Advice from William of Orange for the Federal Reserve's Framework Review

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The Federal Reserve's (Fed's) latest framework review, announced in November 2024 and planned to conclude later in 2025, aims to evaluate the monetary policy strategy, tools, and communication practices of the Federal Open Market Committee (FOMC or the Committee) to achieve better its goals of maximum employment and price stability[2]. We've been told that this review focuses on the FOMC's Statement on Longer-Run Goals and Monetary Policy Strategy and its policy communications tools. That is, the framework review essentially drafts the annual mission statement to be repeated until the next framework review in five years.

Asking me to comment on this process came with an invitation to reminisce, which I take. While working at the Federal Reserve Board, I quoted William of Orange so often in the Board Room that I was given bookmarks with the aphorism on leaving. The circumstances were usually that, after several hours of special Committee discussion of strategy or communication, none of the nineteen participants would agree on anything.[3] The Chair would deliver a reliable laugh line by turning to me and saying, "Vincent will review the transcript, find common ground, and come back with a proposal that we can all agree on at the next meeting." Cue William of Orange, "One need not hope to undertake, nor succeed to persevere."

I propose this as an organizing device for understanding the ongoing framework review. I will sort what is being done into the categories "hopeless" and merely "unlikely to succeed". By the time I'm over, I hope to convince everyone that this exhausts the topics under review.

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[1] The views expressed are my own and not necessarily shared by anyone where I work now or previously.

[2] At https://www.federalreserve.gov/monetarypolicy/review-of-monetary-policy-strategy-tools-and-communications-2025.htm.

[3] In the transcript of the February 2005 FOMC meeting, you can find me telling participants: "My experience in surveying you has been that if I ask the 19 of you "What is the color of an orange?" I couldn't be sure of getting a majority on a single answer." Page 135 at https://www.federalreserve.gov/monetarypolicy/files/FOMC20050202meeting.pdf.

Hopeless

An important ambition of the framework review is to be clear about the Fed's long-run goals and strategy. Structural impediments, central to the Fed's design, suggest to me that it shouldn't try and cannot succeed.

Notwithstanding the seriousness and solemnity sometimes surrounding the institution, the structure of monetary policy making we know today is a legislative mulligan. The US Congress created the central bank with the Federal Reserve Act of 1913, delegating to the new institution its Constitutional authority to coin money, which is the rationale for the Fed to conduct monetary policy. (The preamble also directed it to "other purposes," be what they may.) The monetary policy making part was revisited twenty years (and one Great Depression) later in the Banking Act of 1933, which set up the Federal Open Market Committee. Present at those two creations were two design features that hobble the framework review at the starting gate.

The first design feature is about purpose. Congress has been serially negligent in telling the Fed what to do to be successful. At the start, the preamble to the Federal Reserve Act of 1913 mentions only an "elastic currency." The most specific the Congress got, halfway through the Fed's existence, was to tell the institution to foster "maximum employment, stable prices, and moderate long-term interest rates" in amending the Act in 1977. There was no definition of the variables, measurement, or sense of trade-offs in transition in achieving these goals. When Congress got more specific about economic goals for the entire government a year later in the Full Employment and Balanced Growth Act of 1978, the aspirations were overdetermined, inconsistent, and mostly unattainable. Congressional efforts at more precision about Fed policy sputtered thereafter, including attempts to mandate the single goal of price stability, with proposed legislation never making its way out of committee.

That brings me to another story. I started working in the Federal Reserve System at the Federal Reserve Bank of New York. New to Manhattan, I found myself sharing a barber with Paul Newman. The first time I was in the chair, the barber asked, "What do you want to look like?" I pointed to the autographed picture on the wall. He turned to me seriously and said, "Man cannot put in what God left out." As applied to the Federal Reserve, that means the creation cannot put in what the creator left out. (This also applies to the Numenoreans in Tolkien's *Silmarillion*, which went poorly for them in the effort.)

As a creation of Congress, the Fed cannot assert a long-run commitment on its own other than what Congress wants it to achieve as a long-run outcome. [4] The Committee must confine itself to exegesis of the original scripture, the Federal Reserve Act as amended in 1977. All else is hopeless.

Nonetheless, Fed officials have tried to fill the void of Congressional silence over the years. Look at the annual mission statement and appreciate that this has two parts. First, there's the FOMC's interpretation of the goals, in principle. Second, there's a quantification of the goals, in practice, given current understanding of the structure of the economy and data.

As for the first, the framework review doesn't till new ground in the FOMC's interpretation of its goals. A succession of Federal Reserve chairs asserted that the three directives by the Congress collapse into one in the long run. Only with price stability in the long run will employment be at its maximum. If prices are stable and employment is at its maximum, then long-term interest rates will be moderate. The three goals are just one long-run one. Otherwise, the level of maximum employment is not in the Fed's purview, and the institution has been silent about what moderate long-term interest rates mean, unless as a backdoor discussion of the Fed's responsibility for financial stability. As for the transition, the Fed must respect deviations from the goals of maximum employment and stable prices, effectively giving it a dual mandate.[5]

At least, this is my interpretation of the Committee's interpretation of what the Congress has told it to do, which adheres to the admonition of Paul Newman's barber.

Under the second part, quantification of the goal, the Fed repeats in its annual mission statement the assertion from the framework review that price stability is consistent in the long run with inflation running at 2 percent as measured by the personal consumption expenditure price index (PCE). We are also reminded that officials monitor all labor market indicators and observe that they are silent about moderate long-term interest rates. This advice, while practical, reads specificity into the Act that is not there, inappropriately violating the hierarchy of creator and creation.

To my originalist bent, the enterprise has three other flaws beyond undue specificity that makes me think it is hopeless. An annual statement revised every five years in a framework review has no effective enforcement mechanism, is not obviously needed, and may be counterproductive.

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[4] A case study in inventing a goal in "other purposes" was the Fed's attempt to go with the flow of popular opinion and read a green initiative into its mission. The result was an embarrassing round-trip in and out of The Network for Greening the Financial System.

[5] As explained by then-Governor Mishkin in a speech in 2007, here.

The lack of an enforcement mechanism follows from the second design feature of enabling legislation on monetary policy. In the 1933 Act, the Congress directed that monetary policy be made by a group that reorganizes itself every year. Many in the audience took part in the bit of vaudeville that plays out at the first Committee meeting each year when someone opens with an unbiased search for a new chair and vice chair. (The box at the end gives examples over three decades of this role play for those never in the room, which we know was all in good fun because the Secretary helpfully inserted "[Laughter]" at multiple points.) In what is the only time they make a quick decision that year, participants vote on a chair and then a succession of appointees and rules. In doing so, the Committee creates itself at its organizational meeting.

As a consequence, this year's Committee can't make promises about the behavior of future Committees because some later Committee can rewrite the rules. A rule maker trying to do otherwise, to bind future rule makers, falls into the legal fallacy known as entrenchment. However well-intentioned, a mission statement voted on by the Committee at the start of the year has no standing past that year, inimical to the purpose of anchoring long-term beliefs.[6]

As for the need to specify a numeric goal in the mission statement, the Committee already signals a 2 percent PCE goal in its Summary of Economic Projections, and more.[7] Among the most important innovations in the Fed communications were adding a column and row to the Summary of Economic Projections. The extra column, introduced in 2009, provides a longer-run assessment of key macro indicators. Once the Committee included that long-run column, it revealed participants' expectations of potential output growth, the goal for inflation (because ultimately the inflation rate is what the central bank wants it to be), and the natural rate of unemployment. The row, inserted in 2012, gives the appropriate policy rate at the end of the year. The last entry in the row, the appropriate policy rate in nominal terms in the long run, conveys the group view on the real federal funds rate in the long run, i.e., the neutral rate.

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[6] To be persnickety, the Committee has no formal long run goals in 2025 as it has yet to approve a Statement of Longer Run Goals and Monetary Policy Strategy this year. Leaving the statement from 2024 on the website is a nice historical touch, but, as it indicates, the document was reaffirmed on January 30, 2024 by a Committee that no longer exists. If this logic is wrong, why did the Committee formally vote at its organizational meeting to approve the FOMC Policy on Investment and Trading for Committee Participants and Federal Reserve System Staff, the Program for Security of FOMC Information, the FOMC Policy on External Communications of Committee Participants, and the FOMC Policy on External Communications of Federal Reserve System Staff (as described in the minutes of the January meeting, here)? In doing so for organizational matters, the 2025 Committee recognized that it is not bound by decisions of prior Committees. It is similarly not bound by a prior statement about policy goals that is not reaffirmed.

[7] I appreciate that the Summary of Economic Projections has a fraught history. As David Lindsey explained here, FOMC participants were first surveyed about the outlook as an alternative to providing the staff forecast to Congress. A survey of modal expectations is a poor way of explaining policy makers' expectations, with that value eroded further by giving respondents the freedom to base their forecasts on their own views of all outside influences on the economic outlook. However, the Summary of Economic Projections is the only place the Committee writes down numbers.

Moreover, the entries across the SEP table show that there is a range of views among participants, important for the public's understanding that monetary policy is made by a group. Except, the group uniformly agrees to the goal of price stability, as indicated by the single entry of 2 percent in the cell for PCE inflation in longer run. Doesn't that cast the anchor of price stability?

As for being counterproductive, what is the anchoring ability of a document explicitly revised every five years? On that schedule, the purchaser of a thirty-year Treasury bond intending to hold it to maturity has five opportunities for the Fed to change the rules of the game. I am encouraged that the discussion of the 2 percent inflation goal has explicitly been ruled out this time. I think, however, it was not on the logic just given but to quell suspicion that the framework review offered an opportunity to revise that goal when the Fed is still inconveniently above it.

Unlikely to Succeed

My advice is to curb the Committee's ambitions. I suggest that the framework review produce two documents. The first, on stone tablets that are carved once and for all, would be an assertive statement of beliefs accepted by Federal Reserve officials over the years about Congressional instructions. Price stability is a steady low rate of inflation. If achieved, employment will be at its maximum, on which any further influence is outside the Federal Reserve's ability. Moderate long-term interest rates will eventuate if the economy is at price stability, and the Federal Reserve has no independent tools to influence them. Lastly, there'd be nothing about the tools the Federal Reserve would use because Congress has been silent about them.

It's important to be specific about all three because the Congress provided instructions about all three. It's important not to be too specific about all three because Congress wasn't, and participants' enthusiasm for being more precise should be tempered.

Every year's new Committee can start by repeating the truisms carved in stone. True, that statement made in January has no legal reach beyond December 31st, but one need not hope to undertake. The purpose of consistent repetition is to create precedent to bind future Committees somewhat. The obvious example is why there are now nine justices of the Supreme Court of the United States. The Constitution is silent as to the number, but Congress hasn't touched the Court's composition since 1869. This creates a hurdle, not an insurmountable one, to change. Similarly, the Committee can create a hurdle for future Committees, its future selves, to deviate from the definition of price stability.

The second document would be the five-year mission plan giving current understanding of how to operationalize the instructions from the Congress. This is not set in stone; it's a working plan given the current understanding of the economy, the economic data available, and provides guidance on what to look at and when to think policy changes fast or slow. Given current knowledge, price stability is a 2 percent annual change in the personal consumption expenditure price index. A small set of labor market indicators are appropriate in judging maximum employment. If the Committee has them, it should explain an asymmetric tolerance of trade-offs from deviations from the two goals and the relative tolerance of being reactive versus preemptive. (There is precedent. The previous framework review talked about the problems of being at the zero bound and the need to be preemptive.) Are there also times that the Committee might need to be reactive? The framework review, which is about strategy, is the opportunity to say that in advance.

In a five-year flight plan, the Committee could also discuss the likelihood of hitting the zero lower bound and using unconventional policy. This sets a bar in advance of taking a tool out of the kit that makes some FOMC participants uncomfortable. I file this in the category "persevere without expectation of success." There's a strong tendency to improvise with each crisis, partly from the fear of being gamed, i.e., essentially formalizing a put to markets. But those episodes are also costly, consequential, and hard to reverse. If the probability is uncomfortably high, shouldn't someone be diagraming the game plan now?

Every five years is also a good cadence to consider the composition of the Fed's balance sheet over the longer term. Where do Committee participants want the portfolio to get to? My sense is that most FOMC participants are extremely uncomfortable in holding the securities of government-sponsored enterprises. That's understandable given the associated message on moral hazard to the private sector. If that's really the case, then tell us it will ultimately be only Treasuries. Tell us the average maturity of those Treasuries in the portfolio in the long run. To be practical, the framers should focus on the big picture of the long run, not the month-to-month evolution of the System Open Market Account starting from the hundreds of securities currently held.

The last part of the five-year review could consider the main channels of communication: the FOMC statement, the Summary of Economic Projections, the press conference, and the minutes. I think this may present the biggest opportunity. Going back to the transcripts, every time the FOMC considered a change in its communication policy, somebody said, "We have to be sure we want to do this because we can't take it back." That's a formula for delaying useful innovations and continuing existing ones past their sell-by date. If all aspects of its communication were tied together in a package that is reviewed every five years, it may be possible to consider changes to individual parts as part of a trade with the public.[8]

In discussions of transparency and communication, advocates of transparency have high ground. Who could argue against sunlight being the best disinfectant? The problem, going back to the design of Congress, is that people make monetary policy. Being human, communication mechanisms sometimes impinge on deliberations. Among the examples: the existence of the transcript makes FOMC meetings more scripted because participants don't want to ad-lib for the history books; the statement makes deliberations and policy choice more inertial because the statement is mostly drafted in advance of the meeting; and the press conference has created an incredible incentive not to surprise markets.

Consider the last two. For one, the most important decision the Committee votes on is mostly settled before it meets. For the other, the key practical arithmetic for the chair is that the FOMC statement is released half an hour before the press conference starts. No chair wants to walk into a room full of reporters having just surprised the world. As a result, since the institution of regular press conferences, there have been many fewer surprises from meetings. The press conference also shifts attention to the chair, deviating from the instructions from Congress that policy should be set by a group, and provides a first draft of the minutes from the perspective of the chair but not the group, eroding its value as a communication mechanism.

One other nod to originalism is related to that final point. All initiatives on communication should be assessed in light of the Congressional design principle that monetary policy is made by a group that deliberates to arrive on a joint decision. How do I read that last bit into the Act? The number twelve. If it's just a simple majority who should make decisions, then Congress would have chosen an odd number, as with the courts.[9] The Congress took a cue from the other side of the judge's bench in a courtroom. Twelve seems much more like a jury of peers that must come to universal agreement for a decision to bind. Keep this in mind when considering changes that may have the unintended consequence of shifting power to the chair.

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[8] I leave out the semi-annual report and testimony with some sadness because over the years it's been gutted of relevance. What was the premier device for chairs Volcker and Greenspan to communicate to the world just doesn't matter anymore. Here is also a case study of where more is sometimes less. The other reports to Congress on financial stability and bank supervision and regulation are similar box-ticking exercises, slipped out on Friday afternoons to escape attention.

[9] Here, I am channeling Bertie Wooster's frustration about the annual darts tournament at the Drones Club when it ended in a tie for the 17th year in a row. "You know, Jeeves, I can't help thinking, somewhere at the back of my mind, there must be a better method of deciding the championship than playing the best of six games." Here.

Another Aphorism to End

Let me end with another aphorism: the best is the enemy of the good. In my experience, most FOMC discussions of strategy and communication went off the rails because of an excess of ambition. With good intentions, participants went into the discussion wanting to eliminate every cost, maximize every welfare triangle, and cover every contingency. Finding common ground became almost hopeless when everyone's maps were finely detailed in high resolution.

To me, one signifier of such specificity is excessive reliance on large-scale models. I suspect that, for some, the impetus to quantifying the Committee's goals and trade-offs is to provide the parameters to close such systems. The Committee need only periodically fill in the boxes: Long-run goals; implied weights of employment and inflation in a welfare function; and the "stars" anchoring the rest points to the unemployment rate, trend growth, and the natural rate. Out will come the optimal path for the policy rate.

Don't get me wrong. Models are critically important in disciplining monetary policy making. But I'm talking about the models that can be explained on the back of cocktail napkins. Inflation is always, everywhere, and ultimately a monetary phenomenon. Nominal interest rates embed expected inflation. Supply relative to demand matters for prices, some of which adjust more quickly than others. Balance sheets balance. A useful reference point for the appropriate policy rate can be calculated from inflation and unemployment. The value of liabilities today equals the present value of future net income appropriately discounted. These models anchor policy choice but are not a reason to moor in the harbor of a large one. Big models can inform policy choice but only usefully if the audience appreciates that it is relying on the judgment of the modelers buried in every nook and cranny of the code. Informed policy makers must know the assumptions they're making.

That is why it'd be unfortunate to use the framework review to double-down on the Committee's reliance on big models by advocating the regular production of fan charts, alternative scenarios, and optimal policy paths. Such a reliance distances Committee participants from the assumptions underlying their policy choice and concentrates analysis at the center, where those materials would be produced.

Instead, chisel the few big devotional beliefs on stone tablets and dare anyone to doubt. Repeat and repeat, don't change. Put everything else on a five-year review cycle to keep up with the advice from academics, the availability of data, and the experience of the prior five years. That may make it possible to winnow out the unhelpful. If it's important, it should be on the list. If it's contentious, there should at least be a marker to remind the Committee of an open issue.

To sum up, my assessment that the pitfalls in the framework review owe to an excess of ambition might lead some to conclude I am deficient in ambition. I call it realism to hope that the Committee acts within the limits set by Congress and by human nature. Man can't put in what God left out, both in terms of design instructions and natural abilities. To work within these limitations is challenging, but one need not hope to undertake, nor succeed to persevere.

Transcript of Federal Open Market Committee Meeting of February 2-3, 1999
February 2, 1999 – Afternoon Session

CHAIRMAN GREENSPAN. We will start off, as we do in the first meeting of each year, with the election of officers. I will turn the gavel over to Governor Rivlin to bring us a Chairman and Vice Chairman for this year.

MS. RIVLIN. Thank you. It is not clear by what authority you were making those announcements! [Laughter] I would like to open the floor for nominations for Chairman of the FOMC. Governor Kelley.

MR. KELLEY. After long and careful consideration, I nominate Alan Greenspan.

MS. RIVLIN. Is there a second?

SEVERAL. Second.

MS. RIVLIN. Any discussion at this point?

MR. BOEHNE. I would like to hear Governor Kelley's long and careful reasoning!

MR. KELLEY. That's confidential!

MS. RIVLIN. All in favor say "aye."

SEVERAL. Aye.

MS. RIVLIN. Opposed? I believe we have a Chairman.

CHAIRMAN GREENSPAN. I thank you, everyone.

Transcript of the Federal Open Market Committee Meeting on
January 27–28, 2009—Afternoon Session

MR. KOHN. Mr. Chairman, it is a pleasure and an honor to recommend Ben Bernanke to be Chairman of this Committee. I am not sure what sins you committed in an earlier life, but I sure hope you had fun. [Laughter]

MR. HOENIG. It's the first nomination I've heard like that. [Laughter]

CHAIRMAN BERNANKE. Is there a second?

MS. YELLEN. Second.

CHAIRMAN BERNANKE. Without objection. Thank you all very much.

Transcript of the Federal Open Market Committee Meeting on January 30–31, 2018
January 30 Session

MS. BRAINARD. Thank you, Madam Chair. I will be calling for three sets of nominations and votes. First, I'd like to ask for a nomination for FOMC Chair to serve through February 2, 2018. [Pause]

MR. POWELL. I would like to nominate Janet Yellen. [Laughter]

CHAIR YELLEN. I was getting a little scared there. [Laughter]

MS. BRAINARD. Is there a second?

MR. QUARLES. Second the nomination.

Note: The transcripts can be found here.