11-30-2009

UA36I/29 Gary Ransdell - Fed. Reserve Board - Right Reform for the Fed

St. Louis Federal Reserve Board

Subject: FedDigest November 29, 2009: Chairman Bernanke's Op-Ed, "The Right Reform for the Fed," in The Washington Post
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Date: Mon, 30 Nov 2009 11:47:20 -0600
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Chairman Bernanke writes in the Washington Post that a number of legislative proposals being circulated would significantly reduce the capacity of the Federal Reserve to perform its core functions. He explains his concerns about the legislation and concludes, "Now more than ever, America needs a strong, nonpolitical and independent central bank with the tools to promote financial stability and to help steer our economy to recovery without inflation."

Full text provided below and at:
http://www.washingtonpost.com/wp-dyn/content/article/2009/11/27/AR2009112702322.html

For many Americans, the financial crisis, and the recession it spawned, have been devastating--jobs, homes, savings lost. Understandably, many people are calling for change. Yet change needs to be about creating a system that works better, not just differently. As a nation, our challenge is to design a system of financial oversight that will embody the lessons of the past two years and provide a robust framework for preventing future crises and the economic damage they cause.

These matters are complex, and Congress is still in the midst of considering how best to reform financial regulation. I am concerned, however, that a number of the legislative proposals being circulated would significantly reduce the capacity of the Federal Reserve to perform its core functions. Notably, some leading proposals in the Senate would strip the Fed of all its bank regulatory powers. And a House committee recently voted to repeal a 1978 provision that was intended to protect monetary policy from short-term political influence. These measures are very much out of step with the global consensus on the appropriate role of central banks, and they would seriously impair the prospects for economic and financial stability in the United States. The Fed played a major part in arresting the crisis, and we should be seeking to preserve, not degrade, the institution's ability to foster financial stability and to promote economic recovery without inflation.

The proposed measures are at least in part the product of public anger over the financial crisis and the government's response, particularly the rescues of some individual financial firms. The government's actions to avoid financial collapse last fall--as distasteful and unfair as some undoubtedly were--were unfortunately necessary to prevent a global economic catastrophe that could have rivaled the Great Depression in length and severity, with profound consequences for our economy and society. (I know something about this, having spent my career prior to public service studying these issues). My colleagues at the Federal Reserve and I were determined not to allow that to happen.

Moreover, looking to the future, we strongly support measures--including the development of a special bankruptcy regime for financial firms whose disorderly failure would threaten the integrity of the financial system--to ensure that ad hoc interventions of the type we were forced to use last fall never happen again. Adopting such a resolution regime, together with tougher oversight of large, complex financial firms, would make clear that no institution is "too big to fail"--while ensuring that the costs of failure are borne by owners, managers, creditors and the financial services industry, not by taxpayers.

The Federal Reserve, like other regulators around the world, did not do all that it could have to constrain excessive risk-taking in the financial sector in the period leading up to the crisis. We have extensively reviewed our performance and moved aggressively to fix the problems. Working with other agencies, we have toughened our rules and oversight. We will be requiring banks to hold more capital and liquidity and to structure compensation packages in ways that limit excessive risk-taking. We are taking more explicit account of risks to the financial system as a whole. We are also supplementing bank examination staffs with teams of economists, financial market specialists and other experts. This combination of expertise, a unique strength of the Fed, helped bring credibility and clarity to the "stress tests" of the banking system conducted in the spring. These tests were led by the Fed and marked a turning point in public confidence in the banking system.

Going forward, there is a strong case for a continued role for the Federal Reserve in bank supervision. Because of our role in making monetary policy, the Fed brings unparalleled economic and financial expertise to its oversight of banks, as demonstrated by the success of the stress tests.

This expertise is essential for supervising highly complex financial firms and for analyzing the interactions among key firms and markets. Our supervision is also informed by the grass-roots perspective derived from the Fed's unique regional structure and our experience in supervising community banks. At the same time, our ability to make effective monetary policy and to promote financial stability depends vitally on the information, expertise and authorities we gain as bank supervisors, as demonstrated in episodes such as the 1987 stock market crash and the financial disruptions of Sept. 11, as well as by the crisis of the past two years.

Of course, the ultimate goal of all our efforts is to restore and sustain economic prosperity. To support economic growth, the Fed has cut interest rates aggressively and provided further stimulus through lending and asset-purchase programs. Our ability to take such actions without engendering sharp increases in inflation depends heavily on our credibility and independence from short-term political pressures. Many studies have shown that countries whose central banks make monetary policy independently of such political influence have better economic performance, including lower inflation and interest rates.

Independent does not mean unaccountable. In its making of monetary policy, the Fed is highly transparent, providing detailed minutes of policy meetings and regular testimony before Congress, among other information. Our financial statements are public and audited by an outside accounting firm; we publish our balance sheet weekly; and we provide monthly reports with extensive information on all the temporary lending facilities developed during the crisis. Congress, through the Government Accountability Office, can and does audit all parts of our operations except for the monetary policy deliberations and actions covered by the 1978 exemption. The general repeal of that exemption would serve only to increase the perceived influence of Congress on monetary policy decisions, which would undermine the confidence the public and the markets have in the Fed to act in the long-term economic interest of the nation.

We have come a long way in our battle against the financial and economic crisis, but there is a long way to go. Now more than ever, America needs a strong, nonpolitical and independent central bank with the tools to promote financial stability and to help steer our economy to recovery without inflation.

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