THE FEDERAL RESERVE BANK OF RICHMOND
RICHMOND ▪ BALTIMORE ▪ CHARLOTTE

Background on Fed Transparency

In 1975, the economy was just recovering from a deep recession and the country was still dealing with the aftermath of Watergate. The public was skeptical of executive authority and government secrecy.

During the mid-to-late 1970s, Congress passed several pieces of legislation that increased congressional oversight of the Federal Reserve. In 1978, a resolution was passed requiring the GAO to audit the operations and activities of the Board of Governors and Reserve Banks.

How The Fed Is Audited

The Board of Governors, the 12 Federal Reserve Banks, and the Federal Reserve System as a whole are all subject to several levels of audit and review:

- The Government Accountability Office (GAO) conducts numerous reviews of Federal Reserve activities.
- The Board's financial statements, and its compliance with laws and regulations affecting those statements, are audited annually by an outside auditor retained by the Office of Inspector General (OIG).
- The Board's OIG audits and investigates Board programs and operations as well as those Board functions delegated to the Reserve Banks. Completed and active GAO reviews and completed OIG audits, reviews, and assessments are listed in the Board's *Annual Report*. (Before 2002, the reviews were listed in the Board's *Annual Report: Budget Review*.)
- The financial statements of the Reserve Banks are also audited annually by an independent outside auditor.
- Each week, the Federal Reserve publishes its balance sheet and charts of recent balance sheet trends, as well as provides an interactive guide to the Fed's balance sheet. The balance sheet is included in the Federal Reserve's H.4.1 statistical release, "Factors Affecting Reserve Balances of Depository Institutions and Condition Statement of Federal Reserve Banks."

In addition, the Reserve Banks are subject to annual examination by the Board. The Board's financial statements and the combined financial statements for the Reserve Banks are published in the Board's *Annual Report*.

The Federal Reserve Transparency Act of 2011

The 1978 resolution requiring the GAO to audit the operations and activities of the Fed excluded the "deliberations, decisions, and actions on monetary policy matters, including discount window operations, reserves of member banks, securities credit, interest on deposits, and open market operations". (See Resolution) The Federal Reserve Transparency Act of 2011 introduced by Ron Paul would repeal this exemption.

Why the Exemption is Important to Maintaining Central Bank Independence

As a nonpartisan central bank, we focus on promoting the goals of moderate long-term interest rates, maximum employment and stable prices. The Fed conducts monetary policy without legislative or executive branch involvement. A politically insulated central bank is more likely to pursue policies that align with its congressional mandate.

In contrast, elected governments in a democratic society potentially face incentives to pursue accommodative monetary policies that promote output and employment for political gain in the short run, even when those policies would eventually lead to inflation. A central bank that is subject to short-run political pressures could lead it to abuse its money-creation powers, which may lead to high inflation and high interest rates. Research shows that countries that have central banks that are insulated from political pressures tend to have lower inflation.

Monetary policy requires complex and difficult analytical judgments because the effects of monetary policy actions are uncertain and can take years to appear. The removal of exemption outlined in the 1978 resolution would allow any member of Congress to request a GAO "audit" immediately following an FOMC meeting. Such audits are unlikely to be illuminating, since it will be too soon to judge the ultimate effects of any policy action, but they could be used to attempt to embarrass or harass the Fed. Members of Congress could use such audit requests to attempt to influence the course of monetary policy for short-term electoral purposes, which could detract from longer-term economic objectives.

Monetary Policy Transparency

By law, the Board of Governors must keep a record of the actions taken by the FOMC on all questions of policy and to include in its annual report to Congress the vote on and reasons for each action. To provide this information on a timely basis, minutes of regularly scheduled meetings are released to the public three weeks after the date of the FOMC meeting. The full FOMC transcripts are released to the public after five years of the meeting. One solution to improve transparency in monetary policy has been introduced by Rep. Kevin Brady’s Sound Dollar Act of 2012. The bill proposes to reduce the release of FOMC transcripts from five to three years.

Twice a year the Board submits a written report to Congress on the state of the economy and the course of monetary policy, and the Chairman is called on to testify on this report.

In addition to its regular reports to Congress, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 established several reviews of the Fed's lending programs — including an audit of lending during the financial crisis — and required the Fed to disclose the amounts, terms, and conditions of its emergency and discount window lending and open market transactions. To further increase transparency, the Dodd-Frank Act required the Board of Governors to establish an Audit page on its external website to make documents easily accessible to the public. The Act maintained the exclusion from GAO audit of monetary policy deliberations, decisions, and actions.

Conclusion

Historically, the Richmond Fed has advocated for increased transparency in monetary policy. In 2001, Al Broaddus, former president of the Richmond Fed, gave a speech that argued greater transparency is desirable in U.S. monetary policy.

The increased disclosure over the years has ensured that the Fed is transparent to Congress and the public. On balance, this system of governance, one of independence but also accountability, has been beneficial to the institution, the public it serves, and the American economy.

June 20, 2012