

EXAMINING MONETARY POLICY AND ECONOMIC OPPORTUNITY

HEARING

BEFORE THE

TASK FORCE ON MONETARY POLICY, TREASURY
MARKET RESILIENCE, AND ECONOMIC PROSPERITY

OF THE

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EXAMINING MONETARY POLICY AND ECONOMIC OPPORTUNITY

Tuesday, March 4, 2025

U.S. HOUSE OF REPRESENTATIVES,
TASK FORCE ON MONETARY POLICY,
TREASURY MARKET RESILIENCE, AND
ECONOMIC PROSPERITY,
COMMITTEE ON FINANCIAL SERVICES,
Washington, DC.

The Task Force met, pursuant to notice, at 10:04 a.m., in room 2128, Rayburn House Office Building, Hon. Frank D. Lucas [Chairman of the Task Force] presiding.

Present: Lucas, Hill, Huizenga, Barr, Stutzman, Fitzgerald, Flood, Downing, Vargas, Waters, Sherman, Casten, Fields, and Bynum.

Chairman LUCAS. The Task Force on Monetary Policy, Treasury Market Resilience, and Economic Prosperity will come to order.

Without objection, the chair is authorized to declare a recess of the Committee at any time.

This hearing is entitled, “Examining Monetary Policy and Economic Opportunity.”

Without objection, all members will have 5 legislative days in which to submit extraneous material to the chair for inclusion in the record.

I now recognize myself for 4 minutes for an opening statement.

OPENING STATMENT OF HON. FRANK D. LUCAS, CHAIRMAN OF THE TASK FORCE ON MONETARY POLICY, TREASURY MAR- KET RESILIENCE, AND ECONOMIC PROSPERITY, A U.S. REP- RESENTATIVE FROM OKLAHOMA

Chairman LUCAS. Welcome to the first hearing of the Task Force on Monetary Policy, Treasury Market Resilience, and Economic Prosperity. Our task force is charged with examining issues related to monetary policy, the Federal Reserve Act, and how economic growth and price stability affect the financial well-being of all Americans, all of which we will discuss today.

The task force will also focus on the fundamental role that the U.S. Treasury debt plays in our economy and the resilience of the Treasury market.

It is impossible to overstate the importance of a healthy Treasury market, and we will pay special attention to the recent stresses the market has faced and how to increase liquidity and stability for the market and its participants.

Today, we will focus on monetary policy, how the Federal Reserve System (Fed) controls the money supply and interest rates, and why it matters to everyone in this country.

The Fed uses interest rates, its open market operations, its reserve requirements, and a whole host of policy tools to stimulate the economy or to cool it down.

While our constituents may not monitor the actions of the Fed on a daily basis; they all feel the squeeze when inflation runs rampant and their dollar does not go as far at the grocery store or at the gas pump. That is why it is important that the Fed gets it right.

Since the first central bank in 1791 to the Federal Reserve System we have today, the bank has evolved as the country has. Three recent changes are worthy of focus today.

First, the Fed's move to the ample reserve regime forced the Fed to use administered rates rather than the supply of bank reserves to steer policy.

Second, the growth of the Fed's balance sheet. The four rounds of quantitative easing over the past 20 years have expanded the Fed's balance sheet, peaking at nearly \$9 trillion in 2022. We will hear about this today as the Fed now engages in quantitative tightening.

Third, the Fed's move in 2020 to their flexible average inflation targeting strategy, or FAIT. This strategy tolerates high inflation after periods of low inflation. I hope to discuss the effectiveness of this strategy considering the stubbornly high inflation we have dealt with since FAIT was announced.

Finally, Dodd-Frank's considerable expansion of the Fed's regulatory and supervisory authority has exposed the Fed to more political pressures, threatening its monetary policy independence. The Fed enjoys broad independence in its implementation of monetary policy, but it is not unaccountable to Congress for its actions, particularly as we see the remarkable changes I have described.

Our conversation today will be insightful to the Fed as it is wrapping up its 5-year review of its framework.

The Federal Reserve system is an ongoing project. Congress' attention to this work is crucial as we know the actions of the Fed indirectly impact the economic well-being of all Americans.

I want to thank Chairman Hill for creating this task force and Ranking Member Vargas for leading with me, and I look forward to our work together.

With that, I yield back.

The chair now recognizes the ranking member of the subcommittee, Mr. Vargas of California, for 4 minutes for an opening statement.

OPENING STATEMENT OF HON. JUAN VARGAS, RANKING MEMBER OF THE TASK FORCE ON MONETARY POLICY, TREASURY MARKET RESILIENCE, AND ECONOMIC PROSPERITY, A U.S. REPRESENTATIVE FROM CALIFORNIA

Mr. VARGAS. Good morning, Mr. Chairman, and thank you very much for introducing me.

Again, good morning to everybody else.

Let me congratulate you on being named as chairman of this task force. As you know, I have a great deal of respect for you. When I first came to Congress 13 years ago, I was on the Agriculture Committee, which you chaired, and I thought that you treated everyone evenhandedly, straightforward, and honestly. I appreciate that. I look forward to working with you and together on issues where we find common ground.

Through this task force, I look forward to discussing important issues that affect our constituents and the entire economy, including the Federal Reserve's monetary policy framework review, the supplemental leverage ratio, and the debate between rule-based and discretionary monetary policy.

I also plan to defend my core principles, and I know you will. Two of those core principles are my belief in the importance of the Fed's dual mandate and the need to protect the Fed's independence.

The importance, first, of the dual mandate. As members of this task force, we are well aware that the Fed's dual mandate was established in 1977. The amendments to the Federal Reserve Act passed that year tasked the Fed with two important goals to create economic conditions that achieve both maximum employment and stable prices.

The inclusion of employment was no accident. The addition was thanks, in large part, to the work of Coretta Scott King and many in the labor movement. Some have argued that the Fed's reserve dual mandate has been a distraction from solely focusing on price stability, but maximum employment should not be on the chopping block.

When Congress charged the Fed with this dual mandate; it recognized that having access to a job is a signal of a healthy economy. Preventing the Fed from addressing employment would misunderstand the key way that many Americans experience the economy and would also disproportionately hurt working-class people.

Low employment harms Americans who are already living on the edge working multiple jobs and surviving paycheck to paycheck.

Chairman Powell said that the dual mandate has "served us well" and that he "does not see the case" to move forward with a single mandate of price stability. I agree. As the ranking member, I intend to continue to advocate for the importance of preserving the Fed's dual mandate.

Now, with respect to the independence of the Fed, another area where the Fed has come under increased scrutiny is its independence. The research is clear that the central banks around the world function at their best when they are allowed to operate independently.

Elected officials mostly operate on a short-term horizon, responding to short-term political incentives, but the Fed must make decisions considering a much longer time horizon. That is why it is critical that monetary policy be insulated from external political pressure.

The President's recent executive order requiring independent agencies to submit proposed regulatory actions, strategic plans, and priorities to the White House for review only makes this issue more important.

It is also worrisome that now Treasury Secretary Scott Bessent has floated the idea of creating a shadow Fed Chair before Chairman Powell's term expires in May 2026. We in Congress, regardless of political party, must continue to strongly defend the independence of the Fed.

The new administration has brought in a wave of uncertainty. Whether it is tariffs or the future independence of the Fed, our constituents are increasingly unsure of their economic future. We see it in the recent national consumer sentiment numbers, which have shown that consumer confidence fell by seven points in the most recent Conference Board's Consumer Confidence Survey.

I am hearing from businesses in my district in San Diego who are increasingly concerned about the impact that tariffs and trade wars will have on the economy.

I hope that this task force will provide a forum for substantive debate and collaboration on these issues that impact our constituents. I am looking forward to it.

With that, I yield back, Mr. Chair.

Chairman LUCAS. The gentleman yields back. The chair appreciates the very thoughtful discussion.

With that, the chair now recognizes the chairman of the full committee, Mr. Hill, for a minute.

STATEMENT OF HON. FRENCH HILL, CHAIRMAN OF THE COMMITTEE ON FINANCIAL SERVICES, A U.S. REPRESENTATIVE FROM ARKANSAS

Chairman HILL. Thank you, Chairman Lucas.

The Federal Reserve's dominance affects everyday family, business, and worker decisions in our country, and those Fed decisions, whether it is the cost of a mortgage or the return on savings or the stability of the economy, it is at the central—plays a central role.

Many Americans who were not alive during the 1970s or early 1980s quickly learned just how devastating inflation can be at the pump or at the grocery store with this 40-year record high inflation under President Biden. That is why the new Monetary Policy Task Force led by Chairman Lucas is holding its first hearing to examine how monetary policy shapes economic opportunity and what that means for the future of American prosperity.

To begin this work, we must first establish a solid foundation. Today will be a level set for our members so that we can do deeper dives during this Congress. We will start with the fundamentals, including the Fed's monetary policy tools, decision making, balance sheet policy, and U.S. Treasury markets. We will hear how these policies have real consequences for investment, wages, and even the Federal debt where rising debt levels and interest costs pose a growing risk to our fiscal health.

I look forward to our witnesses' testimony today.

I yield back, Mr. Chairman.

Chairman LUCAS. The gentleman yields back.

The chair now, today welcomes the testimony of Dr. Donald Kohn, who is currently a Senior Fellow at the Economic Studies at the Brookings Institute. He spent 40 years at the Federal Reserve system, serving previously as Vice Chairman of the Board of Governors.

Mr. Joseph Wang is currently the Chief Investment Officer at the Monetary Macro LLC, a registered investment advisor. From 2016 to 2021, he was a Senior Trader on the Open Market Desk of the Federal Reserve Bank of New York.

Norbert J. Michel is currently the Vice President and Director of Cato Institute Center for Monetary and Financial Alternatives.

Michael Konczal is the Senior Director of Policy and Research for the Economic Security Project.

We thank each of you for taking the time to be here, and each of you will be recognized for 5 minutes to give an oral presentation of your testimony.

Without objection, your written statements will be made a part of the record.

Dr. Kohn, you are now recognized for 5 minutes for your oral comments.

**STATEMENT OF DR. DONALD KOHN, SENIOR FELLOW,
BROOKINGS INSTITUTION**

Dr. KOHN. Thank you, Mr. chairman. It is a pleasure to be back in front of this committee.

Mr. Hill told me I had not aged a day in the 10 years since I was last here. I sometimes do not feel that way, but it is nice. Thank you for the compliment.

This task force should enhance Congress' ability to oversee monetary policy. Congress has set goals for the Federal Reserve in the conduct of policy maximum employment.

Chairman LUCAS. Would the gentleman redirect his microphone a little more in the direct—please.

Dr. KOHN. All right. Thank you.

Congress has set goals for the Federal Reserve in the conduct of policy, the dual mandate, maximum employment, stable prices. It has also very wisely allowed the Fed to determine the best policies to meet those goals without direct interference from the political process.

That is because history shows that political pressures are invariably on one side—for lower interest rates, which people facing election see as boosting jobs. Giving into those pressures results subsequently in costly inflation.

With a high degree of policy independence, however, comes responsibility—of the Federal Reserve to clearly explain what it is doing and why, and of the Congress to examine those explanations. Your staff suggested that I might be helpful in this regard by giving an overview of how monetary policy works.

The path from policy choices on Constitution Avenue to prosperity on Main Street is a long and winding one. Policy decisions start by asking how the economy is likely to evolve over coming quarters relative to these goals, and if it is not likely to achieve the goals soon, how policy should be altered.

Since 2012, the Fed's Federal Open Market Committee has issued a statement on longer run goals and monetary policy strategy that defines the goals and gives some very general thoughts on the approach to achieving them.

In 2020, in response to a prolonged period of very low interest rates and persistent shortfalls of inflation, the Fed altered its strat-

egy. The intention was mainly to make sure that inflation was high enough to average 2 percent over time which, in turn, would keep interest rates high enough to give the Fed sufficient room to lower interest rates should an adverse shock hit the economy.

Obviously, the post-coronavirus disease (COVID) recovery presented the Fed with a very different environment, and it is now reviewing its statement. Its strategy must be robust to a variety of shocks and stresses.

Adjusting an overnight interest rate is the main instrument the Fed uses to make progress toward the goals. That rate does not directly affect prices or employment; rather, it works by influencing prices in financial markets, which, in turn, induce changes in spending and the balance of aggregate demand and aggregate supply.

Note how indirect this process is. Mr. Chairman, you used the term “indirect,” and that is exactly right. The effects of a policy on objectives will depend on how financial markets react to actual and expected policy and then how households and businesses respond to changes in financial markets.

Moreover, financial conditions and the balance of aggregate supply and demand are affected by many things, in addition to monetary policy.

In considering these shocks to financial conditions in the economy, the Fed needs to differentiate between those that happen on the demand side of the economy and those that happen on the supply side of the economy.

Monetary policy is well suited to offsetting demand side shocks, but it cannot offset an adverse supply shock—the rise in the price of a good, say, from a reduction in supply, as we experienced in the 1970’s in the petroleum markets, or an increase in taxes on that good.

Advice for policymakers in this situation is to avoid trying to offset these effects because trying to might actually worsen the outcomes. Policymakers need to be very attentive to the second-round effects, the follow-on effects of these initial supply shocks.

Expectations of prices and interest rates have played a critical role in our story. Expectations anchored around the Fed’s targeted 2 percent are necessary to achieve that target. Expectations about future policy have important effects on financial conditions and, hence, on achieving objectives.

The better people understand Fed policy and intentions, the more stabilizing market responses to policy and to unexpected economic developments are likely to be. That is why the Fed has become much more transparent over time about why it is making its decisions and its outlook.

I hope my testimony has provided a framework for discussing monetary policy. I am happy to take your questions.

[The prepared statement of Dr. Kohn follows:]

Testimony for the Task Force on Monetary policy, Treasury Market Resilience
and Economic Prosperity of the House Committee on Financial Services

Donald Kohn

Senior Fellow, Brookings Institution

March 4, 2025

I appreciate this opportunity. The Task Force is an important innovation that will enhance the Congress' ability to oversee Federal Reserve monetary policy. Congress has, in the Federal Reserve Act, set goals for the Federal Reserve in the conduct of monetary policy—maximum employment and stable prices. But it also has, very wisely, allowed the Fed to determine the best policies to meet those goals without direct interference from the political process. That's because history shows that political pressures are invariably on one side—for lower interest rates, which people facing elections see as boosting job creation in the short term. But giving in to these pressures results subsequently in inflation. That would be very costly. As we've been reminded of late, Americans hate inflation; and for the Fed to eradicate it once it takes hold often entails considerable pain, as it did in the early 1980s.

With a high degree of policy independence, however, comes responsibility—of the Federal Reserve to clearly explain what it is doing and why, and of the Congress to examine those explanations and to challenge them, especially when the Federal Reserve has not met its legislated goals for a while. Obviously, the better informed you are, the more effective this process will be.

The path from policy choices on Constitution Avenue to prosperity on Main Street is a long and winding one, not well mapped and subject to many influences, economic and financial, that are not under the direct control of

the Federal Reserve. Your staff suggested that it might be useful for me to provide a high-level overview of that path. I draw on 40 years of experience in the Federal Reserve. I joined the Fed staff in Kansas City in 1970, came to Washington as a staff economist in 1975, where I served until 2002, when I was appointed to the Board of Governors by President Bush, who subsequently elevated me to vice chairman in 2006. I retired from the Board in 2010 and have been at Brookings since then.

Policy decisions start by asking how the economy is likely to evolve over coming quarters relative to those longer-term goals, and if it is not going to achieve the goals soon, how policy – usually short-term interest rates -- should be altered to get it closer, sooner. Since 2012 the Fed's Federal Open Market Committee has issued a "Statement on Longer-term Goals and Monetary Policy Strategy"—the so-called framework—that is a starting point for this discussion. The framework defines the goals and gives some very general thoughts on the approach to achieving them. Maximum employment is given by influences outside the control of the Fed—the structure of the labor market, the ease of matching people and jobs—and maximum sustainable employment must be inferred from the behavior of other variables, like wages and prices. Inflation is also subject to outside influences, but over time the Fed can control inflation, and it is responsible for achieving and maintaining price stability, which it has defined as 2 per cent annual growth in a particular measure of consumer prices.

In 2020, in response to a prolonged period of very low interest rates—often at zero -- sluggish growth of employment coming out of the recession, and persistent shortfalls of inflation from 2 percent, the Fed altered its strategy for meeting its goals in two ways. It adopted what it called Flexible Average Inflation Targeting, which called for "inflation moderately above 2 percent for some time" after it had been running persistently below 2 percent; this was designed to keep consumer, business, and market inflation expectations anchored at the 2 per cent target. It also would react to shortfalls in employment from estimates of its maximum, but not to overshoots unless pressures in labor markets were already manifested in increases in inflation

above target. The intention here was mainly to make sure that inflation averaged 2 percent over time, which in turn would be reflected in expectations and moderate interest rates, giving the Fed sufficient scope to lower interest rates to counter any adverse shock to the economy. Obviously, the post-covid recovery presented the Fed with a very different environment than the low rate, low inflation one it had been dealing with from 2009 to 2019, and which it was addressing in its revised statement. In light of this experience, the Fed is now reviewing its statement; its strategy must be robust to a variety of shocks and stresses, not just those of its most recent experience. The minutes of the last FOMC meeting confirm that policymakers recognize this imperative.

Adjustment to an overnight interest rate is the main instrument the FR uses to make progress toward the goals you gave it. That rate does not directly affect prices or employment; rather it works by influencing prices in financial markets, which in turn induce changes in spending and the balance of aggregate supply and demand. To give an example, if the Fed sees softness developing in the economy and inflation potentially falling below 2 percent, it will cut rates. The decrease, along with any expected future decreases, will reduce the longer-term interest rates households and businesses pay when they borrow to buy cars and houses or to build factories, stimulating demand. Lower rates also tend to raise the prices of other assets, like equities and houses, promoting spending by the owners of that wealth. Lower rates also tend to reduce the foreign exchange value of the dollar, stimulating exports and damping import competition for US producers.

Note how indirect this process is. The effects of a policy on the objectives will depend on how financial markets react to the action and any shifts in expectations about future actions, and how households and businesses respond to the evolution of interest rates, equity prices, and the exchange rate. Our knowledge of the dimensions of all these steps and their timing is incomplete. Although asset prices respond promptly to any change in the policy outlook, businesses and households take time to make and alter decisions. Hence the well-known lags in the effects of monetary policy. And

experience suggests that the lags are especially long between policy actions and changes in inflation. Given contracts and commitments, it takes a while for workers and businesses to decide whether a change in spending is large enough and persistent enough to call for an adjustment to wages and prices, and then some time to execute on any shift that seems warranted. For this reason, whenever possible, monetary policy decisions should be based importantly on a forecast of future employment and inflation.

Moreover, financial conditions and the balance of aggregate supply and demand are affected by many things in addition to monetary policy. Indeed, I often thought about my policy decisions as hinging on identifying those other influences and then offsetting them. Here's how the Fed's statement on longer-run goals and strategy puts it. "Employment, inflation, and long-term interest rates fluctuate over time in response to economic and financial disturbances. Monetary policy plays an important role in stabilizing the economy in response to these disturbances."

In considering these so-called shocks to financial conditions and the economy, the Federal Reserve needs to differentiate between those that happen to demand and those that affect supply. Monetary policy is generally well suited to offsetting demand shocks. The chain I just described was about boosting (or in the case of raising rates, damping) demand. It cannot offset an adverse supply shock—a rise in the price of a good resulting for example from a reduction in supply or an increase in taxes on that good. Adverse supply shocks raise prices and reduce real incomes—moving the economy away from both objectives at least temporarily. Advice for policymakers in this situation is often to "look through" the supply shock—not try to offset its effects, which might worsen outcomes. But policymakers need to be attentive to second-round effects. If a rise in the price level from supply restriction begins to get built into higher inflation expectations, a price level change can result in persistently higher inflation and require a policy response. And uncertainty about future disturbances that discourages consumption or investment can put the employment goal at greater risk. In the presence of second-round effects, adverse supply shocks require

policymakers to perform a balancing act—assess which goal is at greater risk over the intermediate to longer-term and take actions to mitigate that risk.

Monetary policy's ability to perform its balancing role in response to demand or supply disruptions—in particular to boost growth and prevent unwelcome disinflation in response to economic weakness-- has been constrained several times in recent years because the policy interest rate had already been reduced to zero. In these circumstances, the Fed has activated what are known as unconventional policy instruments—asset purchases (QE) and forward guidance about interest rates. These are simply extensions of conventional rate policy when that policy is no longer available. Asset purchases directly lower long-term rates and boost asset prices to make purchases of houses, cars, and business capital more attractive. Forward guidance on interest rates is intended to prevent premature expectations of rising rates from becoming built into higher actual rates, tightening financial conditions.

Expectations of prices and interest rates have played a critical role in our story. Inflation expectations anchored around the Fed's target of two percent are necessary to achieve that target. When people expect inflation to be higher or lower than the target, they will raise prices and wages at rates that will tend to make those expectations a reality. That's why the Fed keeps such a careful eye on measures of inflation expectations.

And expectations about future policy have important effects on current financial conditions and hence on achieving objectives. The better people understand Fed policy and intentions, the more stabilizing market responses to policy and to unexpected economic developments are likely to be; markets and the Fed in synch will foster faster progress toward the goals. And that's why the Federal Reserve has become much more transparent over time about why it is making its decisions and its outlook for the future. It has announced that in its 2025 framework review it will be looking at ways to make its communication even more helpful.

The bottom line is that, for a variety of reasons, the path to realizing the Congressionally mandated objectives is surrounded by a good deal of uncertainty. Policymakers need to operate flexibly and adapt their policy actions and communication to new information about the forces acting on the economy and transmitting policy impulses to employment and prices.

I recognize that this overview has been at a very high and abstract level. Your attention is undoubtedly focused more on recent experience with the economy and monetary policy and prospects going forward. I hope this has provided a framework for discussing these issues, and I am happy to take your questions on various topics related to monetary policy.

Chairman LUCAS. Thank you, Dr. Kohn.

Mr. Wang, you are now recognized for 5 minutes for your oral remarks.

**STATEMENT OF JOSEPH WANG, PRINCIPAL, MONETARY
MACRO LLC**

Mr. WANG. Good morning, Chairman Lucas, Ranking Member Vargas, members of the committee. Thank you for inviting me. I appreciate the opportunity to testify today.

My name is Joseph Wang, and my work focuses on understanding the transmission and impact of monetary policy.

The ultimate effect of monetary policy depends on many variables outside of the Fed's control, so setting policy is a difficult job whose success rests upon good judgment. The significant discretion accorded to the Fed makes oversight especially important, but the complexity of the subject makes its actions difficult to evaluate. An understanding of the tools within the Fed's grasp and corresponding tradeoffs in their use can be helpful in that regard.

Before discussing their tools, I will note the Fed's significant influence over the economy stems, in part, from the ambiguity within their dual mandate of price stability and full employment. While price stability is a mandate given by Congress, the current 2 percent inflation target was decided by the Fed itself. The level of unemployment rate considered to be full employment is also decided by the Fed itself. Where they decide to set these goalposts have wide ranging impacts on everyday people.

Generally speaking, the two mandates call for conflicting policy prescriptions. The balance between the two mandates is a judgment left to the Fed, as is the appropriate timeline to meet their goals. The Fed's discretions to set its own goals, to balance these goals, and to set timelines to achieve them makes oversight difficult.

Moving on to the Federal Reserve's tools. The Fed's primary monetary policy tools are interest rates and balance sheet policy. Regulatory policy is an additional tool that does not specifically target monetary policy goals but also has significant impact on the economy and financial markets.

The reliance on interest rate policy means that the economic impacts of monetary policy are primarily through interest rate sensitive sectors. Typically, high interest rates would dampen economic activity in sectors like housing and autos as buyers in those sectors tend to finance their purchases. This lays the brunt of economic adjustments onto blue collar workers. Note that the overall economy's interest rate sensitivity also varies over time, where an asset light services focused economy tends to be less interest rate sensitive.

Interest rates also impact economic activity through the wealth effect, where higher rates lower the price of financial assets and thus the spending power of households. Asset holdings are concentrated in a small percentage of the population, but that group has an outsized impact on economic activity.

One last note on interest rate policy is its impact on fiscal policy. As the level of the public debt has risen, so has the level of interest rate payments. Interest rate expenditures now exceed \$1 trillion a

year, in part, due to the level of interest rates. An increasingly important side effect of Fed actions is its impact on the Nation's budget.

The Fed's secondary tool is its balance sheet, which can influence interest rates and also allocate credit. The Fed can create money out of thin air and lend directly to borrowers or indirectly through purchases of debt. This is essential to performing its lender of last resort function.

Fed purchases of securities are limited to a very small subset of assets that include mortgage-backed securities, which is, in effect, allocating credit to home buyers. Most recently, it was deployed during the pandemic where hundreds of billions of dollars worth of mortgages were purchased even as home prices nationally surged by 20 percent in a year. The distributional consequences of those actions look to last many years.

Regulatory policy is less visible but also an influential part of the Fed's toolkit. Regulatory policy places constraints and costs on the actions of banks. More stringent regulation reduces the willingness of banks to take risks and results in a stronger banking system. However, a more constrained banking system also limits the supply of credit to the public. Small-and medium-sized businesses are more heavily reliant upon banks for financing, while larger businesses tend to borrow directly from the capital markets.

More stringent regulation also impacts the function of Treasury markets and the level of interest rates. Regulations like the Supplementary Leverage Ratio contributed to the strength of the banking sector through the pandemic but also the malfunctioning of the Treasury market at that time.

In summary, the Federal Reserve has large latitude in setting its own goals and exercising a range of tools toward achieving those goals. How those goals are set, and which tools are used have large impacts on the lives of the American people. This makes the task of overseeing the activities of the Fed both very important and difficult.

I thank Chairman Lucas and Chairman French for their wisdom in establishing this task force to improve the performance of monetary policy toward greater economic prosperity.

[The prepared statement of Mr. Joseph Wang follows:]

March 4, 2025

Task Force on Monetary Policy, Treasury Market Resilience, and Economic Prosperity: Examining Monetary Policy and Economic Opportunity

Testimony of Joseph Wang

Good morning. Thank you for inviting me and I appreciate the opportunity to testify today.

My name is Joseph Wang and I am the principal of Monetary Macro, an investment research and advisory firm. I have over 15 years of experience across the fields of law, financial services, and monetary policy. My experience includes five years on the Open Markets Desk of the Federal Reserve Bank of New York, where I implemented monetary policy and studied the financial system. I hold a bachelor's degree in economics from Northwestern University, a J.D. from Columbia Law School, and an MSc. in financial economics from Oxford University.

I believe the Federal Reserve is unique among agencies in the wide discretion granted to it, and in the economic influence of its tools. The Federal Reserve's dual mandate and range of tools allow tremendous flexibility in undertaking actions that have a large impact the economy as a whole, sometimes in very uneven ways. The ultimate effect of monetary policy depends on many variables outside of the Fed's control, so it is a difficult job whose success rests upon good judgement. The significant discretion accorded to the Fed makes oversight especially important, but the complexity of the subject makes its actions difficult to evaluate. An understanding of the tools within the Fed's grasp and corresponding tradeoffs in their use can be helpful in that regard.

But before discussing their tools, I will note the Fed's significant influence over the economy stems in part from the ambiguity within their dual mandate of price stability and full employment. While price stability is a mandate given by Congress, the current 2% inflation target was decided by the Fed itself. The level of unemployment considered to be "full employment" is also decided by the Fed itself. Where they decide to set these goal posts have wide ranging impacts on every day people. For example, if the neutral unemployment rate were perceived to be higher, then significant job losses would be permitted.

Generally speaking, the two mandates call for conflicting policy prescriptions where above target inflation calls for tighter monetary policy that could also have the impact of raising the unemployment rate. And an unemployment rate perceived to be too high would call for looser monetary policy, which could also have the impact of raising inflation. The balance between the two mandates is a judgement left to the Fed, as is the appropriate timeline to meet their goals.

The Fed's discretion to set its own goals, to balance these goals, and to set timelines to achievement them makes oversight difficult. However, the Fed does provide a framework that sketches out their thinking.

The Federal Reserve's current framework is built on the post-financial crisis era, where the fear was low inflation. The framework calls for an asymmetric response to inflation that tolerates inflation overshoots, but responds to undershoots with a commitment to allow inflation to run above target in the future. This framework was reasonable when designed, but also may have contributed to the bout of higher inflation in recent years. Reports suggest it will be recalibrated at the next policy framework review.

Moving on to the Federal Reserve's tools – the Fed's primary monetary policy tools are interest rates and balance sheet policy. Regulatory policy is an additional tool that does not explicitly target monetary policy goals, but also has significant impact on the economy and financial markets.

The Federal Reserve has strong control over overnight interest rates, which in turn allows it to influence longer dated interest rates that are more economically impactful. Longer dated interest rates are largely the market's expectation of the future path of overnight rates, but are also influenced by supply and

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demand dynamics. At times the Federal Reserve has directly purchased longer dated Treasuries in an effort put downward pressure on longer dated interest rates.

The reliance on interest rate policy means that the economic impacts of policy are primarily through interest rate sensitive sectors. Typically, higher interest rates would dampen economic activity in sectors like housing and autos as buyers in those sectors tend to finance their purchases. This lays the brunt of economic adjustments onto blue collar workers and aspiring home owners. Similarly, these groups disproportionately benefit from low-interest rate policies. Note that the overall economy's interest rate sensitivity varies over time, where an asset light services focused economy tends to be less interest rate sensitive.

Interest rates also impact economic activity through a wealth effect, where higher rates lower the prices of financial assets and thus the spending power of households. Consumer spending can be financed from wages, debt, or by spending down wealth. A correction in the stock market and other risky assets from higher rates reduces the ability of asset holders to spend, and a stock market boom from lower rates does the opposite. Asset holdings are concentrated in a small percentage of the population, but that group has an outsized impact on economic activity.

One last note on interest rate policy is its impact on fiscal policy. As the level of public debt has risen, so has the level of interest rate payments. Interest rate expenditures now exceed \$1 trillion dollars this year, in part due to the level of interest rates. An increasingly important side effect of Fed actions is its impact on the nation's budget.

The Fed's secondary tool is its balance sheet, which can influence interest rates and also allocate credit. The Fed can create money out of thin air and lend directly to borrowers or indirectly through purchases of debt. This is essential to performing its lender of last resort function, which has expanded in recent decades. The Fed was originally a lender of last resort to commercial banks, but in times of crisis has also expanded this role to include emergency lending to securities dealers, money market funds, corporations, and foreign central banks. Some of these actions were done in cooperation with Treasury. These actions were essential to restoring financial stability and avoiding potentially significant economic declines.

Fed purchases of securities are limited to a very small subset of assets that include mortgage-backed securities, which is in effect allocating credit to homebuyers. These purchases were important when they were first rolled out during the great financial crisis, which originated in the housing market. Most recently it was also deployed in the pandemic, where hundreds of billions worth of mortgages were purchased even as home prices nationally surged over 20% in a year. This boosted the housing wealth of homeowners, the business of homebuilding, but also pushed the dream of homeownership further away for a generation of young buyers. The distributional consequences of those actions look to last many years.

Regulatory policy is less visible, but also an influential part of the Fed's tool kit. Regulatory policy places constraints and costs on the actions of banks, which in turn impact their lending decisions. More stringent regulation reduces the willingness of banks to take risk and results in a stronger banking system. However, a more constrained banking system also limits the supply of credit to the public. Small and medium sized businesses are more heavily reliant upon banks for financing, while large businesses tend to borrow by issuing debt in the capital markets.

More stringent regulation also impacts the functioning of Treasury markets and level of interest rates. Banks and bank affiliated securities dealers are the primary market makers in the Treasury market. They

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buy securities from one client, hold the securities in inventory, and then sell them to another client. Regulations like the supplementary leverage ratio place costs based on the size of a bank's balance sheet that disincentivizes low risk and high-volume activities. These regulations contributed to the strength of the banking sector through the pandemic, but also the malfunctioning of the Treasury market at that time. The Fed reacted by temporarily suspend the SLR on Treasuries for one year.

Other regulations can also directly impact the level of interest rates through demand for Treasuries. Regulations such as the liquidity coverage ratio mandate banks to hold certain levels of high quality liquid assets, which include Treasury securities. An increased demand for Treasury securities places downward pressure on interest rates.

In summary, the Federal Reserve has large latitude in setting its own goals and exercising a range of tools towards achieving those goals. How those goals are set, and which tools are used, have large impacts on the lives of the American people. This makes the task of overseeing the activities of the Fed both very important, and difficult. I thank Chairman Lucas for his wisdom in establishing this taskforce to improve the performance of monetary policy towards greater economic prosperity.

Chairman LUCAS. Thank you, Mr. Wang.

Dr. Michel, you are now recognized for 5 minutes for your oral remarks.

**STATEMENT OF NORBERT J. MICHEL, VICE PRESIDENT AND
DIRECTOR OF THE CENTER FOR MONETARY AND FINAN-
CIAL ALTERNATIVES, CATO INSTITUTE**

Dr. MICHEL. Good morning, Chairman Lucas, Ranking Member Vargas, members of the committee. Thank you for the opportunity to testify at today's hearing.

My name is Norbert Michel. I am Vice President and Director for the Center for Monetary and Financial Alternatives at the Cato Institute, but the views that I express today are my own and should not be construed as representing any official position of the Cato Institute.

In my testimony today, I argue that Congress has given the Fed too much to do and too much discretionary authority to carry out those mandates. To secure the best outcomes for the typical American, Congress should give the Fed less to do with less discretionary authority.

The engine that drives prosperity for Americans is private enterprise, and the Fed should carry out its core function, supplying the economy's base money, by interfering as little as possible with that engine. It should ensure that it does not become the source of monetary induced slowdowns or inflation, and it should remain transparent and directly accountable through elected officials, goals that can be best accomplished with a monetary policy rule.

Now, I will make three main points in support of my position.

First, stable prices should not be equated with 2 percent inflation every year. Optimally, the rate of inflation would vary with the Nation's productivity, sometimes gently rising, sometimes gently falling. By targeting an always positive rate of inflation, even as productivity improves, monetary policy has been biased toward expansion, and that has hurt Americans by preventing them from enjoying the full benefits of a growing economy. Through much of the past several decades, the price level should have fallen gently, but it has not, meaning that Americans have experienced an unnecessarily high cost of living.

Second, as the recent inflationary episode clearly demonstrates, Americans hate inflation, as I am sure I do not need to tell you. They understand that it lowers real income and that it reduces their real returns to savings. They also understand that the Fed cannot simply flip a switch and stop inflation once it takes off and that expansionary fiscal policy makes the Fed's job even harder. They do get it.

They do not want to hear that, over time, nominal incomes tend to rise, offsetting inflation. They do not want to wait, and they do not want high inflation. They know that it increases their cost of living, and that is what they care about.

Increasing inflation is only one side of the monetary policy coin. If the Fed mishandles monetary policy, it can also lead to an economic slowdown, one where output employment and income falls as the economy shrinks.

During the past few decades, we have been spoiled and not had to endure many of those types of monetary induced slowdowns, but the potential is there and must be considered during any efforts to reform the Fed and improve monetary policy.

Together, those types of slowdowns and inflation are examples of why congressional oversight of the Fed is so important and why it is critical that Americans are given the opportunity to hold both Congress and the unelected officials at the Fed accountable.

Finally, the Fed should not be expected to fine-tune or manage the economy to hit precise macroeconomic targets, much less precisely improve micro-level metrics for certain groups of Americans.

Monetary policy is a very blunt tool, one that works in conjunction with fiscal policy. Providing funds, whether through loans or grants, to specific groups or companies, financial or otherwise, is not an appropriate role for a central bank and representative democracy.

If Congress wants to provide loans to just, for example, municipal governments, then it can appropriate the money and do so in a transparent manner so that voters can either approve or disapprove of those actions taken by their elected representatives.

In closing, I am arguing that Congress has given the Fed too much to do and that it is hard enough to get monetary policy right in the first place. Many of these other tasks given to the Fed have only exacerbated that problem.

Thank you for your consideration. I am happy to answer any questions you may have.

[The prepared statement of Dr. Norbert J. Michel follows:]



Testimony
Before the House Financial Services Committee:
Hearing on "Examining Monetary Policy and Economic Opportunity"

Norbert J. Michel
VP and Director
Center for Monetary and Financial Alternatives, Cato Institute

March 4, 2025

Introduction

Chairman Hill, Ranking Member Waters, and Members of the Committee, thank you for the opportunity to testify at today's hearing. My name is Norbert Michel and I am Vice President and Director for the Center for Monetary and Financial Alternatives at the Cato Institute. The views I express in this testimony are my own and should not be construed as representing any official position of the Cato Institute.

Good monetary policy helps American workers, retirees, and savers by ensuring that the economy does not stall due to an insufficient supply of money. It also ensures that the economy does not overheat due to an excessive supply of money. To accomplish this task, the Federal Reserve needs to supply the amount of base money the economy needs to keep moving. It needs to do so in a neutral fashion, rather than allocate credit to preferred sectors of the economy. This operating standard dictates that the Fed maintains a minimal footprint in the market so that it does not create moral hazard problems, crowd out private credit and investment, or transfer financial risks to taxpayers. Finally, the Federal Reserve should conduct monetary policy in a transparent manner, with maximum accountability to the public through their elected representatives. Through much of its history, and particularly since the 2008 financial crisis, the Federal Reserve has failed on all these measures, culminating in abnormally high and prolonged inflation following the COVID-19 pandemic.

A central bank's policy failures are particularly damaging because money is the means of payment for all goods and services. The Fed's misguided policies have long distorted prices and interest rates, thus causing people to misallocate resources in ways that have exacerbated business cycles. The Fed's regulatory failures have also led to resource misallocation and increased moral hazard, a most unfortunate outcome given that a central bank does not need to be a regulator to conduct monetary policy. Aside from these regulatory failures' contribution

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to the 2008 crisis, the Fed's monetary tools have grown and morphed beyond the simple and standard way it conducted monetary policy during the Great Moderation. The Fed has essentially been paying large financial institutions to refrain from lending to Main Street businesses by paying them risk-free interest to sit on cash. The Fed has been able to conduct these experimental monetary policies largely because Congress has given the Fed so much policy discretion. To correct these problems, Congress must first recognize that the Federal Reserve is not an indispensable part of the economy.

Too many policymakers view the Fed as a temple of scientists who know exactly which dials to turn to speed up or slow down the economy at precisely the right time, even though there is more than enough evidence to question this idea. These facts, along with the Fed's long-term track record, should put to rest the notion that the central bank can fine-tune the economy. Congress has an obligation to oversee the Fed, and the Fed has not, even according to its own projections, delivered on its economic promises. Congress should hold the Fed accountable and ensure that it no longer has the discretion to "manage" the economy however it sees fit through some vague macroeconomic mandate.

Understanding Monetary Policy

When considering the tools the Fed has at its disposal, it seems unreasonable to expect the Fed to achieve economic fine tuning. The Fed's main tool is buying (or selling) government securities to increase (or decrease) the monetary base—it conducts these operations to influence the federal funds rate (FFR) towards a predetermined target. Since the FFR is the cost at which banks can raise liquid money themselves, it in turn affects the various rates at which banks are willing to lend to consumers and other economic agents. At least, this is how monetary policy is supposed to work.

Note that even when the Fed buys securities to increase reserves in the banking system, private banks still have to make loans to result in increased economic activity. Likewise, if the Fed increases its target rate and sells securities to make reserves scarcer, private banks have to decrease their lending to slow economic growth. In either instance, there is no guarantee that the Fed's operations will lead to a precise change in lending that will lead, in turn, to a precise change in the broader money supply, interest rates, prices, unemployment, or overall economic activity.

Post-Pandemic Fed Failure

The Fed's inability to control the economy was apparent when it failed at its primary responsibility to keep prices stable in the aftermath of the COVID-19 pandemic. Figure 1 shows the annualized quarterly CPI-based inflation rate in the U.S. over the past ten years. As the graph shows, inflation was significantly higher, exceeding 10% in 2022, than the Fed's 2% target through much of the immediate aftermath of Covid. It is true that excessive fiscal spending and severe supply shocks made the Fed's price stability mandate difficult to achieve but nonetheless the Fed exacerbated rather than curtailed inflationary pressure—primarily by

discarding objective policymaking.¹ Economic evidence routinely demonstrates that the Fed performs better when following a policy rule.² Despite this evidence, the Fed had been getting increasingly discretionarily ever since the financial crisis.³ The Fed doubled down on subjective monetary policy during its disastrous 2020 framework review that increased the vagueness of its policy goals. For instance, the FOMC adopted “flexible average inflation targeting” (or FAIT) during the review—under this method, the Fed would target inflation to be 2 percent on average over an undefined period. Post-pandemic inflation was a direct and predictable consequence of increased Fed discretion.

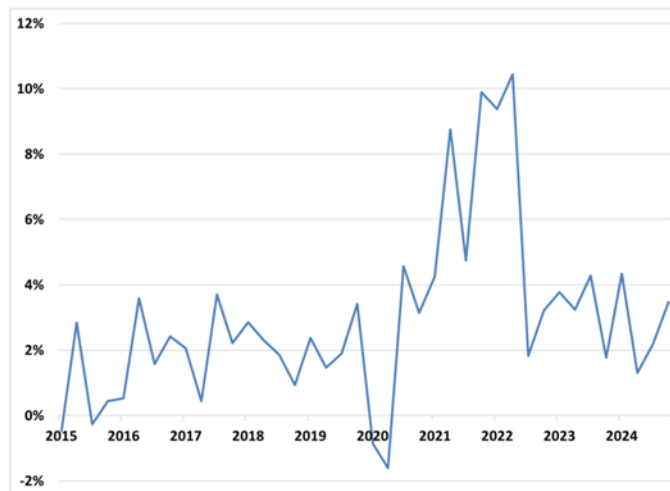


Figure 1: Annualized Consumer Price Index Inflation in the U.S., Quarterly

Fixing Monetary Policy with a Rule

While money supply changes do not affect the “real” level of economic activity in the long run, they can still affect real outcomes in the short run. Consequently, many economists have long sought ways to use monetary policy to minimize short run economic disruptions (often called “business cycles”). Of course, the main tool for the Fed to try to minimize these

¹ Jai Kedia, “Fiscal Spending Contributed to Post-COVID-19 Inflation,” *Cato at Liberty*, August 18, 2023, <https://www.cato.org/blog/fiscal-spending-did-contribute-inflation>.

² John B. Taylor, “Monetary Policy Rules Work and Discretion Doesn’t: A Tale of Two Eras,” *Journal of Money, Credit and Banking* 44, no. 6 (September 2012): 1017–32, <https://onlinelibrary.wiley.com/doi/10.1111/j.1538-4616.2012.00521.x>.

³ Jai Kedia, “Following the Taylor Rule: Has the Fed Learned from Its Own ‘Success’?,” *Cato Institute Working Paper* no. 77, June 1, 2023, <https://www.cato.org/working-paper/following-taylor-rule-has-fed-learned-its-own-success>.

economic disruptions is influencing short-term credit markets by targeting a value for the federal funds rate.

For decades, many have argued for various monetary policy rules to help achieve this goal. Some, for instance, have argued that the monetary base should be frozen, with private banks creating currencies to fill the demand for money. Others have called for constant growth of the monetary base at a given percentage each year. Many modern macroeconomists advocate for rules that directly determine the target for the FFR rather than rules that govern the growth of the money supply. These rules generally update the target rate in response to current values of macro indicators such as inflation, unemployment, or output growth.

Many central bankers argue that these kinds of monetary rules are too restrictive, and that they would prevent the Fed from enacting the appropriate monetary policy response to the economic changes they face. Instead, they advocate for maintaining a high level of discretion to implement monetary policy as they see fit because of the enormous complexity of the economy and its ever-changing nature. But the nature of the economy makes the case for rules-based policy. Since no one person (or small group of central bankers) can be expected to understand and react properly or consistently to changing economic conditions, policy rules would reduce uncertainty among citizens and firms by making the Fed more predictable and transparent. Committing to a rule would also prevent the Fed from raising or lowering rates out of undue political pressure and, therefore, better insulate its policy independence.

Debates over which specific rule the Fed should adopt are useful but ultimately should not stand in the way of committing to a rule in the first place. Most monetary policy rules take the form of an interest rate feedback system where the Fed sets the target for the FFR in response to current values of key macroeconomic indicators. Since the economy is interlinked and most macroeconomic indicators mirror each other, the general recommendations the various rules offer should (theoretically) be similar. Indeed, this is borne out by the data.

Figure 2 below compares the actual FFR to its hypothetical counterparts under various monetary policy rules. The rules considered are popular choices from academia or policy analysts and include: the Taylor rule, a difference rule, NGDP targeting, and pure inflation targeting.⁴ As Figure 2 shows, policy recommendations across the various rules closely align. (NGDP targeting is slightly more volatile than the other rules.) The key observation is that any of these policy rules would have helped the Fed avoid its costly post-pandemic mistakes. All rules recommended raising the FFR well before the Fed did so in early 2022. Instead, discretionary monetary policy led the Fed to incorrectly label inflation as “transitory” and its sluggishness in tightening its stance likely allowed inflation to become entrenched. Once it realized its mistake, the Fed had to execute a series of rapid rate hikes and has since kept its rate target higher than

⁴ Federal Open Market Committee, “An Overview of Simple Policy Rules and their Use in Policymaking in Normal Times and Under Current Conditions,” July 18, 2012, <https://www.federalreserve.gov/monetarypolicy/files/FOMC20120718memo02.pdf>

all the rules recommend. Had the Fed followed such a rule, it is likely that Americans may have experienced a stable increase in rates and avoided suffering the highest bout of inflation in at least 40 years.⁵

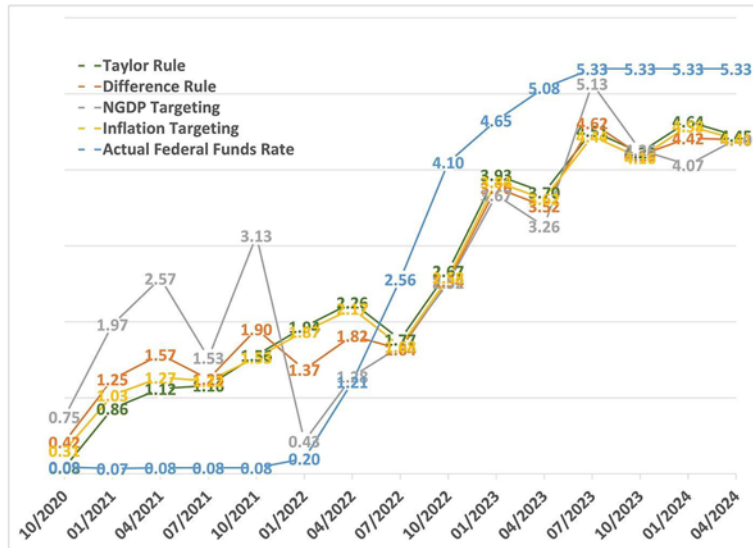


Figure 2: Comparing the Fed Funds Rate Target to Rules-Based Alternatives

Still, we should not expect the Fed to successfully manage the economy by consistently reaching precise macroeconomic goals. A central bank is ill-suited to this sort of management of the economy. Instead, Congress should require the Fed to adopt a rules-based monetary policy to reduce uncertainty by anchoring people's expectations regarding what the Fed will do on an ongoing basis. A template for such policy already exists—the Fed Oversight Reform and Modernization (FORM) Act of 2015. Under legislation such as the FORM Act, the Fed would be required to specify and follow a rule when setting its interest rate target. The choice of which rule is up to the Fed, and the rule is binding only in that once the Fed picks a rule it must follow the rule unless it explains deviations from the rule to Congress.

⁵ Norbert Michel, "Fed's Rate Cut Shows Why Policy Rules Are Needed," Cato at Liberty, September 18, 2024, <https://www.cato.org/blog/feds-rate-cut-shows-why-policy-rules-are-needed>.

The Fed Should Revise its Inflation Target

The Fed measures the success of its price stability mandate against a 2 percent inflation target. Aside from the fact that the Fed has on average, overshot its target throughout the post-World War II period, if the Fed keeps annual inflation at 2 percent or above, US consumers will never realize the benefits of long-term productivity growth. The reasons the Fed has used to justify a constantly positive rate of inflation—it greases the wheels of the economy, it prevents workers from suffering wage declines, it shields the economy from deflation, etc.—are not empirically founded or based in sound economic theory.

As products become more efficient to produce through permanent technology improvements (such as major computer chip improvements or AI automation), goods become cheaper to produce and consequently result in cheaper prices for consumers. As a result, long-term price level changes are inextricably linked to long-term productivity. Along with reviewing its current rule choice, Congress should also require the Fed to review data on productivity trends and adjust its inflation target accordingly. One benefit of a pre-announced inflation target (2 percent or otherwise) is that it helps cement inflation expectations. Consequently, if an adjustment is made to the inflation target, the new choice should be clearly communicated to U.S. firms and consumers to ensure an adequate adjustment to their inflation expectations.

The Fed Should Not Engage in Credit Allocation

In December 2008, the Fed began quantitative easing (QE), large-scale asset purchasing programs whereby the Fed purchased long-term Treasuries and the mortgage-backed securities (MBS) of Fannie Mae and Freddie Mac that were (at that time) held by private financial institutions. By the end of 2014, the Fed had expanded its balance sheet by purchasing approximately \$2 trillion of long-term Treasuries and MBS, respectively. The Fed took its balance sheet from less than \$1 trillion to nearly \$4.5 trillion. The COVID-19 pandemic prompted a fresh round of QE raising the Fed's balance sheet to a current value of \$6.8 trillion – roughly one-third the size of the U.S. commercial banking sector.

These purchases, ostensibly, were designed to inject liquidity into the banking system, thus preventing a collapse in bank lending and a simultaneous collapse in the economy. However, as these purchases created excess reserves in the banking system, the Fed chose to pay above-market interest rates on these excess reserves. As a result, instead of creating new money through additional lending and preventing (or lessening the severity of) a recession, the Fed's QE policies expanded *only* the amount of excess reserves in the banking system. Banks mostly held onto the cash that the Fed gave them when it executed all those securities purchases, so it is rather difficult to argue that these Fed policies did much of anything to expand the economy or prevent a macroeconomic collapse. According to press releases, the

Fed paid interest expenses of \$6.9 billion to banks in 2015, an amount that increased to \$281.1 billion in 2023.⁶ Consequently, the Fed reported operating losses of \$114.3 billion in 2023.

Interest payments to financial institutions aside, the initial QE policies allocated credit to the housing and government sectors through purchases of Treasuries and MBS, respectively. At the very least, the Fed's actions have distorted prices in the housing market as well as the broader financial markets. Because an increase in demand for Treasuries, all else constant, puts upward pressure on their price, it also puts downward pressure on their interest rates. Thus, the Fed's policies, which increased the demand for low-risk financial assets, certainly contributed to the low-interest-rate environment experienced in the aftermath of the financial crisis. Individuals with low-risk asset preferences, therefore, suffered lower returns than normal partly because of the Fed's policies.

This balance sheet expansion by the Fed diverted hundreds of billions of dollars in credit from the private sector to the federal government,⁷ a twofold problem because the private sector allocates credit more efficiently than the government⁸ and because it does so without directly placing taxpayers at risk for financial losses.⁹ Aside from distorting interest rates in credit markets, these policies did not make housing prices more affordable.¹⁰

⁶ Board of Governors of the Federal Reserve System, "Federal Reserve Board announces Reserve Bank income and expense data and transfers to the Treasury for 2015," Press Release, January 11, 2016, <https://www.federalreserve.gov/newsevents/pressreleases/other20160111a.htm>; and, Board of Governors of the Federal Reserve System, "Federal Reserve Board announces preliminary financial information for the Federal Reserve Banks' income and expenses in 2023," Press Release, January 12, 2024, <https://www.federalreserve.gov/newsevents/pressreleases/other20240112a.htm>. Also see "Is the Federal Reserve giving banks a \$12bn subsidy?" *The Economist*, March 18, 2017, <http://www.economist.com/news/finance-and-economics/21718872-or-interest-fed-pays-them-vital-monetary-tool-benefits>.

⁷ Mark Perry, "The Fed's \$3.5T QE Purchases Have Generated Almost Half a Trillion Dollars for the US Treasury Since 2009," American Enterprise Institute, January 12, 2015, <http://www.aei.org/publication/since-2009-feds-qe-purchases-transferred-almost-half-trillion-dollars-treasury-isnt-gigantic-wealth-transfer/>.

⁸ In some cases, during the crisis, the government even forced banks to take money against their objections. See James Gattuso, "Paulson and the Banks: What an Offer You Can't Refuse Looks Like," *The Daily Signal*, May 15, 2009, <http://dailysignal.com/2009/05/15/paulson-and-the-banks-what-an-offer-you-can%E2%80%99t-refuse-looks-like/>; Nina Easton, "How the Bailout Bashed the Banks," *CNN Money*, June 22, 2009, http://money.cnn.com/2009/06/19/news/economy/trouble_with_tarp_bailout.fortune/index.htm?postversion=2009062107; and John A. Allison, *The Financial Crisis and the Free Market Cure: Why Pure Capitalism is the World Economy's Only Hope* (New York: McGraw Hill, 2013), pp. 170 and 171.

⁹ See Norbert Michel and Stephen Moore, "Quantitative Easing, The Fed's Balance Sheet, and Central Bank Insolvency," Heritage Foundation Backgrounder No. 2938, August 14, 2014, <https://www.heritage.org/monetary-policy/report/quantitative-easing-the-feds-balance-sheet-and-central-bank-insolvency>.

¹⁰ Prior to the crash that began in 2006, the government's housing policies (well beyond the Fed's policies) proved to make housing less affordable, and starting in 2011, that trend resumed. See, for example, the ratio of home prices to median income available on "America's Housing Market in Five Interactive Charts," *The Economist*, August 24, 2016, <http://www.economist.com/blogs/graphicdetail/2016/08/daily-chart-20>. Also see Johannes Stroebe and John B. Taylor, "Estimated Impact of the Federal Reserve's Mortgage-Backed Securities Purchase Program," *International Journal of Central Banking*, June 2012, <http://www.ijcb.org/journal/ijcb12q2a1.pdf>.

These policies exemplify why a neutral central bank is desirable. For a central bank to remain neutral, it must keep a minimal footprint in the private sector. A central bank that, for instance, purchases nearly one-third of an asset class, as the Fed did with Treasury securities following the financial crisis, cannot remain neutral. There is a fundamental speculative nature to all financial activity, a fact that further dictates that government agencies, including central banks, should undertake as little market activity as possible to maintain liquidity in the banking system. Although the Fed has episodically adhered to providing only system-wide liquidity, the Fed's lending policies have gone against such a sound prescription for the bulk of its history. In fact, judged against the classic prescription for a lender of last resort (LLR), the Fed's long-term track record is rather poor. Its LLR policies have frequently jeopardized its operational independence and put taxpayers at risk.¹¹

During the 2008 financial crisis the Fed allocated credit directly to a select few firms and officially allocated credit to specific firms through several broader lending programs. The U.S. Government Accountability Office (GAO) estimates that from December 1, 2007, through July 21, 2010, the Federal Reserve lent financial firms more than \$16 trillion through its Broad-Based Emergency Programs.¹² To put this figure in perspective: Annual gross domestic product (GDP) reached \$16.8 trillion in 2013, an all-time high for the U.S. at that time. During the crisis, the Fed created more than a dozen special lending programs by invoking its emergency authority under Section 13(3) of the Federal Reserve Act. Separately, *Bloomberg Markets* magazine estimates that the Fed's total emergency loans from 2007 to 2010 charged \$13 billion below market rates.¹³

Charging below market rates to select firms, on suspect collateral, is the exact opposite of the classic LLR prescription. The goal should be to lend widely, as safely as possible, at high rates so that firms have every incentive to stop relying on the Fed for funds. Instead, the Fed effectively provided financial institutions with a source of subsidized capital for up to several years. These policies encouraged more risky behavior than would have otherwise taken place because the government accepted much of the downside risks for private firms (the well-

¹¹For a look at policies beyond the 2008 crisis, see Norbert J. Michel, "The Fed's Failure as a Lender of Last Resort: What to Do About It," Heritage Foundation *Backgrounder* No. 2943, August 20, 2014, http://www.heritage.org/report/the-feds-failure-lender-last-resort-what-do-about-it#_ftn35.

¹²U.S. Government Accountability Office, "Federal Reserve System: Opportunities Exist to Strengthen Policies and Processes for Managing Emergency Assistance," *Report to Congressional Addressees*, GAO-11-696, July 2011, p. 131, <http://www.gao.gov/new.items/d11696.pdf>. For a complete list of programs, see U.S. Government Accountability Office, "Federal Reserve Bank Governance: Opportunities Exist to Broaden Director Recruitment Efforts and Increase Transparency," *Report to Congressional Addressees*, October 2011, GAO-12-18, p. 76, <http://www.gao.gov/new.items/d1218.pdf>. Also see, Lawrence H. White, testimony before the Subcommittee on Monetary Policy and Trade, Committee on Financial Services, U.S. House of Representatives, March 12, 2014, <http://mercatus.org/publication/ending-federal-reserve-system-s-overreach-credit-allocation>.

¹³Bloomberg derived these estimates based on data received from a Freedom of Information lawsuit. See Bob Ivry, Bradley Keoun, and Phil Kuntz, "Secret Fed Loans Gave Banks \$13 Billion Undisclosed to Congress," *Bloomberg Markets*, November 27, 2011, <http://www.bloomberg.com/news/print/2011-11-28/secret-fed-loans-undisclosed-to-congress-gave-banks-13-billion-in-income.html>.

known moral hazard problem), and they also crowded out private alternatives as the Fed essentially became a lender of *first* resort. Though difficult to quantify, these policies surely detracted from the number of income-producing jobs available in the private sector. Critics argue that the 2008 liquidity crisis was atypical because market participants had difficulty determining the value of various securities, thus justifying such policies, but the Fed has no advantage over anyone else in determining the market value of securities.

In response to the COVID-19 government shutdowns, the Fed again initiated multiple special lending facilities. The peak usage for the emergency lending through these facilities (from 2020 to 2021) was \$222.32 billion.¹⁴ Though many of the Fed's actions—appropriately—provided system wide liquidity, the Fed also established two facilities to support credit to large employers that went further. These facilities were the Primary Market Corporate Credit Facility (PMCCF) for new bond and loan issuances and the Secondary Market Corporate Credit Facility (SMCCF) for outstanding corporate bonds. Of the two, the PMCCF was the most troubling because it allowed the Fed to lend directly to commercial businesses. Ultimately, the Fed did not use this facility, but its establishment was reminiscent of the failed 1930s emergency lending programs established after the 1934 Industrial Advances Act created Section 13(b) in the Federal Reserve Act. By 1939, the district banks had provided nearly \$200 million in working capital loans to nearly 3,000 applicants, and the Fed itself eventually lobbied Congress to remove the 13(b) provision, getting its wish in 1958.¹⁵

The Fed's Failure as a Regulator

The Fed's actions leading up to the 2008 crisis also highlight the central bank's failure as a financial market regulator.¹⁶ The U.S. central bank has been involved in banking regulation since it was founded in 1913, and it became the regulator for all holding companies *owning a member bank* with the Banking Act of 1933. When bank holding companies, as well as their permissible activities, became more clearly defined under the Bank Holding Company Act of 1956, the Fed was named their primary regulator. Under the 1999 Gramm-Leach-Bliley Act (GLBA), the Fed alone approved applications to become a financial holding company—and only after certifying that both the holding company and all its subsidiary depository institutions were

¹⁴ This figure refers only to the Fed's lending facilities, not any other support the Fed provided during the COVID-19 pandemic. Federal Reserve Bank of New York, "Federal Reserve Special Facilities Initiated in Response to COVID-19," September 23, 2021, <https://www.newyorkfed.org/medialibrary/media/markets/13-3-facilities/facility-summary-table-2021>. Also see Eric Milstein and David Wessel, "What Did The Fed Do In Response to The COVID-19 Crisis?" Brookings, January 2, 2024, <https://www.brookings.edu/articles/fed-response-to-covid19/>.

¹⁵ Norbert Michel, "The Federal Reserve Should Not Help Congress Duck Its Responsibilities: Part 2," *Forbes*, April 27, 2020, <https://www.forbes.com/sites/norbertmichel/2020/04/27/the-federal-reserve-should-not-help-congress-duck-its-responsibilities-part-2/>; and, Norbert Michel, "The Federal Reserve Should Not Help Congress Duck Its Responsibilities," *Forbes*, March 23, 2020, <https://www.forbes.com/sites/norbertmichel/2020/03/23/the-federal-reserve-should-not-help-congress-duck-its-responsibilities/>.

¹⁶ For more on the Fed's regulatory failures, see Norbert J. Michel, "A Roadmap to Monetary Policy Reforms," *The Cato Journal*, Vol. 35, No. 2 (Spring/Summer 2015), pp. 315–329, <https://object.cato.org/sites/cato.org/files/serials/files/cato-journal/2015/5/cj-v35n2-9.pdf>.

“well-managed and well capitalized, and . . . in compliance with the Community Reinvestment Act, among other requirements.”¹⁷

Although it would be unjust to place all the blame on the Fed, the fact remains that the United States experienced major bank solvency problems during the Depression era, again in the 1970s and 1980s, and during the late 2000s. At best, the Fed did not predict these crises, even though it was heavily involved (more so in the later crises) in regulating banks’ safety and soundness. In 2008, for example, Fed Chairman Bernanke testified before the Senate that “among the largest banks, the capital ratios remain good and I don’t anticipate any serious problems of that sort among the large, internationally active banks that make up a very substantial part of our banking system.”¹⁸ Simply being mistaken about banks’ capital is one thing, but the Fed played a major role in developing these capital ratios used to measure safety and soundness.

In the 1950s the Fed developed a “risk-bucket” approach to capital requirements,¹⁹ and that method became the foundation for the Basel I capital accords, which the Fed and the Federal Deposit Insurance Corporation (FDIC) adopted for U.S. commercial banks in 1988. Under these capital rules, U.S. commercial banks have been required to maintain several different capital ratios above regulatory minimums in order to be considered “well capitalized.” According to the FDIC, U.S. commercial banks exceeded these requirements by 2 to 3 percentage points, on average, for the six years leading up to the crisis.²⁰ The Basel requirements sanctioned, via low risk weights, investing heavily in MBS that contributed to the 2008 meltdown. Furthermore, the Fed was directly responsible for the recourse rule, a 2001 change to the Basel capital requirements that applied the same low-risk weight for Fannie- and Freddie-issued MBS to highly rated private-label MBS.²¹

In March 2023, Silicon Valley Bank (SVB) and Signature Bank failed, again triggering much anger toward financial institutions and the “big” banks. Setting aside any financial missteps these banking organizations may have made, Congress should not absolve federal regulators, including the Fed, from major regulatory failures. The federal agencies released a flurry of reports on April 28. In fact, the Fed and the Government Accountability Office (GAO) both released reports on these bank failures that reveal serious shortcomings of the U.S.

¹⁷D. Avraham, P. Selvaggi, and J. Vickery, “A Structural View of U.S. Bank Holding Companies,” Federal Reserve Bank of New York *Economic Policy Review*, July 2012, pp. 65–81,

<https://www.newyorkfed.org/medialibrary/media/research/epr/12v18n2/1207avra.pdf>.

¹⁸“Fed Chairman: Some Small US Banks May Go Under,” CNBC, February 28, 2008, <http://www.cnbc.com/id/23390252>.

¹⁹H.D. Crosse, *Management Policies for Commercial Banks* (Englewood Cliffs, NJ: Prentice-Hall, 1962), pp. 169–172.

²⁰J. Jablecki and M. Machaj, “The Regulated Meltdown of 2008,” *Critical Review* 21 (2–3), 2009, pp. 306 and 307.

²¹See J. Friedman, and K. Wladimir, *Engineering the Financial Crisis: Systemic Risk and the Failure of Regulation* (Philadelphia: University of Pennsylvania Press, 2011). Also see Norbert J. Michel and John Ligon, “Basel III Capital Standards Do Not Reduce the Too-Big-to-Fail Problem,” Heritage Foundation *Backgrounders* No. 2905, April 23, 2014, <http://www.heritage.org/markets-and-finance/report/basel-iii-capital-standards-do-not-reduce-the-too-big-fail-problem>.

regulatory framework for banks. To the Fed's credit, its report even acknowledged supervisory mistakes at the Fed leading up to SVB's failure.²²

Though any federal financial regulator could have made the very same mistakes as the Fed, a central bank does not need to be a financial regulator to conduct monetary policy. Allowing the Fed to serve as a financial regulator increases the likelihood that policy decisions will be compromised as the Fed's employees become embedded in the financial firms they are supposed to be overseeing. The fact that Dodd–Frank imposed a nebulous financial stability mandate on the Fed only increases this possibility. Aside from these recent changes, it is completely unnecessary for the U.S. central bank to serve in a regulatory capacity, and removing the Fed from its regulatory role would leave at least five other federal regulators that oversee U.S. financial markets. The Fed is now micro-managing even more firms than it was prior to the 2008 crisis, even though it has repeatedly failed to predict, much less prevent, financial turmoil.

Conclusion

The Federal Reserve has not fulfilled the long-term promise of taming business cycles, and its overall track record on inflation is not much better. These facts alone require Congress to question the Fed's mission and role. Given that the Fed's credit allocation policies, regulatory failures, and monetary policy mistakes—after 100 years to gain experience—worsened the most recent bout of inflation, Congress would be derelict in its duty to the American public if it allowed the Federal Reserve to continue operating under its existing ill-defined statutory mandate. It is difficult to argue that the Fed's recent policy actions accomplished anything other than saving a favored group of creditors at the expense of all others. Providing liquidity broadly and refraining from sterilizing its operations—the opposite of what the Fed has done in its recent past—surely would have done more to benefit Main Street Americans.

Rather than hold the Federal Reserve accountable for these mistakes, policymakers appear to have put even more faith in the Fed's ability to influence interest rates and inflation, to tame unemployment, and to ensure the safety and soundness of financial markets. Monetary policy under the current framework is clearly not working—if it were, people would have more confidence in the economy and expect lower inflation.²³ To reform the nation's monetary policy, Congress should, at the very least, take the following steps.

1. Require the Federal Reserve to normalize its operations by shrinking its balance sheet, ending the payment of interest on reserves, and closing its overnight reverse repurchase facility.

²² Norbert Michel, "SVB Reports From the Fed and GAO Reveal Regulators Long Knew of Problems," *Cato at Liberty*, May 3, 2023, <https://www.cato.org/blog/svb-reports-fed-gao-reveal-regulators-long-knew-problems>.

²³ Bryan Mena, "Consumer Confidence Registers Biggest Monthly Decline Since August 2021 As Inflation Fears Take Hold," *CNN*, February 25, 2025, <https://www.cnn.com/2025/02/25/economy/us-consumer-confidence-february/index.html>.

2. Require the Fed to implement a simple rule for its interest rate target that Congress can easily monitor and use to hold the Fed accountable. The Fed can choose its preferred rule. However, it is imperative that once Fed officials decide on a rule, they are required to either follow it or publicly explain any deviations from it.
3. Require the Fed to evaluate and update its inflation target at regular intervals to account for long-term changes to productivity and technology improvements.
4. Ensure that all federal policies, including those of the Federal Reserve, remain neutral with respect to whichever mediums of exchange people decide to use.
5. Reduce both explicit and implicit guarantees by ending the Fed's emergency lending authority and ending the Fed's role as a financial regulator.

Thank you for the opportunity to provide this information, and I welcome any questions that you may have.

Chairman LUCAS. Thank you, Doctor.

Mr. Konczal, you are now recognized for 5 minutes for your oral remarks.

**STATEMENT OF MICHAEL KONCZAL, SENIOR DIRECTOR OF
POLICY AND RESEARCH, ECONOMIC SECURITY PROJECT**

Mr. KONCZAL. Thank you.

Chairman Lucas, Ranking Member Vargas, and distinguished members of the task force, thank you for inviting me to testify. My name is Mike Konczal, and I am the Senior Director of Policy and Research at the Economic Security Project, where we advocate for ideas that build economic power for all Americans.

Previously, I was a special assistant to the President and chief economist at the National Economic Council under President Biden, where I specialized in macroeconomic issues.

I applaud this task force for investigating central bank independence and the dual mandate. Despite the challenges after COVID, the U.S. economy performed better than many peers, and by late last year, we were on a solid footing. The balance between full employment and price stability, free from short-term political pressures, has worked well for us.

I want to make three key points here today. First, the Federal Reserve helped the United States avoid a recession after the inflationary shocks caused by COVID and the war in Ukraine, achieving a rare soft landing. Second, this achievement is now at risk due to current administration policies. Third, the key macroeconomic decision this year will revolve about whether or not Congress worsens the debt and deficit, which will put pressure on the Federal Reserve, interest rates, and everyday families.

First, there is a growing consensus that the global wave of inflation following the reopening was driven by rapid shifts in the composition of demand and shocks to supply chains and key inputs, like semiconductors, made far worse when global commodity markets went into chaos following Russia's unprovoked invasion of Ukraine. As Ben Bernanke, the former Federal Reserve Chair and Chairman of President George W. Bush's Council of Economic Advisors recently said, quote, I think that the inflation was caused pretty much by the supply side and that the demand factors were not strong enough, end quote.

Professional forecasters and financial markets did not predict this inflation, which was, in fact, global. Other countries saw inflation in the same range as the United States, even countries like Canada and Australia that had less direct exposure to Russian energy, though all of their growth lacked their own.

Many thought that this inflation was driven by excess demand and spending and, thus, we need a recession, higher unemployment and slower demand growth for inflation's decline. Inflation fell 6 percentage points as growth took off at an annualized 2.9 percent over the past 2 years, well above the average of the 21st century.

Now, for people, for the Federal Reserve and others, this strong economy now faces three immediate macroeconomic risks from the, frankly, irresponsible policies of this current administration: unexpected tariffs, weakened State capacity, and pressures on Federal Reserve independence.

Publicly announcing high tariffs outside formal processes and in an inconsistent and confusing manner not only weakens an investment but risks inflation expectations. Normally, tariffs are small, strategic, and have little effect on aggregate prices. However, the tariffs currently under discussion are significantly higher and broader than anything in recent history. Already, the University of Michigan survey found inflation expectations peaking in February to levels not seen since 1995, and certainly was not hit, as inflation expectations were managed under the Biden Administration.

This is exacerbated by attacks on State capacity. Cutting government waste and fraud is important, and Congress' own research services have found many ways in which that can be done. This is not what is happening right now. This will raise prices and costs for everyday families, whether that is weakening consumer financial protections, poor Social Security services, or the inability to contain bird flu.

We also dealt with avian flu outbreaks in the Biden Administration, but we were able to work with government agencies, such as the U.S. Department of Agriculture (USDA), to contain it. Instead, communications are altered for ideological reasons, and severe cuts at (USDA) include those tasked managing bird flu. Egg prices now exceed the peak seen during the commodity market turmoil and the avian flu outbreaks under the Biden Administration.

The most important and I think the task force's most—it is most important you engage with is the removal of central bank independence. Though the executive order removing independence currently says that Federal Reserve monetary policy is exempted, I believe that is an unstable arrangement, as the politicization of other Federal Reserve functions and personnel will seep into monetary policy and central bank policy. Nothing could destabilize an economy faster.

The President sought to influence central bank actions during his first term. The threat of him doing so again would risk the overall economy and the stability premium that we have as a Nation. Nothing this task force will discuss will matter for the long-term stability of macroeconomic conditions as much as stopping this effort.

Third and last and most important, immediate determinant for macroeconomics this year will come from fiscal policy, in particular, how Congress handles the expiration of the Tax Cut and Jobs Act (TCJA). Right now, we are seeing that nonpartisan estimates have the current bill under discussion increasing that primary deficit to—or the deficit to 6.8 percent, a rate far higher given the near full employment we currently have. Worse, this exploding deficit will be used as justification for painful cuts to healthcare and social insurances and weakening some of the few countercyclical programs we have if a recession happens.

The overall plan of tariffs and spending cuts creates a potential cruel double whammy where the proposed tariff packages could skyrocket the cost for everyday goods, coupled with cuts for critical services. Meanwhile, corporations getting these tax breaks can simply pass their costs on to consumers. The Federal Reserve is left with a very difficult decision about how it manages the subsequent price hikes.

I look forward to taking your questions.

[The prepared statement of Mr. Michael Konczal follows:]



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Mike Konczal

Senior Director of Policy and Research, Economic Security Project

Testimony before the House Financial Services Committee

Task Force on Monetary Policy, Treasury Market Resilience, and Economic Prosperity

"Examining Monetary Policy and Economic Opportunity"

March 4, 2025

Chairman Lucas, Ranking Member Vargas, and distinguished Members of the Task Force:

Thank you for inviting me to testify. My name is Mike Konczal, and I'm the Senior Director of Policy and Research at the Economic Security Project, where we advocate for ideas that build economic power for all Americans. Previously, I was a Special Assistant to the President and Chief Economist for the National Economic Council under President Biden, where I specialized in macroeconomic issues.

I applaud this Task Force investigating the importance of central bank independence and the dual mandate. Though the period following COVID was difficult, the United States had outcomes that far surpassed peer countries, and, as of late last year, the country was on a solid macroeconomic footing. There is always more to investigate and refine, but the core tools of balancing full employment and price stability outside short-term political pressures have served the country well.

I want to make three points today. First, the Federal Reserve was able to achieve the rare 'soft landing' of significantly bringing down the inflation that was driven by the global shocks of reopening with no cost to growth. Second, this achievement is now at risk due to the dangerous and irresponsible policy of the current administration, which will make high prices even more of a problem for everyday families. Finally, one of the most important macroeconomic decisions this year will be whether Congress increases the debt and deficit, putting pressure on the Fed and interest rates while raising the cost of mortgages and credit cards for families.

Soft Landing

First, there is a growing consensus that the global wave of inflation following the reopening was driven by multiple shocks.

Consumers radically shifted their spending from services to goods. Though overall real spending was on trend, this acted as a kind of cost-push shock, as the price of goods skyrocketed as people bought more, but the price of services did not fall. The shock to supply chains and commodities caused overall prices to rise, as businesses ran out of key inputs like semiconductors. This was made far worse when global commodity markets went into chaos following Russia's unprovoked invasion of Ukraine, especially for food and energy markets. Inflation peaked following that invasion, up to between 6 and 9 percent in the summer of 2022.

Professional forecasters and financial markets did not predict this inflation. The highest 10 forecasts for inflation compiled by Blue Chip in April 2021 averaged 2.7% for the following year, with the highest at 3.2%. The actual value was 8%.¹ This inflation was also global. Other countries saw inflation in the same range as the United States, even countries like Canada and Australia that had less direct exposure to Russian energy.

Many thought this inflation was driven by excessive demand and spending, requiring slower growth and higher unemployment for inflation to decline. Some believed unemployment would have to go to 10 percent; Bloomberg forecasted 100% chance of a recession in 2023.² But just as forecasters and markets missed inflation on the way up, they also missed it on the way down. Inflation fell between 3 and 6 percent, depending on the measurements, from its peak in early 2022 to the end of 2024.³

Meanwhile, we not only didn't have a recession, growth took off as inflation fell, pointing to the supply-side of the economy. Using contemporary macroeconomic tools, the 'sacrifice ratio,' or the amount GDP needs to fall to bring down inflation 1 point, for this disinflation was essentially 0, rather than the historically expected value well above 2. Over the last two years of the Biden administration, unemployment averaged below 4 percent and GDP growth was an annualized 2.9%, the former among the lowest values in 50 years and the latter well above the average of the 21st century.

As Ben Bernanke, the former Federal Reserve Chair and chairman of President George W. Bush's Council of Economic Advisers, recently said:

"I think that the inflation was caused pretty much by the supply side [...] that it was most a supply shock. [...] This was primarily a supply shock inflation. The quantitative analysis suggests that the demand side factors were not strong enough [...] those of us who

¹ The Blue Chip Economic Indicators for April, 2021, full year over prior year, had CPI inflation at 2.2, 2.7, and 3.2 percent for average, top 10, and highest respectively in 2022. The actual value was 8 percent. The equivalent for PCE inflation was 2, 2.5, 2.8, and 6.6. For the 3-month treasury rate, it was 0.2, 0.3, 0.8, and 3 percent.

² Wingrove, J. (2022, October 17). *Forecast for US recession within year hits 100% in blow to Biden*. Bloomberg.

³ Headline CPI, the prices consumers face, peaked at 8.6% year-over-year in the second quarter of 2022, and has since fallen 5.9% by the fourth quarter of 2024. Core PCE fell 2.8% from 5.6% in the first quarter of 2022 to 2.8%.

thought this was a supply side shock said, no, it'll be a pretty benign disinflation as the supply shocks unwind."⁴

The shock of the reopening and the subsequent price increases were difficult for working families. Real wages fell in 2021-2022 during the worst of the shocks, but began increasing again in 2023 and 2024. But, as the Economist magazine declared in late 2024, the US economy was "the envy of the world." Contrast with today, where reports describe a world of profound government policy uncertainty and CEOs worried about investing given their confusion as to what the basic rules of the road are going to be.⁵

Policy Uncertainty

Tariffs

That points us to the most immediate economic risk to inflation, the irresponsible policies of this current administration. I want to focus on three in particular: tariffs, weakened state capacity, and Federal Reserve independence.

Publicly announcing high tariffs outside formal process and in an inconsistent and confusing manner - where businesses go into a weekend uncertain what the actual North American trade law will be when they reopen on Monday - weakens growth and investment and makes consumers face higher prices. We are already seeing headlines about concerned CEOs and a striking decline in consumer sentiment, unanimous across age, income, and wealth groups.⁶

Normally, tariffs are small, strategic, and have little effect on aggregate prices. However, the tariffs currently under discussion are significantly higher and broader than past tariffs. One estimate from the Yale Budget Lab for the reciprocal tariffs being studied by the Commerce Department had prices rising "by 1.7-2.1%, the equivalent of an average per household consumer loss of \$2,700 - 3,400" in a particularly regressive manner.⁷

The aggressive nature of this puts pressure on inflation expectations, as people and businesses start changing their behavior assuming higher prices are coming. The long-running University of Michigan survey found that "Inflation expectations over the next 5-10 years just rose to 3.5%, above expectations and the highest reading since April 1995" with consumers "fears that tariff-induced price increases are imminent."⁸ Longer-term inflation expectations never slipped during

⁴ American Economic Association. (2025, January 4). Inflation and the macroeconomy panel session. Panel video available here: <https://www.aeaweb.org/webcasts/2025/inflation-macroeconomy>

⁵ The Economist. (2024, October 19). The American economy: The envy of the world. Special reports. Also, Hoffman, L., & Goswami, R. (2025, February 27). American business leaders are turning on Trump — fast. Semafor.

⁶ University of Michigan. (2025, February 21). Consumer sentiment drops as inflation worries escalate.

⁷ Yale Budget Lab. (2025, February 18). The fiscal, economic, and distributional effects of illustrative "reciprocal" US tariffs. Updated February 19, 2025.

⁸ University of Michigan. (2025, February 21). Consumer sentiment drops as inflation worries escalate.

the reopening inflation as both the Biden administration and the Federal Reserve were committed to stopping price increases - the opposite of what we have here.

State Capacity

This is exacerbated by the attack on state capacity taking place during this administration, for example the government services being shut down and our private data being harvested by the DOGE committee. Cutting government waste and fraud is important, and Congress's own research services have found many ways in which that can be done. But this is not what is happening here.

This has two important macroeconomic impacts. In the long run it will weaken growth, as investments in research are randomly and haphazardly cut, and we lose our competitive edge in higher education and research.

But in the short run it will raise prices and reduce incomes for everyday people. Weakening consumer protection, allowing firms to rip off consumers with junk fees, raises prices. Forcing people to wait longer to address issues with Social Security payments because of disorderly layoffs is a de facto cut to Social Security. Reducing IRS capacity is a giant tax cut to billionaires who don't have to worry about playing by the rules.

Yet the state capacity issue is more subtle. We also dealt with avian flu outbreaks in the Biden administration, but we were able to work with government agencies such as the United States Department of Agriculture (USDA) to make sure information was being communicated clearly with the public, private markets, and food producers. Instead, now we see those agencies being dismantled and having their communications altered for ideological reasons, with severe cuts at USDA including those involved in managing bird flu.⁹ According to government data, the retail price of a dozen eggs in January was \$4.95, the highest on record and exceeding the peaks seen during commodity market turmoil or avian flu outbreaks under the Biden administration.¹⁰

Central Bank Independence

But the most dangerous item for macroeconomic policy is the removal of the independence of regulatory agencies through executive orders, threatening the independence of the central bank and of monetary policy.¹¹ Though the executive orders currently say that Federal Reserve monetary policy is exempted, that is an unstable arrangement, as politicization of other Federal Reserve functions and personnel will seep into monetary policy and central bank policy. Nothing

⁹ Smith, A., Zanona, M., & Strickler, L. (2025, February 18). USDA says it accidentally fired officials working on bird flu and is now trying to rehire them. NBC News.

¹⁰ Federal Reserve Bank of St. Louis. (FRED). Average Price: Eggs, Grade A, Large (Cost per Dozen) in U.S. City Average. <https://fred.stlouisfed.org/series/APU0000708111>

¹¹ The White House. (2025, February 18). Ensuring accountability for all agencies: Executive order.

could destabilize an economy faster. The President sought to influence central bank actions during his first term; the threat of him doing so again would risk the overall economy.

Debt and Deficits

But ultimately the most important determinant for macroeconomics and the prices faced by people will be fiscal policy this year. And when it comes to that, the most important thing Congress will do is in handling the expiration of the Tax Cuts and Jobs Act (TCJA). And here, I also fear Congress will force everyday people to eat the costs of tax cuts for billionaires not just through massive cuts to health care and social insurance, but also through higher interest rates.

The TCJA could be extended only for everyday families to keep taxes low for them. However the extension of the tax cuts for those with high incomes and any additional tax cuts for the top on top of that will put pressure on spending at a time when the economy is near full employment. Previous unpaid Republican tax cuts were at times when there was more economic slack in the economy; now the end result will likely be higher interest rates for mortgages, credit cards, and loans with that extra level of spending.¹² Deficits under the House budget would average 6.8 percent of GDP per year over the next decade, a very high level given the low rates of unemployment.¹³

Worse, the exploding deficit caused by tax cuts will be used as a justification for painful cuts to health care and social insurance. Some estimates suggest that 36 million people are at risk of losing Medicaid due to likely Republican proposals aimed at covering the cost of tax cuts for billionaires.¹⁴ Who is covered by Medicaid? That's 2 out of every 5 births and coverage for 2 out of every 5 children. That's the largest payer for mental health and long-term care services, with 3 out of 5 nursing facility residents.¹⁵ And it is broader, as these cuts will put pressure on many rural hospitals that rely on Medicaid funding to stay open. Furthermore, in the event of a downturn, Medicaid and SNAP remain two of the few countercyclical programs available.

The overall plan of tariffs and spending cuts creates a potential for a cruel double whammy for working families: the proposed tariff package could skyrocket the cost of everyday goods, coupled with cuts to critical services as corporate tax breaks drain funding for public resources. Meanwhile, giant corporations getting these tax breaks can simply pass their costs on to consumers – protecting their profits while families struggle.

I look forward to taking your questions.

¹² Bivens, J. (2025, February 13). There will be pain: Continuing low tax rates for the rich and corporations will hurt working families. Economic Policy Institute.

¹³ Committee for a Responsible Federal Budget. (2025, February 21). House budget allows at least \$2.8 trillion of deficit increases.

¹⁴ Lukens, G., & Zhang, E. (2025, February 5). Medicaid work requirements could put 36 million people at risk of losing health coverage. Center on Budget and Policy Priorities.

¹⁵ Orris, A., & Lukens, G. (2024, December 13). Medicaid threats in the upcoming Congress. Center on Budget and Policy Priorities.

Chairman LUCAS. The gentleman yields back.

The chair now recognizes the gentlewoman from California, the ranking member of the full committee, Ms. Waters, for 1 minute.

STATEMENT OF HON. MAXINE WATERS, RANKING MEMBER OF THE COMMITTEE ON FINANCIAL SERVICES, A U.S. REPRESENTATIVE FROM CALIFORNIA

Ms. WATERS. Thank you very much, Mr. Chairman.

I thought we were going to talk about capital formation today rather than monetary policy.

If we really want to discuss the cost of living; we should discuss President Trump's policies that have left working-class families bracing for disaster.

Just yesterday, Trump announced massive new import taxes on Americans and American businesses buying things from Canada and Mexico. Last week, Republicans voted to advance Trump's budget and cut up to \$880 billion in Medicaid funding, which could eliminate coverage for nearly 16 million people.

Experts have said that Chairman Hill's district alone would lose \$2.3 billion in funding for more than 180,000 of his constituents covered by Medicaid and other programs.

We should reject these misguided policies that are raising the cost of living for most families while Elon Musk and billionaire class are pushing for their taxes to be cut.

Thank you, and I yield back the balance of my time.

Chairman LUCAS. The gentlelady yields back.

We will now turn to member questions.

The chair now recognizes himself for 5 minutes for questions.

Dr. Kohn, you spoke in your testimony about Fed independence. We know an independent central bank is important in making sure that monetary policy is not subject to the whims of partisan politics. That does not mean that the Fed cannot or should not be held accountable to Congress and the public.

Can you talk more about the limitations of Fed independence, where it is important for Congress to exercise its constitutional authority to conduct oversight?

Dr. KOHN. Absolutely, Mr. Chairman. I agree with what you said. I think the Fed has an arm's length relationship with the political system. It makes the decisions on the setting of its policies in order to achieve the goals that you gave it. It is—it should be account—it is accountable to the public and to you. You need to press it: Why did you make that decision? Why was it this way? How is that going to further your goals?

I think the Federal Reserve benefits from good, focused questioning from the Congress.

Chairman LUCAS. Switching subjects, Dr. Kohn. In the past two decades, the Fed has moved to the ample reserve regime and, since then, we have seen a dramatic increase in the size of the Fed's balance sheet stressing dramatically. In 2022, the Fed began quantitative tightening and has decreased the size of its balance sheet. Chair Powell has said that the Fed will stop quantitative tightening (QT) when reserve balances are somewhat above the level judged to be consistent with ample reserves.

Where should the Fed look to target its balance sheet size? Is there an ideal level of reserves they should aim for?

Dr. KOHN. I think what they are aiming for, as Chair Powell said, is to reduce its balance sheet until reserves are just large enough to stabilize market interest rates. It is looking very carefully at those market interest rates to see whether it has gone down that far or not, and so far, the market rates have been stable. There is no sense of instability. It is continuing to reduce its balance sheet.

I think that is fine. I do not think—I do not see it as a big deal as to whether reserves are \$2 trillion or \$1 trillion. I mean, the Fed has government securities on one side of its balance sheet, it issues reserves to the banks on the other side of the balance sheet. I think the ample reserves regime should work just fine to control interest rates, and that is what you need it to do.

Chairman LUCAS. Mr. Wang, you include in your written testimony a discussion of the supplemental leverage ratio (SLR) and the Fed's regulatory relief during the pandemic. You write that the Fed's current regulations on the SLR disincentivize low risk activities like holding Treasuries.

Given the stress we have seen in the Treasury market, do you think the Fed should reevaluate the SLR?

Mr. WANG. Thank you for your question, Chairman Lucas.

I absolutely agree. The SLR is basically a regulation that makes banks hold capital based on the size of the balance sheet without regard to the riskiness of their assets.

Now, when you are looking at assets, for example, like reserves, which are very liquid, have zero credit risk, or Treasury securities that have no credit risk and are very liquid, it does not make sense to have to hold capital against those.

Looking across the world, there are also other countries who have regulations that do not require reserves in the SLR.

I think some adjustment there would significantly increase the capacity of the banking system and improve the functioning of the Treasury market.

Chairman LUCAS. Dr. Kohn, back to you for just a moment in the time I have remaining. There have been many significant developments in our economy, the market conditions, and the Fed's implementation of monetary policy these last 5 years.

Are the issues you think the Fed—what are the issues you think the Fed should pay attention to during this framework review? Dr. Kohn.

Dr. KOHN. I think it should pay attention—it said it is going to look at the strategy. I think it should look at what it did in 2020, assess whether that contributed to a delay in responding to inflation, and then change. I think it needs—the 2020 framework review stressed the strategy was what do I do to counter the low interest rate, low inflation environment that 2010 to 2019 put in. Remember, interest rates were at zero for a lot of this. It did not think about a high inflation environment.

They need to have a strategy that is robust to all kinds of different outcomes. The minutes of their last meeting suggest that it is what they are trying to do. They are trying to modify that framework.

Chairman LUCAS. Thank you. My time has expired.

The chair now recognizes the Ranking Member of the Task Force, Mr. Vargas, for 5 minutes of questions.

Mr. VARGAS. Thank you very much, Mr. Chairman.

Again, I want to thank all the witnesses here today. I appreciate it.

It is interesting that we seem to have an uneasy agreement with the independence of the Fed. I was curious to see that the first question that the chairman asked was the limitations that the Fed has in their independence.

Dr. Kohn, the question was directed to you, and you gave a very interesting answer.

I would ask Mr. Konczal. It is interesting that we seem to agree on the independence of the Fed and then very quickly we go to limitations of the Fed. Could you speak a little bit more—because you said that this is probably the most important issue we will talk about on this task force. Go a little more into depth about that. Because I think that, again, with the dual mandate and the independence, those are the two most important things that we should focus on in this task force.

Go ahead, sir.

Mr. KONCZAL. Yes, absolutely. Accountability is quite important, and Congress, obviously, sets the goals for the central bank. As you know, legislative bodies across the world set the goals for their central banks. Then there is reporting back.

Obviously, Chair Powell and other Federal Reserve Chairs have come and talked to Congress twice a year. There is a lot of transparency in the way that they are talking about their actions, how they are carrying them out. I just feel that there is a lot of public accountabilities with media and so forth on their actions as well.

What I would worry about is executive control of their day-to-day functions, excessive control about the way in which they are conducting—in the way that they are prioritizing and balancing their different priorities in the ways that reflect short-term political gains but may have long-term economic cost.

Dr. KOHN. Can I pick up on that a little bit?

Mr. VARGAS. Yes, sure.

Dr. KOHN. I think the main limitation on independence is you guys set the goals. They do not have independence with respect to their objectives. That is set by the people's representatives. That is just independence about how they get to those.

Mr. VARGAS. I think this is where the rubber hits the road because, obviously, we have political pressures that the Fed should not have. For example, the last time President Trump was President Trump, he clearly wanted to influence the Fed. I think we could all agree on that. He certainly said that about Mr. Powell, that is where I get concerned. Some of these executive orders get very close to that.

Mr. Konczal, is not that correct?

Mr. KONCZAL. Yes, absolutely. The executive orders, as currently stated—and, obviously, everyone is trying to figure out what is going to actually happen, to the extent they can politicize the Federal Reserve functions of financial regulatory policy, and many

other things. I find that there is no way to have a strict wall and separation between the monetary policy and the regulatory policy.

I do not think that works in practice. When I talk to people who have worked at the Federal Reserve, they agree that it is not a clear, separate room you can just put someone in. The supervisory functions seep into the monetary and open market policy discussions in a way that I think really risks the stability of our macroeconomy in a way that I—we are going to talk about a lot of different things here, but I really want to emphasize.

Mr. VARGAS. I do want to now move to the dual mandate. Now, one of the things that I heard today in testimony, and I think it is true, that most of the assets of the United States are held by very few people. Most people, most families, really deal with the economy with their job, their employment.

I think that is why it is so important to have the dual mandate. Because, again, this should not be—the Fed should not be for the very wealthy that control most of the assets. It should be for the economy of all the people. Most of the people, the way they interact with the economy is their job, employment.

Could you comment a little bit about that?

Mr. KONCZAL. Yes. What I would emphasize—and, obviously, we are going to talk about the 5-year review—there are many different central banks among pure and developed countries that have many different ways of trying to implement their policies. All of them saw the same inflation we saw.

The European Central Bank (ECB) is a very austere central bank. It has just a price stability mandate. Their inflation peaked at 10 percent, and it was rising even before Russia's invasion of Ukraine.

You can go to New Zealand, which was one of the first inflation targeting banks. It has the reputation of being a particularly effective central bank. They use a range from 1 to 3 percent, which I think might be a very effective thing for us as well. Their inflation also peaked at 8 percent.

The dual mandate did not cause our inflation. What probably played an important role was the huge labor market recovery we saw both in 2019, before COVID, and over 2023 and 2024, where we have record high levels of labor force participation for women, for minorities, for people with disabilities.

Mr. VARGAS. This is where I reclaim my time. I think one of the things used to drive me crazy about Janet Yellen when she was—I think she is one of the smartest people that was here—every time she was asked about inflation, she never put it in the wider context of the world. Instead, of course, my good colleagues on the other side would beat us up, and rightfully so, about inflation because it was hurting our people.

She never put it in the context of the whole world. The European Union (EU) was running much harder than we were, and she never mentioned it once. Even though I have great respect for her, she sure blew it on that one.

With that, I yield back.

Chairman LUCAS. The gentleman yields back.

The gentleman from Arkansas, Mr. Hill, the full chairman of the committee is recognized for 5 minutes.

Chairman HILL. Thanks, Chairman. I appreciate it.

I appreciate the panel. Great testimony. We are grateful for that.

Dr. Michel, you said that you think the Fed is trying to do too many things. I heard that. Mr. Wang talked about that as well.

Dr. Kohn, in your testimony, you say maximum employment is given by influences outside the control of the Fed, particularly the structure of the labor market. Then you say inflation is also subject to outside influences, but over time, the Fed can control inflation.

Would you say that of the so-called dual mandate, that price stability is certainly something the Fed has more direct influence over rather than, quote/unquote, full employment, which is severely impacted by regulatory policy, tax policy, spending policy, budget deficits? Is that true?

Dr. KOHN. Yes. I think economists would agree that over time inflation is, as Milton Friedman put it, everywhere and anywhere, a monetary phenomenon. That does not mean that the money supply directly feeds inflation. The Federal Reserve can control inflation over longer periods of time.

In terms of full maximum employment, basically, the level of maximum employment, the lowest possible unemployment rate is inferred from the behavior of other variables around it. If you push the unemployment rate—

Chairman HILL. You are not arguing that you are a Phillips curve guy, are you, Dr. Kohn?

Dr. KOHN. Yes, I am a Phillips curve guy.

Chairman HILL. Okay. All right. We will have another visit about that, because I think the last 50 years discredited that economic thought.

You have been such an important voice in the Fed. We are glad to have you back before the committee.

I heard you answer the question about the Fed's framework issue. What do you think would be the single most important thing that would go into that assessment about whether they missed it this time?

I would argue I do not support setting 2 percent either under former Chair Yellen. Because that means in 25 years, we are happy that we have lost 50 percent of our purchasing power. How can you argue for that as a public official?

What do you think, when you are—if you were sitting back in that meeting, what would be the most important point you would make about having missed it in 2021?

Dr. KOHN. I think a lot of what happened in 2021 was a bad forecast, and the Fed was not the only person making a forecast that inflation was going to come down over 2022 as these supply constraints, the supply chain stuff—remember the ships off of Long Beach and the chips and all that thing came off. People returned to work—then prices would come back down again and that took much longer. In addition, there was way too much pressure in the labor market. It was not only supply constraints. There were demand constraints, but I think the bad forecast was a major reason why the Fed took so long.

I think another reason was the forward guidance they gave on interest rates. Married with that forecast, they said: We are going

to keep them at zero until we are back at full employment. I think it all delayed it.

Now, if the Fed had gone a few months earlier, would that have made a big difference? No, but it might have made a little difference.

Chairman HILL. Yes, I think—certainly, if you listen to Dr. Summers and other very prominent former officials in the Obama Administration, for example, going in Q4 of 2020 and starting, the shrinking of the balance sheet and slightly raising rates would have been potentially better.

I think there you have bad monetary policy decisions, which we have talked about, but equally bad fiscal policy decisions by the incoming administration at the time of the Biden Administration.

Dr. KOHN. I do think the Fed needs to be——

Chairman HILL. Let me reclaim my time. I want to switch subjects. Thank you for that. Please respond in writing if you want to talk some more about that.

Let me talk about the Fed balance sheet. Dr. Michel, you were talking about the Fed allocating credit as one of those things that you thought was beyond strictly scope on price stability. Do you think that is the case in buying mortgage-backed securities?

Dr. MICHEL. Oh, yes, no doubt. Your——

Chairman HILL. Should Treasurys be the only open market asset for the Fed for the Open Market Committee?

Dr. MICHEL. That would be my preference, yes, Short-term Treasurys only.

Chairman HILL. What do you think, have you looked at the pernicious impact of—as was said in your testimony—too much gas on the fire for housing right at the time when the housing market was rebounding?

Dr. MICHEL. Yes. No, that never made any sense at all.

Chairman HILL. Would you give us some more background of that in writing, please?

With that, I yield back, Mr. Chairman.

Chairman LUCAS. The gentleman yields back.

The gentleman from California, Mr. Sherman, who is also the Ranking Member of the Subcommittee on Capital Markets, is now recognized for 5 minutes.

Mr. SHERMAN. Thank you.

Mr. Wang, and I believe Dr. Michel, you may be right that the Fed should only buy U.S. Government paper rather than picking winners and losers in the economy, but I would argue that it should not just be short-term paper. There are times when we have to drive down long-term interest rates, which I think are more significant for those making investments in housing and in factories, especially factories.

Dr. Michel, I have to strongly disagree with you on deflation, even gentle deflation being a good thing. If we are going to design things so that we may have gentle deflation, then we would have to realize that sometimes we would have ungentle inflation. You do not always get it right.

Want to bring to the attention of this task force that, a few hours ago, the Securities Exchange Commission (SEC) sent an email to its staff offering \$50,000 to every staff member who will resign.

Those resignations are required by March 21. They are available to the top 60 percent.

This is no way to run an agency. It means you lose the best people, the ones who can, between now and March 21, line up a job on the outside. It means you have no control over which parts of your agency get smaller and which stay the same size. Your support personnel to blind personnel gets radically changed because none of these buyouts were available to the bottom 40 percent.

Most importantly, I oppose defunding the police, whether it is crime in the streets or crime in the suites. When we offer \$50,000 to every cop to quit, we get more crime in the streets.

I will point out this is all courtesy of Elon Musk, a man who has been investigated time and again for violating our securities laws, seems to have violated them even more on the issue of Department of Government Efficiency (DOGE) coin. Letting Al Capone set the size of the Chicago Police Department strikes me as a very bad idea.

Let us talk about independence, Mr. Konczal. We have an independent Fed. Some countries do not. Turkiye comes to mind a place where there is intense pressure.

Has that worked out well for other countries to let politicians or even dictators tell their central bank what to do?

Mr. KONCZAL. I would say no.

Mr. SHERMAN. Could not agree with you more.

Project 2025 has some ideas that are interesting, such as, as I said, limiting which kinds of bonds the Fed would buy and limiting the lender of last resort function. When we were crafting Dodd-Frank, I was a strong voice for trying to hem in the right of the Fed to bail out private entities.

The key thing that is being talked about is the dual mandate. Mr. Konczal, if we just had—if we did not have a dual mandate, so we told the Fed, do not care about unemployment, would we get more unemployment?

Mr. KONCZAL. I believe so. I believe we probably would have caused an unnecessary recession to bring down the inflation that came down anyway. I think a lot of people at the margins of our labor force would be left behind under that kind of regime.

Mr. SHERMAN. I would like to focus on tariffs but particularly their effect on housing. We need millions of new housing units built in this country. We now need to replace all the housing units in the Palisades and most of them in Altadena.

The John Burns Research and Consulting folks say that the proposed White House tariffs will raise the cost of building structures in this country by 5 percent. Is that good for people who are looking to own a home?

Mr. KONCZAL. No. I believe the cost of housing is already too high because of many things, including regulations. I think the tariff regulation will be quite bad for housing.

Mr. SHERMAN. Another thing, a little off to the side of the Fed but part of 2025, is to, quote, privatize Fannie and Freddie. We had them privatized once where the taxpayers took all the risk and the private shareholders were supposed to make the profit.

Should we go back to that, Mr. Konczal?

Mr. KONCZAL. No. I think the old system is quite broken, and any system of conservatorship would have to be done carefully and accountable——

Mr. SHERMAN. If we just did not have Fannie and Freddie, could we give 30-year mortgages with 10 percent or 5 percent down payments to ordinary Americans?

Mr. KONCZAL. No. I believe our mortgage rates would be quite higher, even higher than they already are under Trump.

Mr. SHERMAN. I yield back.

Chairman LUCAS. The gentleman yields back.

The gentleman from Michigan, Mr. Huizenga, who also is vice chairman of the full committee, is now recognized for 5 minutes.

Mr. HUIZENGA. Thank you, Mr. Chairman.

Dr. Kohn, good seeing you again. It has been a while. I was around first time you were in, but——

The Federal Reserve system, what I want to talk about, the dual mandate. It actually is focused on three key monetary policy objectives: maximum employment, price stability, and moderation of long-term interest rates. Somehow that seems to get sort of forgotten.

I am going to ask you a “too high,” “too low,” or “about right” for a response to this question. Are interest rates right now too high, too low, or about right, Dr. Kohn?

Dr. KOHN. I do not have a judgment on what the right level——

Mr. HUIZENGA. Okay. I do not have time for an explanation.

Dr. KOHN. Okay.

Mr. HUIZENGA. Do you think they are about right?

Dr. KOHN. They are about right for what people expect.

Mr. HUIZENGA. Okay.

Mr. Wang.

Mr. WANG. Today the 10-year yield is about 4 percent. I think that is about right.

Mr. HUIZENGA. Okay.

Dr. Michel.

Dr. MICHEL. Sure. I have really no idea, and I do not think they do either.

Mr. HUIZENGA. Okay.

Mr. Konczal.

Mr. KONCZAL. They are slightly restrictive, which I think is appropriate given inflation right now.

Mr. HUIZENGA. Too low?

Mr. KONCZAL. Slightly too high.

Mr. HUIZENGA. Okay.

Mr. KONCZAL. Appropriate but higher than they should be in the long run.

Mr. HUIZENGA. All right. Great.

Obviously, I was not here for the creation of Dodd-Frank in 2010. I got elected in 2010, but I have been living with the echo effects of it ever since. I believe that today the Fed has even more power, more influence, and more control over our financial system than ever before.

While improvements, as, Dr. Kohn, you had said, have happened in transparency, partially because of the push that came out of this

committee, it does, I believe, remain shrouded in a mystery to most of the American people.

Frankly, we are not talking about groundbreaking stuff right now. These are things that we talked about over a decade ago, and we were asking many of the same questions: How could the Fed be more transparent to Congress and the American people? How could they communicate its policy choices better and the direction it was taking so that consumers and investors could make informed decisions about today and the future?

Dr. Michel, let us start with you. You noted and cited a paper by economist John Taylor, one of my favorites, titled, "Monetary Policy Rules Work and Discretion Doesn't." As you know, Dr. Taylor became famous for the Taylor rule, which essentially has a suggestion of guides on how central banks could adjust interest rates to stabilize economic activity.

I had suggested when Chair Yellen was in here that she could create the Yellen rule. It did not really matter what it was but where there were some rules that were published.

Now, everybody says, well, we do this behind the scenes. The problem is it is behind the scenes, and nobody really knows what they are doing. They are saying a guessing game.

Could you explain to the committee, Dr. Michel, how something like the Taylor rule or the Yellen rule or any other rule could have impacted the Fed's decision during the most recent economic downturn?

Dr. MICHEL. Sure. If we go by the standard, any of the standard rules, really, that are accepted by a macroeconomist, then in that case, yes, the rates are too restrictive at the moment.

If they had been following a rule, at the very least we would know what they are doing and why they are doing it. By we, I mean, you guys, Congress. I think that is the most important thing. There is no way to judge how good or how badly they are doing because you do not really know what they are doing.

Mr. HUIZENGA. Okay.

Dr. MICHEL. That is why a rule is important.

Mr. HUIZENGA. Would something like the Federal Oversight Reform and Modernization (FORM) Act—

Dr. MICHEL. Yes.

Mr. HUIZENGA [continuing]. which had been a piece of my legislation, would that be a good starting point?

Dr. MICHEL. I think that is a perfect starting point because it provides what we call a flexible rule. They put a base rule in place. They can pick the rule that they like, and they can stick to them, until they do not, as long as they explain to Congress what they are doing, that is different and why.

Mr. HUIZENGA. I am running out of time, so I am having to jump around here a little bit.

Obviously, the Fed now sets rates administratively, partly through interest on reserve balances, and there are significantly more reserves in the system now.

Do not want to put words in Dr. Kohn's mouth, but it almost sounded like you said it does not really matter what the reserves are. What I need to know, though, is, has the Fed incentivized fi-

nancial institutions to hoard reserves instead of putting capital work into the real economy?

Dr. KOHN. I think the liquidity regulations put a premium on holding liquidity, and they need to look carefully into that, as to whether they are over-incentivizing holding liquidity. I do not think they are. It is important for financial stability.

I agree that there are adjustments, as Mr. Wang said, to the leverage ratio that could be made that enable banks to intervene more or more aggressively in stabilizing the Treasury market and that would be helpful. For example, exempting reserves from the leverage ratio.

Mr. HUIZENGA. Okay. My time has expired. We may be following up with some written questions.

I yield back. Thank you.

Chairman LUCAS. The gentleman yields back.

The chair now recognizes the gentlewoman from California, the ranking member of the full committee, Ms. Waters, for 5 minutes.

Ms. WATERS. Thank you very much.

Mr. Konczal, reporting has shown that American families are bracing for higher prices as consumer confidence fell drastically in February in response to Trump's actions as President so far.

In my home State of California, a dozen eggs are going for \$9 or more, and that is just the beginning. Families expect the price of housing, groceries, gas, and basic necessities to rise even further. This is especially true now that Trump said he would institute 25 percent import taxes on consumers and businesses buying goods from Canada and Mexico, and stock markets dropped in response.

Given these trends, one of the Republican policies aimed at decreasing the cost of living are under Republican leadership. Can we only expect the cost of living to rise?

Mr. KONCZAL. I think the policy—independent—I think the policy uncertainty about what is happening—for instance; I was off the grid last night, so I did not know whether or not we were going to have a North American trade war when I woke up this morning. Apparently, we do. That kind of policy uncertainty is very poor for investments, very poor for growth. The emphasis on prices increasing at a period where consumers and everyday people are much more sensitive to prices than they may have been in more decades. I do worry it will feed into inflation expectations, price increases, and wage demands in the way that will be much more persistent than what we saw during Biden Administration.

Ms. WATERS. Let me just ask you. This business of increasing the tariffs on our neighbors, will that absolutely increase the cost of living for Americans because there may be retaliation of some sort?

Mr. KONCZAL. Very much so. That is kind of the point of the tariffs is to raise prices. We have already seen auto prices going up over the last several months in anticipation of this, I believe, after having declined for about 2 years beforehand. The way it particularly hits internal supply chains, because something like a car will go across the border so many times. I think it will be pretty complicated and very difficult for firms to do even if there were clear communications and a better process for implementing them.

Ms. WATERS. Committee Democrats have many proposals to address the rising cost of living. We are fighting for legislation to

grow the middle class, lower costs, and fight against wealthy corporations. I am especially committed to addressing our Nation's growing housing and homelessness crisis through bills like, My Housing, Crisis Response Act, Ending Homelessness Act, and Down Payment to an Equity Act.

If Republicans will take up these bills and pass them, would Democratic policies lower Americans' housing costs?

Mr. KONCZAL. I believe so. I believe there is a real supply issue as well. I do believe that we need more money in people's pockets. It will help provide economic security and crucially find ways to build up the labor force, build the middle class better health outcomes, better education outcomes, I think, builds our labor force and our productivity and our ultimate growth.

Ms. WATERS. Do you have any idea what percentage of the American public are paying 30 percent or more for rent, for example?

Mr. KONCZAL. It would not shock me. It would be quite high. I do not know. I am sorry.

Ms. WATERS. Do you believe that with the bills that I have just identified that we are passing would increase perhaps the ability to develop more housing, more affordable housing for people who are making lower incomes?

Mr. KONCZAL. I believe so.

Ms. WATERS. Would you recommend that these bills be passed not only by Democrats, but by Republicans who are having tremendous problems in their own districts with people not being able to afford a decent cost of living?

Mr. KONCZAL. I think housing is a serious concern for bipartisan support of major initiatives, yes.

Ms. WATERS. Thank you very much, and I yield back.

Chairman LUCAS. The gentlelady yields back. The gentleman, I should say, from Kentucky, Mr. Barr, who is also Chair of the Subcommittee on Financial Institutions, is now recognized for 5 minutes.

Mr. BARR. Thank you, Mr. Chairman. You lone dissenting voice in Lesley Stahl's biased and one-sided 60 minutes report on DOGE's audit of the Consumer Financial Protection Bureau (CFPB), which as you know is funded entirely from the Fed.

In Ms. Stahl's critique of DOGE's access to personal, private financial information, she failed to point out—and by the way former Director Chopra also failed to point out—the only reason why DOGE had access to that information is because the bureau itself collected that information.

Let me just ask you to correct the record for 60 minutes. Would DOGE have had access to personally identifiable financial information of Americans had the CFPB not collected it in the first place?

Dr. MICHEL. No.

Mr. BARR. No. Okay. Can you also inform the American public who maybe were misinformed by the 60-minutes interview what happened with all of that personal financial information that the CFPB collected in, I believe, it was March 2023 when the CFPB experienced a data breach?

Dr. MICHEL. They had a data breach. A lot of people got access to information that they should not have had access to because that was collected in the first place.

Mr. BARR. What is the greater threat to Americans' financial data privacy, the CFPB or DOGE?

Dr. MICHEL. I did answer on that interview. I do not know that it made the segment, but I said they have no greater concern than anybody in the administration now has access to that information than it did at the agency. The Bureau itself had. I would say yes, my problem is that they have that information to begin with.

Mr. BARR. Yes, exactly. Let me ask you this. Does the Fed's role in funding the CFPB politicize the Fed?

Dr. MICHEL. Absolutely. It should not be set up that way.

Mr. BARR. If you are concerned about politicization of the Federal Reserve, why we do not, how about this, take the Bureau away from the Federal Reserve and subject it to the congressional appropriations process? Do you think that is a good idea?

Dr. MICHEL. Absolutely.

Mr. BARR. Let us join in a bipartisan way, reassert Congress' appropriation authority, and actually depoliticize the Federal Reserve by taking the Bureau out of the Fed Bank regulation—Mr. Wang, I want to ask you about the bank regulation's impact on monetary policy, specifically, the way the SLR has currently calculated disincentivizing banks from serving as intermediators in the primary, secondary, and repo market for U.S. Treasury securities decreasing liquidity in the Treasury markets.

Mr. Wang, would an increase in market liquidity and stability help bring the long end of the yield curve down, which would in turn reduce mortgage rates and therefore reduce the cost of living for Americans?

Mr. WANG. I believe it would.

Mr. BARR. Would this give the Federal Reserve greater flexibility to lower the Fed funds rate and ease monetary policy?

Mr. WANG. Yes, it would.

Mr. BARR. This is very important for all of us to remember. If you want lower interest rates, if you want to lower inflation, the Fed needs to focus on deregulation, and especially with the SLR.

Let me ask you about the balance sheet, and I would like Dr. Kohn to weigh in on this. Shrinking balance sheet on the one hand obviously pulls the money supply back and from that standpoint might be disinflationary. Also shrinking the balance sheet decreases demand for Treasuries, possibly pushing upward pressure on the 10-year. Is shrinking the balance sheet inflationary or disinflationary?

Dr. KOHN. I would say it is disinflationary to a minor extent for the reason you said. Pulling it back probably puts a little bit of upward pressure on that 10-year.

Mr. BARR. Okay. Let me ask a final question, a lot of conversation about the 50-basis point cut in September. Certainly, even if Chairman Powell is right that they are not focused on politics, the perception was really bad. It was a bad look 2 months before a major election to cut that aggressively 50 basis points in my view. Was this a mistake because even though the Federal funds rate was cut aggressively, you still had an increase in the 10-year? All at the same time, anyone?

Dr. KOHN. I do not think the increase in the 10-year reflected the cut in the Federal funds rate. There was very little increase in in-

flation expectations as measured in the market. It was mostly term premium over the next few months, and that is about uncertainty. Uncertainty created by the election, by financial and economic development, so it was not really about the cut in the funds rate.

Mr. BARR. Obviously, the 30 or fixed-rate mortgage shot up despite the rate cut.

Dr. KOHN. Right.

Chairman LUCAS. The gentleman's time has expired.

Mr. KONCZAL. I would also flag, that summer, we breached this on rule. So many people were quite worried about an incoming recession; that rates were quite restrictive at that point.

Chairman LUCAS. The gentleman's time has expired. The chair now recognizes the gentleman from Illinois, Mr. Casten, for 5 minutes.

Mr. BARR. Okay. I yield back.

Mr. CASTEN. Thank you. I just note Mr. Barr's support for giving unvetted personnel access to the Treasury payment system with unsecured devices, hacking in not only U.S. taxpayers' information, but other information held by the Treasury is neither patriotic nor supported by the full committee.

I want to ask a really dumb question first—and this is not a gotcha question—does anybody disagree with the statement that price increases are inflationary? I see—Okay. We agree that the tariff policy that Donald Trump is imposing to raise prices on imported goods is inflationary. I am sure we may have differences. We certainly have differences up here. The fiscal consequences of that, but it raises questions about what happens when the first policy of the United States is at odds with the monetary policy of the Fed. One is trying to bring down inflation. One is actively working to bring it up.

The 1890s show an example of what happens. I would rather not make America great again back in that time period, even though a lot of the White House seems to support what life was like in the 1890s. For us to manage that, we are going to have to keep an eye on the data and the system.

Do all of you support—as Chairman Powell indicated when he was here a few weeks ago—that we have to make sure that data at the Bureau of Economic Analysis and the Bureau of Labor Statistics stays pure, stays accurate, stays untouched by political appointees trying to change that data.

Dr. KOHN. I think the accuracy and the purity of that data—and the credibility of that data are absolutely essential. Can I make a distinction between price increases.

Mr. CASTEN. I want to just move on because I want to get to another point that is not as partisan, but I think more supportive. I appreciate you saying that, because when Donald Trump is saying that he wants to go in and put schedule F employees—get rid of them, make this political, there are bad things that happen.

I want to shift to a different issue. I have heard concerns from a number of people who I trust about the surging volumes of dollar-denominated deposits in non-U.S. banks. Specifically, that—and I have a hard time getting data that is—some of the data gets a little stale. In 2021, global banks were holding over 15 trillion in dollar denominated deposits. The first quarter of 2023, it broke a

streak of three consecutive contractions. There was an increase \$326 billion of U.S. dollar deposits in foreign banks.

I guess, Mr. Konczal, given your work on the Federal Reserve board, is that consistent with what you are saying that we are seeing increased dollar deposits in non-U.S. banks?

Dr. KONCZAL. I do not know anything about that.

Mr. CASTEN. Okay. Have any of you seen this data or heard the concern before? Okay. The issue that has been raised to me by several folks is that there is a consistent bipartisan push at Treasury to have a strong dollar because it lowers our borrowing costs. That in terms makes the dollar very attractive for remittances, it makes the dollar very attractive as it—it makes our exports stronger.

If we have increased dollar deposits at U.S. banks, we do not have—the Federal Deposit Insurance Corporation (FDIC) does not regulate those banks. If there is run on those dollars, there is macroeconomic concern. Bank of International Settlements (BIS) recently noted that global banks are turning to increasingly flighty funding services to secure those.

In the first step of 2023, dollar funding by money market funds to global banks went up by 53 percent. Most of that came in the form of repos.

I guess, Dr. Kohn, are there any hidden risks sitting out there in the repo market? Should we be concerned about any broader contagion if there is a run on those dollars?

Mr. KONCZAL. I do not know enough to comment. I apologize.

Mr. CASTEN. Anybody have any intel into that?

Mr. WANG. I was a repo trader at the Federal Reserve. The repo loans are secured by Treasury collateral, so they are very safe. In the past, a lot of banks traded unsecured, there was a credit risk then. Today, it is a much more stable form of finance.

Mr. CASTEN. I guess the security of money market funds makes sense when we are looking at our own borders. The concern I have is what happens if we have large volumes—I mean, maybe if any of you just want to answer academically, if you are familiar with the immediate data. If you have large growing volumes of dollar deposits that are outside the FDIC system, and those are being backed by money market funds, should we be concerned about that? It seems like with all of the checks we have internal to our economy, we know how to regulate those because our banks are regulated in the United States. What happens if you have huge numbers of dollar deposits at the Bank of China?

Mr. WANG. Historically, what happens if we have a dollar distributed abroad is the Federal Reserve has foreign sublines, ethic soft lines where they will lend to foreign Central Banks who in turn support the dollar deposits in foreign jurisdictions.

Mr. CASTEN. Does not that then create an issue where our foreign adversaries could potentially be creating a run that we have to step in and backstop with taxpayer money?

Mr. WANG. That is possible depending on jurisdiction. Not all jurisdictions have soft lines.

Dr. KOHN. I do think it is important for the authorities in the United States and globally to look for spots, examples of things that might become unstable because of runs. I do not know whether this is—that you have actually spotted one or not, but—

Mr. CASTEN. I am getting a tap. I do not know if there is a—it is a concern. If you learn more, I would love to chat with you.

Chairman LUCAS. The gentleman's time has expired. The gentleman from Nebraska, Mr. Flood, who is also the Chairman on the Subcommittee on Housing and Insurance is now recognized for 5 minutes.

Mr. FLOOD. Thank you, Mr. Chairman. Good morning, everyone. I too have been concerned about the side of the Federal Reserve's balance sheet. Quantitative easing is a monetary policy tool that is less than two decades old. It has already led the Federal Reserve to carry a significant balance over the last decade.

Today, the Federal Reserve's balance sheet remains more than \$6.7 trillion of assets, despite recent efforts at quantitative tightening. My concern is that with a pattern of quantitative easing over the next couple of years, I feel that we will see the Fed's balance sheet grow much faster in bad economic times than it will shrink when the Fed moves to quantitative tightening during the good times. In this scenario, we could see the Fed's balance sheet grow larger and larger, and larger over time.

I would like each one of our panelists to comment on this concern that I have. Here is the question. Do you feel that it is misplaced, or do you think that there is reason to have concern about the possibility of what I am talking about? Dr. Kohn, let us start with you.

Dr. KOHN. I think the balance sheet would grow only if interest rates were already at zero and they were a threat to the U.S. economy. I am glad that the Federal Reserve has the authority and would make the decision to grow the balance sheet in order to lower interest rates and stimulate spendings at time of weakness. I am not particularly concerned about that.

Mr. FLOOD. Thank you. Mr. Wang.

Mr. WANG. Under current bank regulations, banks are required to hold lots of liquid assets, among them reserves. In a sense, in order for banks to meet those requirements, we would expect the Federal Reserve to gradually grow its balance sheet—maybe not at the same rate as it does during emergencies, but over time simply to produce liquidity for the banks to hold.

Mr. FLOOD. Thank you. Dr. Michel.

Dr. MICHEL. Yes, so especially if anything else happens, any other emergency situation, not necessarily as bad as the COVID crisis, but the runoff is so slow, as it was the first time; that it is more likely to increase than decrease in the long run I think for now.

Mr. FLOOD. Thank you. Mr. Konczal.

Mr. KONCZAL. I think there is a very big academic debate about whether or not we are still in so-called secular stagnation or in a period of very low interest rates in normal times. If we are still in that world, it would probably expand again in the next recession, but if we are not, the Federal Reserve has enough leeway with its interest rate policy to manage a business cycle, then not. My assumption is that baseline probably declined.

Mr. FLOOD. Okay. Now that the Federal Reserve has amassed such a large balance sheet, one concern is that quantitative tightened too quickly could lead to instability in the market for Treasury security.

Here is the question: If we are unable to unwind quantitative easy measures in a timely manner due to concern with the Treasury market, does that raise questions about how viable quantitative easing is as a long-term sustainable monetary policy tool? Dr. Kohn, let us start with you.

Dr. KOHN. I think that I would answer that question the way I answered the previous one. I think they can still go out and buy more securities if they need to under the circumstances. There is really no relationship between the size of the balance sheet and inflation. I know that people worry about that in the 20 teens. People from this committee had conversations with staff on this committee. The sheet is blowing up. We are going to have inflation. It did not happen until the COVID thing. Right? I do not worry about the size of the balance sheet relative to inflation, for example.

Mr. FLOOD. Thank you. I would like to pivot to Federal Reserve's emergency liquidity 13(3) authority. Dodd Frank made some changes to Section 13(3), and in the economic downturn accompanying the onset of COVID-19's pandemic, we saw the Federal Reserve use this revised authority for the first time in its new form with Treasury.

Mr. Wang, what lessons can we learn from how the Federal Reserve used Section 13(3) facilities during 2020, and how should we in Congress be thinking about this authority moving forward?

Mr. WANG. When I take a step back and look, it seems like these 13(3) facilities are growing in their extent. We saw them come out during the great financial crisis to help money market funds asset that commercial paper. This time around in 2020, they also helped corporate credit and mainstream lending facilities. It seems that they keep growing, growing, and the Fed is in effect being the lender of last resort to everyone in the economy. I think it is worth thinking about if that is the design of the Fed, if that is in agreement with the wishes of Congress.

Mr. FLOOD. Thank you, Mr. Wang and thank you, Mr. Chairman, for chairing today's committee. With that, I yield back.

Chairman LUCAS. The gentleman yields back. The chair recognizes the gentleman from Louisiana, Mr. Fields, for 5 minutes.

Mr. FIELDS. Thank you, Mr. Chairman, for having this hearing, and also the ranking member. Also I want to thank the witnesses for being here. I only have three questions that I am going to direct all three of them to Mr. Konczal.

First, the Trump Administration's plan to shut down the Consumer Protection Bureau to lead to many consumers—to financial exploitation, including predatory lending and overdraft fees. Could the absence of strong consumer protection contribute to the economic instability or financial distress for the working class?

Mr. KONZAL. Yes, sir, I believe so.

Mr. FIELDS. The Trump Administration also has openly pressured the Fed to cut rates. While Chairman Powell has consistently said that he has resisted those pressures, and he has, do you believe that the Fed is facing greater risk of political influence today than previous administrations?

Mr. KONZAL. Yes, I believe the attack on the independence of the independent agencies, including the Federal Reserve is—we have not seen that kind of risk in a long time. I think the way that they

are trying—the Trump Administration is trying to thread a needle where they are saying the Fed would not be independent except for monetary policy is unstable. The people I talked to, who would know Reserve and nonpartisan analysts, believe that is not really a stable arrangement, and that the whole institution, including monetary policy, will be politicized under this administration.

Mr. FIELDS. My last question is: There are reports that the Feds have recently removed public—removed public diversity and inclusion data from this website following the Trump Administration and opening an unlawful order to eliminate Diversity, Equity and Inclusion (DEI) programs.

Do you see this as a concerning trend? How could we reduce transparency in the workforce and have an impact on financial policymaking?

Mr. KONCZAL. This is not my world, but I do know many experts are worried not just about this or that initiative, but a more wholesale attack on Civil Rights Law in this country. We saw some of the Executive orders that came out. Financial inclusion is quite important. It is a huge priority for our administrations. You see things about research being pulled because it is looking into, say, the way credit or other things impact different populations. I think not being able to research that or address that would leave many Americans behind.

Mr. FIELDS. All right. Thank you, Mr. Chairman. I yield back the balance of my time.

Chairman LUCAS. The gentleman yields back.

The chair now recognizes the gentleman from Montana, Mr. Downing, for 5 minutes.

Mr. DOWNING. Thank you, Mr. Chairman. To the witnesses that are on the panel, thank you so much for your time and being here today. I am going to start out a little bit on transitory inflation.

Dr. Kohn, the Biden Administration and the Federal Reserve spent most of 2021 assuring the American people that the inflation they were seeing was merely transitory, and that no action was needed. What followed was the worse rate of inflation since the early 1980s when the Federal Reserve finally changed course. Inflation hits rural areas like Montana's Second District that I represent the hardest. How did the Federal Reserve get this wrong for so long?

Dr. KOHN. I think, first of all, the Federal Reserve was not alone in getting it wrong. Most economists had it wrong. If you look at surveys of economists, they had that wrong.

Second, I think we need to recognize how unique and unusual the situation was. Once a century, the global economy closes down because of a pandemic. Right? 1918, and the last time. There is really no precedent in how they are going to analyze this, what is going on, how soon it is going to unwind. It is very, very difficult.

Third, I think to the Fed's credit, they recognize they made a mistake, and they tightened quite substantially in 2021. They will be the first to tell you, no, we should have gone a little earlier if we knew now—if we had good foresight, we would have gone earlier, but it was a very difficult situation. To separate the supply effects, when they were going to run off versus the demand effects, and tightening policy.

Mr. DOWNING. Thank you. Switching here a little bit, this is for Mr. Wang. The United States now exceeds \$36 trillion in debt. That is over \$100,000 per person. It is staggering. The United States pays more on its interest than it does on national defense every year. At our current pace, the interest on our debt will be the second largest U.S. expenditure by 2035 after Social Security. Chairman Powell has repeatedly stated our national debt is on an unsustainable path. What does an actual debt crisis look like, and how much longer can the United States stay on this debt path?

Mr. WANG. I think in the case of the United States, we are special in that we can print our own currency. In that sense, we can always afford our debts, but there are macroeconomic consequences to this where that could ultimately place upward pressure on inflation.

Mr. DOWNING. Thank you. Switching again, this is for Dr. Michel. I know that Chairman Hill asked a similar question to Dr. Kohn, but I am going to try to rephrase. I would love to hear yours.

Federal Reserve has a dual mandate of stabilizing prices and maximizing employment. We also know an economy that is too hot is likely to suffer from high inflation. The Federal Reserve had to react to the trillions in dollars in spending from congressional Democrats during the 117th Congress by raising interest rates.

I noticed in your opening remarks that you said that Congress gives the Fed too much to do and too much discretionary authority. My question to you is: Would the Federal Reserve be more effective if its sole mandate was to achieve stable prices?

Dr. MICHEL. Yes—no, I believe it would. You would be giving it something to do that it could actually control, and that it could actually directly affect as opposed to something that is nebulous and very difficult to define, much less control.

Mr. DOWNING. Thank you. Dr. Kohn, back to you. During the first 2 years of the Biden Administration, congressional Democrats spent trillions of dollars in economic stimulus despite early warning signs of inflation. Does this sort of unprecedented spending make the Federal Reserve's job of combating inflation more difficult?

Dr. KOHN. I think the Fed still had the tools to combat inflation. I think what disappointed me a bit was that they took so long to use them, and they should have seen the demand-enhancing effects of those spending. That should have sent their antennas quivering a bit faster on that inflation. The Fed could have fought the inflation, but there was difficulty analyzing it and difficulty figuring out when to move.

Mr. DOWNING. All right. I thank you for your answers, and, unfortunately, I have run out of time. Mr. Chair, I yield.

Chairman LUCAS. The gentleman yields back. The chair now recognizes the gentlewoman from Oregon, Ms. Bynum, for 5 minutes.

Ms. BYNUM. Thank you, Mr. Chair, and thank you to our witnesses today. The first question I have—kind of, I am a mom. I have four kids. Two of them are college age. I love them. I want them to live in our community, but it does not feel like there is a whole lot of hope for our kids moving out of our homes these days. I wanted to ask if any of you knew the average age of the first-

time home buyer and whether we should be concerned? I believe it is.

Dr. MICHEL. I believe it has risen up to 32.

Ms. BYNUM. 38 is what I was told.

Dr. MICHEL. I believe it is in the thirties now, which is higher than it has been, yes. If you are asking me if I am concerned about that, no.

Ms. BYNUM. Would you elaborate?

Dr. MICHEL. I do not think that the policy that the U.S. Congress implements or that the Federal Government implements should be directed at picking a particular age for the first-time home buyer. I think that the age has gone up is a whole set of circumstances, some of which they cannot control. I do not think that should be the goal anyway.

Dr. KOHN. A lot of this is a response to constriction on local supply. I think a lot of this has to do with our local communities and the zoning laws. We need to increase the supply of houses, and that would make it more affordable. A lot of that is just State and local regulation.

Ms. BYNUM. Okay. That is very helpful. Thank you.

Mr. KONCZAL, so rising mortgage rates have made it much harder for first-time home buyers to afford a home and so many existing homeowners are locked into low rates, limiting our housing supplies, some of which was just alluded to. Given that monetary policy plays a role in interest rates, but is not the only factor in housing costs, what policy solutions do you think could complement the Fed's efforts to ensure affordability without increasing inflationary pressures?

Mr. KONCZAL. Investments vary. I think associations believe there are somewhere between three and six million too few homes, so policies that allow us to build homes faster and cheaper. More generally, productivity and construction and housing have lagged quite a bit over the last few decades. I think there has been a lot of research trying to figure out why. As Dr. Kohn mentioned, local constraints seem to play a role in that.

I will say efforts to boost income security for young families are quite important. I look at the monthly child tax credit that was fully refundable that was passed by the American Rescue Plan, which cut child poverty in half. I think it was an incredibly good investment in families and community, and then that investment in children and families pays off dividends decades later as better health outcomes, better education outcomes and better outcomes for everyone.

Ms. BYNUM. Thank you. My second question on that is we know that increasing the housing supply is critical to long-term affordability, but the higher borrowing costs have made it more expensive for developers to build new homes. How do we ensure that efforts to curb inflation do not worsen the housing shortage and make affordability even harder in years to come?

Mr. KONCZAL. There was an irony, and a difficult part of the recovery was that one place where we knew higher restrictive interest rates were particularly binding was on the housing market, which slowed quite dramatically after having picked up. That said, the housing deficit is a longer-term problem. It certainly comes

from the aftermath of the financial crisis, the large rate of foreclosures that happened after that, and the much lower rate of housing building that happened following that. That was something the Federal Reserve actually took into account.

The fact that the housing—the way that housing inflation was measured was quite high, but they were also restricting the supply of new housing. That was a more temporary short-term problem. As rates normalize, hopefully, we can see home building pick up, and we can find ways to make home construction productivity even better.

Ms. BYNUM. Mr. Chair, I would just like to put on the record, I am very concerned that our young people, based on the testimony of the witnesses here today, cannot really look forward to being able to purchase a home in the next 10 years if they are just graduating college at about 22. I think that is what you are seeing as an uprising in his country, and that is really challenging for me. Maybe it is on policymakers. Maybe what you all are suggesting is not on the Fed, but it is on policymakers to make that a reality for our young people.

Chairman LUCAS. The gentlelady is duly noted. Statements and comments are duly noted.

Ms. BYNUM. Thank you. I yield back.

Chairman LUCAS. The gentlelady yields back. The chair now turns to the gentleman from Indiana, Mr. Stutzman, for 5 minutes.

Mr. STUTZMAN. Thank you, Mr. Chairman, and I thank you, gentlemen, for being here, for your comments. I would like to go to Dr. Michel and then would also like to invite any other comments from the panel as well. As we know, the Federal Reserve is mandated by Congress to ensure price stability and promote maximum employment. It was only in 2012 that the Fed publicly made it known that it had a 2 percent inflation target.

Dr. Michel, your testimony describes some of the reasons the Fed has used to justify the 2 percent target. Practically speaking, what does it mean to target a constantly positive rate of inflation? Is it fair to think about it as debasing the value of the dollar by 2 percent a year? I think there are a lot of folks on this 2 percent inflation number. I would like to hear your comments on that.

Dr. MICHEL. That is fair. That is an accurate way of looking at it. The most common sort of reason given is that the Fed needs to keep inflation going so that the economy keeps moving, sort of a grease the wheels thing and motive, rather. There is a lot of academic research that suggested that is not really the way that works. If you do have a growing economy, an increase in supply, everything else constant, you should see prices come down. There are more goods and services available. They should become less expensive. We prevent that from happening. I do not solely blame the Fed, because there is a fiscal component, a spending component to that. In conjunction, I do blame Federal policy, partly on the Fed side, for trying to ensure that the price level never falls.

Contrary to what Mr. Sherman believes, it is perfectly okay, and it has been historic to have a gently falling price level. It does not mean that there is a calamity.

There is a huge difference between a collapse in asset prices and a gently falling price level. The latter is not a bad thing. It is a good thing.

Mr. STUTZMAN. Supply and demand dictate price levels to a point, but it feels like we are also trying to manipulate the market to hit this 2 percent number.

Mr. Wang, would you comment? You are shaking your head there like——

Mr. WANG. No, I agree. The 2 percent target is something the Fed has said itself where it is demanding given by Congress is price stability. It seems like that could be defined by Congress if it were of their choosing.

Mr. STUTZMAN. So——

Dr. KOHN. I like the definitions that Chairman Volker and Greenspan gave to price stability. That is, is inflation low enough that people do not have to take account of it in their everyday activities. I think we have a lot of evidence that 2 percent reaches that. No one was talking about inflation when inflation was two or just a little under the teens, or two in the early 2000's.

I think—and another—Dr. Michel is right that one of the reasons that people favor a little bit of inflation is that it greases the wheels of the—and I have some purical studies that I counter him with. I think another reason is the level of nominal interest rates.

Expected inflation gets built into nominal rates. If nominal rates are already at one or zero and something bad happens to the economy, there is very little the Fed can do to lower interest rates. It will be forced into buying securities.

Keeping nominal rates high enough to embody that 2 percent inflation and a 1 or 2 percent real rate, 4 percent means in equilibrium, and then something bad happens, then the Fed as 4 percentage points to lower interest rates to stimulate the economy without resorting to quantitative easing (QE).

Mr. STUTZMAN. I know my district—I want to come to you, Mr. Konczal. I know my district is full of small businesses, manufacturing, agriculture. To anticipate these marks is sometimes difficult. It is more important to look at where you are in the business and where do you believe you can make profits. Mr. Konczal, would you?

Mr. KONZAL. I was just going to amplify, the committee seems very concerned about the level of balance sheet, and that is something that people wonder about. If we were trying to target zero percent inflation, the balance sheet would be much more volatile because that would basically be the only tool you have.

Mr. STUTZMAN. You think the 2 percent target is the right target?

Mr. KONZAL. I personally prefer a 1 to 3 percent target. If it had served New Zealand and many other countries that had really fantastic macroeconomic concerns, I think the point target is a little hard and gets into this averaging question that the Fed is currently doing—it is actually a wide variety, and I think it would be a great thing for the task force to study.

Mr. STUTZMAN. Mr. Chairman, I will yield back the balance of my time, but I do think supply and demand economics is critical for our country to really be successful.

Chairman LUCAS. The gentleman yields back. The chair now recognizes the gentleman from Wisconsin, Mr. Fitzgerald, for 5 minutes.

Mr. FITZGERALD. Thank you, Chairman. Thank you, gentlemen, for being here. Jason Furman—I think, his name came up earlier—was President Biden’s top economist at the Council of Economic Advisors (CEA). He recently published a lengthy op-ed admitting that Bidenomics was a failure. His arguments, what he argued was—I think a lot of Democrats were kind of in denial of this, but the inflation was principally caused by too much government spending. I know there were numerous bills that were rolled through while I was a Member the last couple of Congresses and not just the global shock of the supply chains, right?

Yet, when I read Mr. Konczal, your written testimony, you did not acknowledge that government spending led to inflationary increases at all. I would just like to hear your response to that because I think it is important as we look back on what happened now. What is the case with those that say that did not happen? I do not want to put words in your mouth.

Mr. KONCZAL. Absolutely. I am very familiar with Jason’s article. To me it is an argument from 2022. Jason Furman at that point argued you would need a mild recession to get inflation below 4 percent, a severe recession to get inflation below 3 percent. Right now inflation is about 2.5 percent, still a little higher than we would like it, with a period of growth that was above trend and unemployment below 4 percent on average.

I think that argument, which is what the argument is of the piece—there is a lot of different arguments about how much the American Rescue Plan (ARP) may have contributed. Prices rose to about 21 percent under President Biden’s 4 years. Normally, they would have risen about 8 percent.

I have seen some arguments that maybe about 2 percent of that could have been attributed to fiscal stimulus. With 19 percent instead of 21 percent, prices really have changed the needle for everyday families, probably not. The income security that came particularly through the child tax credit and many other things helped stabilize balance sheets that I believe gave us the best recovery following the invasion.

You can look at blue chip forecast. It was brought up before this private, nonpartisan. Even after the American Rescue Plan passed the highest estimate in blue chip for inflation in 2022 with 3.2 percent, the actual number was 8 percent. I think the shocks of the reopening, the shocks of huge changes and demand and as a reminder, the unprovoked invasion of Ukraine by Russia really threw commodity markets into turmoil, which in the long run those relative prices do not matter.

In the short term, the price of goods skyrockets, but the price of services does not fall. That increases overall inflation, and services come back online to a higher price level.

We can argue at the margins how much a difference it made, but the idea that it was the primary driver of an inflation that was global and was seen by other peer countries, I just do not think the evidence is there.

Mr. FITZGERALD. Dr. Michel, was not inflation a result of not just supply side shocks related to the pandemic, but just too much government spending? I mean——

Dr. MICHEL. Yes, it definitely was a cause, one of the causes for sure, and that it did occur globally by the way. We are not the only country that did a lot of government spending. We are not unique in that regard either.

Mr. FITZGERALD. Dr. Kohn, let me just kind of switch topics really quick. Recent economic data indicates long-term interest rates have disconnected from the Fed's expectations. With 10-year rates now about 40 basis points higher than what the Fed expected, do you think that was predictable, or do you feel like everything that has happened—we have had the chairman before the committee numerous times, the full committee. Where do you think we are right now?

Dr. KOHN. I think there have been a couple of different contributors to the rise in long-term rates. One is that because the economy was so strong in the fourth quarter and coming into the first quarter, and financial markets were ebullient, people took out some easing that they had built into the Fed policy. They thought the economy was going to be weaker, Fed policy was restrictive, Fed was going to have to cut into rates by more.

Now, they have put a little more back in there, but the Fed itself and the market saw less need for easing. It was not a question that the Fed would need to raise rates, but it would be easing less.

Second, there is a little bit of extra inflation in there partly because of the concerns about the tariffs and what that would do to the price level near-term inflation.

Third, a lot of it is the so-called premium, the stuff we cannot attribute to expected policy or inflation. It is uncertainty about what is coming next. The fact that if you are holding a long-term security, you are taking risks because the price of those securities goes up and down. You need to be compensated for risks, and you have concerns about the risks.

Some of it could be the fiscal trajectory that we have been talking about. The unsustainable fiscal trajectory and few hints that it will change any time soon. I think there are a bunch of different reasons for that basis point increase in the 10-year rate.

Mr. FITZGERALD. Mr. Chairman, before I yield back, can I ask unanimous consent to insert Jason Furman's op-ed titled, "The Post-Neoliberal Delusion. The Tragedy of Bidenomics," into the record.

Chairman LUCAS. Seeing no objection, so ordered.

[The information referred to can be found in the appendix.]

Chairman LUCAS. The gentleman's time is expired. I would like to thank all of our witnesses for their testimony and simply to note that as we would say back home, monetary's policy is a chess game. It is not checkers, is it gentlemen?

Without objection, all members will have 5 legislative days to submit additional written questions for the witnesses to the chair. The questions will be forwarded to the witnesses for their response. Witnesses please respond no later than April 30, 2025. This hearing is adjourned.

[The information referred to can be found in the appendix.]
[Whereupon, at 11:49 a.m., the committee was adjourned.]

APPENDIX

MATERIALS SUBMITTED FOR THE RECORD

No delusions: Bidenomics wasn't perfect, but it did many great things

Responding to Jason Furman



JARED BERNSTEIN
FEB 12, 2025



Share



The economist Jason Furman has penned an aggressive, more-wrong-than-right [critique](#) of President Biden's economic record. Because it's Jason, a friend and a top-flight economist, there are also good, substantive critiques, and sound arguments from which we should learn. We of the Biden econ team made mistakes, he's right to raise them, and we should recognize them. It is also very much the case that Jason was frequently and generously supportive and helpful to me and CEA in those years.

But I was surprised to see language more familiar to the Fox news chyron than to a substantive debate: a subtitle reads "the tragedy of Bidenomics;" figures are titled "the Biden Bust" and "Unmade in America." And there's a lot in here that I wouldn't expect from an economist with extensive government experience, who should (and does) know more than he reveals about the intersection of economics and politics. Relative to his usual work, this piece suffers from logical flaws, important omissions, and an unwillingness to deal with powerful political constraints.

The argument is built around the following claims:

--Bidenomics rejected "neoliberal" economics: "respect for markets, enthusiasm for trade liberalization and expanded social welfare protections, and an aversion to industrial policy" along with "an unwillingness to contend with tradeoffs." It's advocates and architects suffered from a "post-neoliberal delusion."

--We were so focused on boosting demand that we a) overdid it, with stark and long-term damaging inflationary consequences, and b) ignored the supply side (this one is a bit odd as he also incorrectly argues that there was no supply shock, just a demand shock).

--Our climate work was well-intentioned and somewhat successful, but it was hampered by our rejection of basic principles. Same with our industrial policy.

--All of this contributed to Harris losing to Trump. Our "missteps reflected a broader unwillingness to contend with tradeoffs in economic policy and allowed Trump to ride a wave of discontent back into the White House."

Many of these claims are wrong and many fail to recognize economic input from CEA and others that Jason would recognize as sound. Jason devalues remarkably positive economic outcomes from our tenure, and ignores important contributions we made to the living standards of vulnerable families. There are also cases where politics pushed us toward sub-optimal policies, and where we did the best we could with the cards we held. And then there are some important critiques that we should take to heart and learn from.

Fiscal Stimulus and Inflation

Let me start by agreeing with a core part of Jason's argument. He's right that the American Rescue Plan contributed to inflation. But, especially given his argument about the impact of this effect on the election outcome, it is essential to try to quantify its contribution. When I and others do so, we find that inflation would have spiked under any realistic counterfactual.

It's equally important, again in terms of his case, to point out that ARP's size was not due to a rejection of neo-classical economics nor an embrace of "post-neoliberal economics." To the contrary, our main talking point back then—one that explicitly admits to tradeoffs—was "the risk of doing too little is greater than the risk of doing too much." Fed Chair Powell made the [same point](#).

Now, I grant you that this is quantitatively vague. How much is too much? But it is a concern rooted in an awareness of tradeoffs, of which we were as mindful as any economist would be in that situation. We analyzed output gaps, Phillips Curves, and ran standard macro models. Regarding our desire to quickly get back to full employment—a north star for President Biden at this time; he said the phrase five times in a Feb '21 [speech](#)—we're guilty as charged.

We thought it was extremely important to get families and businesses to the other side of the crisis, to avoid lasting scarring, to avoid business failures and housing evictions. We recalled past stimulus packages that underperformed on these goals, generating initially “jobless” recoveries. In January 2021 we were unconvinced that, even with all the previous stimulus, the economy would power through the pandemic-induced shutdown without the Rescue Plan. COVID deaths were peaking then; the vaccine had not been anywhere close to adequately distributed; we did not not believe the pandemic-induced shock was behind us and we were right: both the Delta and Omicron virus variants were waiting in the wings. The last jobs report we'd seen (December 2020 data, released January 8th, 2021) showed employment down by 140,000 jobs, with the unemployment rate stuck at 6.7%. CBO at the time thought real GDP would remain below its potential until 2025.

There were also political pressures inflating the ARPs price tag. Georgia voters engaged in a crucial runoff for the Senate were promised stimulus checks. Any suggestion to dial them back was shut down by claims that we must make a play for a Senate majority. That's another tradeoff, familiar to any experienced gov't economist: sometimes your best economic argument loses to a political one. In this case, the politicians may have been right. There were people who likely got bigger checks than they needed, but Ketanji Brown Jackson is on the Supreme Court.

Where Jason loses me, and, I suspect, others who've dug into this, is his downplaying of the impact of the pandemic-induced supply shock on inflation. ***The '21-'22 spike in inflation was born of strong demand colliding with damaged supply.*** You need both to explain what happened. One way to make this case is to show, as we did many times, that inflation went up in all advanced economies (even Japan!), all of whom applied

different fiscal and monetary responses, but all of whom had to deal with the fallout from the pandemic's impact on supply chains.

Jason appears to disagree:

“...the fact that inflation was a worldwide phenomenon does not let U.S. macroeconomic policy off the hook any more than the global nature of the Great Depression or the Great Recession exonerated U.S. policymakers then for their mistakes in managing the economy.”

I find it very straightforward to establish the role of supply shocks. I recall [chip factories](#) shutting down in Malaysia and elsewhere due to COVID, which led to the numerous-week shuttering of North American auto production plants (a potent example of a non-resilient supply chain, a point I'll return to below). Various data series that track supply chains showed these dynamics, and their impact on inflation, as in the chart below from CEA's [latest](#) Economic Report of the President.

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Figure 1-19. Supply Chain Pressure and Core Goods Inflation



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Sources: Institute for Supply Management (ISM); Bureau of Economic Analysis; CEA calculations.

Note: Gray bars indicate recessions. Data are seasonally adjusted. ISM index represents manufacturing firms.

2025 Economic Report of the President

Here again, unless a bunch of well-established economists, including Ben Bernanke and Olivier Blanchard, are all post-neoliberal delusionists, we're in good company. Their model also reflects the role of supply chain disruptions, as does work by Peter Orszag, who [wrote](#):

The central cause [of the inflationary spike] was the pandemic itself — and the nearly unprecedented supply-side shock it caused, which extended beyond the crisis itself.

I think Jason disagrees and believes the supply shortfall was itself a function of over-stimulating demand. But there are two empirical problems with his argument. First, as he correctly emphasizes, demand was well above trend for manufactured goods (to which I would add, the very goods that often depend on snarled supply chains to get to markets). But the much larger service share of the economy was in a deep slump and it's aggregate, not sectoral, demand that matters. As we wrote in the latest ERP: "Because services account for around two thirds of total consumption, the unprecedented services spending shortfall dwarfs the increase in goods consumption over the period of the services shortfall."

Second, I lived through the damn shutdowns and snarl-ups!

Once you concede the supply shock, then it is the case that even in the absence of the ARP, inflation would have spiked. It's also worth noting here that contrary to Jason's claim of "laser-like focus on the demand side came at the expense of addressing impediments to supply," we worked hard and successfully, in tandem with both management and unions at the ports, to help unsnarl supply [chains](#) (which is also how I know they were broken!).

All that said, good evidence, including our own at CEA, suggests that inflation would have peaked lower, perhaps by 1-2 percentage points, without the ARP. However, nobody, including Jason, is arguing there should have been no Rescue Plan. That is a totally unrealistic counterfactual. Had we done Jason's \$650 billion instead of \$1.9 trillion, maybe inflation would have peaked at ~7.5-8% instead of 9%. And it matters, inflation-wise, what you'd cut. The \$350 billion in state and local support may have been too large given their budget conditions, but those dollars spent out very slowly over many years.

For these reasons, I'm pretty confident that a smaller ARP wouldn't have changed the public mood very much.

And to do that much less in stimulus would have come at a cost that Jason ignores (more tradeoffs, dude!). As I said publicly at the [time](#), "To the extent that we got more heat, we got a lot more growth for it." When Jason references macro mismanagement, I

think (and hope) that he's remembering back to insufficient stimulus packages that left the economy underheated rather than overheated.

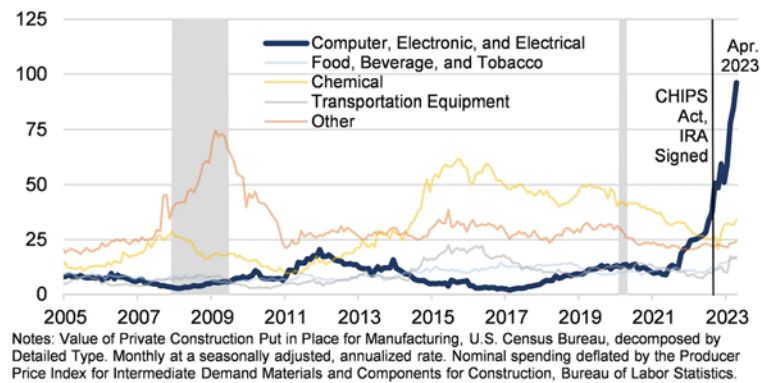
I'm not unequivocally defending the latter. Like I said, he and others (Larry Summers, Michael Strain) were right about the ARP contributing to inflation, though none predicted it would peak as high as it did. But there's no outcome here wherein inflation would not have spiked, and the excess demand helped get us back quickly to full employment, staved off a lot of pain and scarring, and set up a uniquely powerful expansion.

Industrial and Climate Policy

I'm a bit more confused about Jason's critique of our industrial policy. He [recognizes](#) that "an increase in factory construction, which has more than doubled in the last five years" may be a "hopeful sign," but considers a violation of the neoliberal principle of "aversion to industrial policy."

Figure 2: Real Manufacturing Construction Spending by Type

Billions of 2022 U.S. Dollars



This feels like an awfully tame assessment given the empirical record (throughout the piece, Jason weirdly discounts positive economic outcomes; “Bidenomics” can’t just be the parts you don’t like!). The investment incentives we managed to legislate, against tall odds, were pulling in hundreds of billions of private capital, much in the form of foreign investment (see Chapter 6 [here](#)). They were standing up a domestic American presence in key sectors where markets were underinvesting.

Which is why his “aversion” point is wrong. Once you define the rationale for industrial policy—government intervention to shape sectoral outcomes—as offsetting market failures that are generating costs to both economic and national security, you’re back in a pretty traditional framework. I suspect Jason and I disagree about the extent of market failures in the spaces we targeted, but I believe I’m on solid ground arguing that left to its own devices, the market would underinvest in climate mitigation. Same with our international supply chain exposure to chip shortages.

Relatedly, on climate policy, I don’t think you could find an economist in Biden world who would disagree with him that the most efficient way to address climate change is to internalize the externality by putting a cost on carbon. But he has to know that a carbon price cannot be legislated. It could not then, and it certainly can’t now. As he admits, “Given the political constraints, Biden’s administration could have done little more to fight climate change.”

Thus, we are in second-best world, and our climate policy scores well in that world, including in the paper he [references](#): “Even at the higher end of fiscal costs, IRA tax credits reduce CO2 emissions at an average abatement cost of \$36-87 per metric ton for the power sector—considerably less than recent estimates of the social cost of CO2...”

Once again, no “post-neoliberal delusion” was in play here. We followed the standard microeconomic principle of incentivizing desired behavior to offset a market failure through subsidies and tax breaks. And our approach was comprehensive, with credits for EVs, charging stations, heat pumps, and more. It is certainly the case that we’d get more emissions reduction for a lot less spending with a carbon tax. But that wasn’t in

the cards we were dealt and I think we played those cards a lot better than even I thought we could.

What Jason reasonably objects to in this space is a) accompanying add-ons to achieve other goals in this space, like Buy American or add a child-care function if you want the loan/grant, and b) our failure to do more to clear out regulatory brush that needlessly slowed our progress. These are generally valid critiques, especially regarding permitting, but not all barriers are created equal. “Buy American” is quantitatively too small to distort much and it yields political space to enact important public goods (the Jones Act is a much better target).

The Biden Economic Record

My next objection is Jason’s dismissive take on our record. This surprised me as Jason was among those who made numerous public predictions that it would take much higher unemployment than it did to get the inflation reduction we got. He recognizes that “the U.S. economy has bounced back much faster than it did after previous recessions, and its post-pandemic performance has also outpaced that of many peer countries in terms of economic growth.” But somehow this doesn’t garner us any good-economic-stewardship points for Bidenomics.

I am also hard-pressed to see how this connects to Jason’s theme. We posted strong macro-outcomes and achieved a “soft-landing,” after pulling out of a 100-year pandemic that massively shocked the global economy. Contrary to his claims, we advanced some critical safety net gains. Where does adherence or rejection of neoliberal economics fit into any of that?

He and I also have some data disagreements in this space, which we should work out, because both of us argue such disagreements in good faith. He’s a solid data guy (even if he left out a bunch of links in this piece—bad form!).

At CEA, we carefully documented the macro record. We didn’t just bounce back faster, we continuously beat the forecasts and expectations, as shown in the figures below for

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unemployment, real GDP growth, and contrary to what I thought Jason claimed, business investment.

Figure i-1. Unemployment Rate



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Sources: Bureau of Economic Analysis; Congressional Budget Office; Blue Chip Economic Indicators; Federal Reserve Board of Governors; CEA calculations.

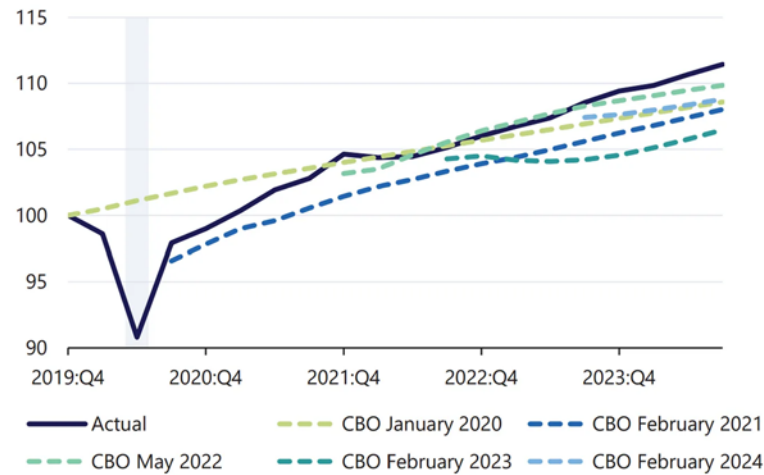
Note: Data are seasonally adjusted. All forecasts (besides Blue Chip) were finalized before 2022:Q4 data were released. Summary of Economic Projections (SEP) data reflect median Federal Open Market Committee projections, Q4 level. Shaded area indicates the difference between Blue Chip Top 10 average and Blue Chip Bottom 10 average estimates. *2025 Economic Report of the President*

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Figure 1-1. Real Gross Domestic Product and CBO Forecasts

Index (2019:Q4 = 100)



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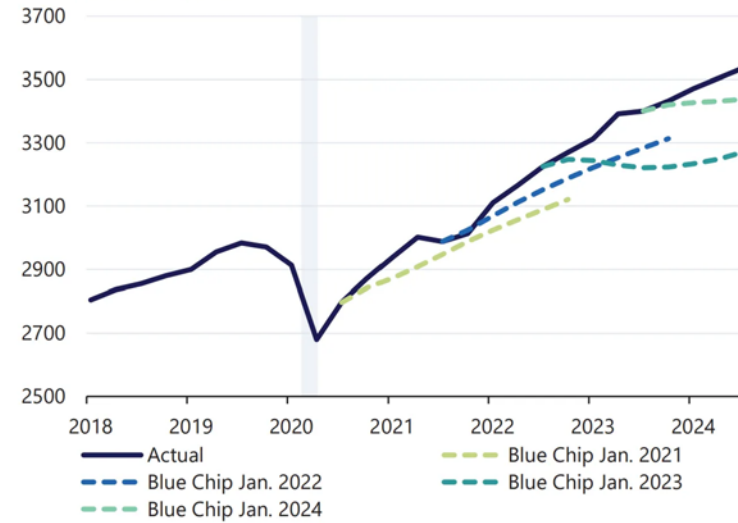
Sources: Bureau of Economic Analysis; Congressional Budget Office; CEA calculations.

Note: Gray bar indicates recession. Data are seasonally adjusted. CBO projections may not line up with actual data due to revisions.

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Figure 1-12. Real Private Nonresidential Fixed Investment

Billions of 2017 dollars



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Sources: Bureau of Economic Analysis; Blue Chip Economic Indicators; CEA calculations.

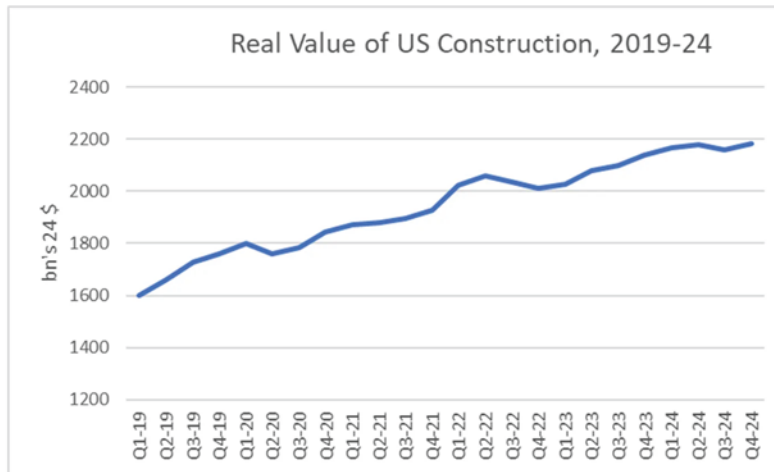
Note: Gray bar indicates recession. Data are seasonally adjusted. Blue Chip growth rates are applied to actual data for the first quarter of the forecast.

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Jason suggested we lost ground on infrastructure spending, but BEA data shows real government investment in [structures](#) are up 2019-24, as is real infrastructure [spending](#) on transportation on roads, water, airports, etc. But I'm sure we're using different data here. I've also got real construction spending going up, whether it's investment in building or expanding non-residential [structures](#) or real construction spending (Census Bureau data), as in the figure below.

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Next, this claim seemed pretty egregious to me: "Biden was the first Democratic president in a century who did not permanently expand the social safety net," probably because I was part of the team that worked hard on what the NY Times called...well, here's the headline:

Biden Administration Prompts Largest Permanent Increase in Food Stamps

The jump in benefits, the biggest in the program's history, comes after a revision of the initiative's nutrition standards that supporters say will reduce hunger and better reflect how Americans eat.

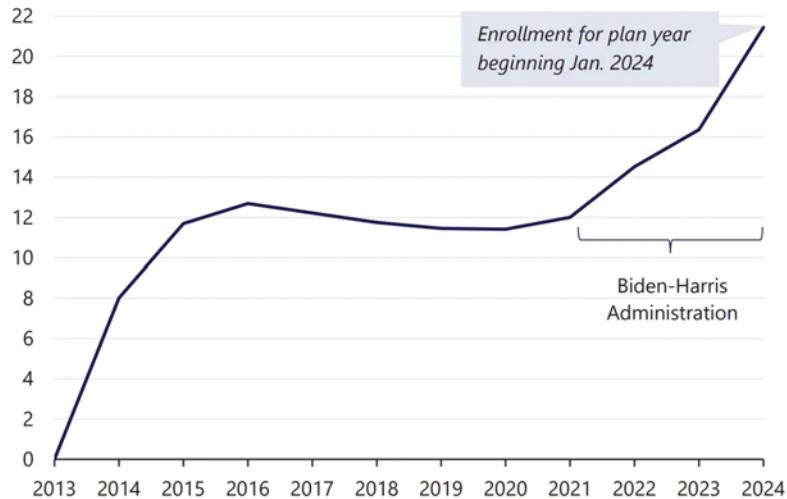
It's not just that this was an important safety net expansion. It's that we took endless flack from Republicans for it, as we made the change through an administrative rule

that instructs us to regularly update the costs and contents of the relevant food basket.

He noted our measures to boost health coverage by raising the subsidies for marketplace enrollment, one we featured prominently in the ERP, though he's right that, despite our efforts, it was temporary. Of course, as you see given the Trump 1 flattening of the first upward slope in the figure, the Obama administration's effort suffered the same fate. That's no more a "tragedy" of Bidenomics than it is of team Obama's work in this space. It is, however, a stark reminder that health coverage, like child poverty, is a policy variable, and in both cases we fought, unsuccessfully, to preserve our gains.

Figure i-4. Marketplace Enrollment at the End of Open Enrollment

Number of individuals who selected a marketplace plan (millions)



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Sources: Centers for Medicare & Medicaid Services; Department of Health and Human Services.
 Note: Data for each year denote plan selections during the open enrollment period for that plan year.

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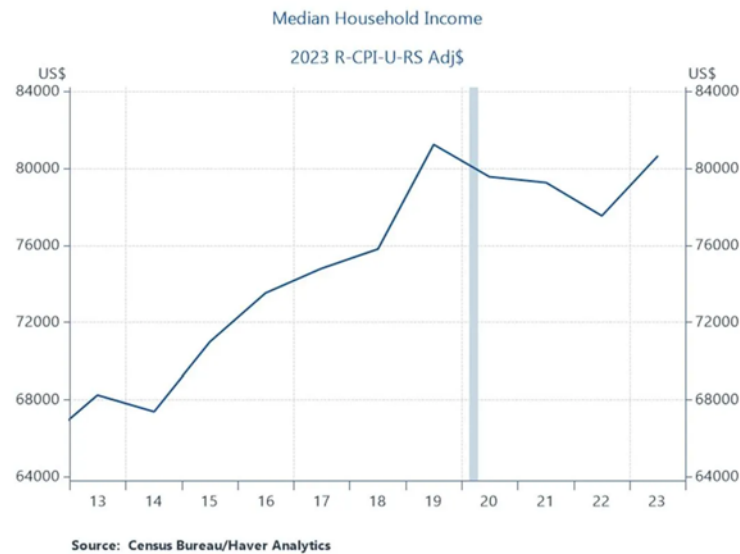
Jason makes a better point regarding real median income, but he leaves out a “future fact” that I’m sure he agrees with. By 2023, this important indicator was almost back to its 2019 level, and I agree with him that this was a source of discontent. However, there are two shortcomings to his case. First, I’m again hard-pressed to see our economic unorthodoxy in play here vs. pandemic shocks which we aggressively fought? If the answer is around the ARP and inflation, go ahead and deflate this series by whatever

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reduced-ARP-leading-to-less-inflation path you like. I seriously doubt you could plot a series that leads to the median household feeling much better.

Second, this series lags. Jason would agree that this variable very likely maintained its '23 momentum in '24. My forecast (and Jason will remind you that I do pretty well with this variable) is that real median income grew 2-3% last year, lifting it about \$1,500 above its 2019 level. (The MotioResearch group derives a [similar estimate](#) using monthly CPS data.)



He's on less solid ground on wages. Besides the Fox chyron title of his wage figure ("The Biden Bust"), I'm not sure he's using the right data for this. Some of the Atlanta wage series do not track wage levels: the low-wage quartile isn't tracking workers in the bottom 25%. It's tracking the bottom quartile of wage changes, which could be

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workers from any wage level. Its longitudinal framework also tends to down-weight occupational upgrading, which was a positive contributor to wage growth over the years in question. But I could be wrong about this and he and I will straighten this out. Either way, you've got to track at a variety of wage series to see what's going on in that space.

Below, I show the real wage progress of middle and low-wage workers—the 80% of the workforce that's blue collar or non-managerial. By this measure, they've surpassed their 2019 peak and are above their pre-pandemic (2016-19) trend. This is one of the more favorable wage series, but I think it's better for tracking paycheck-derived living standards than the series Jason plots. And once again, in comparing 2014-19 to the last few years, Jason is comparing macro apples and oranges: he's comparing the end of a long, strong business cycle with our pretty remarkable emergence from the shock of our lifetimes.

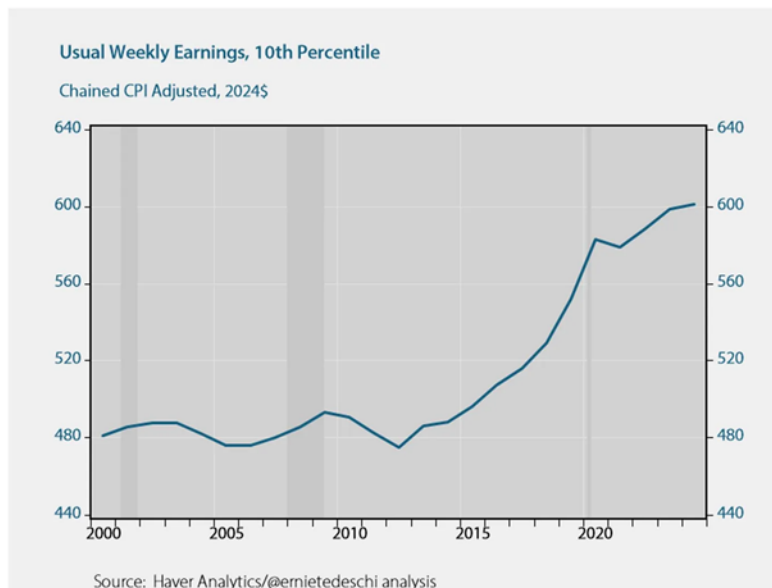
Real hourly wage, mid/low wage workers 2016-25
(Trend: 2016-19)



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There's another important real wage series to cover here—weekly earnings (from the CPS)—because it directly relates to the core Bidenomics goal, one rooted in classical economics, of sustaining full employment. Our view, elaborated in every [ERP](#) I could get my hands on, is that sustained full employment disproportionately lifts the earnings of the least advantaged, and true to form, we see solid real weekly earnings gains by the lowest wage workers (this force was in play pre-pandemic as well).



Wages and incomes recovered a lot more quickly due to fiscal and monetary policies that punched back hard at the pandemic-induced downturn, and in this regard, Bidenomics deserves credit. That said, I of course don't deny Jason's point that faster wage and income growth would have likely improved the negative vibes a lot of Americans felt over this period.

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Conclusion

Bidenomics had great successes, ones of which our team will always and rightfully be proud. The incoming administration were met with a uniquely strong macroeconomy and labor market, with years of full employment, easing inflation, and real wage and income gains supporting strong spending and solid investment. Jason and others predicted that it would take much higher unemployment to get to where we are, but we left with a soft landing in play.

Bidenomics also had shortcomings. We didn't do enough, as Jason reminds us, to take down barriers to progress such as permitting and other such obstacles. We left the field with unfinished business in the supply of affordable housing and child care. The ARP contributed to inflation; it would have spiked no matter what, but less so if the ARP had been smaller. But the package was born of both great, pandemic-induced economic uncertainty of the moment and political pressures that added to the price tag.

We never abandoned basic economic principles like tradeoffs or faith in markets. We did see more market failures than Jason does, and he and I should argue about that. But to conclude on the basis of the extensive empirical evidence I present here that Bidenomics was a tragedy, or that it sank Harris' electoral chances, requires a rewriting of recent economic and political history that does a great disservice to an administration that worked as hard as we could on behalf of the American people.

[I kinda suspect Jason will want to react to this. That's as it should be, and perhaps, if I can figure out how to work it, he and I could film a video for this Substack. I know I learn something every time we talk!]



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Discussion about this post

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Comments

Restacks



Write a comment...



Wb Bw Feb 12

Even an amateur non economist jackass like me recognized something was f'd up when Jason claimed no supply shock due to the pandemic.

So I wonder if heritage dink tank types didn't backdoor funnel some \$ to Harvard to in effect purchase some of those fox chyron claims

♡ LIKE (3) ◻ REPLY

🔗 SHA



Bob Wenning 8d

From what I read he seemed to hardly consider Trump's role in leaving the hole he did. His analysis covers 2019 to 2024 - Trump was president 2019 - 20 but he only focuses on 2021- 24. Also Trump begged the Saudis to cut their oil production in 2019 increasing the price of gas to satisfy oil companies and Putin.

With friends like Furman who needs the GOP?

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Has U.S. infrastructure investment really declined?

Has U.S. infrastructure investment really declined?

The devil is in the deflator, and most deflators show it has risen since 2019



ERNIE TEDESCHI AND ERIC VAN NOSTRAND

FEB 19, 2025



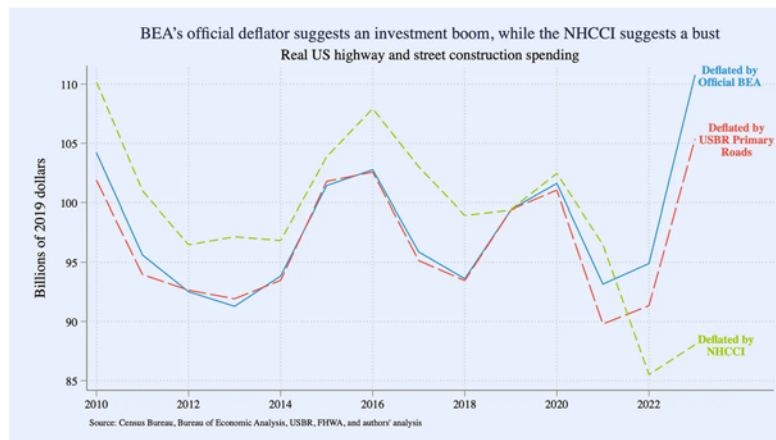
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Last week in *Foreign Affairs*, Obama Administration CEA Chair Jason Furman argued that real investment in U.S. infrastructure has fallen since the pandemic. This is a provocative claim: increasing infrastructure investment was a significant focus of the Biden Administration, especially via the 2021 Bipartisan Infrastructure Law (BIL).

Here, we explore the analytics behind measuring real infrastructure, focusing on the highway and street construction data that Professor Furman emphasized. The details matter: whether real infrastructure investment rose significantly or fell turns on the specific price index used to adjust for inflation. We find that using the official price index that the Bureau of Economic Analysis (BEA) uses to deflate these data, real highway spending has risen 11 percent since 2019. Professor Furman's claim that it has fallen depends on using something different, the National Highway Construction Cost Index (NHCCI). The NHCCI is an outlier relative to other measures of highway spending costs. It has shown much more inflation than the official price index, therefore showing less real investment than BEA's official published series. We also explore non-spending measures of real infrastructure, including miles of highway measured by the Federal Highway Administration and inferred from OpenStreetMap. These measures both show an increase in highway construction since the BIL was passed.



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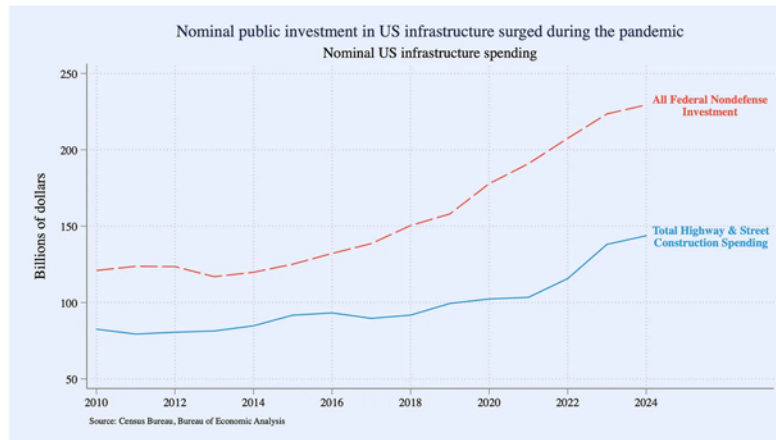
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How should we measure real investment?

Everyone agrees that *nominal* infrastructure spending has risen in the United States since before the pandemic. We focus first on highway and street construction, a dominant component of U.S. infrastructure funding and the component on which Professor Furman bases his argument. Total highway and street construction spending at all levels of government—federal, state, and local—grew by \$39 billion, or 39%, between 2019 and 2023, reaching \$138 billion (see chart below). Nearly this entire increase occurred after 2020. Roughly half of this spending is accounted for by direct federal highway spending, federal-aid highway grants, or state matching funds for federal highway projects. If we ignore state & local infrastructure spending for a moment but look at a broader measure of all federal nondefense investment (including in non-highway infrastructure like mass transit and energy transmission), the increase is even larger in nominal terms: federal nondefense infrastructure spending rose to \$224 billion in 2023.

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However, everyone also agrees that the increase in costs since the pandemic has dampened the impact of that sharp increase in nominal infrastructure spending. The key question is whether *real*, or inflation-adjusted, infrastructure spending has risen: in other words, whether the increase in nominal spending was sufficient to overcome the increase in costs and leading to more miles of road or higher-capacity power lines. Real spending is ultimately a way of tallying up whether the **quantity** of actual infrastructure investment—independent of price—has risen or fallen. The “dollars” in a real investment calculation are just a convenient, apples-to-apples way of adding together otherwise incompatible units of quantity. If I build 500 lane-miles of highway and 10 hydroelectric power plants one year, and 1,000 lane-miles of highway and 7 hydroelectric power plants the next, has the quantity of investment increased or decreased? It’s hard to say at first glance since it’s not obvious how one would combine “lane-miles of highway” and “number of hydroelectric power plants” in a compatible and understandable way. But by taking the dollar cost of both in a common base year and then inflation-adjusting for any cost changes before or after that base year, we can track the total quantity of all investment over time using shared units of measurement

between all types of investment; in this case, constant dollars in whichever base year we choose.¹

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The devil's in the deflator

To figure out how much real highway and street spending changed, we need a price deflator that reflects the underlying costs of road construction. There are a few valid candidates. Importantly, the answer to the key question of whether real infrastructure has risen or fallen turns on this choice. Therefore, it is critical to closely understand the differences between those candidate deflators.

The Federal Highway Administration produces a metric called the [National Highway Construction Cost Index \(NHCCI\)](#), which Professor Furman relies upon to argue that real infrastructure investment has fallen. The NHCCI measures the average change in prices that State transportation departments pay for the materials and services that go into roadway construction. It is constructed from State web-postings of winning bids for highway construction projects. In theory, then, the NHCCI should also reflect both materials and labor costs. But the bids underlying the NHCCI do not always reflect final costs. And as we unpack shortly, other candidate deflators have grown somewhat between what canonical measures of materials costs and labor costs have done. The NHCCI, however, has grown much faster than either one.

The **Bureau of Economic Analysis (BEA)** publishes a different price index used to calculate real highway spending for the purposes of GDP accounting, which is important since highway investment counts as a part of GDP. The BEA uses this price index to adjust the same nominal highway spending data on which Professor Furman's piece relies. The BEA price index reflects the costs of both materials and labor used in constructing highways. We can be confident it reflects both types of costs because it is an explicit composite of two other indices: the Producer Price Index (PPI) for Highways & Streets—which like the NHCCI measures prices for road construction

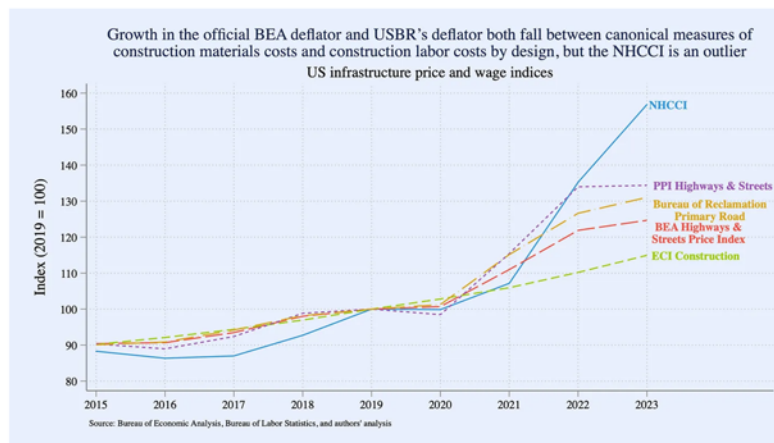
materials, but, unlike the NHCCI, from the seller's, not the buyer's, perspective—and wage costs from the Employment Cost Index (ECI) for Construction worker compensation (both the PPI and ECI series come from the Bureau of Labor Statistics). In other words, the BEA approach guarantees that the index will always incorporate materials and labor costs together.

Finally, the [Bureau of Reclamation](#) (USBR) produces a construction cost trends index that combines PPI data on various materials as well as other public and private data on materials, lands, and labor, weighted to different types of Bureau of Reclamation projects. In other words, the USBR approach is similar to BEA's with some overlapping and some distinct data. We include their "Primary Road" subindex below.

The chart below compares each of these series and indexes them to a common 2019 base for comparison. The key takeaway is that the NHCCI is a major outlier among these cost indices. It grew significantly faster than the other measures, especially in 2023. Deflating by the NHCCI rather than by BEA's official measure or USBR's will therefore by definition show lower real highway spending than using any other deflator on the table.

The drivers of the deviation between NHCCI and the BEA and USBR measures are not entirely clear, since in theory all three should account for materials and labor costs. One hypothesis is that the NHCCI in practice underweights labor costs, since it is estimated from winning bids at the time of award; this approach could understate the true labor cost share of final costs if a project runs long, utilizes more overtime than anticipated, or if contractors intentionally underbid labor costs due to cost-plus or other provisions. As the chart shows, underweighting labor costs would compositionally raise a composite index, since construction compensation grew more slowly than materials costs measured either by NHCCI or PPI. The fact that NHCCI and PPI, which by design excludes labor costs entirely, rose in tandem through 2022 supports this hypothesis. That approach may be appropriate for some purposes. But for the goal of deflating nominal dollars spent on construction labor and construction costs, a method reflecting the final balance of material and labor costs is more appropriate.

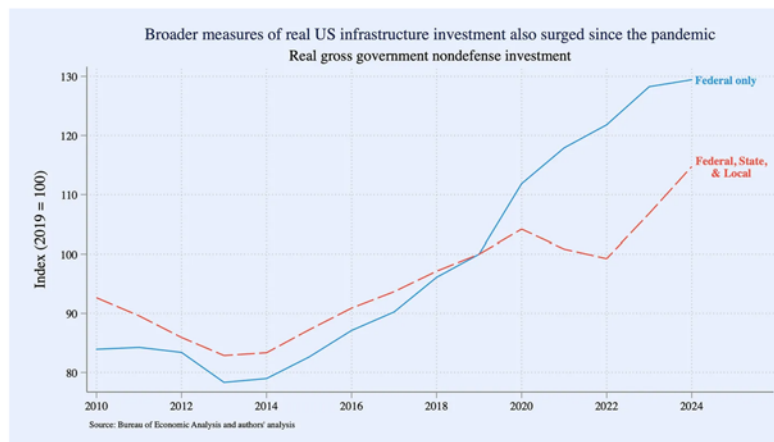
Of course, another possibility is that the NHCCI is correctly measuring the prevailing average cost of building a highway in the United States, reflecting the prevailing balance of material and labor costs, and the other two indices are not. If true, however, that raises much larger and more serious questions about price and wage measurement in official data, since both the BEA and USBR measure draw heavily on different PPI and ECI series that are supposed to be capturing the same price and wage drivers NHCCI is implicitly picking up.



In the end, the conclusion about real US highway spending over the pandemic is completely different depending on the deflator, as shown in the introductory chart. Using either the official BEA price index for highways that goes into GDP, or the USBR construction cost trends index for primary roads, real public highway and street construction fell in 2021 but then grew in 2022 and then shot up in 2023 to levels unseen since 2006. Deflated by NHCCI, real highway spending ended 2023 at its second lowest point in the past two decades.

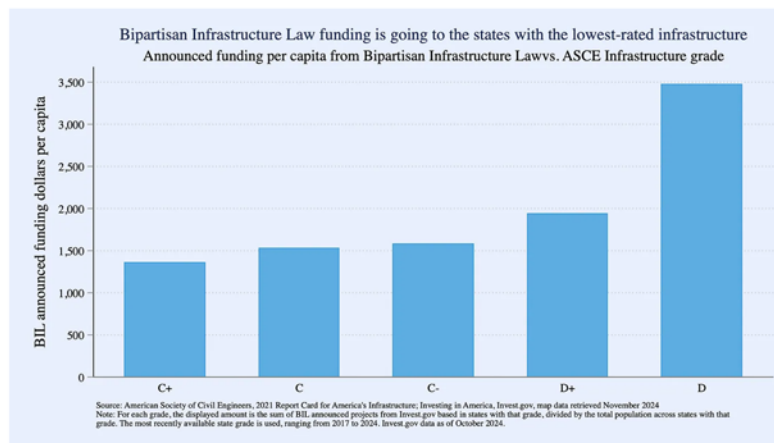
Broader measures of real infrastructure have boomed

Broader measures of real infrastructure investment beyond highway construction also show a significant increase since the pandemic. There are many ways to define and measure infrastructure investment; the highway spending data that Professor Furman and we have focused on thus far are indeed an important specific element. The chart below takes a broader view, showing all gross public investment outside the defense sector—including highways and streets, but also other transportation, power, and public building construction. This measure may be somewhat overinclusive for your chosen definition of infrastructure, including things like software and investment in conservation. The BEA publishes this real data directly, using official deflators produced just for these time series. At both the Federal level and across all levels of government, real public nondefense investment has risen significantly since the pandemic—consistent with the narrower view of highway spending (using all deflators except the NHCCI).



Beyond the macroeconomic data, one may wonder whether the new public investment is being dispersed efficiently. Importantly, the post-pandemic infrastructure spending appears to be landing in the places that need it most. The American Society of Civil

Engineers (ASCE) grades U.S. states on the quality of their infrastructure across several dimensions, including roads, bridges, water, and public transit. The chart below tallies infrastructure projects announced with funding from the Bipartisan Infrastructure Law (BIL) since its passage in 2021. It shows the per-capita BIL funding going to states with various ASCE grades. The states most in need of infrastructure improvements are disproportionately attracting funding. This suggests that the BIL was targeted thoughtfully and, in turn, was more likely to be effective in real terms.



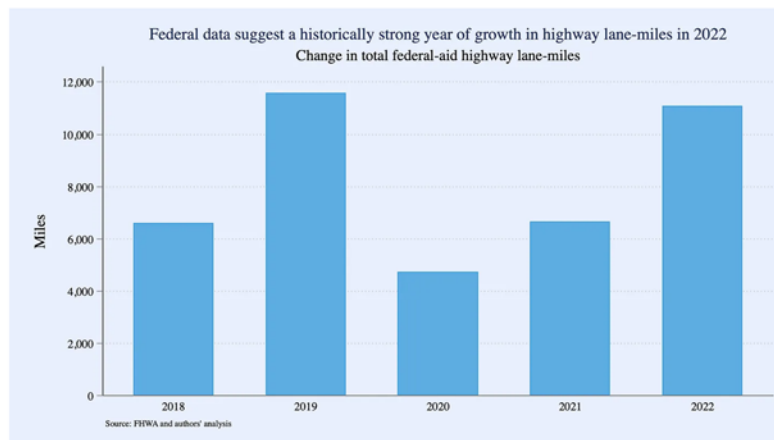
Directly measuring highway length shows a surge in infrastructure growth

So far, the answer about real highway spending during the pandemic depends on the deflator used. Is there any validation of real infrastructure investment during the pandemic without relying on nominal spending data and adjusting it for inflation?

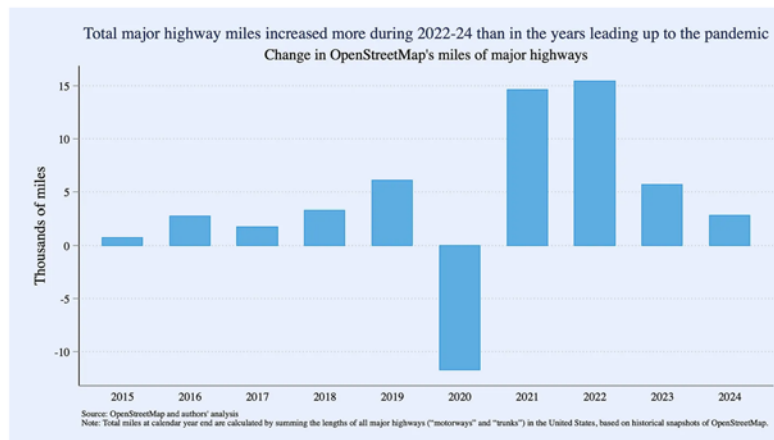
Recall that the goal of a real series is to estimate the *quantity* of investment. There are a few ways we can proxy for the quantity of investment without deflating spending data.

One is to ask, “How much highway was built during the pandemic?” To estimate this, we look at the annual *change* in the number of lane-miles of federal-aid highways in the US as reported by FHWA. Granted, this is not a perfect parallel to the highway construction figures used earlier. First, construction spending is recorded at the time a highway project is started, whereas lane-miles only increase once a project is completed, so there is a timing difference. Second, construction spending is a gross investment concept, without adjustments for depreciation, whereas change in lane-miles is a net concept, since it will reflect both new highways coming online but also highways that close due to deterioration, disaster, or other depreciation.

With those asterisks in mind, what we see is that the quantity of federal-aid highways grew consistently throughout the pandemic (2023 data have not yet been released by FHWA), and in fact 2022 saw the largest expansion in the length of federal-aid highways, as measured by lane-miles, since pre-pandemic. While 2022's net new lane-miles do not exceed 2019's in these data, they are well above 2018's, 2020's, and 2021's. In contrast, the NHCCI-deflated highway spending suggests 2022 should have been the smallest year in decades. The pattern of the FHWA data is thus closer to the BEA- or USBR-deflated spending data than the NHCCI-deflated data.



Another non-spending measure of highway construction can be inferred from OpenStreetMap, a freely available database tracking global geographical information including roadways. We took historical snapshots of OpenStreetMap's freely available data listing the locations and lengths of all roadways in the United States, and measured the total miles of highway in the United States at the end of each of the past few calendar years. Again, this is a slightly different concept: our sample does not reflect federal-aid highways specifically, but rather all major public roadways in the United States. (Specifically, we count those roads classified in OpenStreetMap as "motorways" or "trunks," corresponding to major highways; this excludes smaller highways, residential streets, and service roads.⁴) But importantly, OpenStreetMap is updated nearly in real-time, so we can extend our analysis through 2024. This measure saw a dip in 2020, likely as typical road closures were not offset with new construction during the pandemic. But after a rebound in 2021, the following three years were stronger than any period prior to the pandemic (with data back to 2014).



Conclusion

Measuring real infrastructure investment is a complicated business, and we do not suggest that there is one unimpeachable method to do so. But most reasonable approaches point to a significant increase in real investment following the BIL's passage in 2021. Official deflators that explicitly incorporate both material and labor costs show significant increases in real highway spending in the wake of the BIL; broader measures of real infrastructure saw robust gains as well in the official data. And while outside validation of real spending data is difficult, what we do have is consistent with the conclusion that the quantity of infrastructure rose following BIL. To support the claim that real infrastructure investment has been the weakest in decades, one must use an outlier deflator that shows considerably higher prices than comparable measures.

- 1 The trade-off between choice of base year and adding/subtracting real components gets much more complicated when using chain-weighted/Fisher price indices like the NHCCI or BEA's indices. We save that topic for another discussion.
- 2 Road definitions from OpenStreetMap wiki,
<https://wiki.openstreetmap.org/wiki/Key:highway>



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A guest post by

Ernie Tedeschi

Ernie Tedeschi is a Research Scholar at Yale Law School and a Visiting Fellow at the Psaros Center for Financial Markets & Policy at Georgetown University. He recently served as Chief Economist for the White House Council of Economic Advisers.

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2/20/25, 1:00 PM

Has U.S. infrastructure investment really declined?



A guest post by

Eric Van Nostrand

Former Assistant Secretary of the Treasury for Economic Policy (acting) & Chief Economist at U.S. Treasury, 2023-25; previously BlackRock, Obama CEA.

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excellent piece! ALWAYS appreciate careful analyses by folks who actually understand the data.

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March 4, 2025

The Task Force on Monetary Policy, Treasury Market Resilience, and Economic Prosperity
Honorable Members
House Financial Services Committee
Washington, DC 20515

Dear Members of the Task Force,

Thank you for the opportunity to submit this written statement for the record. As the Federal Reserve undertakes its 2025 framework review, it is an opportune moment to pay close attention to the critical connections between price stability, monetary policy, productive capacity, and economic prosperity.¹

Framing the Moment

The Federal Reserve's *Statement on Longer-Run Goals and Monetary Policy Strategy*² serves as a foundational guide for how the Fed interprets and executes the mandate entrusted to it by Congress: maximum employment, stable prices, and moderate long-term interest rates.³ The 2025 review offers a unique opportunity to reflect on the noisy and complex macroeconomic environment of the early 2020s, including the pandemic recovery, the inflation surge, and the wide array of policy responses that followed.

This review should be forward-looking, preparing for a future defined by ongoing supply chain realignments, commodity price volatility shocks, and policy uncertainty — including the potential for blunt tariffs and unpredictable geopolitical disruptions.

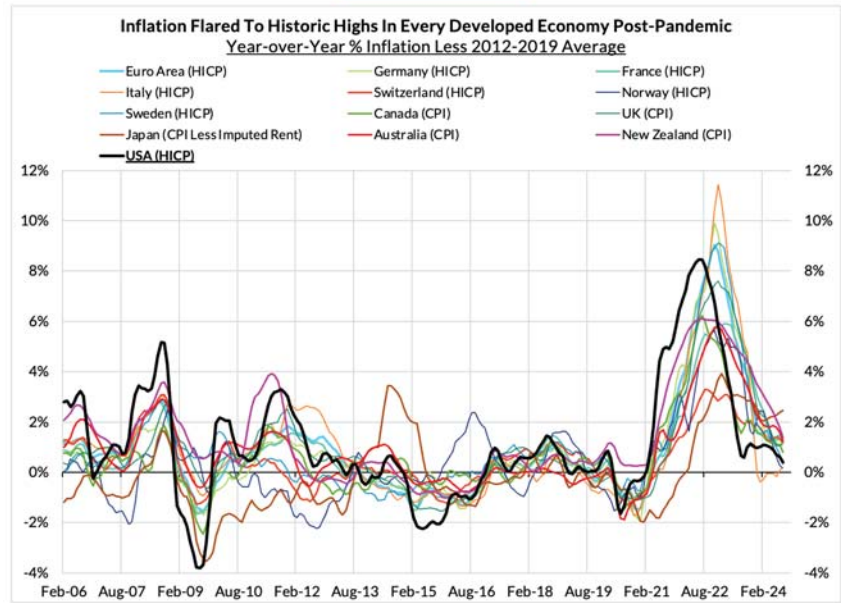
The Economic State: Recovering From Cost of Living Shocks As New Policy Risks Emerge

Americans understandably feel that prices remain uncomfortably high. Thanks to sharp and severe shocks to a range of key commodities, goods, and services in 2021 and 2022, the cost of living surged all over the world.

¹ The Federal Reserve's framework review is the second of its kind, and more formally known as its "Review of Monetary Policy Strategy, and Communications." <https://www.federalreserve.gov/monetarypolicy/review-of-monetary-policy-strategy-tools-and-communications-2025.htm>

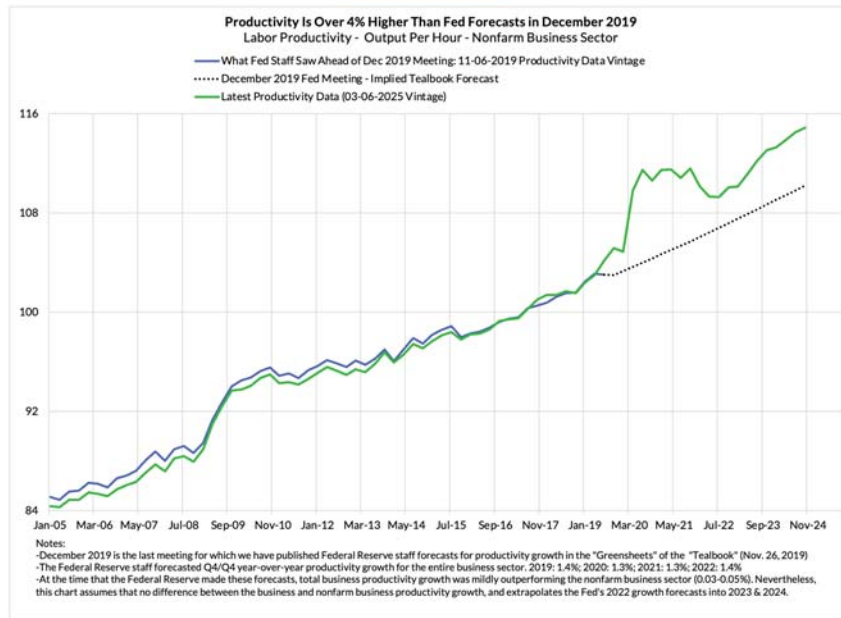
² Federal Reserve Board of Governors. "Statement on Longer-Run Goals and Monetary Policy Strategy. Adopted effective January 24, 2012; as reaffirmed effective January 30, 2024." https://www.federalreserve.gov/monetarypolicy/files/fome_longerrungoals.pdf

³ 12 U.S.C. § 225a - Maintenance of long run growth of monetary and credit aggregates

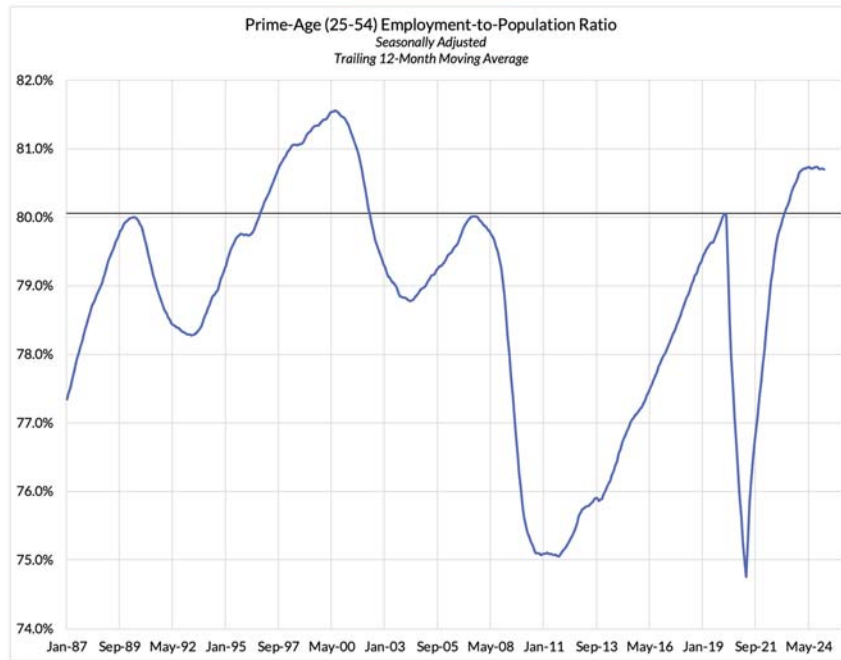


Even as the pace of price increases has evidently slowed, the outright level of prices and the uncertainty and volatility of the past few years have understandably weighed on Americans. That said, there have been signs of meaningful economic progress in recovering from these shocks while avoiding additional sources of economic pain. Real GDP growth was robustly above trend in 2023 and 2024, such that productivity is running meaningfully above the trends and Fed forecasts that prevailed prior to the pandemic.

⁴ Chart uses Harmonised Index of Consumer Prices (HICP) methodology wherever available and national level CPI measures where unavailable.

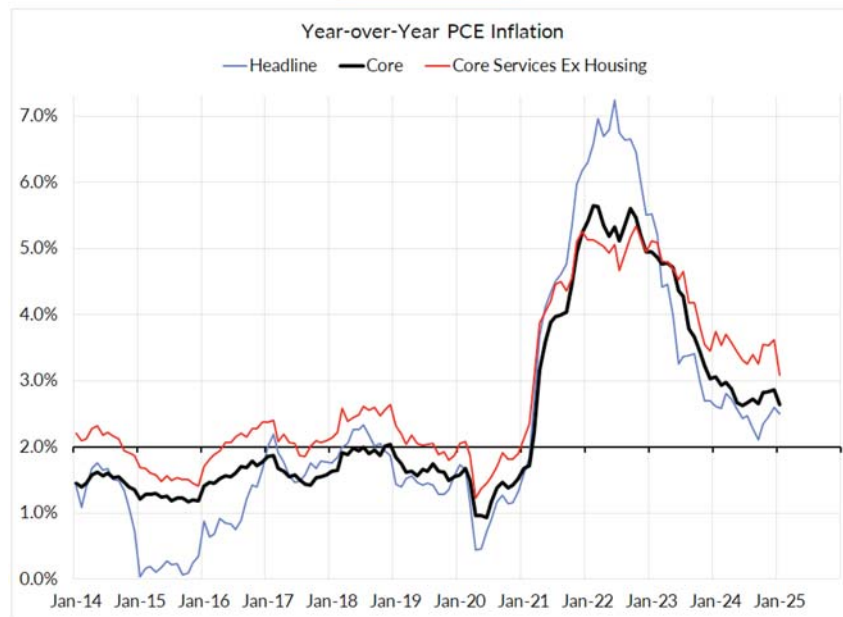


The unemployment rate remained low, while the labor force participation rate and employment-to-population ratio among prime-working-age 25 to 54 year old Americans reached multi-decade highs.



Job growth has remained impressively robust, adding 162 thousand jobs per month on average in 2024, 160 thousand per month coming from outside the federal government and 130 thousand of which were in the private sector. These rates of job growth outpace what would be implied purely by demographics and the recently elevated level and rate of employment.

These positive economic developments have coincided with falling rates of inflation, defying a pessimistic economic forecasting consensus over recent years that underestimated the scope of supply-side recovery and improvement taking place in the economy.



If the lagging components to the Fed's inflation gauges continue to fall with no new sources of inflationary upside, the Fed should be able to achieve its 2% inflation target in 2025.⁵

While the recovery to the pre-pandemic trend in real wage growth remains uneven and in some cases incomplete, most measures of wages and prices, after accounting for their biases, suggest tangible improvements in real wages.

⁵ Amarnath, Skanda. Employ America. "Small Upside Surprises and Three Lagged Quirks That Stand In The Way Of The Fed's Target." March 3, 2025. <https://www.employamerica.org/blog/january-2025-core-cast-post-pce/>



Real wage measures	Annualized growth rates			Accelerative relative to pre-pandemic trends	
	Since the pandemic (2020-24)	Latter 2010s (2015-19)	Earlier 2010s (2010-14)	Post-pandemic vs. latter 2010s	Post-pandemic vs. earlier 2010s
CES - average hourly earnings (all employees)	+0.3% to +1.2%	+0.7% to +1.4%	+0.2% to +0.4%	-0.8% to 0.0%	0.1% to 0.8%
CES - average hourly earnings (rank-and-file)	+0.9% to +1.8%	+0.7% to +1.5%	+0.2% to +0.4%	-0.3% to 0.6%	0.7% to 1.3%
CPS (median)	+0.5% to +1.4%	+1.2% to +2.0%	+0.4% to +0.7%	-1.1% to -0.3%	0.1% to 0.7%
CPS (lowest quartile)	+1.2% to +2.1%	+2.0% to +2.8%	-0.3% to +0.1%	-1.3% to -0.3%	1.5% to 2.0%
ECI (wages & salaries)	-0.3% to +0.6%	+0.6% to +1.3%	-0.1% to +0.3%	-1.3% to -0.5%	-0.3% to 0.3%

Note: Ranges derived using headline and core CPI & PCE from table above.

6

At a more tractable level, we also saw that key benchmark commodity prices, like oil and gasoline, return to a healthy level, balancing consumer affordability with domestic producer resilience after spiking following Russia's invasion of Ukraine.

The macroeconomic outlook presents potential opportunities and real challenges. A period of supply side stability and strength would create the conditions for workers to earn faster pay increases relative to the high levels of prices they have endured in recent years. Productivity is already outperforming its prepandemic trend and suggests a regime of higher potential growth is indeed feasible, especially if the promise of artificial intelligence (AI) investments and technologies pay off. Inflation is also not far from the Fed's target and with further improvements in lagging components, it may soon be feasible to reduce interest rates further, and for welcome reasons.

On the other hand, the risks to prices and inflation are equally hard to ignore. Tariffs and tariff threats are already causing businesses to aggressively bid up imports and carry more inventory.⁷ We are also facing

⁶ Amarnath, Skanda. Economic Innovation Group. "The Tight 2020s." August 2024. <https://eig.org/wp-content/uploads/2024/08/TAWP-Amarnath.pdf>

⁷ Bureau of Economic Analysis. U.S. International Trade in Goods and Services, January 2025



unusually high levels of trade policy uncertainty, which can muddy how firms assess their cost structure. In addition to burdening competitive export-oriented manufacturing and energy sectors as a result of retaliatory measures, tariffs are likely to have an outsized impact on the homebuilding sector. By raising the costs of building materials and appliances, homebuilders are likely to build less housing, resulting in greater scarcity and higher housing costs for Americans.

Haphazard trade and energy policies are liable to raise uncertainty, pushing up critical costs that underlie our energy systems. Tariffs on Canadian crude are now likely to be passed on fully to motorists in various states and regions where refineries are tuned for their heavier grade of oil.⁸ A trade conflict with Canada is also liable to raise the cost of electricity and heating for states in the midwest and northeast that import directly from Ontario and Quebec.⁹ While the administration's open efforts to lobby OPEC to raise production and potentially lift Russian sanctions may bring more of their oil onto global markets and successfully lower global oil prices in the short run, the adverse impact to US production and industry may also breed future price volatility.^{10,11} US industry has raised production and provided the marginal barrel of crude oil to global markets over the past few years but may be forced to reduce investment and production if oil prices fall further while OPEC and Russia take greater share.

The US economy also remains vulnerable to some inflationary byproducts from the AI boom, as it pushes up demand for electricity and energy infrastructure. In the absence of a diversified strategy for generating more electricity and energy generally, the constraints on natural gas turbine manufacturing and the rise in natural gas prices will likely spill over into household utility bills.^{12,13} Unfortunately, recent policy announcements from the administration suggest a narrow-minded dislike for the most immediately scalable sources of power. Suspending leases for renewable energy on federal lands is unwise, as is repeal of technology-neutral investment and production tax credits.¹⁴ Only through greater investment in a range of supply can the electricity and energy needs of today and tomorrow be met.

Finally, with greater trade policy uncertainty and the demand for semiconductors likely to remain robust across sectors and in relation to the AI boom, repealing support for onshoring supply chains would be a

⁸ <https://www.bea.gov/news/2025/us-international-trade-goods-and-services-january-2025>

⁹ Amal, Matias. U.S. Energy Information Administration. "Canada's crude oil has an increasingly significant role in U.S. refineries." August 1, 2024. <https://www.eia.gov/todayinenergy/detail.php?id=62664>

¹⁰ Killian Staines, Daniel Weeks, Kip Keen, Zack Hale, and J Robinson. S&P Global. "Trump tariffs include 10% carve-out for Canadian gas, power, minerals." February 2, 2025. <https://www.spglobal.com/commodity-insights/en/news-research/latest-news/natural-gas/020225-trump-tariffs-include-10-carve-out-for-canadian-gas-power-minerals>

¹¹ President Donald J. Trump. White House. "Remarks By President Trump at the World Economic Forum." January 23, 2025. <https://www.whitehouse.gov/remarks/2025/01/remarks-by-president-trump-at-the-world-economic-forum/>

¹² Banco, Erin. Reuters. "White House seeks plan for possible Russia sanctions relief, sources say."

<https://www.reuters.com/world/white-house-seeks-plan-possible-russia-sanctions-relief-sources-say-2025-03-03/>

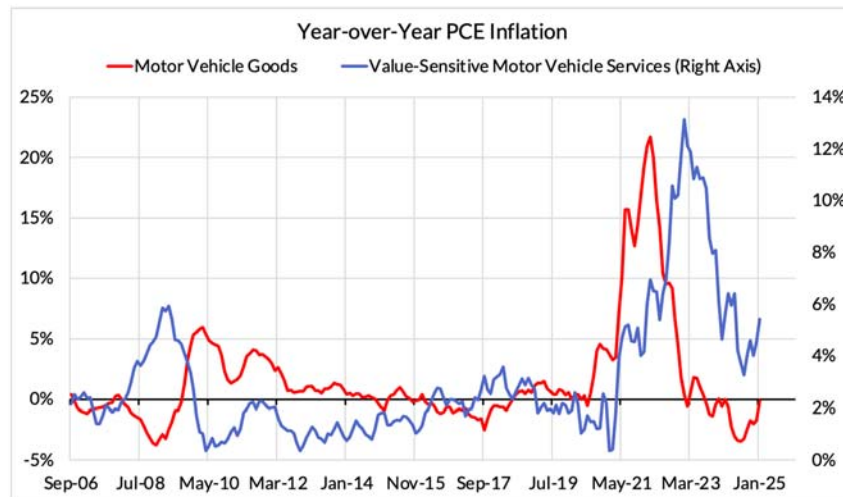
¹³ Corrina Ricker and Andrew Iraola. U.S. Energy Information Administration. "EIA expects higher wholesale U.S. natural gas prices as demand increases." January 23, 2025. <https://www.eia.gov/todayinenergy/detail.php?id=64344>

¹⁴ Clark, Kevin. Power Engineering. "Long lead times are dooming some proposed gas plant projects." February 20, 2025. <https://www.power-eng.com/gas/turbines/long-lead-times-are-dooming-some-proposed-gas-plant-projects/>

¹⁵ Cruickshank, Waleter. Department of the Interior. Order NO. 3415. "Subject: Temporary Suspension of Delegated Authority." January 20, 2025. <https://www.doi.gov/document-library/secretary-order/3415-temporary-suspension-delegated-authority>



mistake.¹⁵ Microchips are highly relevant to the productive capacity of the US economy both at the lagging and leading edge. Commoditized semiconductors, where China currently plays a growing role, were a total blindspot to the global auto industry during the pandemic and at the onset of the global chip shortage. Global automobile production had to be shuttered for two years.¹⁶ The knock-on effects of this dynamic included spiking prices not just for new and used cars or parts, but also, with an understandable lag, a range of value-sensitive motor vehicle services, including rental, leasing, repair, maintenance, and insurance.



On the other hand, the CHIPS Act is already yielding meaningful benefits in the production of leading-edge microchips in the United States.¹⁷ Replacing this program with tariffs would likely do less to support production, and inadvertently raise prices that Americans pay for information technology hardware.¹⁸

Why the Fed Framework Review Matters

¹⁵ American Automotive Policy Council. "American Automakers Applauds Largest CHIPS Investment Since Inception of Program." February 20, 2024. <https://www.americanautomakers.org/american-automakers-applauds-largest-chips-investment-inception-program>

¹⁶ Brinley, Stephanie. S&P Global. "The semiconductor shortage is – mostly – over for the auto industry." July 12, 2023. <https://www.spglobal.com/mobility/en/research-analysis/the-semiconductor-shortage-is-mostly-over-for-the-auto-industry.html>

¹⁷ Hawkins, Mackenzie. Bloomberg News. "TSMC's Arizona Chip Production Yields Surpass Taiwan's in Win for US Push." October 24, 2024. <https://www.bloomberg.com/news/articles/2024-10-24/tsmc-s-arizona-chip-production-yields-surpass-taiwan-s-a-win-for-us-push>

¹⁸ Ezell, Stephen. Information Technology & Innovation Foundation. "Trump's Proposed Tariffs on Taiwanese Semiconductors Would Backfire." January 28, 2025. <https://itif.org/publications/2025/01/28/trump-s-proposed-tariffs-on-taiwanese-semiconductors-would-backfire/>



If the present and recent past are at all representative, we are in an age of greater supply-side volatility, and the Fed's job will be made all the more complicated as a result. The US economy's productive capacity and resilience has shaped, and will continue to shape, both sides of the dual mandate—maximum employment and stable prices—and the Fed's ability to achieve those goals. The 2025 framework review offers the Fed an opportunity to build a more durable framework that robustly incorporates these supply-side realities when pursuing its Congressionally mandated objectives in an operationally independent and apolitical manner.

The Fed's framework review is not just a technical exercise — it is an opportunity to institutionalize lessons learned about how supply-side volatility complicates both policy formulation and public communication.

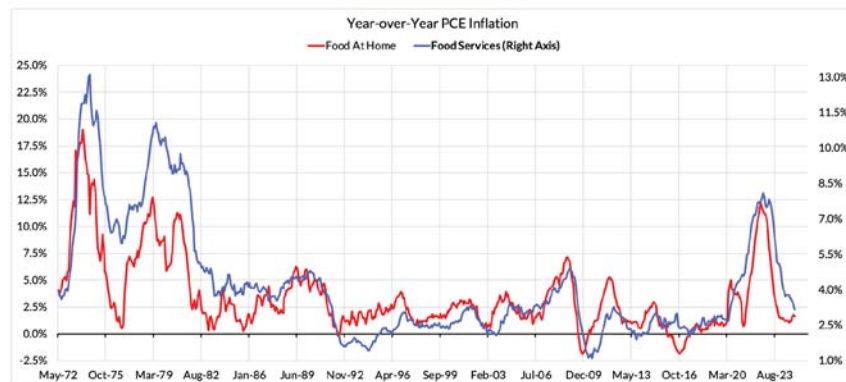
Productive capacity — the economy's supply side — clearly interacts with the Fed's dual mandate. Maximum employment depends on key labor supply inputs (e.g. population, demographics, human capital) and other supply factors that determine how workers can be employed productively, at scale. Price stability outcomes are also a function of supply side stability, including the avoidance of bottlenecks, trade disruptions, and geopolitical uncertainty. If monetary policy fails to respond effectively to recessions or recession risks, the first-order effect may be weaker demand, but there are also adverse long-term effects on productive capacity.

In this context, Fed's framework for independently and objectively pursuing the "dual mandate" is not just an institutional nicety. It reflects the strategy for ensuring that monetary policy fulfills the mission Congress intended with its Constitutionally enumerated powers, and legislated through Section 2A of the Federal Reserve Act.

The Supply Side and The Fed: Why It Matters More Than Ever

A Historic Blind Spot: 2021-2023 Inflation and the Fed's Analytical Shortcomings

The Fed and most economists underestimated the scope, scale, and duration of key inflationary shocks. Supply chain bottlenecks, best exemplified by the semiconductor shortage, curtailed global motor vehicle production for over two years. Commodity prices were vulnerable to historic geopolitical shocks, agricultural input disruptions, and general market volatility. Surges in goods prices affected by supply shocks, including food and motor vehicles, also had substantial passthrough implications for a range of food and motor vehicle service prices.



While it is also true that much of the inflation in this period was driven by unique demand-side factors tied to recovering from a pandemic, not all of the inflation was demand driven. By applying demand-suppression tools to problems heavily shaped by supply-side dynamics, the Fed has risked excessive policy tightening, which it is only recently beginning to remedy through corrective interest rate reductions.

Looking Through Asynchronous Relative Price Shocks

The Fed's PCE inflation gauge does not automatically distinguish between generalized inflation from excess demand, and sizable, permanent but one-off price increases in key sectors. Both in 2008 and in 2011, headline and core inflation accelerated due to oil and commodity price shocks and their passthrough effects, but nominal spending and income growth weakened — a sign that not every price increase is a result of monetary or demand-side factors.¹⁹ Misinterpreting these episodes led to premature tightening, worsening demand weakness.

The 2021-2023 cycle echoed some of these dynamics, where broad-based consumer price inflation occurred due to compounding supply disturbances. But because nominal consumer spending and labor income growth remained robust through this period, the risk of a policy mistake was lower. Especially with tariff threats and policies continuing to loom large over the economy right now, even as nominal labor income and consumer spending trends have cooled, the risk of excessive policy restriction is high. The Fed needs to refine its approach and clearer communication strategies to distinguish between relative price shocks and the sustained overheating of demand.

¹⁹ Amarnath, Skanda. Employ America. "By Doubling Down On Inflation Targeting, The Fed Is At Risk of Forgetting Lessons From 2008 & 2011." <https://www.employamerica.org/researchreports/by-doubling-down-on-inflation-targeting-the-fed-is-at-risk-of-forgetting-lessons-from-2008-2011>

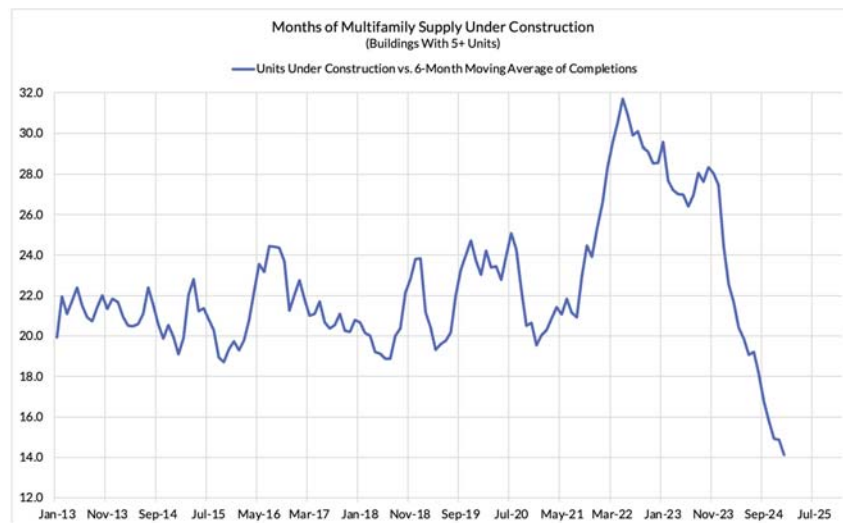


The Fed's Own Influence on Productive Capacity

Monetary policy affects future supply capacity, particularly in credit-dependent sectors. Research by Drechsler, Savov, and Schnabl demonstrates how policy tightening can constrain sectors that depend more directly on external financing for investment.²⁰ As a result, higher interest rates and tighter monetary policy can even reduce productive investment and amplify future inflation risk. Industrial sectors that depended on financing to support more inventory and capital formation in the 1970s were more likely to face adverse supply side conditions and raise prices as a result.

Housing is arguably an even better example of the interconnection between monetary policy, the supply side, and inflation. While mortgage rates influence homeownership demand, they do not directly affect rental demand, since rent is typically paid through borrowed funds. Those who cannot afford to buy a home due to high home prices and mortgage rates typically must rent instead.

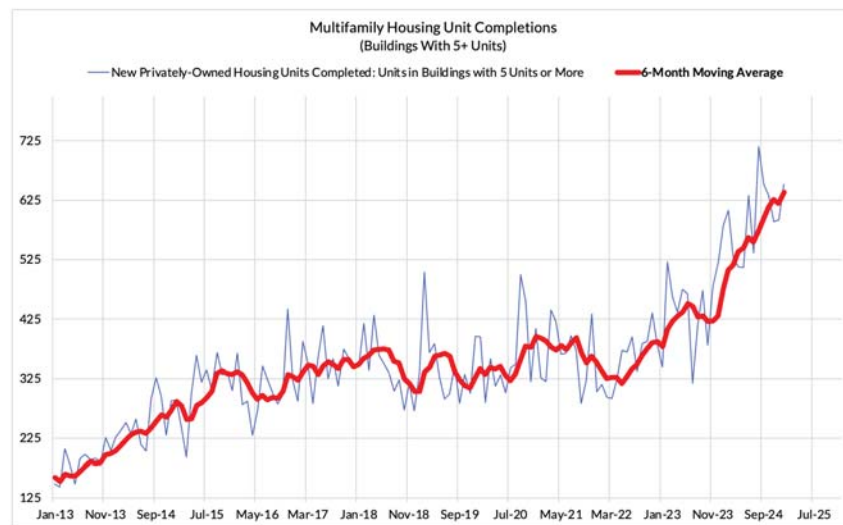
On the other hand, homebuilders depend on financing to develop both owner-occupied and rental housing. Higher mortgage rates have clearly depressed the production of both single family homes that are typically owned and multifamily units that are typically rented.



²⁰ Itamar Drechsler, Alexi Savov, and Philipp Schnabl, "Credit Crunches and the Great Stagflation," March 2023, https://pages.stern.nyu.edu/~asavov/alexisavov/Alexi_Savov_files/DSS_Credit_Crunches.pdf



Given that housing inflation is measured in terms of rental cost and not in terms of home price appreciation, the Fed's restrictive policies counterintuitively present some upside risks to inflation over the medium term. We are currently benefitting from elevated construction levels from a few years ago translating into heavy delivery of supply. But the robust pace of completions is likely to fade in the coming quarters.

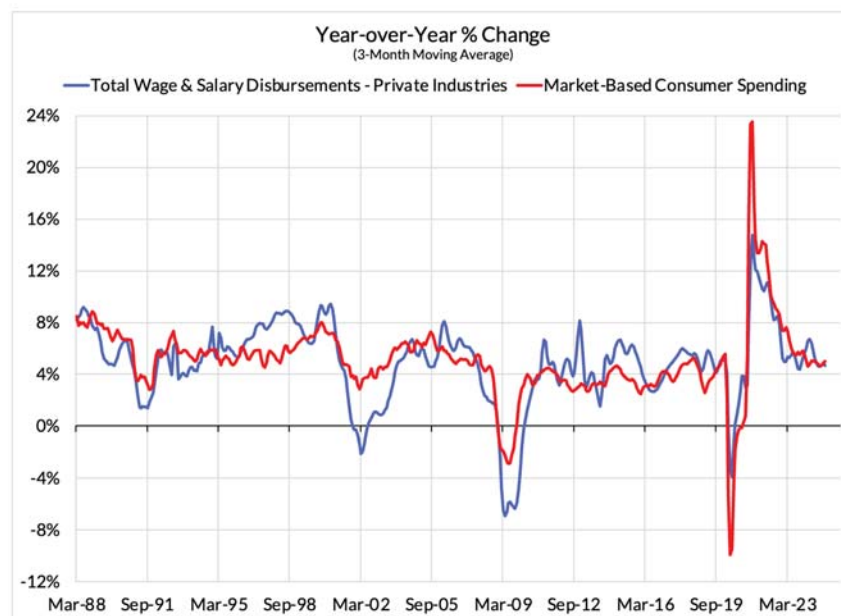


Restrictive Fed policy has more direct effects on the construction of residential units than it does on households' demand to rent those units. As the delivery of newly constructed units slows, the restrictive policies of the past three years raise the risk of rising market rent inflation in the next 18 months. Prolonged restrictive policy depresses homebuilding, reducing future housing supply and elevating medium-term housing inflation. At a moment when housing costs are already far too high, it is essential to support more new residential construction.

There are other sectors, like energy and manufacturing, where finance-sensitive investment may also be undermined when Federal Reserve policy is restrictive and supply constraints are already binding. After all, financing costs are also costs, and higher costs will warrant even higher final prices to justify investment. These considerations do not appear to be formally factored into Federal Reserve policymaking. The framework review should formally recognize these dynamics where they exist and take a nuanced, objective, and independent approach to weighing them in policy decisions.



A straightforward adjustment would be to elevate the role of nominal consumer spending and nominal labor income trends in the Fed's framework. Nominal consumer spending trends help distinguish supply-side price shifts from demand-driven inflation. Nominal labor income trends capture job growth and wage momentum, ensuring that maximum employment assessments are at least partially anchored to workers' bargaining power. Both indicators help strengthen the Fed's commitment to both sides of the dual mandate and its communication strategy with the public.



Nominal consumer spending and nominal labor income also correlate strongly and relate causally. Every additional paycheck or paycheck increase adds to consumer spending to some reliable degree. Unlike nominal GDP, nominal consumer spending excludes spending on fixed capital formation, thereby preventing the Fed from overreacting if a supply-additive investment boom is present.

Defending the Fed's Independence and the Dual Mandate

At various points the maximum employment mandate has come under scrutiny, but there is no good reason it should take on an ideological or partisan valence. Stakeholders across the spectrum may disagree on the means for achieving economic goals, but virtually all aspire to see an economy in which inflation is



low, employment is high, and recessions are avoided to the extent feasible. The value of the maximum employment mandate is to ensure balance in how the Federal Reserve pursues its objectives.

Solely focusing on price stability can yield a narrow approach to policymaking that ignores how monetary policy actually works and the potential costs to economic prosperity. The Federal Reserve sets the interest rate on reserves to target the overnight borrowing cost for bank reserves and other short-term money market rates. Those short-term interest rates affect the opportunity cost of holding riskier assets, including instruments of longer duration and greater credit and equity risk. The prices of those assets then affect the willingness and ability of businesses and households to spend, borrow, and invest. That spending behavior in turn affects inflation outcomes.

The long causal chains for transmitting monetary policy to the real economy involve long and variable lags. As we saw in 2008, the elevated inflation outcomes of that time were not a good indicator of where they would be over the long term amidst a brewing financial crisis and rising unemployment. While the dual mandate objectives are generally consistent with each other, narrow-minded approaches to pursuing price stability may ultimately yield to more financial market volatility and greater labor market instability.

To put things in more practical terms, without the maximum employment mandate, the Fed would likely be setting interest rates even higher and pushing up borrowing costs for businesses and households. While inflation should slow later this year thanks to the benefit of lagging components finally decelerating, inflation is still elevated relative to the Fed's target and the upside inflationary effects from trade policy are uncertain but potentially significant. A singular price stability mandate would encourage the Fed to disavow a textured view of the data, lags, and one-time relative price shifts stemming from tariffs. Such an approach would encourage the Fed to raise interest rates or else fail to lower interest rates even in the presence of downside labor market and financial stability risks. The Fed's ability to take a balanced, forward-looking approach to managing inflation while avoiding deep recessions would be hindered.

The macroeconomic risks right now are very real and are uniquely challenging for the Fed to manage. Additional trade barriers implemented this year could push up inflation meaningfully for a temporary period of time but should not affect longer run inflation rates necessarily. January 2025's surge in imports suggests that businesses have already front-loaded expenditures and costs that risk getting passed on to consumers. At the same time, trade barriers may depress real economic activity and hiring and thereby weigh more heavily on employment than they increase in prices. In 2018 and 2019, the trade conflict with China had a more pronounced effect in depressing output than it did in raising inflation, thus warranting lower interest rates.²¹ It's not a given that today's policies and threats will yield a similar outcome, but the dual mandate objectives are an effective insurance policy against a wider array of scenarios.

Congress has entrusted the Federal Reserve with setting monetary policy and operating with political independence. The requisite decisions are subject to high levels of complexity, uncertainty, expertise,

²¹ Aaron Flaen and Justin Pierce, Finance and Economics Discussion Series 2019-086, Washington: Board of Governors of the Federal Reserve System, "Disentangling the Effects of the 2018-2019 Tariffs on a Globally Connected U.S. Manufacturing Sector," December 23, 2019. <https://www.federalreserve.gov/econres/feds/files/2019086pap.pdf>



nuance, and human judgment. The long and staggered terms for Federal Reserve governors are highly consistent with what the Supreme Court recently recognized to be deliberative bodies aligned with legislative power vested in Congress.²² The Fed's independence is thus critical to aligning with Congressional intent by ensuring it navigates all scenarios, including supply shocks and trade policy risks, in an apolitical and objective manner.

Complementary Nonmonetary Policies To Lower Prices and Expand Prosperity

Housing is a prime example of where costs for too many Americans remain too high and forthcoming policies are at risk of exacerbating these challenges. Instead of proposed tariffs on building materials (lumber, steel), which will raise construction costs and deter new development, policies that expand housing investment should be prioritized.²³ Construction financing measures can incentivize builders and developers to expand supply at all affordability levels. All of these measures would be further bolstered and complemented by a Federal Reserve that recognized the need for expanded residential fixed investment to ensure longer run price stability.

Energy policy needs to support diversification. Natural gas prices have already risen in recent months to historically elevated levels, while natural gas turbine manufacturers are already reporting multi-year bottlenecks that will limit growth. Preserving the technology-neutral investment and production tax credits in the Inflation Reduction Act would support a diverse range of sources for electricity generation. Likewise, there should be a technology-neutral approach to supporting electricity generation on federal lands, especially since renewables' buildout is likely to be more immediately scalable. Rationalizing the regulatory and permitting process for building out transmission lines can drastically expand their value to the grid. Diversification efforts are also likely to be more successful if paired with financing conditions that more directly support investment. The Fed's approach to setting monetary policy could prove especially helpful to the development of a healthy range of sources for energy production.

At a time of geopolitical instability and rapid technological development, it would be wise to support efforts to improve the resilience of semiconductor manufacturing supply chains. In addition to resilience against inflationary supply shocks, there are positive technological externalities to prosperity from developing indigenous knowhow and capabilities in the manufacture of complex goods. The CHIPS Act was a bipartisan enterprise that is improving the resilience of domestic and global supply chains. Greater resilience will ensure lower prices for the technological equipment Americans increasingly utilize in their daily lives, whether through computers and phones or automobiles and appliances.

²² *Seila Law LLC v. Consumer Fin. Prot. Bureau*, 140 S. Ct. 2183 (2020)

²³ David Lawder and Andrea Shalal. Reuters. "Trump orders new tariff probe into US lumber imports." March 1, 2025. <https://www.reuters.com/world/us/trump-orders-new-tariff-probe-into-us-lumber-imports-2025-03-02/>



Conclusion

We enter 2025 both with an economy capable of greater prosperity and lower inflation, but also subject to a variety of new economic and policy risks. The 2025 review is an opportunity to embed supply-side awareness into the Fed's framework while preserving the dual mandate and independence, essential to resilient economic prosperity. The 2025 framework review offers the Federal Reserve a critical opportunity to incorporate supply-side realities into its framework while pursuing its mandated objectives from Congress in an independent and objective manner.

Complementary fiscal and regulatory policies that enhance productive capacity, housing affordability, and broader industrial resilience will strengthen the Fed's ability to fulfill its core mission of fostering maximum employment and stable prices.

Sincerely,

Skanda Amarnath
Executive Director
Employ America

Answers from Donald Kohn**Questions for the Record**

Task Force on Monetary Policy, Treasury Market Resilience, and Economic Prosperity Hearing
 “Examining Monetary Policy and Economic Opportunity”

March 4, 2025

Chairman Hill:

1. Dr. Kohn, you and I discussed the Federal Reserve’s current review of the Federal Open Market Committee (FOMC) Statement on Longer-Run Goals and Monetary Policy Strategy, focusing on the parts of the FOMC Statement the Federal Reserve should pay particular attention to in light of the recent period of high inflation.

- a. What is the most important subject the Federal Reserve should review when assessing the FOMC Statement in 2025? Are there other subjects the Federal Reserve should also focus on?
- b. What role did the FOMC Statement’s Flexible Average Inflation Targeting (FAIT) framework play in the Federal Reserve’s in response to rising prices starting in March 2021?
- c. Should the Federal Reserve reconsider the FAIT framework given potential persistent inflation, a rising neutral rate of interest, and the possibility of a sustained increase in nominal interest rates?

Answer

1. a. The Federal Reserve’s most important task in considering changes to its framework is to make sure the monetary policy strategy is robust to a wide variety of economic developments. The 2020 framework was focused primarily on dealing with the situation the Federal Reserve found itself in through the 2010-19 period, which was characterized by inflation below its objective and very low nominal interest rates that threatened to constrain its response to an adverse economic shock to demand. In the event, of course, it was faced with high inflation that persisted far longer than anticipated. The framework should provide guidance to the committee and the public on how it will respond to a much more diverse set of circumstances, including a return to the low-rate environment, but also persistent upward pressure on inflation, including from expansive fiscal policy and adverse supply shocks such as are likely to be posed by higher tariffs. Stress testing its new framework to a variety of potential developments and publishing the results will help the FOMC think through the issues it might face and the public and markets anticipate how it might react. I am encouraged that the minutes of the March meeting of the FOMC indicate that Committee participants “judged that any strategy conveyed in the statement should be robust to a wide range of economic circumstances.”

There are a number of other topics that it would be useful to focus on in the review. One is justifying the choice of the 2 percent inflation target—a subject that arose in our hearing. Another would be to spell out more clearly the thinking behind the use of asset purchases (QE) and to review the lessons learned from how QE and forward guidance on QE

and interest rates played out in the post-Covid period. Finally, our hearing also illustrated that the Federal Reserve needs to continue to work on communication; it is doing a pretty good job with the market and academics, but members of the Task Force noted several times that they had trouble understanding the Fed's strategy, so it would seem that communication with people who are not specialists in monetary policy could be improved.

b. It's difficult to tell exactly what led to the delayed response. People inside the Fed that I've discussed this with downplay the role of the 2020 strategy statement, including Flexible Average Inflation Targeting. They cite the foreword guidance that promised that interest rates would remain at zero until full employment, even if inflation were going above the target, and forecasts by the Federal Reserve and many others that saw a rapid decline in inflation that was thought to be caused by "transitory" factors. To a considerable extent, the strategy, forward guidance, and forecasts all were shaped by the same persistent low-inflation experience of the 2010-19 period. Even if the FAIT strategy were not the cause, it still needs rethinking for a more inflation-prone environment, and so does the one-sided response to labor markets—easing when they are weak but not tightening when they are very tight until inflation actually rises above target. That labor market asymmetry appears to rule out pre-emptive tightening—getting ahead of the inflation curve. The minutes of the FOMC's March meeting also indicate that the Committee is re-examining the labor market asymmetry in its statement, and I'm sure they will be looking hard at FAIT as well.

c. Yes, see my previous answers.

Chairman Hill:

Dr. Michel, you and I discussed the composition of the Federal Reserve's balance sheet, focusing on the types of assets it holds and their maturity structure. Our discussion included the Federal Reserve's purchases and holdings of agency mortgage-backed securities (agency MBS), both generally and during its response to the pandemic.

- a. What do you believe the composition of the Federal Reserve's balance sheet should be in terms of asset types and maturity structure?
- b. What effects do you think the Federal Reserve's purchases of agency MBS have had, both generally and during its pandemic response?

Answers:

The Fed should only hold short-term Treasury securities (mostly 3-month maturity and below, but nothing with a maturity greater than 1-year).

Based on a few research papers (provided below), I believe that the Fed's MBS purchases did lower mortgage rates, both generally and during the COVID-19 pandemic. The size of the effect on rates was likely no more than 50 basis points in interest rates decreases, leading in part to higher home prices (though I do not wish to specify, at this time, the share of the increase in housing prices attributable to the MBS purchases). There is also some disagreement on whether these purchases lowered rates because they lowered the risk premium on financial assets (especially in the wake of the 2008 crisis) or whether they led to lower mortgage rates by making MBS more scarce.

Did the Federal Reserve's MBS Purchase Program Lower Mortgage Rates?

<https://www.federalreserve.gov/pubs/feds/2011/201101/201101pap.pdf>

The Ins and Outs of LSAPs

<https://www.kansascityfed.org/documents/4563/2013Krishnamurthy.pdf>

QE/QT during the 2020-24 monetary policy cycle expanded/contracted mortgage credit.

https://www.kansascityfed.org/Jackson%20Hole/documents/10336/schnabl_jh.pdf

Answers from Donald Kohn

Questions for the Record

Task Force on Monetary Policy, Treasury Market Resilience, and Economic Prosperity Hearing
“Examining Monetary Policy and Economic Opportunity”
March 4, 2025

Ranking Member Waters:

1. Which of the following options best describes your self-identified race? (you may choose more than one) a. White or Caucasian
b. Black or African American
c. Hispanic/Latinx
d. Asian
e. Middle Eastern/North African
f. Choose not to answer
g. Prefer to self-describe (please specify)
2. Which of the following options best describes your gender identity? a. Woman
b. Man
c. Non-binary
d. Transgender Man
e. Transgender Woman
f. Choose not to answer
g. Prefer to self-describe (please specify)

Answer

I choose not to answer both questions. My race and gender are irrelevant to my expertise and testimony.

Joseph Wang
Monetary Marco, LLC
PO Box 371150 Las Vegas, NV 89137

April 15, 2025

Honorable Representative Maxine Waters
United States House of Representative
Committee on Financial Services

Re: Task Force on Monetary Policy, Treasury Market Resilience, and Economic
Prosperity Hearing "Examining Monetary Policy and Economic Opportunity"

Dear Ranking Member Waters,

Thank you for your follow up question. My response is below:

Ranking Member Waters:

1. Which of the following options best describes your self-identified race? (you may choose more than one)
 - a. White or Caucasian
 - b. Black or African American
 - c. Hispanic/Latinx
 - d. Asian
 - e. Middle Eastern/North African
 - f. Choose not to answer
 - g. Prefer to self-describe (please specify)
2. Which of the following options best describes your gender identity?
 - a. Woman
 - b. Man
 - c. Non-binary
 - d. Transgender Man
 - e. Transgender Woman
 - f. Choose not to answer
 - g. Prefer to self-describe (please specify)

Please let me know if there is anything else I can help with.

Sincerely,

Joseph Wang

Answers from Donald Kohn**Questions for the Record**

Task Force on Monetary Policy, Treasury Market Resilience, and Economic Prosperity Hearing
“Examining Monetary Policy and Economic Opportunity”
March 4, 2025

Rep. De La Cruz:

If another currency, such as the Chinese renminbi, were to become competitive with the dollar as the world’s reserve currency, how would that make the Fed’s job more challenging? What steps can policymakers take to ensure this does not happen?

Answer

If another currency or group of currencies were to become competitive with the dollar as a reserve currency it would tend to raise interest rates in the US and depreciate the dollar. Higher interest rates would exacerbate the government deficit and make it more expensive for businesses and households to borrow. The Fed could lean against this tendency by lowering its policy rate, but it might face constraints from the depreciating dollar which would add to inflation pressures. We saw worrisome signs last week (April 5-10) that this shift might already be underway as the yields on Treasury bonds rose while the dollar fell. It’s possible that President Trump’s efforts to reshape the global trading system are also reshaping the global financial system, with Treasury bonds no longer seen as a safe haven in an environment of rapid and unpredictable shifts in tariff policies and a generally hostile attitude toward global economic engagement.

Joseph Wang
Monetary Marco, LLC
PO Box 371150 Las Vegas, NV 89137

April 15, 2025

Honorable Representative De La Cruz
United States House of Representative
Committee on Financial Services

Re: Task Force on Monetary Policy, Treasury Market Resilience, and Economic
Prosperity Hearing “Examining Monetary Policy and Economic Opportunity”

Dear Representative De La Cruz,

Thank you for your question on how the growing dominance of a foreign currency such as the Chinese RMB could make the Fed’s job more challenging, and on what steps could be taken by policymakers to ensure this does not happen. This is an important and timely question.

The dollar’s role as a dominant currency makes the Fed’s job of full employment and price stability easier because it allows the Fed to conduct policy without having to focus on the exchange rate. International goods are largely priced in dollars, so fluctuations in the dollar have a limited impact on domestic inflation. U.S. businesses earn dollars, and pay importers in dollars. In contrast, foreign central banks must keep their exchange rate against the dollar in mind when setting monetary policy. In foreign countries, foreign businesses earn foreign currency but pay importers in dollars. So in foreign countries a weaker exchange rate against the dollar would lead to higher inflation through higher priced imports.

However, reserve currency status can make U.S. exports less competitive. The dollar’s reserve currency status makes the dollar stronger than it otherwise would be by increasing foreign demand for dollars. Foreign private investors value the liquidity and widespread acceptance of dollar assets, and foreign central banks hold dollar assets in their currency reserves. A stronger dollar makes U.S. goods more expensive to foreigners, which could impact the employment of U.S. export sectors.

A potential weakening of the dollar’s dominant position would make the Fed’s job more difficult because the Fed would have to keep the exchange rate in mind when setting policy.

Domestic inflation would become more volatile if more international goods were priced in a foreign currency. A weaker dollar would raise inflation through higher import prices, and a stronger dollar would put downward pressure on inflation through lower import prices. This

could make changes in the interest rate more impactful, as changes in interest rates would impact the economy through financing costs and also through the exchange rate. That additional currency aspect would make setting monetary policy more challenging.

A decline in dollar dominance would also make the Fed's employment mandate more challenging to manage. The decline in dollar dominance would lead to a weaker dollar, which makes U.S. exports more competitive and stimulates employment in export sectors. But a decline in dollar dominance may also lead to fewer international goods priced in dollars. This implies higher import costs for industries dependent on imports, potentially impacting employment in those industries. As the exchange rate becomes more impactful on employment, Fed decisions would involve difficult trade-offs between employment in import and export industries.

The dollar's role as a global reserve currency is clear and dominant at the moment, but history shows that reserve currencies do not last forever. Aside from making the Fed's job a bit easier, reserve currency status increases the capacity to run fiscal deficits and allows the use of financial sanctions to achieve foreign policy goals. The benefits of reserve currency are significant and worth protecting.

The simplest way to retain reserve currency status is to continue to give foreigners a reason to use dollars. This means protecting the value of dollars through prudent fiscal and monetary policy, as well as respecting the property rights of dollar holders even when their actions are reprehensible. The dollar is a network, so most users do not want to spend the time and resources to move to another network. As the incumbent reserve currency, the throne is ours to lose.

Please let me know if there is anything else I can help with.

Sincerely,

Joseph Wang

Rep. Downing;

The Federal Reserve raises interest rates to slow down an overly stimulated economy. Treasury rates impact both the equity and debt markets for private companies. Investors are more likely to seek out “risk-free” Treasuries when interest rates are high rather than take a risk in the private market. Should Congress be concerned by this “crowding out” effect when private businesses, who rely on debt and equities to grow and create jobs, must compete with higher Treasury rates because the federal government cannot get its fiscal house in order?

Answer

Yes, the Congress should be concerned about the effects of increases in the ratio of government debt to GDP caused by continuing very large budget deficits in the near term and the effects of rising numbers of social security and Medicare recipients as the population ages. The government and retirees are competing for resources with private businesses and, I agree, the resulting higher interest rates will crowd out private investment for expansion and productivity improvement. Moreover, the upward trajectory of debt-to-income poses a risk that supply/demand imbalances will put further upward pressure on rates, beyond even the crowding out effects. It's imperative to bend that curve toward a more sustainable trajectory; sadly, neither political party seems willing to take the difficult steps to make this happen.