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For starters, should the Fed modify its 2% inflation interpretation of its 'price stability' mandate?

A Few Questions for Aspiring Federal Reserve Chiefs

By John H. Cochrane

The discussion about President Trump and Federal Reserve Chairman Jerome Powell has been all about lower interest rates, with some hyperventilating about the Fed's independence and a kerfuffle over its renovation budget. Congress and the media should ask potential Fed chiefs to consider much deeper questions, including these: Should the Fed modify its 2% inflation interpretation of its "price stability" mandate? Should the Fed aim for zero inflation, or a steady price level?

After an inflation surge, should the Fed try only to bring subsequent inflation back to target, while accepting higher prices, as it does now? Or should the Fed slowly bring back the level of prices, to achieve its inflation target as a long-term average? Note

What strategy or rule should the Fed adopt in place of its ill-fated Flexible Average Inflation Targeting? Or should it abandon strategies and just raise and lower interest rates as it sees fit?

Should the Fed address employment by simply focusing on price stability, avoiding the inflation and disinflation that upsets labor markets? Or should the Fed sacrifice some price stability to pursue employment goals? Should the Fed aim for "inclusive employment," worry about left-behind areas, or include other distributional goals? Should the Fed view its mandate as direction not to worry about anything else, or a starting point from which missions may creep?

Should the Fed be formally accountable for its inflation performance, fulfillment of its mandate, or actions that exceed its mandate?

Which economic theory do you think best describes monetary policy? There are many today, including Keynesian, New-Keynesian, Monetarist, Modern Monetary, and Fiscal theories, and they disagree fundamentally. Should the Fed manage the "credit cycle" with regulatory as well as interest rate tools?

Did Quantitative Easing significantly affect long term rates, output, and inflation? Should QE continue as a routine part of the Fed's tools? If QE works, should the Fed more directly target long-term rates rather than buy some bonds and see what happens?

Should the Fed continue to pay interest on ample reserves? Or should it stop paying interest, return to a tiny quantity of reserves, and manage interest rates by changing that small quantity? Should the Fed continue to pay banks more on reserves than it pays other institutions? Should the Fed follow other central banks and elastically lend new reserves to banks as they demand, rather than strictly control the size of its balance sheet?

Should the Fed maintain its prohibition of banks that hold only reserves, such as TNB, which the Fed in 2024 denied a master account on fanciful grounds? Or should the Fed encourage such narrow banks, as impossible-to-fail institutions that can provide low-cost transactions services and large safe uninsured deposits? Should the Fed allow access to reserves and its payments system to a larger range of financial institutions—such as money market funds—that aren't banks? Should the Fed allow stablecoins to hold reserves? Should the Fed institute a digital or crypto dollar? Should the Fed instead encourage Treasury to offer fixed-value, floating-rate electronically transferable debt—essentially, reserves—to people and nonbank financial institutions?

Was it a mistake for the Fed to buy trillions of dollars of new Treasury debt, thereby financing the huge 2020-22 deficits with new money? Was it a mistake for the Fed to keep interest rates at zero for a year after inflation surged in 2021? If so, how will you avoid repeating these mistakes?

How will you improve the Fed's decision-making processes? How will you restructure the Fed's operations, including staff size and scope, diversity programs, and research?

Higher interest rates raise interest costs on the debt. Inflation wipes out federal debt. Should the Fed think about these budgetary implications? Should it work with the Treasury to coordinate policy?

The Treasury issues long-term debt, which pays a fixed rate. The Fed buys that debt and turns it into floating- rate debt. That makes interest costs flow on to the budget faster.

How should the Fed and Treasury agree on the proper maturity of the debt? Should the Fed buy only shortterm debt?

Should the Fed continue to buy mortgage-backed securities? In 2020 the Fed announced a corporate bondbuying program, to prop up their prices. Is it proper for the Fed to prop up asset prices? Should the Fed worry about stock prices and exchange rates?

Will you end bailouts and how? Will the Fed again bail out money market funds and their investors? Will the Fed bail out stablecoins if they prove not so stable? Will the Fed allow losses among uninsured depositors? What financial institutions will the Fed let fail, or suffer credit losses in the next crisis?

The Fed failed to notice simple interest- rate risk in the Silicon Valley Bank collapse yet continues to implement massively complex regulations, which also reduce competition and raise costs. How will you reform financial regulation? How much of the money that banks invest in risky assets should come from equity? Are "climate risks to the financial system" worthy of separate study, regulation and disclosure?

Treasury markets, dominated by dealer banks, have experienced turmoil. Do you think reforms to liquidity and capital regulation will solve the problem? Will you allow or require exchange trading of Treasurys, and allow other investors access? How would you react to a global sovereign debt crisis, with governments unable to roll over debt and interest rates spiking?

Should financial regulation be integrated with or separated from monetary policy? Should financial regulation be less independent of Congress and the administration, as other regulators are?

These questions are the tip of the iceberg. The financial and monetary system have evolved past the current Fed, and a wise Fed chair will need answers.

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