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Statement of the Shadow Financial Regulatory Committee on
Reducing Inappropriate Political Pressure on the Federal Reserve

May 5, 2008

The current financial turmoil has brought into greater focus the political danger to the Federal Reserve of being responsible both for economic and financial stability and for day-to-day regulation and supervision of financial markets and institutions, including consumer protection. As the Shadow Committee has stressed in numerous past statements (e.g., Statement No. 153, December 7, 1998), there are large disadvantages to saddling the Fed with supervisory and regulatory responsibilities. Doing so tends both to politicize the regulatory process and to limit the Fed's ability to pursue bona fide financial stability objectives.

Because of its regulatory responsibilities, the Fed is constantly drawn into the highly politically charged battles raging over (1) appropriate measures for protecting consumers against lender abuse and (2) whether and how taxpayer dollars might be channeled to assist distressed homeowners to avoid foreclosure. Members of Congress have urged the Fed to be more aggressive in using its powers, and have sought Chairman Bernanke's support for their foreclosure-avoidance initiatives. Neither consumer protection nor foreclosure relief lies within the purview of the central bank. Not only is the proper ambit of a central bank unrelated to these two issues, but combining central banking authority with these other concerns opens avenues of political pressure that can poison outcomes both for monetary policy and regulatory policy.

The more goals that the Fed is asked to pursue, the more the Fed becomes enmeshed in politics. The Fed may in the future hesitate to provide appropriate assistance to a financial institution if (out of a political calculation of "fairness") it is also called upon to provide compassionate aid to homeowners or consumer borrowers. In the face of political stress, the Fed might decide to give in to political pressures directed at areas other than monetary policy and financial stability in order to preserve the political capital necessary to have a free hand in these two central fields of responsibility. At a minimum, consumer protection responsibilities should be removed from the Federal Reserve.