

Restoring independence and credibility means getting politics out of central banking.



POLITICAL ECONOMICS

How Kevin Warsh Could Make the Fed Great Again

Ask not whether President Trump's nomination of Kevin Warsh to be chairman of the Federal Reserve is "political." It obviously is, since the nomination is made by a politician. Ask instead what Mr. Warsh could do to depoliticize the Fed if confirmed by the Senate. The answer? Quite a lot.

In most nomination fights there are plenty of good-faith policy or philosophical reasons to criticize a president's pick. Especially so in monetary policy. But the early skepticism of Mr. Warsh's nomination feels like something else.

The rap is a confused melange of complaints that he was somehow ineffective in an earlier stint on the Fed's Board of Governors, that he's too hawkish, and (these folks aren't constrained by consistency) that he has become too dovish to appease Mr. Trump's low-interest-rate whims. One suspects his biggest "sin" is that Mr. Trump is the president who nominated him.

Mr. Warsh will defend his own record. Senators should instead ask Mr. Warsh during confirmation hearings how he might depoliticize the Fed. Even without Mr. Trump's influence, the Fed since 2008 has become far too intrusive in the economy, with baleful political consequences. Here are three things Mr. Warsh (or anyone else) could do to solve the Fed's politicization problem:

- Emphasize the inflation half of the Fed's mandate. The original sin that has turned monetary policy into such a political football was Congress's decision in the 1970s to saddle the Fed with a dual mandate: price stability and also full employment. This mires the Fed in economic policy trade-offs that an unelected technocracy has no business making.

The Fed's own economic models hold that the central bank must strike a balance between inflation and employment, which if true would be a fundamentally political decision. Worse, the Fed interprets its two mandates in expansive ways that drag it into political debates. Starting in 2020, Chairman Jerome Powell's Fed flirted with measuring full employment via "inclusive" employment metrics accounting for racial disparities in the labor market, a political hot potato if ever there were one.

As for price stability, the central bank in 2012 announced it would define this as 2% annual inflation. Nothing in economic theory argues

for that specific numerical target as superior to any other. And no one voted for that degree of constant erosion of purchasing power, which could be construed as a form of tax.

If the Fed is going to interpret its statutory mandate creatively, it should do so with humility. A good start would be to assert that the Fed believes it best supports full employment by delivering price stability and then focusing like a laser on that goal. This too is a political choice, but at least it's defensible.

- Shrink the balance sheet. The post-2008 decision to purchase Treasury debt and mortgagebacked securities (quantitative easing) embroiled the Fed in the credit-allocation decisions that for centuries have created political economy migraines for central banks. Those who are supportive of or indifferent to the Fed's large balance-

sheet policy argue it's inevitable and inoffensive—a harmless consequence of changes in the financial plumbing since the 2008 panic.

But a Fed that intrudes on markets in this way is a political menace. Maintaining a large balance sheet exposes the Fed to pressure from lawmakers regarding which assets to buy and for what reasons. It can mute important market signals to the extent the Fed becomes a significant marginal buyer of government bonds of varying maturities. A smaller Fed would be a less political Fed.

• Ditch forward guidance. Perhaps the Fed's greatest political liability is its loquacity—the policy statements, economic projections, speeches, press conferences, meeting minutes and the rest that the central bank foists on the public. This started (slowly at first) in the 1990s and picked up pace after 2008. It's now completely out of control.

Many of Mr. Powell's political problems arise from this constant din of Fed chatter. For instance, he's at loggerheads with Mr. Trump over whether tariffs may prove inflationary. Why did Mr. Powell ever let anyone ask him that question in the first place?

Every time Fed officials make statements about the possible course of monetary policy or the state of the economy, they hint at some sort of judgment about fiscal, regulatory, trade and other policies that are the purview of elected politicians. They can even steer political debates: If Fed officials signal government borrowing costs will remain low for an extended period, you better believe the spendthrifts in Congress take note. Mr. Warsh could improve the Fed's institutional standing considerably by never delivering another press conference.

Note how little any of this has to do with Mr. Trump, despite his counterproductive rhetorical and prosecutorial assaults on the central bank. The Fed has a central role to play in restoring its own independence and credibility. It's a worthy task for the next chairman.

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