BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

BEN S. BERNANKE
CHAIRMAN

October 28, 2008

The Honorable Paul E. Kanjorski
Chairman
Subcommittee on Capital Markets, Insurance,
and Government Sponsored Enterprises
Committee Oversight and Government Reform
House of Representatives
Washington D.C. 20515-3811

Dear Mr. Chairman:

I am responding to your letter of October 16, 2008. You noted that recent economic developments are reducing state tax revenues and that financial market strains are impeding the access of municipal governments to funding.

We at the Federal Reserve recognize that many states as well as municipal governments are confronting significant fiscal and financial difficulties. As you indicated, these difficulties are impairing the ability of state and municipal governments to conduct some of their key responsibilities. Moreover, the constraint on spending by state and municipal governments threatens to add to the macroeconomic weakness currently being experienced by the United States.

The Federal Reserve will continue to do everything in its power to address the strains in financial markets. As you know, we have taken a number of important steps over recent months to improve market liquidity. The recent announcements by the U.S. Treasury, the Federal Deposit Insurance Corporation, and the Federal Reserve regarding bank capital, guarantees of banks' senior debt and other liabilities, and the establishment of new special liquidity facilities to support the money markets represent additional important steps that should help to restore normal credit market functioning. Moreover, the Federal Reserve has eased monetary policy appreciably to help support economic growth.

Regarding the immediate funding difficulties of state and municipal governments, the appropriate officials may wish to discuss directly with the Administration and the Congress the potential for direct aid from the U.S. Treasury, perhaps in the form of grants, loans, or guarantees. Because decisions regarding the possible allocation of federal funds to state and municipal governments are inherently political, these matters should be discussed and ultimately determined by elected officials rather than appointed officials such as those at the Federal Reserve.

You also asked about statutory changes that may be necessary to enhance the ability of the federal government to assist states and localities during this credit crisis. The Federal Reserve Act provides the Federal Reserve with only limited ability to purchase directly the obligations of states and municipalities. In addition, the Federal Reserve generally has little or no authority to lend directly to a state or municipal government. The Congress wisely established these limitations to support fundamental principles such as the independence of the central bank and a strong federal system of government in which states and municipalities have powers and responsibilities that are not subject to review or oversight at the national level. We believe that it is important to preserve these basic principles and, as a result, we would not seek any new statutory authorities at this time.

For our part, the Federal Reserve is absolutely committed to maintaining the overall stability and liquidity of the financial system, and we will continue to use all the tools at our disposal to pursue this objective. A return to more stable market conditions, in turn, should help to mitigate the financial strains affecting many state and municipal governments.

I hope these comments are helpful. Please let me know if I can be of further assistance.

Sincerely,