The Honorable Barney Frank
Chairman
Committee on Financial Services
U. S. House of Representatives
Washington, D. C. 20515

The Honorable Spencer Bachus
Ranking Member
Committee on Financial Services
U. S. House of Representatives
Washington, D. C. 20515

November 2, 2009

Gentlemen,

Economic theory provides strong support for the independence of central banks in their conduct of monetary policy. Subjecting central banks to short-run political pressure makes it more likely that the monetary policy authorities will pursue excessively expansionary monetary policy to lower unemployment in the short run, with an outcome of higher inflation, higher interest rates, and yet no better performance on the unemployment rate in the long-run. This has happened over and over again in the past, not only in the United States but in many other countries throughout the world. Indeed, research shows that less independent central banks lead to worse economic performance than more independent ones. This experience and research helps explain the pronounced trend throughout the world of governments granting increased independence to their central banks.

Recently, Representative Ron Paul has sponsored a bill to subject the Federal Reserve's monetary policy and discount-lending actions to GAO audit. We organized a petition to Congress and the Executive branch in July of 2009 that was signed by nearly four hundred prominent economists opposing this type of incursion on the Federal Reserve's independence. While we want the central bank to be accountable and transparent, sooner or later, the Federal Reserve will have to scale back its unprecedented monetary accommodation. When the Federal Reserve judges it is time to begin tightening monetary conditions, it must be allowed to do so without political interference. In addition, weakening of the Federal Reserve's independence now might raise inflation risk, which would cause interest rates to rise, thereby raising borrowing costs and dimming prospects for a strong economic recovery. The Federal Reserve already testifies on and releases minutes and transcripts about its monetary policy actions, so an audit would only serve to undermine the Federal Reserve's independence.

Reports in the press indicate that the Congress is considering an amendment to the Ron Paul bill that would allow the GAO to audit the new lending facilities at the Federal Reserve that were authorized under the 13(3) "unusual and exigent circumstances" clauses of the Federal Reserve Act. This audit would involve oversight of the operational integrity of these facilities' accounting, internal controls, protection against losses, etc. and also disclose the borrowers from these facilities one year after the facilities are closed. The audit would, therefore, produce new, important information which is not otherwise available. Importantly, the amendment would not

give the GAO the power to audit the normal monetary policy actions of the Federal Reserve.

We strongly support an amendment of this type because it will increase transparency and accountability of the Federal Reserve, but will not compromise the monetary independence of the Fed. We also believe that disclosing the names of borrowers one year after the 13(3) lending facilities are closed would enable Congress to have appropriate oversight over these facilities, but would not compromise their effectiveness. Earlier disclosure of the borrowers from these facilities would diminish the efficacy of these facilities because of the so-called "stigma" problem: financial firms will not borrow from emergency lending facilities if doing so is immediately made public because it would signal to the markets that they might have financial difficulties which would make it harder for them to conduct their business.

Thank you for your attention.

Sincerely,

Ricardo Caballero *MIT*
Kenneth French *Dartmouth College*
Robert Hall *Stanford*
Anil Kashyap *Chicago Booth*
Pete Klenow *Stanford*
Frederic Mishkin *Columbia*
Thomas Sargent *NYU*
Michael Woodford *Columbia*