

Lesson Plan

The FOMC and Transparency

Overview:

In this lesson, students will explore transparency in monetary policymaking. Students will participate in an activity that demonstrates the reasons behind the FOMC's move toward greater transparency, actively read the September 2, 2005 *Economic Letter*, and complete a student handout.

Economic Concepts Covered in the Lesson Plan:

- The Federal Reserve (the Fed)
- The Federal Open Market Committee (FOMC)
- Transparency
- Monetary Policy

Student Objectives:

Students will:

- Understand the FOMC's commitment to providing the public with timely information.
- Understand why transparency might make monetary policy more effective.
- Understand the history of transparency within the Federal Reserve System.

Time:

One class period

Materials:

- White board/chalk board
- Student Handout (1 copy per student)
- Student Announcements sheet (1 copy of each sheet per student group)
- Student Questionnaire sheet (1 copy per student)
- September 2, 2005 *Economic Letter: Policymaking on the FOMC: Transparency and Continuity*. (1 copy per student)

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Procedure:

1. Conduct the following discussion:
 - a. Today, we are going to expand our knowledge of the Federal Reserve System, specifically the Fed's committee responsible for monetary policy decisions, the Federal Open Market Committee or the FOMC. We are going to focus on an important issue that the FOMC is facing today: transparency. (Write this word on the board).
 - b. To demonstrate this concept, we are going to engage in a short activity and I am going to break the class into four groups.
2. Break the class into four different groups. Ask one group to sit in the front of the class. Make sure that all students have a pen/pencil and a copy of the **Student Questionnaire** sheet (it is not necessary for the group in the front of the class to have a copy of the **Student Questionnaire** sheet).
3. Instruct the class that the group in front of the classroom will be called the "Lunch Committee."
4. Designate the remaining groups: Group A, Group B, and Group C.
5. Distribute to the "Lunch Committee" copies of the **Student Announcement** sheets.
6. Discuss the following:
 - a. The Lunch Committee will hand each group a **Student Announcement** sheet. Upon receiving your announcement, discuss the announcement with your group. Appoint a member in your group to scribe group answers on a **Student Questionnaire** sheet.
 - b. One student from each group will be asked to read the group's answers to the class.
7. Instruct the Lunch Committee to read each **Student Announcement** silently.
8. Ask for three student volunteers from the Lunch Committee to hand out the **Student Announcement** sheets. Ensure group A receives **Student Announcement A** and so forth.
9. Allow 3-5 minutes for Groups A-C to write a group response to the **Student Announcement**.
10. After each group has finished writing its responses, ask a representative from Groups A-C to read their group response. Group A should go first, finishing with group C.
11. After each group has read its responses to the **Student Announcement**, ask a representative from each group to read aloud to the class the **Student Announcement** they received.
12. Discuss the following:
 - a. Why is there a difference in how each group responded to the same questions?
 - b. If all the groups had received announcement C would they have been in favor of the shortened lunch period?
 - c. Was it important to receive the information behind the decision to shorten the lunch period? Why or why not?

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13. State the following:

- a. By sharing more information in each announcement, the Lunch Committee demonstrated transparency in its decision making. With more information, students could more effectively adjust their plans for the day according to the Committee's decision.
- b. In the next few minutes, you are going to read an article about the Federal Reserve and the FOMC, the body responsible for monetary policy decisions. In this article, you will learn how transparency is vital to the Fed's policy actions and how the Fed has changed its views on transparency over the past decade.

14. Distribute a copy of the *Economic Letter* and the **Student Handout**, one per student.

15. Direct students to read the *Economic Letter*, complete the **Student Handout**, and be prepared to discuss their answers.

Extension Activity:

- Find examples of transparency within governmental or corporate organizations. Students may present their findings in writing or give oral reports to the class.

Assessment Activity:

After your students have read and answered the **Student Handout** questions, replay the transparency activity with the following details:

1. The class will be split into four groups. Explain to the students that one group will be designated as the Loan Committee and the three remaining groups each will represent one consumer who has taken out a \$1,000 adjustable interest rate loan on a used car.
2. If necessary, give a definition of a loan and explain how a loan works. (An arrangement in which a lender gives money or property to a borrower and the borrower agrees to return the property or repay the money, usually along with interest, at some future point(s) in time. Usually, there is a predetermined time for repaying a loan, and generally the lender has to bear the risk that the borrower may not repay a loan). For example, suppose that you take out a \$1,000 loan for 1 year at an interest rate of 5%. That means that at the end of the year, you must return to the lender \$1,000 you borrowed along with the accrued interest (\$50).
3. Also, explain to the students the difference between an adjustable interest rate loan and a fixed interest rate loan. (An adjustable rate is an interest rate that changes on a periodic basis and is usually tied to an outside indicator such as the prime interest rate. A fixed rate is an interest rate that is "locked" at one particular rate and does not fluctuate.)
4. The group in the front of the class will issue three different messages--one message per group.
Group A message: "The interest rate on your \$1,000 adjustable interest rate used car loan has been changed."

Group B message: "For the next year, the interest rate on your \$1,000 adjustable interest rate used car loan has been changed by five percentage points."

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Group C message: For the next year, the interest rate on your \$1,000 adjustable interest rate used car loan has been increased by five percentage points due to higher expected overall interest rates. The Loan Committee reminds you that paying more interest on your loans may mean that you will need to adjust your budget for the next year. Because the interest rate on this type of load is adjustable, the interest rate may change again for the following year.

5. After each group receives its message, they will be asked to answer the following questions:
 - Do you know if you will have to pay more or less for your car loan? How can you tell?
 - Do you understand why the Loan Committee changed your loan rate?
 - How well does the information you received allow you to plan your budget for the next year?
 - If you see interest rates in the economy change, can you guess how it might affect the interest rate on your adjustable rate loan?
6. After the majority of the students have finished writing their answers, ask a representative from each group to share their responses.
7. After the group activity concludes, facilitate a discussion using the following questions:
 - As you make plans for working, spending, playing, etc. next year, which group, A, B, or C, will be in a better position to make plans? (Group C because they have more information and can plan accordingly).
 - How might more information about Fed policy actions, the condition of the economy, and the possible direction of future policy help individuals and businesses make more informed decisions? (The more information individuals have the better planners they are.) Should that help or hinder the economy? (This transparency should help because consumers would be better equipped to make wise financial decisions.)

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Student Announcements

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(Cut along dotted lines.)

Student Announcement A:

“Effective immediately, all students will have a shortened lunch period.”

Student Announcement B:

“Due to the cafeteria’s remodeling, next month all students will have a shortened lunch period. To compensate, all students will be released from school early. ”

Student Announcement C:

“Due to the cafeteria’s remodeling, next month lunch will be shortened from one hour to thirty minutes. To compensate, all students will be released from school thirty minutes earlier each day.”

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Student Handout

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Directions: With your copy of the *Policymaking on the FOMC: Transparency and Continuity Economic Letter*, please respond to the following questions in preparation for a class discussion.

1. List three steps the FOMC has taken over the past decade to increase transparency.
2. What does the author cite as potential costs to expediting the release of the FOMC minutes?
3. What examples does the author give as potential benefits to expediting the release of the FOMC minutes?
4. According to the author, why is cooperation critical to the FOMC's success?
5. What does the author suggest are two benefits of a numerical inflation objective?
6. What was the author's preferred numerical inflation target at the time of the *Economic Letter*?
7. How might increased transparency of the FOMC impact your financial decisions?

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Student Handout Answer Key

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Directions: With your copy of the *Policymaking on the FOMC: Transparency and Continuity Economic Letter*, please respond to the following questions in preparation for a class discussion.

1. List three steps the FOMC has taken over the past decade to increase transparency.

"In February 1994, just months before I became a Federal Reserve Governor, the FOMC started to explicitly announce changes in the Federal funds rate target. Later that year, the FOMC added descriptions of the state of the economy and the rationale for the policy action to the post-meeting press release. In January 2000, the FOMC introduced a statement describing the "balance of risks" to the outlook, and in March 2002 began releasing the votes of individual Committee members and the preferred policy choices of any dissenters. In August 2003, the Committee added explicit forward-looking language concerning future policy into its statement. Finally, in December 2004, it decided to release the minutes of its meeting with only a three-week delay."

2. What does the author cite as potential costs to expediting the release of the FOMC minutes?

"Financial markets could misinterpret and overreact to the minutes. Great emphasis on the minutes might also lead to less productive discussions at the meetings, because even speculative and off-the-cuff commentary would soon be out in the open and, hence, discouraged."

3. What examples does the author give as potential benefits to expediting the release of the FOMC minutes?

"...expedited release of the FOMC minutes proves more timely information to the public about the rationale for monetary policy actions and a more nuanced explanation of the reasons for the Committee's decisions. Such a move toward greater transparency facilitates accountability, which is essential for unelected central bankers in a democratic society, and might make monetary policy more effective by helping to align financial market expectations with policy objectives."

4. According to the author, why is cooperation critical to the FOMC's success?

"My sense is that FOMC participants are highly motivated to cooperate in seeking, finding, and articulating a Committee consensus, and their ability to do so enhances the credibility, legitimacy, and likely effectiveness of monetary policy. "

5. What does the author suggest are two benefits of a numerical inflation objective?

"In terms of Committee operations, it could help to focus and clarify our own discussions. It could also help to anchor the public's long-term inflation expectations from being pushed too far up or down. That is, a numerical long-run inflation objective may help avoid both destabilizing inflation scares and pernicious price deflations. Indeed, a credible inflation objective could enhance the flexibility of monetary policy to respond to the real effects of adverse shocks."

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6. What was the author's preferred numerical inflation target at the time of the *Economic Letter*?

"More specifically, I would now favor a 1.5% numerical objective for inflation as measured using the core personal consumption expenditures (PCE) price index..."

7. How might increased transparency of the FOMC impact your financial decisions?

Answers will vary but should reference the student's understanding of how the FOMC's decisions may affect interest rates and the cost of borrowing money.