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Intricate Interdependencies in the Federal Reserve System

I. Project Title and Descriptive Summary

My project proposal for a Russell Ackoff Doctoral Student Fellowship is embedded within my proposed dissertation research. In my dissertation proposal, I propose to develop a new model for analyzing the institutional parameters of the Federal Reserve System (Fed System) and (2) use this model to offer a normative framework for addressing pressing issues surrounding the Fed System. These broad issues include (a) the appropriate scope of the Fed's regulatory responsibility (b) the accountability/governance mechanisms necessary to insure the Fed System, as an independent agency, is accountable to its regulatory mandate, (c) the level of transparency appropriate for the Fed System, and (d) the governing principles that should be used to inform the Fed System's institutional responses to financial and regulatory institutions such as the US Treasury and international central banks.

Three aspects of this proposed dissertation research are specifically related to human decision processes and risk management. First, the model I anticipate developing includes a negotiation component. Second, the model will also be designed to address network interdependencies of the Fed System. I anticipate that Howard Kunreuther and Geoffrey Heal's research on interdependent security problems will heavily influence this analysis. Finally, I plan to explore possible regulatory mechanisms for review of financial contracting innovations or the institutionalization of financial contracting best practices. This exploration is motivated by at least two considerations: 1) the opacity of much financial contracting/engineering arguably poses an unacceptable risk to financial market stability, and 2) in specific circumstances, contract provisions designed for security purposes might actually increase market insecurity. For example, Federal Reserve Governor Randall S. Kroszner recently noted that standard contract provisions, such as credit rating triggers, “can exacerbate the impact of a systemic event and make financial markets less stable…[so that] contractual provisions that might seem on the surface to be prudent counterparty risk management could actually increase financial market stress.”[1]

II. **Name of a primary faculty member with whom the student is working**: Professor Kenneth Shropshire

III. Signatures

[1] Governor Randall S. Krozner, *Assessing the Potential for Instability In Financial Markets*, Speech, December 8, 2008, available at: http://www.federalreserve.gov/newsevents/speech/kroszner20081208a.htm.