Testimony on:

"Fewer Mandates. More Independence"

Douglas Holtz-Eakin
President, American Action Forum*

House Committee on Financial Services
Task Force on Monetary Policy, Treasury Market Resilience, and Economic Prosperity

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Chairman Lucas, Ranking Member Vargas, and members of the task force, thank you for the privilege of appearing today to discuss the issue of statutory mandates for the Federal Reserve. Given that the Federal Reserve (Fed) has updated its monetary policy framework, this is an appropriate time for such a hearing. Notice, however, that this review will focus on how the Fed implements its dual mandate for price stability and maximum employment. The question facing us today is whether that dual mandate remains the appropriate framework.

I would like to make three main points:

1. The Fed has too many mandates, and its mission should be simplified.

2. Although there are reasonable arguments on both sides of the question, I believe on balance that the U.S. economy would be best served by a single mandate for the Fed.

3. The design of that single mandate could focus on either prices or nominal gross domestic product (GDP), although I believe that targeting the level of prices would be most practicable.

Let me discuss these in turn.

In November 2024, the Federal Reserve announced that it would be conducting a periodic review of its monetary policy strategy, tools, and communications it uses to pursue its congressionally assigned goals of maximum employment and price stability (the "dual mandate").[1] The Fed is already tasked with bank holding company supervision (microprudential regulation), systemic risk management (macroprudential regulation), and the dual mandate of price stability and maximum employment. At other times policymakers have suggested that the Fed be concerned with climate-related financial services issues and targeting the labor market performance of specific demographic groups.

This is clearly too many jobs, and the Fed would benefit from clarifying its roles. There is little support for climate or targeted labor market mandates, and the post-Dodd-Frank experiment with macroprudential regulation of systemic risk should be shelved. This would permit the Fed to focus its regulatory efforts on the safety and soundness of individual banks and its monetary policy on the path of prices and employment.

With regard to the latter, the dual mandate was created by Congress in 1977 and requires the Fed to deliver "stable prices" and "maximum employment."[2] At the outset, however, there was no explicit operational definition of these objectives. With experience, and the example of other central banks that adopted explicit inflation targets, the Fed began an internal debate on setting an explicit inflation target. With the arrival of Ben Bernanke as chairman, the Federal Open Market Committee (FOMC) approved an inflation target in 2012.[4]

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[1] https://www.federalreserve.gov/newsevents/pressreleases/monetary20241122a.htm

The "Statement on Longer- Run Goals and Monetary Policy Strategy" enshrined the target within the dual mandate[2]:

> The inflation rate over the longer run is primarily determined by monetary policy, and hence the Committee has the ability to specify a longer-run goal for inflation. The Committee judges that inflation at the rate of 2 percent, as measured by the annual change in the price index for personal consumption expenditures, is most consistent over the longer run with the Federal Reserve's statutory mandate.

In contrast, the FOMC did not specify a target for full employment, instead seeking only sustained, rapid employment growth.

Advantages of a Single Mandate

I see three primary advantages to a single mandate. The first is improved accountability of the Fed. It will be much easier for Congress to assess whether the Fed is performing well, improving the accountability of the Fed to Congress.

A second advantage is improved predictability and transparency. The Fed has devoted great efforts to communicating more effectively to market participants and the public; a single mandate would simplify this communication task.

Finally, a single mandate would more firmly anchor inflation expectations. A clear and explicit commitment to an inflation target reduces uncertainty, provides forward guidance, and promotes better economic outcomes. The importance of inflation expectations was summarized by Former Federal Reserve Chair Alan Greenspan as a "state in which expected changes in the general price level do not effectively alter business or household decisions."[3] In other words, when consumers and businesses are confident that expected inflation will remain stable, they will be more willing to invest, borrow, and save. Stable prices are a condition for both economic and employment growth.

A final consideration regarding a single mandate is the political independence of the Fed. There is a growing body of literature that indicates more independent monetary authorities generate superior economic outcomes. For example, the recent work of Athanasopoulos, Masciandaro, and Romelli[4] indicates that "an advanced economy moving from the first to the fourth quartile of the index of central bank independence would experience a long-run reduction of annual inflation of approximately 3.7 percentage points."

With the Fed operating under a dual mandate, there will always be a temptation for political actors to attempt to put their thumb on the scale to change the Fed's emphasis on one mandate or the other. In contrast, a single mandate allows no such trade-off and reduces the temptation to interfere with the Fed.

[2] https://www.federalreserve.gov/monetarypolicy/files/FOMC_LongerRunGoals_201201.pdf
[3] https://www.federalreserve.gov/monetarypolicy/files/FOMC19960703meeting.pdf
[4] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=5110065

Concerns With a Single Mandate

My primary reservation with a single mandate is that it may interfere with broad public support for the Fed. Put simply, the public cares about both inflation and unemployment. In the absence of extensive public education, a single mandate may send the message that the Fed cares only about inflation, perhaps even at the expense of the labor market experiences of American workers.

Recent Experience

The recent episode of high inflation dating to 2021 is illuminating. The Fed made a fundamental policy error by keeping the target federal funds rate at the zero bound, and continuing the quantitative easing, throughout the year. Combined with excessive fiscal stimulus and the remnants of COVID-related supply constraints, loose monetary policy generated consumer price inflation that rose from 1.4 percent (year-over-year) in January 2021 to a peak of 9.1 percent in June 2022.

When the Fed moved to tightening, it effectively chose to operate as a single-mandate monetary authority, with an exclusive focus on inflation. Speaking at Jackson Hole in 2022, Chairman Powell noted[5]:

> The Federal Open Market Committee's (FOMC) overarching focus right now is to bring inflation back down to our 2 percent goal. Price stability is the responsibility of the Federal Reserve and serves as the bedrock of our economy. Without price stability, the economy does not work for anyone. In particular, *without price stability, we will not achieve a sustained period of strong labor market conditions* that benefit all. [Emphasis added.]

Operating in this fashion, the Fed achieved rapid and relatively painless disinflation, with inflation falling to 3.1 percent by January 2024. (A similar pattern prevails for core inflation, as well as inflation measured by the personal consumption expenditures price index.) At the same time, the unemployment rate remained at or below 4 percent. Yet in 2024, the Fed reverted to operating under the dual mandate. Again, speaking at Jackson Hole, Chairman Powell said[6]:

> Overall, the economy continues to grow at a solid pace. But the inflation and labor market data show an evolving situation. The upside risks to inflation have diminished. And the downside risks to employment have increased. As we highlighted in our last FOMC statement, we are attentive to the risks to both sides of our dual mandate.

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[5] https://www.federalreserve.gov/newsevents/speech/powell20220826a.htm
[6] https://www.federalreserve.gov/newsevents/speech/powell20240823a.htm

> The time has come for policy to adjust. The direction of travel is clear, and the timing and pace of rate cuts will depend on incoming data, the evolving outlook, and the balance of risks.

What was the result? Progress against inflation reached a low of 2.3 percent in April, but has steadily crept back toward 3.0 percent since. Moreover, employment growth was not notably improved; the unemployment rate remained near 4 percent.

Operational Issues

There are two key issues with a single mandate. The first is whether to target inflation or to target nominal GDP. There is a wide variety of arguments on both sides. I will simply note that an enormous policy advantage of the Fed is that it is capable of being nimble and changing its stance quickly. To do so, however, requires that the data be available and of high quality. Monthly, high-quality price data from the Bureau of Labor Statistics and the Bureau of Economic Analysis more closely fits this objective than do the quarterly data on GDP. The latter are also subject to revision, and often substantial revision. I think practical considerations in executing policy tip the scale toward an inflation target.

The second issue is whether to target the inflation rate or the price level. Price levels seem better than year-to-year inflation targets because they provide stronger forward guidance. They have the drawback, however, that they have never been tested.

Thank you, and I look forward to your questions.