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Central bank intervention in credit markets threatens independence, says Lacker

Richmond Federal Reserve president Jeffrey Lacker says use of Fed's asset portfolio to intervene in credit markets threatens to diminish its independence

Jeffrey Lacker, president of the Richmond Federal Reserve, on Wednesday warned measures by the Federal Reserve to provide assistance to dysfunctional segments of credit markets may jeopardise the central bank's independence.

At the CATO Institute's 29th Annual Monetary Conference in Washington, DC, Lacker said: "The ability of a central bank to intervene in credit markets using the asset side of its balance sheet creates an inevitable tension. The desire of the executive and legislative branches to provide governmental assistance to particular credit market participants can rise dramatically in times of financial market stress. The resulting political entanglements, as we have seen, create risks for the independence of monetary policy."

Lacker said the Federal Reserve's credit policy was motivated by a sincere belief that central banks have a civic duty to alleviate significant ex-post inefficiencies in credit markets. However, he said credit allocation can redirect resources from taxpayers to financial market investors and, over time, can expand moral hazard and distort the allocation of capital. He said no matter how the net benefits are assessed, central bank intervention in credit markets will have distributional consequences. "Contentious disputes about which credit market segments receive support, and which do not, can entangle the central bank in political conflicts that threaten the independence of monetary policy-making," he said.

The Federal Reserve has increasingly come under attack from politicians in Washington for its policy in the lead-up to the crisis. Meanwhile, Republican leaders of the House and Senate are urging the Fed against taking further steps to stimulate the economy. Legislation has also been proposed that, if passed, would rescind the rate-setting rights of regional Federal Reserve presidents, bringing monetary policy decisions closer to Washington.

As political pressure mounts on central banks, there is growing risk that central banks will lose their independence. Thirty-eight percent of respondents in a *CentralBanking.com* poll, which went live on August 26, believe central banks are losing their independence, while 45% said central banks were never independent to begin with. Meanwihle, 17% of respondents to the poll said central banks are not losing their independence.