



A look at what's behind the 'Audit the Fed' battle

By Greg Robb

Feb 11, 2015

WASHINGTON (MarketWatch) — Calls to “audit the Fed” have returned to the spotlight with a vengeance after Sen. Rand Paul, Republican of Kentucky, introduced the bill last month and made it the centerpiece of a presidential campaign stop in Iowa.

Federal Reserve officials have sharply criticized it. Supporters are energized.

But where did the measure come from and what is at stake?

Here is a look behind the rhetoric and the politics surrounding the proposed legislation that former Fed Chairman Ben Bernanke once called a “nightmare scenario.”

The audit-the-Fed movement ironically has its roots in post-Watergate legislation to make government more transparent.

In 1978, Congress gave the Government Accountability Office greater access to federal bank regulatory agencies. However, the legislation carved out an exemption for the Fed, precluding the watchdog agency for Congress from auditing activities related to the Fed’s monetary policy, transactions with foreign central banks and Federal Open Market Committee operations.

In 1993, the GAO estimated that 90% of the Fed’s \$368 billion balance sheet was not subject to GAO audits.

The central bank’s balance sheet, post-crisis, has ballooned to over \$4.5 trillion.

The GAO audits are not simple financial reviews. At the request of a member of Congress, the GAO can also conduct performance audits “designed to assess whether an entity is achieving its stated goals and include questions of efficiency, effectiveness and compliance with related laws and regulations.”

Legislation to include all of the Fed’s activities in GAO audits was first championed by Rand Paul’s father, U.S. Rep. Ron Paul, Republican of Texas. Paul was a voice in the wilderness criticizing the Fed until the 2008 financial crisis.

Indeed, prior to the crisis, the Fed was the favorite banking regulator of Republicans, who valued the agency's skepticism about heavy-handed government action and light touch on banking regulation.

The U.S. central bank's actions during the crisis, which revealed for the first time since the Great Depression just how extensive the Fed's latent powers actually were, came as a shock to many, especially populists.

"Between the Fed's intervention in the banking system, the New York Fed marrying firms to each other, the TARP [\$700 billion bank rescue] and the quantitative easing...there was some questioning on how independent the Fed was and whether the central bank was too heavy handed," said Brian Gardner, senior vice president for Washington research for Keefe, Bruyette & Woods Inc.

With the Fed as a poster child for big government, measures meant to limit the powers of the Fed have grown in popularity since the crisis.

Supports called the Fed a secretive institution that needed greater oversight.

"Over the century, since its inception in 1913, the Fed has controlled our Nation's monetary policy — and therefore our economy — under a veil of secrecy. Throughout these last 100 years, Congress has only exercised a relatively small degree of oversight over the Fed. This lack of accountability has led to grievous consequences, and this must end," said Rep. Paul Broun, a former Republican Congressman from Georgia, during the debate over the "Audit the Fed" measure last year.

"Wall Street bankers and the big money folks are fine, but the policies of the Federal Reserve hurt poor folks, they hurt senior citizens and they hurt the middle class," Broun added.

The "Audit the Fed" measure last passed the House of in the fall of 2014 by a vote of 333-92, with support of 227 Republicans and 106 Democrats.

The measure was never taken up by the Democrat-controlled Senate.

Opponents of the measure said the bill isn't about transparency, but about ideology.

Rep. Barney Frank, a former chairman of the House Financial Services panel, said on the House floor that the bill would be a way to pressure the Fed to focus on inflation and not unemployment.

The markets "will see it as political interference...not with the budget...but with how they [the Fed] decide on interest rates," he said.

In the past, the Fed has been reticent to publicly take on members of Congress. But not this time.

The Fed has launched an all-out campaign against the measure, perhaps trying to kill it in its infancy.

Dallas Fed President Richard Fisher told the Fox Business Network that the Fed is already audited “out the whazoo.”

And Richmond Fed President Jeffrey Lacker said the legislation was simply a scheme for “high-frequency harassment” of Fed officials.

Fed officials are worried because the measure will allow almost real-time audits. At the moment, the Fed does not release transcripts of its policy meetings until five years later, although it does release a summary of the discussion.

Another argument is that the measure would inhibit the Fed’s deliberations.

“If [Fed] board members know that their statements may become public, they may be inhibited from speaking candidly about the economic trends they are observing or the monetary policies they believe would best respond to current conditions,” said Rep. Elijah Cummings, Democrat of Maryland, during debate on the measure last year.

Fed Gov. Jerome Powell said financial markets would wonder if the U.S. central bank was independent.

Supporters of the measure think the Fed is crying wolf about a possible market reaction.

“The Fed is exaggerating that this is going to cause a market crash. Would it be any worse that the taper tantrum from Bernanke’s slips,” said Mark Calabria, director of financial regulation studies at the libertarian Cato Institute.

He said the Fed may think that the bill is the “camel’s nose under the tent” and if they concede on this measure they are uncertain where it would end.

What is the outlook for the legislation? Observers say it is likely to easily pass the House again but the necessary 60 votes in the Senate is more uncertain.

Calabria said that the measure could pass. “You’ve got at least five or six Democrats who would support it,” he said.

On Tuesday, Sen. Elizabeth Warren, a Democrat from Massachusetts and a leading populist Democrat, said she strongly opposed the “audit the Fed” measure.

“Warren’s opposition will give cover to a number of populists on both sides of the aisle” to also oppose the measure, Gardner of KBW said.

Also on Wednesday, Jason Furman, President Barack Obama's top economist, said the "audit the Fed" measure was "dangerous" and that he would recommend that the president veto it. That would require 67 senators to override a veto.

"As a stand alone bill, it doesn't have much of a shot," Gardner said.

But he thought the bill could be added to any Dodd-Frank fix that is expected to emerge from the Senate Banking Committee, led by Richard Shelby, a Republican of Alabama.

"That is several months down the road," Gardner said.

Shelby has indicated he would hold a hearing on the audit-the-Fed measure.

"But there are a lot of things we don't know" about Shelby, Gardner said. including how sympathetic he is to the measure and what changes he might like to make to the bill.