JEB HENSARLING, TX , CHAIRMAN

United States House of Representatives
Committee on Financial Services
Washington, D.C. 20515

MAXINE WATERS, CA, RANKING MEMBER

**M E M O R A N D U M**

To: Members of the Committee on Financial Services

From: FSC Majority Staff

Date: March 7, 2014

Subject: March 12, 2014, Subcommittee on Monetary Policy and Trade Hearing Entitled "Federal Reserve Oversight: Examining the Central Bank's Role in Credit Allocation"

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As part of the Committee's announced Federal Reserve Centennial Oversight Project, the Monetary Policy and Trade Subcommittee will hold a hearing entitled "Federal Reserve Oversight: Examining the Central Bank's Role in Credit Allocation" at 10 a.m., March 12, 2014, in room 2128, Rayburn House Office Building. This will be a one-panel hearing and will include the following witnesses:

- Marvin Goodfriend, Friends of Allan Meltzer Professor of Economics, Carnegie Mellon University
- Paul H. Kupiec, Resident Scholar, American Enterprise Institute
- Lawrence White, Professor of Economics, George Mason University
- Josh Bivens, Research and Policy Director, Economic Policy Institute

***Background***

In response to the 2008 financial crisis, the Board of Governors of the Federal Reserve System (the "Fed") significantly loosened monetary policy in an attempt to stem the deterioration of the economy and, later, as the market stabilized, to stimulate it. Specifically, the Fed first pushed the federal funds rate to zero. When economic growth remained sluggish and conventional monetary stimulus was no longer an option, however, the Fed turned to "quantitative easing"—a monthly multi-billion dollar investment in long-term government securities and mortgage-backed securities—to attempt to stimulate the economy. Those actions were, according to the Fed, aimed at fulfilling the central bank's "dual mandate" of keeping prices stable and maximizing employment.

The Fed's recent quantitative easing and other unconventional policies give cause to re-examine the independence of our central banking system. Independence preserves a central bank's focus on price stability and protects a central bank from short-term political pressure to finance government spending. In 1951, the Treasury Department and the Federal Reserve entered into an Accord that ended the Federal Reserve's previous support for deficit spending during the Second World War. That Accord has been cited by former

Fed Chairman Ben Bernanke as an important milestone in maintaining the Federal Reserve's independence in setting monetary policy in the latter half of the twentieth century.

The Federal Reserve has in recent years engaged in credit allocation policy—an objective distinct from its monetary policy mission—in at least three ways that call into question its independence. First, the Federal Reserve's extraordinary purchase of over $2 trillion in Treasury obligations through "quantitative easing" has lowered the cost of Treasury's borrowing, over 40 percent of which is reset every two years at current interest rates, effectively making the Federal Reserve a financier and enabler of federal deficit spending. Second, the Federal Reserve's unprecedented purchase of over $1.5 trillion in mortgage-backed securities, making the Fed the owner of over 25 percent of outstanding mortgage-backed securities, arguably puts the central bank in the position of favoring certain sectors of the economy over others, with troubling implications for its independence. Finally, the Federal Reserve and other banking regulators have promulgated regulations like the Volcker Rule and negotiated international capital standards under Basel III that provide strong incentives for banks to crowd into certain asset classes, particularly sovereign debt.

This hearing will explore these issues and consider whether a revision of the 1951 Accord and a reexamination of the Federal Reserve Act may be necessary to address the Federal Reserve's participation in credit allocation policy.

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