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Report

Reform the Federal Reserve's Governance to Deliver Better Monetary Outcomes

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Executive Summary

Central bank independence is widely regarded as an essential element of effective economic stewardship. Yet pure independence is incompatible with a democratic system. Therefore, any particular example of central bank independence within a democratic system necessarily features a series of judgments about the central bank's institutional design. The overall goal of this design is delivering the economic benefits of a central bank that is insulated from the day-to-day political process while maintaining a level of accountability that a democratic society must demand.

The Federal Reserve's record in recent years raises questions about whether it has been operating in line with the best practices of central bank independence. The Fed's unique structure, including removal protections, lengthy terms, and private ownership of the Reserve Bank system, is designed to ensure the independence of monetary policy. However, our analysis shows that in practice, the Fed's current governance has facilitated groupthink that has led to significant monetary-policy errors while allowing the Fed the flexibility to unwisely expand its remit into inherently political areas such as credit rationing and banking regulation.

About Us

The Manhattan Institute is a think tank whose mission is to develop and disseminate new ideas that foster greater economic choice and individual responsibility.

This report argues that important benefits flow from a central bank that can conduct monetary policy free from short-term political pressures—and that to enable the Fed to do so, its governance should be overhauled. We propose a series of reforms aimed at recalibrating the Fed's governance to ensure that it remains insulated from day-to-day politics while enhancing its accountability and democratic legitimacy.

The proposed reforms include restructuring the terms of Fed board members and Reserve Bank leaders; altering the structure of the Federal Open Market Committee (FOMC) to enhance the relative power of the Reserve Banks; reforming the Reserve Bank system to provide more accountability at the state level; and cordoning off nonmonetary-policy functions such as bank regulation and crisis response from the FOMC. These changes are designed to create better incentives to allow the FOMC to conduct monetary policy free from short-term political considerations, partly by introducing what we call "monetary federalism" to check the ability of the U.S. president to completely dominate the balance of power on the FOMC. These changes also ensure that the Fed can operate with the necessary independence to set effective monetary policy while being accountable to democratic institutions.

Introduction

Central bank independence has long been considered an essential element for successful monetary policy. But central banks are creations of political exigency, and pure independence exists only in textbooks. That shibboleths like "independence" generally deliver superior economic outcomes is taken as axiomatic by the economics and policy communities. In practice, central bank independence is intended to allow the pursuit of long-term goals despite short-term political vicissitudes, but it can also bestow power without accountability.

But recent missteps at the Federal Reserve demonstrate that the Fed is falling short of these aims, with attendant economic consequences. Large-scale asset purchases following the 2008–09 financial crisis distorted the allocation of credit across the economy. The attempt to tighten policy in 2018 had to be reversed quickly. The Fed's swift response to Covid-19 is often lauded, but its unilateral transition to a framework where it explicitly sought to overshoot its inflation target,[1] its excessive monetary accommodation, and its dismissal of incipient inflation as "transitory"[2] contributed to two years of declining real incomes[3] and the highest inflation in four decades.[4] A cluster of regional banks failed while their supervisors were asleep at the wheel, largely because the banks took interest-rate risks that were reasonable based on their supervisors' forward guidance—a tool used by the central bank to influence market expectations of future interest rates.[5] This checkered record invites the question: Why is a supposedly "independent" central bank making such obvious errors?

These failures are due largely to the erosion of the key elements that traditionally underpinned central bank independence. Scrutiny of Fed rhetoric and actions makes it clear that the Fed has moved beyond its traditional narrow, technocratic role and instead has pursued a much more expansive monetary and regulatory agenda that is more consistent with an explicitly political institution. The Fed's mandate has expanded to include inherently political activities such as credit allocation, the selection of economic winners and losers, and bank supervision. Furthermore, the Fed has itself voluntarily waded into highly political debates, such as urging increased fiscal stimulus[6] ahead of a presidential election and incorporating environmental considerations[7] into the financial regulatory framework. Leadership that was traditionally regarded as technocratic has been replaced with highly qualified, but highly political, personnel who move freely between the White House and the Eccles Building.

Worst of all, policy accountability has been absent. Current governance structures and practices lack negative feedback channels, so poor policy decisions do not necessarily result in consequences for Fed leadership. Fed officials can rightly face pressure to resign for personal trading improprieties but not for ruinous policy errors. In practice, independence without accountability serves as a shield to protect the status quo at the central bank.

To redress the Fed's institutional drift, we propose a fundamental overhaul of the Fed's governance, focused on democratic accountability and monetary federalism with the aim of producing better monetary policy over time.

Balancing Accountability and Independence

The core of our proposal balances increased presidential oversight for the Board of Governors, which confers greater democratic legitimacy, against a strengthened system of Reserve Banks.[8] We recommend shortening board member terms and clarifying that members serve at the will of the U.S. president, as well as imposing bans on the revolving door between the executive branch and the Fed. Heightened presidential control over the board should be balanced by increasing the influence of the Reserve Banks, whose boards of directors should be chosen by state governors in each district, instead of the undemocratic special interests that currently dominate.

Any reform needs to weigh central banks' contradictory needs of democratic legitimacy and sufficient freedom from short-term politics. Rather than pretend that we can eliminate politics at the Fed, we prefer to recognize that political motivations will always exist and to try to provide mechanisms to block them from unduly affecting policy.

Political independence is inherently undemocratic, and increased democratic legitimacy in our national institutions is usually an end in itself. However, in the traditional approach to monetary economics, this fundamental principle is absent. Our reform proposal focuses as heavily on increasing democratic legitimacy as it does on improving policy outcomes, attempting to find a better balance in the trade-off between democratic legitimacy and political independence. The corner solutions of a Fed wholly obedient to politicians, or a Fed uncontrollable by the citizenry, are both unacceptable.

Moreover, our proposal seeks to alter the governance mechanisms by which the Fed acts, without removing any of its policy instruments. Although limiting the Fed's scope of action *ex ante* to policy approaches condoned by democratically accountable bodies would also address the Fed's democratic deficit, effective central banking does require policy flexibility to respond to an uncertain future. Curtailing the Fed's authority requires the ability to prescriptively lay out all economic and policy possibilities in advance, which runs risks both of allowing loopholes and preventing legitimate policy actions that may be needed in extreme circumstances. Rather than limiting the Fed's ability to act, the more pragmatic approach is to increase its democratic accountability when it does so.

Our proposal embodies the most classic American system of checks and balances: federalism balancing increased presidential influence on the board with an empowered Reserve Bank system. A monetary federalist framework that diffuses power across the Fed system can sustain the fundamental contradiction between democratic accountability and a strong degree of political insulation that is a necessary ingredient of effective monetary policy.

Nationalize and Empower Reserve Banks

Currently, Reserve Banks are private corporations controlled by local private banks, nonprofits, and corporations, without democratic legitimacy. We propose nationalizing Reserve Banks, empowering governors of the states in their districts with the selection of their boards of directors, which, in turn, will continue to appoint Reserve Bank leadership. Allowing Reserve Bank leadership to

vote at every meeting of the Federal Open Market Committee (FOMC)—the 12-member branch of the Federal Reserve that determines the direction of monetary policy—will balance increased White House control over the Federal Reserve Board of Governors.

The combination of these two forces ratchets up accountability with better political oversight and, for the first time, democratic legitimacy for the entire Fed system. The checks and balances provided by monetary federalism can prevent the FOMC's increased accountability to voters from resulting in monetary policy that is too heavily dictated by the political pressures of Washington.

Such a system would be designed to safeguard the concept of central bank independence while disincentivizing the FOMC from straying too far from its core mandate, or carrying out its mission in a way that is inappropriately political. We further propose removing overtly political responsibilities such as credit rationing and bank supervision from the Board of Governors and putting them solely under the jurisdiction of new sections of the Fed that would be directly supervised by presidential appointees, as is appropriate for fiscal functions of the executive.

Excessive control by elected, political actors (like the president) interferes in good policy and results in bad economic outcomes. But clearly, too little democratic oversight creates the possibility for a powerful, entrenched Fed that may deliver poor economic outcomes with little recourse. We attempt to chart midway between these two, balancing increased political accountability against the need to keep day-to-day politics out of monetary policy.

We argue that by diluting the power of the board in favor of newly democratized Reserve Banks, our proposal better safeguards independence than current law does. For example, if, under current law, a president attempted to dismiss the entire board (with or without cause) and replace it with a slate of new nominees, there is a significant chance that the Supreme Court would side with the president and deliver direct control of the FOMC to the White House. In contrast, under our proposal, the president's sway over the FOMC is buffered by a Reserve Bank majority that he did not select. Moreover, our approach will empower representatives of different regions of the economy to more seriously contribute to the setting of monetary policy. We believe that this increased role for the Reserve Banks will reduce pernicious groupthink and increase the frequency of dissent—problems that former Richmond Fed president Jeffrey Lacker has argued contributed to the policy mistakes of 2021.[9]

The tension between democratic legitimacy and independent agencies is explored at length by Paul Tucker, who argues for publicly agreed self-restraint on behalf of central bankers to their core mandates and publicly agreed consensus among politicians and voters on narrow mandates for independent agencies.[10] We share many of Tucker's concerns but view such public agreements as unlikely to come about anytime soon. Therefore, we seek to reform the Fed in such a way as to preserve its independence in the modern political climate.

Our proposal can be implemented in a piecemeal fashion, one policy at a time, if legislatively easier. However, because the heart of the proposal balances more democracy with decentralized power, the full benefits require holistic implementation.

In this report, we briefly review the ways in which Fed independence and political neutrality have been undermined by intermeshing monetary and regulatory policy with fiscal policy, and then we present our reform proposals. Next, we address potential market responses to the reform proposal and recommend a phased-in implementation period to support market stability. The final section discusses our proposal in the context of other reform ideas, how reform might be politically implemented, and concludes.

Lack of Accountability and Mandate Expansion Undermine Fed Effectiveness

As we have noted, there is a trade-off between independence and democratic accountability. All stakeholders have been willing to accept this trade-off while the central bank delivered good outcomes and remained above the partisan fray, but the Fed has gradually become more political, and its performance has become worse.

Gradually, the Federal Reserve expanded its narrow congressional mandate into inherently political fiscal territory and waded into sensitive political, social, and cultural debates. Partisan figures have been placed in top leadership positions. Most important, the Fed's privileged position has enabled an absence of accountability. All these developments have weakened the effectiveness of the Federal Reserve.

Addition of Inherently Political Responsibilities

Because of two decades of successful macroeconomic stewardship under chairmen Paul Volcker and Alan Greenspan, the Fed acquired a reputation for competence that has (mostly) endured to this day. Such a reputation has brought more responsibilities to the Fed, many of which are necessarily fiscal and therefore political. Assuming these responsibilities has obviously eroded Fed independence.

Picking Winners and Losers

For example, during bouts of financial instability in the last two decades, the Fed created Section 13(3) facilities (named for the part of the Federal Reserve Act that authorizes them).[11] Section 13(3) facilities allow the Fed to purchase virtually any debt instrument (e.g., bonds, mortgages, loans, securities backed by credit-card debt, and assets that legally obligate the debtor to pay interest and the principal) issued by a borrower not in a bankruptcy or resolution process. Facilities have covered wide-ranging categories of debt, such as asset-backed securities,[12] commercial paper,[13] municipal bonds,[14] and direct loans to small businesses.[15] Following the Dodd-Frank reforms of 2010, the Fed needs the permission of the Treasury secretary to set up a facility; but once it is established, the Fed has prerogative over terms, eligibility, and prices, and the secretary cannot direct the Fed to channel credit to a particular segment of the economy. Oversight by an official accountable to voters is therefore limited, despite the political nature of the selection of winners and losers by credit rationing and deciding whom to infuse with cash by buying debt.

Who gets credit, how much, at what price, and with what collateral or other requirements? Should haircuts[16] or borrowing rates on bonds backed by student loans be higher or lower than those backed by used cars? What about on loans to small businesses on Main Street? And how do we account for—or determine—differences in creditworthiness? These are unavoidably political questions, but they are decided by Fed officials claiming to be nonpolitical.

Moreover, since 2008, the Fed has freely engaged in large-scale asset purchases (LSAPs), sometimes called quantitative easing, to reduce benchmark government interest rates when the short-term policy rate was already at the zero lower bound.[17] The utility of this tool, pursued outside a crisis when the Fed thought that inflation was merely a few tenths of a percent below its announced inflation target, has always been debated.

Government Debt

While purchasing government obligations is traditionally understood as an appropriate tool of monetary policy, the Federal Reserve under former chairman Ben Bernanke extended quantitative easing to longer-term government-guaranteed mortgage-backed securities (MBS). In a historic policy mistake, the Fed under current chairman Jerome Powell continued buying MBS into 2022[18] despite unemployment near seven-decade lows and housing prices already up 20% over a year,[19] when it was clear that the housing sector did not need more credit support.

Whereas lowering interest rates affects all credit markets, mortgage purchases and 13(3) facilities privilege some groups of private borrowers over others. The selection of winners and losers by credit rationing is intrinsically fiscal, but the Fed's mandate that warrants independence is monetary. The decision that housing, or overindebted municipal governments, deserve additional credit, while other sectors do not, or that some will receive preferential terms, is a political decision, allocating government resources from one group of Americans to another.

Additionally, the sheer magnitude of LSAPs has transformed a traditionally central tool of monetary policy—the purchase of government obligations—into one that crosses clearly into fiscal territory. Since the American public is responsible for U.S. public debt, the maturity profile of debt should rest with the fiscal authority (Treasury), not the monetary authority (the Fed). The fiscal authority must manage the interest obligations of the taxpayer and select the maturity profile for a variety of fiscal reasons. LSAPs have consequences for the maturity profile of debt held by the public that can interdict Treasury's decisions about debt issuance.[20]

Co-incident LSAPs and large government budget deficits bear a strong resemblance to monetary financing of the deficit.[21] This was particularly true during and after the Covid recession, given the uniquely large government outlays. The unwinding of LSAPs—quantitative tightening—similarly has fiscal implications. As the Fed allows Treasury obligations to mature off its balance sheet, the Treasury must fund these maturities with other debt issued to the market. The maturity composition of these new issues has significant implications for interest rates and financial conditions and, therefore, monetary policy. For example, this was seen in the rise in long-term interest rates following the Treasury's August 2023 announcement of its intent to boost its supply of long-term bonds.[22] LSAPs have pushed the Fed into fiscal territory and also created an opening for government debt management to influence monetary policy.[23] The erosion of the barrier between monetary and fiscal policy has eroded the political neutrality of the Fed.

Bank Regulation

Bank regulation, too, has veered into outright political territory. The U.S. is a participating member in the Basel Committee on Banking Supervision, an international group establishing regulatory standards respecting the regulation, supervision, and risk management of the banking sector.[24] As the Fed has implemented successive Basel regulatory frameworks, it must weigh the riskiness of various assets (called "risk weights") in determining how much capital banks must hold against them. This process involves making judgments about the allocation of credit to municipal or privately issued instruments. The Fed can waive various ratios in the Basel framework, but that is also a normative, political decision.

Similarly, regulatory decisions related to bank mergers and resolutions[25] involve the Federal Reserve in unnecessary debates about market concentration and political economy.[26] While the Fed purports to carry out a congressional mandate, such an incremental grant of authority pollutes the ability of the central bank to maintain the independence necessary for implementing effective monetary policy. These are all political decisions that belie the standing of the Federal Reserve as a technocratic body making decisions about the money supply.

Entry into Highly Political Debates

The Fed has waded into the political arena and advocated political approaches when prudence would have dictated silence. For a decade, the Fed made explicit calls for more government fiscal stimulus because it was worried about undershooting its inflation target. Fed officials frequently ask Congress to address long-term budget problems; but whenever actual fiscal retrenchment materializes, they typically argue against it. For example, in 2012, former chairman Bernanke urged Congress to fix its long-run fiscal sustainability problems but to avoid contractions in fiscal spending in the short term.[27] "Although long-term fiscal sustainability is a critical objective," Bernanke said almost two years later, "excessively tight near-term fiscal policies have likely been counterproductive."[28] Chair Janet Yellen similarly made throwaway comments about long-term fiscal problems throughout her term but emphatically blamed fiscal sequestration for the slow recovery from the financial crisis and repeatedly emphasized that more fiscal spending would improve the growth outlook.[29] Augustine's monetary heirs might as well cry, "God, give me fiscal sustainability—but not yet!"

More recently, during the pandemic recession, even after the $2.2 trillion CARES Act had begun to usher in the fastest recovery since World War II, Chair Powell urged Congress to take even *more* aggressive fiscal action, "to use the great fiscal power of the United States" to provide "direct fiscal support."[30] Later, in October 2020, amid intense preelection political debates with dueling stimulus proposals from House Democrats and Senate Republicans, Powell again urged Congress to go big, warning that "too little support would lead to a weak recovery." This comment was described in the press at the time as coming even "as Senate Republicans worry about the size of the next fiscal package,"[31] since the Democratic proposal was 10 times the size of the Republican proposal.[32]

When the Fed backs one party's economic proposals, it has the effect of an intervention in electoral politics, even if that is not the Fed's intent. Though Powell's entry into the fiscal package debate was categorically inappropriate for a Fed chair, the subsequent inflation created by excessive fiscal spending following the 2020 election suggests that his prescription was also mistaken, adding insult to injury.

The Fed must take fiscal variables into account in setting monetary policy, but there is little reason for it to openly debate fiscal issues or call on Congress to adopt its preferred policies. The problem is particularly acute because the Fed appears to suffer from the same near-termism on fiscal matters as lawmakers: notably, Chair Powell refrained from calling for fiscal responsibility, spending cuts, and regulatory reform in 2021 and 2022, which would have assisted the Fed in bringing down inflation. The Fed politicized itself by wading into fiscal debates, and doubly so by doing it so one-sidedly.

Mandate Creep

The increased politicization of the Fed in recent years is partly a function of the inherently fiscal functions that it has accreted over time. The emergence of the Federal Reserve as a primary bank regulator and supervisor is particularly problematic, as banking regulation unavoidably affects credit allocation among different groups of Americans. As part of the Dodd-Frank Act, Congress created the politically appointed role of vice chair for supervision. By doing so, Congress recognized that bank regulation and supervision are intrinsically political and wanted such activities to be carried out by an explicitly political appointee.

Predictably, the Fed is following the pattern of other regulatory agencies:[33] policies change from one administration to the next, and Vice Chair Michael Barr even blamed his predecessor of the opposite political party for the Fed's supervisory failures that contributed to the collapse of Silicon Valley Bank (SVB) in March 2023.[34]

The Fed's mandate has further expanded to encompass highly political issues outside its area of responsibility, such as climate change. Following the Bank of England[35] and the European Central Bank,[36] the Fed is introducing "climate-related" regulation[37] principles into the bank regulatory framework, an action that has drawn stern rebuke from dissenting members of the Board of Governors.[38] The Fed's proposals would force the banking system to devote significant resources toward studying climate change and structuring the banking sector's strategic planning, policies, and procedures around climate. They would also mandate that banks consider climate as part of the underwriting and monitoring of portfolios—i.e., to engage in credit allocation with respect to climate risk.

The Fed is an institution with finite resources. Therefore, the Fed's increasing attention to climate issues has accompanied worse performance on its traditional bank regulatory responsibilities. For instance, the Financial Stability Oversight Council, of which the Fed chair is a key member, described climate change as its top priority in the immediate runup to the failure of SVB. Had the Fed been paying attention to the banking system's interest-rate risk instead of climate risk, the system might have been spared significant volatility.[39]

The Fed has also allowed, through contemporary civil rights law, inducements to discriminate on the basis of race to creep into its operations.[40] The Fed's own website prominently displays[41] a breakdown of Reserve Bank directors by race and gender, including categories of racial classifications that the Supreme Court recently noted "rest on incoherent stereotypes."[42] In 2020, the Reserve Banks collectively launched a 12-part series focused on the implications of structural racism in America's economy.[43] The mere appearance of joining highly charged debates on the role of race in American society makes it harder for the Fed to maintain the political distance necessary to conduct effective monetary policy.

Mandate creep at the Fed is not just a series of discrete unjustified endeavors that can be quickly reversed. Rather, it is symptomatic of a pernicious institutional culture that caused the attitude that "central banks are the only game in town," as one book title described it.[44] Following the financial crisis, fiscal retrenchment in the U.S. and Europe allowed central bankers to believe that they alone could deliver us from society's ills. Beyond the obvious cases of mandate expansion, this mindset infected the monetary-policy process—most notably, with the disastrous adoption of flexible average inflation targeting (FAIT), a more risky strategy for managing inflation, in 2020.[45] In the FAIT framework, the central bank attempts to aim for an average level of inflation over time by sometimes overshooting that target level of inflation; the inflation should average out to the target level. However, the framework does not address what is to happen if the overshooting is persistent.

The Fed's decision to adopt the FAIT framework was partly a function of intense pressure within the central bank to address an increasingly popular view among economists that longer-term stagnation was the result of changes in technology and international trade. However, the adoption of FAIT comprised a radical reinterpretation of the Fed's price mandate—"stable prices," as written by legislators—in which the Fed decided purposively to overshoot 2% inflation on a "sustained" basis.[46] Only an institution with self-confidence approaching hubris could believe that it could successfully manage such a policy, which is based on the impossibility of both accurately measuring inflation and precisely controlling its future course as to overshoot.[47]

Whether that is good or bad monetary policy, it is profoundly undemocratic and a significant overstep of its statutory authority for the Fed to adopt such an agenda on its own, without license from democratically elected representatives. In the aftermath of the FAIT debacle, the same lack of accountability insulated it from any consequences of its misadventure. This episode makes plain how the vagueness of the Fed's statutory mandate is precisely why democratic oversight is essential: left to its own devices, the Fed can interpret the mandate any way it likes, in order to justify policies that are the exact opposite of what Congress envisioned.

Personnel Is Policy

Two significant issues of politicization exist with personnel at the Fed. First, the ease with which top Fed personnel slide between party politics and supposedly nonpartisan technocracy gives lie to the latter. For instance, Austan Goolsbee, the new leader of the Chicago Fed, who was a top advisor to President Barack Obama, cochaired the economic advisory council[48] for the Biden campaign and frequently appeared in the media, described by journalists as a "Biden campaign surrogate."[49] Former Fed vice chair Lael Brainard took a single weekend off between roles as the Fed's vice chair and director of the National Economic Council (NEC).[50] NEC director is the single most political economic policy job in the entire federal government.

To be clear, Brainard and Goolsbee are both extremely talented economists who have made significant contributions to our nation. But to pretend that one can easily shift between highly political and allegedly nonpolitical roles without letting political biases inform policy is, at best, naïve—and, at worst, sinister.

The second issue with personnel is the lack of performance-based accountability or incentives for performance. Since 2021, there were six appointments and reappointments to the Board of Governors and four new leaders of Reserve Banks. Despite the biggest monetary errors in four decades, not even one of these nine appointments was on record as having made reasonable predictions about the path of inflation. Recent Fed appointments have seemed to focus more on nominees' immutable characteristics rather than qualifications. Some in Congress are even imposing racial tests on nominees.[51] Moreover, no Fed leader has resigned or been fired after the recent slew of monetary and regulatory errors. Two resigned in 2021 after scandals related to their personal trading, as they should—but what does it say about our priorities that we discard Fed leaders for minor ethical improprieties but not for poor performance that causes enormous economic pain to all Americans?[52]

Rewarding those who have made egregious errors with promotions, instead of recruiting personnel who have a track record of making correct calls on the economy, results in a culture that is likely to make further errors. What are Americans to conclude about the priorities and competence of the central bank?

Institutional Design

Nongovernmental Influence

The Reserve Banks, or regional Fed banks, are private institutions owned by local banking consortia. Each Reserve Bank board of directors has six board members who are appointed by member banks, three of whom are designated to represent member banks ("Class A directors") and three of whom are designated to represent the public ("Class B directors"). The Board of Governors appoints the remaining three board members, who are also designated as representing the interests of the public ("Class C directors"). Class B and Class C directors select the president of each Reserve Bank, subject to the approval of the Federal Reserve Board of Governors. This structure results in member banks and other nongovernmental actors having far too much influence on the Federal Reserve system.

A typical Reserve Bank board of directors comprises executives from special interests like local banks, corporations, and nonprofits, all of whom have their own varying political agendas. Across the entire Reserve Bank system, 35 out of 105, or one-third of directors, are executives of public companies, including the Class A directors. Since institutional investors own about 80% of the stock market,[53] this implies that institutional investors wield significant influence over the Federal Reserve system. One of the top three asset managers is the top shareholder in 88% of S&P 500 companies.[54] Since these investors almost always subscribe to some sort of impact-investing

philosophy—often environmental and social activism under the banner of "ESG"—it means that these interests are being indirectly voted into Fed policy. Further, the wealthiest 10% of Americans own 89% of stocks, providing them outsize influence over monetary policy, which should aim for the benefit of all Americans.[55]

Conflicts of Interest

As statutorily required, a third of Reserve Bank directors come from Fed member banks—a situation described, at best, as inherently conflicted and, at worst, as regulatory capture. In total, 41% of directors come from the financial sector, including nonbank corporations. In no other sector of the economy are regulated entities allowed to directly control their regulators in such a manner. This situation creates clear conflicts of interest that inhibit the Fed's work.

For example, the San Francisco Fed reportedly avoided removing the SVB CEO from its board in late 2022 because of concerns about signals that such an action would send to the market—only to watch SVB spectacularly collapse only months later.[56] The Reserve Banks' board of directors should obviously not be filled with entities that they are supposed to regulate. In a strange inversion, here the regulated entities oversee the regulator.

Unsuited Overseers

Some Reserve Bank directors are particularly unsuited to oversee the Fed's monetary and fiscal powers. For example, the local AFL-CIO head sits on the boards of the Minneapolis and New York Reserve Banks and is chairman of the Kanas City board.[57] The Boston Fed's board contains a member whose career has been spent supporting "foundations, businesses, and nonprofits to achieve equitable social change."[58] Until the end of 2023, the San Francisco Fed's board included a member who is CEO of an affordable housing company that describes its mission as "decolonizing" the "lands stolen" from various tribes and fighting those who benefit from "stolen labor."[59]

The Fed also exploits this dual private-public ownership structure to maximum advantage; sensitive FOIA requests can be redirected toward the appropriate Reserve Bank, which will report that, while it tries to comply with the "spirit of FOIA," it is not bound to comply at all—and can withhold any documents it chooses.[60]

This degree of political independence is extreme. Other than through new legislation, there is no way for voters to exert control over the Reserve Banks or demand accountability and therefore no incentives for good performance. For example, anywhere in the private sector or elsewhere in government, a failure of risk controls of the scope that led to the collapse of SVB would have resulted in a major shakeup of personnel. A year later, Mary Daly is still leading the San Francisco Fed, and there is no recourse for voters to demand better performance from their bank regulators.

A New Framework for Accountability Reform

Reinstituting accountability and improving performance at the Fed require a wholesale restructuring of the institutional design of the Federal Reserve system. Our proposed solution is to dispense with the current structure and the illusion of independence that it provides, and instead introduce transparency and accountability throughout the Federal Reserve system while restraining dominance by any center of political power. Such an agenda will require changes to the structure of both

the Board of Governors and the Reserve Banks. These reforms should produce greater insulation from the day-to-day political process—enabling superior monetary outcomes—than the current construct of false independence.

We propose enhanced democratic oversight and accountability for Fed officials, while also imposing reforms that would reduce the incentives for them to pursue partisan political agendas. Our proposal makes the Board of Governors significantly more accountable to the president. We then check that influence with employment restrictions for board members and with a reform of the Reserve Banks that increases their influence on the FOMC and their democratic legitimacy. This is done by letting state governors of each district appoint Reserve Bank boards of directors rather than the current combination of local private corporations and the Fed Board of Governors. Monetary federalism offers an attractive balance of political legitimacy with political independence.

Personnel Reforms

The appointment structure of the Board of Governors is unusual in the executive branch, with fixed calendar terms for each position of 14 years—more than three presidential terms.[61] However, board members rarely serve their full term, and a board member appointed to complete a predecessor's term may be subsequently reappointed to a full term. (Only two board members, one of whom was Alan Greenspan, have ever served their full terms.)[62]

Reform Term Limits

Since virtually all board members resign before the end of their terms, powerful incentives exist for members of the board to strategically time their resignation, as argued by Peter Conti-Brown.[63] They might wish their resignation to coincide, as is frequently urged for Supreme Court justices, with the term of a president who will appoint a sympathetic successor. Or they might guide their policy decisions in such a way as to maximize their exit opportunities in the executive branch. Contrary to its intent, the long board term provides incentives for board members to be more, rather than less, political.

Congress should amend the Federal Reserve Act to shorten all board members' and Reserve Bank leaders' terms to a single term of eight years. These terms should not be fixed calendar-year terms but, rather, terms of eight years from the time of confirmation by the Senate. Additionally, board members and Reserve Bank leaders should be subject to at-will removal by the president to ensure their accountability to the democratic process.[64]

While moving to at-will removal seems to be, at first glance, a fundamental break from the traditional construct of central bank independence, the reality is that the U.S. constitutional system is in some degree of tension with central bank independence. Recent Supreme Court jurisprudence is casting doubt on the constitutionality of independent agencies not under direct presidential control,[65] and it is conceivable that in the coming years, the Supreme Court will eliminate for-cause removal protections for officials exercising executive authority, as Fed board members do.[66] Indeed, the best way to preserve the Fed's insulation from the political process in advance of such a decision is to adopt the series of reforms that we suggest here.

Close the Revolving Door

To further insulate board members from the day-to-day political process, they should be prohibited from serving in the executive branch for four years following the end of their term.[67] Short-circuiting the revolving door between the Fed and the executive branch is critical to reducing the incentives for officials to act in the short-term political interests of the president. Doing so would also helpfully increase the incentives for presidents to seek candidates with professional

experience in Congress—an important source of expertise that has often been missed at the FOMC, particularly as some of the Fed's recent blunders relate to misunderstanding the role of fiscal policy in the economy.

Internal Hiring Policies: Board of Governors

Direct political accountability of the board would represent a clear mandate from the executive branch, which would assist board members in exercising authority over a staff that has too often strayed into areas outside the Fed's core mandates. However, newly empowered members would also be assisted in exercising proper oversight by bringing Fed staff within the so-called Schedule F proposals that would allow the appointees of any president to discharge their constitutional role faithfully without undemocratic interference from unaccountable professional staff.[68]

Furthermore, there should be no doubt over whether hiring in the Federal Reserve system is based on merit and not on unconstitutional racial quotas. This could be accomplished through a legislative solution or via the president amending Executive Order 11478,[69] which purports to ban racial discrimination in the typical civil service but mandates affirmative action regimes throughout the executive branch that, in practice, often function as racial quotas.[70]

Nationalization of the Reserve Banks

To offset increased presidential influence on the Board of Governors, we recommend increasing the influence and independence of the regional Reserve Banks. The regional structure of the Federal Reserve system is an important feature of U.S. monetary policy and helps avoid myopic policymaking—a risk of large, centralized systems. Any set of reforms to the Reserve Banks should seek to preserve and enhance this feature, while also increasing the transparency and accountability of Reserve Bank governance. Positioning the Reserve Banks as a check on the Board of Governors is a classic expression of American federalism, a formula that has proved successful for over two centuries.

The Reserve Banks should be formally nationalized to make clear that these are government institutions that are accountable to the American people.[71] However, to maintain the important regional perspective of the Reserve Banks and to increase their insulation from day-to-day political pressures in Washington, their boards of directors should be selected by the governors of the states in each district.[72] Some tweaks to the map of Federal Reserve Districts would be required to ensure that states like Illinois and Louisiana are not split by district, and also to ensure appropriate political representation so that the system is not gerrymandered to favor Republicans or Democrats.

Boards of directors would continue to select the leaders of the Reserve Banks, who would be subject to the same eight-year term limits and executive branch cooling-off periods as members of the Board of Governors. Such a process would ensure that functions of the Reserve Bank incorporate essential economic perspectives from throughout the country, enhancing the conduct of monetary policy and continuing in the best traditions of federalism. Reserve Bank leaders and their boards of directors would continue to require approval from the central Board of Governors, preserving the current constitutional basis for the Reserve Banks' exercise of federal authority.[73]

While tension might emerge between Reserve Bank leadership and presidentially appointed Board of Governors members, this already exists with the current system. The fact that board members almost never dissent—but Reserve Bank leaders sometimes do—reveals that the two groups are often in tension, but current institutional arrangements give the board the upper hand. Further, the term limits and cooling-off period that we suggest should lessen the political incentive for board members to strongly contest Reserve Bank nominations that the president might be inclined to fight. As mentioned above, Reserve Bank executives should also be removable at will by the president, in order to ensure alignment with proper constitutional design.[74]

The unique role of the Federal Reserve Bank of New York (FRBNY) should also be reimagined. With control over Reserve Bank boards of directors moving to state governors, it would not be appropriate to give the governors of New York, New Jersey, and Connecticut heightened influence on the Federal Reserve system, which they will arguably possess in any event because of the importance of New York's financial sector to the overall economy. Instead, FRBNY's role in conducting open-market operations to implement monetary policy should be brought under the operational control of the Board of Governors. Additionally, the leader of FRBNY should no longer have preferential rights to serve on the FOMC relative to other Reserve Bank leaders, as a vice chair or in the line of succession during an emergency without leadership.

FOMC Voting Rights

A revamped regional Reserve Bank system will possess newfound democratic legitimacy, rather than reflecting private special interests, as it currently does. In turn, the FOMC can be expanded to allow all Reserve Bank leaders to vote at every meeting. This would replace the current rotating FOMC structure, in which Reserve Bank leaders' views are insufficient to tip the balance of the committee toward their preferred policies. The president's increased control over the Board of Governors will be balanced against decreased control of the board over the FOMC, while still maintaining democratic legitimacy and accountability throughout the system.

Structure

Under our proposal, the voting structure balance between the board and the Reserve Banks on the FOMC changes dramatically, from 7–5 in favor of the board to 12–7 in favor of the Reserve Banks.[75] A benefit of this is that the swing in the voting balance between the board and Reserve Banks will likely create voting balance between appointees of different political parties that is not materially different from the status quo. For example, a newly elected president will likely nominate all seven new board members in the early portion of his term. But while the presidency is a winner-take-all system, the composition of state governors more closely resembles the political balance between the two major parties. With the president controlling seven seats on the Board of Governors, the opposing political party would need to control the boards of directors of 10 of the 12 Reserve Banks to outweigh the president's selections—an extremely unlikely outcome, given the healthy competition between the political parties.

The most likely scenario is for the 12 Reserve Bank leaders to reflect a balance between Democratic and Republican appointees, which would create an FOMC balance of approximately 13–6 between appointees of the president's party and the opposing party, respectively. Such a balance would be similar to the status quo, where holdover appointees from previous presidents increasingly become a minority on the board (and the voting members on the FOMC) as the president fills vacancies that tend to follow a presidential transition.

Political Party Breakdown

How likely is it that power would become more concentrated than in the current system? As of this report's publication, 27 states have Republican governors and 23 states have Democratic governors. Essentially all conceivable methodologies for allocating the Reserve Bank appointment power among state governors would reflect the close political balance. For example, if state governors' voting weights within districts were governed by population, the balance would reflect the House of Representatives (where Republicans currently hold a slim 219–213 majority, with three vacancies as of March 2024). Alternatively, the balance could reflect the Electoral College weightings, where the composition of the Senate (currently a slim 51–49 Democratic majority, including three independents who caucus with or count toward the Democratic Party) would also be reflected. Therefore, the influence of the political parties over the selection of Reserve Bank leaders is likely to be balanced over time, as long as the parties themselves remain balanced against each other.

There is some risk that in a "wave" election in which one party sweeps most contested ballots, the majority of the FOMC would be aligned in desiring or tolerating higher inflation. However, this scenario would not be a large deviation from the status quo, in which a president gets to appoint the majority of the board, which, in turn, sets policy with little consequential resistance from the Reserve Banks. Moreover, such a concentration of power would require a successful "wave," and these are only a subset of political offices, given the realities of the electoral calendar.

Further, given that both major parties are coalitions of disparate political constituencies that sometimes suffer intense intra-party disagreements on policy issues, a perfect correlation between local and national party preferences on monetary policy is not likely. There is no guarantee that Reserve Bank members of the same party as the president and board will see eye to eye on policy in light of often severe intra-party disagreements. And given the ongoing requirement for Senate advice and consent on board appointees, the president does not have unlimited power over the board, even if he gets to nominate all the candidates.

While the balance of political power on the FOMC is not likely to be significantly altered under our proposal, the composition of the FOMC and the nature of the policymaking process would change for the better. The important regional perspectives of Reserve Bank leaders, already recognized as a strength of U.S. central banking, would carry more weight in the Eccles Building's cavernous boardroom.[76] Critically, those regional perspectives would be carried by appointees who ultimately owe their position to voters in their district, not to the DC-centric national political and policy communities.

Combined with a larger FOMC, these dynamics will likely create the conditions for much more frequent dissents from FOMC decisions. The last dissent by a Fed board member was in 2005, and Chair Powell has had only 13 dissents from Reserve Bank leaders across the 50 FOMC meetings since he became chair; indeed, Powell has faced the fewest dissents of any chair in the modern era.[77] The empowerment of diverse viewpoints will help the FOMC avoid the groupthink in the central banking community and the economics profession generally that is widely seen as having contributed to the monetary-policy errors of recent years.[78]

Appropriations and Congressional Oversight

Another critical area in which the Federal Reserve suffers from a lack of accountability that degrades its ability to achieve its mission is in its ongoing oversight by Congress. Indeed, that its limited congressional oversight is arguably its most effective form of accountability today—as argued by Sarah Binder and Mark Spindel—is a reminder of the inadequate status quo.[79] While the Fed is a creation of Congress, its congressional oversight regime is significantly less rigorous than that of other government agencies—even so-called independent agencies.

The foundation of the congressional oversight process is the appropriations process. Unlike most government agencies, the Fed funds its operating budget with income from monetary operations, including interest on securities that it holds. This arrangement serves to insulate the Fed from congressional influence. The Fed's operating budget should instead be brought within the congressional appropriations process. This appropriation should be done on a five-year basis, in order to guard against the chance that annual budget negotiations create an opportunity for undue political influence into the Fed's operations.

A standard appropriations process would also force the Fed to better manage its expenses, which will help address the problem of staff bloating[80] and institutional drift that is enabled by the Fed's setting of its own budget constraints, currently at $6 billion annually. Similarly, the newly nationalized Reserve Banks' budgets would be subject to congressional appropriation.

The overall long-term cost to the taxpayer will be the same as under the current system, since the Fed remits income after operating costs to the Treasury. If the Fed instead funds its operating budget with congressional appropriations, there will be a corresponding increase in net income and remittances to Treasury. Such a change will not impair the Fed's ability to operate with a negative equity position if need be, as losses from monetary operations should not require congressional appropriations.[81] Indeed, the long-run burden on taxpayers will actually be lower if the appropriated budget is smaller than a Fed-determined budget.

Beyond the budgeting process, ongoing congressional oversight of the Fed should be significantly expanded. As recently argued by Andrew Levin and Christina Parajon Skinner,[82] the current congressional oversight regime is more appropriately termed "undersight." The Fed's required reporting on the conduct of monetary policy is formulaic, and its monetary-policy operations are exempt from scrutiny by the Government Accountability Office or a fully independent inspector general. The Fed should welcome legitimate congressional oversight, which would also increase its credibility to resist illegitimate congressional attempts to drag the Fed beyond its mandate into the political process.[83]

Chinese Walls

While monetary policy does have downstream political implications, bank regulation and supervision should be cordoned off from monetary policy to avoid unnecessarily polluting the monetary-policy process. This separation will need to be carefully constructed, as the banking and financial-market insights provided by the bank regulation function are an important input into the monetary-policy process. However, representation at the board by the vice chair for supervision is sufficient to achieve this aim. The board's authority over bank regulation should be stripped and instead vested in the vice chair for supervision, who should report directly to the president and maintain a seat on the board. Such a change should apply to the entirety of the bank regulatory function and personnel at the Fed.

As a practical matter, this structure appears to be consistent with current law and practice. Congress created the vice chair for supervision position in the Dodd-Frank Act of 2010. Though the Federal Reserve Board of Governors still retains ultimate authority over the Fed's statutory responsibilities, Congress charged the vice chair for supervision with "develop[ing] policy recommendations for the Board regarding supervision and regulation … of firms supervised by the Board … and … oversee[ing] the supervision and regulation of such firms."[84]

Despite the board's formal retention of authority, current practice is in line with the proposal to vest regulatory and supervisory authority directly with the vice chair for supervision. Chair Powell has essentially deferred to the vice chair for supervision on regulatory matters, stating that he "respect[s] the authority that Congress has deferred on … Vice Chair Barr"[85] and that he therefore allows the vice chair to shape—and be accountable for—the bank regulatory agenda. Formalizing this arrangement would improve the FOMC's insulation without significantly changing the unavoidably political bank regulatory process.[86]

Similarly, the Fed's crisis-fighting responsibilities should be shifted away from the board. Dodd-Frank sensibly required the Treasury secretary to approve all new 13(3) programs to ensure political accountability for programs that directly affect credit allocation, including through the purchase of private obligations. Yet under the current structure, the Board of Governors is still responsible for crafting and executing such programs. Instead, Congress should redesignate one of the existing Board of Governors positions as a new vice chair for crisis response. This new vice chair position should be subject to important restrictions and should be accompanied by changes to the Fed's authority to purchase assets and lend under 13(3). In ordinary circumstances, the Fed should only have the authority to purchase federal government obligations (which should not include

agency securities) and to lend through the discount window. And under such circumstances, the vice chair for crisis response should have the same authorities and responsibilities as other Fed board members.

However, in the event that the U.S. president declares a financial emergency, the vice chair for crisis response will assume authority for all 13(3) programs and any other asset purchases other than federal government obligations. In exercising this authority, the vice chair should report directly to the president. Unlike with bank regulation, the creation of asset purchase programs should still be subject to a vote of the FOMC, as such programs have significant monetary implications, in addition to their fiscal qualities.

The authority of the vice chair for crisis response—including any lending or asset purchase facilities established pursuant to their authority—should last for only three months, to ensure that crisis facilities are only for true crises. Facilities should be renewable only with congressional authorization for another six months, which Congress could then renew successively.

Market Responses, Implementation, and Phase-In

Given the Fed's central importance to the U.S. economy and financial markets, implementation of our sweeping reform proposals should be carefully managed so as not to create unnecessary market turbulence. In a worst-case scenario, an abrupt announcement of the intent to pursue the reforms that we suggest could risk an increase in long-term interest rates as the market priced in some probability that increased presidential control over the Board of Governors might lead to the installation of Fed leaders who would deliver easier monetary policy during that president's term. To avoid adverse market reactions and soothe investors' concerns, we recommend the following implementation procedures, which will align with the lengthy timeline that can be expected for the legislation required to implement these proposals.

First, the extent of any increase in borrowing costs will be a direct function of the market's expectations of the competence and agenda of potential appointees. Such fears can be allayed if any proposed personnel changes to the Board of Governors are announced at the same time as the reform proposal. The best way to allay market concerns that the board may be taken over by irresponsible new appointees is to announce widely respected appointees at the same time.

Second, the president's new at-will removal power for board members and Reserve Bank leaders should be phased in. All terms should be immediately converted to eight years from when the current board member began serving, but the at-will ability of the president to remove any official should begin only with the next person serving in that seat. To address any potential constitutional defect with continued for-cause protections, the president should voluntarily announce that he will refrain from removing any incumbent board members or Reserve Bank leaders through their terms.

In such a manner, the president will be unable to remake the entire board in one swoop, and the expanded authority of the president will be phased in over time. Such gradual implementation should help allay any market concerns over a sudden change in the board. Going forward, presidential elections might be sources of increased market volatility, as the board might experience greater turnover; but elections are already sources of dramatic changes in policy across government. Any marginal volatility will put pressure on candidates and presidents to announce credible and respected nomination intentions for the board.

Conclusion: Putting It into Practice

Given the Fed's increasing proclivity for intervening in heavily political domains, it is important to find a means of political oversight that does not overly impede day-to-day monetary policy. The 2022 Fed reform legislation proposed by Senator Cramer (along with Senators Lee, Lummis, Tillis, Hagerty, Cruz, and formerly, Senator Toomey) is a promising start but can be pushed further.[87]

We agree with the Cramer proposal that politicization is a significant problem at the Federal Reserve, and we endorse the suggestions to make the Fed's general counsel a political appointment and to ban the Fed system from lobbying the federal government. Piecemeal implementation of elements of our proposal (including those that overlap with the Cramer bill) would be an improvement on the status quo; but ultimately, such reforms will fall short without an increase of political legitimacy, accountability, and checks and balances that would allow for appropriate insulation from daily politics.

Indeed, any reforms that would increase the political accountability of the Fed must include appropriate safeguards, as we propose herein, given that accountability is the key point of tension in the independent central bank model. Too much accountability, and we risk an insufficiently independent central bank; too little, and we risk an ineffective and overreaching central bank. The strength of our proposal is that it relies on the great American traditions of federalism and checks and balances to create a more stable institutional structure over the long term.

We believe that our proposal could attract bipartisan support because it would increase congressional authority and would diffuse power back to state governments in a manner that is likely proportional to the existing political balance. The proposal also opens legitimate democratic pathways to achieve political aims through the regulatory process. Under our proposal, there is a democratic means of changing bank regulations: winning elections. Elections also can reverse such regulatory actions, and it would be odd to suggest that bank regulation is beyond the purview of electoral outcomes.

Optimizing between the contradictory aims of democratic accountability and insulation from political exigency is necessary for the effective conduct of monetary policy. Increasing presidential control over the Board of Governors via shorter term limits and at-will service and balancing that influence against a nationalized and empowered regional Reserve Bank system will create an appropriate equilibrium of checks and balances against politicized monetary policy. Such a reformed structure would walk the fine line between providing enough political accountability to preserve the democratic legitimacy of the Fed and preventing it from becoming an entrenched partisan force, while maintaining its necessary freedom of action unhindered by the day-to-day political process of Washington, DC. Only by providing for both accountability and a reliable measure of independence can the Fed restore its reputation in the eyes of the public.

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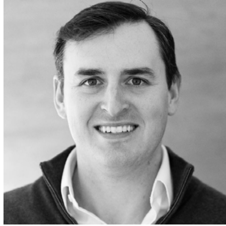

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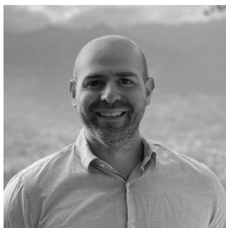

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67 The eight-year term limit and at-will dismissal could result in periods where the FOMC is understaffed, particularly at the beginning of a new presidential administration. However, it is important not to allow "acting" governors to carry out FOMC functions as a workaround to the appointment process. This might result in temporary instances where the balance of the FOMC consists of Reserve Bank presidents, but such a dynamic should strongly incentivize the president to move quickly to nominate and confirm board members.

68 Appointees' ability to discharge their office as they and their appointor see fit is critical to ensuring effectiveness and accountability. Yet a new appointee coming in to an organization will take time to come up to speed because of bureaucratic inertia and, especially in the Federal Reserve system, as a result of the highly technical nature of the institution. Therefore, appointees' increased authority over the bureaucracy is critical, as are the eight-year terms that we suggest, which will ensure that appointees do not squander a large portion of their term while they are still coming up to speed (particularly for candidates from nontraditional backgrounds).

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72 An alternative means of having boards of directors appointed by state governors would be for the president to retain the appointment power but to adopt a "blue slip" policy akin to the historical practice of the Senate Judiciary Committee for judicial and U.S. attorneys nominations, whereby home-state senators of both parties have the ability to influence the president's selection. Such an approach would not offer the same level of decentralization as selection by state governors, but it would be an improvement on the status quo.

73 Some might argue that empowering state governors presents constitutional problems. However, doubts as to the constitutionality of this arrangement could be addressed through the same mechanism on which the FOMC currently relies to address the constitutional status of the existing quasi-public institutions. Typically, someone executing an executive function must be appointed by and accountable to the president. If state governors selected Reserve Bank leaders, this would raise the constitutional question of whether such individuals could properly exercise constitutional power within the executive branch. The Fed currently satisfies this requirement by having the Board of Governors approve the Reserve Bank leaders' status. This approval serves as the constitutional basis for Reserve Bank leaders' status on the FOMC, supervisory authority, and other executive functions.

74 While some might fear that at-will removal will reduce the weight of the Reserve Banks, appointments will still need to run through boards of directors appointed by state governors, providing institutional stability. In theory, this could lead to a standoff whereby the president

decides to continually remove Reserve Bank presidents, but such an outlandish situation would at least have the benefit of clarifying the president's responsibility for monetary policy and his desired agenda, which can be addressed through the democratic process.

75 Or, 8–4 at present in favor of the Board of Governors, using the convention that the FRBNY president votes with the Board of Governors, as has traditionally been the case.

76 Federal Reserve Bank of St. Louis, "Making Sense of the Federal Reserve: Federal Reserve Banks and Policy."

77 Federal Reserve Bank of St. Louis, "A History of FOMC Dissents," *On the Economy* (blog), Sept. 16, 2014; Craig Torres and Catarina Saraiva, "Powell's Fed Sticks Together in Fight Against Inflation Despite Differences," *Bloomberg*, Nov. 17, 2023.

78 "Group of Thirty's Working Group on Monetary Policy," in *Central Banking and Monetary Policy* (Washington, DC: Group of Thirty, November 2023).

79 Sarah Binder and Mark Spindel, *The Myth of Independence: How Congress Governs the Federal Reserve* (Princeton, NJ: Princeton University Press, 2018).

80 Chris Edwards, "Federal Reserve: High Pay, Low Performance," *Cato at Liberty* (blog), Cato Institute, Oct. 25, 2022.

81 If the Fed experiences losses, an appropriations-funded operating budget will mean that the taxpayer has an additional burden for the year with Fed losses. But whether the Fed funds losses out of its operating income or out of appropriations is immaterial, in that any losses funded out of the Fed's income would otherwise go to the U.S. government's overall budget. Thus, as long as the Fed is profitable in the long run, costs to taxpayers are not material. Moreover, direct budgetary supervision might make the Fed less likely to engage in LSAPs or operate an ample reserves system if it will end up resulting in significant losses in the future.

82 Andrew T. Levin and Christina Parajon Skinner, "Central Bank Undersight: Assessing the Fed's Accountability to Congress," Hoover Institution Economics, working paper 23120, Dec. 4, 2023.

83 See, e.g., Elizabeth Warren, "At Hearing, Federal Reserve Board of Governors Nominees Agree with Chair Powell that the Fed Should Address Climate Risks and Safeguard Financial Stability," press release, Feb. 3, 2022.

84 Dodd-Frank Wall Street Reform and Consumer Protection Act, "Section 1108. Federal Reserve Act Amendments on Supervision and Regulation Policy," Public Law 111–203, 124 Stat. 2126, 111th Cong. (2010).

85 Jerome Powell, "Transcript of Chair Powell's Press Conference," transcript, May 2, 2023.

86 Why not remove bank regulation from the Fed altogether, allowing the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency to execute all regulatory functions? While such a structure is appealing, as it would insulate the Fed from political activities, there can be important synergies between having regulatory and monetary-policy staff in one building. Regulatory and monetary-policy matters affect each other deeply, particularly during times of crisis, and should be inputs to each other. While it is less than ideal to have bank regulation continue at the Fed, it is likely to do so for this reason, and the constraints that we propose will be an improvement on the status quo.

87 Kevin Cramer, "Structural Reform Will Improve the Fed's Accountability," press release, Dec. 29, 2022.