Federal Open Market Committee *

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The Federal Open Market Committee (FOMC), the main monetary-policy making body for the United States, has embodied since its creation a shifting balance of political, academic, and operational concerns. The Federal Reserve Act of 1913 rested essentially on the so-called real bills doctrine in its effort to create a sufficiently elastic monetary system for the nation. This vision entailed the creation of a liquid private market in acceptances. After the model of European central banks, the US Federal Reserve (Fed) would provide elasticity to this market through management of the discount rate for acceptances. By 1935, however, the power of the US Federal Reserve branches to affect economic and financial conditions through open-market operations had been proven, and the US Banking Act of that year confirmed the shift with the formal constitution of the FOMC.

After subsequent adjustments, the FOMC consists of the entire seven-member Board of Governors of the Federal Reserve System, along with five of the twelve US Federal Reserve Bank branch presidents. The Governors are appointed by the president to staggered 14-year terms, while the Fed presidents serve on the FOMC under a regional rotation structure (with weight toward New York above all, Chicago and Cleveland jointly second, and the other nine branches third), reflecting a complex political balance between central, regional, and local interests in the US banking system. Though this design suggests the representation of a diversity of views, in practice dissenting votes (though not infrequent) are rarely enough to upset the high level of consensus on the FOMC (Wynne, 2013).

The First World War, prior to the creation of the FOMC, and then the Second, shortly after,

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immediately eroded the real bills doctrine, as the Fed was forced to acknowledge its role as government bank in the conduct of war finance (Mehrling, 2010). Thus the emergence of open-market operations as the main instrument of monetary policy went hand-in-hand with a changing understanding of the Fed's proper role. It was finally the 1951 Fed–Treasury Accord that freed the Fed from its wartime obligation to fix the price of US Treasury debt, paving the way for the emergence of a non- wartime monetary policy regime. Meanwhile, the Employment Act of 1946 evolved first into a commitment to full employment, and later to a problematic "dual mandate" to support both employment and price stability (Meltzer, 2009), giving a purpose to that regime.

By the eve of the global financial crisis that erupted in 2007, the framework for FOMC policymaking was organized around the establishment of a target for the overnight interest rate in the interbank market for reserves at the Fed. Open-market operations allowed the management of the supply of reserves in this market, and arbitrage relations among the various short- term funding instruments meant that conditions in money markets generally could be affected from a small base of high-powered money (Board of Governors of the Federal Reserve System, 2005).

The shift from the discount-window framework imagined at the Fed's creation was profound. In that vision, the Fed discounts, at the initiative of member banks, self-liquidating acceptances (real bills) in support of trade, agriculture, and industry. Thus fluctuations in the demand for reserves are met by their provision at the discount window, with the price set at the policy discount rate. This elasticity of reserves supports the elasticity of note issue and credit provision, reducing the seasonal fluctuations that had led to recurrent crisis in the pre-Fed era. In this passive, constrained role the Fed would provide liquidity to securities markets by expanding its balance sheet as needed in response to the demands of the financial system, while the self-liquidating character of acceptable collateral would automatically restore balance once the need had subsided.

In the vision that was to dominate by the early 2000s, the Fed transacts, at its own initiative, to affect the supply of reserves in order to maintain the policy short-term interest rate. Countercyclical adjustments to the price of overnight funds, through one of a number of possible transmission channels, reduce cyclical macroeconomic fluctuations, supporting some balance between the dual objectives of price stability and full employment. This countercyclical role moves initiative to the Fed itself, and involves the central bank's taking liquidity in securities markets in order to adjust the supply of reserves.

The challenges of monetary policymaking during the global financial crisis have made further evolution likely, both to this framework and to its academic foundations. The target for the US federal funds rate of interest reached the nominal zero lower bound in December 2008 (Board of Governors of the Federal Reserve System, 2008). By then the focus of policymaking was already shifting towards the Fed's many special liquidity programmes. These were eventually replaced on the Fed's balance sheet with purchases of mortgage-backed securities in the first phase of so-called quantitative easing (QE). Subsequent rounds of QE were an attempt to prolong monetary accommodation with the US federal funds rate of interest still at zero.

The operational norms for the FOMC have evolved incrementally since the 2007 crisis, reflecting the shifts in monetary conditions and in academic debate. In form, much remains unchanged. The policymaking process is organized around eight meetings each year. Inputs to this process come in the form of analyses of economic conditions (the "Beige Book"), projections of future economic conditions (the "Green Book"), and monetary policy alternatives (the "Blue Book"). FOMC meetings are structured around the committee's conversion of these inputs into outputs in the form of a policy directive to the open-market desk at the New York Fed, a public statement, a summary of the committee's economic projections, and, with a lag, the minutes of the meetings themselves.

The post-meeting statement emerged in 1994 as a way to communicate the FOMC's first move to tighten monetary policy after several years of accommodation, and has since grown in importance (Wynne, 2013). Current focus on the FOMC statement is driven by the lack of other policy tools with interest rates at the nominal lower bound, and is supported by an intellectual paradigm, dominant in US academic economics and reflected in the Fed's economics staff, which emphasizes the role of expectations in economic decision-making (Blinder, 2004). In such a paradigm, FOMC communication about the future course of policy, so-called forward guidance, can be a way to affect economic conditions in the present by adjusting today expectations about the future. Recent developments along these lines include the publication of FOMC members' economic projections, and the acceleration of the release of FOMC meeting minutes, as mechanisms for affecting expectations.

Post-crisis FOMC meetings are dominated by discussion of the timing and pace of the removal of Fed balance-sheet accommodation, and the eventual rise of short-term interest rates above zero. The introduction of interest on reserves, and recent experiments with a reverse repo standing facility, suggest the technical ingredients of a future framework, while the predominance of US dollar-denominated global finance and market- intermediated credit suggest some of the challenges that framework will face. The details are not yet apparent.

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