Central Bank Undersight: Assessing the Fed's Accountability to Congress

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ABSTRACT— The Federal Reserve exercises some of Congress's most important constitutional powers and prerogatives—namely, the duty to regulate the value of money, and the ability to spend and borrow against the good name of the United States—yet does so with practically no congressional oversight. This Article details the statutory gaps and structural factors that have resulted in such "undersight." The Fed's financial operations are exempted from the appropriations process, the federal debt ceiling, standard accounting rules, and external reviews of efficacy and efficiency; indeed, the Fed's technical insolvency is not visible on its balance sheet. Moreover, the Fed's monetary policymaking process has practically eliminated all dissents, contrary to Congress' express intent. The Article concludes by discussing potential approaches for enhancing Congress' oversight of the Fed, including a number of tried-and-true approaches for overseeing other independent agencies.

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Introduction

It may seem extraordinary that any public agency could conduct a program that will cost U.S. taxpayers more than $1 trillion.[1] And it might seem equally extraordinary that such a program could be undertaken without any Congressional budget hearings or appropriations. Yet that is the expected outcome of the Federal Reserve's latest round of securities purchases conducted in 2020-22.[2]

When the Fed was established in 1913, Congress endowed it with the authority to issue paper currency as legal tender.[3] Legislators recognized that this authority would be extraordinarily valuable because the Fed would earn interest on its assets while paying no interest on its liabilities of paper currency.[4] Accordingly, the Federal Reserve Act directed all of the Fed's net earnings to be remitted to the U.S. Treasury.[5] That stream of profits belongs to the United States, not the Fed itself. By granting this authority, Congress effectively designated the Fed to serve as its conservator with a fiduciary duty to ensure that the profits reaped from issuing currency are managed well so that they may be remitted to the Treasury for the benefit of the general public.[6] So, how did the Fed come to put such significant sums of taxpayer money at risk?

The essential focus of this Article is to assess Congress' ability to oversee the Fed's use of its balance sheet. Our analysis identifies statutory gaps and

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1 The mark-to-market valuation of the Federal Reserve's securities holdings declined by $1.4 trillion from the end of 2021 to the third quarter of 2023; *see* Board of Governors of the Federal Reserve System, *Federal Reserve System Audited Annual Financial Statements*, BD. GOV. FED. RSRV. SYS. (Mar. 24, 2023), https://www.federalreserve.gov/aboutthefed/audited-annual-financial-statements.htm [https://perma.cc/LVT8-35XX]; Board of Governors of the Federal Reserve System, *Federal Reserve Banks Combined Quarterly Financial Reports (Unaudited),* BD. GOV. FED. RSRV. SYS. (Nov. 17, 2023), https://www.federalreserve.gov/aboutthefed/combined-quarterly-financial-reports-unaudited.htm [https://perma.cc/FZ94-E68P]

2 See Andrew T. Levin, Brian Lu, and William R. Nelson, *Quantifying the Costs and Benefits of Quantitative Easing,* (Nat'l Bureau of Econ. Rsch., Working Paper No. 30749, 2022) (projecting the Fed's net interest income and remittances over the period from 2023 to 2032). That analysis has been updated for this Article using the path of interest rates implied by the Treasury yield curve at the end of September 2023; see Figure 4 below.

3 From 1913 onwards, the Federal Reserve Act has stated that all Federal Reserve notes "shall be obligations of the United States." (section 16, part 1).

4 Section 7 of the Federal Reserve Act of 1913 required all of the Fed's net earnings (after covering operating expenses and fixed dividends on paid-in capital) to be remitted to the U.S. Treasury. *See* Federal Reserve Act of 1913, sec. 7.

other structural issues that have created legislative blind spots regarding the Fed's issuance of monetary liabilities and acquisition of securities. The result is constitutionally problematic central bank "undersight." Indeed, the Fed's current state of technical insolvency and ongoing operating losses is a contemporary case study that illustrates the costs and risks of leaving congressional undersight untreated.

Generally speaking, the purpose of congressional oversight is a monitoring and investigative one: so that Congress can "gather[s] information on [an agency's] activities," and "make[s] sure that laws are working as intended and are being administered in an effective, efficient, and economical manner." [7] More generally, Congress's oversight creates "a general environment of accountability and transparency" between Congress and the agencies implementing the law.[8] Indeed, since the conception of the American administrative state, scholars and policymakers alike have recognized that without rigorous oversight, "the country must remain in embarrassing, crippling ignorance of the very affairs which it is most important it should understand and direct."[9] Congress's duty to oversee the agencies should thus be understood as equally important as—and ancillary to—its Article I lawmaking role.[10]

Congress's responsibility to conduct vigorous oversight of monetary policy—and the Fed's balance sheet operations more broadly—is arguably compelled by the breadth of the delegations it has, over the years, made to the Federal Reserve. In 1977, Congress formally delegated to the Fed the responsibility for regulating the value of money (power constitutionally vested in Congress in Article I, section 8, the so-called Coinage Clause).[11] Moreover, the Fed has been empowered with Congress' Article I Power of the Purse, spending funds outside of the constitutionally required appropriations process and borrowing funds directly from the public.[12]

Yet Congress reserved little capacity to rein in this delegated power, should it need to. Notably, the Fed is the only independent agency whose

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7 BEN WILHELM ET AL, CONG. RSCH. SERV., RL30240, CONGRESSIONAL OVERSIGHT MANUAL 2 (2021)

8 *Id.* at 2-3.

9 *Id.*

10 WOODROW WILSON, CONGRESSIONAL GOVERNMENT _ (1885).

11 The Federal Reserve Reform Act of 1977, Pub. L. No. 95-188, 91 Stat. 1387, added section 2A to the Federal Reserve Act, thereby giving the Fed a formal mandate for price stability for the first time since its creation in 1913. For a history of the origins of section 2A and the "dual mandate," see, for example, Christina Parajon Skinner, *Capture the Fed*, *in* POPULISM AND THE FUTURE OF THE FED 65–69 (James A. Dorn ed., 2022).

12 *See infra* Part II.

operating expenses are not included in the federal budget and whose liabilities are not covered by the federal debt ceiling.[13] The Federal Open Market Committee (FOMC) is the Fed's monetary policymaking body.[14] However, the FOMC is not required to provide any cost-benefit analysis of its programs or to alert Congress about potential risks of its policies.[15] Moreover, the Fed sets its own accounting rules and is exempt from the Generally Accepted Accounting Practices (GAAP) that are followed by every other federally-created entity. For these reasons, the fact that the Fed is now technically insolvent is practically invisible on its balance sheet.

The Fed's monetary policy programs and operations are not subject to the scrutiny of independent inspector generals (IGs) or the Government Accountability Office (GAO). The programs of every other major federal agency (with operating expenses exceeding $5 billion) are evaluated by a fully independent IG, appointed by the President and confirmed by the Senate. In contrast, the Fed's IG is an employee appointed by the Fed's Board of Governors who cannot investigate any monetary policy matter without permission from the Fed Chair.[16] The GAO, commonly known as "the taxpayer's best friend,"[17] regularly assesses the efficiency and effectiveness of every other federal office and agency, but the FOMC's programs have been completely exempted from such reviews.[18]

Congress's ability to oversee the Fed's monetary policymaking function is also increasingly undermined by the growing influence of the Executive

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13 Paul H. Kupiec & Alex J. Pollock, *A Frightening Solution to the Debt Ceiling Crunch,* AM. ENTER. INST. (Apr. 27, 2023), https://www.aei.org/op-eds/a-frightening-solution-to-the-debt-ceiling-crunch. [https://perma.cc/L3WW-CLKS]

14 Federal Reserve Bank of St. Louis Staff, *Federal Open Market Committee,* FED. RSRV. HIST. (Sept. 14, 2021), https://www.federalreservehistory.org/essays/federal-open-market-committee [https://perma.cc/F676-G7ZP]

15 Eric A. Posner & Glen Weyl, *The Case for Cost-Benefit Analysis of Financial Regulations,* Cato Inst. (2013), https://www.cato.org/regulation/winter-2013-2014/case-cost-benefit-analysis-financial-regulations [https://perma.cc/2R59-9DUL];

16 *See About Us*, OFF. INSPECTOR GEN., https://oig.federalreserve.gov/faq-about-oig.htm#q142 [https://perma.cc/5YFN-CGXT]

17 Press Release, Homeland Security & Governmental Affairs, *Comptroller General Nominee Testifies Before HSGAC* (Nov. 18, 2010), https://www.hsgac.senate.gov/media/reps/comptroller-general-nominee-testifies-before-hsgac/ [https://perma.cc/2EWR-G458]

18 *See* 31 U.S.C. § 714 (describing the GAO's requirement to audit the operations and activities of the Fed but excluding the "deliberations, decisions, and actions on monetary policy matters, including discount window operations, reserves of member banks, securities credit, interest on deposits, and *open market operations*") [emphasis added].

Branch within the Federal Reserve System.[19] The Chair of the Fed's Board of Governors, who serves as its active executive officer and as the chair of the FOMC, has a four-year term of office that coincides with the presidential election cycle.[20] All seven seats on the Fed Board have staggered 14-year terms, but its members (apart from the Chair) rarely stay longer than 3-4 years, and it has become commonplace for practically everyone on the Fed Board to have been appointed by the current incumbent of the White House.[21]

The FOMC also includes the presidents of regional Federal Reserve Banks, which are private institutions with their own boards of directors.[22] But in recent years, the Fed Board has become directly involved in the selection of new Fed Bank presidents, prompting the White House Office of Legal Counsel (OLC) to opine that the Fed Bank presidents should now be viewed as "subordinates" of the Fed's Board of Governors—contrary to the express intent of Congress.[23]

Indeed, Congress clearly intended that the FOMC's policies would be determined by a committee of independent experts who would be individually accountable for their votes. Nonetheless, there were no dissents at all during 2021, when the FOMC persisted with enormous securities purchases even as unemployment plummeted and inflation accelerated.[24] In effect, the FOMC's policymaking has departed from the intent of Congress

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19 The Supreme Court has characterized the fundamental nature of an independent federal agency. *See* Humphreys Executor v. United States, 296 U.S. 602 (1935) ("Such a body cannot in any proper sense be characterized as an arm or an eye of the executive...To the extent that it exercises any executive function—as distinguished from executive power in the constitutional sense—it does so in the discharge and effectuation of its quasi-legislative or quasi-judicial powers, or as an agency of the legislative or judicial departments of the Government.")

20 12 U.S.C. § 242.

21 Sarah Foster, *The Federal Reserve's Board of Governors, Explained*, BANKRATE (Nov. 13, 2020), https://www.bankrate.com/banking/federal-reserve/federal-reserve-board-of-governors-explained/ [https://perma.cc/W36R-YXGL]

22 Board of Governors of the Federal Reserve System, *Federal Open Market Committee*, BD. GOV. FED. RSRV. SYS. (Nov. 1, 2023), https://www.federalreserve.gov/monetarypolicy/fomc.htm.

23 OFF. LEG. AFF. APPOINTMENT AND REMOVAL OF FEDERAL RESERVE BANK MEMBERS OF THE FEDERAL OPEN MARKET COMMITTEE (2019)

24 See Federal Reserve Bank of St. Louis, *A History of FOMC Dissents*, Fed Rsrv. Bank St. Louis (Sept. 14, 2014), https://www.stlouisfed.org/on-the-economy/2014/september/a-history-of-fomc-dissents [https://perma.cc/BSJ8-JDQW].

and is now eerily similar to a corporate board whose directors are constrained to "speak with one voice" regardless of their views.[25]

The lack of adequate congressional oversight of the Fed is even more worrisome in light of the fact that the Fed's monetary policymaking is not subject to any substantive judicial review. The federal courts have consistently ruled that the FOMC's governance and policy decisions are not justiciable in accordance with the political question doctrine.[26]

The principal aim of this Article is to document and analyze these patterns of central bank "undersight." In doing so, the Article contributes to two overlapping literatures relevant to the law and policy of U.S. central banking. The first of these literatures, of course, pertains to the Fed. Although rafts of scholarship have explored the topic of central bank independence and, more recently, the Fed's expanding power, there has been no comprehensive accounting of where the Fed sits within the U.S government and how to explain and rationalize that constitutionally.[27] Nor has there been any systematic assessment of the Fed's exemptions from routine forms of congressional oversight.

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25 *See* Craig Torres and Catarina Saraiva, "Powell's Fed Sticks Together in Fight Against Inflation Despite Differences", BLOOMBERG NEWS (Nov. 17, 2023), https://www.bloomberg.com/news/articles/2023-11-17/inflation-fight-has-powell-fed-voting-together-on-interest-rates("former Richmond Fed President Jeffrey Lacker, who dissented during the Bernanke and Yellen terms, said that the FOMC "seems to be behaving more like a corporate board, keeping dissenting views internal and hewing to the 'house view' externally"').

26 *See* Riegle v. Federal Open Market Committee, 656 F.2d 873 (1979) (affirming the dismissal of a senator's suit challenging the constitutionality of the Federal Reserve Act. Senator Riegle argued that the method by which members of the Federal Open Market Committee were elected, without the advice and consent of the Senate, violated his rights under the Appointments Clause of the United States Constitution. Although the court found that the senator had standing to sue, it adopted a thesis that the court should exercise its equitable discretion to dismiss the legislator's action.)

27 Such rationalization is present in other executive authorities. *See, e.g.*, Aditya Bamzai, Tenure of Office and the Treasury: The Constitution and Control over National Financial Policy, 1787 to 1867, 87 GEO. WASH. L. REV.1299, 1378–79 (2019) (offering contemporaneous evidence why Congress imposed a reason-giving requirement on the President for the Comptroller, namely, that "if the Senate did not approve of the reasons given by the President, they could refuse to confirm the successor" (quoting CONG. GLOBE, 38th Cong., 1st Sess. 1865 (1864))); *also see* Aaron L. Nielson & Christopher J. Walker, *Congress's Anti-Removal Power*, 76 VAND. L. REV. 1 (Jan. 2023) (challenging the conventional wisdom that Congress will further weaken agency independence); ; Adrian Vermuele, *Conventions of Agency Independence*, 113 COLUM. L. REV. 1163, 1196 (2011); Caroline W. Tan, *What the Federal Reserve Board Tells Us About Agency Independence*, 95 N.Y.U. L. REV. 326 ; Steffi Ostrawski, Note, *Judging the Fed*, 131 YALE L. J. 370 (Nov. 2021) (providing a comprehensive overview of judicial review of the Fed).

Second, but closely related, the Article is directly relevant to the active debate on agency accountability, including questions on which the Supreme Court is now intensely focused. The Court has recently or is actively considering the President's ability to hold agencies accountable through the removal power,[28] the ability to compel agency action to enforce the law as written,[29] the funding structure of a non-appropriated agency,[30] and the extent to which courts should defer to agencies' interpretation of their own mandates under the so-called *Chevron* deference doctrine.[31] Each of these constitutional questions applies with equal if not greater force to the Fed, and this Article raises the possibility of strengthened congressional oversight as a constitutional salve.

The remainder of this Article is organized as follows: Part I develops a comprehensive framework for analyzing Congress' delegation of monetary policy. This includes an in-depth descriptive analysis of the Fed's dual mandate, the governance structure that is designed to facilitate independent monetary policy making, and the mechanisms that are meant to ensure the Fed's accountability to Congress. Part II focuses on Congress' delegation of fiscal power to the Fed by examining the Fed's external source of funding and its exemptions from the appropriations process, the debt ceiling, standard accounting rules, and scrutiny by the GAO or a fully independent IG. Part III briefly discusses potential steps that could be taken to enhance congressional oversight of the Fed's monetary policy function while avoiding risks of greater political interference. Such steps could include statutory changes to facilitate regular reporting, ensure congressional access to internal Fed information, and strengthen the roles of the GAO and the Fed's IG in serving as congressional watchdogs.[32]

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28 Collins v. Yellen, 594 U.S. _ (2021); Seila Law v. CFPB, 591 U.S. _ (2020).

29 United States v. Texas, 599 U.S. _ (2023).

30 CFPB v Community Financial Servs. Assoc., No. 21-50826 (5th Cir., Oct. 19, 2022), cert. granted, No. 22-448 (Feb. 27, 2023).

31 Loper Bright Enterprises v. Raimondo, 45 F.4th 359 (D.C. Cir. 2022), cert. granted, No. 22-451 (May 2023).

32 The Article does not consider any potential changes in the Fed's governance structure or statutory mandate. Moreover, it bears noting that the analysis does not encompass any of the Fed's other key responsibilities such as banking supervision and regulation of the payments system.

I. Monetary Delegation to the Fed

The Fed's monetary policymaking body, the FOMC, has a remarkable scope of authority and an extraordinary degree of independence, far beyond that of any other federally created entity. The FOMC directly exercises Congress's Article I power to regulate the value of money, with practically unfettered discretion in interpreting and implementing its statutory mandate of fostering maximum employment and price stability.

Yet the FOMC is largely immune to the standard checks and balances that are associated with other forms of national economic policymaking done by agencies. Nearly half of the voting members of the FOMC are exempted from the President's plenary power to appoint and remove officers of the United States. Furthermore, federal courts have consistently found that the FOMC monetary policy decisions are not justiciable.

Originally, the rationale for this level of insulation was grounded in well-accepted canons of central bank independence. However, as the Fed's functions and operations have evolved over time, its scope of authority and the structures that facilitate its independence might reasonably be viewed now as those approximating a "fourth branch" of the U.S. government.[33]

A. The Delegation of the Coinage Clause

1. *The Locus of Constitutional Responsibility*

The founding generation recognized that responsible stewardship of public money would be critical to the successful establishment of a well-functioning representative democracy. Accordingly, the framers and the ratifiers of the Constitution were quite delicate—and deliberate—in assigning the power to create currency and regulate its value.

Thus, Article I, section 8 indicates that Congress shall have the power "To coin Money, regulate the Value thereof, and of foreign Coin, and fix the Standard of Weights and Measures."[34] While this power is generally referred to as the "coinage clause," it effectively authorized Congress to establish and

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33 Concerns about federally-created entities emerging as a "fourth branch" were initially raised by the Brownlow Committee, a taskforce commissioned by President Franklin D. Roosevelt; see The President's Committee on Administrative Management, *Report of the Committee with Studies of Administrative Management in the Federal Government*, U.S. Printing Office (1937), 32-53. See also Jennifer L. Selin and David Lewis, *Sourcebook of United States Executive Agencies, 2nd edition*, Administrative Conference of the United States (2018), 10.

34 U.S. CONST., Art. 1, § 8, c. 5.

regulate the value of paper currency as well as coins to serve as legal tender for all debts, public and private.[35]

This power would be the exclusive prerogative of the legislature. As indicative of that intent, the Constitution expressly prohibits states from issuing their own local versions of money—a practice that had been commonplace across the colonies before the Revolution. During the ratification debates, it was noted that state-issued currencies would "materially interfere with the exercise of the like by Congress." [36] Accordingly, section 10 of the Constitution establishes that "[n]o State shall . . . coin Money; emit Bills of Credit; make any Thing but gold and silver Coin a Tender in Payment of Debts."[37]

Moreover, the framers and ratifiers clearly intended to cordon off the President's power to issue currency.[38] History was replete with monarchial abuse of such power; indeed, as Robert Natelson has pointed out, quoting William Blackstone, "The Framers all had lived the first part of their lives under law that identified the Crown as the 'arbiter of commerce' within Great Britain."[39] The result of the monarchial system, whereby Kings and Queens enjoyed the privilege of altering money's value, were generally de-stabilizing

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35 *See* Benjamin Franklin, *A Modest Enquiry into the Nature and Necessity of Paper Currency* (1729). At the constitutional convention, Nathaniel Gorham advocated for issuance of bills and notes to be neither prohibited nor explicitly authorized so that Congress would be able to do so "as far as it will be necessary or safe." BERNARD H. SIEGAN, THE SUPREME COURT'S CONSTITUTION: AN INQUIRY INTO JUDICIAL REVIEW AND ITS IMPACT ON SOCIETY 24 (1987). The Supreme Court confirmed this congressional power in the Legal Tender cases of Knox v. Lee, 79 U.S. 457 (1871) and Parker v. Davis 78 U.S. 682 (1871) and in the later case of Juilliard v. Greenman, 110 U.S. 421 (1884).

36 JAMES MONROE, OBSERVATIONS UPON THE PROPOSED PLAN OF FEDERAL GOVERNMENT (1788), *reprinted in* 9 DOCUMENTARY HISTORY OF BANKING AND CURRENCY IN THE UNITED STATES 655, 676-77 (Herman E. Krooss ed. 1969).

37 U.S. Const., art. I, § 10, cl 1. At Pennsylvania's ratifying convention, Jasper Yeates stated: "It is confessed the 10th section abridges some of the powers of the state legislature, as in preventing them from coining money, [and] emitting bills of credit . . . If state governments are prevented from exercising these powers, it will produce respectability, and credit will immediately take place . . . Congress alone with the powers given them by this system, or similar powers, can effect these purposes." *See* R. Carter Pittman, *Jasper Yeates's Notes on the Pennsylvania Ratifying Convention, 1787,* 22 WM. & MARY Q. 301, 308 (1965).

38 The pre-Revolutionary history of coinage powers belonging to the King are researched in detail. *See e.g.,* MICHAEL MCCONNEL, THE PRESIDENT WHO WOULD NOT BE KING 161 (2020).

39 Robert G. Natelson, *Paper Money and the Original Understanding of the Coinage Clause*, 31 HARV. J. L. & PUB. POL'Y 1017, 1029-30 (2008); *see also* Christina Parajon Skinner, *Central Bank Digital Currency as New Public*, 172 U. PA. L. REV. 167 (forthcoming 2024). (discussing the framers' desire to avoid past abuses associated with the King's prerogative over coinage).

over time as monarchs would tend to abuse the power to inflate the currency (i.e., to debase it), in ways that would lead to popular unrest.[40] Conversely, there was general recognition that monetary expansion might become imperative in case of war or other national emergency.[41] Thus, the Constitution unequivocally vested the coinage power with the most representative branch of government—the Congress.

For nearly one and a half centuries, Congress directly carried out this mandate by specifying the value of the dollar in terms of precious metals, starting with the creation of the "silver dollar" in the Coinage Act of 1792 and then effectively shifting to a gold standard in 1834.[42] Congress authorized the issuance of national paper backed by reserves held in bank vaults or at the U.S. Treasury.[43] The role of gold at the core of the monetary system was reaffirmed by the Gold Standard Act of 1900. However, that system remained susceptible to periodic banking panics.[44]

2. *Delegation to the Federal Reserve*

When Congress created the Federal Reserve System in 1913, its stated goals were "for the establishment of Federal Reserve Banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, [and] to establish a more effective supervision of banking in the United States, and

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40 *See* Skinner *supra 39*.

41 *See* ERIC P. NEWMAN AND RICHARD G. DOTY, STUDIES ON MONEY IN EARLY AMERICA (1976). At the onset of the American Revolution in 1775, the Continental Congress began financing the costs of the continental army by issuing paper currency, which depreciated to only 1/40th of its face value by 1780, thereby giving rise to the phrase "not worth a continental."

42 *See* CRAIG K. ELWELL, CONG. RSCH. SERV., R41887, BRIEF HISTORY OF THE GOLD STANDARD IN THE UNITED STATES (2011). The Coinage Act of 1792 specified the dollar prices of gold and silver with a ratio of 15:1, thereby supporting the use of silver coins and silver-backed bank notes while incentivizing exports of gold to foreign markets. The Coinage Act of 1834 raised the gold price to $20.30 (up from $19.75), thereby shifting the monetary system to gold backing of bank notes and exports of silver.

43 Notes were issued by the first and second Banks of the United States in 1792-1811 and 1816-36, respectively, and then by nationally-chartered commercial banks starting in 1863. During the Civil War, Congress enacted the Legal Tender Act of 1862 authorizing the issuance of unbacked notes known as "greenbacks", which were subsequently withdrawn from circulation by 1879; *see* Michael D. Bordo, Andrew T. Levin, Christopher J. Erceg, and Ryan Michaels, *Three Great American Disinflations* (Nat'l Bureau of Econ. Rsch., Working Paper No. 12982, 2007).

44 *See* Gary Richardson & Tim Sablik, *Banking Panics of the Gilded Age*, FED. RSRV. HIST. (Dec. 4, 2015), https://www.federalreservehistory.org/essays/banking-panics-of-the-gilded-age [https://perma.cc/8KHT-C5ER]

for other purposes."[45] Although the Constitution assigned the coinage power to Congress, there was longstanding precedent for delegating that authority to a federally-created entity.[46]

Of course, the gold standard was in effect when the Fed was established, and hence it did not carry out monetary policy in the modern sense of that term.[47] Rather, the phrase "elastic currency" conveyed the intent that the Fed would use its tools to smooth out seasonal fluctuations and to provide short-term liquidity in periods of financial stress. [48]

Unfortunately, the statutory minimum for the Fed's holdings of gold severely constrained its role as lender of last resort in the early 1930s, leading to widespread bank panics and the onset of the Great Depression.[49] In 1933 the gold standard was abolished and monetary uses of gold were prohibited; soon thereafter, the constraint on the Fed's gold reserves was lifted and eventually eliminated altogether.[50]

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45 Federal Reserve Act, Pub. L. No. 63-43, 38 Stat. 251 (1913) (codified as amended in scattered sections of 21 U.S.C.).,.

46 McCulloch v. Maryland, 17 U.S. 316 (1819) (establishing that the Second Bank of the United States, which exercised some facets of the coinage power, was constitutional as Congress had implied powers under Article I to create the institution insofar as it was "necessary and proper" to carrying out Congress's responsibilities under the coinage clause).

47 *See* MICHAEL D. BORDO & ANNA J. SCHWARTZ, A RETROSPECTIVE ON THE CLASSICAL GOLD STANDARD (1984) and THOMAS M. HUMPHREY & RICHARD H. TIMBERLAKE, GOLD, THE REAL BILLS DOCTRINE AND THE FED: SOURCES OF MONETARY DISORDER (2019).

48 In the 1920s, under the leadership of New York Fed President Benjamin Strong, the Federal Reserve used discount window policies and open market operations to foster stability in economic and financial conditions. *See* Skinner, *supra* note 11.

49 *See* MILTON FRIEDMAN & ANNA J. SCHWARTZ, A MONETARY HISTORY OF THE UNITED STATES, 1867-1960 (1963). See also Ben S. Bernanke and Harold James, "The Gold Standard, Deflation, and Financial Crisis in the Great Depression: An International Comparison", in R. Glenn Hubbard, ed., Financial Markets and Financial Crises, University of Chicago Press (1991).

50 The gold standard was suspended by Presidential Proclamation 2039 (March 6, 1933) and terminated by the Gold Repeal Joint Resolution (June 5, 1933), which abrogated all gold clauses in private contracts; the Supreme Court upheld that abrogation in Norman v. Baltimore and Ohio Railroad Company (1935). Monetary gold holdings were prohibited by Executive Order 6102 (April 5, 1933). Following the enactment of the Gold Reserve Act of 1934, President Roosevelt raised the official price of gold to $35 per ounce, thereby enabling the Federal Reserve to issue currency without being constrained by the statutory minimum on its gold holdings. That constraint was reduced by P.L. 79-84 (June 1945) and abolished by P.L. 90-269 (March 1968).

Congress then proceeded to overhaul the Fed's governance in Title II of the Banking Act of 1935.[51] This legislation diminished the role of the regional Federal Reserve Banks, which are private institutions owned by commercial banks, and magnified the role of the Federal Reserve Board, which had previously been merely an oversight body. Moreover, that legislation reshaped the FOMC into its modern form, with the Federal Reserve Board comprising a majority of its voting members.[52]

In doing so, Congress enacted several measures to insulate the Federal Reserve from the executive branch: (i) removing the Secretary of the Treasury and the Comptroller of the Currency, who served at the pleasure of the President and had held *ex officio* roles as members of the Federal Reserve Board; (ii) establishing staggered 14-year terms for the seven Board members, who would henceforth be referred to as "governors," the title used at many other central banks; and (iii) limiting the President's ability to remove any Federal Reserve Board member from office except "for cause".[53]

At its inception in the mid-1930s, the FOMC would not have been expected to have a central role in monetary policymaking. The Federal Reserve's key policy lever was perceived to be the discount rate, that is, the interest rate on loans to commercial banks.[54] The Federal Reserve's portfolio of tradable securities was limited to Treasuries, at a time when the outstanding federal debt remained small, and short-term interest rates remained close to zero in conditions of depressed economic activity and consumer prices.

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51 At the hearings on this legislation, Treasury Secretary Henry Morgenthau proposed a government buyout of all Federal Reserve Bank stock, while Fed Chair Marriner Eccles advocated the delegation of all monetary policy decisions to the Federal Reserve Board. Rep. Henry Steagall favored a purely advisory role for Fed Bank officials but acceded to the compromise proposed by Sen. Carter Glass. See Mark F. Bernstein, *The Federal Open Market Committee and the Sharing of Governmental Power with Private Citizens*, 75 VA. L. REV. 111, 121-122 (1989).

52 During the 1920s, the twelve Federal Reserve Banks began voluntarily coordinating their open market operations under the general supervision of the Federal Reserve Board. The Glass-Steagall Act of 1933 established the Federal Open Market Committee as comprising the heads of the 12 Federal Reserve Banks, with Federal Reserve Board members in attendance but playing no formal role in its decisions.

53 *See* Gary Richardson, Alejandro Komai, and Michael Gou, *The Banking Act of 1935*, Fed. Rsrv. Hist. (Nov. 22, 2013), https://www.federalreservehistory.org/essays/banking-act-of-1935 [https://perma.cc/3ZMG-XMR9]

54 The reserve ratio prescribes the fraction of a bank's deposits that must be held at the Federal Reserve Bank. The discount rate (i.e., the interest rate charged by each Federal Bank in extending credit to member banks in its district)

During World War II and its aftermath, economic and financial conditions shifted markedly. Retail banks regained a solid footing due to strengthened supervision as well as the provision of deposit insurance, and hence the Fed's lending to banks through the discount window practically vanished. Meanwhile, as the federal debt ballooned, the Federal Reserve's primary role was viewed as conducting open market operations to facilitate the smooth issuance of Treasuries, and the FOMC's policy decisions were practically dictated by Treasury officials.[55]

By the late 1940s, however, key members of Congress were calling publicly for the cessation of Treasury interference and thereby enable the FOMC to carry out its statutory mission of regulating the value of money. In 1950, the policy subcommittee of the Joint Economic Committee stated that "it is the will of Congress that the primary power and responsibility for regulating the supply, availability, and cost of credit in general shall be vested in the duly constituted authorities of the Federal Reserve System."[56]

After further congressional hearings and floor debates, the Federal Reserve System and the Treasury issued a joint statement in March 1951 (commonly known as the Fed-Treasury Accord) that finally removed the Fed's straight-jacket.[57] From that point onwards, the FOMC was able to use open market operations to adjust the level of short-term interest rates as judged appropriate to foster economic stability.[58]

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55 In characterizing the period from 1917 to 1951, Allan Meltzer noted that the "Treasury dominated the Federal Reserve more than half the time." *See* ALLAN MELTZER, A HISTORY OF THE FEDERAL RESERVE: 1913-1951 4 (2003).

56 S. REP. NO. 129, AT 2 (1950). In a subsequent speech before the U.S. Senate on February 22, 1951, Sen. Paul Douglas called for the Treasury to "abate its policies and yield on this issue" and for the Federal Reserve to "gird its legal loins and fulfill the responsibilities which I believe the Congress intended it to have."

57 For a narrative overview, see Jessie Romero, *The Treasury-Fed Accord*, FED. RSRV. HIST. (Nov. 22, 2013), https://www.federalreservehistory.org/essays/treasury-fed-accord [https://perma.cc/H7Z6-U5RU]. As an Assistant Secretary at the U.S. Treasury, William M. Martin, Jr. had a key role in negotiating the Accord and became Fed Chair soon thereafter; see *William McChesney Martin, Jr. Papers*, MO. HIST. SOC., https://fraser.stlouisfed.org/archival-collection/william-mcchesney-martin-jr-papers-1341/.

58 *See* Allan Sproul, The "Accord" – A Landmark in the First Fifty Years of the Federal Reserve System, FED. RSRV. BANK N.Y. MONTHLY REV. 227 (Nov. 1964).

3. *The Monetary Policy Mandate*

As Chief Justice Marshall wrote, "Congress may certainly delegate . . . powers which the legislature may rightfully exercise itself." [59] However, Congress cannot abdicate its constitutional duties, particularly for "important subjects" such as national economic policy. [60] Moreover, in delegating such powers, Congress must supply some "intelligible principle to which [the agency] is directed to confirm." [61] If detailed rules are impractical, then "it becomes constitutionally sufficient if Congress clearly delineates the general policy."[62] At the outer limit, the Supreme Court has found impermissible those delegations that "provide literally no guidance for the exercise of discretion" or that "confer authority to regulate the entire economy" under a vague standard such as "fair competition".[63]

Nonetheless, Congress did not specify any mandate whatsoever for the FOMC until long after its creation. A nascent effort occurred in 1937, at which point members of Congress considered the merits of adopting a Monetary Authority Act. At those hearings, Senator Robert Owen—one of the principal architects of the Federal Reserve Act a quarter-century earlier—explained that his vision of the central bank had always included an affirmative duty to "promote the economic stability of this country." [64] Senator Owen elaborated as follows:

> The Constitution provides very specifically that the Congress shall have the power to coin money and to regulate the value thereof, and we are only presuming now to consider the advisability of vitalizing that provision of the Constitution . . . It never has been done, and there have been reasons for it not having been done, but it occurs to

[59] Wayman v. Southard, 23 U.S. 1 (1825), 1, 43.

[60] Gundy v. United States, 139 S. Ct. 2116, 2136 (2019) (contrasting important subjects with those "of less interest, in which a general provision may be made, and power given to those who are to act . . . to fill up the details")

[61] The intelligibility principle standard was first announced in 1928, J.W. Hampton, Jr. & Co v. United States, and has since been referred to as the guiding standard. *See, e,g.*, Whitman v. Am. Trucking Associations, 531 U.S. 457, 472 (2001).

[62] American Power & Light Co. v. SEC, 325 U.S. 90, 105 (1946).

[63] *See* Panama Refining Co. v. Ryan, 293 U.S. 388 (1935); A.L.A. Schechter Poultry Corp. v. United States, 295 U.S. 495 (1935). In similar spirit, the Court has said that the "The degree of agency discretion that is acceptable varies according to the scope of the power congressionally conferred" *supra* Whitman note 61, at 475

[64] *Hearings on the Monetary Authority Act before the Subcomm. On Comm. On Agric. & Forestry*, 75th Cong. 115 (1937) (statement of Sen. Owen). [hereinafter Hearings, Monetary Authority Act 1937].

> some of us that the time has come where it is not only advisable, but absolutely necessary.[65]

In similar spirit, one of the principal experts testified:

> Now, it seems to me that there is no congressional duty more important than the necessity of preservation of our national economic existence . . . It is therefore the duty of Congress to assign a legal obligation to some authority which will be responsible for our economic stability . . . . If this legal obligation had been included in the Federal Reserve Bank Act in 1912, I feel positive that we would have avoided most of our serious financial difficulties.[66]

However, no legislation was adopted at that time, and the FOMC remained without any statutory mandate for the next four decades.[67]

In 1977, Congress enacted the Federal Reserve Reform Act, which added a new section to the Federal Reserve Act directing the FOMC to:

> maintain long run growth of the monetary and credit aggregates . . . so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates.[68]

The goal of "maximum employment" was taken directly from the Employment Act of 1946, which declared a "national policy . . . to promote maximum employment, production, and purchasing power."[69] The goal of stable prices echoed Congress' constitutional duty to "regulate the value of money" and provided greater clarity than the Employment Act's goal of maximizing "purchasing power."[70] The goal of "moderate long-term interest rates has generally been viewed as complementary to the first two goals, and hence the full clause is often referred to as the "dual mandate."

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65 *Id.* at 116.

66 *Id.* at 107-108 (statement of Mr. George L. LeBlanc).

67 In a 1962 report provided to the House Banking Committee, Clark Warburton stated: "The most needed change in the Federal Reserve Act is the insertion of a suitable directive for monetary policy." *The Federal Reserve System After Fifty Years: Hearings before the Subcomm. on Dom. Fin*, 88th Cong. 1320 (1964).

68 Federal Reserve Act, § 2A.

69 Employment Act of 1946, title and section 2.

70 In its 1950 report to the Joint Economic Committee, the Subcommittee on Monetary, Fiscal and Credit Policies highlighted "the vigorous use of restrictive monetary policy as an anti-inflation measure." See *supra* note 56. Likewise, in 1966 the Council of Economic Advisors provided a two-decade retrospective on the Employment Act that underscored the Fed's success in fostering low inflation during the 1950s and early 1960s; see *Economic Report of the President* (1966), chapter 7.

Evidently, this mandate is extraordinarily broad and discretionary. Congress chose not to define "stable prices"—the lodestar of its Article 1 coinage power—in terms of any specific price index or inflation rate. Likewise, the phrase "maximum employment" is vacuous in the absence of any specific measure of the job market. Thus, Robert Hetzel concluded that these objectives "amount to little more than instructions to achieve all good things."[71]

Furthermore, the FOMC's mandate provides no directive about how to prioritize among these goals in circumstances involving tradeoffs between them.[72] That ambiguity obscures Congress' ability to assess the Fed's performance and to ensure that its monetary policy is not unduly influenced by the administration or any other special interests.[73]

B. Appointment of FOMC Officials

Congress often guards against over-delegation—that is, an inadvertent delegation to the Executive Branch—by structuring some agencies to be 'independent.' This is to say that some agencies are designed to be relatively more resistant to influence from the President than others. Maintaining these structural features of independence is thus one way that Congress retains control (a form of oversight) over an agency.

Indeed, Congress long ago identified certain key characteristics of an independent agency in 1887 when it established the Interstate Commerce Commission. Those characteristics largely referred to the composition and identity of the agency's leadership, and the basis upon which those leaders should be appointed to office and the grounds upon which they could be removed from it. Specifically:

> An uneven number of commissioners . . . appointed to staggered terms of a fixed period extending beyond the term of the President . . . . can only be removed by the President for "inefficiency, neglect of

[71] Robert Hetzel, *How the Federal Open Market Committee Can Start Learning from Experience*, MERCATUS CENTER (July 21, 2022), https://www.mercatus.org/research/research-papers/how-federal-open-market-committee-can-start-learning-experience

[72] In 2012, the FOMC adopted a *Statement of Longer-Run Goals and Monetary Policy Strategy* which indicated that it would take a "balanced approach" to fostering its dual objectives of maximum employment and price stability; however, that commitment was omitted from the FOMC's 2020 revision of this statement.

[73] *See* Christina Parajon Skinner, *Capture the Fed*, in POPULISM AND THE FUTURE OF THE FED (James A. Dorn ed.) (2022). See also Christina Parajon Skinner, *Central Banks and Climate Change*, 75 VANDERBILT L. REV. 1301 (2021).

> duty, or malfeasance in office"; [and] no more than a bare majority can come from the same political party.[74]

With those lodestars of independence in mind, Congress designed the FOMC to be even more insulated from the Executive Branch compared to the ICC or other independent regulatory agencies.[75] The Federal Reserve Board members, who have 7 of the 12 votes on the FOMC, are presidential appointees subject to Senate confirmation, but these officials cannot be removed except "for cause," as distinct from the heads of executive departments who serve at the President's pleasure. Moreover, the FOMC is a "unique example of the sharing of legislative power with private interests," because the other five voting members of the FOMC are private officials who serve as the heads of private financial institutions—the Federal Reserve Banks.[76]

However, in seeming contradiction to that congressional intent as evidenced by the FOMC's statutory design, several factors diminish the FOMC's effective insulation from the Executive Branch:

The Fed Chair. The Federal Reserve Board's Chair, who also serves as FOMC Chair, has a four-year term of office that coincides with the presidential election cycle.[77] That timing might be viewed as innocuous if the Fed Chair merely served as first among equals. In point of fact, however, the Fed Chair sets the agenda for FOMC meetings; that role is crucial when monetary policy is being conducted on a "meeting-by-meeting" basis rather than following a systematic and transparent strategy.[78] Moreover, the

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74 Act to Regulate Commerce of 1887, §§ 11-13. The Act also highlighted several other key design features: "Individuals appointed to fill a vacancy can only fill the unexpired term, but there is no prohibition on reappointment; No professional qualifications for office set out in the statute; Federal service is full time and agency members cannot hold any financial interest in a member of the regulated sector; Combination of rule-making, enforcement and adjudication functions."(§§ 15, 20)

75 See PETER CONTI-BROWN, THE POWER AND INDEPENDENCE OF THE FEDERAL RESERVE (2017).

76 Mark F. Bernstein, *The Federal Open Market Committee and the Sharing of Governmental Power with Private Citizens*, 75 VA. L. REV. 111 (1989). The head of the Federal Reserve Bank of New York is a permanent voter on the FOMC, and the heads of the other 11 Fed Banks cast votes on a rotating basis: Chicago and Cleveland on a 2-year cycle, and the other nine Fed banks on a 3-year cycle.

77 The Chair, Vice Chair, and Vice Chair for Supervision are each appointed by the President, subject to Senate confirmation, and must be members of the Board of Governors (Federal Reserve Act, §10). The position of Vice Chair for Supervision was established by the Dodd-Frank Act of 2010.

78 The FOMC's officers are not determined by statute but chosen annually by its voting members; by longstanding custom, the Chair of the Fed Board and the President of the New York Fed are unanimously chosen as the FOMC's Chair and Vice Chair, respectively.

Federal Reserve Act designates the Fed Chair as the Fed Board's "active executive officer," a somewhat antiquated title whose modern equivalent is CEO; in contrast, the other six Fed Board members are relegated to non-executive roles.[79] Thus, the Chair directs the entire Fed Board staff, who produce economic forecasts and other background materials that serve as the focal point for the FOMC's monetary policy deliberations.[80]

Tenure of Fed Board members. By statute, the seats on the Fed Board have staggered 14-year terms, but in practice its members rarely stay for more than a few years. Indeed, nearly every Vice Chair has departed after a single four-year term.[81] Many other Fed Board members have served for 2-3 years before taking positions in the administration, moving to the private sector, or returning to academia.[82] Given the staggered design of the Board, incoming members almost always fill a vacant seat with a partial term rather than starting a full 14-year term.[83] Thus, the Fed Chair is typically the most senior member of the Board, further strengthening the centrality of that role.

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79 The Federal Reserve Board's governance is similar to that of U.S. corporations whose head has a dual role as CEO and board chair; such arrangements have practically disappeared from corporations in other jurisdictions such as Canada and the United Kingdom; see David G. Blanchflower & Andrew T. Levin, *Diverse Views in Monetary Policy*, INT'L MONETARY FUND (March 2023), https://www.imf.org/en/Publications/fandd/issues/2023/03/diverse-views-in-monetary-policy-blanchflower-levin.

80 Under the Federal Reserve Act of 1913, the President simply appointed the Federal Reserve Board's Chair and Vice Chair without any formal consideration by the Senate. Since the enactment of the Federal Reserve Reform Act of 1977, these appointments have been subject to Senate confirmation.

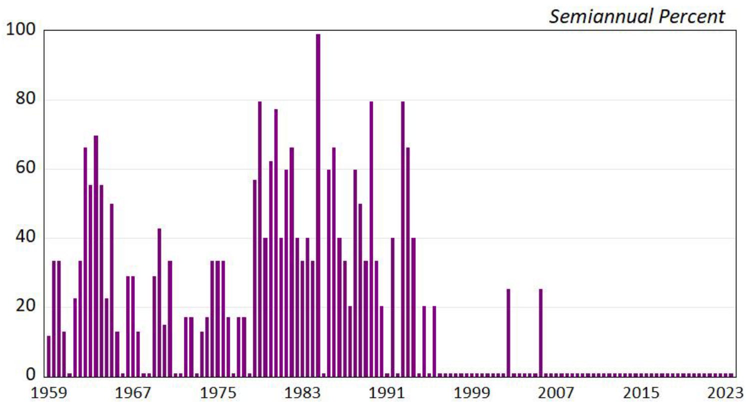
81 Janet Yellen, the sole exception, became Chair after previously served as Vice Chair.

82 Since the mid-1950s only a single Fed Board member has completed a full 14-year term: Alan Greenspan was appointed to a vacant seat in 1987, reappointed in 1992, and retired in 2006. *See* Board of Governors of the Federal Reserve System, *Alan Greenspan*, FED. RSRV. HIST., https://www.federalreservehistory.org/people/alan-greenspan [https://perma.cc/6S78-6XRK]

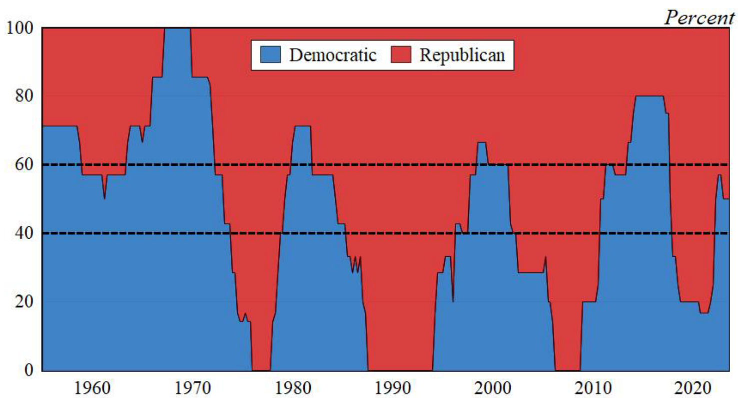
83 Vacancies have frequently been protracted by delays in the selection and confirmation of nominees, thereby making the remaining tenure of those seats even shorter.

Figure 1: The Federal Reserve's Board of Governors

A. FOMC Meetings with Dissents by Federal Reserve Board Members



B. Partisan Affiliations of Federal Reserve Board Members



Notes: For each semiannual period from 1959 to 2023, Panel A shows the proportion of FOMC meetings (in percent) at which any Federal Reserve Board member(s) cast any dissenting votes. Panel B shows the partisan affiliation of incumbent Fed Board members from 1955 to 2023, with blue for Democrats and red for Republicans. *Sources*: Federal Reserve Board, Federal Reserve Bank of St. Louis, authors' calculations.

As shown in Figure 1A, from the late 1950s until the early 1990s, Fed Board members regularly cast dissenting votes on FOMC decisions, consistent with other public boards and commissions at which the chair is simply "first among equals." By contrast, such dissents subsequently became rare and then vanished; since 2006, not a single Fed Board member has dissented on any FOMC decision.[84]

Moreover, as shown in Figure 1B, the shortened tenure and frequency of appointments to the Fed Board has resulted in dramatic swings in the partisan affiliations of Fed Board members in the wake of each presidential election cycle. Indeed, in recent decades it has become commonplace for every Fed Board member to have been appointed by the current incumbent of the White House. Among the major independent agencies, the Fed Board is practically unique in having statutory protection from executive removal but no requirements to ensure its partisan balance.[85] At other key agencies, statutory requirements ensure that the proportion of board members or commissioners affiliated with each political party consistently remains within a range of about 40 to 60 percent.

Fed Bank Presidents. In designing the Federal Reserve System, Congress obviously intended the Federal Reserve Banks to be independent institutions that are overseen but not subordinated to the Fed Board. And in their role as voter members of the FOMC, Fed Bank presidents have a truly unique position in determining national economic policies.[86]

The president of each Fed Bank is appointed by its directors, subject to the approval of the Fed's Board of Governors.[87] In effect, the Fed Board's role in appointments is roughly analogous to the Senate's "advise and consent" role in confirming Presidential nominees.[88] Likewise, the Act states that the

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84 From 2006 to 2021 there were more than 80 dissents by Fed Bank presidents; see Federal Reserve Bank of St. Louis, *A History of FOMC Dissents*, FED. RSRV. BANK ST. LOUIS (Sept. 16, 2014), https://www.stlouisfed.org/on-the-economy/2014/september/a-history-of-fomc-dissents [https://perma.cc/7HL6-BUL9].

85 See Table 5 of Kirti Datla & Richard L. Revesz, *Deconstructing Independent Agencies (and Executive Agencies)*, 98 CORNELL L. REV. 769, 797 - 799 (2013), 797-799.

86 In 2019, the OLC concluded that Fed Bank presidents "have authority that may be exercised only by officers of the United States. "*See supra* note 23 at 6 and 13. . The stature of Fed Bank presidents as U.S. officers raises a host of issues that warrant attention from Congress, especially because these issues are not likely to be justiciable.

87 12 U.S.C. § 341. Under the original Federal Reserve Act, each Fed Bank president was appointed by all nine directors; that provision was amended by the Dodd-Frank Act of 2010, which excluded the three Class A directors from the appointment process.

88 Fed Bank presidents serve 5-year terms that are uniformly renewed unless the individual resigns or reaches the specified age ceiling. Any Fed Bank president whose initial

president of each Fed Bank is accountable to its board of directors and may be dismissed at pleasure, while the Fed Board is authorized to remove any officer or director of any Federal Reserve Bank, "the cause of such removal to be forthwith communicated in writing" to that person and to the Fed Bank's directors.[89]

Nonetheless, the selection process for appointing a Fed Bank president is extraordinarily opaque. For nearly a century, the search was conducted by the Fed Bank's directors with little or no involvement of the Fed Board, which almost invariably approved the directors' preferred candidate. That hands-off approach ceased about a decade ago; since then, a Fed Board member "meets regularly with the search committee chair throughout the search process regarding the candidate pool."[90] Thus, there have been growing concerns that the Fed Board's oversight and veto powers can be used to practically dictate the selection of a new Fed Bank presidents.[91]

Likewise, the Fed Board has unbridled discretion in deciding whether to remove a Fed Bank president, because the term "cause" is vague and not justiciable for the reasons noted above. In a 2019 memo on the constitutionality of Fed Bank presidents serving on the FOMC, OLC opined:

> Nothing in the statute limits the Board's removal authority . . . we think that "cause" in this context means whatever reasons (if any) the Board has for removing the [Fed Bank president], and therefore permits the Board to remove the officer at will.[92]

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appointment occurred before reaching age 60 must step down upon reaching age 65. Comparable restrictions apply if the initial appointment occurred after reaching age 60.

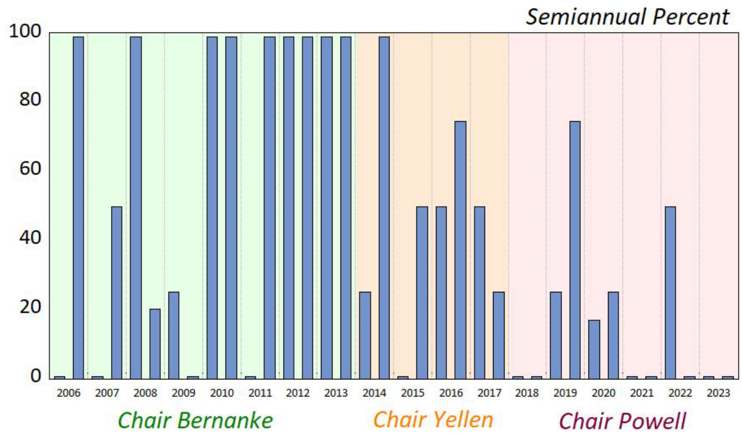
89 Federal Reserve Act, section 4(4): "To appoint by its board of directors a president [and other officers]...and to dismiss at pleasure such officers." The Fed Board's authority to suspend or dismiss Fed Bank officers is stated in Federal Reserve Act, section 11(f).

90 This process is described on the Fed Board's website in an FAQ on "How is a Federal Reserve Bank President Selected?" *See* Board of Governors of the Federal Reserve System, *How is a Federal Reserve Bank President Selected?*, Bd. Gov. Fed. Rsrv. Sys (Jan. 25, 2016), https://www.federalreserve.gov/faqs/how-is-a-federal-reserve-bank-president-selected.htm [https://perma.cc/733U-RF3E]..

91 In an online symposium hosted by the Yale Journal on Regulation, Daniel Hemel noted: "As a practical matter, the [Fed] governors can disapprove every nominee until the directors send them someone they like." *See* Daniel Hemel, *Maybe the Federal Reserve Banks are Constitutional After All*, YALE J. REG. (Apr. 4, 2016), https://www.yalejreg.com/nc/maybe-the-federal-reserve-banks-are-constitutional-after-all-by-daniel-hemel/ [https://perma.cc/NS3R-AGTN].

92 See supra note. 23 at 11.

Figure 2: FOMC Meetings with Dissents, 2006-2023



Note: For each semiannual period from 2006 to 2023, this figure shows the proportion of FOMC meetings (in percent) at which any member(s) cast dissenting votes. *Source*: Federal Reserve Bank of St. Louis, authors' calculations.

Therefore, OLC concluded that Fed Bank presidents "are subordinates of the Board of Governors"—a conclusion contrary to the intent of Congress.[93]

In recent years, these patterns appear to have been consequential for the selection of Fed Bank presidents and the FOMC's decision-making. In prior decades, recognized experts in monetary economics and macroeconomics were frequently appointed as Fed Bank presidents, made notable contributions to the FOMC's deliberations, and cast dissents whenever they disagreed with its decisions, whereas there have been no such appointments over the past decade.[94]

As shown in Figure 2, dissents at FOMC meetings have practically vanished in recent years. There was no dissent at all during 2021 when the FOMC remained on hold in the face of accelerating inflation. A recent paper coauthored by former Fed Vice Chair Donald Kohn highlighted the recent lack of dissent as "raising questions about whether Committee discussions and decisions were being sufficiently challenged by diverse viewpoints."[95]

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93 See *ibid.* at 9. This conclusion reflected OLC's assessment of the Fed Board's influence in the selection of Fed Bank presidents, scope of control over their budgets and operations, and ability to remove them for any reason.

94 See Jeffrey M. Lacker, Governance and Diversity at the Federal Reserve, Remarks at the Mercatus Center Conference: The Legacy of Bennett McCallum and Lessons for Monetary Policy Today (Oct. 10, 2023).

95 Gauti B. Eggertsson and Donald Kohn, *The Inflation Surge of the 2020s: The Role of Monetary Policy*, 87 (Hutchins Ctr., Working Paper #87, 2023).

C. Monetary Policy Reports to Congress

When Congress reconstituted the FOMC in 1935, the Fed's Board of Governors was directed to "keep a complete record" of the FOMC's policy actions, including "the votes taken . . . and the reasons underlying the actions" and to publish that record in its annual report.[96] Thus, over the next four decades, the Federal Reserve Board's annual report included a very brief "Record of Policy Action" from each of the prior year's FOMC meetings, with a synopsis of the committee's discussion, the text of its policy directive to the New York Fed, and the tally of its vote on that directive.[97]

By the mid-1960s, however, members of Congress were becoming increasingly discontented with the Fed's lack of transparency.[98] That sentiment was subsequently magnified by worsening inflation and the Fed's stop-go policy actions.[99] Indeed, by the 1970s legislators were concluding that the absence of reporting requirements was facilitating "myopia in the conduct of monetary policy."[100]

Thus, in 1975 Congress adopted a joint resolution urging the Fed to start providing regular reports about its "objectives and plans with respect to the ranges of growth or diminution of monetary and credit aggregates in the upcoming twelve months."[101] That language was incorporated into formal reporting requirements in the Federal Reserve Reform Act of 1977.[102] A year later, the Humphrey-Hawkins Act initiated a semiannual process of reports and congressional hearings: At the start of each year, the Fed would report on its objectives and plans for the current year, and then midway through the

96 Banking Act of 1935, §203(d).

97 *See* Board of Governors of the Federal Reserve System, *Annual Report of the Board of Governors of the Federal Reserve System,* Bd. Gov. Fed. Rsrv. Sys., https://fraser.stlouisfed.org/title/annual-report-board-governors-federal-reserve-system-117?browse=1910s (listing annual reports from 1914 and onwards).

98 For example, at a congressional hearing in 1964, Rep. Riohard Hanna suggested that "establishing more responsible directives from Congress to the Board of Governors requesting some kind of responsive reporting." *Supra* note 67 at 1347.

99 Andrew T. Levin and John B. Taylor, *Falling Behind the Curve: A Positive Analysis of Stop-Start Monetary Policies and the Great Inflation*, in MICHAEL D. BORDO & ATHANASIOS ORPHANIDES, THE GREAT INFLATION: THE REBIRTH OF MODERN CENTRAL BANKING (2013).

100 Robert E. Weintraub, *Congressional Supervision of Monetary Policy,* 4 J. MONETARY ECON. 341, 343 (1978) (recounting congressional deliberations and concluding: "Congress weakened its own hand in supervising monetary policy and strengthened the hand of the Executive.")

101 Senate Concurrent Resolution 18 and House Concurrent Resolution 133.

102 This Act added Section 2A to the Federal Reserve Act, setting forth the FOMC's mandated objectives as well as these new reporting requirements. (P.L. 95-188, §202)

year it would provide its initial projections for the following calendar year.[103] The relevant portion of that statute concluded as follows:

> Nothing in this Act shall be interpreted to require that [these] objectives and plans...be achieved if the Board of Governors and the FOMC determine that they cannot or should not be achieved because of changing conditions, provided that...the Board of Governors shall include an explanation of the reasons for any revisions to or deviations from such objectives and plans.[104]

Over subsequent years the FOMC succeeded in restoring price stability in a context of robust economic growth and employment, leading to an era known as the "Great Moderation" that endured until the financial crisis of 2008.[105]

During the 1990s, in the face of unpredictable swings in money demand, the Fed shifted away from targeting monetary aggregates and refocused on using the target federal funds rate as the primary tool of monetary policy. Consequently, the Fed's projections of monetary aggregates became practically irrelevant in its semiannual reports and congressional testimony. In principle, legislators could have responded to those developments by revising the reporting requirements and directing the Fed to explain its "objectives and plans" in terms of its strategy for setting the target federal funds rate, perhaps using simple benchmarks such as the Taylor Rule.[106]

In fact, however, the Fed's reporting requirements were practically eliminated by an omnibus bill at the end of the year 2000.[107] Thus, under current law the Fed's semiannual reports to Congress are simply required to contain "a discussion of the conduct of monetary policy and economic developments and prospects for the future."[108] In effect, the Fed has been permitted to revert to the same opacity that had been in place prior to 1977.

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103 P.L. 95-523, §108(a).

104 *Ibid*.

105 See Shaghil Ahmed et al, *Recent U.S. Macroeconomic Stability: Good Policies, Good Practices, or Good Luck*, 86 REV. ECON. & STAT. 824 (2004)

106 See John B. Taylor, *Discretion Versus Policy Rules in Practice*, 39 CARNEGIE-ROCHESTER CONF. SERIES PUB. POL'Y 195 (1993)(showing that the federal funds rate was broadly consistent with the Taylor Rule in the early years of the Great Moderation).

107 The American Homeownership and Economic Opportunity Act (enacted on December 27, 2000) eliminated the Humphrey-Hawkins reporting requirements (P.L. 106-569, §1003).

108 Federal Reserve Act, § 2B.

This Part has broadly discussed the breadth of Congress's delegation of its power and duty to regulate the value of money to the FOMC, while detailing the pathologies of chronic undersight of the exercise of that delegated power. It bears emphasizing that this aspect of undersight is particularly problematic in light of the absence of any judicial reviews of FOMC actions —checks and balances that are in place for the administrative actions of every other independent agency.

The federal courts have consistently demurred from ruling on issues related to the Fed's monetary policymaking on grounds that monetary policy is non-justiciable as a political question reserved to Congress. For example, in *Bryan v. FOMC*, the district court held that the plaintiff's "complaint and views on the monetary policy of the United States may properly be presented to Congress" and hence not justiciable.[109] The inclination towards judicial deference on monetary policymaking has been reinforced by the complexity and fluidity of economic and financial conditions. In 1929, the Second Circuit stated that judicial review of the Federal Reserve's setting of discount rates would be "grotesque, when we remember that conditions in the money market often change from hour to hour."[110] The D.C. District Court reached a parallel conclusion in 1985:

> [I]n light of the complexity of the modern economy, it is also highly uncertain whether and to what extent such policies were responsible for the adverse economic conditions that allegedly resulted in harm to the appellants...We think that courts lack both the competence and the authority to determine such abstract issues, which are better addressed through political and economic debate over the role of monetary policy in the national economy.[111]

Thus, as the federal courts have deferred to Congress on these issues, persistent congressional undersight has resulted in a stark lack of public accountability for the Fed's monetary policy decisions.[112]

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[109] Bryan v. Federal Open Market Committee, 235 F. Supp. 877 (1964).

[110] Raichle v. Federal Reserve Bank of New York, 34 F.2d 910, 915 (1929).

[111] Comm. for Monetary Reform v. Bd. of Governors of the Fed. Reserve Sys., 766 F.2d 538, 542 (D.C. Cir. 1985).

[112] The federal courts have also refrained from ruing on the Federal Reserve's governance structure. [citations]. They have also consistently treated reserve banks as private financial institutions, or "hybrid entities," with the result of exempting reserve banks from key statutory transparency requirements, like the Freedom of Information Act (FOIA) that are applicable to other federal agencies. [citations]

II. FISCAL DELEGATION TO THE FED

Having examined how Congress has delegated its coinage power to the Fed, we now consider how Congress has granted the Fed extraordinary fiscal powers while exempting it from the modes of fiscal oversight that are in place for every other major independent agency.

Under the Constitution, Congress is responsible for appropriating all public funds and authorizing all public debt. Specifically, Article 1 states that "No money shall be drawn from the Treasury, but in consequence of appropriations made by law . . . ." and vests Congress with the sole authority to "borrow money on the credit of the United States."[113] Commonly, these provisions are referred to as Congress's "power of the purse," because together they provide that no public money can be spent or borrowed without congressional authorization.[114]

Congress has allowed the Fed to use the nation's purse with practically no oversight at all. The Fed funds itself using its authority to issue legal tender, but unlike other independent agencies with external funding sources, the Fed is exempt from the congressional appropriations process. Moreover, the Fed has authority to issue interest-bearing liabilities, but those liabilities are not subject to the federal debt ceiling set by Congress. The Fed sets its own accounting rules rather than following generally accepted accounting procedures (GAAP). And the Fed's monetary policy programs and operations are exempted from scrutiny by the GAO or a fully independent

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[113] U.S. CONST., Art. 1, § 9, cl.7 and § 8, cl. 2, respectively. James Madison wrote: "When Congress exercises the power of the purse, it can reduce all the overgrown prerogatives of the other branches of government." (*Federalist No. 58*) The Appropriations Clause has been described as "a bulwark of the Constitution's separation of powers" that gives Congress "exclusive power over the federal purse." U.S. Department of the Navy v. FLRA, 665 F.3d 1339, 1346-47 (D.C. Cir. 2012) (Kavanaugh, J.).

[114] Over the years, Congress has developed a vast array of statutes to invigorate or plug holes in its power of the purse. Notable examples include the prohibition on agencies spending funds in advance or excess of an appropriation and the requirement that they remit all funds received, from any source, to the U.S. Treasury. Anti-deficiency Act, Miscellaneous Receipts Act]. The bulk of this law is found in Title 31 of the U.S. Code. As the GAO has explained, these statutes "did not spring up overnight, but have evolved over the span of more than two centuries. Nevertheless, when viewed as a whole, they form a logical framework that governs the collection and use of public money." *See* GOV. ACCOUNTABILITY OFFICE, PRINCIPLES OF FEDERAL APPROPRIATIONS LAW, Ch. 1, at 13 (Mar. 2016) [hereinafter, GAO, CH. 1, PRINCIPLES OF FEDERAL APPROPRIATIONS LAW]. As Kate Stith has argued: "In specifying the activities on which public funds may be spent, the legislature defines the contours of the federal government." Kate Stith, *Congress' Power of the Purse*, 97 YALE L.J. 1343, 1344 - 1345 (1988)..

IG. As such, the Fed is the only federal entity or agency to exercise the purse strings without any meaningful congressional oversight.

A. The Fed's External Funding

When the Fed was established in 1913, Congress endowed it with the authority to issue paper currency as legal tender.[115] Legislators were fully aware that this authority would be extraordinarily valuable, because cash is not interest-bearing: As the amount of currency in circulation expanded over time, the Fed would accumulate a corresponding amount of interest-bearing assets while owing no interest whatsoever on its liabilities of paper currency.

Thus, Congress anticipated that the Fed's profits would substantially exceed the amount needed to cover its own operating expenses. The Federal Reserve Act of 1913 directed the Fed to issue dividends at a fixed rate of 6% on the paid-in capital contributed by its member banks and to build up a surplus fund proportional to its paid-in capital.[116] Apart from those specific provisions, the Act stated that all of the Fed's net earnings "shall be paid to the United States as a franchise tax."[117] The Federal Reserve Act exempts the Federal Reserve Banks from all other taxation except for taxes on real estate.[118]

In effect, the stream of profits from issuing paper currency belongs to the United States, not to the Fed. Congress has designated the Fed to serve as the conservator for this public trust, with a fiduciary duty to ensure that those profits are not spent wastefully but are instead remitted to the U.S. Treasury for the benefit of the general public.[119]

For most of the Fed's history, Congress expected that the Fed's profits would be treated as such. For example, when the FDIC was created in 1933, Congress directed the Fed to transfer one-half of its accumulated surplus

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[115] The Coinage Act of 1965 states that Federal reserve notes "are legal tender for all debts, public charges, taxes and dues." (31 U.S.C. § 510) See also supra note 47 and note 55.

[116] The FAST Act of 2015 amended section 7 of the Federal Reserve Act by specifying that the dividend rate paid to large banks (total assets exceeding $10 billion) would be the 10-year Treasury bond yield whenever that yield is less than 6%. (P.L. 114-94, sec. 33203(a).)

[117] Federal Reserve Act of 1913, sec. 7. The characterization of payments as a "franchise tax" reflected the fact that the Federal Reserve Banks are chartered as private institutions. This provision capped the surplus fund of each Federal Reserve Bank at 40% of its paid-in capital. In 1919 Congress amended it and authorized each Fed Bank to retain all of its net earnings until its surplus fund reached 100% of subscribed capital (which was 2x larger than paid-in capital) and to retain 10% of its net earnings thereafter. (P.L. 65-329, ch. 101)

[118] Federal Reserve Act, sec. 7(c).

[119] *Supra* Stith note 114. ("All funds belonging to the United States . . . are public monies, subject to public control and accountability.")

(equivalent to about 0.25% of GDP) to serve as the FDIC's initial working capital.[120] At that time, Congress suspended the Fed's franchise tax payments to the Treasury, thereby enabling the Fed to gradually replenish its surplus fund.[121]

In 1947, the Fed resumed remitting all of its net earnings once its surplus fund had reached 100% of subscribed capital.[122] From 1947 to 2014, these remittances to the U.S. Treasury were recorded in the Fed's accounts as "interest payments on Federal Reserve notes."[123] As stated in the Federal Reserve Board's annual report to Congress in 1947:

> the Board concluded that it would be appropriate for the Federal Reserve Banks to pay to the Treasury the bulk of their net earnings after providing for necessary expenses and the statutory dividend. . . . By invoking its authority under Section 16 of the Federal Reserve Act, the Board is able to accomplish the same results as were accomplished by the payment of a franchise tax, i. e., the transfer of excess earnings to the U.S. Government. The payments can thus be reflected in current revenues and taken into account in the Government's budget without further legislation.[124]

In the early 1960s, the Fed revisited its operating framework and concluded that it could downsize its surplus fund to match the amount of paid-in capital rather than subscribed capital.[125] Thus, in 1964 the Fed initiated a one-time transfer to the Treasury of nearly $500 million in addition

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120 As instructed in section 12B(d) of the Banking Act of 1933, in January 1934 the Fed transferred $139,299,557 to the FDIC and received the same nominal amount of FDIC Class B shares. However, that class of FDIC shares was non-marketable and accrued no dividends, and hence the acquisition of those shares was never recorded as an asset on the Federal Reserve's books. See 21FED. RSRV. BD. ANN. REP. 93 (1934).

121 *Id.* § 4. *See also* 20 FED. RSRV. BD. ANN. REP. 41 (1933).

122 As of December 31, 1946, the Fed's combined surplus was about $440 million while its subscribed capital was about $374 million. See 34 FED. RSRV. BD. ANN. REP. 41 (1948).

123 Section 3002 of the Omnibus Budget Reconciliation Act of 1993 included specific instructions regarding the Fed's remittances in fiscal years 1996 and 1997, and hence those remittances appear in the Fed's accounts as "statutory payments." See 80 FED. RSRV. BD. ANN. REP. (1993). Likewise, the Comprehensive Appropriations Act of 1999 included specific instructions regarding the Fed's remittances in fiscal year 2000 (Title III, sec. 302), and hence the Fed's accounts also categorize those remittances as "statutory payments."

124 34 FED. RSRV. BD. ANN. REP. 84 (1947).

125 "After examination of the attendant circumstances, including the risks to which operations of the Federal Reserve Banks were currently subject, the Board concluded that the maintenance of surplus accounts of Federal Reserve Banks at an amount equal to their paid-in capital would be adequate." 51 FED. RSRV. BD. ANN. REP. 49-50 (1965)

to its regular annual payment of $1.1 billion in interest earned on Federal Reserve notes.[126]

In the 1990s, Congress passed two appropriations bills that specified the Fed's remittances for fiscal years 1997, 1998, and 2000.[127] In 2015, Congress enacted a transportation act which included a provision capping the Fed's surplus at $10 billion, with the effect that the Fed made a one-time transfer of $19.9 billion from its surplus account to the U.S. Treasury.[128] In a pair of appropriation bills passed in 2018, Congress reduced the Fed's surplus cap to about $6.8 billion, resulting in the transfer of about $3.2 billion to the Treasury.[129]

Figure 3 shows the evolution of the Fed's remittances over the past six decades, gauged in proportion to the overall size of the U.S. economy.[130] From 1960 to 2008, the Fed's remittances ranged from about 0.2% to 0.4% of nominal GDP. Those variations reflected changes in the level of interest rates and in the composition of money demand. For example, a rising amount of U.S. paper currency was shipped overseas, reflecting its role as a safe and liquid asset in countries facing turbulent political and economic

[126] The surplus fund stood at $990 million in December 1963 and was reduced to $524 million at the end of 1964. Ibid, 223.

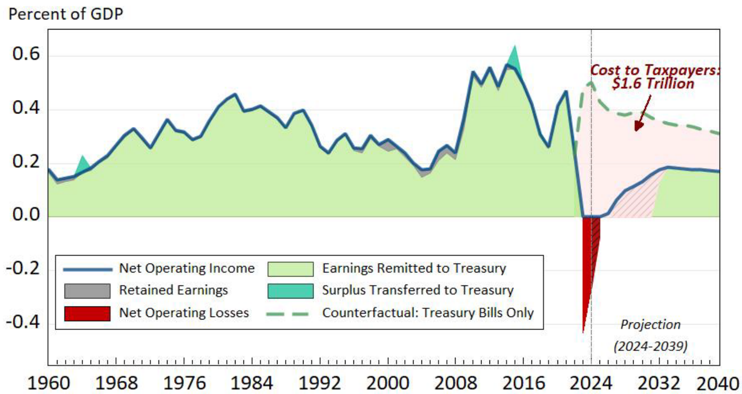
[127] The Omnibus Budget Reconciliation Act of 1993 specified the Fed's remittances for FY1997 and FY1998. *(P.L. 103-66, section 3002)* The Fed's remittances for FY2000 were specified in an omnibus appropriations bill enacted on November 29, 1999. (P.L. 106-113, Appendix E, section 302).

[128] Fixing America's Surface Transportation (FAST) Act of 2015 (P.L. 114-94, sec. 33202). The transfer of $19.9 billion to the U.S. Treasury is reported in the Federal Reserve Board's 102 annual report. *See* 102 FED. RSRV. BD. ANN. REP. 104 (2015)

[129] In February 2018, Congress enacted the Bipartisan Budget Act, which reduced the Fed's surplus cap from $10 billion to $7.5 billion (P.L. 115-123, sec. 30205). A few months later, in May 2018, the Economic Growth, Regulatory Relief, and Consumer Protection Act reduced the cap to $6.825 billion. (P.L. 115-174, sec. 217). In January 2021, the National Defense Authorization Act made a further reduction of $40 million. (P.L. 116-283, sec.6510)

[130] Gauging the Fed's remittances in terms of GDP is appropriate because the U.S. economy has grown markedly over the past six decades: Nominal GDP was about $540 billion in 1960 and is now approaching $27 trillion.

Figure 3: Federal Reserve Remittances to the U.S. Treasury



Note: This figure shows the total value and composition of the Federal Reserve's annual remittances to the U.S. Treasury as a percent of nominal GDP, using actual data for 1960 to 2023 and projections for 2024 to 2039. *Sources*: Federal Reserve Board (remittance data), Bureau of Economic Analysis (nominal GDP data), and the authors' projections.

conditions.[131] Moreover, the quantity of required reserves held at the Fed (which paid no interest until 2008) evolved in proportion to the amount of checkable funds held at depository institutions.

In the wake of the global financial crisis, the Fed's remittances increased sharply to around 0.5% of GDP from 2009 to 2015 before subsiding back to more normal levels over the rest of that decade.[132] This surge in remittances partly reflected a huge increase in demand for U.S. currency, which roughly doubled from about $800 billion in 2007 to around $1.5 billion in 2016.[133] The Fed's net earnings were also boosted by the differential between the yields accruing on its securities holdings and the interest rate paid on its reserves.

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131 Research by Fed economists has indicated that more than half of U.S. currency in circulation is held abroad; see Ruth Judson & Richard Porter, *Currency Demand by Federal Reserve Cash Office: What Do We Know?*, 56 J. ECON & BUS. 273 (2004).

132 *See* Miguel Faria e Castro & Samuel Jordan-Wood, *The Fed's Remittances to the Treasury: Explaining the 'Deferred Asset'*, FED. RSRV. BANK ST. LOUIS (Nov. 21, 2023), https://www.stlouisfed.org/on-the-economy/2023/nov/fed-remittances-treasury-explaining-deferred-asset [https://perma.cc/3KBA-KSFR].

133 Board of Governors of the Federal Reserve System, *Factors Affecting Reserve Balances*, BD. GOV. FED. RSRV. SYS. (Nov. 24, 2023), https://www.federalreserve.gov/releases/h41/ [https://perma.cc/Z36F-SQZH].

That pattern has been reversed more recently: The Fed's net interest income turned sharply negative in 2022, and it is now projected to incur very large

Table 1: Independent Agencies with External Funding

Agency Name	**Operating Expenses** ***($ millions)***	**Government Appropriations** ***(percent)***	**External Funding Sources**
Federal Reserve System	118,476	NA	seigniorage, fees on large banks
Federal Deposit Insurance Corporation	33,637	0.1	fees on member banks
Federal Communications Commission	20,200	11.1	spectrum auctions, regulatory fees
Securities & Exchange Commission	2,515	1.6	regulatory fees
Office of the Comptroller of the Currency	1,269	0	fees on national banks
Nuclear Regulatory Commission	947	13.0	fees on regulated entities
Consumer Financial Protection Bureau	637	0	transfers from Federal Reserve
Federal Trade Commission	526	35.4	merger application fees
Federal Housing Finance Administration	457	11.4	fees on regulated entities
Fed. Retirement Thrift Investment Board	457	0	fees on employee plans
Commodity Futures Trading Commission	419	72.3	regulatory fees
National Credit Union Administration	393	0	fees on credit unions
Farm Credit Administration	90	0	fees on regulated entities
Japan-U.S. Friendship Commission	3	0	proceeds from trust fund

Note: Data on operating expenses is tabulated using estimated gross outlays and budgeted appropriations (excluding external funding sources) for FY2024 as published by the Office of Management and Budget, *Budget of the U.S. Government, Fiscal Year 2024*. The FDIC's Office of Inspector General is funded by congressional appropriations; the table excludes all other federally-chartered corporations, nonprofit institutions, and federally-funded R&D centers. The table also excludes limited-purpose trust funds as follows: CFTC, Customer Protection Fund; FDIC, Federal Savings & Loan Resolution Fund; NCUA, Credit Union Share Insurance Fund; SEC, Investor Protection Fund and Reserve Fund.

operating losses over coming years—an outcome that merits substantial attention. How could this happen?

B. The Fed's Exemption from the Appropriations Process

With the sole exception of the Fed, the outlays of every federal department and agency are included in the annual budget that the White House submits to Congress for its approval.[134] This appropriations process "grants agencies authority to enter into financial obligations that will result in immediate or future outlays of government funds."[135] As the Government Accountability Office (GAO) explains:

> Appropriations law is not only about ensuring that federal agencies follow a set of rules that Congress has enacted. These laws also help ensure that government carries out the will of, and remains accountable to, the American people.[136]

Table 1 lists all independent agencies whose outlays are partially or fully covered by external sources. Nearly all of these agencies are funded by assessments and fees on regulated entities, and hence their outlays are naturally scrutinized by those entities in addition to being reviewed by the administration and approved by Congress.[137] In fact, the Fed itself charges fees on large banks to cover the costs of its supervision and regulation of those entities, but those fees comprise only a tiny portion of its total income and outlays.[138] One notable departure from these practices is the Consumer

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[134] OFF. OF MGMT & BUDGET, BUDGET OF THE UNITED STATES – FISCAL YEAR 2024 (2023). The federal budget also includes other federally-created entities, such as regional commissions and the U.S. Postal Service, that receive congressionally-appropriated funds.

[135] GOV. ACCOUNTABILITY OFFICE, PRINCIPLES OF FEDERAL APPROPRIATIONS LAW, Ch. 2, at 2-3 (Mar. 2016). [hereinafter GAO, LEGAL FRAMEWORK]

[136] GAO, CH. 1, PRINCIPLES OF FEDERAL APPROPRIATIONS LAW, *supra* note 114, at 9. Indeed, GAO explains that "This body of law gives flesh and force to one of the key pillars of democracy that the framers incorporated in the Constitution."

[137] Various scholars have remarked upon the independent financial regulators' self-funding structure. *See, e.g.*, Lisa Schultz Bressman & Robert B. Thompson, *The Future of Agency Independence*, 63 VAND. L. REV. 599, 611 (2010); Anne Joseph O'Connell, *Bureaucracy at the Boundary*, 162 U. PA. L. REV. 841, 920 n.446 (2014); David Zaring, *The Corporatist Foundations of Financial Regulation*, 108 IOWA L. REV. 1303, at 1321, 22 (2023).

[138] *See* Board of Governors of the Federal Reserve System, *Supervisory Assessment Fees*, BD. GOV. FED. RSRV. SYS. (Dec. 2, 2020), https://www.federalreserve.gov/supervisionreg/supervisory-assessment-fees.htm [https://perma.cc/K5UH-EK7L]

Financial Protection Bureau, which collects no fees and is fully funded by transfers from the Fed.[139]

The Fed's exemption from the federal budget is particularly remarkable because this omission seems to be directly at odds with the expressed intent of Congress.[140] The Budget and Accounting Act of 1921 specifically stated that the federal budget encompasses every "executive department, independent commission, board, bureau, office, agency, or other establishment of the Government."[141]

To eliminate any potential ambiguities in the wake of the *Humphrey's Executor* decision, this Act was amended in 1939 to include "any independent regulatory commission or board."[142] In remarks on the House floor, a member of the Select Committee on Governmental Organization explained the measure as follows:

> some of these agencies . . . shrugged their shoulders and said "We are not under any budgetary control," quoting that case [of *Humphrey's Executor*] . . . Now, all that title II does is to bring every single, solitary one of them under Budget control, and I believe everybody in this House favors that.[143]

The Federal Reserve's Board of Governors was specifically listed among the agencies covered by that legislation.[144] Nonetheless, the Fed's outlays and receipts have never been incorporated into the federal budget.

In effect, the Fed has received an implicit exemption from this statute, and that inconsistency would not be justiciable for the reasons noted above in Part I.[145] Of course, such exemptions are commonplace for many other types of federally-created entities, including public corporations such as

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139 *Funds Transfer Requests*, CONSUMER FIN. PROT. BUREAU, https://www.consumerfinance.gov/about-us/budget-strategy/funds-transfer-requests/ [https://perma.cc/S84B-466E]

140 See GAO, CH. 1, PRINCIPLES OF FEDERAL APPROPRIATIONS LAW, *supra* note 114, at 6 (explaining that "any government obligation or expenditure whatsoever—whether it is derived from the general fund [of Treasury], from fees arising from the government's business-like activities, or from any other source—may be made only as authorized by an appropriation").

141 Budget and Accounting Act of 1921 (P.L. 67-13, Title I, sec. 2.) This clause specifically exempted "the legislative branch of the U.S. Government and the Supreme Court."

142 Reorganization Act of 1939 (P.L. 53-19, Title II.)

143 CONGRESSIONAL RECORD 84:2315 (1939). *See also* Peter L. Strauss, *The Place of Agencies in Government: Separation of Powers and the Fourth Branch*, 84 COLUM. L. REV. 573 (1984).

144 Reorganization Act of 1939 (P.L. 53-19, Title I, part I, sec. 3(b)).

145 Paul R. Verkuil, *Jawboning Administrative Agencies: Ex Parte Contacts by the White House*, 80 COLUM. L. REV. 963 (1980) (observing that Congress has the authority to withdraw agencies from OMB jurisdiction).

Amtrak, non-profit institutions such as the American Red Cross, and federally-funded research centers such as the Jet Propulsion Lab.[146] But as a major economic policymaking agency with a gargantuan balance sheet, the Federal Reserve is utterly different from any of those federally-created entities.

C. The Fed's Exemption from the Federal Debt Ceiling

The Congressional Budget Act broadly requires that any "new authority to incur indebtedness for the repayment of which the United States is liable" be limited to amounts that have been specified in an appropriations bill.[147] Moreover, the GAO has recommended that "borrowing authority be provided only to those accounts that can generate enough revenue in the form of collections from non-federal sources to repay their debt."[148]

Since 2008, however, the Fed has been issuing huge amounts of interest-bearing liabilities, and such issuance has not been constrained by the plain meaning of the Congressional Budget Act or the specific recommendations of GAO. In effect, the Fed is using excess reserves and reverse repos to borrow trillions of dollars directly from the public, and it is doing so without any specific congressional authorization.

When the Fed was established in 1913, Congress took specific steps to ensure its financial soundness. As "banker to the banks," the Fed would hold the reserves of its member banks and provide them with liquidity through the discount window. But the original Federal Reserve Act tasked the Federal Reserve Board with ensuring that such lending would not incur substantial losses and would diminish rapidly once financial strains subsided.[149] The Fed was also authorized to engage in open market transactions of U.S.

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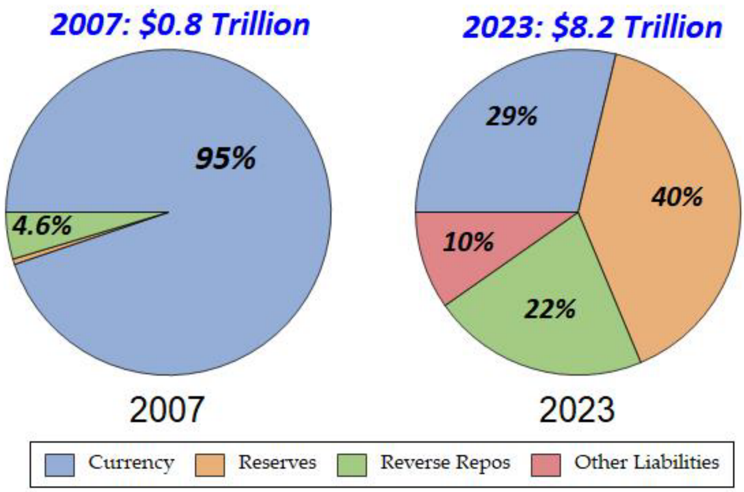
146 *See* GOV. ACCOUNTABILITY OFFICE, FEDERALLY CREATED ENTITIES: AN OVERVIEW OF KEY ATTRIBUTES 1, appx. II (Oct. 2009)

147 21 U.S.C. § 651. Indebtedness incurred under chapter 13 of title 31 is excepted. *See* 31 U.S.C. Ch. 13,. GAO analysis indicates that Congress can delegate its constitutional borrowing authority to a federal entity "through the issuance of promissory notes or other monetary credits." *See* GAO, LEGAL FRAMEWORK, *supra* note135, at 2.

148 *Id.* at 2-3.

149 Section 13 of the Federal Reserve Act of 1913 specified that the Federal Reserve Banks could engage in discount lending for maturities up to 90 days, with eligible forms of collateral to be determined by the Federal Reserve Board. Such provisions were broadly consistent with the longstanding central banking practices described by Walter Bagehot. *See* WALTER BAGEHOT, A DESCRIPTION OF THE MONEY MARKET (1873).

Figure 4: The Federal Reserve's Liabilities



Note: This figure shows the total amount and composition of the Federal Reserve's liabilities in December 2007 (left panel) and June 2023 (right panel). *Source*: Federal Reserve System Audited Statements (2007), Unaudited Statements (2023:Q2).

government securities as well as bills of exchange backed by such securities, with the aim of fostering the growth and stability of those markets.[150]

Thus, over subsequent decades the Fed's balance sheet was viewed as practically risk-free and its capital and surplus as merely a formality.[151] The Fed's holdings of interest-bearing government securities expanded in parallel with its issuance of non-interest-bearing paper currency, and hence the Fed was assured of a growing stream of positive net income.

Indeed, that characterization remained broadly accurate as of 2007. As shown in Figure 4, the Fed's balance sheet was about $800 billion, and paper currency accounted for 95% of its liabilities. By mid-2023, the balance sheet had expanded by a factor of 10 to around $8 trillion, with interest-bearing

150 "Any Federal Reserve Bank may, under rules and regulations prescribed by the Federal Reserve Board, purchase and sell in the open market...bills of exchange of the kinds and maturities by this Act made eligible for rediscount." Federal Reserve Act of 1913, section 14 ("Open Market Operations").

151 At the end of 2007, the Fed's paid-in capital and surplus stood at $37 billion, roughly 4% of its total assets of $915 billion. Board of Governors of the Federal Reserve System, Federal Reserve System Audits, BD. GOV. FED. RSRV. SYS. (July 18, 2008), https://www.federalreserve.gov/boarddocs/rptcongress/annual07/sec6/c2.htm [https://perma.cc/9XH3-LH3H]

bank reserves and reverse repos now comprising nearly two-thirds of its total liabilities. Indeed, the ability to issue practically unlimited amounts of interest-bearing liabilities has made the Fed "super-independent."[152]

Interest-Bearing Reserves. From the early 1950s until 2007, bank reserves comprised a small portion of the Fed's liabilities but played a crucial role in implementing monetary policy.[153] Throughout that period, bank reserves accrued no interest (just like paper currency), thereby incentivizing depository institutions to meet biweekly average reserve requirements while keeping only a minimum amount of excess reserves at the Fed.[154] After all, the opportunity cost of excess reserves was the foregone interest that banks could earn by lending out those funds or investing them in securities.

In 2006, Congress granted the Fed authority to begin paying interest on reserves (IOR) starting in 2011.[155] Legislators were swayed by the argument that requiring banks to hold non-interest-bearing balances at the central bank was imposing a tax on bank deposits and incentivizing disintermediation to the non-bank financial sector (the so-called "shadow banking" system).[156] What Congress surely did not anticipate was that granting IOR would

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152 See Juliana B. Bolzani, *Independent Central Banks and Independent Agencies: Is the Fed Super Independent?*, 22 U.C. DAVIS BUS. L. J. 195 (2022).

153 When reserve balances were "scarce," so to speak, the Fed could use relatively small adjustments in their supply to affect the Federal funds rate. By increasing the supply of bank reserves, it would lower the federal funds rate (the rate at which banks lend to one other in the overnight market, and affects other short-term interest rates in the broader economy). The inverse also applied—the reducing reserves, the Fed would make credit conditions tighter and push up the interest rates. For a basic explanation, see, for example, Ben S. Bernanke & Donald Kohn, *The Fed's Interest Payments to* Banks, BROOKINGS (Feb. 16, 2016), https://www.brookings.edu/articles/the-feds-interest-payments-to-banks/ [https://perma.cc/3HUF-WRH5]

154 Such an argument can be derived from George Tolley and Milton Friedman, who first argued that opportunity costs of banks holding reserves should be driven to zero. One way to satisfy this efficiency condition is for the central bank to pay interest on required reserves. *See* Peter Ireland, *Interest on Reserves: History and Rationale, Complications and Risks*, CATO J. (2019), https://www.cato.org/cato-journal/spring/summer-2019/interest-reserves-history-rationale-complications-risks [https://perma.cc/ENT7-MQM2] (explaining that higher interest rate on required reserves would "permit the Federal Reserve to expand its balance sheet as necessary to provide the liquidity necessary to support financial stability while implementing the monetary policy that is appropriate in light of the System's macroeconomic objectives of maximum employment and price stability".)

155 Financial Services Regulatory Relief Act of 2006 (P.L. 109-351, Title II, sec. 201).

156 The Riegle Act of 1994 directed the Fed, in conjunction with the FDIC and the NCUA, to conduct a study and report to Congress about "the appropriateness of paying a market rate of interest to depository institutions on sterile reserves" (P.L. 103-325, sec. 302).

facilitate a monumental expansion in the size and riskiness of the Fed's balance sheet.

At the onset of the financial crisis in early fall 2008, Fed officials requested authorization to start using IOR immediately, and Congress granted that authority in a brief paragraph of the 176-page bill that created the Troubled Asset Relief Program (TARP).[157] At that juncture, the Fed's emergency lending had pushed the federal funds rate well below the FOMC's target, and Fed officials indicated that IOR would be helpful in serving as a "floor" for the federal funds rate.[158] As the financial crisis intensified and spread worldwide, however, the FOMC decided to reduce the target federal funds rate close to zero – the level judged to be its effective lower bound given that currency pays zero interest.[159] At that point, it became clear that IOR was not an effective floor due to institutional factors; in fact, from December 2008 to December 2015, IOR was set at 0.25% -- the top of the FOMC's target range for the fed funds rate.[160]

In late 2008, the Fed initiated large-scale securities purchases—commonly known as "quantitative easing" (QE)—with the aim of fostering recovery of mortgage and housing markets as well as reducing borrowing costs in credit markets.[161] Over the next two quarters, the Fed purchased a

157 The Emergency Economic Stabilization Act of 2008 changed the effective date from 10/1/2011 to 10/1/2008 (P.L. 110-343, sec. 128).

158 The Fed's operating framework was characterized as a "corridor" arrangement, because day-to-day fluctuations in the federal funds rate were bounded by the "ceiling" of the primary credit rate (the rate at which banks could borrow directly from the Fed rather than from other banks) and would henceforth be bounded by the "floor" of IOR (the rate which banks could earn at the Fed rather than lending those funds to other banks).

159 Press Release, Board of Governors of the Federal Reserve System, *FOMC Statement* (Dec. 16, 2008), https://www.federalreserve.gov/newsevents/pressreleases/monetary20081216b.htm [https://perma.cc/9BMY-DTZW]

160 *Supra note* 154.

161 Press Release, Board of Governors of the Federal Reserve System, Federal Reserve announces it will initiate a program to purchase the direct obligations of housing-related government-sponsored enterprises and mortgage-backed securities backed by Fannie Mae, Freddie Mac, and Ginnie Mae (Nov. 25, 2008), https://www.federalreserve.gov/newsevents/pressreleases/monetary20081125b.htm [https://perma.cc/ADC7-2MQ5].The FOMC stated that its MBS purchases were intended to "provide greater support to mortgage lending and housing markets" while its purchases of Treasury securities were intended to "help improve conditions in private credit markets." Press Release, Board of Governors of the Federal Reserve System, FOMC Statement (Mar. 18, 2009), https://www.federalreserve.gov/newsevents/pressreleases/monetary20090318a.htm [https://perma.cc/RY6W-SUFY].

total of $1.25 trillion in mortgage-backed securities (MBS), $300 billion in longer-term Treasury securities, and $200 billion in debt securities issued by the housing-related government-sponsored enterprises (GSEs).[162]

The Fed implemented these securities purchases by expanding the amount of excess reserves of depository institutions, in effect, printing "digital money" instead of paper money. In particular, the open market desk at the New York Fed paid for each individual security by creating a corresponding book entry in the reserve account of the seller's bank. These additional reserves could migrate freely between banks, but the aggregate quantity of reserves grew far beyond the amount needed to meet the reserve requirements on bank deposits. Thus, as of March 2010 reserve balances stood at $1.1 trillion, more than 200-fold greater than at the end of 2007.[163]

At the conclusion of the QE1 program, Fed officials emphasized that IOR would play a central role in its "exit strategy" for withdrawing extraordinary monetary policy accommodation.[164] As Fed Chair Bernanke explained in a high-profile editorial in the *Wall Street Journal*:

> When the time comes to tighten policy, we can raise the rate paid on reserve balances as we increase our target for the federal funds rate… the interest rate that the Fed pays should tend to put a floor under short-term market rates . . . Raising the rate paid on reserve balances also discourages excessive growth in money or credit, because banks will not want to lend out their reserves at rates below what they can earn at the Fed.[165]

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162 *See* Press Release, Board of Governors of the Federal Reserve System, FOMC Statement (Dec. 16, 2008), https://www.federalreserve.gov/newsevents/pressreleases/monetary20081216b.htm [https://perma.cc/K86G-GJX2]; Press Release, Board of Governors of the Federal Reserve System, FOMC Statement (Jan. 28, 2009), https://www.federalreserve.gov/newsevents/pressreleases/monetary20090128a.htm [https://perma.cc/4V94-JBKV]; Press Release, Board of Governors of the Federal Reserve System, FOMC Statement (Mar. 18, 2009), https://www.federalreserve.gov/newsevents/pressreleases/monetary20090318a.htm [https://perma.cc/37VH-3VR5].

163 *Supra* note 133. By March 2010 the Fed had closed practically all of the emergency liquidity facilities that had been initiated at the onset of the financial crisis, and hence the expanded size of its balance sheet mainly reflected its QE1 purchases of longer-term securities.

164 *Federal Reserve's Exit Strategy, Hearing before the Comm. On Fin. Serv.*, 111th Cong. (2010) (statement of Ben S. Bernanke, Chairman, Bd. Gov. Fed. Rsrv. Sys.).

165 Ben Bernanke, *The Fed's Exit Strategy*, WALL ST J. (Jul. 21, 2009), https://www.wsj.com/articles/SB10001424052970203946904574300050657897992. Bernanke's editorial also noted that the Fed could reduce the quantity of reserves by expanding its reverse repo operations, issuing term deposits, or selling off some of its securities.

As it turned out, policy normalization was still a half-decade away. In 2010 and in 2012-14, the Fed initiated two more rounds of securities purchases known as QE2 and QE3 with the aim of providing additional monetary stimulus while the federal funds rate remained close to zero.[166] Thus, by the end of 2014 reserve balances stood at $2.4 trillion – twice the level at the end of QE1.[167]

Over that period, it became apparent that IOR was a "leaky" floor due to structural and institutional factors. With large amounts of excess reserves, banks practically never engaged in overnight borrowing from their peers, while nonbank institutions such as money market funds and GSEs were not authorized to hold funds directly at the Fed.[168] Moreover, overnight bank deposits are subject to an FDIC insurance fee of about 0.1%. Consequently, from 2009 onwards the federal funds market was essentially limited to transactions in which a GSE provided overnight funds to a bank, which could earn IOR on those funds and then remit a portion of the interest to the GSE.[169] Indeed, from late 2008 to 2015, the target federal funds rate had a range of 0 to 0.25%, and IOR was set at the top of that range, *not* the bottom.

Reverse Repos. An overnight repo is a form of collateralized lending in which the sale of a security is coupled with a contract to repurchase it on the following day at a specified price; the phrase "reverse repo" refers to the same transaction viewed from the standpoint of the borrower rather than the lender.[170] The Fed conducts repo operations using its statutory authority to engage in open market transactions of short-term paper secured by high-quality collateral.[171] For nearly a century, the Fed's repo transactions were

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166 *See, e.g.*, Mark Gertler and Peter Karadi, *A Framework for Analyzing Large Scale Asset Purchases as a Monetary Policy Tool*, 29 INT'L J. CENT. BANKING 5 (2013)*See also* Lowell R. Rickets, *Quantitative Easing Explained*, FED. RSRV. BANK ST. LOUIS, (Apr. 2011), https://research.stlouisfed.org/publications/page1-econ/2011/04/01/quantitative-easing-explained/

167 *Supra* note 133.

168 Financial Services Regulatory Relief Act of 2006, sec. 201.

169 *See generally* Peter Ireland, *Interest on Reserves: History and Rationale, Complications and Risks*, CATO J., (2019), https://www.cato.org/cato-journal/spring/summer-2019/interest-reserves-history-rationale-complications-risks. [https://perma.cc/K7UB-ZPE7]

170 The proceeds of the initial sale correspond to the principal amount of the loan, and the excess of the repurchase price over the initial sale price corresponds to the interest paid on the loan.

171 Section 14.1 of the Federal Reserve Act (unamended since 1913) states: "Any Federal Reserve Bank may, under rules and regulations prescribed by the Board of Governors of the Federal Reserve System, purchase and sell in the open market, at home or abroad, either from or to domestic or foreign banks, firms, corporations, or individuals, cable

focused on fostering money market liquidity while keeping its net balances close to zero to minimize its footprint in those markets.[172] For example, over the five-year period from 2003 to 2007, the Fed's average balances of repos and reverse repos were $26.7 billion and $25.6 billion, respectively.[173]

Since then, the Fed's repo operations have changed dramatically: Its repo balances have practically vanished while its reverse repo balances have expanded by 100-fold. This evolution was triggered by the recognition that the Fed would not be able to rely solely on IOR to ensure that adjustments to the target federal funds rate would be fully reflected in market rates.[174]

Thus, the Fed began taking steps to expand its capacity to drain excess reserves and ramp up its reverse repo (RRP) balances.[175] Traditionally, the New York Fed had only engaged in repo transactions with a small group of financial institutions known as "primary dealers."[176] During 2010-14, the New York Fed modified its rules to permit a wider range of counterparties, including GSEs and money market mutual funds.[177] By the end of 2014, its

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transfers and bankers' acceptances and bills of exchange of the kinds and maturities by this Act made eligible for rediscount, with or without the indorsement of a member bank."

172 In 1917, Federal Reserve Banks used repos to extend credit to member banks whose liquidity was constrained by wartime conditions; a few years later, in the 1920s, the New York Fed used repos to foster the development of markets for bankers' acceptances. *See* Kenneth D. Garbade, *The Evolution of Repo Contracting Conventions in the 1980s*, 12 ECON. POL'Y REV. 27 (2006)

173 The Federal Reserve Bank of St. Louis disseminates historical data on the Fed's repo and reverse repo balances; see generally *FRED*, FED. RSRV. BANK ST. LOUIS, https://fred.stlouisfed.org.

174 See *supra* note 185. See also Jane Ihrig et al, *Monetary Policy 101: A Primer on the Fed's Changing Approach to Policy Implementation*, FED. RSRV. BD. (2015), https://www.federalreserve.gov/econresdata/feds/2015/files/2015047pap.pdf [https://perma.cc/CN3N-FFN2]

175 Operating Policy, Federal Reserve Bank of New York, Operating Policy: Statement Regarding Counterparties for Reverse Repurchase Agreements (Mar. 8, 2010), https://www.newyorkfed.org/markets/rrppolicy/rrp_operating_policy_100308.html [https://perma.cc/8W78-95LD]

176 As of mid-October 2023, 24 financial institutions were certified as primary dealers by the New York Fed; see Press Release, Federal Reserve Bank of New York, Primary Dealers List (June 30, 2023), https://www.newyorkfed.org/newsevents/news/markets/2023/an230630p [https://perma.cc/2CSQ-999H]. These institutions facilitate the Fed's transactions in secondary markets for Treasuries and agency MBS.

177 Operating Policy, Federal Reserve Bank of New York, Operating Policy: Statement Regarding Counterparties for Reverse Repurchase Agreements (Nov. 12, 2014), https://www.newyorkfed.org/markets/RRP-Counterparty-Eligibility-Criteria.html [https://perma.cc/V8BY-PTFT]

eligible RRP counterparties had grown to encompass Fannie Mae, Freddie Mac, the Federal Home Loan Banks, and 22 money funds.[178]

The Fed's own analysis indicated that an open-ended RRP facility could have adverse consequences for market efficiency and financial stability.[179] Indeed, FOMC members expressed "concerns about a sustained expansion of the Federal Reserve's role in financial intermediation and the risk that overnight RRPs might magnify strains in short-term funding markets during periods of financial stress."[180] To mitigate those concerns, Fed officials concluded that an RRP facility should be limited and temporary, and that conclusion was expressed in the Fed's exit strategy principles in September 2014 and reiterated in its monetary policy report to Congress a few months later:

> During normalization, the Federal Reserve . . . will use an overnight reverse repurchase agreement facility only to the extent necessary and will phase it out when it is no longer needed to help control the federal funds rate.[181]

As it turned out, the RRP facility stood at around $250 billion when policy normalization was initiated in December 2015. Rather than being phased out, however, RRP balances averaged about $150 billion through the remainder of the decade.[182]

At the onset of the pandemic in March 2020, the Fed initiated a new securities purchase program (QE4) that continued through March 2022. Over that period, the Fed purchased about $4.6 trillion in Treasuries and agency

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178 Press Release, Federal Reserve Bank of New York, New York Fed releases expanded reverse repo counterparties list. (Jan. 16, 2015), https://www.newyorkfed.org/markets/rlist-150116.html [https://perma.cc/5P4R-U5PM].

179 This analysis was presented at FOMC meetings in mid-2014 and then issued as a Federal Reserve Board working paper; see Josh Frost et al, *Overnight RRP Operations as a Monetary Policy Tool: Some Design Considerations* (Fed. Rsrv. Bank N.Y., Staff Report No. 712, 2015).

180 Press Release, Board of Governors of the Federal Reserve System, Minutes of the Federal Open Market Committee, June 17-18, 2014 (Jul. 9, 2014), https://www.federalreserve.gov/newsevents/pressreleases/monetary20140709a.htm [https://perma.cc/UZ2G-6ZM9]; Press Release, Board of Governors of the Federal Reserve System, Minutes of the Federal Open Market Committee, July 29-30, 2014 (Aug. 20, 2014), https://www.federalreserve.gov/newsevents/pressreleases/monetary20140820a.htm [https://perma.cc/CE8Q-ES3U].

181 BD. GOV. FED. RSRV. SYS. MONETARY POL'Y REP. 35 (2015). *See also* Board of Governors of the Federal Reserve System, *Policy Normalization Principles and Plans*, BD. GOV. FED. RSRV. SYS. (Sept. 16, 2014), https://www.federalreserve.gov/monetarypolicy/files/fomc_policynormalization.pdf [https://perma.cc/RV7X-7T43] ,

182 Federal Reserve Bank of New York, *Reverse Repo Operations*, FED. RSRV. BANK N.Y., https://www.newyorkfed.org/markets/desk-operations/reverse-repo

MBS and funded those purchases by expanding its liabilities of excess reserves and overnight RRPs. Thus, the Fed's RRP balanced reached $1.9 trillion as of March 2022.[183] Moreover, the rationale for concerns about potential adverse consequences materialized in late 2022 and early 2023, when about $500 billion was transferred out of the banking system into the Fed's RRP facility.[184] In effect, the "leaky floor" of IOR is now being accompanied by the "spraying faucet" of the RRP facility.

D. The Fed's Exemption from Standard Accounting Practices

The Federal Reserve has been technically insolvent since March 2023, but that fact is practically invisible on its published accounts.[185] The essential reason is that the Fed is exempted from the Generally Accepted Accounting Principles (GAAP) that are followed by all other federally-created entities.

The Federal Accounting Standards Advisory Board (FASAB) is responsible for determining GAAP for all federal financial reporting entities.[186] The financial statements of these entities—including cabinet departments, offices, agencies, commissions, boards, advisory councils, and federally-chartered corporations—are incorporated into the *Financial Report*

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183 In spring 2021 the New York Fed broadened its eligibility criteria for RRP counterparties; thus, as of November 2023, the RRP facility was used by 112 money funds as well as 19 GSEs and 16 primary dealers. See Press Release, Federal Reserve Bank of New York, Operating Policy: Statement Regarding Reverse Repurchase Transaction Counterparties (Apr. 30, 2021), https://www.newyorkfed.org/markets/opolicy/operating_policy_210430 [https://perma.cc/WB8S-MJQU]; Press Release, Federal Reserve Bank of New York; *see also* Federal Reserve Bank of New York, *Reverse Repo Counterparties*, FED. RSRV. BANK N.Y. (Apr. 25, 2023), https://www.newyorkfed.org/markets/rrp_counterparties.html [https://perma.cc/ZD4M-7FSH]

184 RRP balances (excluding foreign official and international accounts) expanded from about $1.8 trillion in March 2022 to about $2.3 trillion by the end of 2022; more recently, those balances have declined to around $1.2 trillion. *Supra* note 133.

185 At the end of the first quarter of 2023, the Fed's liabilities exceeded the sum of its paid-in capital and the mark-to-market value of its assets; see Board of Governors of the Federal Reserve System, *Federal Reserve Bank Combined Financial Statements for 2023*, BD. GOV. FED. RSRV. SYS. (Nov. 17, 2023), https://www.federalreserve.gov/aboutthefed/combined-quarterly-financial-reports-unaudited.htm

186 The heads of the GAO, OMB, and Treasury Department created the FASAB in 1990 "to serve the public interest by…issuing federal financial accounting standards" and those three agencies are responsible for funding the FASAB and overseeing its work. In 1999 the American Institute of Certified Public Accountants (AICPA) recognized FASAB as the board that promulgates GAAP for federal entities. FASAB, HANDBOOK OF FED. ACCT. STANDARDS & OTHER PRONOUNCEMENTS, AS AMENDED 1 – 2 (2022))

of the United States Government.[187] In the preface to the FY2022 edition of that report, Secretary Janet Yellen stated that it "provides the American people with a comprehensive view into the nation's finances and fiscal outlook" and "demonstrates the government's steadfast commitment to accountability and transparency in managing the nation's finances."[188]

FASAB's stated objectives for federal financial reporting are to foster budget integrity, operating performance, stewardship, and control systems. In particular, FASAB states that such reporting should assist public officials in their "duty to be publicly accountable for monies raised through taxes and other means" and should help users of these reports to evaluate the services and costs of the reporting entity and "the management of its assets and liabilities."[189]

In contrast, the Fed's accounting standards are determined by the Federal Reserve Board and are not subject to any external input or review. As the Board of Governors has noted:

> Accounting principles for entities with the unique powers and responsibilities of the nation's central bank have not been formulated by accounting standard-setting bodies. The Board of Governors has developed specialized accounting principles and practices that it considers to be appropriate for the nature and function of a central bank.[190]

In 2011, the Fed quietly introduced the possibility that future interest earnings could be booked as a "deferred asset" on its financial statements. In particular, a footnote in the Federal Reserve Board's annual report stated that the book entry for *Interest on Federal Reserve notes due to U.S. Treasury* would represent a deferred asset in cases where the Reserve Banks' net earnings became insufficient to equate surplus to capital paid-in.[191]

The notion of booking unpredictable future profits as a current asset lacked any precedent among public agencies or private institutions, but the

187 As of February 2023, there were 164 federal financial reporting entities, including CFTC, FDIC, FHFA, NCUA, PBGC, and SEC; see DEP'T OF TREASURY, FINANCIAL REPORT OF THE UNITED STATES GOVERNMENT FY2022. Fannie Mae, Freddie Mac, and Amtrak were designated as "disclosure entities" while the Federal Home Loan Banks were designated as "related parties." *Ibid* at 215. Each of those federally-chartered institutions follows the standards of GAAP as determined by the Public Company Accounting Oversight Board (PCAOB).

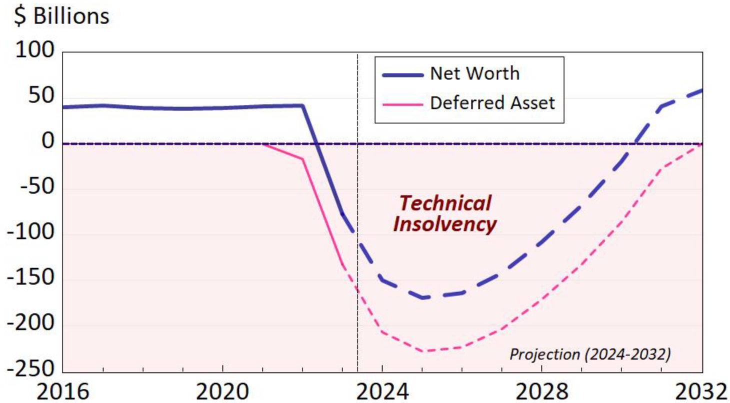
188 *Ibid*.

189 FASAB, HANDBOOK OF FED. ACCT. STANDARDS & OTHER PRONOUNCEMENTS, AS AMENDED 1 – 2 (2022)

190 BD. GOV. FED. RSRV. SYS., FIN. ACCOUNTING MANUAL FOR FED. RSRV. BANKS1 (2022).

191 BD. GOV. FED. RSRV. SYS, 97 ANN. REP. 2010, 308 (2011),,

Figure 5: The Federal Reserve's Net Worth and the "Magic Asset"



Note: This figure shows the Federal Reserve's net worth and the book entry for its deferred asset (the "magic asset"), using published data for 2012 to 2023 and projections for 2024 to 2032. *Source*: FRS Audited Statements (2012-22), FRS Unaudited Statements (2023:Q2), Federal Reserve Board (H.4.1 Release, 10/12/2023), and the authors' projections.

footnote in the Fed's report was merely raising a hypothetical scenario and hence drew no attention. Two years later, after the launch of QE3, then-Governor Jerome Powell gave public remarks that briefly noted the possibility that if the Fed's balance sheet became impaired it could incorporate "a deferred asset representing a flow of future income to be retained and not remitted to the Treasury."[192] Even at that time, the prospect of booking a deferred asset still seemed very improbable.

In the wake of its QE4 program, however, the Fed began incurring large operating losses and had become technically insolvent by the end of 2022. In 2020 and 2021, the Fed purchased huge amounts of low-yielding Treasuries and MBS and financed those asset purchases by expanding its liabilities of reserves and reverse repos. Thus, as the Fed subsequently pushed up market rates more than 5 percentage points in its fight against inflation, the interest expense on its liabilities far outstripped the interest income on its securities portfolio, and its cumulative operating losses came to exceed its paid-in capital and surplus.

As shown in Figure 5, the Fed's net worth fell below zero in March 2023 and is now projected to reach a trough of about −$200 billion over the next

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[192] Jerome Powell, "Discussion of 'Crunch Time: Fiscal Crises and the Role of Monetary Policy,'" remarks given at the U.S. Monetary Policy Forum (Feb. 22, 2013), 7.

few years. A private institution in such circumstances might well be faced with the prospect of a takeover, bankruptcy, or liquidation. By contrast, the Fed can issue an unlimited amount of legal tender, and hence all of its liabilities are effectively backed by the full faith and credit of the U.S. government.[193] Thus, the Fed's negative net worth is properly characterized as technical insolvency rather than actual insolvency.[194]

Notably, the Fed's use of a deferred asset book entry is wholly at odds with GAAP and that system's overarching goal of financial transparency:

Surplus. Under GAAP, an institution's surplus is defined as the amount by which its retained earnings exceed its paid-in capital. The surplus shrinks when the institution uses retained earnings to cover its operating expenses, and it vanishes at the point when retained earnings fall below the level of paid-in capital.[195] By contrast, the Fed's published accounting statements continue to report a surplus of $6.785 billion even though it has consumed all of its retained earnings.[196]

Deferred Assets. The phrase "deferred asset" does not appear anywhere in GAAP, which uses the term "deferred tax asset" to describe tax credits that have been earned but not yet used.[197] In contrast, the Fed's financial statements use the term "deferred asset" to characterize prospective operating profits in future years, *not* profits that have already been earned.[198]

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193 In principle, the Fed could default on its holdings of commercial banks' reserves, but such an eventuality would likely trigger a global financial crisis.

194 Technical insolvency, also known as *accounting insolvency*, refers to circumstances in which an organization's liabilities exceed the value of its assets and is distinct from circumstances of *actual insolvency* in which an organization is unable to meet its debt obligations; see Will Kenton, *Accounting Insolvency: Overview and Examples*, INVESTOPEDIA (June 30, 2021), https://www.investopedia.com/terms/a/accounting_insolvency.asp. [https://perma.cc/4EMN-J5JA]

195 Will Kenton, *What is a Surplus? Definition, Reasons, and Consequences*, INVESTOPEDIA (Aug. 29, 2023), https://www.investopedia.com/terms/s/surplus.asp [https://perma.cc/KC7M-6FEN]

196 *Federal Reserve Banks Combined Financial Statements as of and for the years ended December 31, 2022 and 2021* (April 2023), 6-7. Federal Reserve Banks Combined Quarterly Financial Report: 2023Q2 (August 2023), 2. These statements are posted at: https://www.federalreserve.gov/aboutthefed/fed-financial-statements.htm.

197 Julia Kagan, *Deferred Tax Asset: What It Is and How to Calculate and Use It, With Examples*, Investopedia (Nov. 23, 2023), https://www.investopedia.com/terms/d/deferredtaxasset.asp [https://perma.cc/6HUT-J4C9]

198 The Fed's audited financial statements simply note that "This deferred asset is periodically reviewed for impairment and no impairment existed as of December 31, 2022." See *supra* note 195, 7.

Cash Flow Projections. Under GAAP, direct loans that have been disbursed are recognized as assets at the present value of their estimated net cash inflows, and the present value is re-estimated each year taking into account "all factors that may have affected the estimated cash flows."[199] Of course, direct loans are legally binding contracts, whereas the Fed's net operating income is contingent on the outlook for interest rates, currency demand, and other factors that are difficult to predict over multi-decade horizons. At any rate, the Fed's financial statements do not include any projections of its net operating income nor assessments of uncertainty about its net cash flows.

In effect, the Fed's "deferred asset" is an accounting device that obscures the extent to which its cumulative operating losses now exceed its paid-in capital and surplus. In fact, one former Fed official has referred to this accounting device as the Fed's "magic asset" in light of its departure from fundamental accounting principles.[200]

E. The FOMC's Exemption from GAO Audits

With the sole exception of the Fed, every program of every federal department, office, and agency is audited by GAO, an independent agency that serves as the supreme audit institution of the United States.[201] GAO conducts annual accounting audits of every federal financial reporting entity, including CFPB, CFTC, FHFA, FDIC, OCC, and SEC.[202] More broadly, GAO conducts performance audits to "help improve the performance and ensure the accountability" of these entities.[203] In fact, GAO has often been characterized as "the taxpayer's best friend."[204]

However, GAO is prohibited by statute from auditing the efficiency and effectiveness of the Fed's monetary policies or balance sheet programs:

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199 FASAB, HANDBOOK OF FED. ACCT. STANDARDS & OTHER PRONOUNCEMENTS, AS AMENDED 4 (2022)

200 William R. Nelson, *Helicopter Money, Fiscal QE, the Magic Asset, and Collateralizing the Currency*, in POPULISM AND THE FUTURE OF THE FED (2022).

201 See U.S. Government Accountability Office, *Role as an Audit Institution*, GAO, https://www.gao.gov/about/what-gao-does/audit-role [https://perma.cc/2P2H-CZ4A].

202 See *supra* note 66. For example, the results of GAO's FY2022 audit of CFPB were published in the *Financial Report of the Consumer Financial Protection Bureau for Fiscal Year 2022*, 54-59.

203 U.S. GOV'T ACCOUNTABILITY OFF. GAO-23-207089, ADDITIONAL OPPORTUNITIES TO REDUCE FRAGMENTATION, OVERLAP, AND DUPLICATION AND ACHIEVE BILLIONS OF DOLLARS IN FINANCIAL BENEFITS (2023).

204 *See* DONALD J. GUERRIERI, GLENCOE ACCOUNTING, FIRST-YEAR COURSE: REAL-WORLD APPLICATIONS & CONNECTIONS (2012) ("The watchdog GAO is clearly the taxpayer's best friend."); *see also* Alfred Steinberg, *GAO: The Taxpayer's Best Friend*, 91 READER'S DIGEST 133-137 (1967)

> [GAO] audits of the [Federal Reserve] Board and Federal Reserve Banks may not include...deliberations, decisions, or actions on monetary policy matters, including discount window operations, reserves of member banks, securities credit, interest on deposits, and open market operations [and] transactions made under the direction of the Federal Open Market Committee.[205]

While GAO's auditing role is proscribed, the Fed's website gives an affirmative answer to the question, "Does the Federal Reserve ever get audited? Yes." [206] Nonetheless, such audits are limited in scope and hampered by governance issues. In particular, the Fed's financial statements are examined every year by a private accounting firm with the sole purpose of verifying accuracy and no consideration of efficacy or efficiency as in a performance audit. The Fed's Office of Inspector General (OIG) evaluates specific programs and operations at the Federal Reserve's Board of Governors but is not authorized to assess the FOMC's policies or operations; moreover, the OIG is headed by a Fed employee who works at the direction of the Fed chair.

It seems remarkable that the central bank's books are examined by a private accounting firm rather than the nation's supreme auditor, especially when one considers the track records of these institutions.[207] As shown in Table 2, GAO's performance audits and recommendations resulted in savings to U.S. taxpayers that totaled nearly $1 trillion during 2011-2022. By contrast, the private firms responsible for auditing the Fed have been

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205 31 U.S.C. § 714(b). The Dodd-Frank Act added the provision that GAO may audit such transactions solely for the purposes of assessing operational integrity, accounting and financial reporting, internal controls, eligibility criteria, security and collateral policies, and the selection and payment of third-party contractors. (31 U.S.C. § 714(f)(2)).

206 Board of Governors of the Federal Reserve System, *Does the Federal Reserve Ever Get Audited,* BD. GOV. FED. RSRV. SYS. (Jan. 2, 2019), https://www.federalreserve.gov/faqs/about_12784.htm [https://perma.cc/8LSN-DZ6]. (The Fed's response to this FAQ refers to annual financial audits, OIG investigations, GAO reviews, publication of its balance sheet, and an interactive tool for visualizing that information.

207 in 2015, Robert Appleton, former assistant U.S. attorney and former chief of the United Nations Anti-Corruption Task Force, commented as follows about KPMG's gross negligence in auditing the books of FIFA, the global soccer federation: "There were sufficient red flags of improper and highly suspicious payments...and other highly questionable activities, coupled with a history of similar issues, that should have been identified and that should have caused the auditors to highlight and report on them internally and to recommend further investigation."; *see* Francine McKenna, *FIFA Auditor KPMG Totally Missed the Soccer Scandal,* MARKETWATCH (June 5, 2015), https://www.marketwatch.com/story/fifa-auditor-kpmg-missed-scandal-but-stays-out-of-spotlight-2015-06-03 [https://perma.cc/2DTN-6ZW6].

regularly prosecuted, sued, and fined for gross negligence and malfeasance.[208] In early 2023 the same accounting firm that audits the Fed's books issued unqualified audits -- a clean bill of financial health -- for Silicon Valley Bank and two other banks just a few weeks before they failed.[209]

Arguably, had GAO been involved in a performance review of the Fed's previous securities purchase programs, it might have highlighted concerns about efficacy and risks in advance of the Fed's latest round of purchases. At the very least, with the Fed now incurring huge operating losses, it would be sensible for GAO to conduct a post-mortem to identify lessons learned.

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208 At a UK hearing on the Carillion scandal, a member of Parliament told the KPMG's spokesperson: "I would not hire you to do an audit of the contents of my fridge, because when I read it, I would not know what was actually in my fridge or not." *See* Madison Marriage, *MPs Turn Fire on KPMG and Deloitte Partners over Carillion*, FIN. TIMES (Feb. 22, 2018), https://www.ft.com/content/71c8f2b8-17d7-11e8-9e9c-25c814761640 [https://perma.cc/ED2Q-U7KF]

209 Stephen Davies, *Three failed US banks had one thing in common: KPMG*, FIN. TIMES (May 3, 2023), https://www.ft.com/content/feb33914-493e-467c-b67e-28fcd1b3814d [https://perma.cc/H88P-4YBB]. See also Nicola M. White & Amanda Iacone, *KPMG Under Pressure After Clean Audits of SVB, Signature Bank*, BLOOMBERG NEWS (Mar. 14, 2023), https://news.bloombergtax.com/financial-accounting/kpmg-gave-no-auditor-warning-before-back-to-back-bank-failures [https://perma.cc/9EAM-992J].

Table 2: The Track Records of GAO and Federal Reserve Auditors

Audit Year	U.S. Govt Auditor	GAO Savings to U.S. Taxpayers	Federal Reserve Auditor	Notable Developments regarding Fed's Auditor
2011	GAO	$46 billion	Deloitte	UK fines Deloitte for auditing negligence[i]
2012	GAO	$56 billion	Deloitte	New York State fines Deloitte for money laundering cover-up[ii]
2013	GAO	$52 billion	Deloitte	Malaysia fines Deloitte for negligence on 1MDB[iii]
2014	GAO	$54 billion	Deloitte	UK fines Deloitte for negligence[iv]
2015	GAO	$75 billion	KPMG	KPMG ignores corruption at FIFA's governing body[v]
2016	GAO	$63 billion	KPMG	KPMG fails to uncover illegal sales practices at Wells Fargo Bank[vi]
2017	GAO	$74 billion	KPMG	Chief KMPG USA auditor fired for cheating scandal[vii]
2018	GAO	$75 billion	KPMG	UK Parliamentary Committee finds KPMG "complicit" in fraud[viii]
2019	GAO	$215 billion	KPMG	KPMG apologizes to South Africa for facilitating corruption[ix]
2020	GAO	$78 billion	KPMG	UK watchdog criticizes KPMG audit deficiencies[x]
2021	GAO	$66 billion	KPMG	Government of Malaysia sues KPMG for 1MDB[xi]
2022	GAO	$56 billion	KPMG	SEC probes conflicts of interest at big-4 auditors[xii]

Sources: The amounts shown in column 3 are taken from each annual GAO PERFORMANCE AND ACCOUNTABILITY REPORT for fiscal years 2011 to 2022. The annual report of the Fed's independent auditor is included in FEDERAL RESERVE BANKS COMBINED FINANCIAL STATEMENTS.

(Table continues below)

Table 2 ***(contd.)***

[i] *Financial Times*, "Deloitte fined £6.5 million over Serco audit misconduct in 2011-12," July 3, 2019.

[ii] *Reuters*, "Deloitte to pay New York $10 million for misconduct over Standard Chartered," June 18, 2013.

[iii] *Reuters*, "Deloitte to pay Malaysia $80 million to settle claims linked to 1MDB," March 3, 2021; this settlement encompassed all claims related to Deloitte's audits of 1MDB from 2011 to 2014.

[iv] *Financial Post*, "Deloitte ordered to pay $84.8 million for failing to detect fraud," April 6, 2014.

[v] Lynnley Browning, "Corruption in FIFA? Its Auditors Saw None," New York Times, June 5, 2015 (noting that KPMG audited FIFA for 16 consecutive years prior to the DOJ's indictment for $150 million in bribes and kickbacks).

[vi] KPMG audited Wells Fargo from 2011-15 but found no flaws in its internal controls, whereas federal regulators uncovered massive fraud involving the creation of more than a million unauthorized deposit accounts and over 500,000 fraudulent credit card applications; see "OCC Assesses Penalty Against Wells Fargo, Orders Restitution for Unsafe or Unsound Sales Practices," U.S. OCC News Release 2016-106.

[vii] Dave Michaels and Michael Rapaport, "KPMG Fires Partners Over Leak of Audit Regulator's Confidential Plan," *Wall Street Journal*, April 14, 2017.

[viii] KMPG served for 19 consecutive years as the auditor of Carillion but never qualified any audit opinion even as it became "a giant and unsustainable corporate time bomb." U.K. House of Commons, *Joint Report on Carillion*, Committees on Business, Energy & Industrial Strategy and Work & Pensions, HC 769, May 16, 2018, 5. The report concluded: "In failing to exercise professional scepticism towards Carillion's accounting judgements over the course of its tenure as Carillion's auditor, KPMG was complicit in them." *ibid*, 4.

[ix] KPMG South Africa, *Rebuilding Trust, Redefining Professionalism: Annual Integrated Report 2018*. See also Antony Squazzin, "KPMG South Africa Apologizes for Scandals, Seeks Second Chance", *Bloomberg News*, Dec. 10, 2018.

[x] U.K. Financial Regulatory Council, *KPMG Audit Quality Inspection*, July 2020 (finding substantial deficiencies in 39% of KPMG's corporate audits -- the worst deficiency rate among the "Big Four" auditors).

[xi] Rozanna Latiff and Liz Lee, "Malaysia, 1MDB seeking more than $5.6 bln in damages from KPMG partners", *Reuters*, July 12, 2021. KPMG subsequently settled the case; see ABC News, "KPMG pays Malaysian government $111 million settlement over 1MDB audit scandal", January 13, 2022.

[xii] Dave Michaels, "Big Four Accounting Firms Come Under Regulator's Scrutiny: SEC has launched probe into how firms manage conflicts of interest caused by sale of nonaudit services", *Wall Street Journal*, March 15, 2022.

F. The FOMC's Exemption from the Inspector General Act

Congressional oversight of the Fed's monetary policy programs and operations is also impaired by the FOMC's exemption from the Inspector General Act of 1978. That Act established a fully independent inspector general (IG) for every federal department and every major agency, with the sole exception of the Fed.[210] Each of these IGs is appointed by the President, confirmed by the Senate, and may only be removed by the President for cause.[211] Moreover, each Office of the Inspector General (OIG) receives its own appropriation separately from its affiliated entity; CRS notes that "this requirement provides [the OIG] with an additional level of budgetary independence."

The statutory duty of each IG is to assist Congress by evaluating agency programs and identifying steps for promoting efficiency and effectiveness. At a congressional hearing in 2009, GAO's chief counsel attested that the IGs "have been instrumental in enhancing government accountability."[212] In fact, apart from the Fed, a fully independent IG is now in place at every independent agency with operating expenses exceeding $5 billion.[213] The OCC is overseen by the Treasury Department's IG, while FDIC has had an independent OIG since 1993 and FHFA has had an independent OIG since its creation in 2008.[214]

A decade after Congress established the fully independent OIGs, it instituted quasi-independent OIGs at other agencies known as "designated federal entities" (DFEs), including the Fed's Board of Governors.[215] These OIGs have several distinct limitations:

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210 Inspector General Act of 1978 (P.L. 94-452).

211 The President must notify Congress to indicate the reasons for removal.

212 Gary L. Kepplinger, "Inspectors General: Independent Oversight of Financial Regulatory Agencies," Testimony before the Subcommittee on Government Management, Organization & Procurement, House Committee on Oversight & Government Reform, March 25, 2009 (issued as GAO document 09-524T), 1.

213 The federal departments and independent agencies with a fully independent OIG are listed in Table A-1 of CRS, *Statutory Inspectors General in the Federal Government: A Primer*, CRS Report R45450 (February 8, 2023).

214 The Treasury Department OIG's evaluations and annual audits of OCC are available to the public. *See* Office of Inspector General, *Audit and Evaluation Reports*, OFF. INSPECTOR GEN., https://oig.treasury.gov/reports/audit-and-evaluation

215 Amendments to Inspector General Act of 1978 (P.L. 100-504). The agencies classified as DFEs are listed in Table A-2 of CRS, *Statutory Inspectors General in the Federal Government: A Primer*, CRS Report R45450 (February 8, 2023). When the CFPB was established in 2010, the Federal Reserve Board's OIG was designated to serve jointly as the CFPB's OIG.

IG Appointment and Removal. At each DFE, the IG is an employee, not a presidential appointee. At agencies headed by a board or commission, such as CFTC and SEC, the IG is appointed by the governing board and is removable by a two-thirds vote of its members.[216] The sole exception is the Federal Reserve Board, whose IG is appointed by the Fed Chair.[217] In its 2009 report, GAO stated that "independence is one of the most important elements of an effective IG . . . [and] the cornerstone of professional auditing."[218] That report concluded as follows:

> We believe that the differences in the appointment and removal processes between presidentially-appointed IGs and those appointed by agency heads result in a clear difference in the organizational independence of these IGs.[219]

Operating Budget. At each DFE, the OIG's operating expenses are contained within the agency's overall budget but listed as a distinct item in the budget request submitted to Congress. The IG may annotate that line item if the agency's proposed amount would substantially inhibit the OIG's ability to carry out its duties. According to GAO, these statutory provisions "help ensure adequate funding and additional independence of IG budgets by providing the Congress with transparency into the funding of each agency's IG."[220] The sole exception is the Fed Board, which determines its OIG's budget outside of the appropriations process.

Scope of Authority. The IG Act states that each IG shall work under the general supervision of the agency head, who "shall not prevent or prohibit the IG from initiating, carrying out, or completing any audit or investigation or from issuing any subpoena during the course of any audit or investigation."[221] Apart from special provisions for national security, the notable exception is that the statute specifically states that the Federal Reserve Board's IG shall work "under the authority, direction, and control" of the Fed Chair in conducting any audit or investigation that requires access to sensitive information concerning "deliberations and decisions on policy

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216 The Dodd-Frank Act tightened the restrictions on IG removal at DFEs, requiring a written vote and approval by at least two-thirds of the governing board. 5 U.S.C. App. §8G, clauses (a)(4) and (e)(1).

217 5 U.S.C. App. , §8G(c).

218 *See supra* note 191, 5.

219 *See supra* note 191, 3.

220 GAO, Inspector Generals: Reporting on Independence, Effectiveness, and Expertise, GAO Report 11-770 (Sept. 2011), 10. Nonetheless, CRS suggests that OIGs at DFEs "may be more susceptible to some reallocation of funds"; see *supra* note 192, 15.

221 5 U.S.C. App., §8G(d)(1).

matters, including documented information used as a basis for making policy decisions, the disclosure of which could reasonably be expected to have a significant influence on the economy or market behavior," with written notice to be sent to congressional oversight committees whenever this power is exercised.[222] In practice, however, one might reasonably expect the IG to defer to the Fed Chair on all such matters to avoid triggering any formal notification process.

Regardless of these specific concerns, a fundamental gap in Congress' oversight is that current law designates an OIG for the Federal Reserve Board, *not* the FOMC. Thus, the Fed has no OIG with statutory authority to audit or evaluate its monetary policy programs or operations. In principle, the Fed Chair could direct the Fed Board's IG to conduct a comprehensive evaluation of the FOMC's balance sheet policies and programs. If such an evaluation had been conducted in the late 2010s, following the completion of preceding rounds of QE, an IG report might have alerted Congress that such a program could pose incur huge costs that would be borne by US taxpayers. Perhaps not surprisingly, there is no indicating that the Fed's IG has ever embarked on such an evaluation, even in the wake of the trillion-dollar losses associated with QE4,

[222] 5 U.S.C. App., §8G(g)(3). This clause is parallel to a subset of provisions of §8D(a), which specifies conditions in which the Secretary of the Treasury can control the work of its OIG. However, that official is directly accountable to the President. Moreover, all of the Treasury's programs and operations can be investigated by GAO.

III. APPROACHES FOR ENHANCED OVERSIGHT

In light of the foregoing analysis, it seems useful to discuss the merits and pitfalls of potential approaches for enhancing congressional oversight of the Fed's monetary policymaking function. Such steps could include statutory changes to facilitate regular reporting, ensure congressional access to internal Fed information, and strengthen the roles of the GAO and the Fed's IG in serving as congressional watchdogs. In weighing such measures, it is important to consider how to enhance congressional oversight while keeping the Fed well insulated from political interference.

A. Fed Reports to Congress

The issuance of public reports can be helpful in fostering transparency and accountability without hampering an institution's ability to carry out its mandated responsibilities. To accomplish this goal, reporting requirements need to be carefully designed and should be updated periodically in light of recent and prospective developments. Indeed, the present juncture could be an opportune time for Congress to revisit the statutes governing the Fed's monetary policy reporting.

1. *Mandated Objectives*

Congress has given the FOMC a broad mandate of fostering maximum employment and price stability. Thus, it could be sensible to require the Fed to provide regular reports regarding its quantification of these objectives, including an explanation of any recent or prospective changes to its methods and assessments.

In 2012, the Fed formally quantified its price stability mandate as an inflation target of 2%, as measured by the price index for personal consumption expenditures.[223] Before doing so, Fed Chair Bernanke engaged in extensive consultations with key members of Congress, including the chair and ranking member of each oversight committee.[224] At that time, the FOMC characterized this target as symmetric and indicated that policy would be

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223 The FOMC's *Statement of Longer-Run Goals and Strategy* was adopted in January 2012; *see* Board of Governors of the Federal Reserve System, *Statement on Longer-Run Goals and Monetary Policy Strategy*, BD. GOV. FED. RSRV. SYS. (Jan. 24, 2012), https://www.federalreserve.gov/monetarypolicy/files/FOMC_LongerRunGoals.pdf [https://perma.cc/T2RA-4P4Y].

224 *See* BEN S. BERNANKE, THE COURAGE TO ACT: A MEMOIR OF A CRISIS AND ITS AFTERMATH (2015).

aimed at achieving it over the medium run—an approach commonly known as "flexible inflation targeting."[225]

By contrast, there are no indications that the Fed engaged in any congressional consultations prior to overhauling its monetary policy framework in August 2020, when it shifted to "average inflation targeting" with an asymmetric tilt towards elevated inflation.[226] That revision made the operational definition of price stability much more opaque and discretionary, with ambiguity about the horizon over which inflation would be averaged ("over time") as well as the duration over which it would remain elevated ("for some time"). Indeed, some former Fed officials have concluded that this framework revision paved the way for the Fed's subsequent inertia in responding to the inflation surge of 2021.[227]

More recently, a number of prominent economists have been calling for the Fed to raise its inflation target to 3% or even higher.[228] Such a change might seem blatantly inconsistent with the Fed's price stability mandate but could be adopted at any time. Thus, strengthened reporting requirements might be appropriate to foster appropriate congressional oversight of such changes.

Likewise, the Fed's 2012 framework effectively quantified its maximum employment in terms of the longer-run sustainable rate of unemployment, whereas the 2020 revision omitted that paragraph and simply indicates that the FOMC uses "a wide range of indicators" in making those assessments.[229]

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225 Richard H. Clarida, Vice Chair, Bd. Gov. Fed. Rsrv. Sys., Flexible Average Inflation Targeting and Prospects for U.S. Monetary Policy, Speech at the Brookings Institution Symposium on Monetary Policy Frameworks (Nov. 8, 2021)

226 Since August 2020, the FOMC's *Statement of Longer-Run Goals and Policy Strategy* has indicated that "The Committee seeks to achieve inflation that averages 2 percent over time, and therefore judges that, following periods when inflation has been running persistently below 2 percent, appropriate monetary policy will likely aim to achieve inflation moderately above 2 percent for some time." *Supra* note 222.

227 See Charles I. Plosser, *The Fed's Risky Experiment* (Hoover Inst. Econ. Working Paper No. 21116, 2021)

228 *See* Jason Furman, *The Fed Should Carefully Aim for a Higher Inflation Target*, WALL ST. J. (Aug. 23, 2023), https://www.wsj.com/articles/the-fed-should-carefully-aim-for-a-higher-inflation-target-reserve-powell-greenspan-5fef5051 [https://perma.cc/DB2W-76WM]; See also Greg Ip, *How to Deal With Above-Target Inflation: Raise the Target*, WALL ST. J., https://www.wsj.com/articles/how-to-deal-with-above-target-inflation-raise-the-target-11630504980 [https://perma.cc/7GS7-S4YK]; Jeff Sommer, *The Fed Has Targeted 2% Inflation. Should It Aim Higher*?, N.Y. TIMES (Mar. 24, 2023), https://www.nytimes.com/2023/03/24/business/inflation-federal-reserve-interest-rates.html [https://perma.cc/H5ZY-EFAG].

229 The FOMC's *Statement of Longer-Run Goals and Policy Strategy* characterizes maximum employment as a "broad-based and inclusive goal."

Thus, requiring the Fed to quantify its maximum employment objective could facilitate oversight of the Fed's performance in carrying out its statutory mandate.

2. *Simple Benchmarks*

Simple benchmarks, such as the Taylor Rule, can be very helpful in facilitating the central bank's monetary policy decisions and communications. The creator of that rule, Professor John B. Taylor, has emphasized that no simple benchmark can be followed mechanistically.[230] However, when policymakers deviate from the benchmark policy, such deviations should be clearly explained.[231]

Since 2017, the Fed's monetary policy reports to Congress have generally included information about the prescriptions of simple rules, although such information was not included in two such reports (June 2020 and February 2021).[232] However, the glaring omission is that the Fed's reports have provided no explanation whatsoever about the rationale for substantial deviations from those benchmarks.

3. *Stress Testing for Monetary Policy*

The Fed publishes a quarterly summary of the baseline economic outlook of FOMC participants, that is, their assessments of the most likely trajectory of the economy under appropriate monetary policy and in the absence of any further shocks.[233] However, such an approach may be misleading in the absence of information about specific risks to the outlook. For example, in the spring and summer of 2021 Fed officials' baseline projections hinged on the premise that the recent surge in inflation would be "transitory," but the

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[230] *See supra* note 108.

[231] Andrew T. Levin, *The Design and Communication of Systematic Monetary Policy Strategies*, 49 J. ECON. DYNAMICS & CONTROL 52 (2014)..

[232] *See* Board of Governors of the Federal Reserve System, *Monetary Policy Report*, BD. GOV. FED RSRV. SYS. (June 12, 2020), https://www.federalreserve.gov/monetarypolicy/files/20200612_mprfullreport.pdf; Board of Governors of the Federal Reserve System, *Monetary Policy Report*, BD. GOV. FED RSRV. SYS. (Feb. 19, 2021), https://www.federalreserve.gov/monetarypolicy/files/20210219_mprfullreport.pdf;

[233] See Board of Governors of the Federal Reserve System, *Summary of Economic Projections*, BD. GOV. FED. RSRV. SYS. 1 (Sept. 20, 2023), https://www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20230920.pdf [https://perma.cc/DS7N-2MSJ] . This document also includes a tabulation of historical forecast errors to provide information about the typical magnitude of uncertainty surrounding FOMC participants' projections.

Fed provided no indication about how policy might need to be adjusted if that premise turned out to be incorrect.

Ironically, the Fed requires all large and systemically important banking institutions to undergo "stress tests" to show how their balance sheets would be affected by specific adverse economic and financial shocks. Thus, it would seem plausible that Congress could establish a similar regimen in requiring the Fed to engage in "stress tests for monetary policy."[234]

B. Congressional Access to Internal Fed Information

In carrying out its constitutional responsibility for oversight of the Federal Reserve, members of Congress have raised concerns about a range of issues, including (a) the process of selecting the president of each regional Federal Reserve Bank, especially given their roles as members of the FOMC; (b) the FOMC's management of its balance sheet, especially given that its decisions may cost nearly a trillion dollars to U.S. taxpayers; and (c) the FOMC's complacency about elevated inflation in 2021, which set the stage for rapid tightening and major bank failures more recently.

Nonetheless, two distinct obstacles have hampered Congress' ability to carry out inquiries and investigations of such issues, and statutory measures would likely be necessary to overcome each of these obstacles.

1. *Federal Reserve Bank Information*

The regional Federal Reserve Banks are private financial institutions overseen by the Fed's Board of Governors, which has comprehensive authority to examine their internal records. Thus, a federal court has ruled that the Board must protect the confidentiality of Reserve Bank records, just like the proprietary information of commercial banks or other private financial institutions overseen by the Fed.[235]

Of course, the Reserve Banks are government-chartered institutions, and hence Congress could adjust their charter to clarify that all records produced by Reserve Banks are the legal property of the U.S. government and subject to all statutes applicable to records produced by federal agencies.[236] Such a clarification would enable the Board and the Reserve Banks to be fully

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[234] *See* supra note 106, at 53.

[235] *See* Ball v. Bd. of Governors, 87 F. Supp. 3d 33, 56 (2015); *supra* notes **Error! Bookmark not d efined.-Error! Bookmark not defined.** and accompanying discussion.

[236] Such a statutory adjustment would make FRB records subject to the provisions of FOIA.

responsive to congressional requests involving internal Reserve Bank records.[237]

2. *Market-sensitive information*

The FOMC regularly reiterates its commitment to "explain its monetary policy decisions to the public as clearly as possible" because such clarity "facilitates well-informed decisionmaking by households and businesses, reduces economic and financial uncertainty, increases the effectiveness of monetary policy, and enhances transparency and accountability, which are essential in a democratic society."[238] In contrast, the inadvertent release of confidential FOMC information might well be confusing or alarming, with potentially adverse consequences for the stability of financial markets and the broader economy.[239]

Under the Federal Reserve's current procedures, detailed information about the FOMC meetings held in each calendar year—including a lightly-edited transcript of each meeting and all background materials produced by staff—are published on the Fed's website after a lapse of five years.[240] This

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237 Under the Fed's current regulations, all Federal Reserve System officials and staff are strictly prohibited from providing confidential FOMC information to members of Congress, even in response to a congressional subpoena: "Unless authorized by the Committee or as ordered by a Federal court in a judicial proceeding in which the Committee has had the opportunity to appear and oppose discovery, any person who is required to respond to a subpoena or other legal process concerning exempt Committee information shall attend at the time and place required and respectfully decline to disclose or to give any testimony with respect to the information, basing such refusal upon the provisions of this part. If the court or other body orders the disclosure of the information or the giving of testimony, the person having the information shall continue to decline to disclose such information and shall promptly report the facts to the Committee for such action as the Committee may deem appropriate." (12 CFR 71.120(b), "Rules Regarding Availability of Information").

238 The FOMC's Statement of Longer-Run Goals and Policy was adopted in 2012 and has been subsequently reaffirmed on an annual basis.

239 Confidential FOMC information could be highly valuable if leaked to a small number of individuals or private firms. Indeed, the FOMC's external communications rules specifically prohibit policymakers from communicating their own personal views "in any meeting or conversation with any individual, firm, or organization who could profit financially from acquiring that information unless those views have already been expressed in their public communications."

240 For example, the FOMC materials for calendar year 2017 were released to the public on February 2023; see Board of Governors of the Federal Reserve System, *Federal Open Market Committee*, BD. GOV. FED. RSRV. SYS., (Jan. 28, 2022) https://www.federalreserve.gov/monetarypolicy/fomc_historical.htm. [https://perma.cc/U23H-W9YR].

degree of transparency is immensely helpful for academic scholarship but not adequate for facilitating congressional oversight. For example, FOMC decisions in mid-2021 hinged on officials' view that elevated inflation would be transitory, but those FOMC materials will not be released until 2027.

In principle, of course, Congress could adopt legislation prescribing a more rapid schedule for the release of FOMC documents, but such an approach could risk impinging on the deliberative process and/or exacerbating confusion about the Fed's policymaking.[241]

An alternative approach might be for Congress to enact rules analogous to those adopted to facilitate congressional oversight of intelligence activities while ensuring the protection of highly sensitive national security information. In particular, the Central Intelligence Agency ("CIA") was established by the National Security Act of 1947 without any specific oversight provisions. More than four decades later, in light of bipartisan concerns about congressional undersight, the Intelligence Act of 1991 was enacted with the following oversight procedures:

Non-Covert Intelligence Activities. The CIA director and other intelligence officials must ensure that both of Congress' oversight committees are kept "fully and currently informed" about all non-covert activities, including any significant intelligence failures, and must respond to oversight committee requests by providing all information or material within their custody or control.[242]

Covert Intelligence Activities. A parallel set of provisions requires the CIA director and other intelligence officials to keep the oversight committees "fully and currently informed" about all covert activities "[t]o the extent consistent with due regard for the protection from unauthorized disclosure of classified information relating to sensitive intelligence sources and methods or other exceptionally sensitive matters."[243]

Extraordinary Covert Operations. The President must specifically authorize every covert operation with a written finding that is promptly given to both congressional oversight committees.[244] However, if the President determines that it is essential to limit access to the finding "to meet extraordinary circumstances affecting vital interests of the United States, the finding may be reported to the chairmen and ranking minority members of the

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241 For further discussion, see Ellen E. Meade & David Stasavage, *Publicity of Debate and the Incentive to Dissent: Evidence from the US Federal Reserve,* 118 ECON. J. 695 (2008).

242 50 U.S.C. § 3092.

243 *Id.* § 3093(b)

244 *Id.* § 3093(a).

intelligence committees, the Speaker and minority leader of the House of Representatives, the majority and minority leaders of the Senate, and such other member or members of the congressional leadership as may be included by the President."[245]

The provisions of the Intelligence Act could readily serve as a template for strengthening congressional oversight of the Federal Reserve System. In particular, Fed officials would be required to keep both oversight committees –the Senate Banking Committee and the House Financial Services Committee— *"fully and currently informed"* about the Fed's internal procedures and operations and to provide prompt and complete information in response to all committee requests. Moreover, the Fed's Board of Governors could be authorized to limit access to highly market-sensitive information by providing such information solely to the chair and ranking minority member of each oversight committee and to the top officials in each chamber of Congress.

C. Strengthening Congressional Watchdogs

Since the 1970s, the Fed has been exempt from comprehensive GAO reviews. When it was granted by Congress, that exemption importantly reflected the simplicity of the Fed's financial operations and balance sheet. The asset side of the Fed's balance sheet was comprised of Treasury securities, and its liabilities consisted almost entirely of Federal Reserve notes (i.e., paper cash, which does not pay interest) and bank reserves held at the Fed (which did not bear any interest at that time). The Fed occasionally engaged in transactions in the repurchase market, but those operations were minor in scope and transitory in duration.

By contrast, over the past fifteen years the Fed's balance sheet has expanded dramatically in size and complexity, and its operating framework now has a very large influence on financial market functioning. Consequently, the case for authorizing the GAO to engage in comprehensive reviews of the Fed seems far more compelling relative to a half-century ago.

The GAO has a very strong track record as an effective congressional watchdog. Every recommendation that GAO makes to every federal agency is posted on the GAO's website with an indication of whether or not it was implemented. Thus, GAO can document that over the past decade, about 80 percent of their recommendations have been followed, and those measures have saved taxpayers nearly $1 trillion. These benefits have far outweighed the administrative costs that GAO incurs in paying staff, hiring consultants,

[245] *Id.* § 3093(c).

and conducting reviews. Indeed, GAO's rate of return to taxpayers is in the range of 500:1 to 1000:1.[246]

One potential concern is whether GAO reviews could undermine the FOMC's independence in determining the stance of monetary policy. Of course, the GAO itself is an independent federal agency. Nonetheless, it could be sensible for GAO to be authorized to conduct comprehensive reviews on a fixed annual schedule; such reviews would *not* be triggered by requests from congressional committees or individual members of Congress.

Finally, Congress could enhance the independence and scope of authority of the Fed's IG. In particular, it could be sensible to establish a fully independent IG who would serve as a watchdog for the entire Federal Reserve System, including the FOMC, not just the Fed's Board of Governors.

CONCLUSION

The Constitution specifically assigns Congress with the duty of regulating money. Thus, Congress may delegate that duty to the Federal Reserve as the nation's central bank, give it a broad monetary policy mandate, and bolster its independence by exempting it from the regular appropriations process and the federal debt ceiling. However, Congress may neither abdicate responsibility for overseeing the exercise of its duty to regulate the value of money nor relinquish its power over the purse.

As this Article has detailed, recent experience has highlighted the fiscal consequences of central bank undersight. With those costs in view, it would be sensible for Congress to consider enhancing its oversight of the Fed, perhaps by using tried-and-true approaches for overseeing other independent agencies.

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246 Of course, effective GAO oversight of the Fed could not occur instantly. If Congress directed the GAO to be a watchdog for the Federal Reserve, it would likely take several years for GAO to build up a team of experts to fill that role, especially because the Fed itself is so complex.