Under the banner of increasing Federal Reserve transparency, Congressman Ron Paul has sponsored a bill that would subject the Fed’s monetary policies to an audit by the Government Accountability Office (GAO). The bill is a veiled attempt to undermine the Fed’s independence. If it passes, it will cripple policy making—particularly when it comes to inflation.

It is completely appropriate to hold the Fed accountable for its decisions. But the Paul bill, H.R. 1207, will only produce redundancies: Congress already has multiple ways of finding out what the Fed is doing and why.

The Fed produces a report and testifies twice a year before Congress about its monetary policy actions. During this testimony, the Fed is forced to explain what it has done, and elected officials question the Fed about its choices. In addition, the Fed makes the minutes from its monetary policy meetings available to the public, and Fed officials routinely give speeches explaining their approach.

What’s more, it is highly doubtful that the GAO has the technical competence to evaluate monetary policy. If it did try to conduct these audits, at best it would merely rehash known information. At worst, the GAO would generate confusion by offering its own analysis.

Economic theory and massive amounts of empirical evidence make a strong case for maintaining the Fed’s independence. When central banks are subjected to political pressure, authorities often pursue excessively expansionary monetary policy in order to lower unemployment in the short run. This produces higher inflation and higher interest rates without lowering unemployment in the long term. This has happened over and over again in the past, not only in the United States but in many other countries throughout the world.

The Fed’s independence is critical to its credibility. During the financial crisis, this credibility allowed the Fed to take extraordinary action to prevent a possible depression without triggering inflation. But eventually the Fed will have to scale back its unprecedented monetary accommodation. When it does move to tighten monetary conditions, it must be allowed to do so without political interference.

Weakening the Fed’s independence now might raise the risk of inflation, which would cause borrowing costs to rise and would lower prospects for a strong economic recovery. For these reasons, we joined over 400 prominent economists in July when we signed a petition opposing the type of incursion on the Federal Reserve that Mr. Paul is proposing.

Fortunately, Congress is considering an amendment to the bill that would prevent the negative consequences of the original Paul legislation. This amendment, put forward by Rep. Mel Watt (D., N.C.) would change the focus of the bill by instructing the GAO to audit the new lending facilities at the Federal Reserve that were authorized under the 13(3) “unusual and exigent circumstances” clause of the Federal Reserve Act. The 13(3) lending authority, which...
had not been used by the Fed since the Great Depression, was the basis for many of the most controversial
decisions made during the crisis, including the rescue of AIG and the establishment of new lending facilities.

This audit would involve oversight of the operational integrity of these facilities’ accounting, internal controls, and
protection against losses. It would also disclose the borrowers from these facilities one year after the facilities are
closed. The audit would produce new, important information that is not otherwise available and would play to the
strengths of the GAO. And the amendment would exempt the Fed’s normal monetary policy actions from the audit.

We strongly support an amendment of this type because it will increase the Fed’s accountability without
compromising its monetary independence. We also believe that the lag in disclosing the names of borrowers would
enable Congress to have appropriate oversight over these facilities without compromising their effectiveness.
Earlier disclosure would diminish the efficacy of these facilities because of the so-called stigma problem: If
borrowing from emergency lending facilities is immediately made public, the markets would know that the
borrowers might have financial difficulties, which would make it harder for the borrowers to operate.

No one can be fully comfortable with all the unprecedented actions that the Fed has taken to limit the damage from
the financial crisis. We appreciate the frustration of the public and members of Congress who want a better
understanding of what has happened. Forming a committee of experts to write a report on the crisis might help
reassure the public and provide some lessons for crisis management in the future. But the Paul bill, as originally
written, won't help with these goals and will only stifle the recovery.

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