Fed Politics

The Congressional heat on the U.S. central bank is about to intensify.

By Matthew Benjamin

An enduring consequence of the Federal Reserve's unconventional policy response to the financial crisis and ensuing recession is the intensifying congressional scrutiny now focused on the U.S. central bank. That scrutiny has manifested in a concerted, ongoing congressional campaign to thoroughly examine and "reform" the Fed and its policies, a campaign poised to strengthen as incoming Chair Janet Yellen and her colleagues continue to focus on maximizing employment in the wake of quiescent inflation.

Since the Fed's robust response to the crisis, antipathy toward the institution has become considerably deeper and more pervasive, particularly on the U.S. political right. Politicians associated with the upstart Tea Party movement in particular—as well as many establishment Republicans—believe the Fed has strayed too far from its initial objective of controlling the money supply.

The list of complaints about the Fed is lengthy:

■ It has attempted, primarily through its large-scale asset purchase program, to compensate for a lack of fiscal stimulus through credit allocation to a specific sector (housing through purchases of mortgage-backed securities).

■ Its Treasury purchases enable and encourage irresponsible borrow-and-spend fiscal policies.

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THE INTERNATIONAL ECONOMY
THE MAGAZINE OF INTERNATIONAL ECONOMIC POLICY
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Washington, D.C. 20002
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■ Its low-interest-rate stance creates asset bubbles and favors Wall Street and other economic elites over ordinary savers and retirees for whom interest on savings is an important source of income.

■ Its money creation to finance bond purchases risks higher future inflation as well as an erosion of the value of the dollar.

■ Its asset purchase program is having unintended and deleterious consequences in developing nations.

■ Its dual pursuit of the sometimes contradictory goals of maximum employment and stable prices renders the Fed ineffective and in fact leads to lower employment and higher interest rates.

■ Its policymaking is undemocratic in that it is neither fully transparent nor well understood by ordinary citizens.

As a result of these problems, perceived or actual, there is now broad-based enthusiasm among Capitol Hill Republicans for a significant overhaul—sometimes labeled a "modernization"—of the Fed to equip it for the twenty-first century.

Central to the various legislative proposals is a fundamental alteration of the Fed's mandate, restricting it to price stability (within a framework of overall economic stability) while jettisoning the goal of maximum employment. The justification for this change is that the two mandates are inconsistent and force policymakers to attempt an unrealistic middle course. Further, proponents of a single mandate argue that U.S. monetary policy has been most successful during periods when the Fed neglected the employment mandate and focused on inflation. The 1980s and 1990s are the most often cited time frame for this.

Pending legislation would also diversify the Federal Open Market Committee by extending voting membership on the committee to all regional bank presidents. This stems from the populist idea that Washington and Wall Street have considerably louder voices on monetary policy than other regions and sectors of the U.S. economy.

Other proposed changes include requirements that the Fed monitor prices of additional asset classes—including gold, real estate, and securities, among others—when setting policy. The Fed would also need to report to Congress on the impact of its policies on the exchange rate value of the dollar. And open market operations would be restricted to Treasury purchases in order to ensure credit allocation neutrality.

The Republican bills also contain multiple "demystification" proposals designed to render Fed deliberations and policymaking more transparent. These range from accelerating the release of meeting transcripts to public disclosure of the economic metrics used to set policy.

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Another Republican proposal, most enthusiastically championed by libertarian-Republican Senator Rand Paul of Kentucky (and son of longtime Fed antagonist Ron Paul), would subject FOMC decisions to intensive review by the Government Accountability Office, Congress's investigative arm. Monetary policy has long been off-limits from such reviews, which could be politically motivated.

While opponents of the various proposals express concern that they are a threat to the Fed's independence, advocates argue that the opposite is in fact the case: The changes to the institution's structure and processes would collectively ensure its independence, as the Fed has become too politicized in recent years, too close to Wall Street, and far too entwined with the current Democratic administration.

Says Joint Economic Committee Chairman Kevin Brady (R-TX), sponsor of the Sound Dollar Act, one of the bills seeking to reform the Fed, "We need to make sure that the Federal Reserve is representing the interests of the entire nation, not just those of Washington and

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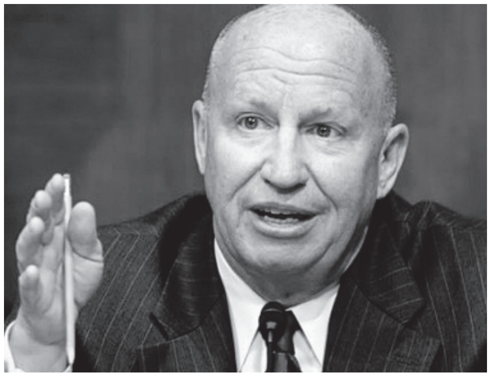

Says Joint Economic Committee Chairman **Kevin Brady** *(R-TX), "We need to make sure that the Federal Reserve is representing the interests of the entire nation, not just those of Washington and Wall Street.*

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Wall Street. These measures will help preserve the Fed's political independence."

The Fed no doubt sees less need for change, a result of confidence in its ability to work toward multiple mandates concurrently as well as satisfaction that it has achieved significant transparency in recent years, including the explicit inflation target, detailed forward guidance, and regular press conferences.

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Interestingly, Ben Bernanke addressed the mandate question in his December press conference. He noted that because the Fed is below its inflation target and unemployment is above the desired level, both sides of the mandate are now pointing in the same direction, that of strong accommodation.

Still, Republicans say their ultimate goal is a more mechanical, rules-based policymaking process for the Fed and a de-emphasis—or even a complete renunciation—of the discretionary policymaking that flowered under both Bernanke and Alan Greenspan before him. In essence, they would prefer a much more boring central bank.

To be fair, Democrats have had their own designs on the central bank in recent years. Barney Frank (MA), the last Democratic chairman of the House Financial Services Committee, felt that regional bank presidents were overly concerned with inflation and insufficiently attentive to employment. Thus, in 2011, he introduced legislation that would strip regional banks of FOMC voting membership. That bill died with Frank's retirement from Congress. But as the Fed unwinds its unprecedented stimulus, it is easy to imagine left-wing populists such as Senator Elizabeth Warren (D) of Massachusetts or Senator Sherrod Brown (D) of Ohio resurrecting the idea.

No major legislation to alter the Fed is likely to be enacted while President Obama remains in office. But Republicans have seized on the Fed's 100th anniversary as an opportunity to launch a comprehensive review of the central bank and its policies. That entails a series of ongoing hearings on the Fed's history, mandate, structure, and policies under the name of the Federal Reserve Centennial Oversight Project.

There is some hope among Republicans that those hearings could give traction to a less controversial bill entitled the Centennial Monetary Commission Act. It would establish a bipartisan commission to evaluate the Fed's performance over its entire history and make recommendations for monetary policy going forward.

Even if that legislation, too, remains in the legislative wilderness until Republicans retake the Senate and the White House, the Fed and its policies will continue to be publicly debated, most prominently when Republicans begin vying for the 2016 presidential nomination. Concern about—if not outright hostility toward—the Fed has become *de rigueur* for Republicans in Congress, and the institution is a major bugbear among the conservative voters who participate most enthusiastically in Republican primaries. Recall that during the 2012 nomination process, Texas governor and presidential hopeful Rick Perry denounced the Fed's bond buying program as "treasonous."

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Whether legislation to alter the Federal Reserve is enacted in the near term or not, there remains the not-insignificant Observer Effect. Borrowed from quantum mechanics, it holds that the mere act of close observation can bring changes to the phenomenon being observed. It is unimaginable, in other words, that all the scrutiny and analysis the Fed will endure in coming months and years will leave it unaltered in complex ways. ◆