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New York Fed's Enhanced Powers May Come With Reduced Autonomy

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June 15 (Bloomberg) -- The Federal Reserve Bank of New York, which carried out central-bank rescues of money markets and Wall Street firms, is poised to have its powers expanded even more -- at the risk of reduced independence.

Senate and House negotiators meet today to begin hammering out a financial-regulation bill that puts the New York Fed at the forefront of the central bank's new role as overseer for financial stability. Lawmakers also want its chief, now nominated by the bank's board, to be a White House appointee.

Senate Banking Committee Chairman Christopher Dodd says the selection process must be overhauled to avoid conflicts of interest at the regional Fed bank, which supervises firms including JPMorgan Chase & Co. and Goldman Sachs Group Inc., where New York Fed chief William Dudley spent two decades. Opponents, including St. Louis Fed President James Bullard, say the legislation represents an effort by politicians to exert more control over monetary policy.

"Congress is concerned about accountability," Gary Stern, Minneapolis Fed president from 1985 to 2009, said in a telephone interview. "You would get a different kind of person in the job. I am an economist by training. You might continue to get some people like that. But you might get people who are more active politically."

The so-called base text of the financial-overhaul legislation would give the central bank a seat on a newly created Financial Stability Oversight Council. The Fed would be delegated to watch over firms that "may pose risks to financial stability," including banks it supervises and non-bank financial firms.

Authority Extended

The New York Fed might have its authority extended to firms such as GE Capital. Jeffrey Immelt, chairman of General Electric Co., the parent of GE Capital, sits on the New York Fed Board.

Dodd's proposal to have the regional Fed chief appointed to a five-year term subject to Senate approval means politicians would pick two-thirds of the Federal Open Market Committee. Dudley, whose term ends in February, is vice chairman of the rate-setting panel. Of the Fed's 12 regional bank presidents, he's the only one with a permanent vote on the FOMC alongside the seven Washington-based governors.

The New York Fed executes monetary policy through its trading desk, which bought billions in bonds during the financial crisis. The Fed's total assets have expanded to $2.33 trillion as it bought Treasury bonds, mortgage-backed securities and agency debt to lower interest rates. That compares with $903 billion two years ago.

Treasury Secretary Timothy Geithner, a former New York Fed president, said in March he opposes White House appointment because it "would tilt the balance substantially in New York's favor."

'Loose Money'

"What Congress ultimately wants out of this is loose money," said Mark Calabria, a former Senate Banking Committee staffer who is now a director of financial-regulation studies at the Cato Institute in Washington, a research center that favors free markets.

Bernard Sanders, a Vermont independent, said having the New York Fed president nominated by the White House "is a great thing" because it removes bankers from the decision.

Senator Judd Gregg, a New Hampshire Republican, called it "bad policy" because it "injects too much congressional activity into the operational side of the Fed." Even so, the presidential appointment clause probably "is going to survive" Gregg said in a June 9 interview.

Krishna Guha, a spokesman for the New York Fed, declined to comment.

Many emergency programs approved by the Board of Governors were designed by Geithner when he headed the Fed, with help from Dudley, who was then executive vice president in charge of markets. Dudley once slept on the carpet of his ninth-story Liberty Street office instead of checking into a nearby hotel during the crisis.

Berkeley Doctorate

Dudley, 57, holds an economics doctorate from the University of California at Berkeley and worked as a Fed economist from 1981 to 1983. He joined Goldman Sachs in 1986 and became its top U.S. economist. He moved to the New York Fed in 2007 and succeeded Geithner in 2009. Dudley's salary at the New York Fed last year was $410,780.

The search committee that picked Dudley was comprised of former Goldman Sachs chairman Stephen Friedman, who was chairman of the New York Fed Board; Charles Wait, chairman of the Adirondack Trust Co. of Saratoga Springs, New York; and Denis Hughes, president of the AFL-CIO in New York. Six of the nine directors that sit on regional Fed boards are bankers or people chosen by them.

Political appointment of the New York Fed chief "makes a lot of sense" given its permanent vote on rates and the larger role the Fed will play in financial-system oversight, said Ken Rogoff, a Harvard University economist.

Center of Gravity

"I can understand concern about giving an administration too much power to shift the center of gravity at the Fed, but presumably the confirmation process still provides some degree of checks and balances," said Rogoff, a former International Monetary Fund chief economist.

Fed officials disagree. The St. Louis Fed's Bullard, in a letter to 13 senators last month, said the change "would introduce an unprecedented level of political intervention in the operation of a reserve bank."

"I don't think that is the right way to go," Fed Chairman Ben S. Bernanke said at a Joint Economic Committee hearing in April.

Marvin Goodfriend, an economist at Carnegie Mellon University and a former Richmond Fed policy adviser, said the legislation "goes right to the heart of the Fed's independent powers."

The Fed opened the door to greater political pressures by stepping into the realm of fiscal policy with rescues of Bear Stearns Cos. and American International Group Inc., says Allan Meltzer, a historian of the central bank.

"The Fed has done more credit allocation and fiscal policy than ever before," said Meltzer, an economist at Carnegie Mellon University in Pittsburgh. "Most of the damage was done before this bill."

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