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# Bernanke Heads to Congress Battling Calls to Tame the Fed

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Federal Reserve Chairman Ben Bernanke helped steer the economy away from what he calls "Depression 2.0." Now he's trying to defend the Fed itself.

As Mr. Bernanke heads to Capitol Hill today for two days of testimony on the economy, the central bank is fending off attacks on many fronts from critics who want to rein in its power and autonomy.

Rallying one charge is Ron Paul, an iconoclastic Texas Republican who wants to abolish the central bank entirely. Mr. Paul's economic ideas sometimes make him the target of ridicule -- in the new film "Bruno," shock comedian Sacha Baron Cohen tries to seduce the startled congressman in a hidden-camera scene while discussing economic theory.

Still, Mr. Paul has persuaded nearly two-thirds of the House to co-sponsor a bill requiring far-reaching congressional audits of the Fed. Audits would show "that it's the Fed that has caused all the mischief" in the U.S. economy, Mr. Paul says.

President Barack Obama has proposed giving the Fed some new powers to oversee financial institutions -- but he also wants to limit its authority to make emergency loans like the ones used to bail out [American International Group Inc.](#) and Bear Stearns. Meanwhile, the Fed is being pushed to rethink its structure amid concerns that bank-industry executives have too much influence in its actions.

Many Fed critics blame it for the economic crisis. They say it failed as a bank regulator and also fueled a bubble by keeping interest rates too low for years. They also feel Mr. Bernanke, who became chairman in 2006, stretched the Fed's powers too far by bailing out firms like [AIG](#), pushing [Bank of America](#) to complete its Merrill Lynch takeover, and pumping hundreds of billions of dollars into the financial system.

Mr. Bernanke defends his actions. "I don't regret anything we've done," he said in a recent interview. "If the Fed and the Treasury hadn't acted" as they did, "then the global economic environment would have been much, much worse than it is today," he said. "There would have been some risk of a 1930s-style Great Depression. We averted that."

He strongly opposes the proposal to audit the Fed, calling it "self-defeating and dangerous." The risk: If investors see the Fed facing new political oversight, they will doubt its ability to take unpopular steps to fight inflation -- one of the Fed's top jobs. Fearing inflation, bond investors will push interest rates up, hurting the weak economy.

Mr. Bernanke has plenty of support -- 43 of 46 private economists surveyed by [WSJ.com](#) say he should be reappointed. Mr. Obama, though he hasn't tipped his hand on reappointment, recently has said Mr. Bernanke has done a "fine job under very difficult circumstances."

Mr. Bernanke will face a tough audience in his semiannual report to Congress Tuesday and Wednesday. The Fed "went too far in bailing out companies and exposing taxpayers" to the costs, says Sen. Richard Shelby of Alabama, the senior Republican on the Senate Banking Committee. "They utterly failed the American people as a bank regulator."

Mr. Shelby says he doesn't want to impede the central bank's ability to conduct monetary policy independently, but he is also skeptical of giving it new powers.

The central bank has three influential roles in the national economy: Preventing inflation, keeping unemployment low, and acting as a "lender of last resort" to prevent financial panics. If it fails, the consequences can be grave -- an inflation outbreak like the 1970s, or a Great Depression like the 1930s.

Most economists agree that fighting inflation requires political independence because it involves unpopular decisions to raise interest rates and slow economic growth that can fuel unemployment.

"We're at a crossroads," says Frederic Mishkin, a Columbia University economist and Bernanke supporter who was a Fed governor in the early stages of the crisis. "We're going to be facing much more scrutiny and attacks on the independence of the Federal Reserve."

Complicating matters for Mr. Bernanke: His own job is on the line. His term as Fed chairman is up in January, and President Obama must decide whether to offer another four-year term. One possible contender for the job is Lawrence Summers, Mr. Obama's top economic adviser.

While fighting hard on some issues, Mr. Bernanke has found other compromises. He has agreed with administration officials on new checks on the Fed's ability to make emergency loans.

Mr. Bernanke is also reaching out to lawmakers to make his case. On Monday, Linda Robertson, a former Treasury official and Enron lobbyist, started working at the Fed to improve its relations with Congress. Mr. Bernanke has held 25 one-on-one meetings with lawmakers the past six months, as well as nine group sessions.

Despite the public tongue-lashings Mr. Bernanke has received, his private meetings have been notably civil. "Mr. Chairman, I just want to let you know you're doing a fine job," Rep. Don Manzullo (R., Ill.) told him at one meeting recently, according to a person familiar with the matter. It came just a few weeks after the two clashed at a hearing in which Mr. Manzullo began demanding "yes" or "no" answers from him, and Mr. Bernanke retorted: "It's a poorly posed question."

A spokesman for Mr. Manzullo says he respects Mr. Bernanke as a "man of integrity" who "gives straight answers."

Most major democracies let their central banks act without political interference. The Fed is afforded unusual autonomy. Fed officials have long terms -- 14 years for a board governor. Congress controls the purse strings of government departments and agencies -- but not the Fed's.

More than 250 prominent economists recently signed a statement warning that the Fed's independence is at risk. Mr. Bernanke's predecessor, Alan Greenspan, calls Mr. Paul's bill in particular a "serious problem" that could "change the [Fed's] deliberations process and significantly lower the quality of what comes out of the system."

Markets present their own kind of test of the Fed's actions. As part of its economic rescue, the Fed is buying \$300 billion of medium- and long-term U.S. Treasury debt, one of the many unusual steps it has taken to lower interest rates. The move has prompted some worry among Fed officials that it could be seen as an effort to help the U.S. government finance

soaring budget deficits.

Mr. Bernanke has been working the phones to reassure officials in other countries that this isn't happening. The Fed's holdings of U.S.-government bonds, in fact, have gone down the past two years because it sold off a stockpile of Treasuries in the first half of 2008 to help other lending.

"We absolutely will not monetize the debt," Mr. Bernanke says, using economist-speak that means he won't let the Fed become the government's source of cash for deficits. Fed-fueled deficits would be inflationary. Mr. Bernanke says, "we will not abandon price stability."

Yields on 10-year Treasury notes, at 3.60%, are still historically low. That's a sign the debate about the Fed's independence hasn't unsettled the markets.

But the market balance can be delicate. David Kotok, chairman of Cumberland Advisors, a Vineland, N.J., money-management firm, says he worries politics will make it harder for the Fed to fight inflation. "I have one eye on the barn door," and if there is a whiff of inflation, he says, he'll start selling bonds, which pushes up interest rates.

It has taken decades for the Fed to establish its independence. Until the 1930s, the Treasury secretary sat on the Fed's Washington board, and in the early 1950s, the Fed fought with the Treasury for more autonomy. But it wasn't until after former Fed chairman Paul Volcker jacked up interest rates in the early 1980s to kill inflation that full central-bank autonomy became an accepted part of political life. Today, Mr. Volcker is an adviser to President Obama.

When Mr. Bernanke first met Mr. Obama last July in the Fed chairman's stately office, Mr. Obama, then a candidate, began the conversation by saying, "The first thing I want to tell you, Mr. Chairman, is I have great respect for the independence of the Federal Reserve," according to attendees.

Mr. Bernanke got most of what he wanted in the Obama administration's blueprint for renovating the financial system -- including a plan to close big failing financial institutions in the future so they don't land in the Fed's lap, and more authority to keep overseeing those institutions.

The Obama plan gives the Fed some additional powers, but also takes some power away. Mr. Bernanke agreed to a proposal that the Fed must get executive-branch approval for unusual lending, such as the emergency AIG loans.

At the same time, both Congress and the White House are pressing for reviews of the Fed's structure. A prime target: The 12 regional Fed banks that have a say in interest-rate decisions and bank regulation.

Under the 1913 law that created these regional Fed banks -- in places like New York, Richmond, San Francisco and Kansas City -- local boards choose each bank's president. The regional boards are composed in part of private bankers.

Critics say this setup makes the regional banks unaccountable and too close to private bankers. "There's a definite conflict of interest when the banks are involved in selecting their regulators," says Sen. Shelby.

One solution could be subjecting the presidents to Senate confirmation, but Fed officials oppose that. The Fed could try to head off a fight over the banks by proposing its own reforms, for instance by seeking to change the rules overseeing the private sector directors.

The proposal by Mr. Paul, the Texas lawmaker, for a Fed audit by Congress is the most obvious symptom of skepticism

toward the Fed's autonomous status. Mr. Paul says a "natural consequence" of an audit would be that the public "would be so outraged" about the findings that they will decide to kill the institution entirely.

Mr. Paul, an obstetrician and two-time presidential candidate, considers the Fed to be unconstitutional. He sells "Audit the Fed" T-shirts on his Web site, and his movement has a small but deeply committed following: Supporters even have a dating Web site in his name, "Ron Paul Singles," where users seek others displeased with the Fed.

Mr. Paul's bill would repeal limits on audits of the Fed by the Government Accountability Office, opening it to much closer scrutiny from Congress. The GAO already audits some Fed activities, such as its regulation of banks. Mr. Paul's bill opens other Fed activities -- such as interest-rate decisions or trading with other central banks -- to more scrutiny.

In May, Mr. Bernanke left a hearing bristling after an exchange with Mr. Paul. Mr. Bernanke said Mr. Paul's bill would interfere with the Fed's interest-rate decisions. "I certainly would resist any attempt to dictate to the Federal Reserve how to make monetary policy," Mr. Bernanke said.

Mr. Paul shot back: "It's the policy that's the only thing that really counts."

Few lawmakers share Mr. Paul's wish to eliminate the central bank altogether. But his demands for more scrutiny have struck a chord. Some lawmakers want at least a one-time independent review.

Rep. Peter DeFazio, an Oregon Democrat, who has signed onto the Paul bill, argues that even the Central Intelligence Agency and National Security Agency are subject to GAO audits, albeit classified ones. (The Fed's wouldn't be classified.) A full review, he says, wouldn't put Congress in charge of "day-to-day operations," but would have value. It "may expose extraordinary stupidity. It may expose risk-taking."

A companion bill in the Senate faces more resistance. Eighteen lawmakers have signed on so far. "Anyone who doesn't like the Fed's independence should wait until the politicians can control it," said Sen. Chuck Schumer, Democrat of New York. Then, "they'll wish for independence."

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