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More humility, better data and freer disagreements could bring back the central bank's credibility.



POLITICAL ECONOMICS

Kevin Warsh's Plan to Save an Independent Federal Reserve

You don't normally expect excitement at a Senate confirmation hearing for a Federal Reserve nominee, but then again, it hasn't usually been Donald Trump doing the nominating. So it was that the hearing Tuesday to vet Kevin Warsh as the next Fed chairman generated an unusual quantity of heat and light—particularly surrounding questions of the Fed's institutional independence.

Democrats and many investors purport to be alarmed on the point because, well, of Mr. Trump. The president makes no bones about his enthusiasm for low interest rates as economic stimulus. The concern supposedly is that Mr. Trump has nominated Mr. Warsh only because he has agreed to bow to Mr. Trump's wishes.

This is insulting to Mr. Warsh, whose public career ought to instill confidence that he can think for himself. It's also disingenuous on the part of his critics, particularly Senate Democrats such as Elizabeth Warren. She spent much of her own free time in 2022, 2023 and 2024 writing open letters to Chairman Jerome Powell (and an opinion column in this newspaper) to demand easier monetary policies for political purposes such as facilitating financing of renewable energy projects.

Bear in mind, however, that the underlying question here isn't whether Fed decision-making should be political. It already is. The central bank, handed a dual price-stability and full-employment mandate by Congress, chooses to adopt a theoretical approach that assumes it must actively trade off between the two goals. But how much unemployment and how much inflation voters will tolerate fundamentally are political questions.

And over time, the Fed has made itself more political. The central bank's propensity for buying and holding large quantities of assets drags it into fiscal arguments where it doesn't belong, for instance—as Mr. Warsh often points out.

The question instead is how to manage the Fed's inevitable forays into "political" decision-making in ways that will maintain the public's confidence in such a powerful institution. Mr. Warsh's answer to this conundrum is more comprehensive than often assumed.

His approach relies in part on structural modesty. Hence his insistence that the Fed stay in its (relatively narrow) lane with a smaller balance sheet. Hence also his ambivalence toward "forward guidance"—the speeches, policy statements and

other pronouncements by which Fed officials attempt to steer markets.

He added a new layer on Tuesday: The Fed also requires a degree of intellectual humility. Mr. Warsh promised to undertake a major "data project" regarding inflation soon after taking office if confirmed. He plans to address economists' difficulty in understanding what is actually happening to the price level from existing methods of collecting and analyzing data. Admitting that substantial lacunae exist in the Fed's perception of the economy would address a major gap on its credibility, which is the frequent divergence between what Fed officials think is happening and what voters actually experience around their kitchen tables.

More important is Mr. Warsh's desire for "messier" policy-setting meetings. He suggested he'd welcome more open disagreement among the members of the Federal Open Market Committee, which sets interest rates. These meetings have been marked for most of the past couple decades by something approaching pathological agreeability.

Between September 2005 and September 2024, not once did a member of the Fed's Washingtonbased board of governors dissent from an FOMC policy decision, and it was unusual for more than two presidents of regional reserve banks to vote against a policy move. Meetings appear to have become more fractious in recent months, especially with Trump appointee Stephen Miran as a reliable dissent in favor of lower rates. But this appearance deceives. Only once, in December, have three FOMC participants voted against a decision.

We know they don't all agree with one another to that extent. Fed officials tell us so in their speeches and in the economic projections they publish every three months, which reveal uncertainty about economic developments and a range of policy opinions. Which is as it should be, given the dramatic transformations under way in the economy these days (as demonstrated by senators' questions about Mr. Warsh's views on how the artificial-intelligence boom might affect interest rates).

Presumably intended to be reassuring, the thrust toward near-unanimity instead has become discrediting. It projects an aura of certainty no economic-policy maker should feel, and can leave the public wondering why officials who said one thing between meetings voted another way in the conference room. Encouraging officials to vote their minds is an essential element of any plan to reassure voters that the Fed is acting deliberately and humbly.

The common assumption is that institutional independence makes a central bank credible. In truth, a central bank's credibility justifies its independence. Mr. Warsh's efforts to bolster the Fed's credibility will safeguard its independence as well.

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