



POWELL CENTER FOR  
ECONOMIC LITERACY

*Lesson Plan*

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## Making Federal Reserve Policy

### Time Required

2 days

### Grade Level and Subject

High School, Social Studies

### Keystone Principles

Principle # 5 – Incentives produce “predictable” responses

### Voluntary National Content Standards in Economics

Standard #15 – [Growth](#)

Standard #18 - [Macroeconomy – Income/Employment/Prices](#)

Standard #19 – [Unemployment and Inflation](#)

Standard #20 – [Monetary and Fiscal Policy](#)

### Economic Concepts

**Consumer Price Index (CPI)** – *A measure of the overall cost of the goods and services bought by a typical consumer.*

**Depository Institution** – *Financial institution that obtains its funds mainly through deposits from the public; includes commercial banks, savings and loan associations, savings banks, and credit unions.*

**Discount Rate** – *The interest rate on the loans that the Federal Reserve Bank makes to banks.*

**Federal Funds Rate** – *The interest rate banks charge for overnight loans of reserves to other banks.*

**Federal Open Market Committee (FOMC)** – *The Federal Reserve’s committee that directs the buying and selling of U.S. government securities, which are major instruments for controlling the money supply. It consists of the seven members of the Federal Reserve’s Board*

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*of Governors, the president of the New York Federal Reserve Bank, and the presidents of four other Federal Reserve district banks.*

**Federal Reserve** – *The central bank of the United States.*

**Gross Domestic Product (GDP)** – *The total of all goods and services produced by workers in a country; used to monitor economic growth.*

**Leading indicators** – *Variables that change before real GDP changes.*

**Monetary policy** – *Actions by the Federal Reserve System to expand or contract the money supply in order to affect the cost and availability of credit.*

**Nominal GDP** – *Gross Domestic Product not adjusted for the effects of inflation.*

**Open Market Operations** – *The purchase and sale of U.S. government bonds by the Federal Reserve Bank.*

**Real GDP** – *Gross Domestic Product adjusted for inflation*

**Recession** – *A decline in real Gross Domestic Product (GDP) lasting at least two successive quarters or more.*

**Reserve Requirement** – *The minimum balance that the Federal Reserve requires a bank to hold in vault cash or on deposit with the Federal Reserve Bank.*

**Unemployment Rate** – *The percentage of workers actively seeking employment but currently without jobs.*

## Overview

Every six or seven weeks, the world watches as the Federal Reserve's Federal Open Market Committee (FOMC) decides its monetary policy for the coming weeks. This high school lesson plan helps students to understand this process, with a focus on the Fed's primary policy tool — open market operations.

Students will learn that this cyclical process entails many steps: collecting and interpreting data, making forecasts, outlining possible policy actions, and assessing the advantages and disadvantages of each action.

In this lesson, students will face the problem of using conflicting economic indicators to forecast the near-term course of the economy. They will be introduced to just a few of the many economic indicators that the Fed uses. They'll also have a chance to try their hand at setting monetary policy.

Students will imagine that they are members of the Federal Reserve's Open Market Committee — the committee that sets the Fed's monetary policy. Students will assess current economic data, predict future economic performance, advocate a course of action for the Fed, and assess the expected effects of the actions they advocate.

Students will begin to understand the difficulties faced by a central bank. They will assess the intended and unintended effects of alternative monetary policy actions and begin to understand the tradeoffs associated with adopting any particular policy.

The Internet makes such a lesson possible and meaningful, as students use current data provided by the very agencies that had earlier supplied the out-of-date statistics found in textbooks.

## Objectives

- Students learn what economic indicators tell us about the overall economic outlook.
- Students learn to understand how the economic outlook prompts the Federal Reserve to take action.
- Students learn to use the World Wide Web to locate up-to-date data.
- Students learn to predict future economic performance by studying up-to-date data.
- Students learn to advocate a course of action for the Federal Reserve, given current and projected data.
- Students learn to assess the impact of the Fed policy they recommend.

## Materials and Handouts

- Internet-accessible computers, one for each team of two to three students, with Adobe Acrobat software to read government documents
- Computer disk (for each team) containing:
  - [Handout 1](#)--Using Data to Assess Economic Performance
  - [Handout 2](#)--Gathering and Analyzing Current Data and Choosing a Policy
  - [Supplemental Lecture](#)--Didn't You Say the Fed Has Three Tools?

## Teaching Activity

This lesson provides a culminating activity for a macroeconomics course. Therefore, students will require knowledge of several concepts and how they can be used to estimate economic performance and predict economic trends (e.g., consumer price index, unemployment rate, real GDP, index of leading economic indicators). Further, students will need to understand how the Federal Reserve uses its most important policy tool — open market operations — to influence real GDP growth and inflation. They should also understand how open market operations can affect other aspects of the economy.

As an overview, review the following questions with the class:

*How does the Fed assess where the economy has been?*

*How does the Fed estimate where the economy is heading right now?*

*How can the Fed influence the future course of the economy?*

*What will be the likely side effects of the Fed's policy?*

Explain the procedure of this lesson. Tell students they have been chosen to be Federal Reserve Bank presidents or members of the Fed's Board of Governors. Thus, they will be serving on the Federal Open Market Committee (FOMC). In teams of two or three, they are to assess recent U.S. economic performance, predict the near-term future course of the economy, and decide what policy action

to take.

Distribute a disk containing Handout 1 and Handout 2 to each team. The members of the team should work together to type their answers on the disk and turn it in by the end of the period. There may be a strong temptation on the students' part simply to cut and paste definitions; emphasize to students that they are to answer the questions in their own words. If the class is one hour or less in duration, have students complete only Handout 1 on the first day. Check the students' work for understanding, and prepare to reinforce any necessary concepts at the beginning of the second class. If the class runs 90 minutes or longer, quickly check for student understanding of Handout 1 before allowing the students to proceed to Handout 2.

The next class period can be devoted, in part, to team presentations about students' analyses and recommendations for Federal Reserve action, or it can be used as an opportunity to debrief students on the difficulties associated with economic forecasts and weighing the positive and negative effects of monetary policy. The questions reviewed with students at the beginning of this lesson will likely evoke different and more insightful responses than those expressed initially.

Through this exercise, the complexities of the American economy and policymaking procedures become clearer to students. Students seem to take greater care in assessing current real economic data and policy consequences than they do with hypothetical data. This enthusiasm usually extends beyond the classroom as students continue to follow the latest economic reports, which can result in a better-informed electorate.