More Powerful Fed? Many In Congress Don't Seem to Like It

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Don’t fight the Fed.

The old Wall Street axiom isn't playing well in Washington as Congress takes its first shots at the Obama administration's package of sweeping reform proposals for the financial sector.

Though various aspects of the plan released Wednesday have drawn criticism, the role of the Fed has seen some of the most strident opposition, from blatant skepticism to diplomatic doubting.

Legislators from both parties have not only questioned the Fed’s past performance and challenged its future capabilities, but have also expressed concern that the central bank will be politicized more than it already is and turned into a bailout instrument of the executive branch.

Sen. Richard Shelby, R-Ala., for instance, told Treasury Secretary Timothy Geithner during a Senate Banking Committee hearing Thursday that the White House proposals showed a "grossly inflated view of the Fed’s expertise."

The administration proposals would make the central bank part of a systemic risk council as well as the front-line regulator of too-big-to-fail firms, whose potential failure could threaten the financial system. The Fed would also have the authority to determine if such a threat existed and recommend closing the firm. (The FDIC, however, would execute the so-called "unwinding" of the business.)

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Banking committee chairman Chris Dodd, D-Conn., compared administration's treatment of the Fed to giving a new car to a teenage driver who'd just wrecked one.

Sen. Charles Schumer, D-N.Y., added that "the Fed has failed miserably" as a bank holding regulator, reflecting a fairly common bipartisan view.

Such criticism of the Fed is not entirely new, but in the current environment it does suggest that the White

House has perhaps underestimated Congress's concern about the central bank's close cooperation with the Treasury Department during the crisis and the extraordinary use of somewhat fuzzy emergency powers in using its balance sheet to provide what some consider an alternative form of fiscal stimulus.

That's sparked renewed debate about the Fed being politicized and a re-examination of its independence.

The potential misuse of the new combination of powers is particularly worrisome to both Democrats and Republicans alike.

Concerns about the executive branch over-extending its powers were first provoked last fall when then-Treasury Secretary Henry Paulson and Fed Chairman Ben Bernanke sought $700 billion in emergency funding — for the now legendary TARP — with virtually no strings attached.

Though Congress was able to impose some checks and balances as well as some oversight provisions into the final legislation, critics say both the Bush and Obama administrations have nevertheless at times used the TARP as a bailout slush fund.

The program's Congressional Oversight Panel and the General Accounting Office have repeatedly faulted its operation and transparency.

During that time the Fed has provided financial assistance of one kind of another to troubled financial giants such as AIG (NYSE: aig), Citigroup (NYSE: c) and Bank of America (: bac) as part of a historic leveraging of its balance sheet to the tune of $2.2 trillion.

Critics say that goes well beyond the original intention of section 13.3 of its charter, conceived almost a century ago, covering "unusual and exigent circumstances."

For that reason and others Rep. Brad Sherman, D-Calif., who voted against the TARP, wants to make sure the new powers proposed for the Fed are not "used as a cover for a permanent bailout."

The problem for some legislators is that what they doubt the Fed would ever use its proposed resolution authority and would instead prop up the companies with taxpayer money because of what they perceive as an inherent conflict of interest.

"If a company you have regulated is in trouble you could admit the mistake...or you can try to hide, conceal and delay the problem," says Sherman, who has also been critical of the Fed's use of its balance sheet. "How do you do that? First you avoid using resolution authority. Second you give them a transfusion [of money]."

Republican lawmakers are equally concerned and have specifically stripped the Fed of some powers in their regulatory reform proposals. Under that plan, all Fed lending would have to be transferred to the Treasury's balance sheet at a certain point and the central bank would also be subject to regular audits by the GAO.

"What you don't want to do is end up with another bailout czar," Rep. Scott Garrett, R-N.J., one of the plan's authors, recently told CNBC.com.

The Obama plan does require that the Fed seek "prior written approval" from the Treasury Secretary, but given recent events, that's not enough for some lawmakers. Sherman, for one, would like to see the proposal amended to require presidential approval.

Analysts say Congressional skeptics are right to be concerned.

"What the Fed brings to the [resolution] power is fiscal power; it has money to spend," says Mark Calabria, a former senior staffer on the GOP side of the Senate Banking Committee, who recently moved to the Cato

Institute. "If you want to have a pot of money to put into a failed institution and you can't go to Congress for it, then the fed is the only one who has it."

In trying to reassure lawmakers, Geithner told banking committee members that the new Fed powers were "quite modest" and "carefully designed."

The resolution authority being proposed for too-big-to-fail firms is similar to what already exists with the FDIC and commercial banks, so in some ways it is not a stretch.

"We are not proposing to sustain some indefinite capacity to do what Congress authorized on a temporary basis, appropriately so, under the TARP," added Geithner, noting that the program is set to expire Dec. 31.

Though many say the Fed has acted responsibility, there's still lingering concern about that unchecked power, which some say circumvents the Constitution in that it designates spending authority solely to Congress.

Some on Capitol Hill, however, say the Fed debate has been blown out of proportion in the current environment and may be tinged with a bit of political grandstanding.

Congress has struggled with reconciling the Fed's critical but awkward role for years and isn't finished yet.

"We will look into the 13.3 issue next year once we've completed legislation," said one senior Congressional staffer, who added "you will see things [oversight provisions]" much like it happened with the TARP legislation.

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Yet, given the sweeping nature of the reform proposals at a time when the financial crisis continues to linger in the nation's rear-view mirror, there's an unusually high level of wariness in Congress.

There's even been some question about the role of Lawrence Summer, director of the White House's National Economic Council, who along with Geithner is thought to have spearheaded the regulatory overhaul package and has been rumored to be the leading candidate to succeed Bernanke at the Fed, should he not be renominated.

"I think it would be good for us to know, as we move through, that none of the folks involved in helping create these new powers under the Fed are potential Fed chairmen," Sen. Bob Corker, R-Tenn., told Geithner — not once but twice — in the Senate hearing. "I think that would be good to know, but I'll leave that to you all, I think."

"No, I don't think that would be appropriate nor do I think it would be necessary," Geithner responded.

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