



# ***Policy Note***

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## **NO, THE FED IS NOT INDEPENDENT—IT IS A CREATURE OF CONGRESS**

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In response to President Trump’s attack on the Federal Reserve, the natural critics of misguided monetary policy find themselves defending the Fed and the notion that the Fed is—and must be—independent.

In a recent interview, Senator Elizabeth Warren began by admitting, “I completely disagreed with Chair Powell since he was first nominated by Donald Trump, that’s how far back he goes. I have disagreed with him on regulatory policy. I think he’s way too easy on the banks. And I have disagreed with him on interest rate policy. I thought he should have lowered interest rates two years ago, and I have said so quite vocally and done my best to persuade him.” But she then went on to insist “I have never, ever questioned the independence of the Fed and the Fed’s ultimate power to make those decisions based on their best judgment of what’s good for the United States of America” (Inskeep 2025).

But from *whom* should the Fed be independent? This is seldom clarified. And independent to do *what*?

It is essential to bear in mind that the Fed is a creature of Congress. Congress created the Fed in the Federal Reserve Act of 1913. As the Fed’s own website acknowledges: “The law sets out the purposes, structure, and functions of the System as well as outlines aspects of its operations and accountability. Congress has the power to amend the Federal Reserve Act, which it has done several times over the years<sup>1</sup>.”

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Indeed, Congress has “over the years” amended the original 1913 Act, perhaps most importantly with the Humphrey-Hawkins Full Employment Act of 1978, committing the government (including the Fed) to pursuit of full employment while minimizing inflation. It thus refined the directions that mandate the Fed’s macroeconomic goals, as detailed in the full title of the Humphrey-Hawkins Act:

An Act to translate into practical reality the right of all Americans who are able, willing, and seeking to work to full opportunity for useful paid employment at fair rates of compensation; to assert the responsibility of the Federal Government to use all practicable programs and policies to promote full employment, production, and real income, balanced growth, adequate productivity growth, proper attention to national priorities, and reasonable price stability; to require the President each year to set forth explicit short-term and medium-term economic goals; to achieve a better integration of general and structural economic policies; and to improve the coordination of economic policymaking within the Federal Government.

Clearly, the Humphrey-Hawkins Act did not go far enough and was not based on sound theoretical foundations. The Fed took it upon itself to set an inflation target of 2 percent—this is an arbitrarily chosen number that has never been, nor can it ever be, justified. As Powell clumsily admitted when pressed, central bankers have just decided it is the right target<sup>2</sup>. Thus, central bank groupthink has settled on a target that has no theoretical or empirical justification, nor the endorsement of the US Congress.

Nowhere does this amendment or the original 1913 Act declare that the Fed is independent to pursue what *it* believes is the best policy goal or to decide “what’s good for the United States of America.” Indeed, Congress made clear what it believes is in the best interest of Americans. While the precise policy measures that might be appropriate to achieving the goals set by Congress could be debated, there is no room for doubt about what Congress has laid out as the Fed’s mandate.

Senator Warren is correct in her assessment that the Fed has long been operating against the interests of the American people. It has been mismanaging the economy at least since the

days of Chairman Paul Volcker, with an obvious bias against economic growth and job creation. As Chairman Greenspan admitted (Wray 2004)—and as the data clearly show (Wray and Nersisyan 2022)—the Fed raises interest rates whenever the labor market favors workers, that is, whenever their bargaining power to stop the steady deterioration of household purchasing power improves.

Indeed, over the years, the Fed has often mistakenly raised interest rates in the absence of inflation based on a misguided theory that, if unemployment falls below a certain level, inflation is certain to accelerate. Even Jerome Powell admitted that this view has not served us well as he chaperoned the Fed through a review of its policy framework in 2020. In the current cycle, similarly, as most of the measured inflation has come from housing (at least for the past couple of years), the Fed has maintained high rates despite the fact that higher rates do nothing to alleviate the housing shortage or skyrocketing rents.

Ironically, the Fed rarely hits its inflation target. For two decades after the Global Financial Crisis, the Fed could not get the inflation rate *up* to 2 percent, even with its tens of trillions of dollars of lending and asset purchases through quantitative easing (Wray and Fullwiler 2011). Indeed, it was the inability to raise inflation to its goal that served as an impetus for the Fed’s revision of its framework as mentioned above. After all, if the basis for the Fed’s ability to hit its target is market participants believing that it can do so, repeated failure to hit its target creates cracks in its credibility. Consequently, this negatively affects the Fed’s ability to achieve its targets.

Since the COVID inflation—which was caused mostly by supply disruptions—inflation has been running consistently above the target even with interest rates high enough to tank housing markets. And, while the Fed has been given (and has accepted) credit for inflation rates coming down, there is no theoretical or empirical evidence to say this is justified. Inflation rates have come down despite Fed policy, not because of it. And yet Congress refuses to exercise its authority to ensure the Fed’s mandate is to serve the people.

The biggest irony is that President Trump has taken it upon himself to do what Congress will not: pressure the Fed to lower rates. While it is possible that he might have the power to fire sitting Fed Governors (a matter that will likely be settled by the Supreme Court), he has no authority to set Fed policy. Congress, alone, has that power.

## The Fed During the Global Financial Crisis

Congress did exercise its power over the Fed, albeit insufficiently, after the Fed's extensive bailouts of a whole host of financial institutions after the Global Financial Crisis. It curtailed the Fed's ability to create new lending facilities by requiring prior authorization from the Treasury Secretary for doing so. Should the Fed have been allowed to independently decide to open lending facilities, bailing out the shadow banking system—as it ultimately did (Felkerson 2012)—or to lend to individual institutions facing insolvency? What happens when the next financial crisis hits, as crypto markets have become too big to fail?

As Treasury Secretary Bessent (2025) correctly argued recently, the Fed's response during the recovery from the Global Financial Crisis helped to redistribute income and wealth to the top, and its maintenance of high interest rates after the recovery from the COVID recession continues to distort the housing market, resulting in a housing shortage and rising rents. Moreover, the Fed's actions have created the biggest moral hazard in history by implicitly guaranteeing that losses in the financial markets will be socialized, while financial wrongdoing will not be reined in through additional regulation.

## Can the Fed Actually Manage the Economy?

Inflation may well be picking up even as the economy slows, thanks to Trump's tariffs. It would be difficult to imagine a worse Fed response to tariff-induced inflation than to keep rates high—except if the Fed were to raise them even higher! High interest rates will do nothing to fight tariff-driven inflation. Instead, high rates continue to hit workers' pocketbooks—at a time when tariffs are chipping away at their purchasing power—and discourage investment in domestic production to replace the taxed imports.

The truth is that the Fed has only one policy tool at its disposal to promote full employment and price stability: the fed funds rate, which is not effective for pursuing either goal.

The most misguided line of argument Warren makes is the following:

[W]hat I don't want to see is that Donald Trump has squeezed out the independence of the Fed, and that he's managed to get his own lackeys in there, that he's managed to fire someone at the Fed. Because as soon as that happens, the value that the United States has built up, literally for more than a century, by having an independent Fed, we lose the gold standard. And ultimately that costs the American economy. And it also, most importantly, costs American workers. (Inskeep 2025)

Reining in the Fed—and freeing it from economists' groupthink—is the best thing Congress could do to improve economic performance, and that—by itself—will ensure strength of the dollar. It would also be good if Congress could rein in presidential overreach and cancel the inflationary and job-killing tariffs and sanctions that are turning countries away from use of the dollar. But that is a reach. What Congress *can* do is assert its control over the Fed and thus prevent the executive branch's attempt to usurp its power to control the Fed.

In conclusion, we agree with Warren that the Fed should be independent of presidential meddling; however, it is not, should not be, and *cannot* be independent of Congress. It is a public agency created to fulfill the public purpose. As Fed officials themselves have proclaimed over the years, “[t]he Fed is not independent from government. It is independent within government” (Warsh 2010).

Warren is also correct that the Fed has been “too easy on the banks.” Congress should step up and direct the Fed to focus on its core functions: regulating banks, managing the payments system (supplying reserves as necessary for the functioning of the payment system), making and receiving payments for the federal government, acting as a lender of last resort in financial crisis, and stabilizing the base interest rate. It is time for Congress to revisit the Humphrey-Hawkins Act and to assign tasks that are within the Fed's ability to achieve. We recommend:

(1) Setting a target range for the fed funds rate of 1–2 percent. This will promote investment and housing construction while reducing interest spending on mortgages, consumer debt, and student loan debt. It will reduce federal government spending on interest—which is currently reaching a trillion dollars. That is inefficient spending that does nothing

to improve US competitiveness or living standards, as it goes to foreigners, financial institutions, and high-wealth individuals.

(2) Prioritizing the maintenance of financial stability

- by reducing swings of market interest rates that cause capital losses and encourage financial engineering;
- through use of proper oversight of financial institutions; and
- when the next financial crisis hits, acting as lender of last resort while taking necessary precautions to reduce moral hazard and risky behavior.

It is time to drop the fantasy that the central bank can use the overnight interest rate to hit inflation and unemployment targets. The Fed's main role should be to promote financial stability that encourages sustainable growth with high employment and a more equal distribution of income.

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## Notes

1. <https://www.federalreserve.gov/aboutthefed/fract.htm>
2. <https://www.c-span.org/clip/senate-committee/user-clip-jerome-powell-why-2-percent/5171721>