Levy Economics Institute Capitol Hill Series

Rethinking the Federal Reserve's Policy Framework and Independence

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> *"Congress retains the ultimate authority to instruct, to direct, and to even redefine the Federal Reserve's objectives"*
>
> *— Pavlina Tcherneva, President, Levy Economics Institute*

As the independence of the Federal Reserve is publicly under threat from the Trump White House, the **Levy Economics Institute** brought together leading economic thinkers to discuss the important role Congress must play in preserving the independence of the Federal Reserve. Levy Scholar L. Randall Wray made the important distinction that the Federal Reserve is a creature of Congress that is "independent within government," not independent from it. It is up to Congress to make sure that the Federal Reserve follows its mandate through strong oversight.

Three main takeaways on **Federal Reserve independence**:

- The Federal Reserve is a creature of Congress and should be responsible to Congress, not the executive branch.
- An openly political Federal Reserve that is controlled by the White House would compromise trust in the institution.
- Congress should instruct the Federal Reserve to pursue achievable goals: stability, regulation, and maintaining the payment system.

The Fed's **flawed, inflation-targeting framework** and limited tools:

- The Fed consistently raises interest rates not in response to inflation but when the unemployment rate hits cyclical lows—effectively tightening policy to discipline the labor market.
- US inflation has historically been supply-side in origin, and the pandemic disrupted structural, supply-side features that had kept inflation low from the 1980s through the 2010s.
- Raising interest rates could not meaningfully address the core drivers of recent inflation (energy, food, and shelter) and may have exacerbated housing shortages and cost pressures through higher financing costs.

When Federal Reserve officials testify before Congress, **Members should question the distributive impacts of interest rate policy**, as well as **the impacts on federal deficits/debt**:

- In the current system, interest-rate policy—and specifically the large volume of interest paid on reserves—effectively channels billions of dollars to asset holders, functioning as a regressive transfer in an already unequal economy. Any evaluation of rate policy must consider these distributive effects, not only its macroeconomic targets.

Congress should explore a **reorientation of the Fed's framework**:

- The Federal Reserve should target a 1–2 percent federal funds rate corridor to stabilize investment and financial conditions, refocus on its original central banking functions (financial stability, regulation, and payment systems), and abandon the expectations-focused inflation-targeting framework embedded in current models.

The full proceedings may be viewed here. If you have further Federal Reserve policy questions, please contact **Michael Stephens at mstephen@levy.org.**