Since "it's the economy stupid" these days, we'd all better know something about economics and the institutions charged with regulating our money and our markets.

There is no better place to start than the Federal Reserve System. Established in 1913, the System is run by a Board of Governors (appointed by the President of the United States and confirmed by Congress) and 12 Federal Reserve Banks. Independent in the sense that its decisions need not be ratified by the executive or legislative branches, the system was designed to preserve liquidity in money markets without inducing inflation by controlling the amount of money in circulation and setting short-term interest rates.

The Federal Reserve Board monitors economic activity and announces a target rate at each of its regularly scheduled meetings. Its Open Markets Desk makes the policy stick by intervening daily to absorb financial demand.

In "The New Lombard Street," Perry Mehrling, professor of economics at Barnard College, Columbia University, provides a lucid (albeit occasionally technical) account of how the system worked when it was working - and of the growing role assumed by the Fed in an era of global economic volatility and "credit-fueled bubbles."

Following the Great Recession of 2008, which was caused, to some extent, by its "easy money" policies, Mehrling points out, the Fed became "the dealer of last resort," taking the wholesale money market and then the capital market onto its balance sheet. The "central lesson of the crisis," he argues, is that the American system requires Fed support not just for Treasury securities, but also for private securities.

The Fed's initial response to the crisis, Mehrling maintains, was to increase liquidity in financial institutions through the Troubled Asset Relief Program (TARP). In a "normal crisis," he writes, this response would have been adequate: "but this was no normal crisis."

In September, 2008, the Treasury Department in essence took over the debt of Fannie Mae and Freddie Mac. That same month, the Fed assumed responsibility for AIG's book of credit derivatives in exchange for an 80 percent equity stake in the insurance giant. And in March 2009, the Fed's Term Asset Backed Securities Loan Facility back-stopped a broad array of AAA-rated securitized loans (including credit card receivables and auto loans).

These developments, Mehrling suggests, are - or should be - harbingers of the future. He doesn't address - at least not explicitly - whether the financial institutions of the United States are "too big to fail." Or whether Congressional regulation of them is in order. Nor does he explain - at least not directly - why the Fed should become "a leader of last resort" during economic crises.

But he clearly believes that a powerful central banking system, willing to use the resources of the federal government for macro-economic management as well as liquidity management, is necessary to help the private sector address crises in global finance capitalism. His conclusion is compelling: the job of the Fed is not to eliminate risk but to set boundaries around it, to establish an arena within which calculations of profit and loss make sense. And to "keep the system from running off the rails."

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