



Should The US Congress Audit The Federal Reserve?

Description

US : The Federal Reserve system, including its twelve regional district banks that issue our US currency, is a creature of Congress, which passed the Federal Reserve Act in 1913 to create our central bank.

The Fed is neither part of the executive branch of the federal government, nor is it an independent federal agency within the government, although members of the Fed's Board of Governors are appointed by the President and confirmed by Congress.

The Fed's unique independence has two features: 1) the regional Federal Reserve district banks are privately owned by their member commercial banks, and 2) the FR system receives no funding through the federal government budget. Thus, the Fed is arguably the most independent of the world's central banks, a uniquely designed US institution.

The basis for congressional creation of the Fed is a clause in Article I, Section 8 of the US Constitution granting Congress the power "To coin Money, regulate the Value thereof... and Fix the Standard of Weights and Measures."

While the Fed was originally sold to the American public and the banking community as a mere "currency bill" that created Federal Reserve Notes (the "folding money" that we still use today), it has over the years become a powerful entity that has created lending facilities, bailed out commercial banks that have become over-extended or under-capitalized, and executed monetary policy that has often been beneficially benign but that has sometimes notoriously caused or exacerbated both inflation and recessions.

Congress has from time to time amended the original FR legislation to clarify the Fed's major goals, which are currently twofold: maximum employment and price stability.

But in general, our elected representatives appear hardly able to understand the Fed's behavior sufficiently to make wise decisions to alter or interfere with its operations.

During his years in the House of Representatives, former Congressman Ron Paul of Texas regularly

pleaded for Congress to audit the Federal Reserve system.

His efforts received little attention aside from those on the fringes who expressed concern about the US central bank's very independent behavior in its management of the nation's money supply, interest rates, and bank regulation.

But Ron Paul's legacy lives on. In January 2023 Congressman Thomas Massie (R-KY) introduced HR 24, the Federal Reserve Transparency Act of 2023, which was referred to the House Oversight and Reform committee.

The bill then languished there for the duration of the first session of the current 118th Congress. Now in early 2024 Republican Senators Rand Paul (Ron Paul's son) and other sponsors have filed S3566, entitled the Federal Reserve Transparency Act of 2024, referred to the Senate Banking, Housing, and Urban Affairs committee.

Both HR24 and S3566 would call for a full audit of the Federal Reserve System and the twelve Federal reserve district banks by the General Accountability Office (GAO) headed by the Comptroller General of the United States.

Any differences between the two bills would be resolved in conference committee once both bills have passed their respective chambers, before moving on for a presidential signature.

Such legislative proposals are nothing new. In a 2015 Wall Street Journal op-ed, Mises Fellow Alex Pollock expressed the need to audit the Fed stating, that a proper audit would not be a bean-counting exercise, but would rather be a more fundamental effort "...to assure that the checks and balances in a democratic government also apply to central bankers.....figuring out how our elected representatives can effectively oversee unelected monetary 'experts'."

The term "audit" in the context of Fed Reserve oversight falls short of what is appropriately required. Perhaps "investigation" or "examination" or "study" would be more correct.

A credentialed CPA accountant-auditor typically only determines whether existing practices comply with written policies and procedures. An audit per se does not necessarily investigate how or why the relevant policies and procedures were established in the first place, but rather takes them as given.

In the strictest sense, an auditor cannot perform an audit if there are limited or no written policies and procedures because there would be no standards against which to audit.

The word "audit" can unfortunately be misleading, causing many Americans to think of a dreaded IRS tax audit that might be conducted to determine if a taxpayer's tax return complies with the written tax code and IRS regulations.

A tax audit does not address how or why the tax code or IRS regulations were originally written as they were, but simply investigates compliance. Such questions of origin might arise if a taxpayer contests the IRS's attempt to extract more tax, but that is a later step in the process after an audit.

A number of current Fed behaviors might be questioned, investigated, and studied, in a full-scale approach. For example, a recent concern among economists and elected officials is the Fed's large unprecedented operating losses over the past few years, exacerbated by current high interest rates

that have caused the Fed's income on its large bond portfolio to fall short of its expenses. Many observers question on whom these operating losses will ultimately fall.

Whether operating losses cost anyone anything is at the moment an unsettled issue, as I recently commented in this space. Some economists believe that operating losses are irrelevant because the Fed is assigned a macroeconomic role of managing the money supply and implementing monetary policy to fulfill its twin goals of maximum employment and price stability.

Others, however, believe that the burden of Fed losses must inevitably fall on US taxpayers, because there is no "free lunch" for such losses.

Other areas of investigation would consider the very structure of the Fed and its apparent ability to unilaterally design its own accounting policies and procedures instead of following standard FASB or GAPP procedures.

Evaluating the Fed's structure and its accounting methods would be a major effort, one that would require a great deal of explanation to the public and elected officials, could arouse opposition in many quarters, and would undoubtedly require congressional action to amend the Federal Reserve Act.

It's not at all clear that there are many in either chamber of Congress who have the inclination or knowledge to pursue these Fed transparency bills further, so it is questionable whether they will ever advance from their respective congressional committees to floor votes.

Nonetheless, questions about the Fed's policies and procedures are swirling, and Congress should eventually act to fully investigate of its capabilities.

Aside from possible legislative action, the judicial branch of our federal government may be another avenue for reform of the Federal Reserve.

The Supreme Court is considering two cases this term that could shed light on the Fed's circumstances, both questioning the Chevron doctrine that dates from a 1984 Court case, *Chevron USA Inc v. Natural Resources Defense Council Inc*, which deferred administrative decisions to the judgment of independent agencies when the statutory text is silent or ambiguous.

The two cases in question today are *Loper Bright Enterprises v. Raimondo* and *Relentless Inc. v. Department of Commerce*, both of which ask the Court to overturn the Chevron doctrine, which could dramatically alter the power of the "administrative state" as it relates to both the legislative and executive branches of our federal government and the independence of federal agencies.

Whether, and how, these two upcoming SCOTUS decisions may address the Fed's independence depends on how emphatically the Court may attempt to curtail the applicability of the Chevron doctrine to decisions by administrative agencies.

The Federal Reserve system is legally and financially an independent agency, but the question for Congress—and/or possibly the judicial branch—is how independently the Fed should be allowed to operate in its 111th year of existence and on into the future.

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Date Created
03/17/2024