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Bernanke Seeks to Wall Off Rate Policy From Congress (Update1)

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By Craig Torres

July 22 (Bloomberg) -- Federal Reserve Chairman **Ben S. Bernanke** sought to cordon off the central bank's independence on monetary policy from congressional scrutiny as lawmakers challenged its authority on everything from currency swaps to emergency loans.

The 55-year-old Fed chairman yesterday stepped up his defense of the central bank as it faces a bill with 275 legislator-sponsors to repeal immunity from audits of monetary policy. Bernanke told the House Financial Services Committee that Fed actions helped avert a credit "collapse," and gave Congress its own task: cut "unsustainable" budget deficits.

As lawmakers embark on the biggest financial-regulation overhaul in generations, "everything is up for grabs," including Fed independence, said **Christopher Rupkey**, chief financial economist in New York at Bank of Tokyo-Mitsubishi UFJ Ltd. It would "open a Pandora's box" for Congress's Government Accountability Office to probe monetary policy, he said.

At stake is the future structure of the 95-year-old central bank, which was conceived to stem financial panics and is charged with achieving stable prices and maximum employment. Bernanke's remarks yesterday showed he's open to relinquishing some powers, while retaining autonomy on setting interest rates and oversight of consumer finance.

'Political Backdrop'

"You definitely have to read this testimony in the context of the political backdrop," said **Michael Feroli**, an economist at JPMorgan Chase & Co. in New York. "They said they helped to improve financial conditions and they warned not to tread on their independence or the economy is really going to suffer," he said, referring to Fed officials.

Bernanke, appearing before the Senate Banking Committee in Washington today in his second day of semiannual testimony on the economy and monetary policy, presented a written statement that was identical to yesterday's at the House panel.

The Fed is more popular with investors and economists than with Congress, polls suggest. Almost 75 percent of investors surveyed in the first Quarterly Bloomberg Global Poll this month said they have a favorable view of Bernanke. By almost a three- to-one margin, they said he has earned another four-year term when his current one expires in January.

Bernanke said in his remarks yesterday that while financial markets "remain stressed," there have been "notable improvements" in recent months, with many "traced in part to policy actions taken by the Federal Reserve to encourage the flow of credit."

Lawmaker Criticism

That opening didn't faze some members of the House panel.

Representative **Alan Grayson**, a Florida Democrat, questioned what authority the Fed used to lend hundreds of billions of dollars through currency swaps to central banks around the world.

"One of the arrangements is $9 billion for New Zealand -- that works out to $3,000 for every single person who lives in New Zealand," Grayson said. "Wouldn't it have been better to extend that kind of credit to Americans rather than New Zealanders?"

Bernanke countered that "we are lending to all U.S. financial institutions in exactly the same way" and that "we have a longstanding legal authority to do swaps with other central banks."

Representative **Ron Paul**, the Texas Republican who wrote the bill to allow the GAO to audit Fed monetary policy, told Bernanke his proposed legislation "has nothing to do with interference with monetary policy."

Rate Policy

Bernanke noted that there are already questions about whether the Fed will be able to raise interest rates from historic lows without political interference.

"If we were to raise interest rates at a meeting and someone in the Congress didn't like that and said 'I want the GAO to audit that decision,' wouldn't that be viewed as an interference?" he told Paul.

Lawmakers have sought greater scrutiny over the Fed after blaming it for failing to police lending practices during the credit boom that began to burst in 2007, sparking what has become the deepest U.S. recession in at least half a century.

The Obama administration's proposed revamp of financial regulations would have the Fed stripped of powers over consumer finance, while at the same time making it the new overseer of all financial firms big enough to pose a risk to the system. It would also subject the Fed's ability to make emergency loans to approval by the Treasury.

Consumer Finance

Bernanke yesterday said the Fed has done a "good job" protecting consumers and ought to keep authority in that area. He indicated he accepts the need for Treasury oversight of extensions of emergency credit.

Neither House Democrats nor Republicans have fully endorsed the administration's plan. Representative **Jeb Hensarling**, a Texas Republican, said "the Fed should be focused on monetary policy, pure and simple."

Representative **Barney Frank**, the Massachusetts Democrat who chairs the House Financial Services panel, said Bernanke didn't make a convincing argument to keep consumer protection powers at the Fed.

"He is better at it than **Alan Greenspan**," Frank said, referring to the Bernanke predecessor legislators have faulted for failing to employ the Fed's rule-writing authority on lending practices. "But it is simply not at the center of their concern the way it will be at a separate agency."

Deficit Message

Bernanke separately urged Congress and the administration to lay out a plan that would bring the budget deficit down to a "sustainable" level of 2 percent to 3 percent of gross domestic product, from a projected ratio of about 13 percent this year. Much of the shortfall stems from the $787 billion fiscal stimulus -- which Bernanke said is too soon to judge for its effectiveness -- and the Treasury's financial-rescue efforts.

"Unless we demonstrate a strong commitment to fiscal sustainability, we risk having neither financial stability nor durable economic growth," the Fed chairman said in his testimony.

Meantime, the Fed chief laid out his own exit strategy from the central bank's efforts to combat the crisis. The central bank has expanded credit to the economy by $1.1 trillion in the past year through emergency loans and backstops for financial markets. The mixing of monetary policy with what economists call credit policy, or loans to specific organizations or markets, invited the scrutiny of Congress, economists said.

"Bernanke has led the Fed into uncharted waters," said **Gerald O'Driscoll**, a senior fellow at the Cato Institute and former vice president at the Dallas Fed. "There is nominal legal independence, but less and less real independence over time."

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