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

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As America's central bank, the Federal Reserve is unique among independent agencies in exercising powers that the Constitution granted to the legislative branch, namely, regulating the value of money and borrowing funds directly from the public. In delegating these powers, Congress designed the Fed to ensure that its monetary policy decisions would be insulated from political interference. Furthermore, Congress has a constitutional obligation to maintain effective oversight of the Fed's exercise of these duties. Over the past fifteen years, however, the scope and complexity of monetary policy has outpaced Congress's ability to monitor these policies through existing mechanisms of oversight. Consequently, this congressional "undersight" is undermining the delicate balance between the Fed's independence and public accountability. For example, internal shifts in the Fed's governance and power dynamics have led to the disappearance of dissents on monetary policy decisions, thereby hampering legislators' ability to discern the range of views that have informed those decisions. Moreover, in conducting its latest round of securities purchases ("QE4") during 2020-22, the Fed did not provide legislators with cost-benefit analysis or risk assessments at any stage of the program. Indeed, QE4 is now likely to cost taxpayers more than $1 trillion, but its efficacy has still not been scrutinized by any external reviews. To restore effective oversight of the Fed's monetary policymaking, legislators may wish to consider potential approaches such as strengthened reporting requirements, secured access to sensitive information, and external reviews by congressional watchdogs.

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INTRODUCTION

In December 2013, as Federal Reserve Chairman Ben Bernanke was leaving office he advised his successor, Janet Yellen, "the first thing to agree to is that Congress is our boss."[1] Bernanke's remarks reflected the well-settled understanding that the central bank is an agent of Congress.[2] The Fed exercises crucial legislative duties in determining monetary policy and is authorized to act decisively in economic and financial emergencies.[3]

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[1] Transcript of Chairman Bernanke's Press Conference, Dec. 18, 2013, https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20131218.pdf

[2] *See* SARAH BINDER & MARK SPINDEL, THE MYTH OF INDEPENDENCE: HOW CONGRESS GOVERNS THE FED (2017) (discussing why central bank independence does not free the Fed from accountability to Congress); Peter Conti-Brown, *Restoring the Promise of Federal Reserve Governance*, Mercatus Rsch. Paper, 2020; *see generally Hearing on Examining the Accountability of the Federal Reserve System to Congress and the American People*, S. Comm. on Banking, Housing, and Urban Affairs, Mar. 3, 2015, https://www.govinfo.gov/-content/pkg/CHRG-114shrg93893/pdf/CHRG-114shrg93893.pdf (inquiring about the Fed's accountability to Congress).

[3] *See infra* Part I. For a literature on the Fed's emergency power, see, for example, BEN BERNANKE, TIMOTHY F. GEITHNER & HENRY M. PAULSON JR., FIREFIGHTING: THE FINANCIAL CRISIS AND ITS LESSONS (2019);

By 2024, however, the scope, complexity, and frequent use of these collective powers has outstripped Congress's ability to monitor its agent through the existing mechanisms of Fed oversight.[4] Tellingly, the Fed conducted a securities purchase program between 2020 and 2022 that is now estimated to cost U.S. taxpayers more than $1 trillion—yet this program was initiated without any congressional notice or consultations; and now, nearly two years after its conclusion, has still not been subject to meaningful *ex post* legislative review.[5] This Article describes the present situation of central bank 'undersight' and explains why it is constitutionally problematic and may contribute to unforced policy error.

To be sure, the optimal shape of central bank oversight is no simple matter to determine. Generally speaking, Congress oversees administrative agencies for two reasons: to ensure that their actions conform to the law (i.e., that agencies are not pursuing goals that are *ultra vires*) and to prevent them from wasting taxpayer money.[6] To those ends, Congress routinely conducts hearings to ask questions of agency heads, commissions performance and financial audits to probe programmatic efficiency, and adjusts agencies' budget appropriations to steer their attention and priorities.[7]

But overseeing the Fed is far less straightforward. Unlike other administrative agencies, the Fed is not engaged in the work of assisting the

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4 There is a considerable literature on the increased power of central banks and the Federal Reserve in particular, since 2008. *See, e.g.*, JEANNA SMIALEK, LIMITLESS (2023); DAVID WESSEL, IN FED WE TRUST (2009); Christina Parajon Skinner, *Central Bank Activism*, 71 DUKE L.J. 247 (2021).

5 *See infra* Part II.B. The mark-to-market valuation of the Federal Reserve's securities holdings declined by $1.4 trillion from the end of 2021 to the third quarter of 2023; *see* Board of Governors of the Federal Reserve System, *Federal Reserve System Audited Annual Financial Statements*, BD. GOV. FED. RSRV. SYS. (Mar. 24, 2023), https://www.-federalreserve.gov/aboutthefed/audited-annual-financial-statements.htm [https://-perma.cc/LVT8-35XX]; Board of Governors of the Federal Reserve System, *Federal Reserve Banks Combined Quarterly Financial Reports (Unaudited)*, BD. GOV. FED. RSRV. SYS. (Nov. 17, 2023), https://www.federalreserve.gov/aboutthefed/combined-quarterly-financial-reports-unaudited.htm [https://perma.cc/FZ94-E68P]. Because the mark-to-market losses have led to a decrease in the usual remittances from the Fed to the Treasury, they cannot be dismissed as merely "paper losses."

6 Specifically, the function of oversight is to allow Congress to "gather[s] information on [an agency's] activities," and "make[s] sure that laws are working as intended and are being administered in an effective, efficient, and economical manner." BEN WILHELM ET AL, CONG. RSCH. SERV., RL30240, CONGRESSIONAL OVERSIGHT MANUAL 2 (2021). *See also* Congressional Research Serv., Oversight Manual, (noting that agencies must operate "in accordance with their authorizing statutes") [hereinafter OVERSIGHT MANUAL].

7 *See infra* Part III; *see also* CONGRESSIONAL RESEARCH SERV., OVERSIGHT MANUAL (Mar. 2021), https://sgp.fas.org/crs/misc/RL30240.pdf [hereinafter OVERSIGHT MANUAL].

executive "take care" that the law is enforced.[8] Rather, the Fed directly exercises Congress's Article I power. In particular, by executing its monetary policy operations, the Fed both "regulates the value" of money[9] and actively borrows from the public to fund itself by issuing federal reserve notes, bank reserves, and other forms of short-term money-like liabilities to non-banks.[10] Indeed, the federal courts recognize that the Fed is carrying out the work of Congress, not the President, and hence consistently demur in their review of monetary policy decisions. Citing the political question doctrine, courts have directed the plaintiffs to take their case to Congress.[11]

Moreover, in exercising its monetary duties, the Fed wields tremendous power. Its policy decisions touch nearly every facet of economic life. Yet because central bankers are not elected, the legitimacy of this power depends on public acceptance of the Fed's policy actions, which can only be garnered indirectly via Congress's approval. For such approval to be meaningful, congressional oversight must be effective at bringing Fed decisionmaking into public light.[12] On that view, the structure of the Constitution would seem to compel Congress to exercise energetic oversight of the Federal Reserve.[13]

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8 U.S. CONST., Article I, § 3.

9 U.S. CONST., Article I, § 8, cl. 2

10 From 1913 onwards, the Federal Reserve Act has stated that all Federal Reserve notes "shall be obligations of the United States." Federal Reserve Act § 16, part 1. For a discussion of these authorities, see *infra* Part I.

11 For example, in *Bryan v. FOMC*, the district court held that the plaintiff's "complaint and views on the monetary policy of the United States may properly be presented to Congress" and hence not justiciable. Bryan v. Federal Open Market Committee, 235 F. Supp. 877 (1964). The inclination towards judicial deference on monetary policymaking has been reinforced by the complexity and fluidity of economic and financial conditions. In 1929, the Second Circuit stated that judicial review of the Federal Reserve's setting of discount rates would be "grotesque, when we remember that conditions in the money market often change from hour to hour." Raichle v. Federal Reserve Bank of New York, 34 F.2d 910, 915 (1929). The D.C. District Court reached a parallel conclusion in 1985. Comm. for Monetary Reform v. Bd. of Governors of the Fed. Reserve Sys., 766 F.2d 538, 542 (D.C. Cir. 1985) ("We think that courts lack both the competence and the authority to determine such abstract issues, which are better addressed through political and economic debate over the role of monetary policy in the national economy").

12 As scholars and policymakers have long noted, without rigorous oversight, "the country must remain in embarrassing, crippling ignorance of the very affairs which it is most important it should understand and direct." WILHELM ET AL, *supra* note 6, at 2.

13 *See* OVERSIGHT MANUAL, *supra* note 6, at 4 (noting that the "checking" function of oversight "serves to protect Congress's policymaking role and its place under Article I in the U.S. constitutional system of checks and balances"). *See also* ARTHUR SCHLESINGER JR. AND ROGER BURNS, EDS., CONGRESS INVESTIGATES: A DOCUMENTED HISTORY, 1792-1974,

On the other hand, there are equally weighty reasons why Congress defers to the Fed's judgments on specific monetary policy decisions. For one, the Fed's deliberations necessarily involve confidential and highly sensitive information whose disclosure could disrupt financial markets and destabilize the economy. Consequently, the Fed communicates each of its decisions very carefully, with selective or delayed disclosure of such information.[14]

The Fed is also on the frontlines in financial emergencies.[15] When financial crises hit, the nation depends on the central bank to provide liquidity to key financial markets and to solvent but temporarily illiquid institutions.[16] A pluralistic body like the legislature may well be too slow to pre-authorize or review tactical judgments in the heat of battle without causing harm to the collective good.[17]

Reflecting such considerations, Congress has exempted the Fed from almost all of the mechanisms that it uses for overseeing other independent agencies. The Fed is the only independent agency whose operating expenses are not included in the federal budget and whose liabilities are not covered by the federal debt ceiling. The Fed sets its own accounting rules and is exempt from the Generally Accepted Accounting Practices ("GAAP") that are followed by all other federally-created entities.[18] Over the past century the Fed has funded its operating expenses with seigniorage (i.e., net interest income accruing from its exclusive right to issue paper currency), but the Fed

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vol. 1, at xiii (1975) (noting that the Framers did not think "necessary to make an explicit grant of such [oversight] authority" because "[t]he power to make laws implied the power to see whether they were faithfully executed").

14 *See* Kevin L. Kliesen, Brian Levine & Christopher J. Waller, *Gauging the Evolution of Monetary Policy Communication Before and After the Financial Crisis*, Federal Rsrv. Bank of St. Louis, 2018, https://research.stlouisfed.org/publications/economic-synopses/-2018/10/26/gauging-the-evolution-of-monetary-policy-communication-before-and-after-the-financial-crisis.

15 *See* Tim Sablik, *The Fed's Emergency Lending Evolves*, Federal Rsv. Bank of Richmond, 2020, https://www.richmondfed.org/publications/research/econ_focus/2020/q2-3/-federal_reserve.

16 *See, e.g.*, Bd. of Governors of the Federal Reserve Sys., Coronavirus Disease 2019, Funding, Credit, Liquidity, and Loan Facilities, https://www.federalreserve.gov/funding-credit-liquidity-and-loan-facilities.htm.

17 For a summary of the view that the Fed is subject to sufficient oversight, see Marc Labonte, *Federal Reserve: Oversight and Disclosure Issues*, Cong. Rsch. Serv., Mar. 27, 2017, https://sgp.fas.org/crs/misc/R42079.pdf.

18 *See infra* Part II.B.

is now incurring operating losses and is financing those losses by issuing debt directly to the public.[19]

The Federal Open Market Committee ("FOMC")—the Fed's monetary policymaking body—is not required to provide cost-benefit analysis of its programs or to alert Congress about potential risks of its policies. Moreover, the Fed's monetary policy framework and operations are not reviewed by any congressional watchdogs. The Government Accountability Office ("GAO"), commonly known as "the taxpayer's best friend," conducts performance reviews of every other independent agency but is statutorily proscribed from assessing the efficiency and effectiveness of the Fed's monetary policy programs. [20] Likewise, every other major federal agency (with operating expenses exceeding $5 billion) has its own fully independent Inspector General ("IG") who is appointed by the President and confirmed by the Senate, whereas the Fed's IG is appointed by its Board and works at the direction of the Fed Chair on all matters pertaining to monetary policy. Meanwhile, shifts in the governance and power dynamics within the Federal Reserve System have effectively muted dissent on the FOMC, which further hampers Congress's ability to raise questions about the Fed's monetary policy programs and operations.[21]

Many of the decisions to adopt this light-touch Fed oversight were made in the 1970s. More recently, however, the Fed's power has dramatically expanded—and for the most part, outside of any formal changes to the law. By broadening its interpretation of section 13(3) of the Federal Reserve Act, the Fed now intervenes in credit markets to buy debt instruments like commercial paper and corporate bonds.[22] And by re-defining the purpose of open market operations under section 14, the Fed has adopted a practice of providing monetary stimulus by buying large quantities of public debt and mortgage securities referred to as "quantitative easing" ("QE").[23] The Fed now acts as counterparty to a wide range of nonbank money market funds in the overnight money market and provides backup funding to those institutions.[24] While each of these policy innovations may be appropriate in

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19 *See infra* Part I.B.

20 Press Release, Homeland Security & Governmental Affairs, *Comptroller General Nominee Testifies Before HSGAC* (Nov. 18, 2010), https://www.hsgac.senate.gov/media/reps/-comptroller-general-nominee-testifies-before-hsgac/ [https://perma.cc/2EWR-G458].

21 *See* Part I.B. *See also* Federal Reserve Bank of St. Louis, *A History of FOMC Dissents*, Fed Rsrv. Bank St. Louis (Sept. 14, 2014), https://www.stlouisfed.org/on-the-economy/2014/september/a-history-of-fomc-dissents [https://perma.cc/BSJ8-JDQW].

22 *See* Skinner, *supra* note 4.

23 *Id*. *See also* Part I.B.

24 *See* Part II.B.

light of evolving financial market characteristics, the fact remains that none of these facilities or programs were explicitly authorized by Congress.

Longstanding historical experience has underscored the importance of protecting the central bank's monetary policy decisions from political interference—this is, after all, the key insight of the academic literature on central bank independence ("CBI").[25] But the economic rationale that underpins CBI does not supply *a legal basis* for treating the Federal Reserve like a fourth branch of the government.[26] Accordingly, the principal goal of this Article is to interrogate whether the current balance between the operational independence and democratic accountability remains sufficient, thereby ensuring that the Fed is appropriately using its power given how dramatically the central bank's balance sheet and operations have changed.[27]

In doing so, the Article contributes to two overlapping literatures relevant to the law and policy of U.S. central banking. The first of these literatures pertains to the Federal Reserve. Although previous scholarship has explored the topic of central bank independence,[28] there has not been a systematic assessment of the Fed's exemptions from routine forms of congressional oversight as this Article sets out to do.

Second, the Article intervenes in the live constitutional debate on agency accountability. More precisely, the question of how the Fed answers to Congress is squarely within the Supreme Court's ongoing review of whether the President's removal power is sufficient to hold independent agencies accountable,[29] whether agencies can be compelled to enforce the law as

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[25] For a collection of research shortly after the "time-inconsistent" theory was solidified, see Richard Dennis, Time-Inconsistent Monetary Policies: Recent Research, Apr. 11, 2003, https://www.frbsf.org/economic-research/publications/economic-letter/2003/april/time-inconsistent-monetary-policies-recent-research/.

[26] One recent quote from Vice Chair of Supervision Michael Barr illustrates the view adopted by at least some of the Governors, that the Fed is neither part of the executive nor the legislative branches. *See* Michael Barr, Speech, *The Federal Reserve's Role in Supporting Responsible Innovation*, Sept. 8, 2023 (noting that the Fed would only proceed with a CBDC if it had "clear support from the executive branch and authorizing legislation from Congress"). This is baffling from a separation of powers perspective.

[27] To be clear, this project is focused on oversight modernizing. We agree that CBI is important to avoid short-termism. But we ultimately conclude that Congress should be doing more to interrogate policy or strategic shifts after the fact to bring accountability and transparency to Fed balance sheet activity. *See* Part III.

[28] *See, e.g.*, PETER CONTI-BROWN, THE POWER AND INDEPENDENCE OF THE FEDERAL RESERVE (2017); Michael Salib & Christina Parajon Skinner, *Executive Override of Central Banks*, 108 GEO. L. REV. 905 (2020); *see also* Adrian Vermuele, *Conventions of Agency Independence*, 113 COLUM. L. REV. 1163, 1196 (2011).

[29] Collins v. Yellen, 594 U.S. _ (2021); Seila Law v. CFPB, 591 U.S. _ (2020).

written,[30] the constitutionality of the funding structure of non-appropriated agencies,[31] and the extent to which courts may defer to agencies' interpretation of their own mandates under the *Chevron* deference doctrine.[32]

To that end, the Article proceeds in three parts.[33] Part I descriptively analyzes the Fed as a unique fixture within American constitutional democracy. It explains how the Fed directly exercises Article I power and points out that, without robust congressional oversight, this power would be effectively unchecked—an anathema in our system of separated-and-balanced power within government. Part I thus makes the case for energetic congressional oversight of the Fed. Part II examines the structures of Fed oversight and explains why those mechanisms are now anachronistic. Herein the Article develops a framework for assessing 'central bank undersight.' Part III briefly considers some potential options that could strengthen the Fed's public accountability while protecting its independence from political interference.

The Fed would not be the first agency in U.S. history to outpace Congress. By now, it is well documented and understood that after World War II the imperatives of the Cold War motivated the formalization of various intelligence agencies that exercised expansive powers hidden from public view. It was not until the early 1990s that Congress established mechanisms for exercising meaningful oversight of the intelligence community. In similar fashion, Congress may now wish to revisit its mechanisms for overseeing the Federal Reserve System given how radically the Fed has changed.

I. THE FED'S ARTICLE I POWER AND DUTIES

In carrying out its monetary policy duties, the Federal Reserve is directly exercising Congress's Article I powers to regulate money and to borrow directly from the public. The Framers of the U.S. Constitution specifically

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[30] United States v. Texas, 599 U.S. _ (2023).

[31] CFPB v. Community Financial Servs. Assoc., No. 21-50826 (5th Cir., Oct. 19, 2022), cert. granted, No. 22-448 (Feb. 27, 2023).

[32] Loper Bright Enterprises v. Raimondo, 45 F.4th 359 (D.C. Cir. 2022), cert. granted, No. 22-451 (May 2023).

[33] It will be important for the reader to bear in mind that the Article does not consider any potential changes in the Fed's governance structure or statutory mandate. Moreover, it bears noting that the analysis does not encompass any of the Fed's other key responsibilities such as banking supervision and regulation of the payments system.

gave these powers to the legislature, not the Executive.[34] Consequently, the Fed has a unique relationship with the President, whose authority to remove Fed officials is tightly constrained, and with the courts, which have consistently abstained from judicial review.[35] In effect, the Fed exercises legislative power without any of the usual checks and balances. The structure of the Constitution would thus appear to compel robust congressional oversight of the Fed's monetary policy function.[36]

A. Regulating the Value of Money

The founding generation recognized that responsible stewardship of public money would be critical to the successful establishment of a well-functioning representative democracy. Accordingly, the framers and the ratifiers of the Constitution were quite delicate—and deliberate—in assigning the power to create currency and regulate its value. Article I, section 8 indicates that Congress shall have the power "To coin Money, regulate the Value thereof, and of foreign Coin, and fix the Standard of Weights and Measures."[37] While this power is generally referred to as the "coinage clause," it effectively authorizes Congress to establish and regulate the value of paper currency as well as coins to serve as legal tender for all debts, public and private.[38]

This power is the exclusive prerogative of the legislature. As indicative of that intent, the Constitution expressly prohibits states from issuing their

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34 U.S. CONST., Art. 1, § 8, c. 5. *See also* Christina Parajon Skinner, *The Monetary Executive*, 91 GEO. WASH. L. REV. 164 (2023).

35 *See* Aditya Bamzai & Aaron L. Nielson, *Article II and the Federal Reserve*, 108 CORNELL L. REV. _ (forthcoming 2024); Steffi Ostrawski, Note, *Judging the Fed,* 131 YALE L. J. 370 (Nov. 2021) (providing an overview of judicial review of the Fed).

36 Concerns about federally-created entities emerging as a "fourth branch" were initially raised by the Brownlow Committee, a taskforce commissioned by President Franklin D. Roosevelt. *See* The President's Committee on Administrative Management, *Report of the Committee with Studies of Administrative Management in the Federal Government*, U.S. Printing Office (1937), 32-53. See also Jennifer L. Selin & David Lewis, *Sourcebook of United States Executive Agencies, 2nd edition*, Administrative Conference of the United States (2018), 10.

37 U.S. CONST., Art. 1, § 8, c. 5.

38 *See* BENJAMIN FRANKLIN, A MODEST ENQUIRY INTO THE NATURE AND NECESSITY OF PAPER CURRENCY (1729). At the constitutional convention, Nathaniel Gorham advocated for issuance of bills and notes to be neither prohibited nor explicitly authorized so that Congress would be able to do so "as far as it will be necessary or safe." BERNARD H. SIEGAN, THE SUPREME COURT'S CONSTITUTION: AN INQUIRY INTO JUDICIAL REVIEW AND ITS IMPACT ON SOCIETY 24 (1987). The Supreme Court confirmed this congressional power in the Legal Tender cases of Knox v. Lee, 79 U.S. 457 (1871); Parker v. Davis 78 U.S. 682 (1871); Juilliard v. Greenman, 110 U.S. 421 (1884).

own local versions of money—a practice that had been commonplace across the colonies before the Revolution. During the ratification debates, it was noted that state-issued currencies would "materially interfere with the exercise of the like by Congress." [39] Accordingly, section 10 of the Constitution establishes that "[n]o State shall . . . coin Money; emit Bills of Credit; make any Thing but gold and silver Coin a Tender in Payment of Debts."[40]

Moreover, the framers and ratifiers clearly intended to cordon off the President's power to issue currency.[41] History was replete with monarchial abuse of such power; indeed, as Robert Natelson has pointed out, quoting William Blackstone, "The Framers all had lived the first part of their lives under law that identified the Crown as the 'arbiter of commerce' within Great Britain."[42] Monarchs with the power to alter money's value would tend to abuse that power by inflating the currency and eroding its purchasing power, often leading to popular unrest.[43] Conversely, there was general recognition that a monetary expansion might become imperative in case of war or some other national emergency.[44] Thus, the Constitution vested the coinage power with the most representative branch of government—the Congress.

For nearly one and a half centuries, Congress directly carried out this mandate by specifying the value of the dollar in terms of precious metals, starting with the creation of the "silver dollar" in the Coinage Act of 1792 and

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39 JAMES MONROE, OBSERVATIONS UPON THE PROPOSED PLAN OF FEDERAL GOVERNMENT (1788), *reprinted in* 9 DOCUMENTARY HISTORY OF BANKING AND CURRENCY IN THE UNITED STATES 655, 676-77 (Herman E. Krooss ed. 1969).

40 U.S. Const., Art. I, § 10, cl 1. At Pennsylvania's ratifying convention, Jasper Yeates stated: "It is confessed the 10th section abridges some of the powers of the state legislature, as in preventing them from coining money, [and] emitting bills of credit . . . If state governments are prevented from exercising these powers, it will produce respectability, and credit will immediately take place . . . Congress alone with the powers given them by this system, or similar powers, can effect these purposes." *See* R. Carter Pittman, *Jasper Yeates's Notes on the Pennsylvania Ratifying Convention, 1787,* 22 WM. & MARY Q. 301, 308 (1965).

41 The pre-Revolutionary history of coinage powers belonging to the King have been researched in detail. *See e.g.,* MICHAEL MCCONNELL, THE PRESIDENT WHO WOULD NOT BE KING 161 (2020).

42 *See, e.g.,* Robert G. Natelson, *Paper Money and the Original Understanding of the Coinage Clause,* 31 HARV. J. L. & PUB. POL'Y 1017, 1029-30 (2008).

43 *See* Skinner *supra* note 42.

44 *See* ERIC P. NEWMAN AND RICHARD G. DOTY, STUDIES ON MONEY IN EARLY AMERICA (1976). At the onset of the American Revolution in 1775, the Continental Congress began financing the costs of the continental army by issuing paper currency, which depreciated to only 1/40th of its face value by 1780, thereby giving rise to the phrase "not worth a continental."

then effectively shifting to a gold standard in 1834.[45] Congress authorized the issuance of national paper backed by reserves held in bank vaults or at the U.S. Treasury.[46] The role of gold at the core of the monetary system was reaffirmed by the Gold Standard Act of 1900. That system remained susceptible to periodic banking panics.[47]

1. *Delegation to the Federal Reserve*

When Congress created the Federal Reserve System in 1913, its stated goals were "for the establishment of Federal Reserve Banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, [and] to establish a more effective supervision of banking in the United States, and for other purposes."[48] Although the Constitution assigned the coinage power to Congress, there was longstanding precedent (though not without controversy) for delegating that authority to a federally-created entity.[49]

Of course, the gold standard was in effect when the Fed was established, and hence it did not determine monetary policy in the modern sense of that term.[50] Rather, the phrase "elastic currency" conveyed the intent that the Fed

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45 *See* CRAIG K. ELWELL, CONG. RSCH. SERV., R41887, BRIEF HISTORY OF THE GOLD STANDARD IN THE UNITED STATES (2011). The Coinage Act of 1792 specified the dollar prices of gold and silver with a ratio of 15:1, thereby supporting the use of silver coins and silver-backed bank notes while incentivizing exports of gold to foreign markets. The Coinage Act of 1834 raised the gold price to $20.30 (up from $19.75), thereby shifting the monetary system to gold backing of bank notes and exports of silver.

46 Notes were issued by the first and second Banks of the United States in 1792-1811 and 1816-36, respectively, and then by nationally-chartered commercial banks starting in 1863. During the Civil War, Congress enacted the Legal Tender Act of 1862 authorizing the issuance of unbacked notes known as "greenbacks", which were subsequently withdrawn from circulation by 1879; *see* Michael D. Bordo, Andrew T. Levin, Christopher J. Erceg, & Ryan Michaels, *Three Great American Disinflations* (Nat'l Bureau of Econ. Rsch., Working Paper No. 12982, 2007).

47 *See* Gary Richardson & Tim Sablik, *Banking Panics of the Gilded Age*, FED. RSRV. HIST. (Dec. 4, 2015), https://www.federalreservehistory.org/essays/banking-panics-of-the-gilded-age [https://perma.cc/8KHT-C5ER].

48 Federal Reserve Act, Pub. L. No. 63-43, 38 Stat. 251 (1913) (codified as amended in scattered sections of 21 U.S.C.).

49 McCulloch v. Maryland, 17 U.S. 316 (1819) (establishing that the Second Bank of the United States, which exercised some facets of the coinage power, was constitutional as Congress had implied powers under Article I to create the institution insofar as it was "necessary and proper" to carrying out Congress's responsibilities under the coinage clause).

50 *See* MICHAEL D. BORDO & ANNA J. SCHWARTZ, A RETROSPECTIVE ON THE CLASSICAL GOLD STANDARD (1984) and THOMAS M. HUMPHREY & RICHARD H. TIMBERLAKE, GOLD, THE REAL BILLS DOCTRINE AND THE FED: SOURCES OF MONETARY DISORDER (2019).

would use its tools to smooth out seasonal fluctuations and to provide short-term liquidity in periods of financial stress.[51] In the early 1930s, however, the Fed failed to carry out its role as lender of last resort, leading to widespread bank panics and the onset of the Great Depression.[52] In 1933 the gold standard was abolished and monetary uses of gold were prohibited; soon thereafter, statutory constraints on the Fed's holdings of gold reserves were lifted and eventually eliminated altogether.[53]

Congress then proceeded to overhaul the Fed's governance in Title II of the Banking Act of 1935.[54] This legislation diminished the role of the regional Federal Reserve Banks, which are private institutions owned by commercial banks, and magnified the role of the Federal Reserve Board, which had previously been merely an oversight body. Moreover, that legislation

[51] In the 1920s, under the leadership of New York Fed President Benjamin Strong, the Federal Reserve used discount window policies and open market operations to foster stability in economic and financial conditions. *See* Skinner, *supra* note 4.

[52] *See* MILTON FRIEDMAN & ANNA J. SCHWARTZ, A MONETARY HISTORY OF THE UNITED STATES, 1867-1960 (1963). *See also* Ben S. Bernanke & Harold James, *The Gold Standard, Deflation, and Financial Crisis in the Great Depression: An International Comparison*, *in* FINANCIAL MARKETS AND FINANCIAL CRISES (R. Glenn Hubbard ed. 1991). For further analysis of the Fed's failure, see Michael D. Bordo, Ehsan Choudhri, & Anna J. Schwartz, *Was Expansionary Monetary Policy Feasible during the Great Contraction? An Examination of the Gold Standard Constraint*, 39 EXPLORATIONS IN ECONOMIC HISTORY 1–28 (2002); Jim Dorn, *How the Classical Gold Standard Can Inform Monetary Policy*, 40 CAT J. 777, 781 (2020) (noting that the U.S. had "massive excess gold reserves" in the 1930s); Richard H. Timberlake, *The Federal Reserve's Role in the Great Contraction and the Subprime* Crisis, 28 CATO J. 2 (2008) (pointing out that "Whether Fed Banks had excess gold reserves or not, all of the Fed Banks' gold holdings were expendable in a crisis").

[53] The gold standard was suspended by Presidential Proclamation 2039 (March 6, 1933) and terminated by the Gold Repeal Joint Resolution (June 5, 1933), which abrogated all gold clauses in private contracts. The Supreme Court upheld that abrogation in Norman v. Baltimore and Ohio Railroad Company (1935). Monetary gold holdings were prohibited by Executive Order 6102 (April 5, 1933). Following the enactment of the Gold Reserve Act of 1934, President Roosevelt raised the official price of gold to $35 per ounce, thereby enabling the Federal Reserve to issue currency without being constrained by the statutory minimum on its gold holdings. That constraint was reduced by Pub. L. 79-84 (June 1945) and abolished by Pub. L. 90-269 (March 1968).

[54] At the hearings on this legislation, Treasury Secretary Henry Morgenthau proposed a government buyout of all Federal Reserve Bank stock, while Fed Chair Marriner Eccles advocated the delegation of all monetary policy decisions to the Federal Reserve Board. Rep. Henry Steagall favored a purely advisory role for Fed Bank officials but acceded to the compromise proposed by Sen. Carter Glass. *See* Mark F. Bernstein, *The Federal Open Market Committee and the Sharing of Governmental Power with Private Citizens*, 75 VA. L. REV. 111, 121-22 (1989).

reshaped the FOMC into its modern form, with the Federal Reserve Board comprising a majority of its voting members.[55]

In doing so, Congress enacted several measures to insulate the Federal Reserve from the Executive Branch: (i) it removed the Secretary of the Treasury and the Comptroller of the Currency, who served at the pleasure of the President and had held *ex officio* roles as members of the Federal Reserve Board; (ii) established staggered fourteen-year terms for the seven Board members; and (iii) limited the President's ability to remove any Federal Reserve Board member from office except "for cause."[56]

At its inception in the mid-1930s, the FOMC would not have been expected to have a central role in monetary policymaking. The Federal Reserve's key policy lever was perceived to be the discount rate, that is, the interest rate on loans to commercial banks.[57] The Federal Reserve's portfolio of tradable securities was limited to Treasuries, at a time when the outstanding federal debt remained small, and short-term interest rates remained close to zero in conditions of depressed economic activity and consumer prices.

During World War II and its aftermath, economic and financial conditions shifted markedly. Retail banks regained a solid footing due to strengthened supervision as well as the provision of deposit insurance, and hence the Fed's lending to banks through the discount window practically vanished. Meanwhile, as the federal debt ballooned, the Federal Reserve's primary role was viewed as conducting open market operations to facilitate the smooth issuance of Treasuries, and the FOMC's policy decisions were practically dictated by Treasury officials.[58]

By the late 1940s, however, key members of Congress were calling publicly for the cessation of Treasury interference and thereby enable the

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[55] During the 1920s, the twelve Federal Reserve Banks began voluntarily coordinating their open market operations under the general supervision of the Federal Reserve Board. The Glass-Steagall Act of 1933 established the Federal Open Market Committee as comprising the heads of the 12 Federal Reserve Banks, with Federal Reserve Board members in attendance but playing no formal role in its decisions.

[56] *See* Gary Richardson, Alejandro Komai & Michael Gou, *The Banking Act of 1935*, Fed. Rsrv. Hist. (Nov. 22, 2013), https://www.federalreservehistory.org/essays/banking-act-of-1935 [https://perma.cc/3ZMG-XMR9].

[57] The reserve ratio prescribes the fraction of a bank's deposits that must be held at the Federal Reserve Bank. The discount rate is the interest rate charged by each Federal Bank in extending credit to member banks in its district.

[58] In characterizing the period from 1917 to 1951, Allan Meltzer noted that the "Treasury dominated the Federal Reserve more than half the time." *See* ALLAN MELTZER, A HISTORY OF THE FEDERAL RESERVE: 1913-1951 4 (2003).

FOMC to regulate the value of money.[59] In 1950, the policy subcommittee of the Joint Economic Committee stated that "it is the will of Congress that the primary power and responsibility for regulating the supply, availability, and cost of credit in general shall be vested in the duly constituted authorities of the Federal Reserve System."[60]

After further congressional hearings and floor debates, the Federal Reserve System and the Treasury issued a joint statement in March 1951 (commonly known as the Fed-Treasury Accord) that finally removed the Fed's straight-jacket.[61] From that point onwards, the FOMC was able to use open market operations to adjust the level of short-term interest rates as judged appropriate to foster economic stability.[62]

2. *The Monetary Policy Mandate*

When Congress created the FOMC in 1935 it knew that it could "certainly delegate . . . powers which the legislature may rightfully exercise itself,"[63] short of abdicating its constitutional duties.[64] Still, Congress did not specify

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59 In fall 1949 a subcommittee of the Joint Committee on the Economic Report under the chairmanship of Senator Paul Douglas (Illinois) held hearings on these issues; for a detailed recounting, see *id.*at 718-723, 753. The Douglas Committee's report concluded that monetary policy should not be subordinated to debt management; *see* Joint Committee on the Economic Report, Subcommittee on Monetary, Credit, and Fiscal Policies, *Monetary, Credit, and Fiscal Policies*, Hearings. 81st Cong., 2d session (1950).

60 S. REP. NO. 129, AT 2 (1950). In a subsequent speech before the U.S. Senate on February 22, 1951, Sen. Paul Douglas called for the Treasury to "abate its policies and yield on this issue" and for the Federal Reserve to "gird its legal loins and fulfill the responsibilities which I believe the Congress intended it to have."

61 For a narrative overview, see Jessie Romero, *The Treasury-Fed Accord,* FED. RSRV. HIST. (Nov. 22, 2013), https://www.federalreservehistory.org/essays/treasury-fed-accord [https://perma.cc/H7Z6-U5RU]. As an Assistant Secretary at the U.S. Treasury, William M. Martin, Jr. had a key role in negotiating the Accord and became Fed Chair soon thereafter. *See William McChesney Martin, Jr. Papers,* MO. HIST. SOC., https://fraser.stlouisfed.org/-archival-collection/william-mcchesney-martin-jr-papers-1341/.

62 *See* Allan Sproul, *The "Accord" – A Landmark in the First Fifty Years of the Federal Reserve System*, FED. RSRV. BANK N.Y. MONTHLY REV. 227 (Nov. 1964).

63 Wayman v. Southard, 23 U.S. 1, 43 (1825).

64 In delegating such powers, Congress therefore had to supply some "intelligible principle to which [the agency] is directed to confirm." The intelligibility principle standard was first announced in 1928, J.W. Hampton, Jr. & Co v. United States, and has since been referred to as the guiding standard. *See, e,g.*, Whitman v. Am. Trucking Associations, 531 U.S. 457, 472 (2001). Indeed, the same year the FOMC was created, the Supreme Court looked askance as delegations that "provide[d] literally no guidance for the exercise of discretion" or that "confer authority to regulate the entire economy" under a vague

a mandate for the FOMC until long after its creation.[65] A nascent effort occurred in 1937, at which point members of Congress considered the merits of adopting a Monetary Authority Act. At those hearings, Senator Robert Owen—one of the principal architects of the Federal Reserve Act a quarter-century earlier—explained that his vision of the central bank had always included an affirmative duty to "promote the economic stability of this country."[66] Senator Owen elaborated as follows:

> The Constitution provides very specifically that the Congress shall have the power to coin money and to regulate the value thereof, and we are only presuming now to consider the advisability of vitalizing that provision of the Constitution . . . It never has been done, and there have been reasons for it not having been done, but it occurs to some of us that the time has come where it is not only advisable, but absolutely necessary.[67]

In similar spirit, one of the principal experts testified:

> Now, it seems to me that there is no congressional duty more important than the necessity of preservation of our national economic existence . . . It is therefore the duty of Congress to assign a legal obligation to some authority which will be responsible for our economic stability . . . . If this legal obligation had been included in the Federal Reserve Bank Act in 1912, I feel positive that we would have avoided most of our serious financial difficulties.[68]

However, no legislation was adopted at that time, and the FOMC remained without a statutory mandate for the next four decades.[69]

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standard such as "fair competition." *See* Panama Refining Co. v. Ryan, 293 U.S. 388 (1935); A.L.A. Schechter Poultry Corp. v. United States, 295 U.S. 495 (1935). In similar spirit, the Court has said that the "The degree of agency discretion that is acceptable varies according to the scope of the power congressionally conferred." Whitman, 531 U.S. at 475.

[65] During the 1920s, Congress held a series of hearings on proposals to give the Fed an explicit mandate of price stability, but Fed officials were almost uniformly opposed and no legislation was adopted. For a detailed recounting, see ALLAN MELTZER, A HISTORY OF THE FEDERAL RESERVE: 1913-1951, 197-207 (2003).

[66] *Hearings on the Monetary Authority Act before the Subcomm. On Comm. On Agric. & Forestry,* 75th Cong. 115 (1937) (statement of Sen. Owen). [hereinafter Hearings, Monetary Authority Act 1937].

[67] *Id.* at 116.

[68] *Id.* at 107-108 (statement of Mr. George L. LeBlanc).

[69] In a 1962 report provided to the House Banking Committee, Clark Warburton stated: "The most needed change in the Federal Reserve Act is the insertion of a suitable directive for monetary policy." *The Federal Reserve System After Fifty Years: Hearings before the Subcomm. on Dom. Fin,* 88th Cong. 1320 (1964).

It would not be until 1977 that Congress gave the Fed a formal monetary policy mandate. That year, Congress enacted the Federal Reserve Reform Act, which added a new section to the Federal Reserve Act directing the FOMC to:

> maintain long run growth of the monetary and credit aggregates . . . so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates.[70]

The goal of "maximum employment" was taken directly from the Employment Act of 1946, which declared a "national policy . . . to promote maximum employment, production, and purchasing power."[71] The goal of stable prices echoed Congress' constitutional duty to "regulate the value of money" and provided greater clarity than the Employment Act's goal of maximizing "purchasing power."[72] The goal of "moderate long-term interest rates has generally been viewed as complementary to the first two goals, and hence the full clause is often referred to as the "dual mandate."

Congress left the mandate broad and in doing so gave the Fed a great deal of discretion.[73] Specifically, Congress chose not to define "stable prices"—the lodestar of its Article I coinage power—in terms of a specific price index or inflation rate. Likewise, the phrase "maximum employment" lacked a specific reference measure of the job market.[74] Furthermore, the

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[70] Federal Reserve Act, § 2A.

[71] Employment Act of 1946, title and section 2.

[72] In its 1950 report to the Joint Economic Committee, the Subcommittee on Monetary, Fiscal and Credit Policies highlighted "the vigorous use of restrictive monetary policy as an anti-inflation measure." *See supra* note 60. Likewise, in 1966 the Council of Economic Advisors provided a two-decade retrospective on the Employment Act that underscored the Fed's success in fostering low inflation during the 1950s and early 1960s; *see Economic Report of the President* (1966), chapter 7.

[73] For seminal work on the rationale for elected officials to determine the statutory objectives and tools of monetary policy while carefully insulating the central bank's monetary policy decisions from political interference, see Stanley Fischer, *Modern Central Banking*, *in* THE FUTURE OF CENTRAL BANKING, 262-308 (Forrest Capie, Stanley Fischer, Charles Goodhart, & Norbert Schnadt eds., 1995).

[74] Thus, Robert Hetzel concluded that these objectives "amount to little more than instructions to achieve all good things." Robert Hetzel, *How the Federal Open Market Committee Can Start Learning from Experience,* MERCATUS CENTER (July 21, 2022), https://www.mercatus.org/research/research-papers/how-federal-open-market-committee-can-start-learning-experience.

FOMC's mandate would not provide instruction about how to prioritize among these goals in circumstances involving tradeoffs between them.[75]

B. Borrowing

Under the Constitution, Congress is responsible for appropriating all public funds and authorizing all public debt. Specifically, Article 1 states that "No money shall be drawn from the Treasury, but in consequence of appropriations made by law . . . ." and vests Congress with the sole authority to "borrow money on the credit of the United States."[76] Commonly, these provisions are referred to as Congress's "power of the purse," because together they provide that no public money can be spent or borrowed without congressional authorization.[77]

The rationale for vesting Congress with exclusive control over the purse is three-fold. For one, the framers and ratifiers viewed congressional control of public spending as central to the checking and balancing function that motivates the separation of powers. In particular, the power of the purse would be central to restraining an overly ambitious Executive.[78] Second, vesting Congress with the power of the purse would control the size of government. As Professor Kate Stith has argued, the structural function of

75 In 2012, the FOMC adopted a *Statement of Longer-Run Goals and Monetary Policy Strategy* which indicated that it would take a "balanced approach" to fostering its dual objectives of maximum employment and stable prices; however, that commitment was omitted from the FOMC's 2020 revision of this statement.

76 U.S. CONST., Art. 1, § 9, cl.7 and § 8, cl. 2,.

77 Over the years, Congress has developed a vast array of statutes to invigorate or plug holes in its power of the purse. Notable examples include the prohibition on agencies spending funds in advance or excess of an appropriation and the requirement that they remit all funds received, from any source, to the U.S. Treasury. The bulk of these laws—the Anti-deficiency Act and Miscellaneous Receipts Act—is found in Title 31 of the U.S. Code. As the GAO has explained, these statutes "did not spring up overnight, but have evolved over the span of more than two centuries. Nevertheless, when viewed as a whole, they form a logical framework that governs the collection and use of public money." *See* GOV. ACCOUNTABILITY OFFICE, PRINCIPLES OF FEDERAL APPROPRIATIONS LAW, Ch. 1, at 13 (Mar. 2016) [hereinafter, GAO, CH. 1, PRINCIPLES OF FEDERAL APPROPRIATIONS LAW]. As Kate Stith has argued: "In specifying the activities on which public funds may be spent, the legislature defines the contours of the federal government." Kate Stith, *Congress' Power of the Purse,* 97 YALE L.J. 1343, 1344-345 (1988).

78 The Appropriations Clause is "a bulwark of the Constitution's separation of powers" that gives Congress "exclusive power over the federal purse" as "a restraint on Executive Branch officers." U.S. Dep't of Navy v. FLRA, 665 F.3d 1339, 1346-47 (D.C. Cir. 2012) (Kavanaugh, J.). As James Madison wrote in *Federalist No. 58*, "when congress exercises the power of the purse, it can reduce "all the overgrown prerogatives of the other branches of government."

the clause is to ensure that any "expansion of the public sphere" would happen "only with legislative approval"—as such, "[i]n specifying the activities on which public funds may be spent, the legislature defines the contours of the federal government." [79] And thirdly, requiring public expenditures to be authorized through legislation would ultimately improve the public's ability to hold government accountable for how it used any funds raised through revenue-raising, like taxation.[80]

For these three interrelated reasons, today, the power of the purse is most salient in regard to Congress's ability to monitor the scope-of-work performed by administrative agencies. Through an annual appropriation process, Congress sets out each agency's "budget authority," in the form of an "authority . . . to incur obligations and to make payments from Treasury for specified purposes."[81] The process is one of the principal ways in which Congress ensures that agencies are hewing to their statutory responsibilities—neither underperforming nor engaging in mission creep.[82] Congress attaches purse strings to the vast majority of the over 200 agencies and entities it has created or chartered.[83] The appropriation process is, in other words, for the most part comprehensive.[84]

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79 Stith, *supra* note 77, at 1344-45.

80 3 THE RECORDS OF THE FEDERAL CONVENTION OF 1787, at 149– 50 (M. Farrand ed. 1937) (statement of James McHenry) ("When the Public Money is lodged in its Treasury there can be no regulation more consist[e]nt with the Spirit of Economy and free Government that it shall only be drawn forth under appropriation by Law and this part of the proposed Constitution could meet with no opposition as the People who give their Money ought to know in what manner it is expended.").

81 2 GOV. ACCOUNTABILITY OFFICE, PRINCIPLES OF FEDERAL APPROPRIATIONS LAW 2 (3d ed. Feb. 2006); *see also* GOV. ACCOUNTABILITY OFFICE, PRINCIPLES OF FEDERAL APPROPRIATIONS LAW, Ch. 2, at 2-3 (Mar. 2016) (explaining that "Congress finances federal programs and activities by providing 'budget authority,' which grants agencies authority to enter into financial obligations that will result in immediate or future outlays of government funds") [hereinafter GAO, LEGAL FRAMEWORK].

82 "This body of law gives flesh and force to one of the key pillars of democracy that the framers incorporated in the Constitution. Appropriations law is not only about ensuring that federal agencies follow a set of rules that Congress has enacted. These laws also help ensure that government carries out the will of, and remains accountable to, the American people." GAO, CH. 1, PRINCIPLES OF FEDERAL APPROPRIATIONS LAW, *supra* note 77, at 9.

83 *See* GOV. ACCOUNTABILITY OFFICE, FEDERALLY CREATED ENTITIES: AN OVERVIEW OF KEY ATTRIBUTES 1, appx. II (Oct. 2009) [hereinafter GAO, FEDERALLY CREATED ENTITIES].

84 *See* GAO, CH. 1, PRINCIPLES OF FEDERAL APPROPRIATIONS LAW, *supra* note 77, at 6 (explaining that "any government obligation or expenditure whatsoever—whether it is derived from the general fund [of Treasury], from fees arising from the government's business-like activities, or from any other source—may be made only as authorized by an appropriation").

However, in lieu of receiving an appropriation from Congress as other agencies do, the Fed directly exercises this aspect of Congress's Article I power to fund itself.[85] Prior to 2022 the Fed consistently earned net interest income on its portfolio and used those funds to cover its operating expenses.[86] In particular, the Fed has an exclusive right to issue paper currency (on which it pays no interest), and it invested those proceeds in Treasury securities and mortgaged-backed securities. In recent years, the Fed has engaged in large-scale securities purchases funded by issuing interest-bearing liabilities of bank reserves and overnight "repo" contracts.

1. *Currency*

When the Fed was established in 1913, Congress endowed it with the authority to issue paper currency as legal tender.[87] Legislators were aware that this authority would be valuable, because cash is not interest-bearing. As the amount of currency in circulation expanded over time, the Fed would accumulate a corresponding amount of interest-bearing assets while owing no interest on its liabilities of paper currency. Thus, Congress anticipated that the Fed's profits would exceed the amount needed to cover its own operating expenses.

The Federal Reserve Act thus provided instructions to the Fed about what to do with that profit.[88] Specifically, the Act directed the Fed to issue dividends at a fixed rate of 6% on the paid-in capital that was contributed by its member banks and to build up a surplus fund proportional to its paid-in capital.[89] Apart from those specific provisions, the Act stated that all of the Fed's net earnings "shall be paid to the United States as a franchise tax."[90] In

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85 *Id.* at 6, n.6.

86 The Fed also charges fees on large banks to cover the costs of its supervision and regulation of those entities, but those fees comprise only a tiny portion of its total income and outlays. *See* Board of Governors of the Federal Reserve System, *Supervisory Assessment Fees*, BD. GOV. FED. RSRV. SYS. (Dec. 2, 2020), https://www.federalreserve.gov/-supervisionreg/supervisory-assessment-fees.htm [https://perma.cc/K5UH-EK7L].

87 The Coinage Act of 1965 states that Federal reserve notes "are legal tender for all debts, public charges, taxes and dues." (31 U.S.C. § 510).

88 *Supra* Stith note 77. ("All funds belonging to the United States . . . are public monies, subject to public control and accountability.")

89 The FAST Act of 2015 amended section 7 of the Federal Reserve Act by specifying that the dividend rate paid to large banks (total assets exceeding $10 billion) would be the 10-year Treasury bond yield whenever that yield is less than 6%. Pub. L. 114-94, sec. 33203(a).

90 Federal Reserve Act , § 7. The characterization of payments as a "franchise tax" reflected the fact that the Federal Reserve Banks are chartered as private institutions. This provision

effect, then, Congress gave the Fed a fiduciary duty to ensure that the profits derived from creating public money would be remitted to the U.S. Treasury for the benefit of the general public.

2. *Reserves*

This system worked very well for about one hundred years. Currency made up almost all of the Fed's outstanding liabilities and Treasury securities made up almost all of its assets. The only other liability on the Fed's balance sheet was central bank reserves—the money that the Fed issues to the private banks that are members of the Federal Reserve System in the course of lending to these institutions or buying assets (i.e., treasury bonds) from them during open market operations.[91]

But the Fed never paid interest on these reserves that the banks held at the regional Reserve Banks. For that reason, banks' reserve balances in their accounts would be small; around only one percent of the Fed's overall balance sheet liabilities.[92] In this regime, the central bank balance sheet earned a "steady stream" of income from the value of its currency, and the U.S. Treasury received a healthy stream of payments representing the excess profit.[93] That seigniorage, built around paper currency, was valuable enough to cover all of the Fed's expenses and added to the public fisc.

In 2006, Congress gave the Fed a new authority to pay interest on bank reserves.[94] Congress had been persuaded that requiring banks to hold

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capped the surplus fund of each Federal Reserve Bank at 40% of its paid-in capital. In 1919 Congress amended it and authorized each Fed Bank to retain all of its net earnings until its surplus fund reached 100% of subscribed capital (which was 2x larger than paid-in capital) and to retain 10% of its net earnings thereafter. Pub. L. 65-329, ch. 101.

[91] This system also had implications for how the Fed conducted monetary policy. When reserve balances were "scarce," so to speak, the Fed could use relatively small adjustments in their supply to affect the Federal funds rate. By increasing the supply of bank reserves, it would lower the federal funds rate (the rate at which banks lend to one other in the overnight market, and affects other short-term interest rates in the broader economy). The inverse also applied—the reducing reserves, the Fed would make credit conditions tighter and push up the interest rates. For a basic explanation, see, for example, Ben S. Bernanke & Donald Kohn, *The Fed's Interest Payments to* Banks, BROOKINGS, Feb. 16, 2016, https://www.brookings.edu/articles/the-feds-interest-payments-to-banks/

[92] *See* Andrew T. Levin, Brian Lu & William R. Nelson, *Quantifying the Costs and Benefits of Quantitative Easing,* (Nat'l Bureau of Econ. Rsch., Working Paper No. 30749, 2022.

[93] *See id.*

[94] The Financial Services Regulatory Relief Act of 2006 originally authorized the Federal Reserve to begin paying interest on balances held by or on behalf of depository institutions beginning October 1, 2011. The Emergency Economic Stabilization Act of 2008 accelerated the effective date to October 1, 2008.

reserve balances at the central bank without compensation was effectively like a tax on banks. At the onset of the financial crisis in early fall 2008, Fed officials requested authorization to start using this "IOR" power immediately, and Congress granted that authority in a brief paragraph of the 176-page bill that created the Troubled Asset Relief Program ("TARP").[95]

This new power would become central to the Fed's funding of its quantitative easing ("QE") program. After hitting the "effective lower bound," in order to continue stimulating the economy, the Fed thus turned to an unconventional monetary policy tool, large-scale asset purchases ("LASP") which is conventionally referred to as "QE."[96]

When conducting QE, the Fed buys bonds from the "open market"—not Treasury or the GSEs directly. This means that the Fed implements these securities purchases by expanding the amount of depository institutions' reserves, in effect, printing "digital money" instead of paper money. In particular, the open market desk at the New York Fed pays for each individual security by creating a corresponding book entry in the reserve account of the seller's bank.[97] Reserves are a short-term debt liability of the central bank. Accordingly, the creation of new reserves thus allows for the Fed to funding its asset purchases.

3. *Repos*

After some time, it became apparent that IOR was a "leaky" floor due to structural and institutional factors. With large amounts of reserves, banks practically never engaged in overnight borrowing from their peers, while nonbank institutions such as money market funds and GSEs were not authorized to hold funds directly at the Fed.[98] Moreover, overnight bank deposits are subject to an FDIC insurance fee of about 0.1%. Consequently, from 2009 onwards the federal funds market was essentially limited to transactions in which a GSE provided overnight funds to a bank, which could

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95 The Emergency Economic Stabilization Act of 2008 changed the effective date from 10/1/2011 to 10/1/2008 (P.L. 110-343, sec. 128).

96 *See, e.g.*, Mark Gertler & Peter Karadi, *A Framework for Analyzing Large Scale Asset Purchases as a Monetary Policy Tool*, Mar. 2012, *available at* https://www.federalreserve.gov/-events/conferences/2012/cbc/confpaper1/confpaper1.pdf (prepared for a Board of Governors conference).

97 *Supra* note 185. By March 2010 the Fed had closed practically all of the emergency liquidity facilities that had been initiated at the onset of the financial crisis, and hence the expanded size of its balance sheet mainly reflected its QE1 purchases of longer-term securities.

98 *See* Financial Services Regulatory Relief Act of 2006, sec. 201. As of March 2010, reserve balances stood at $1.1 trillion, more than 200-fold greater than at the end of 2007.

earn IOR on those funds and then remit a portion of the interest to the GSE.[99] Indeed, from late 2008 to 2015, the target federal funds rate had a range of 0 to 0.25%, and IOR was set at the top of that range, *not* the bottom.

So, in 2013, the Fed sought to mimic the IOR power for nonbanks by creating the overnight reverse repurchase agreement facility, known as "ON RRP."[100] An overnight repo is a form of collateralized lending in which the sale of a security is coupled with a contract to repurchase it on the following day at a specified price; the phrase "reverse repo" refers to the same transaction viewed from the standpoint of the borrower rather than the lender.[101] The Fed conducts repo operations using its statutory authority to engage in open market transactions of short-term paper secured by high-quality collateral.[102] For nearly a century, the Fed's repo transactions were focused on fostering money market liquidity while keeping its net balances close to zero to minimize its footprint in those markets.[103] For example, over the five-year period from 2003 to 2007, the Fed's average balances of repos and reverse repos were $26.7 billion and $25.6 billion, respectively.[104]

Since then, the Fed's repo operations have changed dramatically. Its repo balances have practically vanished while its reverse repo balances have grown immensely. This evolution was triggered by concerns that the Fed would not be able to rely solely on IOR to ensure that adjustments to the

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99 *See generally* Peter Ireland, *Interest on Reserves: History and Rationale, Complications and Risks*, CATO J., (2019), https://www.cato.org/cato-journal/spring/summer-2019/interest-reserves-history-rationale-complications-risks. [https://perma.cc/K7UB-ZPE7].

100 Bd. of Governors of the Fed. Reserve Sys., Overnight Reverse Repurchase Agreement Facility, https://www.federalreserve.gov/monetarypolicy/overnight-reverse-repurchase-agreements.htm.

101 The proceeds of the initial sale correspond to the principal amount of the loan, and the excess of the repurchase price over the initial sale price corresponds to the interest paid on the loan.

102 Section 14.1 of the Federal Reserve Act (unamended since 1913) states: "Any Federal Reserve Bank may, under rules and regulations prescribed by the Board of Governors of the Federal Reserve System, purchase and sell in the open market, at home or abroad, either from or to domestic or foreign banks, firms, corporations, or individuals, cable transfers and bankers' acceptances and bills of exchange of the kinds and maturities by this Act made eligible for rediscount, with or without the indorsement of a member bank."

103 In 1917, Federal Reserve Banks used repos to extend credit to member banks whose liquidity was constrained by wartime conditions; a few years later, in the 1920s, the New York Fed used repos to foster the development of markets for bankers' acceptances. *See* Kenneth D. Garbade, *The Evolution of Repo Contracting Conventions in the 1980s*, 12 ECON. POL'Y REV. 27 (2006).

104 The Federal Reserve Bank of St. Louis disseminates historical data on the Fed's repo and reverse repo balances; *see generally* FRED, FED. RSRV. BANK ST. LOUIS, https://fred.stlouisfed.org.

target federal funds rate would be fully reflected in market rates.[105] Now, through the ON RRP facility, the Fed may borrow from the nonbank financial private sector to fund its operations and balance sheet just as it does by issuing bank reserves and currency. The Fed's reverse repo balance peaked at around $2.5 trillion during 2022 and has subsequently declined to around $900 billion (as of January 2024).[106]

II. THE SOURCES OF UNDERSIGHT

Until this point, the Article has explained the principal ways that the Fed exercises Congress's Article I power: it "regulates the value" of money, and "borrows" directly from the public. This Part argues that Congress's oversight mechanisms are no longer legally adequate to manage the way that the Fed uses this power.

This Part identifies several distinct factors that have contributed to this congressional undersight of the Fed. In particular, the Fed's governance has quietly evolved in ways that have magnified the power of the Fed Chair and eliminated dissenting votes by other FOMC members, thereby limiting Congress's ability to discern the range of views that have informed the Fed's policy deliberations. The Fed's monetary policy reports provide minimal information about the rationale for its policy decisions, with no cost-benefit analysis of its programs and no discussion of risks or contingency plans. Oversight of the Fed's balance sheet is also constrained by the Fed's exemptions from the federal budget, debt-ceiling, and standard accounting rules. Finally, the Fed's monetary policy framework and operations are not subject to review by the GAO or a fully independent IG—the congressional watchdogs that have been established for every other major agency.

A. Informing Congress

One principal source of Fed undersight is the lack of sufficiently detailed and disaggregated information about what the FOMC does and why. As this Section will explain, certain shifts in Fed governance and reporting practice may have clouded legislative insight into the reasons why certain forecasting or policy judgments are made in pursuit of the Fed's dual mandate.

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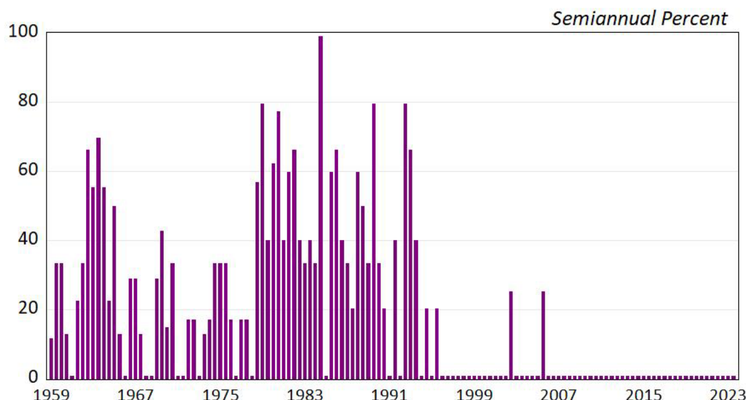
105 See *supra* note 185. *See also* Jane Ihrig et al, *Monetary Policy 101: A Primer on the Fed's Changing Approach to Policy Implementation,* FED. RSRV. BD. (2015), https://www.-federalreserve.gov/econresdata/feds/2015/files/2015047pap.pdf [https://perma.cc/CN3N-FFN2].

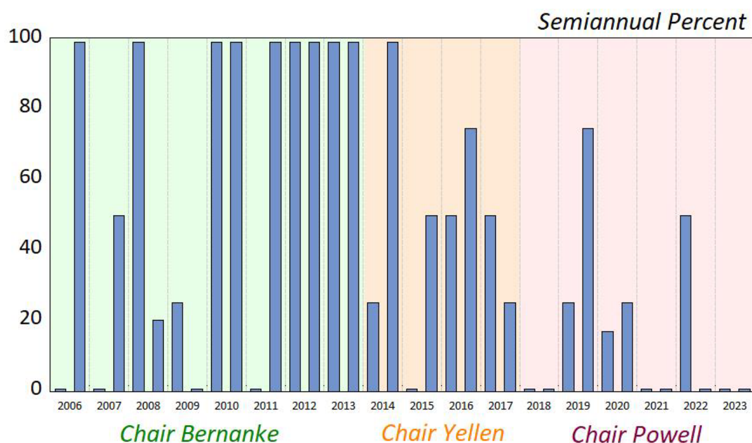
106 Federal Reserve Balance Sheet: Factors Affecting Reserve Balances (H.4.1), 3/29/2023 and 1/18/2024.

Figure 1: Dissenting Votes at FOMC Meetings

A. Federal Reserve Board Members, 1959-2023



B. Federal Reserve Bank Presidents, 2006-2023



Notes: For each semiannual period, Panel A shows the proportion of FOMC meetings at which any Federal Reserve Board member(s) cast any dissenting votes, and Panel B shows the the proportion of FOMC meetings at which any Federal Reserve Bank president(s) cast any dissenting votes. *Sources*: Federal Reserve Board, Federal Reserve Bank of St. Louis, authors' calculations.

1. *The FOMC's Governance and Officers*

As shown in Figure 1A, from the late 1950s until the early 1990s, Fed Board members regularly cast dissenting votes on FOMC decisions, consistent with other public boards and commissions at which the chair is simply the "first among equals." By contrast, such dissents subsequently became rare and then vanished.[107] Since 2006, not a single Fed Board member has dissented on any FOMC decision.[108]

As shown in Figure 1B, dissents by Federal Reserve Bank presidents were not uncommon a decade ago but have practically vanished in recent years. For example, there was no dissent at all during 2021 when the FOMC remained on hold in the face of accelerating inflation. A recent paper coauthored by former Fed Vice Chair Donald Kohn highlighted the recent lack of dissent as "raising questions about whether Committee discussions and decisions were being sufficiently challenged by diverse viewpoints."[109] If Fed officials feel constrained to "speak with one voice" regardless of their individual (and perhaps contrarian) views, Congress may be hampered in discerning the range of views of FOMC members.

Several distinct trends in the Fed's governance have been contributing to this growing uniformity in FOMC decision-making. Although the Federal Reserve Board is a multi-member commission, the Fed Chair is not "first among equals" but has an outsized role in determining its monetary policy decisions.[110] The Fed Chair sets the agenda for FOMC meetings; and that role is crucial when monetary policy is being conducted on a "meeting-by-

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107 Charles I. Plosser, *The Veneer of Consensus at the Fed*, WALL ST. J.(Dec. 9, 2015), https://www.wsj.com/articles/the-veneer-of-consensus-at-the-fed-1449739621; Charles W. Calomiris, *Reforming the Rules that Govern the Fed*, CATO J. 38 (2018), https://www.cato.org/-sites/cato.org/files/serials/files/cato-journal/2018/2/cato-journal-v38n1-chapter-6.pdf.

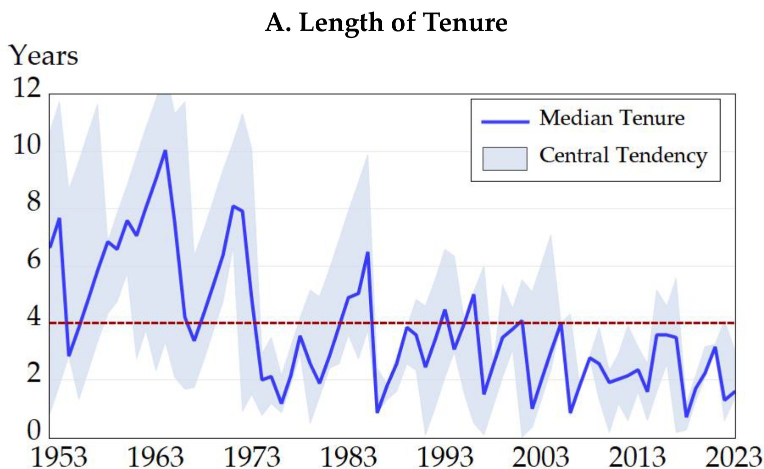
108 From 2006 to 2021 there were more than 80 dissents by Fed Bank presidents. *See* Federal Reserve Bank of St. Louis, *A History of FOMC Dissents*, FED. RSRV. BANK ST. LOUIS (Sept. 16, 2014), https://www.stlouisfed.org/on-the-economy/2014/september/a-history-of-fomc-dissents.

109 Gauti B. Eggertsson & Donald Kohn, *The Inflation Surge of the 2020s: The Role of Monetary Policy*, Hutchins Ctr., Working Paper No. 87 (2023). From 2006 to 2021 there were more than 80 dissents by Fed Bank presidents.

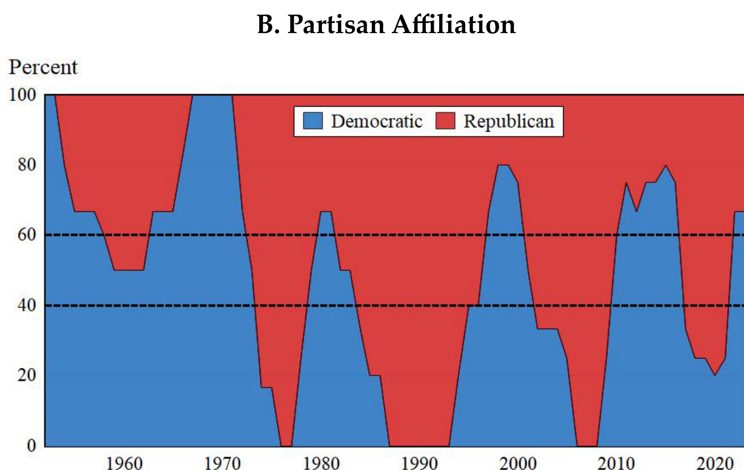
110 The Federal Reserve Board's governance is similar to that of U.S. corporations whose head has a dual role as CEO and board chair; such arrangements have practically disappeared from corporations in other jurisdictions such as Canada and the United Kingdom; see David G. Blanchflower & Andrew T. Levin, *Diverse Views in Monetary Policy*, INT'L MONETARY FUND (March 2023), https://www.imf.org/en/Publications/fandd/-issues/2023/03/diverse-views-in-monetary-policy-blanchflower-levin.

Figure 2: Characteristics of Federal Reserve Board Members (excluding the Fed Chair)

A. Length of Tenure



B. Partisan Affiliation



Note: This figure indicates the characteristics of Federal Reserve Board members (excluding the Fed Chair) at the end of each calendar year from 1953 to 2023. Panel A shows the median and central tendency of their tenure (in years), where the central tendency is computed by excluding the member with the shortest tenure and the member with the longest tenure at each date, and Panel B shows the composition of their partisan affiliations (in percent).
Source: Federal Reserve Board, Federal Reserve Bank of St. Louis, authors' calculations.

meeting" basis rather than following a systematic and transparent strategy.[111]

Moreover, the Federal Reserve Act designates the Fed Chair as the Fed Board's "active executive officer," a somewhat antiquated title whose modern equivalent is CEO; the other six Fed Board members have non-executive roles.[112] Thus, the Chair effectively directs the entire Fed Board staff, who produce economic forecasts and other background materials that serve as the focal point for the FOMC's monetary policy deliberations.[113]

The Fed Chair is often the most senior member on the Board, further strengthening the centrality of this role. The Chair and the two Vice Chairs are appointed to those positions for terms of four years, and in recent years nearly every Vice Chair has departed after a single four-year term.[114] Many other Board members have served for only two or three years before taking positions in the administration, moving to the private sector, or returning to academia.[115] In any case, given the staggered design of the Board, incoming members almost always fill a vacant seat with a partial term rather than starting a full fourteen-year term.[116]

These patterns are evident in Figure 2A: Over the past two decades, the median tenure of Fed Board members (excluding the Fed chair) has hovered at around two years, which is far shorter than the median of about seven years that would prevail if all members served staggered 14-year terms.

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[111] The FOMC's officers are not determined by statute but chosen annually by its voting members; by longstanding custom, the Chair of the Fed Board and the President of the New York Fed are unanimously chosen as the FOMC's Chair and Vice Chair, respectively.

[112] The members of the Fed Board serve on internal committees that are appointed by and accountable to the Fed Chair and which have no independent executive authority, *see* Bd. of Governors of the Federal Rsv. Sys., Board Members, https://www.federalreserve.gov/-aboutthefed/bios/board/default.htm (last visited Jan. 27, 2024).

[113] Under the Federal Reserve Act of 1913, the President simply appointed the Federal Reserve Board's Chair and Vice Chair without any formal consideration by the Senate. Since the enactment of the Federal Reserve Reform Act of 1977, these appointments have been subject to Senate confirmation.

[114] Janet Yellen, the sole exception, became Chair after previously served as Vice Chair.

[115] Since the mid-1950s only a single Fed Board member has completed a full 14-year term: Alan Greenspan was appointed to a vacant seat in 1987, reappointed in 1992, and retired in 2006. *See* Board of Governors of the Federal Reserve System, *Alan Greenspan*, FED. RSRV. HIST., https://www.federalreservehistory.org/people/alan-greenspan. After the Dodd-Frank Act created the role of Vice Chair for supervision, now three of the seven Board seats have a four-year Vice Chair term.

[116] Vacancies have frequently been protracted by delays in the selection and confirmation of nominees, thereby making the remaining tenure of those seats even shorter.

Moreover, the foreshortened tenure and increased frequency of appointments of Fed Board members has resulted in dramatic swings in its partisan composition.[117] As shown in Figure 2B, it has become commonplace for every Fed Board member to have been appointed by the current incumbent of the White House. These shifts in the Fed Board's partisan orientation may obfuscate whether any particular Fed action is apolitical and technocratic (as it should be) or, instead whether it has been taken to please or appease the current administration (as it should *not* be).[118] Indeed, given that Congress has delegated its own Article I powers to the Fed and has placed restrictions on presidential removal of Fed Board members, it is constitutionally imperative for Congress to ensure that the President is not in fact dictating or influencing the Fed's monetary policy decisions.[119]

Third, the Board has become increasingly involved in the selection of Federal Reserve Bank presidents.[120] In establishing the Federal Reserve System, Congress designed the Federal Reserve Banks to be independent institutions that are overseen but not subordinated to the Fed Board. The president of each Reserve Bank is appointed by its private board directors,

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[117] To guard against this development in politically independent agencies, as early as 1887, Congress identified the key characteristics of an independent agency when it created the Interstate Commerce Commission: "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"; [and] no more than a bare majority can come from the same political party. Act to Regulate Commerce of 1887, §§ 11-13.

[118] For an egregious example, see Burton A. Abrams, *How Richard Nixon Pressured Arthur Burns: Evidence from the Nixon Tapes*, 20 J. OF ECON. PERSP. 177–88 (2006). *See also* Andrew T. Levin & John B. Taylor, *Falling Behind the Curve: A Positive Analysis of Stop-Start Monetary Policies and the Great Inflation*, *in* THE GREAT INFLATION (Michael Bordo & Athanasios Orphanides eds. 2013).

[119] Notably, among the major independent agencies, the Fed Board is practically unique in having statutory protection from executive removal but no requirements to ensure its partisan balance. *See* Table 5 of Kirti Datla & Richard L. Revesz, *Deconstructing Independent Agencies (and Executive Agencies*), 98 CORNELL L. REV. 769, 797-99 (2013). At other key agencies, statutory requirements ensure that the proportion of board members or commissioners affiliated with each political party consistently remains within a range of about 40 to 60 percent. *Id.*

[120] The FOMC is thus a "unique example of the sharing of legislative power with private interests," because the other five voting members of the FOMC are private officials who serve as the heads of private financial institutions—the Federal Reserve Banks Mark F. Bernstein, *The Federal Open Market Committee and the Sharing of Governmental Power with Private Citizens*, 75 VA. L. REV. 111 (1989). The head of the Federal Reserve Bank of New York is a permanent voter on the FOMC, and the heads of the other 11 Fed Banks cast votes on a rotating basis: Chicago and Cleveland on a 2-year cycle, and the other nine Fed banks on a 3-year cycle.

subject to the approval of the Fed's Board of Governors. [121] Apropos of this power-sharing arrangement, for nearly a century, the search for Reserve Bank presidents was conducted by the Fed Bank's directors with little or no involvement of the Fed Board, which almost invariably approved the directors' preferred candidate.

That hands-off approach ceased about a decade ago. Since then, a Fed Board member "meets regularly with the search committee chair throughout the search process regarding the candidate pool."[122] Thus, there have been growing concerns that the Fed Board's oversight and veto powers can be used to practically dictate the selection of a new Fed Bank presidents.[123]

The Fed Board also has the power to remove a Fed Bank president "for cause," with "the cause of such removal to be forthwith communicated in writing" to that person and to the Fed Bank's directors.[124] In a 2019 memo on the constitutionality of Fed Bank presidents serving on the FOMC, the OLC opined:

> Nothing in the statute limits the Board's removal authority . . . we think that "cause" in this context means whatever reasons (if any) the Board has for removing the [Fed Bank president], and therefore permits the Board to remove the officer at will.[125]

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[121] 12 U.S.C. § 341. Under the original Federal Reserve Act, each Fed Bank president was appointed by all nine directors; that provision was amended by the Dodd-Frank Act of 2010, which excluded the three Class A directors from the appointment process. Fed Bank presidents serve 5-year terms that are uniformly renewed unless the individual resigns or reaches the specified age ceiling. Any Fed Bank president whose initial appointment occurred before reaching age 60 must step down upon reaching age 65. Comparable restrictions apply if the initial appointment occurred after reaching age 60.

[122] This process is described on the Fed Board's website in an FAQ on "How is a Federal Reserve Bank President Selected?" *See* Board of Governors of the Federal Reserve System, *How is a Federal Reserve Bank President Selected?*, Bd. Gov. Fed. Rsrv. Sys (Jan. 25, 2016), https://www.federalreserve.gov/faqs/how-is-a-federal-reserve-bank-president-selected-.htm [https://perma.cc/733U-RF3E].

[123] See Jeffrey M. Lacker, Governance and Diversity at the Federal Reserve, Remarks at the Mercatus Center Conference: The Legacy of Bennett McCallum and Lessons for Monetary Policy Today (Oct. 10, 2023).

[124] Federal Reserve Act, § 4(4): "To appoint by its board of directors a president [and other officers].and to dismiss at pleasure such officers." The Fed Board's authority to suspend or dismiss Fed Bank officers is stated in Federal Reserve Act, section 11(f).

[125] *See supra* note **Error! Bookmark not defined.**, at 11.

The OLC concluded that Fed Bank presidents "are subordinates of the Board of Governors."[126] Although that conclusion seems directly contrary to the original intent of Congress,[127] the potential threat of removal could further magnify the Fed Board's influence over those officials. Together, the Board's involvement in the selection of Fed Bank presidents, combined with the specter of removal, may be dampening the inclination of those officials to express their own individual views or to dissent from FOMC decisions

2. *Monetary Policy Reports to Congress*

When Congress reconstituted the FOMC in 1935, the Fed's Board of Governors was directed to "keep a complete record" of the FOMC's policy actions, including "the votes taken . . . and the reasons underlying the actions" and to publish that record in its annual report.[128] Thus, over the next four decades, the Federal Reserve Board's annual report included a very brief "Record of Policy Action" from each of the prior year's FOMC meetings, with a synopsis of the committee's discussion, the text of its policy directive to the New York Fed, and the tally of its vote on that directive.[129]

By the mid-1960s, however, members of Congress were becoming increasingly discontented with the Fed's lack of transparency.[130] That sentiment was subsequently magnified by worsening inflation and the Fed's stop-go policy actions.[131] Indeed, by the 1970s legislators were concluding

126 See *id.* at 9. This conclusion reflected OLC's assessment of the Fed Board's influence in the selection of Fed Bank presidents, scope of control over their budgets and operations, and ability to remove them for any reason.

127 In 1935 the Roosevelt administration presented draft legislation to Congress under which the Fed Board would have been granted direct authority to appoint and remove all Fed Bank presidents, who would have assumed a purely advisory role in FOMC decisions; that bill was passed by the House in May 1935, but the Senate's preferred approach – preserving the independence of the Fed Bank presidents and designating five of them as voting members of the FOMC -- was ultimately enacted as the Banking Act of 1935. See ALLAN MELTZER, A HISTORY OF THE FEDERAL RESERVE: 1913-1951 4 (2003).

128 Banking Act of 1935, §203(d).

129 *See* Board of Governors of the Federal Reserve System, *Annual Report of the Board of Governors of the Federal Reserve System,* Bd. Gov. Fed. Rsrv. Sys., https://fraser.stlouisfed.-org/title/annual-report-board-governors-federal-reserve-system-117?browse=1910s (listing annual reports from 1914 and onwards).

130 For example, at a congressional hearing in 1964, Rep. Riohard Hanna suggested that "establishing more responsible directives from Congress to the Board of Governors requesting some kind of responsive reporting." *Supra* note 69 at 1347.

131 Andrew T. Levin & John B. Taylor, *Falling Behind the Curve: A Positive Analysis of Stop-Start Monetary Policies and the Great Inflation*, *in* MICHAEL D. BORDO & ATHANASIOS ORPHANIDES, THE GREAT INFLATION: THE REBIRTH OF MODERN CENTRAL BANKING (2013).

that the absence of reporting requirements was facilitating "myopia in the conduct of monetary policy."[132]

Thus, in 1975 Congress adopted a joint resolution urging the Fed to start providing regular reports about its "objectives and plans with respect to the ranges of growth or diminution of monetary and credit aggregates in the upcoming twelve months."[133] That language was incorporated into formal reporting requirements in the Federal Reserve Reform Act of 1977.[134] A year later, the Humphrey-Hawkins Act initiated a semiannual process of reports and congressional hearings: At the start of each year, the Fed would report on its objectives and plans for the current year, and then midway through the year it would provide its initial projections for the following calendar year.[135] The relevant portion of that statute concluded as follows:

> Nothing in this Act shall be interpreted to require that [these] objectives and plans. . . be achieved if the Board of Governors and the FOMC determine that they cannot or should not be achieved because of changing conditions, provided that...the Board of Governors shall include an explanation of the reasons for any revisions to or deviations from such objectives and plans.[136]

Over subsequent years the FOMC succeeded in restoring price stability in a context of robust economic growth and employment, leading to an era known as the "Great Moderation" that endured until the financial crisis of 2008.[137]

During the 1990s, in the face of unpredictable swings in money demand, the Fed shifted away from targeting monetary aggregates and refocused on using the target federal funds rate as the primary tool of monetary policy. Consequently, the Fed's projections of monetary aggregates became practically irrelevant in its semiannual reports and congressional testimony. In principle, legislators could have responded to those developments by revising the reporting requirements and directing the Fed to explain its

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[132] Robert E. Weintraub, *Congressional Supervision of Monetary Policy,* 4 J. MONETARY ECON. 341, 343 (1978) (recounting congressional deliberations and concluding: "Congress weakened its own hand in supervising monetary policy and strengthened the hand of the Executive").

[133] Senate Concurrent Resolution 18 and House Concurrent Resolution 133.

[134] This Act added Section 2A to the Federal Reserve Act, setting forth the FOMC's mandated objectives as well as these new reporting requirements. Pub. L. 95-188, §202.

[135] Pub. L. 95-523, §108(a).

[136] *Id.*

[137] *See* Shaghil Ahmed et al, *Recent U.S. Macroeconomic Stability: Good Policies, Good Practices, or Good Luck*, 86 REV. ECON. & STAT. 824 (2004).

"objectives and plans" in terms of its strategy for setting the target federal funds rate, perhaps using simple benchmarks such as the Taylor Rule.[138]

In fact, however, the Fed's reporting requirements were practically eliminated by an omnibus bill at the end of the year 2000.[139] Thus, under current law the Fed's semiannual reports to Congress are simply required to contain "a discussion of the conduct of monetary policy and economic developments and prospects for the future."[140] In effect, the Fed has been permitted to revert to the same opacity that had been in place prior to 1977. In conducting its latest round of securities purchases ("QE4") during 2020-22, the Fed did not provide legislators with cost-benefit analysis or risk assessments at any stage of the program.[141]

B. Explaining the Fed's Balance Sheet

When the Fed was established in 1913, Congress took specific steps to ensure its financial soundness. As "banker to the banks," the Fed would hold the reserves of its member banks and provide them with liquidity through the discount window. But the original Federal Reserve Act tasked the Federal Reserve Board with ensuring that such lending would not incur substantial losses and would diminish once financial strains subsided.[142] The Fed was also authorized to engage in open market transactions of U.S. government securities as well as bills of exchange backed by such securities, with the aim of fostering the growth and stability of those markets.[143]

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138 *See* John B. Taylor, *Discretion Versus Policy Rules in Practice*, 39 CARNEGIE-ROCHESTER CONF. SERIES PUB. POL'Y 195 (1993) (showing that the federal funds rate was broadly consistent with the Taylor Rule in the early years of the Great Moderation).

139 The American Homeownership and Economic Opportunity Act (enacted on December 27, 2000) eliminated the Humphrey-Hawkins reporting requirements (P.L. 106-569, §1003).

140 Federal Reserve Act, § 2B.

141 During this period, the Fed issued four semiannual Monetary Policy Reports to Congress (June 2020, February and June 2021, and February 2022) that described the QE4 program but did not include any cost-benefit analysis or assessments of its potential risks; *see* Bd. of Governors of the Federal Rsv. Sys., Monetary Policy Report, https://www.federalreserve.gov/monetarypolicy/publications/mpr_default.htm.

142 Section 13 of the Federal Reserve Act of 1913 specified that the Federal Reserve Banks could engage in discount lending for maturities up to 90 days, with eligible forms of collateral to be determined by the Federal Reserve Board. Such provisions were broadly consistent with the longstanding central banking practices described by Walter Bagehot. *See* WALTER BAGEHOT, A DESCRIPTION OF THE MONEY MARKET (1873).

143 "Any Federal Reserve Bank may, under rules and regulations prescribed by the Federal Reserve Board, purchase and sell in the open market...bills of exchange of the kinds and maturities by this Act made eligible for rediscount." Federal Reserve Act, § 14 ("Open Market Operations").

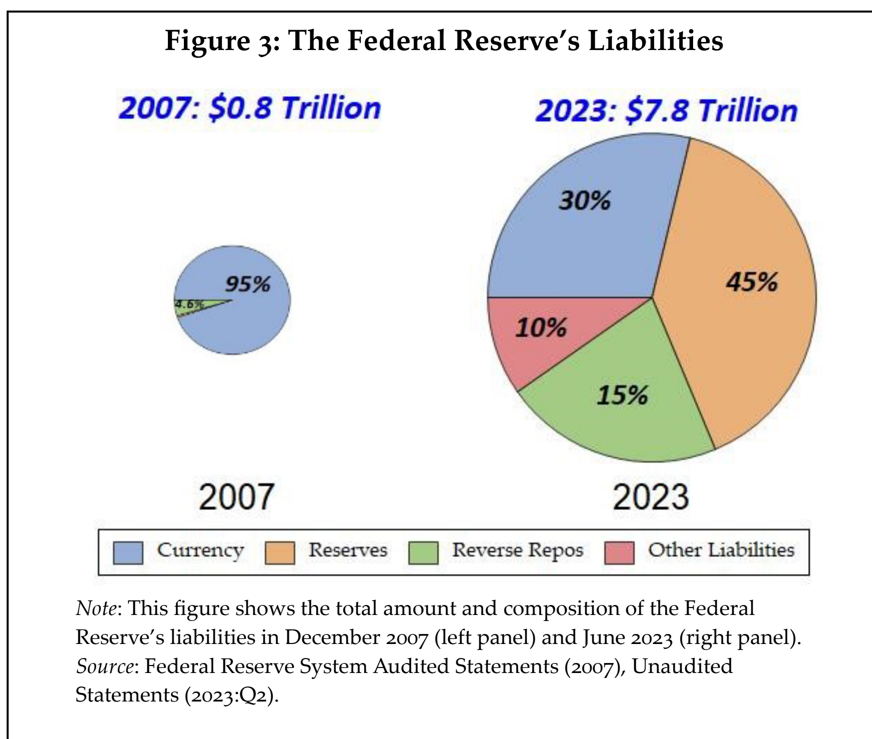

Figure 3: The Federal Reserve's Liabilities

Note: This figure shows the total amount and composition of the Federal Reserve's liabilities in December 2007 (left panel) and June 2023 (right panel). *Source*: Federal Reserve System Audited Statements (2007), Unaudited Statements (2023:Q2).

Thus, over subsequent decades the Fed's balance sheet was viewed as practically risk-free and its capital and surplus as merely a formality.[144] The Fed's holdings of interest-bearing government securities expanded in parallel with its issuance of non-interest-bearing paper currency, and hence the Fed was assured of a growing stream of positive net income.

As shown in Figure 3, however, the size and composition of the Fed's balance sheet has changed dramatically since 2007. At that time, paper currency accounted for 95% of the Fed's liabilities, which stood at about $800 billion. Since then, the Fed's balance sheet has expanded by a factor of 10 to around $8 trillion as of 2023, and interest-bearing bank reserves and reverse repos now comprise nearly two-thirds of the Fed's total liabilities. Moreover, since fall 2022 the Fed has been incurring net operating losses and funding

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144 At the end of 2007, the Fed's paid-in capital and surplus stood at $37 billion, roughly 4% of its total assets of $915 billion. Board of Governors of the Federal Reserve System, Federal Reserve System Audits, BD. GOV. FED. RSRV. SYS. (July 18, 2008), https://www.-federalreserve.gov/boarddocs/rptcongress/annual07/sec6/c2.htm [https://perma.cc/9XH3-LH3H]

Table 1: Independent Agencies with External Funding

Agency Name	Operating Expenses *($ millions)*	Government Appropriations *(percent)*	External Funding Sources
Federal Reserve System	118,476	NA	seigniorage, fees on large banks
Federal Deposit Insurance Corporation	33,637	0	fees on member banks
Federal Communications Commission	20,200	11.1	spectrum auctions, regulatory fees
Securities & Exchange Commission	2,515	1.6	regulatory fees
Office of the Comptroller of the Currency	1,269	0	fees on national banks
Nuclear Regulatory Commission	947	13.0	fees on regulated entities
Consumer Financial Protection Bureau	637	0	transfers from Federal Reserve
Federal Trade Commission	526	35.4	merger application fees
Federal Housing Finance Administration	457	11.4	fees on regulated entities
Fed. Retirement Thrift Investment Board	457	0	fees on employee plans
Commodity Futures Trading Commission	419	72.3	regulatory fees
National Credit Union Administration	393	0	fees on credit unions
Farm Credit Administration	90	0	fees on regulated entities
Japan-U.S. Friendship Commission	3	0	proceeds from trust fund

Note: Data on operating expenses is tabulated using estimated gross outlays and budgeted appropriations (excluding external funding sources) for FY2024 as published by the Office of Management and Budget, *Budget of the U.S. Government, Fiscal Year 2024*. The FDIC's Office of Inspector General is funded by congressional appropriations; the table excludes all other federally-chartered corporations, nonprofit institutions, and federally-funded R&D centers. The table also excludes limited-purpose trust funds as follows: CFTC, Customer Protection Fund; FDIC, Federal Savings & Loan Resolution Fund; NCUA, Credit Union Share Insurance Fund; SEC, Investor Protection Fund and Reserve Fund.

that cost by expanding its interest-bearing liabilities, in effect, borrowing those funds directly from the public without congressional authorization. Indeed, the Fed's programs and operations are exempted from the appropriations process, the debt ceiling, and standard accounting rules. Consequently, Congress may now have an obstructed line of sight.

1. *The Budget Process*

One result of exempting the Fed from the appropriation process is that its outlays are not included in the annual budget that the White House submits to Congress for its approval.[145] Table 1 lists all independent agencies whose outlays are partially or fully covered by external sources. Nearly all of these agencies are funded by assessments and fees on regulated entities, and hence their outlays are naturally scrutinized by those entities in addition to being reviewed by the administration and approved by Congress. One notable departure from these practices is the Consumer Financial Protection Bureau, which collects no fees and is fully funded by transfers from the Fed.

The Fed's exemption from the federal budget has certainly helped insulate it from the threat of political interference. Nonetheless, this exemption was not explicitly granted by Congress. In fact, the Budget and Accounting Act of 1921 specifically stated that the federal budget encompasses every "executive department, independent commission, board, bureau, office, agency, or other establishment of the Government."[146] To eliminate any potential ambiguities in the wake of the *Humphrey's Executor* decision, this Act was amended in 1939 to include "any independent regulatory commission or board."[147] In remarks on the House floor, a member of the Select Committee on Governmental Organization explained the measure as follows:

> some of these agencies . . . shrugged their shoulders and said "We are not under any budgetary control," quoting that case [of Humphrey's Executor] . . . Now, all that title II does is to bring every single, solitary one of them under Budget control, and I believe everybody in this House favors that.[148]

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[145] OFF. OF MGMT & BUDGET, BUDGET OF THE UNITED STATES – FISCAL YEAR 2024 (2023). The federal budget also includes other federally-created entities, such as regional commissions and the U.S. Postal Service, that receive congressionally-appropriated funds.

[146] Budget and Accounting Act of 1921 (P.L. 67-13, Title I, sec. 2.) This clause specifically exempted "the legislative branch of the U.S. Government and the Supreme Court."

[147] Reorganization Act of 1939 (P.L. 53-19, Title II.)

[148] CONGRESSIONAL RECORD 84:2315 (1939). *See also* Peter L. Strauss, *The Place of Agencies in Government: Separation of Powers and the Fourth Branch*, 84 COLUM. L. REV. 573 (1984).

The Federal Reserve's Board of Governors was specifically listed among the agencies covered by that legislation.[149] Nonetheless, the Fed's outlays and receipts have never been incorporated into the federal budget even for informational purposes.

In effect, the Fed has received an implicit exemption from this statute.[150] Of course, such exemptions are commonplace for many other types of federally-created entities, including public corporations such as Amtrak, non-profit institutions such as the American Red Cross, and federally-funded research centers such as the Jet Propulsion Lab.[151] But as a major economic policymaking agency with a gargantuan balance sheet, the Federal Reserve is quite different from any of those federally-created entities.

2. *The Debt Ceiling*

Another implication of excusing the Fed from the appropriations process is that its liabilities are not counted in the debt ceiling. Ordinarily, the Congressional Budget Act requires that any "new authority to incur indebtedness for the repayment of which the United States is liable" be limited to amounts that have been specified in an appropriations bill.[152]

As earlier discussed, however, since 2008, the Fed has been issuing interest-bearing liabilities (reserves and repos), and such issuance has not been constrained by the plain meaning of the Congressional Budget Act. Indeed, the Fed's ability to issue practically unlimited amounts of interest-bearing liabilities has made the Fed "super-independent."[153]

Growth in Interest-Bearing Reserves. From the early 1950s until 2007, bank reserves comprised a small portion of the Fed's liabilities but played a crucial role in implementing monetary policy.[154] Throughout that period, bank reserves accrued no interest (just like paper currency), thereby incentivizing

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[149] Reorganization Act of 1939 (P.L. 53-19, Title I, part I, sec. 3(b)).

[150] Paul R. Verkuil, *Jawboning Administrative Agencies: Ex Parte Contacts by the White House*, 80 COLUM. L. REV. 963 (1980) (observing that Congress has the authority to withdraw agencies from OMB jurisdiction).

[151] *See* GOV. ACCOUNTABILITY OFFICE, FEDERALLY CREATED ENTITIES: AN OVERVIEW OF KEY ATTRIBUTES 1, appx. II (Oct. 2009).

[152] 21 U.S.C. § 651. Indebtedness incurred under chapter 13 of title 31 is excepted. *See* 31 U.S.C. Ch. 13. GAO analysis indicates that Congress can delegate its constitutional borrowing authority to a federal entity "through the issuance of promissory notes or other monetary credits." *See* GAO, LEGAL FRAMEWORK, *supra* note 81, at 2.

[153] *See* Juliana B. Bolzani, *Independent Central Banks and Independent Agencies: Is the Fed Super Independent?*, 22 U.C. DAVIS BUS. L. J. 195 (2022).

[154] *See supra* note 91.

depository institutions to meet biweekly average reserve requirements while keeping only a minimum amount of excess reserves at the Fed.[155] After all, the opportunity cost of excess reserves was the foregone interest that banks could earn by lending out those funds or investing them in securities.

In late 2008, the Fed initiated QE with the aim of fostering recovery of mortgage and housing markets as well as reducing borrowing costs in credit markets.[156] Over the next two quarters, the Fed purchased a total of $1.25 trillion in mortgage-backed securities ("MBS"), $300 billion in longer-term Treasury securities, and $200 billion in debt securities issued by the housing-related government-sponsored enterprises ("GSEs").[157]

At the conclusion of the QE1 program, Fed officials emphasized that IOR would play a central role in its "exit strategy" for withdrawing extraordinary monetary policy accommodation.[158] As Fed Chair Bernanke explained in a high-profile editorial in the *Wall Street Journal*:

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155 Such an argument can be derived from George Tolley and Milton Friedman, who first argued that opportunity costs of banks holding reserves should be driven to zero. One way to satisfy this efficiency condition is for the central bank to pay interest on required reserves. *See* Peter Ireland, *Interest on Reserves: History and Rationale, Complications and Risks,* CATO J. (2019), https://www.cato.org/cato-journal/spring/summer-2019/interest-reserves-history-rationale-complications-risks [https://perma.cc/ENT7-MQM2] (explaining that higher interest rate on required reserves would "permit the Federal Reserve to expand its balance sheet as necessary to provide the liquidity necessary to support financial stability while implementing the monetary policy that is appropriate in light of the System's macroeconomic objectives of maximum employment and price stability").

156 Press Release, Board of Governors of the Federal Reserve System, Federal Reserve announces it will initiate a program to purchase the direct obligations of housing-related government-sponsored enterprises and mortgage-backed securities backed by Fannie Mae, Freddie Mac, and Ginnie Mae (Nov. 25, 2008), https://www.federalreserve.gov/-newsevents/pressreleases/monetary20081125b.htm. The FOMC stated that its MBS purchases were intended to "provide greater support to mortgage lending and housing markets" while its purchases of Treasury securities were intended to "help improve conditions in private credit markets." Press Release, Board of Governors of the Federal Reserve System, FOMC Statement (Mar. 18, 2009), https://www.federalreserve.gov/-newsevents/pressreleases/monetary20090318a.htm.

157 *See* Press Release, Board of Governors of the Federal Reserve System, FOMC Statement (Dec. 16, 2008), https://www.federalreserve.gov/newsevents/pressreleases/-monetary20081216b.htm; Press Release, Board of Governors of the Federal Reserve System, FOMC Statement (Jan. 28, 2009), *https://www.federalreserve.gov-/newsevents/pressreleases/monetary20090128a.htm*; Press Release, Board of Governors of the Federal Reserve System, FOMC Statement (Mar. 18, 2009), https://www.federalreserve-.gov/newsevents/pressreleases/monetary20090318a.htm.

158 *Federal Reserve's Exit Strategy, Hearing before the Comm. On Fin. Serv.*, 111th Cong. (2010) (statement of Ben S. Bernanke, Chairman, Bd. Gov. Fed. Rsrv. Sys.).

> When the time comes to tighten policy, we can raise the rate paid on reserve balances as we increase our target for the federal funds rate… the interest rate that the Fed pays should tend to put a floor under short-term market rates . . . Raising the rate paid on reserve balances also discourages excessive growth in money or credit, because banks will not want to lend out their reserves at rates below what they can earn at the Fed.[159]

As it turned out, policy normalization was still a half-decade away. In 2010 and in 2012-14, the Fed initiated two more rounds of securities purchases known as QE2 and QE3 with the aim of providing additional monetary stimulus while the federal funds rate remained close to zero.[160] Thus, by the end of 2014 reserve balances stood at $2.4 trillion—twice the level at the end of QE1.[161]

Growth in Reverse Repos. Traditionally, the New York Fed had only engaged in repo transactions with a small group of financial institutions known as "primary dealers."[162] During 2010-14, the New York Fed modified its rules to permit a wider range of counterparties, including GSEs and money market mutual funds.[163] By the end of 2014, its eligible RRP counterparties had grown to encompass Fannie Mae, Freddie Mac, the Federal Home Loan Banks, and twenty-two money funds.[164]

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[159] Ben Bernanke, *The Fed's Exit Strategy*, WALL ST J. (Jul. 21, 2009), https://www.wsj.com/-articles/SB10001424052970203946904574300050657897992. Bernanke's editorial also noted that the Fed could reduce the quantity of reserves by expanding its reverse repo operations, issuing term deposits, or selling off some of its securities.

[160] *See, e.g.*, Mark Gertler & Peter Karadi, *A Framework for Analyzing Large Scale Asset Purchases as a Monetary Policy Tool*, 29 INT'L J. CENT. BANKING 5 (2013). *See also* Lowell R. Rickets, *Quantitative Easing Explained*, FED. RSRV. BANK ST. LOUIS, (Apr. 2011), https://research.stlouisfed.org/publications/page1-econ/2011/04/01/quantitative-easing-explained/.

[161] *Supra* note 185.

[162] As of mid-October 2023, 24 financial institutions were certified as primary dealers by the New York Fed. *See* Press Release, Federal Reserve Bank of New York, Primary Dealers List (June 30, 2023), https://www.newyorkfed.org/newsevents/news/markets/2023/-an230630p. These institutions facilitate the Fed's transactions in secondary markets for Treasuries and agency MBS.

[163] Operating Policy, Federal Reserve Bank of New York, Operating Policy: Statement Regarding Counterparties for Reverse Repurchase Agreements (Nov. 12, 2014), https://www.newyorkfed.org/markets/RRP-Counterparty-Eligibility-Criteria.html.

[164] Press Release, Federal Reserve Bank of New York, New York Fed releases expanded reverse repo counterparties list (Jan. 16, 2015), https://www.newyorkfed.org-/markets/rlist-150116.html.

The Fed's own analysis indicated that an open-ended RRP facility could have adverse consequences for market efficiency and financial stability.[165] Indeed, FOMC members expressed "concerns about a sustained expansion of the Federal Reserve's role in financial intermediation and the risk that overnight RRPs might magnify strains in short-term funding markets during periods of financial stress." [166] To mitigate those concerns, Fed officials concluded that an RRP facility should be limited and temporary, and that conclusion was expressed in the Fed's exit strategy principles in September 2014 and reiterated in its monetary policy report to Congress a few months later:

> During normalization, the Federal Reserve . . . will use an overnight reverse repurchase agreement facility only to the extent necessary and will phase it out when it is no longer needed to help control the federal funds rate.[167]

As it turned out, the RRP facility stood at around $250 billion when policy normalization was initiated in December 2015. Rather than being phased out, however, RRP balances averaged about $150 billion through the remainder of the decade.[168]

At the onset of the pandemic in March 2020, the Fed initiated a new securities purchase program (QE4) that continued through March 2022. Over that period, the Fed purchased about $4.6 trillion in Treasuries and agency MBS and funded those purchases by expanding its liabilities of reserves and overnight RRPs.

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[165] This analysis was presented at FOMC meetings in mid-2014 and then issued as a Federal Reserve Board working paper. *See* Josh Frost et al, *Overnight RRP Operations as a Monetary Policy Tool: Some Design Considerations*, Fed. Rsrv. Bank N.Y., Staff Report No. 712 (2015).

[166] Press Release, Board of Governors of the Federal Reserve System, Minutes of the Federal Open Market Committee, June 17-18, 2014 (Jul. 9, 2014), https://www.federalreserve.gov/-newsevents/pressreleases/monetary20140709a.htm; Press Release , Board of Governors of the Federal Reserve System, Minutes of the Federal Open Market Committee, July 29-30, 2014 (Aug. 20, 2014), https://www.federalreserve.gov/newsevents/pressreleases/-monetary20140820a.htm.

[167] BD. GOV. FED. RSRV. SYS. MONETARY POL'Y REP. 35 (2015). *See also* Board of Governors of the Federal Reserve System, *Policy Normalization Principles and Plans,* BD. GOV. FED. RSRV. SYS. (Sept. 16, 2014), https://www.federalreserve.gov/monetarypolicy/files/fomc_-policynormalization.pdf.

[168] Federal Reserve Bank of New York, *Reverse Repo Operations,* FED. RSRV. BANK N.Y., https://www.newyorkfed.org/markets/desk-operations/reverse-repo.

Thus, the Fed's RRP balanced reached $1.9 trillion as of March 2022.[169] Moreover, the rationale for concerns about potential adverse consequences materialized in late 2022 and early 2023, when about $500 billion was transferred out of the banking system into the Fed's RRP facility.[170] In effect, the "leaky floor" of IOR is now being accompanied by the "spraying faucet" of the RRP facility. Over subsequent quarters the RRP facility diminished rapidly, with balances dropping below $1 trillion by the end of 2023.

However, because the liabilities the Fed created to fund QE1, 2, 3 and 4 are not counted in the debt ceiling, Congress has not had a meaningful conversation about the costs of these programs and their long-term fiscal implications.

3. Standard Accounting Practices

Among U.S. public and private institutions, the Federal Reserve is unique in determining its own accounting rules rather than following Generally Accepted Accounting Principles ("GAAP").[171] The Financial Accounting Standards Board ("FASB") determines GAAP for all non-governmental institutions, including federally-chartered enterprises such as Amtrak, Fannie Mae, and Freddie Mac.[172] FASAB is responsible for determining GAAP for all federal financial reporting entities ("FFREs"),

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[169] In spring 2021 the New York Fed broadened its eligibility criteria for RRP counterparties; thus, as of November 2023, the RRP facility was used by 112 money funds as well as 19 GSEs and 16 primary dealers. See Press Release, Federal Reserve Bank of New York, Operating Policy: Statement Regarding Reverse Repurchase Transaction Counterparties (Apr. 30, 2021), *https://www.newyorkfed.org/markets/opolicy/operating_policy_210430*; Press Release, Federal Reserve Bank of New York; *see also* Federal Reserve Bank of New York, *Reverse Repo Counterparties*, FED. RSRV. BANK N.Y. (Apr. 25, 2023), https://www.-newyorkfed.org/markets/rrp_counterparties.html.

[170] RRP balances (excluding foreign official and international accounts) expanded from about $1.8 trillion in March 2022 to about $2.3 trillion by the end of 2022; more recently, those balances have declined to around $1.2 trillion. *Supra* note 185.

[171] The Fed's accounting rules are determined by staff at the Federal Reserve Board and are promulgated in the Financial Accounting Manual for Federal Reserve Banks. Bd. of Governors of the Federal Reserve Sys., Financial Accounting Manual for Federal Reserve Banks, Jan. 2023, https://www.federalreserve.gov/aboutthefed/financial-accounting-manual.htm.

[172] Since 1973, FASB has established financial accounting standards for nongovernmental entities; in its enforcement of federal securities laws, SEC recognizes FASB standards as "generally accepted" and may supplement or supersede those standards as appropriate. *See* Robert K. Herdman, *The Roles of the SEC and the FASB in Establishing GAAP*, Testimony to the House Subcommittee on Capital Markets, Insurance, and Government-Sponsored Enterprises, Committee on Financial Services, May 14, 2002, https://www.sec.gov/-news/testimony/051402tsrkh.htm.

including cabinet departments, offices, and independent agencies such as the CFTC, FDIC, and SEC.[173] The financial statements of these FFREs are incorporated into the *Financial Report of the United States Government*.[174] In the preface to the FY2022 edition of that report, Secretary Janet Yellen stated that it "provides the American people with a comprehensive view into the nation's finances and fiscal outlook" and "demonstrates the government's steadfast commitment to accountability and transparency in managing the nation's finances."[175]

FASAB's stated objectives for federal financial reporting are to foster budget integrity, operating performance, stewardship, and control systems. In particular, FASAB states that such reporting should assist public officials in their "duty to be publicly accountable for monies raised through taxes and other means" and should help users of these reports to evaluate the services and costs of the reporting entity and "the management of its assets and liabilities."[176]

In contrast, the Fed's accounting standards are determined by the Federal Reserve Board and are not subject to external input or review.[177] As the Board of Governors has noted:

> Accounting principles for entities with the unique powers and responsibilities of the nation's central bank have not been formulated by accounting standard-setting bodies. The Board of Governors has developed specialized accounting principles and practices that it

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173 The heads of the GAO, OMB, and Treasury Department created the FASAB in 1990 "to serve the public interest by . . . issuing federal financial accounting standards" and those three agencies are responsible for funding the FASAB and overseeing its work. In 1999 the American Institute of Certified Public Accountants (AICPA) recognized FASAB as the board that promulgates GAAP for federal entities. FASAB, HANDBOOK OF FED. ACCT. STANDARDS & OTHER PRONOUNCEMENTS, AS AMENDED 1 – 2 (2022).

174 As of February 2023, there were 164 federal financial reporting entities, including the CFTC, FDIC, FHFA, NCUA, PBGC, and SEC; see DEP'T OF TREASURY, FINANCIAL REPORT OF THE UNITED STATES GOVERNMENT FY2022. Fannie Mae, Freddie Mac, and Amtrak were designated as "disclosure entities" while the Federal Home Loan Banks were designated as "related parties." *Id.* at 215. Each of those federally-chartered institutions follows the standards of GAAP as determined by the Public Company Accounting Oversight Board (PCAOB).

175 *Id.*

176 FASAB, *supra* note 171.

177 The Fed's combined financial statements are audited annually by an independent external accounting firm, and those audits are conducted using the Federal Reserve's accounting rules. *See* FEDERAL RESERVE BANKS COMBINED FINANCIAL STATEMENTS, https://www.federalreserve.gov/aboutthefed/files/combinedfinstmt2022.pdf.

considers to be appropriate for the nature and function of a central bank.[178]

In 2011, the Fed quietly introduced the possibility that future interest earnings could be booked as a "deferred asset" on its financial statements. In particular, a footnote in the Federal Reserve Board's annual report stated that the book entry for *Interest on Federal Reserve notes due to U.S. Treasury* would represent a deferred asset in cases where the Reserve Banks' net earnings became insufficient to equate surplus to capital paid-in.[179]

The footnote in the Fed's report was merely raising a hypothetical scenario and hence drew no attention. Two years later, after the launch of QE3, then-Governor Jerome Powell gave public remarks that briefly noted the possibility that if the Fed's balance sheet became impaired it could incorporate "a deferred asset representing a flow of future income to be retained and not remitted to the Treasury."[180] Even at that time, the prospect of booking a deferred asset still seemed very improbable.

But in the wake of its QE4 program, the Fed began incurring large operating losses. In 2020 and 2021, the Fed purchased huge amounts of low-yielding Treasuries and MBS and financed those asset purchases by expanding its liabilities of reserves and reverse repos. Thus, as the Fed subsequently pushed up market rates more than 5 percentage points in its fight against inflation, the interest expense on its liabilities far outstripped the interest income on its securities portfolio, and its cumulative operating losses came to exceed its paid-in capital and surplus.

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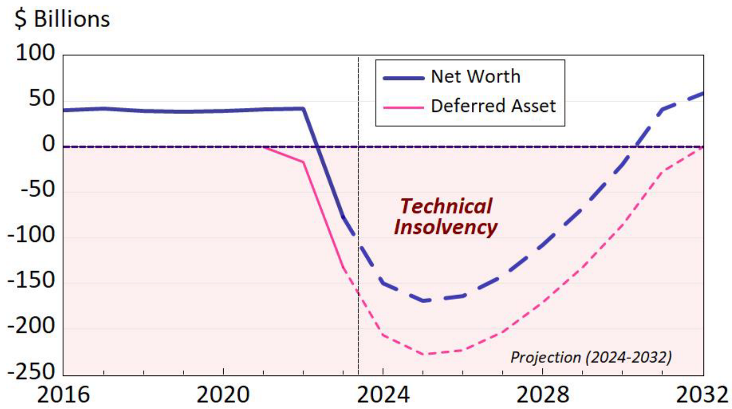
178 BD. GOV. FED. RSRV. SYS., FIN. ACCOUNTING MANUAL FOR FED. RSRV. BANKS1 (2022).

179 BD. GOV. FED. RSRV. SYS, 97 ANN. REP. 2010, 308 (2011).

180 Jerome Powell, *Discussion of 'Crunch Time: Fiscal Crises and the Role of Monetary Policy*, Remarks Given at the U.S. Monetary Policy Forum 7 (Feb. 22, 2013).

Figure 4: The Federal Reserve's Net Worth and the "Magic Asset"



Note: This figure shows the Federal Reserve's net worth and the book entry for its deferred asset (the "magic asset"), using published data for 2012 to 2023 and projections for 2024 to 2032. *Source*: FRS Audited Statements (2012-22), FRS Unaudited Statements (2023:Q2), Federal Reserve Board (H.4.1 Release, 10/12/2023), and the authors' projections.

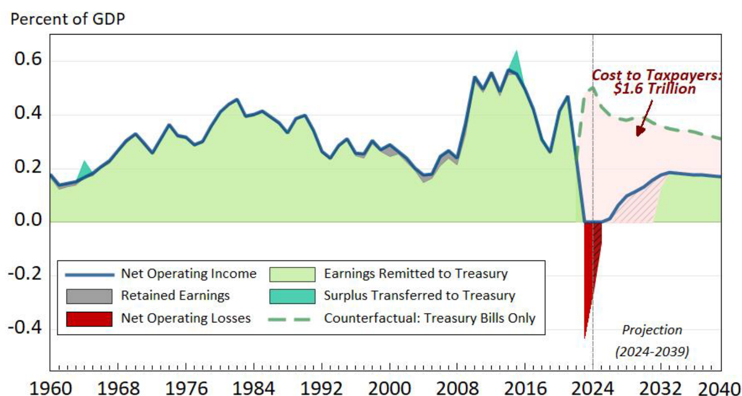
As shown in Figure 4, the Fed's net worth fell below zero in March 2023 and is now projected to reach a trough of about $200 billion over the next few years. A private institution in such circumstances might well be faced with the prospect of a takeover, bankruptcy, or liquidation. By contrast, the Fed can issue an unlimited amount of legal tender, and hence all of its liabilities are effectively backed by the full faith and credit of the U.S. government.[181]

These operating losses have also reduced the Fed's remittances to the U.S. Treasury. Figure 5 shows the evolution of the Fed's remittances over the past six decades, gauged in proportion to the overall size of the U.S. economy.[182] From 1960 to 2008, the Fed's remittances ranged from about 0.2% to 0.4% of nominal GDP. Those variations reflected changes in the level of interest rates and in the composition of money demand. For example, a rising amount of U.S. paper currency was shipped overseas, reflecting its role as a

181 In principle, the Fed could default on its holdings of commercial banks' reserves, but such an eventuality would likely trigger a global financial crisis.

182 Gauging the Fed's remittances in terms of GDP is appropriate because the U.S. economy has grown markedly over the past six decades: Nominal GDP was about $540 billion in 1960 and is now approaching $27 trillion.

Figure 5: Federal Reserve Remittances to the U.S. Treasury



Note: This figure shows the total value and composition of the Federal Reserve's annual remittances to the U.S. Treasury as a percent of nominal GDP, using actual data for 1960 to 2023 and projections for 2024 to 2039. *Sources*: Federal Reserve Board (remittance data), Bureau of Economic Analysis (nominal GDP data), and the authors' projections.

safe and liquid asset in countries facing turbulent political and economic conditions.[183]

In the wake of the global financial crisis, the Fed's remittances increased sharply to around 0.5% of GDP from 2009 to 2015 before subsiding back to more normal levels over the rest of that decade.[184] This surge in remittances partly reflected a huge increase in demand for U.S. currency, which roughly doubled from about $800 billion in 2007 to around $1.5 billion in 2016.[185] The Fed's net earnings were also boosted by the differential between the yields accruing on its securities holdings and the interest rate paid on its reserves. That pattern has been reversed more recently given the Fed's operating losses.

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183 Research by Fed economists has indicated that more than half of U.S. currency in circulation is held abroad. *See* Ruth Judson & Richard Porter, *Currency Demand by Federal Reserve Cash Office: What Do We Know?*, 56 J. ECON & BUS. 273 (2004).

184 *See* Miguel Faria e Castro & Samuel Jordan-Wood, *The Fed's Remittances to the Treasury: Explaining the 'Deferred Asset'*, FED. RSRV. BANK ST. LOUIS (Nov. 21, 2023), https://www.stlouisfed.org/on-the-economy/2023/nov/fed-remittances-treasury-explaining-deferred-asset [https://perma.cc/3KBA-KSFR].

185 Board of Governors of the Federal Reserve System, *Factors Affecting Reserve Balances*, BD. GOV. FED. RSRV. SYS. (Nov. 24, 2023), https://www.federalreserve.gov/releases/h41/ [https://perma.cc/Z36F-SQZH].

The Fed's accounting rules may be transparent to Congress and the public but they nevertheless allow the Fed to paint a rosier financial picture than they would if using GAAP.[186] For example, under GAAP, an institution's surplus is defined as the amount by which its retained earnings exceed its paid-in capital. The surplus shrinks when the institution uses retained earnings to cover its operating expenses, and it vanishes at the point when retained earnings fall below the level of paid-in capital.[187] By contrast, the Fed's published accounting statements continue to report a surplus of $6.785 billion even though it has consumed all of its retained earnings.[188]

Similarly, the phrase "deferred asset" does not appear anywhere in GAAP, which uses the term "deferred tax asset" to describe tax credits that have been earned but not yet used.[189] In contrast, the Fed's financial statements now use the term "deferred asset" to characterize prospective operating profits in future years, *not* profits that have already been earned.[190] In fact, one former Fed official has referred to this accounting device as the Fed's "magic asset" in light of its departure from fundamental accounting principles.[191]

Finally, under GAAP, direct loans that have been disbursed are recognized as assets at the present value of their estimated net cash inflows, and the present value is re-estimated each year taking into account "all factors that may have affected the estimated cash flows."[192] Of course, direct

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186 Paul H. Kupiec & Alex J. Pollock, *Who Owns Federal Reserve Losses and How Will They Impact Monetary Policy*, AEI Economics Working Paper 2022-06, American Enterprise Institute (2022).

187 Will Kenton, *What is a Surplus? Definition, Reasons, and Consequences,* INVESTOPEDIA (Aug. 29, 2023), https://www.investopedia.com/terms/s/surplus.asp [https://perma.cc/KC7M-6FEN]

188 *Federal Reserve Banks Combined Financial Statements as of and for the years ended December 31, 2022 and 2021* (April 2023), 6-7. Federal Reserve Banks Combined Quarterly Financial Report: 2023Q2 (August 2023), 2. These statements are posted at Bd. of Governors of the Federal Reserve Sys., Financial Statements, https://www.federalreserve.gov/-aboutthefed/fed-financial-statements.htm (last visited Jan. 27, 2024).

189 Julia Kagan, *Deferred Tax Asset: What It Is and How to Calculate and Use It, With Examples*, Investopedia (Nov. 23, 2023), *https://www.investopedia.com/terms/d/deferredtaxasset.asp [https://perma.cc/6HUT-J4C9]*

190 The Fed's audited financial statements simply note that "This deferred asset is periodically reviewed for impairment and no impairment existed as of December 31, 2022." *See supra* note 173, 7.

191 William R. Nelson, *Helicopter Money, Fiscal QE, the Magic Asset, and Collateralizing the Currency*, *in* POPULISM AND THE FUTURE OF THE FED (Jim Dorn ed. 2022).

192 FASAB, HANDBOOK OF FED. ACCT. STANDARDS & OTHER PRONOUNCEMENTS, AS AMENDED 4 (2022)

loans are legally binding contracts, whereas the Fed's net operating income is contingent on the outlook for interest rates, currency demand, and other factors that are difficult to predict over multi-decade horizons. At any rate, the Fed's financial statements do not include any projections of its net operating income nor assessments of uncertainty about its net cash flows.

C. Fed Efficiency

Federal agencies are subject to comprehensive performance reviews by public auditors who are accountable to Congress for the quality and rigor of their work. In contrast, the Fed is subject only to narrow financial audits conducted by a private firm, such as Deloitte or KPMG, that has no accountability to Congress or the public.[193]

1. GAO Audits

With the sole exception of the Fed, every program of every federal department, office, and agency is audited by GAO, an independent agency that serves as the supreme audit institution of the United States.[194] GAO conducts annual accounting audits of every federal financial reporting entity, including the CFPB, CFTC, FHFA, FDIC, OCC, and SEC.[195] More broadly, GAO conducts performance audits to "help improve the performance and ensure the accountability" of these entities.[196] In fact, GAO's performance audits and recommendations resulted in savings to U.S. taxpayers that totaled nearly $1 trillion during 2011-2022.[197]

GAO regularly examines various aspects of Federal Reserve operations, such as information technology and payments systems.[198] However, GAO is

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[193] The Fed's combined financial statements were audited by Deloitte from 2007 to 2014 and have been audited by KPMG since then; *see* Fed Financial Statements, https://www.federalreserve.gov/aboutthefed/fed-financial-statements.htm (last visited Jan. 23, 2024). In recent decades the work of auditing firms has been plagued by recurring performance failures, but analysis of that issue is beyond the scope of this paper.

[194] *See* U.S. Government Accountability Office, *Role as an Audit Institution*, GAO, https://www.gao.gov/about/what-gao-does/audit-role [https://perma.cc/2P2H-CZ4A].

[195] *See supra* note 66. For example, the results of GAO's FY2022 audit of CFPB were published in the *Financial Report of the Consumer Financial Protection Bureau for Fiscal Year 2022*, 54-59.

[196] U.S. GOV'T ACCOUNTABILITY OFF. GAO-23-207089, ADDITIONAL OPPORTUNITIES TO REDUCE FRAGMENTATION, OVERLAP, AND DUPLICATION AND ACHIEVE BILLIONS OF DOLLARS IN FINANCIAL BENEFITS (2023).

[197] GAO, PERFORMANCE AND ACCOUNTABILITY REPORT FOR FY2022, https://www.gao.gov/-about/what-gao-does/performance.

[198] All GAO reports regarding its audits of Federal Reserve operations are posted at https://www.federalreserve.gov/regreform/reform-audit-gao.htm.

prohibited by statute from auditing the efficiency and effectiveness of the Fed's monetary policies or balance sheet programs:

> [GAO] audits of the [Federal Reserve] Board and Federal Reserve Banks may not include...deliberations, decisions, or actions on monetary policy matters, including discount window operations, reserves of member banks, securities credit, interest on deposits, and open market operations [and] transactions made under the direction of the Federal Open Market Committee.[199]

Although the GAO's auditing role is proscribed, the Fed's website gives an affirmative answer to the question, "Does the Federal Reserve ever get audited? Yes."[200] But such audits are limited in scope and hampered by governance issues. In particular, the Fed's financial statements are examined every year by a private accounting firm with the sole purpose of verifying accuracy and no consideration of efficacy or efficiency as in a performance audit.

Arguably, had GAO been involved in a performance review of the Fed's previous securities purchase programs at the end of QE3 in 2014, it might have highlighted concerns about efficacy and risks in advance of the Fed's latest round of purchases in QE4. It might have reached conclusions about when and in what proportions it is sensible to buy government debt versus mortgage-backed securities. At the very least, with the Fed now incurring significant operating losses, it would be sensible for GAO to conduct a post-mortem to identify lessons learned.

2. *The Inspector General Act*

Congressional oversight of the Fed's monetary policy programs and operations is also impaired by the FOMC's exemption from the Inspector General Act of 1978. That Act established a fully independent inspector general ("IG") for every federal department and every major agency, with the sole exception of the Fed.[201] Each of these IGs is appointed by the

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[199] 31 U.S.C. § 714(b). The Dodd-Frank Act added the provision that GAO may audit such transactions solely for the purposes of assessing operational integrity, accounting and financial reporting, internal controls, eligibility criteria, security and collateral policies, and the selection and payment of third-party contractors. (31 U.S.C. § 714(f)(2)).

[200] Board of Governors of the Federal Reserve System, *Does the Federal Reserve Ever Get Audited*, BD. GOV. FED. RSRV. SYS. (Jan. 2, 2019), https://www.federalreserve.gov/-faqs/about_12784.htm [https://perma.cc/8LSN-DZ6]. The Fed's response to this FAQ refers to annual financial audits, OIG investigations, GAO reviews, publication of its balance sheet, and an interactive tool for visualizing that information.

[201] Inspector General Act of 1978. Pub. L. 94-452.

President, confirmed by the Senate, and may only be removed by the President for cause.[202] Moreover, each OIG receives its own appropriation separately from its affiliated entity; CRS notes that "this requirement provides [the OIG] with an additional level of budgetary independence."[203]

The statutory duty of each IG is to assist Congress by evaluating agency programs and identifying steps for promoting efficiency and effectiveness. At a congressional hearing in 2009, GAO's chief counsel attested that the IGs "have been instrumental in enhancing government accountability."[204] In fact, apart from the Fed, a fully independent IG is now in place at every independent agency with operating expenses exceeding $5 billion.[205] The OCC is overseen by the Treasury Department's IG, while FDIC has had an independent OIG since 1993 and FHFA has had an independent OIG since its creation in 2008.[206]

A decade after Congress established the fully independent OIGs, it instituted quasi-independent OIGs at other agencies known as "designated federal entities" ("DFEs"), including the Fed's Board of Governors.[207] These OIGs have several distinct limitations:

IG Appointment. At each DFE, the IG is an employee, not a presidential appointee. At agencies headed by a board or commission, such as the CFTC and SEC, the IG is appointed by the governing board and is removable by a two-thirds vote of its members.[208] The sole exception is the Federal Reserve Board, whose IG is appointed by the Fed Chair and removable by the Fed

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[202] The President must notify Congress to indicate the reasons for removal.

[203] Congressional Rsch. Serv., *Statutory Inspectors General in the Federal Government: A Primer*, CRS Report R45450, 15 (February 8, 2023) [hereinafter CRS Report].

[204] Gary L. Kepplinger, *Inspectors General: Independent Oversight of Financial Regulatory Agencies,* Testimony before the Subcommittee on Government Management, Organization & Procurement, House Committee on Oversight & Government Reform, March 25, 2009 (issued as GAO document 09-524T, at 1).

[205] The federal departments and independent agencies with a fully independent OIG are listed in Table A-1 of CRS Report, *supra* note 203.

[206] The Treasury Department OIG's evaluations and annual audits of OCC are available to the public. *See* Office of Inspector General, *Audit and Evaluation Reports,* OFF. INSPECTOR GEN., https://oig.treasury.gov/reports/audit-and-evaluation.

[207] Amendments to Inspector General Act of 1978 (P.L. 100-504). The agencies classified as DFEs are listed in Table A-2 of CRS Report, *supra* note 205. When the CFPB was established in 2010, the Federal Reserve Board's OIG was designated to serve jointly as the CFPB's OIG.

[208] The Dodd-Frank Act tightened the restrictions on IG removal at DFEs, requiring a written vote and approval by at least two-thirds of the governing board. 5 U.S.C. App. §8G, clauses (a)(4) and €(1).

Board.[209] In its 2009 report, GAO stated that "independence is one of the most important elements of an effective IG . . . [and] the cornerstone of professional auditing."[210] That report concluded as follows:

> We believe that the differences in the appointment and removal processes between presidentially-appointed IGs and those appointed by agency heads result in a clear difference in the organizational independence of these IGs.[211]

Operating Budget. At each DFE, the OIG's operating expenses are contained within the agency's overall budget but listed as a distinct item in the budget request submitted to Congress. The IG may annotate that line item if the agency's proposed amount would substantially inhibit the OIG's ability to carry out its duties. According to the GAO, these statutory provisions "help ensure adequate funding and additional independence of IG budgets by providing the Congress with transparency into the funding of each agency's IG."[212] The sole exception is the Fed Board, which determines its OIG's budget outside of the appropriations process.

Scope of Authority. The IG Act states that each IG shall work under the general supervision of the agency head, who "shall not prevent or prohibit the IG from initiating, carrying out, or completing any audit or investigation or from issuing any subpoena during the course of any audit or investigation."[213] Apart from special provisions for national security, the notable exception is that the statute specifically states that the Federal Reserve Board's IG shall work "under the authority, direction, and control" of the Fed Chair in conducting any audit or investigation that requires access to sensitive information concerning "deliberations and decisions on policy matters, including documented information used as a basis for making policy decisions, the disclosure of which could reasonably be expected to have a significant influence on the economy or market behavior," with written notice to be sent to congressional oversight committees whenever this

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209 5 U.S.C. App., €(c) a€§8G(e)(1). Removal of the Fed's IG requires written concurrence by a two-thirds majority of members of the Federal Reserve Board.

210 *See supra* note 204, 5.

211 *See id.* at 3.

212 GAO, Inspector Generals: Reporting on Independence, Effectiveness, and Expertise, GAO Report 11-770 (Sept. 2011), 10. Nonetheless, CRS suggests that OIGs at DFEs "may be more susceptible to some reallocation of funds"; see *supra* note 203, 15.

213 5 U.S.C. App., §8G(d)(1).

power is exercised.[214] In practice, however, one might reasonably expect the IG to defer to the Fed Chair on all such matters to avoid triggering any formal notification process.

Regardless of these specific concerns, a fundamental gap in Congress's oversight is that current law designates an OIG for the Federal Reserve Board, *not* the FOMC. Thus, the Fed has no OIG with statutory authority to audit or evaluate its monetary policy programs or operations. In principle, the Fed Chair could direct the Fed Board's IG to conduct a comprehensive evaluation of the FOMC's balance sheet policies and programs. If such an evaluation had been conducted in the late 2010s, following the completion of preceding rounds of QE, an IG report might have alerted Congress that such a program could incur significant costs. There is no indication that the Fed's IG has embarked on such an evaluation, even in the wake of the operating losses associated with QE4.

III. APPROACHES FOR ENHANCING OVERSIGHT

When incumbent Fed Chair Ben Bernanke advised incoming Fed Chair Janet Yellen to heed Congress as "the boss," he elaborated in further detail what that meant:

> it's up to the Congress to set our structure, to set our mandate, and that's entirely legitimate, and we need to go and explain ourselves. We need to explain why certain approaches are not so good or might be better. But, obviously, they [members of Congress] represent the public, and they certainly have every right to set the terms on which the Federal Reserve operates.[215]

That synopsis is broadly consistent with the constitutionally appropriate balance between maintaining the Fed's accountability to Congress while protecting its independence from political interference. In recent years, however, traditional forms of oversight have not been adequate to facilitate Congress's ability to review major shifts in the Fed's monetary policy framework or to assess the costs and benefits of its balance sheet programs.

Accordingly, in light of the foregoing analysis, it seems useful to discuss the merits and pitfalls of potential approaches for enhancing congressional

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[214] 5 U.S.C. App., §8G(g)(3). This clause is parallel to a subset of provisions of §8D(a), which specifies conditions in which the Secretary of the Treasury can control the work of its OIG. However, that official is directly accountable to the President. Moreover, all of the Treasury's programs and operations can be investigated by GAO.

[215] *See* Bernanke, *supra* note 1.

oversight of the Fed's monetary policymaking function. Such steps could include statutory changes to facilitate regular reporting, ensure congressional access to internal Fed information, and strengthen the roles of the GAO and the Fed's IG in serving as congressional watchdogs. In weighing such measures, it is important to consider how to enhance congressional oversight while keeping the Fed well insulated from political interference, that is, to ensure that the Fed's monetary policymaking is not influenced by tendencies to short-termism that are typical of political cycles.

A. Fed Reports to Congress

The issuance of public reports can be helpful in fostering transparency and accountability without hampering an institution's ability to carry out its mandated responsibilities. To accomplish this goal, reporting requirements need to be carefully designed and should be updated periodically in light of recent and prospective developments. Indeed, the present juncture could be an opportune time for Congress to revisit the statutes governing the Fed's monetary policy reporting.

1. Mandated Objectives

Congress has given the FOMC a broad mandate of fostering maximum employment and price stability. Thus, it could be sensible to require the Fed to provide regular reports regarding its quantification of these objectives, including an explanation of any recent or prospective changes to its methods and assessments.

In 2012, the Fed formally quantified its price stability mandate as an inflation target of 2%, as measured by the price index for personal consumption expenditures.[216] Before doing so, Fed Chair Bernanke engaged in extensive consultations with key members of Congress, including the chair and ranking member of each oversight committee.[217] At that time, the FOMC characterized this target as symmetric and indicated that policy would be

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[216] The FOMC's *Statement of Longer-Run Goals and Strategy* was adopted in January 2012. *See* Board of Governors of the Federal Reserve System, *Statement on Longer-Run Goals and Monetary Policy Strategy*, BD. GOV. FED. RSRV. SYS. (Jan. 24, 2012), https://www.federalreserve.gov/monetarypolicy/files/FOMC_LongerRunGoals.pdf [https://perma.cc/T2RA-4P4Y].

[217] *See* BEN S. BERNANKE, THE COURAGE TO ACT: A MEMOIR OF A CRISIS AND ITS AFTERMATH (2015).

aimed at achieving it over the medium run—an approach commonly known as "flexible inflation targeting."[218]

By contrast, there are no indications that the Fed engaged in congressional consultations prior to overhauling its monetary policy framework in August 2020, when it shifted to "average inflation targeting" with an asymmetric tilt towards elevated inflation.[219] That revision made the operational definition of price stability much more opaque and discretionary, with ambiguity about the horizon over which inflation would be averaged ("over time") as well as the duration over which it would remain elevated ("for some time"). Indeed, some former Fed officials have concluded that this framework revision paved the way for the Fed's subsequent inertia in responding to the inflation surge of 2021.[220]

More recently, a number of prominent economists have been calling for the Fed to raise its inflation target to 3% or even higher.[221] Such a change might seem blatantly inconsistent with the Fed's price stability mandate but could be adopted at any time. Thus, strengthened reporting requirements might be appropriate to foster appropriate congressional oversight of such changes.

Likewise, the Fed's 2012 framework effectively quantified its maximum employment in terms of the longer-run sustainable rate of unemployment,

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218 Richard H. Clarida, Vice Chair, Bd. Gov. Fed. Rsrv. Sys., Flexible Average Inflation Targeting and Prospects for U.S. Monetary Policy, Speech at the Brookings Institution Symposium on Monetary Policy Frameworks (Nov. 8, 2021).

219 Since August 2020, the FOMC's *Statement of Longer-Run Goals and Policy Strategy* has indicated that "The Committee seeks to achieve inflation that averages 2 percent over time, and therefore judges that, following periods when inflation has been running persistently below 2 percent, appropriate monetary policy will likely aim to achieve inflation moderately above 2 percent for some time." *Supra* note 222.

220 *See* Charles I. Plosser, *The Fed's Risky Experiment* (Hoover Inst. Econ. Working Paper No. 21116, 2021); *see also* Gauti B. Eggertsson & Don Kohn, *The Inflation Surge of the 2020s: The Role of Monetary Policy*, BROOKINGS, May 23, 2023, https://www.brookings.edu/wp-content/uploads/2023/04/Eggertsson-Kohn-conference-draft_5.23.23.pdf; Mickey D. Levy & Charles Plosser, *The Murky Future of Monetary Policy*, 104 FED. RSV. BANK OF ST. LOUIS REV. 178 (2022).

221 *See* Jason Furman, *The Fed Should Carefully Aim for a Higher Inflation Target*, WALL ST. J. (Aug. 23, 2023), https://www.wsj.com/articles/the-fed-should-carefully-aim-for-a-higher-inflation-target-reserve-powell-greenspan-5fef5051 [https://perma.cc/DB2W-76WM]. *See also* Greg Ip, *How to Deal With Above-Target Inflation: Raise the Target,* WALL ST. J., https://www.wsj.com/articles/how-to-deal-with-above-target-inflation-raise-the-target-11630504980 [https://perma.cc/7GS7-S4YK]; Jeff Sommer, *The Fed Has Targeted 2% Inflation. Should It Aim Higher*?, N.Y. TIMES (Mar. 24, 2023), https://www.nytimes.com/-2023/03/24/business/inflation-federal-reserve-interest-rates.html [https://perma.cc/H5ZY-EFAG].

whereas the 2020 revision omitted that paragraph and simply indicates that the FOMC uses "a wide range of indicators" in making those assessments.[222] Thus, requiring the Fed to quantify its maximum employment objective could facilitate oversight of the Fed's performance in carrying out its statutory mandate.

2. *Simple Benchmarks*

Simple benchmarks, such as the Taylor Rule, can be very helpful in facilitating the central bank's monetary policy decisions and communications. The creator of that rule, Professor John B. Taylor, has emphasized that no simple benchmark can be followed mechanistically.[223] However, when policymakers deviate from the benchmark policy, such deviations should be clearly explained.[224]

Since 2017, the Fed's monetary policy reports to Congress have generally included information about the prescriptions of simple rules, although such information was not included in two such reports (June 2020 and February 2021).[225] However, the glaring omission is that the Fed's reports have provided no explanation about the rationale for substantial deviations from those benchmarks.

3. *Stress Testing for Monetary Policy*

The Fed publishes a quarterly summary of the baseline economic outlook of FOMC participants, that is, their assessments of the most likely trajectory of the economy under appropriate monetary policy and in the absence of any further shocks.[226] However, such an approach may be misleading in the

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[222] The FOMC's *Statement of Longer-Run Goals and Policy Strategy* characterizes maximum employment as a "broad-based and inclusive goal." *Supra* note 212.

[223] *See supra* note 108.

[224] Andrew T. Levin, *The Design and Communication of Systematic Monetary Policy Strategies*, 49 J. ECON. DYNAMICS & CONTROL 52 (2014).

[225] *See* Board of Governors of the Federal Reserve System, *Monetary Policy Report*, BD. GOV. FED RSRV. SYS. (June 12, 2020), https://www.federalreserve.gov/monetarypolicy/-files/20200612_mprfullreport.pdf; Board of Governors of the Federal Reserve System, *Monetary Policy Report*, BD. GOV. FED RSRV. SYS. (Feb. 19, 2021), https://www.federalreserve.gov/monetarypolicy/files/20210219_mprfullreport.pdf.

[226] *See* Board of Governors of the Federal Reserve System, *Summary of Economic Projections*, BD. GOV. FED. RSRV. SYS. 1 (Sept. 20, 2023), https://www.federalreserve.gov/-monetarypolicy/files/fomcprojtabl20230920.pdf [https://perma.cc/DS7N-2MSJ. This document also includes a tabulation of historical forecast errors to provide information about the typical magnitude of uncertainty surrounding FOMC participants' projections.

absence of information about specific risks to the outlook. For example, in the spring and summer of 2021 Fed officials' baseline projections hinged on the premise that the recent surge in inflation would be "transitory," but the Fed provided no indication about how policy might need to be adjusted if that premise turned out to be incorrect.

Ironically, the Fed requires all large and systemically important banking institutions to undergo "stress tests" to show how their balance sheets would be affected by specific adverse economic and financial shocks. Thus, it would seem plausible that Congress could establish a similar regimen in requiring the Fed to engage in "stress tests for monetary policy."[227]

B. Congressional Access to Internal Fed Information

In carrying out its constitutional responsibility for oversight of the Federal Reserve, members of Congress have raised concerns about a range of issues, including (a) the process of selecting the president of each regional Federal Reserve Bank, especially given their roles as members of the FOMC; (b) the FOMC's management of its balance sheet, especially given recent operating losses; and (c) the FOMC's complacency about elevated inflation in 2021, which set the stage for rapid tightening and major bank failures more recently.

Nonetheless, two distinct obstacles have hampered Congress' ability to carry out inquiries and investigations of such issues, and statutory measures would likely be necessary to overcome each of these obstacles.

1. *Federal Reserve Bank Information*

The regional Federal Reserve Banks are private financial institutions overseen by the Fed's Board of Governors, which has comprehensive authority to examine their internal records. Thus, a federal court has ruled that the Board must protect the confidentiality of Reserve Bank records, just like the proprietary information of commercial banks or other private financial institutions overseen by the Fed.[228]

Of course, the Reserve Banks are government-chartered institutions, and hence Congress could adjust their charter to clarify that all records produced by Reserve Banks are the legal property of the U.S. government and subject

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[227] *See* supra note 106, at 53.

[228] *See* Ball v. Bd. of Governors, 87 F. Supp. 3d 33, 56 (2015). *See also* House Comm. on Oversight & Accountability, NYFRB Continues to Obstruct Transparency—Issa Demands Details on Maiden Lane I, Mar. 31, 2010, https://oversight.house.gov/nyfrb-continues-to-obstruct-transparency-issa-demands-details-on-maiden-lane-i/.

to all statutes applicable to records produced by federal agencies.[229] Such a clarification would enable the Board and the Reserve Banks to be fully responsive to congressional requests involving internal Reserve Bank records.[230]

2. *Market-sensitive information*

The FOMC regularly reiterates its commitment to "explain its monetary policy decisions to the public as clearly as possible" because such clarity "facilitates well-informed decisionmaking by households and businesses, reduces economic and financial uncertainty, increases the effectiveness of monetary policy, and enhances transparency and accountability, which are essential in a democratic society."[231] In contrast, the inadvertent release of confidential FOMC information might well be confusing or alarming, with potentially adverse consequences for the stability of financial markets and the broader economy.[232]

Under the Federal Reserve's current procedures, detailed information about the FOMC meetings held in each calendar year—including a lightly-edited transcript of each meeting and all background materials produced by

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229 Such a statutory adjustment would make FRB records subject to the provisions of FOIA.

230 Under the Fed's current regulations, all Federal Reserve System officials and staff are strictly prohibited from providing confidential FOMC information to members of Congress, even in response to a congressional subpoena: "Unless authorized by the Committee or as ordered by a Federal court in a judicial proceeding in which the Committee has had the opportunity to appear and oppose discovery, any person who is required to respond to a subpoena or other legal process concerning exempt Committee information shall attend at the time and place required and respectfully decline to disclose or to give any testimony with respect to the information, basing such refusal upon the provisions of this part. If the court or other body orders the disclosure of the information or the giving of testimony, the person having the information shall continue to decline to disclose such information and shall promptly report the facts to the Committee for such action as the Committee may deem appropriate." 12 CFR 71.120(b) ("Rules Regarding Availability of Information").

231 The FOMC's Statement of Longer-Run Goals and Policy was adopted in 2012 and has been subsequently reaffirmed on an annual basis.

232 Confidential FOMC information could be highly valuable if leaked to a small number of individuals or private firms. Indeed, the FOMC's external communications rules specifically prohibit policymakers from communicating their own personal views "in any meeting or conversation with any individual, firm, or organization who could profit financially from acquiring that information unless those views have already been expressed in their public communications."

staff—are published on the Fed's website after a lapse of five years.[233] This degree of transparency is immensely helpful for academic scholarship but not adequate for facilitating congressional oversight. For example, FOMC decisions in mid-2021 hinged on officials' view that elevated inflation would be transitory, but those FOMC materials will not be released until 2027.

In principle, of course, Congress could adopt legislation prescribing a more rapid schedule for the release of FOMC documents, but such an approach could risk impinging on the deliberative process and/or exacerbating confusion about the Fed's policymaking.[234]

An alternative approach might be for Congress to enact rules analogous to those adopted to facilitate congressional oversight of intelligence activities while ensuring the protection of highly sensitive national security information. In particular, the Central Intelligence Agency ("CIA") was established by the National Security Act of 1947 without any specific oversight provisions. More than four decades later, in light of bipartisan concerns about congressional undersight, the Intelligence Act of 1991 was enacted with the following oversight procedures:

Non-Covert Intelligence Activities. The CIA director and other intelligence officials must ensure that both of Congress' oversight committees are kept "fully and currently informed" about all non-covert activities, including any significant intelligence failures, and must respond to oversight committee requests by providing all information or material within their custody or control.[235]

Covert Intelligence Activities. A parallel set of provisions requires the CIA director and other intelligence officials to keep the oversight committees "fully and currently informed" about all covert activities "[t]o the extent consistent with due regard for the protection from unauthorized disclosure of classified information relating to sensitive intelligence sources and methods or other exceptionally sensitive matters."[236]

Extraordinary Covert Operations. The President must specifically authorize every covert operation with a written finding that is promptly given to both

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[233] For example, the FOMC materials for calendar year 2017 were released to the public on February 2023; see Board of Governors of the Federal Reserve System, *Federal Open Market Committee,* BD. GOV. FED. RSRV. SYS., (Jan. 28, 2022), https://www.federalreserve.gov/-monetarypolicy/fomc_historical.htm. [https://perma.cc/U23H-W9YR].

[234] For further discussion, see Ellen E. Meade & David Stasavage, *Publicity of Debate and the Incentive to Dissent: Evidence from the US Federal Reserve,* 118 ECON. J. 695 (2008).

[235] 50 U.S.C. § 3092.

[236] *Id.* § 3093(b)

congressional oversight committees.[237] However, if the President determines that it is essential to limit access to the finding "to meet extraordinary circumstances affecting vital interests of the United States, the finding may be reported to the chairmen and ranking minority members of the intelligence committees, the Speaker and minority leader of the House of Representatives, the majority and minority leaders of the Senate, and such other member or members of the congressional leadership as may be included by the President."[238]

The provisions of the Intelligence Act could readily serve as a template for strengthening congressional oversight of the Federal Reserve System. In particular, Fed officials would be required to keep both oversight committees –the Senate Banking Committee and the House Financial Services Committee—*"fully and currently informed"* about the Fed's internal procedures and operations and to provide prompt and complete information in response to all committee requests. Moreover, the Fed's Board of Governors could be authorized to limit access to highly market-sensitive information by providing such information solely to the chair and ranking minority member of each oversight committee and to the top officials in each chamber of Congress.

C. Strengthening Congressional Watchdogs

Since the 1970s, the Fed has been exempt from comprehensive GAO reviews.[239] When it was granted by Congress, that exemption importantly reflected the simplicity of the Fed's financial operations and balance sheet. The asset side of the Fed's balance sheet was comprised of Treasury securities, and its liabilities consisted almost entirely of Federal Reserve notes (i.e., paper cash, which does not pay interest) and bank reserves held at the Fed (which did not bear any interest at that time). The Fed occasionally engaged in transactions in the repurchase market, but those operations were minor in scope and transitory in duration.

By contrast, over the past fifteen years the Fed's balance sheet has expanded dramatically in size and complexity, and its operating framework now has a very large influence on financial market functioning. [240] Consequently, the case for authorizing the GAO to engage in comprehensive reviews of the Fed seems far more compelling relative to a half-century ago.

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[237] *Id.* § 3093(a).

[238] *Id.* § 3093(c).

[239] *See supra* Part II.C.

[240] *See supra* Part II.B.

The GAO has a very strong track record as an effective congressional watchdog. Every recommendation that GAO makes to every federal agency is posted on the GAO's website with an indication of whether or not it was implemented. Thus, GAO can document that over the past decade, about eighty percent of their recommendations have been followed, and those measures have saved taxpayers nearly $1 trillion. These benefits have far outweighed the administrative costs that GAO incurs in paying staff, hiring consultants, and conducting reviews. Indeed, GAO's rate of return to taxpayers is in the range of 500:1 to 1000:1.[241]

One potential concern is whether GAO reviews could undermine the FOMC's independence in determining the stance of monetary policy. Of course, the GAO itself is an independent federal agency. Nonetheless, it could be sensible for GAO to be authorized to conduct comprehensive reviews on a fixed annual schedule; such reviews would *not* be triggered by requests from congressional committees or individual members of Congress.

Finally, Congress could enhance the independence and scope of authority of the Fed's IG. In particular, it could be sensible to establish a fully independent IG who would serve as a watchdog for the entire Federal Reserve System, including the FOMC, not just the Fed's Board of Governors.

CONCLUSION

The Constitution specifically assigns Congress the duty of regulating, borrowing, and spending public money. Thus, Congress may delegate that duty to the Federal Reserve as the nation's central bank, give it a broad monetary policy mandate, and bolster its independence by exempting it from the regular appropriations process and the federal debt ceiling. However, Congress may neither abdicate responsibility for overseeing the exercise of its duty to regulate the value of money nor relinquish its power over the purse. As this Article has detailed, recent experience has highlighted a gap in Congress's capacity to oversee the Fed, resulting in structural undersight. At this juncture, Congress may wish to consider revisiting its approach to oversight of the Fed, perhaps by adapting approaches used for overseeing other independent agencies.

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[241] Of course, effective GAO oversight of the Fed could not occur instantly. If Congress directed the GAO to be a watchdog for the Federal Reserve, it would likely take several years for GAO to build up a team of experts to fill that role, especially because the Fed itself is so complex.