic goals

E.C.10.4 "Describe the organization and functions of the Federal Reserve System, including its role in promoting price stability, maximum employment, and financial stability."

NAME _____ DATE _____

1 READ AND MARK

Read it twice

YOUR JOB Underline the parts of the Fed and circle actions they take. Number each action 1 for price stability, 2 for maximum employment, or 3 for financial stability so you can see how the system works toward each goal.

From the Bakery to the Bank

1. On a Monday morning, a bakery owner checks the cost of flour and the interest rate on a new oven loan. Both can be affected by the Federal Reserve, the United States' central bank. The Fed has a national Board of Governors in Washington, D.C., and 12 regional Federal Reserve Banks that serve different parts of the country. The Board oversees the Reserve Banks and helps supervise banks. Regional banks gather information about local businesses, support the nation's payment system, and supervise some banks. This structure brings national leadership together with regional evidence before major decisions are made.

2. The Federal Open Market Committee, or FOMC, makes key monetary policy decisions. It includes all seven Board governors and five Reserve Bank presidents who vote, with the New York Fed president always among them. To influence borrowing costs, the committee sets a target range for the federal funds rate, the rate banks charge one another for overnight loans. When inflation is too high, a higher target can slow spending and help stabilize prices, though effects take time. When job losses rise, a lower target can encourage loans, spending, and hiring. The Fed seeks both price stability and maximum employment, goals that can pull in different directions.

3. Imagine a sudden wave of bank withdrawals after a rumor spreads online. The Fed's work goes beyond interest rates: it supervises certain banks for safety and can lend to eligible banks facing short-term cash shortages, usually against collateral. Regional Reserve Banks also help move payments among financial institutions. These roles can reduce the chance that trouble at one bank interrupts payments or spreads to others, supporting financial stability. Emergency lending is not a promise to rescue every bank, and the Fed cannot prevent every crisis. Its tools work alongside, but are different from, federal deposit insurance provided by the FDIC.

2 ANSWER WITH EVIDENCE

Use the passage

1. How do the Board of Governors and regional Reserve Banks divide their work, and how does that structure help the Fed make decisions?

2. If inflation is too high, what FOMC decision could promote price stability? Explain how it could work.

3. If job losses rise, what FOMC decision could support maximum employment? Why might that decision be difficult if prices are also rising?

4. How could Reserve Banks' payment and lending functions help keep trouble at one bank from spreading?

3 YOUR TURN

Your own words

A storm disrupts electronic payments at several local banks while layoffs rise and prices keep climbing. Write a recommendation explaining which parts of the Fed could respond, what each could do, and one limit or trade-off they would face.

Inside the Fed

PART 1 · READ AND MARK

Underline the parts of the Fed and circle actions they take. Number each action 1 for price stability, 2 for maximum employment, or 3 for financial stability so you can see how the system works toward each goal. Accept any marking that follows this job and points at the right text.

PART 2 · ANSWERS

#	QUESTION	ANSWER
1	How do the Board of Governors and regional Reserve Banks divide their work, and how does that structure help the Fed make decisions?	**The Board provides national oversight and helps supervise banks. Regional Banks gather local economic information and carry out other duties, bringing regional evidence to national decisions.**
2	If inflation is too high, what FOMC decision could promote price stability? Explain how it could work.	**The FOMC could raise its target range for the federal funds rate. Higher borrowing costs can slow spending and help stabilize prices over time.**
3	If job losses rise, what FOMC decision could support maximum employment? Why might that decision be difficult if prices are also rising?	**The FOMC could lower its rate target to encourage borrowing, spending, and hiring. That choice could conflict with the goal of slowing rising prices.**
4	How could Reserve Banks' payment and lending functions help keep trouble at one bank from spreading?	**Reserve Banks help move payments among financial institutions and can lend to eligible banks with short-term cash shortages. Those functions can limit payment interruptions and the spread of financial trouble.**

PART 3 · YOUR TURN (SAMPLE ANSWER)

Regional Federal Reserve Banks could work with financial institutions to keep payments moving and lend to eligible banks facing short-term cash shortages. The FOMC would face a harder choice. Lowering its interest-rate target might encourage borrowing and hiring, but it could also make rising prices harder to control. Keeping rates higher might help slow inflation but could worsen job losses. The Board's supervision of banks can support financial stability, yet none of these tools guarantees that payments recover quickly or that employment and prices improve at the same time.

Accept responses that correctly distinguish the FOMC's interest-rate decisions from Reserve Banks' payment and lending functions. Students should identify a plausible conflict between supporting employment and slowing inflation, and avoid claiming that Fed action guarantees an outcome.