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Prosperity of the House Committee on Financial Services**

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On Federal Reserve Independence, the Accord, and a Possible “New Accord”

Thank you Chairman Lucas and Ranking Member Vargas, for holding this hearing and inviting me to testify on the Treasury-Fed Accord.

Background

The Accord of March 4, 1951, was a watershed event in Federal Reserve independence. Such independence is critical to effective monetary policy and improved economic outcomes. Without independence, monetary policymakers will be subject to short-term political considerations, which can lead to higher inflation. One risk is that the benefits of easier policy – higher output and employment – come sooner than the costs in terms of higher inflation. So a short-term perspective can create incentives for inappropriately easy policy and lead to undesirably high inflation. Another risk is that fiscal strains may lead to political pressure to keep interest rates low, which will again lead to undesirably high inflation. The upshot is that we want policy makers who are insulated from short-term political considerations, since such considerations are likely to push in the direction of easier policy even when that is not appropriate.¹

Fortunately, there seems to be general agreement on the importance of independence. Indeed, when I testified before this Task Force in January, there appeared to be unanimous, bipartisan support for monetary policy independence.

Legal Support for Federal Reserve Independence

The Fed’s monetary policy independence is undergirded by key features of the Federal Reserve Act, as amended in 1935. In particular, the Banking Act of 1935 removed the Secretary of the Treasury and the Comptroller of the Currency from *ex officio* membership of the Board of Governors, established 14-year overlapping terms for Governors, so that a President, over four years, will only get to nominate two Board members if all members serve out their terms.

¹ Of course, independence does not mean that monetary policy should be free of oversight from elected officials. Most important, the President nominates Governors as well as the Chair and two Vice Chairs, and the Senate must confirm those nominees. The nomination and confirmation process provides a great deal of opportunity for oversight by the President and members of Congress. In addition, the Fed has to explain itself to the Congress and the public on a regular basis through reports, testimonies, speeches, FOMC statements, press conferences, and meeting minutes. The Monetary Policy Report and testimony, in particular, provide an opportunity for feedback and discussion with elected officials.

Importantly, it also provided that the President could only remove governors for cause.² In addition, the Act established the modern Federal Open Market Committee, the main monetary policymaking body within the Federal Reserve, which includes all of the members of the Board of Governors as well as five Reserve Bank presidents (following an annual rotation). The inclusion of the Reserve Bank presidents provides additional support for Fed independence because they are not nominated by the President, but are chosen by the Boards of Directors of their Banks and approved by the Board of Governors.

The historical record shows that Congress put these protections in place because it wanted to ensure that the Fed could operate independently, in the public interest. In particular, Congress wanted to ensure that the Fed was independent of the President, who might have political and personal incentives that would affect policy in ways that would harm the public good.³

The Accord⁴

During World War II, policymakers at the Fed decided that it was appropriate to aim monetary policy at maintaining low and stable interest rates to help ease the financing of the war effort. This sort of arrangement is called “fiscal dominance,” and it can easily lead to very high inflation because the central bank cannot tighten monetary policy to offset the effects of high war spending and the resulting large deficits on aggregate demand, leading to an overheated economy. During the war, Congress put in place other policies to limit the inflationary effects of the war effort, including rationing of key products and comprehensive wage and price controls.

After the war, the Fed continued to maintain low interest rates to allow the Treasury to roll over the war debt at low rates. And, as rationing and wage and price controls were withdrawn, inflation rose as high as 20 percent before falling back during a recession that began in 1948. However, demand picked up in 1950, and, with the start of the Korean War, inflation moved higher. Policymakers at the Fed believed that maintaining low rates would lead to excessive inflation over time, and so they wanted to move rates higher. However, the Truman administration wanted the Fed to maintain low rates in order to ease funding pressures. After a lengthy and acrimonious debate, the Fed and the Treasury announced that they had “reached full accord with respect to debt management and monetary policies to be pursued in furthering their common purpose and to assure the successful financing of the government’s requirements and, at the same time, to minimize monetization of the public debt.” Following the release of this statement, the Fed pulled back from support for Treasury prices and set monetary policy based on its assessment of the needs of the US economy.

² This issue is currently before the Supreme Court (Trump vs Cook, No. 25A312).

³ See Richardson and Wilcox (2025).

⁴ See Nelson (2026) and Romero (2013) for more information on the Accord.

Importantly, the Accord was a return to the *status quo ante*. The Fed had chosen to constrain its monetary policy for a time in response to an existential threat to the nation. But that was a temporary expedient, and so it was appropriate to move away from that voluntary constraint and take up the responsibilities that the Congress had intended for the Fed since 1935. Thus, the Accord did not require any legislation.

A Possible “New Accord”

Over the past year or so, some have called for a “New Accord.”⁵ However, it is not entirely clear what the purpose of such an agreement would be.

One issue appears to be the relationship between Treasury debt management and the Fed’s monetary policy decisions, particularly quantitative easing and the shift to an ample reserves framework for policy implementation. There is no doubt that the Fed and Treasury have important, distinct, yet complementary responsibilities in this area. The Treasury decides on which securities to issue and the resulting maturity structure of the debt outstanding. In doing so, the Treasury needs to take account of the likely path of the Fed’s holdings of Treasuries.⁶ The Treasury’s issuance decisions establish a baseline for the maturity structure of government debt. At the same time, the Fed, taking those decisions as given, uses its tools – open market operations and the interest rate paid on reserves – to set short-term rates. Moreover, if there is a large recession, and the Fed is constrained by the effective lower bound on its policy rate, it can use quantitative easing – that is large purchases of longer-term securities – to temporarily change the maturity structure of government debt, thereby reducing longer-term interest rates and providing additional monetary stimulus. Similarly, in the event of disfunction in the Treasury market, as in the spring of 2020, the Fed can purchase Treasury securities to support market functioning and address financial stability concerns.

As one would expect, the Treasury and the Federal Reserve consult regularly on these topics, and it is not clear that any formal agreement is needed at this time. However, both the Treasury and the Fed could improve decision making by the other institution by providing as much clarity as possible about their future plans. For example, the Fed could provide more information about the likely size and composition of its balance sheet over coming years, including the extent to which it plans to shorten the average maturity of its holdings. Similarly, the Treasury could provide information about its plans for the maturity distribution of its issuance over time.

A second possible issue is the extent to which Federal Reserve policy actions have implications for credit allocation. While monetary policy always has implications for borrowing and spending, with different effects across sectors of the economy, explicit decisions regarding credit allocation would seem more appropriately made by elected officials. Indeed, in 2009, the

⁵ For example, Bessent (2025).

⁶ See the Treasury Borrowing Advisory Committee presentation on this point (TBAC 2026).

Fed and Treasury issued a joint statement indicating, in part, that the Fed's actions would be aimed at affecting financial conditions broadly, and not at allocating "credit to narrowly-defined sectors or classes of borrowers."⁷ One type of Fed action that might have the effect of allocating credit is its emergency lending. However, under the Dodd-Frank Act, emergency lending operations require the approval of the Secretary of the Treasury, thereby providing democratic oversight for the use of such tools. In addition, in 2020 the Congress, in the CARES Act, explicitly provided funds to cover losses on some Fed emergency lending programs, again using the Treasury Secretary to provide oversight of how the money was allocated. With this statutory approach, there is no obvious reason for concern about credit allocation in Fed lending.

A related issue is the extent to which Fed purchases of agency MBS allocate credit. Fed holdings of agency securities had been phased out prior to the financial crisis on the argument that they distorted the private allocation of capital. However, after the financial crisis the Fed purchased large amounts of agency MBS as part of its QE operations. In part, that change reflected the change in the status of Fannie Mae and Freddie Mac, which went into conservatorship in September 2008, making them effectively part of the government. Thus, purchases of agency MBS affect credit-risk-free interest rates, just like purchases of Treasuries. Moreover, disruptions in the MBS market after the financial crisis and during the Covid crisis meant that rates on MBS were elevated, and so purchases helped to normalize rates, limiting rather than causing distortions. Nonetheless, the Fed should bear in mind the potential effects on credit allocation of such purchases when considering the benefits and costs of future QE actions.

Concluding Remarks

Any New Accord must take account of the separate objectives, tools, and responsibilities of the Treasury and the Fed. In particular, the agreement must not impinge on the Fed's ability to use its tools, provided by Congress, to foster its objectives, also provided by Congress. The Fed must be able to continue to set monetary policy independent of short-term political pressures. And to do so, it must have control over the size and composition of its balance sheet, subject to the limitations established by Congress. In addition, any New Accord would have to ensure that monetary policy would not be targeted at financing government debt. The Fed was structured by Congress to limit the risk of monetization. Fiscal policy is the responsibility of the administration and the Congress, and the Fed should not try to influence fiscal policy decisions any more than it would decisions on other government policies that are outside its purview.

Thank you. I look forward to our discussion.

⁷ See Department of the Treasury and the Federal Reserve (2009). It may be that those calling for a New Accord have in mind something along the lines of the 2009 statement. That statement noted the different roles of the Treasury and Fed and the areas where they were cooperating in addressing the problems that arose during the financial crisis.

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