OPENING STATEMENT OF REP. MELVIN WATT

Hearing Entitled, "Regulatory Restructuring: Balancing the Independence of the Federal Reserve in Monetary Policy with Systemic Risk Regulation"

Thursday July 9, 2009

Our current regulatory system, created largely as a response to Great Depression in the 1930's, was proven ineffective and outdated at preventing and addressing the financial crisis we are currently experiencing. Recognizing this, the President recently put forth a proposal for comprehensive financial regulatory reform. This hearing will examine one aspect of that proposal -- the part that proposes to delegate to the Federal Reserve broad new powers, including the power to serve as the "systemic risk regulator," for all large, interconnected financial firms.

As the systemic risk regulator, the Federal Reserve would be empowered to structure and implement a more robust supervisory regime for firms with a combination of size, leverage and interconnectedness that could pose a threat to financial stability. The hearing will examine whether and how the Fed could perform and balance the proposed new authority as systemic risk regulator with its current critical role as the independent authority on monetary policy.

While recent events have caused many to re-evaluate and question the role and the extent of independence accorded to the Federal Reserve, the Fed's independence -- independence from political influence by the legislative and executive branches of government -- has long been viewed as necessary to allow the Fed to meet the long-term monetary policy goals of low inflation, price stability, maximum sustainable employment and economic growth.

Most central banks around the world (including the Federal Reserve, Bank of England, Bank of Japan and the European Central Bank) have had a strong tradition of independence in executing monetary policy. Many scholars and commentators agree that an independent central bank that is free from short-term political influence and exhibits the indicia of independence (such as staggered terms for board members, exemption from the appropriations process and no requirement to directly underwrite government debt) can better execute the long term goals of monetary policy.

The important question our hearing today is focused upon is whether the Fed can maintain its current role as the independent authority on monetary policy and take on a new -- and significant -- role as the systemic risk regulator. Some scholars and commentators argue that the Fed is uniquely positioned to become the systemic risk regulator because it already supervises bank holding companies and through its monetary policy function helps manage macroeconomic policy. Others argue that the Fed is already stretched too thin and has strayed from its core monetary policy function, particularly by using its powers under Section 13(3) of the Federal Reserve Act to purchase securities in distressed industries under existing emergency circumstances.

As Congress and the President work to enact financial regulatory reform it is critical for us to examine carefully the extent to which proposed new roles may conflict with existing roles and whether the Fed can effectively juggle all of these roles while performing its vital function as the nation's independent authority on monetary policy. For our economy to function effectively, the Fed's monetary activities, such as open market operations, discount window lending and setting bank reserve requirements, must be independent and free from political influence. We need to get a clear handle on the extent to which the Administration's proposals could compromise or interfere with what the Fed already is charged to do. I look forward to learning more about how and whether the Fed can effectively carry out additional regulatory responsibilities, while maintaining its current role as the independent authority on monetary policy.