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Scrutiny of Fed Seen Intensifying in a Republican Senate

By Jeff Kearns and Craig Torres - Nov 4, 2014

As Janet Yellen was preparing to take over the Federal Reserve, she got some advice from the departing chairman, Ben Bernanke: Keep in mind that "Congress is our boss."

Yellen would do well to heed his words if the Republican Party gains majority control of the Senate in today's midterm elections, giving fresh impetus to congressional efforts to constrain the Fed's powers to supervise the financial system and make monetary policy.

While any threat to the central bank's independence would be subject to a veto by President Barack Obama, Yellen, 68, is likely to face pressure to hasten the Fed's exit from the most aggressive stimulus in its 100-year history.

"A Republican House and Senate will make life more difficult for Janet Yellen and the Fed," said Sarah Binder, who studies the relationship between Congress and the central bank as a senior fellow at the Brookings Institution in Washington.

"Greater scrutiny of the Fed's decisions and GOP pressures to tighten monetary policy more quickly and rapidly will constrain the Fed's autonomy and encourage second-guessing of Yellen's leadership," Binder said.

Several political modeling outlets say the Republican Party is poised to gain the six seats needed to win the Senate majority, even if that outcome isn't immediately known. The Washington Post reported a 97 percent chance of the GOP taking over the Senate; the New York Times gave them a 70 percent chance; and FiveThirtyEight saw a 76.2 percent chance of a Republican takeover.

Potential Challenges

Even before today's election, potential challenges to the Fed's independence were already the greatest in decades, according to Karen Shaw Petrou, managing partner of research firm Federal Financial Analytics Inc. in Washington.

"The Fed is already on thin ice on Capitol Hill," said Petrou, who has advised banks since 1985. "And if anything goes wrong, they're going to be particularly vulnerable."

House Republicans proposed legislation to limit how the Fed sets monetary policy in July, a week before Yellen delivered her semiannual testimony to lawmakers.

The bill, sponsored by Bill Huizenga of Michigan, a vice chairman of the financial services subcommittee on monetary policy, and Scott Garrett of New Jersey, would require the Federal Open Market Committee to describe a strategy or rule for how it would adjust interest rates.

'Grave Mistake'

Yellen opposed the measure during the July hearing, saying "it would be a grave mistake for the Fed to commit to conduct monetary policy according to a mathematical rule. No central bank does that."

Another bill, sponsored by Representative Kevin Brady, a Texas Republican, would make stable prices the Fed's primary goal, subordinating its full-employment mandate.

Given Obama's veto power, large alterations to the Federal Reserve Act are unlikely. The Republicans' most effective lever over the Fed and the president will be nominations to the Board of Governors.

Republican control of the Senate could mean Richard Shelby of Alabama, who turned from Fed supporter to critic during the financial crisis, would lead the Senate Banking Committee, which oversees the central bank.

Shelby voted against Yellen's nomination as vice chair in 2010 and as chair last year. In both cases, he cited "deep concerns about Dr. Yellen's Keynesian bias toward inflation as a member of the Federal Open Market Committee" as well as "her poor record of bank regulation" as president of the San Francisco Fed from 2004 to 2010.

Diamond Nomination

Shelby opposed Obama's 2010 nomination of Nobel Prize-winning economist Peter Diamond to serve as a Fed Board governor. Diamond later withdrew.

Mark Calabria, a former aide to Shelby, said the Senate panel probably won't approve White House nominees to the Fed's board of governors. Two of seven seats are currently vacant.

"It's hard to believe there will be any new Fed nominees confirmed before 2017," said Calabria, an economist and director of financial regulation studies at the Cato Institute in Washington. "It's going to be a tougher attitude."

The Fed came under fire from Republicans during the financial crisis, when its unprecedented actions, including a bailout of American International Group Inc., raised concern it was growing too powerful.

Bond Purchases

Opposition intensified as the Fed engaged in three rounds of large-scale bond purchases intended to pull the economy out of the worst recession since the Great Depression and then keep the recovery going. The purchases quadrupled its balance sheet to a record $4.49 trillion.

Bernanke, a Republican who was first nominated by President George W. Bush, was nominated for a second term by Obama. He won Senate approval in January 2010 by a vote of a 70-30, the narrowest margin since the chamber started confirming Fed chiefs in 1978. Yellen, also an Obama nominee, was confirmed in January 2014 on a 56-26 vote.

The Fed last month announced an end to its third round of quantitative easing, citing an improved labor market, while maintaining its pledge to keep interest rates low for a "considerable time."

"In both time and money, QE has overstayed its welcome by years and by trillions," House Financial Services Committee Chairman Jeb Hensarling, a Texas Republican, said in a statement. "Loose monetary policy before the crisis inflated the housing bubble and six years of QE may have just inflated the next bubble."