

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

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December 2023

Note: This presentation solely reflects the views of the authors and should not be interpreted as reflecting the views of any other person or institution.

The Context

- During 2020-21 the Fed purchased nearly \$5 trillion in medium- and longer-term securities and funded those purchases by issuing short-term debt.
- The Fed's balance sheet program is likely to **cost taxpayers about \$1½ trillion**; indeed, the Fed is now technically insolvent (*assets < liabilities*).
- This outcome is **essentially parallel** to what occurred at Silicon Valley Bank, except that the Fed is backed by the "*full faith and credit*" of the U.S. government.
- How can a public institution conduct a program that costs taxpayers more than \$1 trillion without any congressional appropriations or consultations?

Question #1: Who's The Boss?

- **Congress** has delegated crucial Article I powers to the Fed (the coinage clause; power of the purse) with a very broad mandate and scope of authority, exemption from routine forms of oversight, and practically no reporting requirements.
- **The President** appoints the Fed Chair and other top Fed officials, who can only be removed “for cause.”
- **Federal Courts** have consistently ruled that the Fed’s governance and monetary policymaking are not justiciable under the “political question” doctrine.
- Consequently, the Fed seems practically like a **“fourth branch”** of the federal government.

Question #2: Whose Money?

- Congress gave the Fed a valuable source of income, namely, the issuance of **legal tender**. Thus, the Fed could earn interest on its assets while paying no interest on its liabilities of paper currency.
- Over the past century, Congress consistently indicated that **those profits belong to the public, not the Fed**; i.e., the Fed would cover its own operating expenses and then remit the bulk of the profits to the U.S. Treasury.
- For many decades, the Fed's net operating income and remittances averaged about 0.3% of GDP.
- The Fed is now running **net operating losses** and has **suspended its remittances** to the U.S. Treasury.

Question #3: What's Next?

- Congress can delegate its constitutional powers but cannot abdicate responsibility for overseeing the exercise of those duties.
- Congress could strengthen its oversight of the Fed using tried-and-true approaches for overseeing other independent agencies:
 - Specific reporting requirements
 - Congressional access to all Fed information (with special provisions for sensitive material)
 - GAO reviews of efficacy and efficiency
 - Designation of a fully independent OIG authorized to investigate all Fed programs

Outline of Our Paper

- **Part I: Delegation of Monetary Policy to the Fed**
 - The Fed's Structure & Mandate
 - Appointment of FOMC Officials
 - Congressional Reporting Requirements
- **Part II: Delegation of Fiscal Policy to the Fed**
 - The Fed's Revenue & Remittances
 - The Fed's Exemption from the Federal Budget
 - The Fed's Exemption from the Debt Ceiling
 - The Fed's Exemption from GAAP
 - The Fed's Exemption from GAO Reviews
 - The Fed's Exemption from the IG Act
- **Part III: Strengthening Congressional Oversight**

Part I: Delegation of Monetary Policy

- **The Original Design of the Fed (1913)**
 - “Banker to the banks” and “lender of last resort”
 - Gold Standard ==> no monetary policy
 - 12 regional Federal Reserve Banks
(*private institutions owned by member banks*)
 - Federal Reserve Board (*oversight role*)
- **The Establishment of the FOMC (1933-35)**
 - 7 Federal Reserve Board members
 - 5 Federal Reserve Bank presidents
(*NY Fed = permanent seat; others rotating*)
- **The FOMC’s Statutory Mandate (1977-78)**
 - foster maximum employment & price stability

Design Principles for Independent Agencies

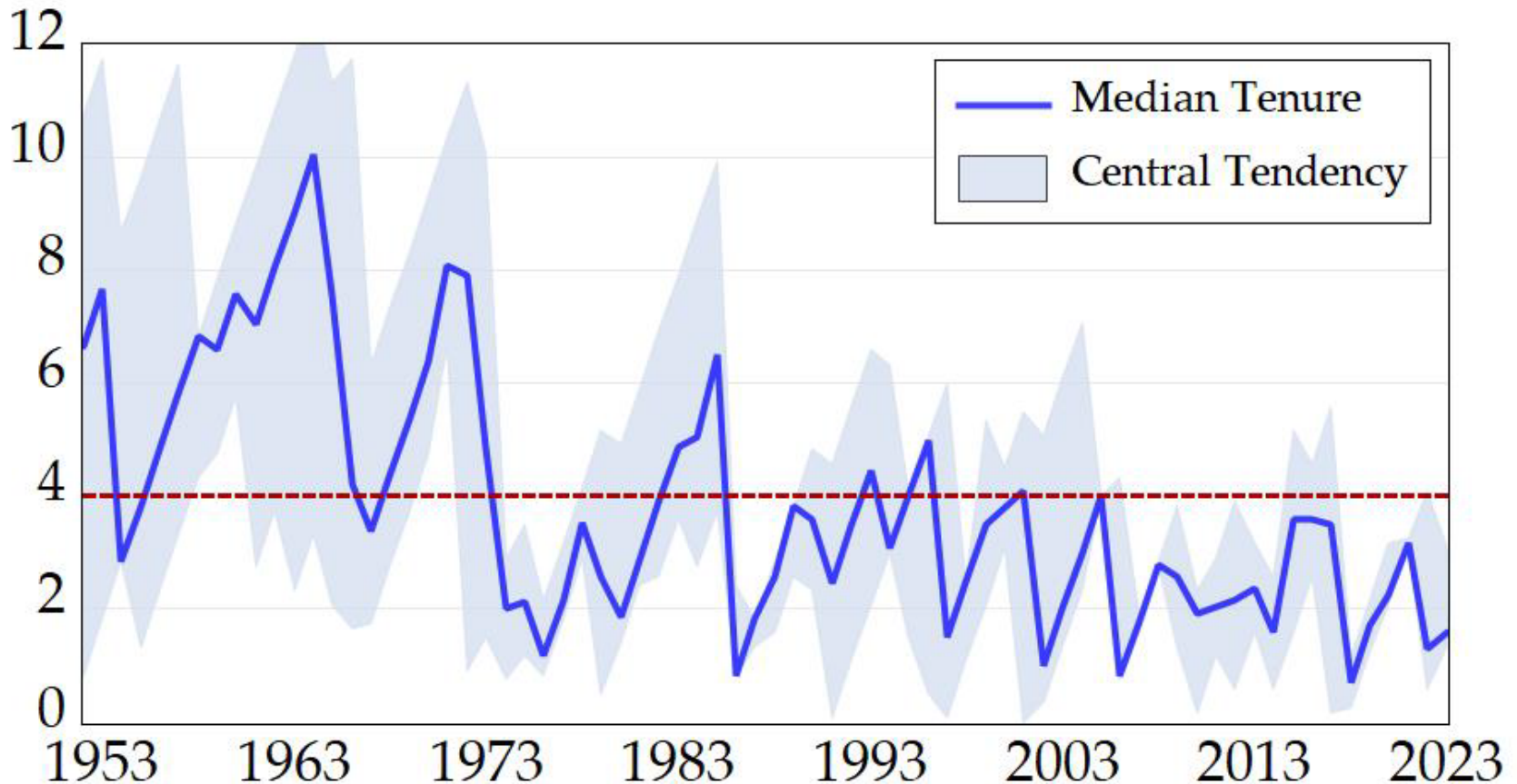
- Congress set forth the following principles in 1887:
“An uneven number of commissioners...appointed to staggered terms of a fixed period extending beyond the term of the President...can only be removed by the President for inefficiency, neglect of duty, or malfeasance in office...no more than a bare majority can come from the same political party.”
- The FOMC was designed to ensure **individual accountability & insulation from political interference**:
 - Federal Reserve Board members with 14-year terms, only removable by the President “for cause”
 - Fed Bank presidents appointed by boards of directors with approval by the Federal Reserve Board, and only removable by the Fed Board “for cause”

The Fed's Governance in Practice

- **The Fed Chair**
 - Four-Year Term (renewable)
 - Active Executive Officer
 - Oversees all Fed Board staff
 - Sets agenda for FOMC meetings
- **Other Fed Board Members**
 - Rarely stay for more than 3-4 years
 - No dissents from FOMC decisions since 2006
- **Fed Bank Presidents**
 - Now viewed as **“subordinates”** of Fed Board
 - No dissents from FOMC decisions since mid-2022

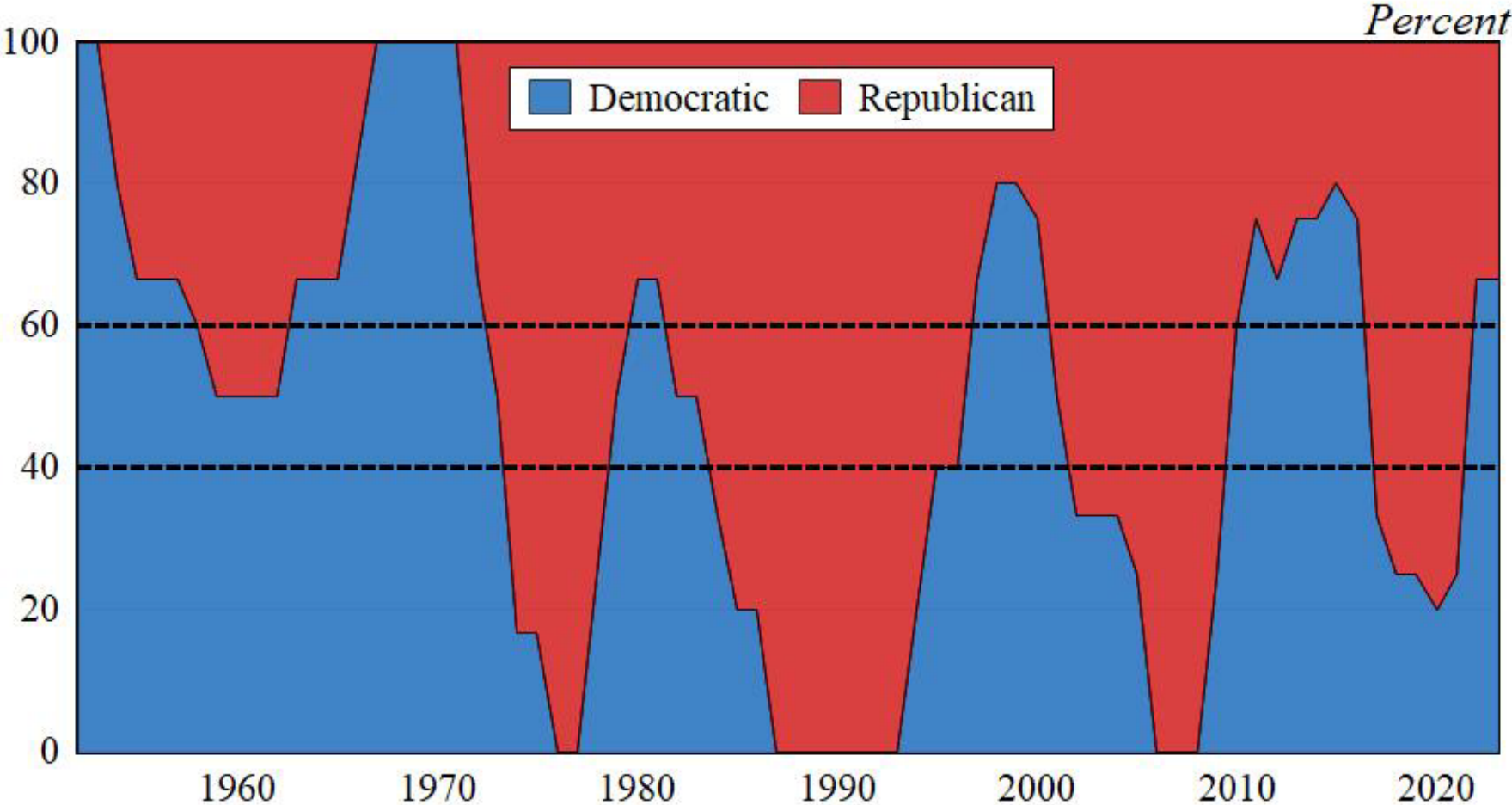
Tenure of Fed Board Members *(excluding Fed Chair)*

Years of Tenure



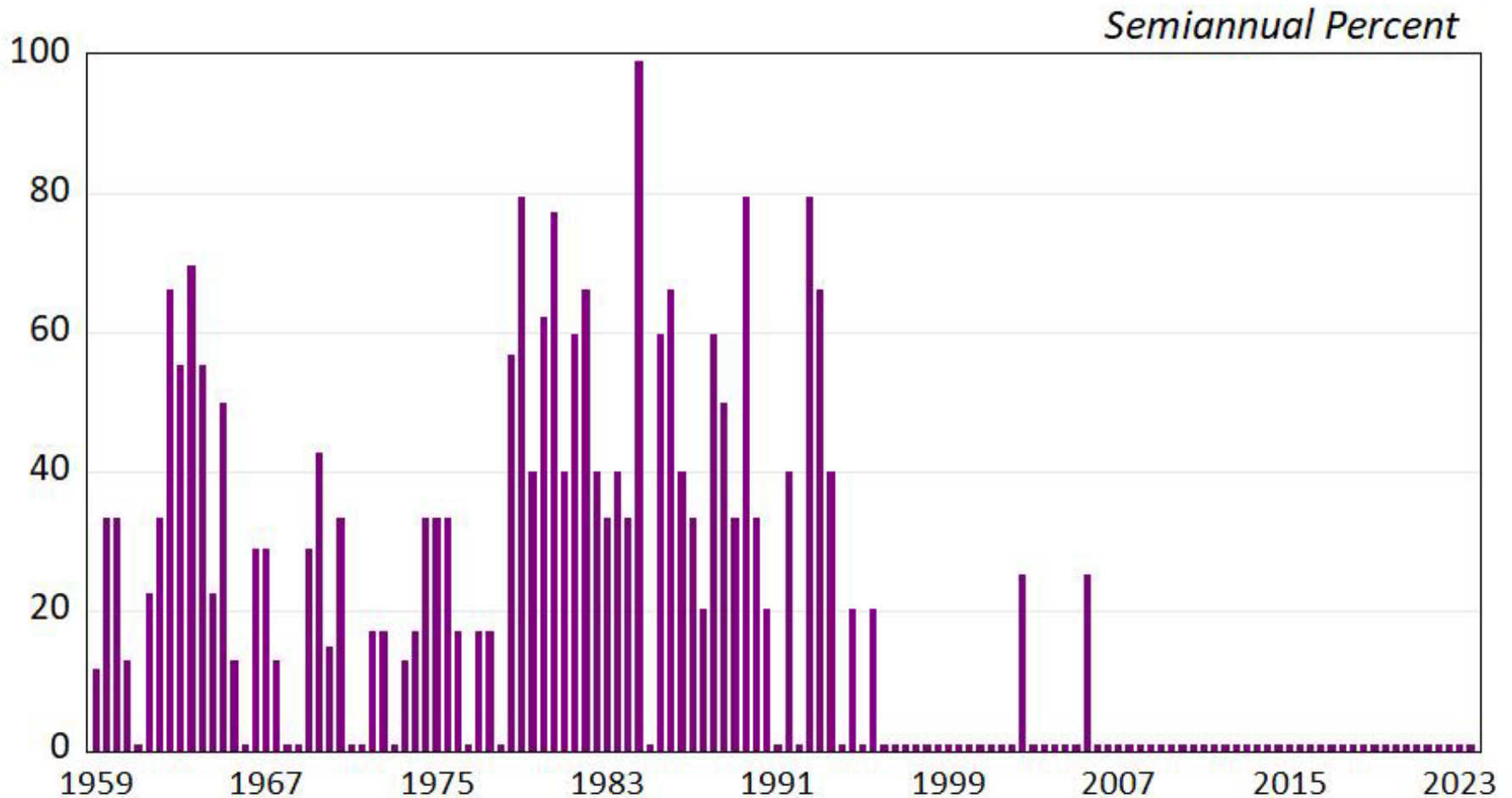
Source: Federal Reserve Board, authors' calculations

Political Affiliation of Fed Board Members *(excluding Fed Chair)*



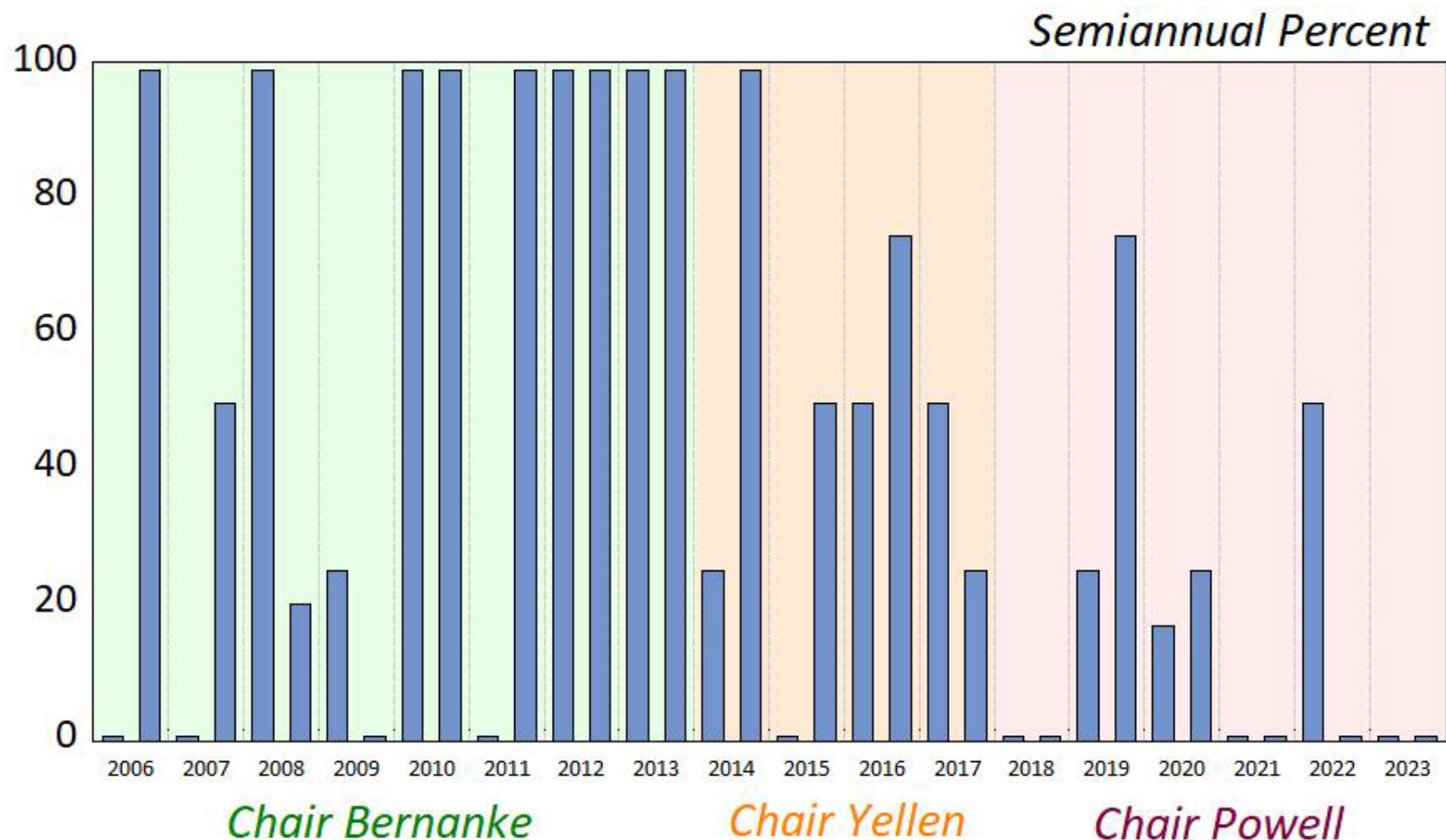
Source: Federal Reserve Board, authors' calculations

FOMC Dissents of Fed Board Members



Source: Federal Reserve Bank of St. Louis, authors' calculations

FOMC Dissents of Fed Bank Presidents

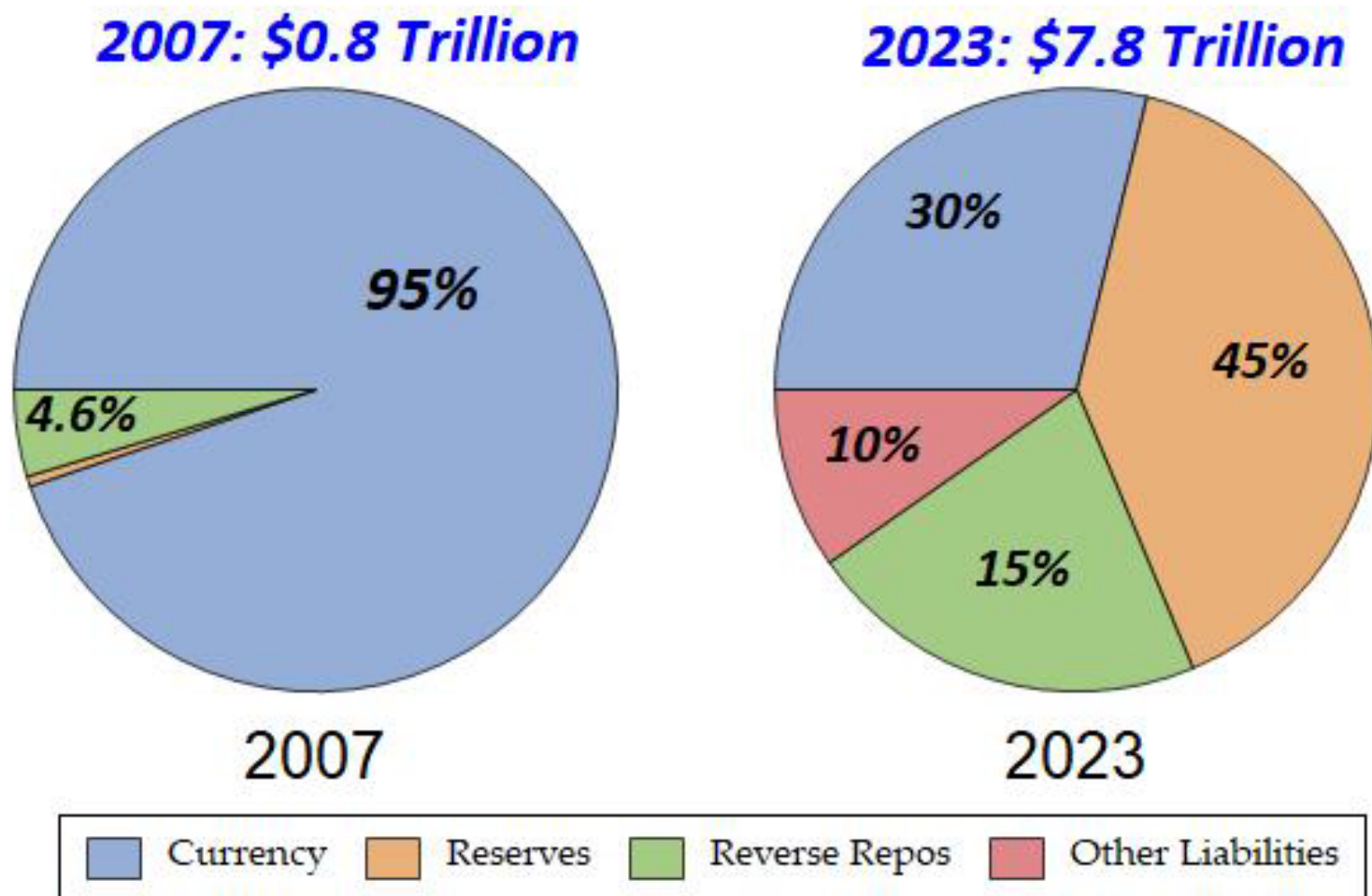


Source: Federal Reserve Bank of St. Louis, authors' calculations

Part II: Delegation of Fiscal Policy

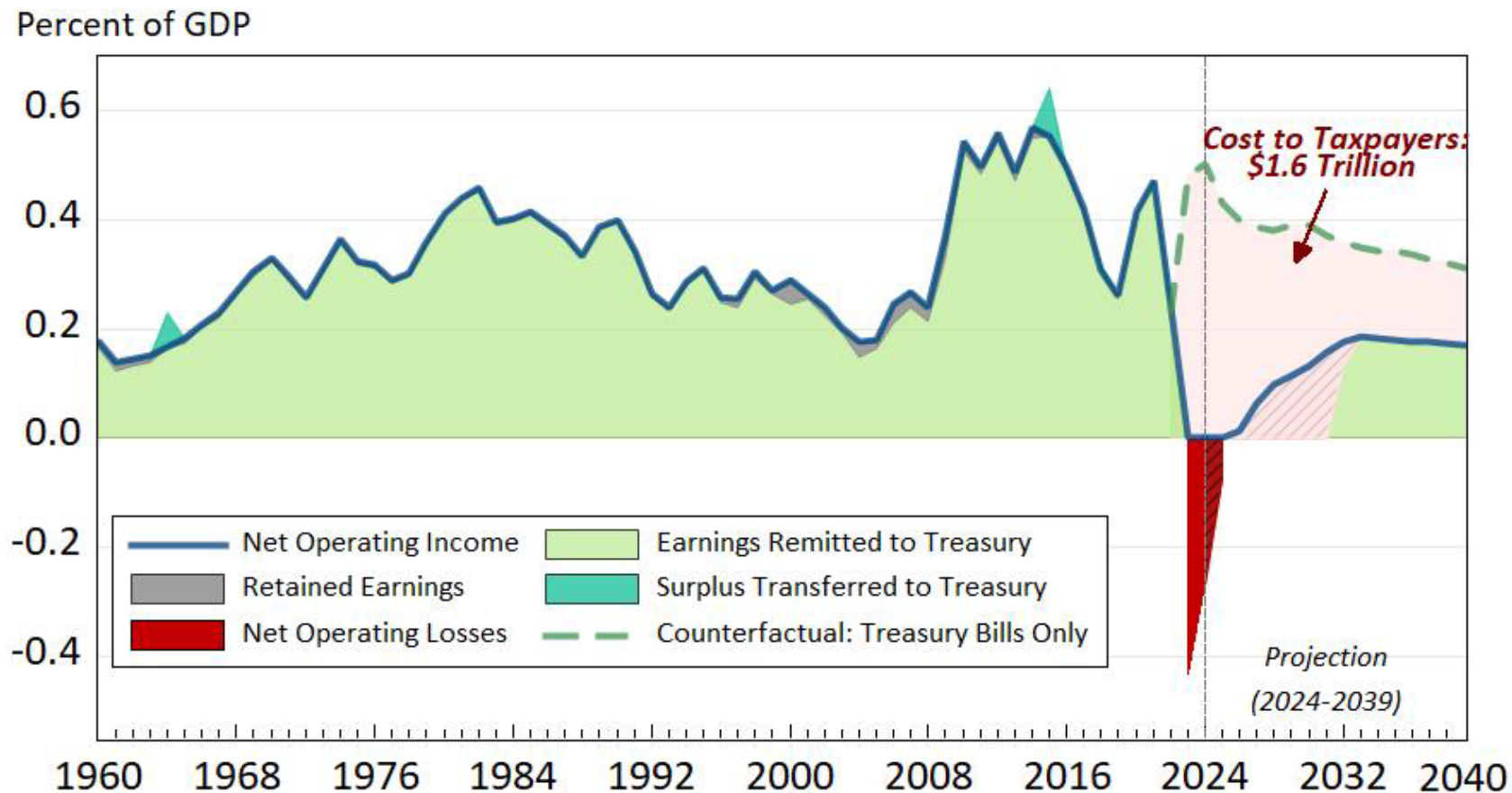
- Congress has delegated its constitutional “power of the purse” to the Federal Reserve:
 - Operating budget not included in the annual **appropriations process** (unlike all other independent agencies, including CFTC, SEC, FDIC, and FHFA)
 - Covers its operating losses by issuing interest-bearing liabilities that are not subject to **federal debt ceiling**.
- Congress has exempted the Fed from the modes of oversight for other major independent agencies:
 - The Fed sets its own **accounting rules** whereas FASAB sets rules for all other federal agencies
 - The Fed is exempt from **GAO performance reviews**
 - The Fed’s **inspector general** is a Fed employee, not an independent official

Composition of the Fed's Liabilities



Source: Federal Reserve Board (H.4.1), authors' calculations

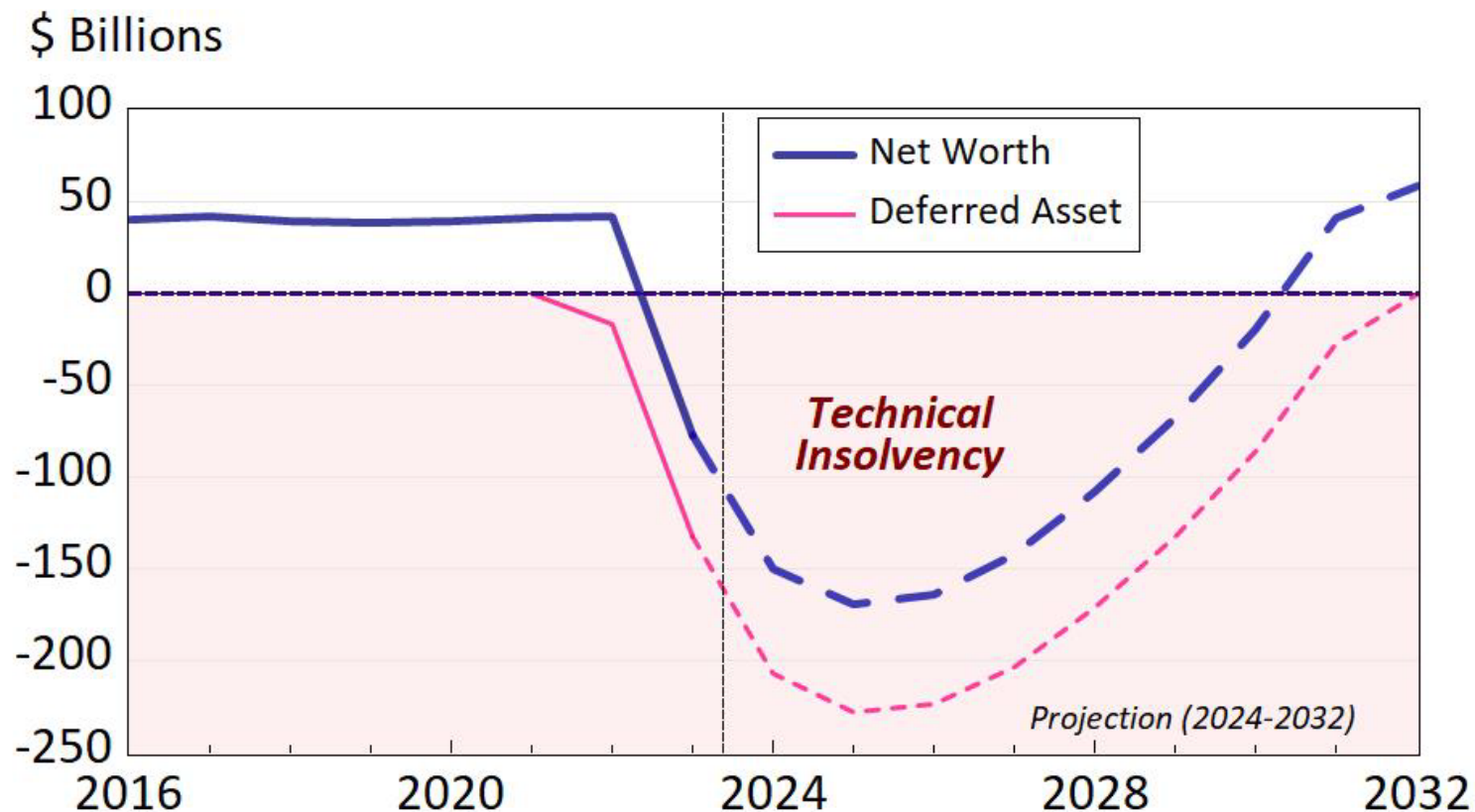
Evolution of the Fed's Remittances



Source: Federal Reserve Board, BEA, authors' calculations.

Note: This projection is an update of Levin, Lu & Nelson (2022) using data and market expectations at the end of 2023:Q3.

Evolution of the Fed's "Magic Asset"



Source: Federal Reserve Board, authors' calculations.

Note: This projection is an update of Levin, Lu & Nelson (2022) using data and market expectations at the end of 2023:Q3.

Limitations of the Fed's Current Audits

- **Limited Scope**

- Material misstatements & fraud
- No consideration of efficacy or efficiency

- **Imperfect Credibility from Recurring Scandals**

***FIFA Scandal:** "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 caused the auditors...to recommend further investigation."*

***Carillion Scandal:** "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."*

***Silicon Valley Bank & Signature Bank:** the auditor issued unqualified audits just weeks before the failure of each institution*

GAO: “The Taxpayer’s Best Friend”

- **Independent and Non-Partisan**
 - Comptroller General selected via bipartisan process
 - Appointed to a single non-renewable 15-year term
- **Comprehensive Reviews of All Federal Agencies**
(including SEC, CFTC, FHFA, FDIC, NASA, etc.)
 - Financial Audits
 - Efficacy and Efficiency
- **Extraordinary Track Record**
 - Documented savings to U.S. taxpayers of **nearly \$1 trillion** over the past decade (2011-2022)

GAO report warns Artemis 3 landing may be delayed to 2027

Jeff Foust December 1, 2023



Illustration of a SpaceX Starship lunar lander on the moon. Credit: SpaceX

Part III: Strengthening Oversight

- **Specific Reporting Requirements**
 - Analysis of simple policy benchmarks
 - Alternative Scenarios (*“stress tests for monetary policy”*)
- **Congressional Access to Fed Information**
 - Sensitive FOMC information can be handled just like sensitive national security information
- **Congressional Watchdogs**
 - GAO authorized to conduct comprehensive reviews of Fed’s monetary policy framework & operations
 - Fully independent IG with authority to investigate all aspects of the Fed’s internal appointments, policymaking, and operations.