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Would GAO Audits Really Hamper Fed?

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WASHINGTON - Though Federal Reserve Board officials view being audited by another government agency as a threat to their political independence and ability to craft monetary policy, observers say such a doomsday scenario is unfounded.

While Congress weighs a host of curbs on the Fed's authority, including stripping it of power to supervise banks and protect consumers, Chairman [Ben Bernanke](#) ▼ has fought being audited by the Government Accountability Office with unusual ferocity.

He will have another chance to make his case today when he appears before the Senate Banking Committee, which is considering his nomination to a second term.

Some argue that the Fed already faces plenty of second-guessing from leading academics, economists and lawmakers.

"A lot of people critique what the Fed does on monetary policy," said Gil Schwartz, a former Fed lawyer who now works in monetary policy issues. "This is just another voice."

The timing of the debate is crucial as the Fed moves toward tightening monetary policy after flooding the financial markets with cash to contain the banking crisis. [Bernanke](#) ▼ has already taken heat for supporting the low interest rates earlier this decade that some say fed the housing bubble and later fueled the financial crisis.

GAO audits are being pushed by Rep. Ron Paul, the Texas Republican who has introduced similar legislation during each session of Congress for more than two decades. His idea gained traction as the Fed's popularity sank. The House Financial Services Committee approved his measure in a bipartisan vote last month over the objection of Rep. Barney Frank, the panel's chairman.

The GAO already reviews the Fed's bank supervision, but Paul's provision would call on the congressional watchdog agency to audit all aspects of central bank operations, including monetary policymaking.

The Fed is counting on Paul language's ultimately being scrubbed or watered down before the overall regulatory reform legislation is enacted, but Frank said Wednesday that this is unlikely to happen in the House.

"There is this tension within the Republican Party," the Massachusetts Democrat told reporters. "A lot of their people who traditionally have a lot of input are troubled by this, but they may be cowed by the anger at the Fed. ... As of now, though, it looks like it will stay unchanged."

He added that Democrats were also unlikely to take up the Fed's cause on the House floor.

"Traditionally, the Democrats have been more critical of the Fed than the Republicans," he said.

The Fed is particularly concerned that, if the GAO audit mandate becomes law, investors may have less faith in the central bank. Markets may worry that the Fed would be more inclined to adopt low-interest-rate policies that would please politicians running for reelection but could spur damaging inflation.

"To support economic growth, the Fed has cut interest rates aggressively and provided further stimulus through lending and asset-purchase programs," [Bernanke](#) ▼ wrote in a rare op-ed article published Sunday in The Washington Post. "Our ability to take such actions without engendering sharp increases in inflation depends heavily on our credibility and independence from short-term political pressures."

But this argument, critics respond, ignores the fact that the Fed is already subject to political forces. [Bernanke](#) ▼ frequently meets with Treasury Secretary Timothy Geithner and other Obama administration officials, along with many members of Congress, some of whom certainly express policy preferences.

"There's already a tremendous amount of political pressure that can be placed on them," said Mark Calabria, the director of financial regulation studies at the **Cato Institute** and a former Republican staff member of the Senate Banking Committee.

"The administration and Congress meet with [Ben Bernanke](#) ▼ all the time," he said.

Others say the Fed is overstating the GAO's clout. The Fed and other government agencies frequently ignore or openly disagree with GAO findings, they point out.

"The GAO does not have any magic wands to wave," said Bert Ely, an independent analyst in Alexandria, Va.

This is not to say the Fed has no reason for concern.

The GAO would have the advantage of hindsight when assessing whether the Fed made the right call.

Even if the Fed and Wall Street disagreed with a GAO report, it would carry weight, said Brian Gardner, an analyst at KBW Inc.'s Keefe, Bruyette and Woods Inc.

"It's tough to just ignore them," he said. "The GAO is going to have this aura about it as being all-knowing and expert in the area, so that complicates things for the Fed. Fed critics will latch on to whatever the GAO says."

What's more, Paul is unlikely to be satisfied with audits. He recently published a book titled "End the Fed," which makes clear that he would like to abolish the central bank.

Paul's measure also worries the Fed because it would expose how individual members of the Federal Open Market Committee argued their positions before a rate decision was made. The Fed already reveals the outlines of the debate in minutes released three weeks after policy meetings, but the full transcripts of who said what are not made public for five years.

Fed officials worry that releasing such specifics sooner would make policymakers more cautious in their deliberations, which they say would produce weaker policy.

The audits "would likely cast a chill on monetary policy deliberations if policymakers believed that GAO audits would result in early publication and analyses of their policy discussions," Scott Alvarez, the Fed's general counsel, told Congress in September.

This argument is analogous to the claims of executive privilege made by the president when, for

example, discussing matters of national security.

"Is it appropriate for the president of the United States and his advisers to have that advice given out to the world?" Schwartz asked. "Most people would say 'no' because the whole concept of deliberative privacy is, you want to give people frank and full advice."

But Calabria countered that monetary policy is not so grave as national security debates.

"There's a world of difference between making public a list of CIA operatives acting in foreign countries and saying, 'Here's the list of counterparties the Fed paid off to bail out AIG,' " he said.

In the end, he added, GAO audits could actually make Fed policy clearer to a public unfamiliar with economic minutia.

"If you're forced to be on the record and explain your position, there's more certainty over what your future decision-making is going to be," he said. "You make better decisions when you know you'll have to defend them."

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