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Remarks as Prepared for Delivery

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Commanding Heights: Central Banks at a Crossroads
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Time and Place

I am honored to give the annual G30 lecture at the IMF Spring Meetings… heartened that you have chosen me to speak…I take it as a sign that policymakers consider it a time that calls for robust debate and serious deliberation…testing and truth-telling…and ultimately, a time for choosing.

I do realize there may be an alternative reason you have summoned me here today… your first choice as speaker cancelled a couple months ago to become Prime Minister.

I am pleased to be a substitute, and I am under no illusions…not exactly bringing coals to Newcastle…modern Wilsonians may be discomfited by my words…granting boundless power to government agencies to solve the world's problems does not square with my disposition.

I cannot think of a time of greater economic consequence since 1980…some may believe the biggest threat to our economy comes from outsiders who seek to change the status quo…I don't agree…I believe the predominant risk come from choices made inside the four walls of our most important economic institutions.

This historic place – the convening chambers of the IMF and the World Bank –is a fitting venue. After World War II, an economic and security commons led by the United States advanced the interests of freedom and liberty for much of the 20th century.[1] It included consequential roles for many of the nations and institutions represented in this room.

The 21st century, however, has been decidedly less kind, especially to the least well-off among our citizens. Shocks, economic and geopolitical, have been fierce and frequent. Key economic institutions that served us well for decades have fallen short of their promises. Absent fundamental reform, we should question if their high summer is past.

In my view, strengthening economic performance requires significant improvement in the governance regime.[2] That means new ideas, some of which I will discuss.

It also means reforming, if not restoring, key economic institutions.

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[1] Kevin Warsh, "Uncle Sam's Guide to Peace and Prosperity" *Wall Street Journal*, March 19, 2024.
[2] John F. Cogan and Kevin Warsh, "Reinvigorating Economic Governance: Advancing a New Framework for American Prosperity," Center for Revitalizing American Institutions, Hoover Institution, March 1, 2022.

To be trusted, economic institutions must be trustworthy. To be trustworthy, they must prove themselves competent. Economic institutions must also:

- Maintain epistemic humility—that is, accepting that knowledge, even great knowledge, has its limits;
- Abide by other limits –limits imposed by the Constitutional and laws – and by the good judgment of leaders –to constrain the inherent tendency to expand their footprint;
- Be permitted to act within well-defined *ex ante* frameworks;[3] and
- Be accountable-- the greater the power of the public institution, the greater its responsibility to explain and answer for its decisions.

Every philosophy is a memoir, of sorts. So, my focus will be on the economic institution with which I am most familiar, the Federal Reserve.

I was a member of the Fed's board of governors more than a dozen years ago…I still have the scars to show from the darkest days of the financial crisis in 2008 and 2009…the debates in Chairman Bernanke's office were civil, also intense and consequential.

Nothing about the period was easy. We made good calls and mistakes, both. Inevitably, the hardest question then—and the most salient now—was the Fed's role and responsibility.

After one particularly intense weekend that resulted in extraordinary policy support, former Chairman Paul Volcker commented: The Fed had gone "to the very edge of its lawful and implied power, transcending certain long embedded central banking principles and practices."[4] We took that as the equivalent of a brushback pitch—high and tight—from a strong institutional ally to his successors.

But Volcker's warning that has gone largely unheeded, even to this day. Changes in the role of the US central bank have been so pervasive as to be nearly invisible. The Fed has assumed a more expansive role inside our government on all matters of economic policy. And moved into matters of statecraft and soulcraft, too.

In my view, forays far afield—for all seasons and all reasons--have led to systematic errors in the conduct of macroeconomic policy.

The Fed has acted more as a general-purpose agency of government than a narrow central bank. Institutional drift has coincided with the Fed's failure to satisfy an essential part of its statutory remit, price stability. It has also contributed to an explosion of federal spending. And the Fed's outsized role and underperformance have weakened the important and worthy case for monetary policy independence.

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[3] Mervyn King *The End of Alchemy: Money, Banking, and the Future of the Global Economy* (W.W. Norton & Company, 2016).

[4] Paul A. Volcker, Remarks to the Economic Club of New York, April 8, 2008.

The Fed is the most influential economic agency in the world. Its policy choices are transmitted through several channels, including the bond market and foreign exchange markets.

The most important economic policy channel, however, is intellectual. That's what I am here to speak about.

My lecture today is more political treatise than how-to-guide.[5] My hope is that it's received in the spirit intended…more as a love letter than a cold critique.

<u>Setting Aside Central Bank Fast Food</u>

It's necessary to set aside some of the fast food that is part of the current practice of monetary policy. Then we can discuss what matters most.

First, frequent changes to the Fed's metrics-- including its professed preferred measures of inflation-- are beneath the high standing of the central bank. Central bank credibility is the coin that purchases American economic strength. In Washington, a central banker can ill-afford to be anything other than a straight-shooter.

Second, I do not find the current Fed policy of 'data dependence' of much real value. We should care little about two numbers to the right of the decimal point in the latest government release. Breathlessly awaiting trailing data from stale national accounts-- subject to significant, subsequent revision-- is evidence of false precision and analytic complacency.

Third, near-term forecasting is another distracting Fed preoccupation. Economists are not immune to the frailties of human nature. Once policymakers reveal their economic forecast, they can become prisoners of their own words. Fed leaders would be well-served to skip opportunities to share their latest musings. The swivel chair problem, rhetorically waxing and waning with the latest data release, is common and counter-productive.

Fourth, forward-guidance – a tool rolled out to great fanfare in the financial crisis—has little role to play in normal times. Moving markets with rolling Fed incantations is tempting, but unhelpful to the Fed's deliberations, and ultimately, to its mission. The central bank should find new comfort in working without applause and without the audience at the edge of its seats.

Now, we can turn to a more substantial offering.

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[5] This framing is adapted from Alexander C. Karp and Nicholas W. Zamiska, *The Technological Republic: Hard Power, Soft Belief, and the Future* (Crown Currency, 2025).

Central Bank Dominance: How it Happened?

From the early 1990s until the global financial crisis, the world was rightly impressed by the Fed's track record in ensuring price stability and financial stability. Central bank chiefs became household names, their credibility was unchallenged, and their opinions were highly sought…more recognizable to the man on the street…but less recognizable to their predecessors.[6]

In exigent circumstances, the Fed is called into action, extending its reach and amplifying its effect. The modern Fed was created by the Federal Reserve Act of 1913, principally to respond to panics. But when panics subside, the Fed is duty-bound to retrace its steps. And for many decades-- after shocks dissipated and economic conditions normalized-- the Fed largely and dutifully exited the main stage.

In more recent years, the Fed has found it harder to insulate itself from all the attention…its leaders wear their inheritance proudly…my inquiry is not about motivations…I am not in search of some nefarious plot…my review is about capabilities and authorities.

Since the panic of 2008, central bank dominance has become a new feature of American governance.

On Fiscal Policy

US fiscal policy is on a dangerous trajectory. Irresponsible spending surged, especially in the aftermath of the pandemic. Today, the federal government is spending in excess of 60% more than five years ago. No plausible economic growth can deliver revenues to match.

I struggle to absolve the Fed of the nation's fiscal profligacy. Fed leaders encouraged government spending when times were tough, a few years back. But did not call for fiscal discipline at the time of sustained growth and full employment. I'd prefer monetary policymakers to steer clear of fiscal commentary altogether. But, if the Fed chooses to cross the line, there should be real and rhetorical symmetry. That, however, is scarcely my chief concern.

The Fed has been the most important buyer of US treasury debt—and other liabilities backed by the US government-- since 2008. The Fed's $7 trillion balance sheet is nearly an order of magnitude larger than the day I joined. It's a proxy for the Fed's growing imprimatur on the economy.

From my time long ago as a Fed governor, I bear some measure of responsibility for the creation of asset purchases, known more commonly as quantitative easing (QE). In the 2008 crisis, we cut interest rates to near zero, and sought new ways to make monetary policy looser and bring liquidity to illiquid markets. I strongly supported this crisis-time innovation, then and now.

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[6] Kevin Warsh, *Transparency and the Bank of England's Monetary Policy Committee* (Bank of England Press, 2014).

But when the crisis ended, the Fed never retraced its steps. I worried mightily in the summer and fall of 2010-- a time of strong growth and financial stability –that the decision to buy more treasury bonds—would involve the Fed in the messy political business of fiscal policy. QE2 was announced. I disagreed with the decision, and resigned from the Fed soon after.

QE – with some fits and starts in the 2010s—has become a near permanent feature of central bank power and policy. Fiscal policymakers—that is, elected members of Congress—found it considerably easier appropriating money knowing that the government's financing costs would be subsidized by the central bank.

Economics teaches a couple lessons: lowering the near-term cost of debt tends to increase its quantum; and, on the current trajectory, the high debt burden threatens to undermine future economic growth.

The Fed often presents itself as humble and technocratic, hewing closely to the remit. They say they take fiscal policy decisions as given, and then react. But, it's no longer obvious whether monetary policy is downstream or upstream from fiscal policy. Irresponsibility has a way of running in both directions.

Fiscal dominance--where the nation's debts constrain monetary policymakers—was long thought by economists to be a possible end-state. My view is that *monetary dominance* – where the central bank becomes the ultimate arbiter of fiscal policy—is the clearer and more present danger.

The line between the central bank and the ostensible fiscal authority has grown harder to identify. The spirit of Treasury-Federal Reserve accord of 1951 is at odds with recent practice.

Immunologists describe a phenomenon where the immune system's response to a virus may impede the response to a subsequent variant. They call it immunological imprinting.

I proffer a theory of *economic imprinting* whereby the policy choices of prior periods make the economy more vulnerable to shocks and less able to adjust organically. Each time the Fed jumps into action, the more it expands its size and scope, encroaching further on other macroeconomic domains. More debt is accumulated…more capital is misallocated…more institutional lines are crossed… risks of future shocks are magnified…and the Fed is compelled to act even more aggressively the next time.

Simply stated, path dependency is driving policy. We need to be careful that it's not driving into a ditch. It's not just dangerous for our economy…its risky business for central bank legitimacy …and riskiest for our citizenry.

On Society

Central bank vanities are not limited to monetary policy.

The Enlightenment elevated the role of reason and autonomy in decision-making.[7] Kant, Locke and Rousseau-- none conceived of a central bank like ours. Still, a fundamental precept of their thinking would be helpful to the modern Fed: a fierce resistance to whims.

Central bankers and bandwagons should be strangers. It would better for the Fed's long-term success to focus on the time-honored and the enduring…rather than the fashionable and the fleeting.

I observe the modern central bank to be a bit too willing to traffic in contraband. Others can adjudicate whether matters of cultural import are in the province of the political class or of civil society. But the Fed's business, it is not.

"Climate change" and "inclusion" are politically-charged issues. People of good conscience have their own views and motivations. Elected officials are tasked with evaluating data, synthesizing views, charting policy, and granting authority, if desired, to executive branch agencies.[8]

The Fed, however, has neither the expertise nor the prerogative to make political judgments in these areas. The Fed's remit is not a suggestion. Or a jumping off point. As Supreme Court jurisprudence makes clear, Congress is not in the business of hiding elephants in mouseholes.[9]

A couple of examples:

First, in late 2020, the Fed joined the "Network of Central Banks and Supervisors for Greening the Financial System." The Fed said it is "active, and in many cases, plays a leading role in climate related work."[10] A year later, the Fed chief said the central bank had "intensified our focus and supervisory efforts on evolving threats such as climate change."[11]

Fast forward to January 2025-- in a somewhat different political environment-- the Fed withdrew from the "greening" group, and substantially changed its tune.[12]

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[7] Immanuel Kant, *The Metaphysics of Morals* (1797).
[8] See chapter 24 in Kenneth Rogoff, *Our Dollar, Your Problem: An Insider's View of Seven Turbulent Decades of Global Finance, and the Road Ahead* (Yale University Press, 2025).
[9] See *Whitman v. American Trucking Assns., Inc.*, 531 U.S. 457, 468 (2001); see also *West Virginia v. Environmental Protection Agency*, 597 U.S. 697 (2022) (Gorsuch, J., concurring).
[10] Board of Governors of the Federal Reserve System, "Statement of Chair Jerome Powell on the Financial Stability Oversight Council's (FSOC) Report on Climate-Related Financial Risk," October 21, 2021.
[11] *Nomination Hearing, Senate Committee on Banking, Housing, and Urban Affairs, 117th US Congress* (2022) (statement of Jerome H. Powell, Chair, Board of Governors of the Federal Reserve System).
[12] *The Federal Reserve's Semi-Annual Monetary Policy Report, House Financial Services Committee, 119th US Congress* (2025) (statement of Jerome H. Powell, Chair, Board of Governors of the Federal Reserve System): "I wouldn't say that climate change is currently a threat to financial stability. . . . I would say it may emerge over time as such."

Second, in August 2020, the Fed announced a newfangled monetary policy framework. In my view, the new regime was the Fed's 'end of history' declaration…high inflation was vanquished…the dominant risk was that prices would be too low.

As part of the new regime, the Fed redefined its legislative remit of "maximum employment" as a "broad-based and inclusive goal."[13] The new nomenclature of 'inclusive employment' was understood to underscore Fed's willingness to accept higher inflation so that certain groups would achieve higher rates of employment.[14]

More recently, however, Fed leadership has sounded considerably more ambiguous whether the Fed's new definition of full employment was different from the old. If it's no different in practice, then was the new language simply a political nod? If the new definition is different, then shouldn't Congress have some say?

I should also note the Fed misjudged the economics: the steepest price of its new policy has been paid disproportionately by the supposed beneficiaries.

There's a final reason to be uncomfortable with the Fed's focus on groups. Some in our profession have tended to de-emphasize individuals, as if larger forces are in charge. In my view, individuals, rather than groups, are at the core of civil society.[15] A successful Fed policy regime should not view the individual as a cog in the macroeconomic machine, or as a member of some static demographic group. What an individual chooses to do as he or she sets out upon the day matters immeasurably to the path of the economy.

More broadly, the central bank should consider adopting a principle of *institutional neutrality*—pioneered in the university context, often associated with the Chicago Principles.[16] Neither the modern university nor the central bank has a comparative advantage as a social justice institution. They should avoid taking positions on social and political issues unless such matters plainly threaten the core missions of those institutions.

The more the Fed opines on matters outside of its remit, the more it jeopardizes its ability to ensure stable prices and full employment. And the more vulnerable it becomes to the body politic. The Fed's expansionist tendencies portend existential risks.

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[13] Jerome H. Powell, "New Economic Challenges and the Fed's Monetary Policy Review," speech given at Navigating the Decade Ahead: Implications for Monetary Policy, a symposium sponsored by the Federal Reserve Bank of Kansas City, Jackson Hole, WY (via webcast), August 27, 2020.

[14] Jerome H. Powell, statement at Federal Open Market Committee press conference, January 27, 2021.

[15] Cogan and Warsh, "Reinvigorating Economic Governance."

[16] Harry Kalven, Jr. Committee, *Report on the University's Role in Political and Social Action* (University of Chicago, 1967).

On Inflation

For about 40 years, Americans scarcely thought about changes in the price level. And if the Fed's enviable track record of price stability had continued through this decade, central bankers may have been granted wider berth. That is, the political class—and the electorate-- might have looked the other way to a fair bit of mission creep.

But then the Fed foundered on fundamentals and inflation surged.

The intellectual errors that contributed to the Great Inflation include some mix of the following: the central bank came to believe that its price stability objective was largely self-executing[17]…that big, black-box DSGE models were anchored in reality…that monetary policy had nothing to do with money…that the central bank was a bystander to forces outside of its control…that the surge of Putin and the pandemic were blameworthy for inflation rather than the surge of government spending and printing.

Stable prices were the Fed's plot armor. Like in the movies, it was protection for the protagonist against those who would dare a challenge. The Fed's roving remit and grand ambitions, however, expanded its surface area and exposed its vulnerability even more.

On Independence

Central bank independence is more often cited than defined. Independence is not a policy goal unto itself. It's a means of achieving certain important and particular policy outcomes.

'Independence' is reflexively declared when any Fed policy is criticized. Congress has granted important functions to the Fed, for example, in bank regulation and supervision. I do not believe the Fed is owed any particular deference in bank regulatory and supervisory policy. Fed claims of independence in bank matters undermine the case for independence in the conduct of monetary policy.

And when the Fed turns away from its creed and tradition, exercising powers that are the province of the Treasury Department, or taking positions on societal issues, it further jeopardizes its operational independence in what matters most.

Since *Marbury v. Madison* (1803), Article III courts under the Constitution have undertaken the task of defining the bounds of Article 1 and Article II powers. And since *McCulloch v. Maryland* (1819), the courts have wrestled with the role and authority of a central bank in our republic.

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[17] Mervyn King, "Monetary Policy in a World of Radical Uncertainty," *Economic Affairs* 42, no. 1 (2022): 2–12 (lecture delivered at the Institute of International Monetary Research, 2021).

Others are better situated than I to sort out the constitutional imperatives and legislative authorities of the current conjuncture.

I strongly believe in the operational independence of monetary policy as a wise political economy decision. And I believe that Fed independence is chiefly up to the Fed.

That does not mean central bankers should treated as pampered princes. When the monetary outcomes are poor, the Fed should be subjected to serious questioning, strong oversight, and, when they err, opprobrium.

A narrow central bank has more going for it than mere tradition. Our constitutional republic is accepting of an independent central bank, only if it sticks closely to its congressionally directed duty and successfully performs its tasks. Ours is, after all, our third experiment with a central bank…not because of the success of its predecessors, but their failure. We should remember that the revealed preference of the body politic is a deep distaste for inflation—and also, for bailouts and power grabs.

The governance objective is clear: it's to make the central bank safe for democracy, not to make democracy safe for the central bank.

<u>Conclusion</u>

The Fed's current wounds are largely self-inflicted, and its plot armor is showing its wear. A strategic reset is necessary to mitigate losses of credibility, changes in standing, and most important – worse economic outcomes for our fellow citizens.

Central bankers are trained to be careful with our critiques, lest the daylight reveal the magic. A bigger risk, however, is that of the sorcerer's apprentice: the misuse of magical powers producing trouble.

Assembled in this room are representatives – past and present – of important institutions in the economy. We are stewards of good and important purposes. We can ill-afford the closing of the monetary mind. We need a richer discourse and richer inquiry.

We should be unworried about violating pieties, prepared to endure periodic frowns of disapproval. It's high time we reclaim intellectual freedom and get policy back on track.

Central bank legitimacy demands nothing less.

Thank you.

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