

Testimony of Jeffrey M. Lacker
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Treasury Market Resilience, and Economic Prosperity

“Revisiting the Treasury-Fed Accord”
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Chairman Lucas, Ranking Member Vargas, and Members of the Task Force, thank you for inviting me here today to discuss the Treasury-Fed Accord.¹ The time is ripe to revisit the 1951 edition of the Accord, given the evolution of monetary, financial and fiscal conditions since then. A reexamination should be grounded in the goals Congress has set out for the Fed: “maximum employment, stable prices, and moderate long term interest rates.” It is widely recognized that the last of these three goals means minimizing the premium that the U.S. Treasury is required to pay to compensate debtholders for potential future inflation and other avoidable macroeconomic risks. The relationship between the Federal Reserve and the issuer of Treasury securities is thus central to the Congressionally-mandated mission of the Federal Reserve and to the terms on which the United States government can fund itself.

Understanding the origin and functioning of the 1951 Accord is essential to the success of any reset. The lead up to the Accord was a bruising public fight between Truman administration and the Fed over ending the World War II interest rate peg. (Hetzel and Leach 2001) The administration wanted to maintain the peg, but Korean war spending was driving up inflation. The Fed, seeing little appetite for a return to wage and price controls, felt compelled to tighten monetary conditions. The Accord negotiated between the Treasury and the Fed in April 1951 allowed the Fed to control its own balance sheet and thereby established the Fed’s monetary policy independence. William McChesney Martin, a senior official at the Treasury, represented the administration in the negotiation of the Accord, so when Truman appointed him as Fed chair shortly thereafter he thought he was getting his own man at the Fed. Martin would go on to chart an independent course, though, leaving Truman bitterly disappointed.

Crucially, Martin was determined to foster the development of a well-functioning market in Treasury securities. Key to that was limiting the New York Fed’s ad hoc discretionary intervention in longer term Treasuries so that private financial institutions would have the incentive to invest in market making capabilities. A 1952 Federal Open Market Committee subcommittee chaired by Martin wrote:

The normal functioning of the market is inevitably weakened by the constant threat of intervention by the Committee. In any market, the development of special institutions and arrangements that serve to provide the market with natural strength and resilience and to give it breadth and depth tend to be greatly inhibited by official "mothering."

¹ Portions of this statement appeared as part of a speech to the Global Interdependence Center Central Banking Series Conference with the University of the Bahamas, March 3, 2026. (Lacker 2026)

Private market institutions of this kind are repressed particularly by the constant possibility of official actions which, by the market's standards, will frequently seem and be—capricious. (*United States Monetary Policy: Recent Thinking and Experience* 1954, 266)

Martin led the FOMC toward a policy of buying “Bills Only” and avoiding intervention in the market for longer-term Treasuries. This no doubt contributed to the tremendous growth in the depth and liquidity of the U.S. sovereign debt market in the decades after WWII. Notably, Martin had to overcome the resistance of the New York Fed, which was more inclined toward ad hoc intervention to support the prices and limit the yields of selected Treasury issues.

Key features of the Fed’s governance structure were designed to strengthen the credibility of the U.S. Treasury. A legislature with constitutional authority over money creates an independent, quasi-public, quasi-private banking entity to exercise that authority. The legislature carefully limits executive branch influence over that entity. The President appoints Board members to 14-year terms as Governor and selects one of them to serve a 4-year term as Chair, but otherwise has no explicit role in monetary policy. This division of responsibility limits the ability of the administration to use monetary policy in ways that might provide short-term stimulus but would inflate away the value of debt held by the public. Institutional constraints thus reduce inflation risk and enhance demand for U.S. debt.

This same basic governance structure dates back to the founding of the Bank of England. The British parliament established the Bank of England in 1694, authorized a large advance by the Bank to the Crown, authorized the Bank to conduct private banking business, granted a monopoly on note issue in London, and, crucially, stipulated that Bank advances to the Crown required Parliamentary approval. This structure was designed to enhance the credibility of the Crown’s borrowing. The Crown had been burning its reputational capital by reneging on its debt through either inflation or outright default. England needed a way to establish and maintain a reputation for honoring its debt. Legislative oversight of and constraints on an independent mechanism for crown borrowing provided that assurance. This greatly enhanced Great Britain’s borrowing capacity, which in turn helped it win several wars with France over the following century, culminating in victory in the Napoleonic wars. (O’Brien and Palma 2023; North and Weingast 1989)

This history is relevant because the outlook for U.S. fiscal policy makes the marketability of Treasury securities a critical issue for global financial stability. That outlook suggests that the role of the Fed in the market for Treasury securities is going to be crucial to whether that market maintains the international stature it now enjoys.

The Fed’s stance toward the Treasury market, however, is quite ambiguous right now. Before the Great Financial Crisis, the Fed maintained strict neutrality, buying no more Treasury securities than it needed, and carefully balancing its holdings across the maturity spectrum. After the GFC, the Fed repeatedly embarked on programs of buying large quantities of long term Treasury

securities as a way of trying to reduce yields and stimulate growth.² In 2020, the Fed purchased massive amounts of Treasury securities, motivated at first by a stated desire to preserve “market functioning,” as they put it, although they did not define that phrase. Later, the stated motivation for their asset purchases shifted toward the broader macroeconomic goals that they had cited as justification for their Large-Scale Asset Purchases in the 2010s. The borderline between “market functioning” and policy interventions is quite hazy though. Financial institutions choose whether to deploy capital and other resources to making markets in government securities based on expectations regarding the future paths and volatility of the prices of those securities, the same expectations underlying wholesale and retail investor decisions. In both types of intervention, therefore, the Fed essentially is trying to offset changes in market views about the fundamentals of Treasury yields. Market participants therefore are likely to find the distinction between “market functioning” intervention and macroeconomic policy intervention quite opaque.

The Fed needs to clarify its role in the Treasury market. (Lacker 2025b) One foreseeable risk is a shift in market perceptions about the outlook for U.S. fiscal or monetary policy that sparks a sudden, sharp rise in Treasury yields. Ideally, you would want such moves to be contained by the natural response of market participants with less adverse views, who have positioned themselves ahead of time to be able to step in and “buy on the dip” or otherwise act to limit the rise in yields. Expectations that the Fed might intervene at scale in such circumstances in the name of “market functioning” would tend to dampen the incentive of investors to set aside dry powder to be ready to buy when opportunities arise. This is precisely the stifling of market making that William McChesney Martin feared would result from the New York Fed’s discretionary interventions. Note that the New York Fed’s aggressive response to the repo market turbulence of September 2019 is likely to have had just such an effect. Ironically, expectations of such intervention are likely to make markets more volatile if, as a result, fewer investors position themselves to take advantage of market swings.

A recalibrated Accord between the Treasury and the Federal Reserve should reflect each entity’s particular attributes. The Fed is endowed with sole control of the monetary instruments that make up its liabilities—Federal Reserve notes and bank reserve accounts. These form the monetary base through which the Fed affects monetary conditions. Once a given quantity of monetary liabilities is set, any asset acquired or loan extended by the Fed requires selling Treasury securities, and thus could equally well be performed by the Treasury.³ Any change in the Fed’s monetary liabilities can be accomplished by changing the Fed’s holdings of Treasury securities. While the Fed’s independent legal structure provides a useful measure of insulation of monetary policy decision-making from short-sighted meddling, constitutional principles suggest extending that insulation only as far as it is needed for the implementation of monetary policy. Use of the Fed’s balance sheet for other purposes, such as lending to private sector institutions or purchasing longer-term Treasury securities, certainly could have economic

² They also bought mortgage-backed securities issued by Fannie Mae and Freddie Mac, the government-sponsored housing finance intermediaries, in an attempt to steer credit flows toward the housing industry.

³ Goodfriend and King (1988).

effects. But many government actions have economic effects—that doesn't make them monetary policy.⁴ The terms on which the Fed supplies monetary liabilities, including the interest rate it pays on reserve account balances, are critical to monetary conditions and so deserve the insulation that the Federal Reserve Act affords, within the broader context of accountability to Congress.⁵ Beyond monetary policy, however, the case for assigning those activities to the Federal Reserve, rather than the U.S. Treasury is on much weaker ground.

These principles suggest five key elements that would be useful to include in a restated Accord.

The Fed's balance sheet will be no larger than needed for monetary policy. The Fed can significantly reduce the size of its balance sheet and still do its part to manage monetary conditions by simply setting the interest rate on reserve account balances. The Fed should limit itself to a narrower role in which its portfolio of Treasury securities functions solely to back the supply of currency and a minimal level of banking system reserves for monetary policy implementation.⁶ The minimum level of reserve account balances in the banking system needed for such an approach is likely on the order of at most a few hundred billion dollars, not three trillion.⁷ Any amount above that level is unnecessary for monetary control.

The Treasury is responsible for debt management. The maturity composition of the federal debt in the hands of the public—that is, outside of the Federal Reserve—is now the result of decisions by both the Treasury and the Fed, each guided by their own distinct objectives and with no obvious coordination taking place. A bright line policy giving the Treasury the sole responsibility for determining the maturity composition of Treasury debt in the hands of the public (that is, outside the Fed) would provide sorely needed clarity to a critical market.

The Fed holds bills only. The easiest method to clarify that the Treasury is responsible for debt management would be for the Fed to return to William McChesney Martin's policy of holding Treasury bills only. (Plosser 2022; Lacker 2022) The Treasury would remain free to intervene as it sees fit through its recently reactivated buyback program if it thinks it worthwhile. That would lodge accountability for debt management with the Treasury, where it belongs. Again, the Federal Reserve would have the full capability to conduct monetary policy.

The Fed sets just one interest rate: A broader Accord agenda could also address the Fed's overly expansive role in money markets, where the Fed now intervenes to control over five key interest

⁴ The Federal Reserve helped fund construction of the Washington Metro in the 1970s, for example, but that doesn't mean transportation infrastructure is monetary policy. (Haltom and Sharp 2014)

⁵ See Levin and Skinner (2023).

⁶ Robert Hetzel (2026) also makes a strong case for a smaller Federal Reserve balance sheet.

⁷ As the Fed has increased the size of its balance sheet it has dramatically revised its estimate of the minimum necessary for the conduct of monetary policy. (Nelson 2024) A "ratchet effect" is clearly evident, however, and appears to reflect the adaptation of banking institutions to what they perceive as permanently higher system-wide balances. A sustained and predictable decrease in overall balances is likely to induce adaptation in bank practices in the opposite direction.

rates.⁸ Setting the interest rate on reserve account balances is entirely sufficient for the conduct of monetary policy. The rest are superfluous and amount to pegging interest rate *spreads* in various segments of money markets, objectives which are tangential to monetary policy and for which the Fed has never provided coherent rationales. Setting one nominal interest rate, just as the FOMC did prior to 2008, would do just fine. (Lacker 2023) Congress could usefully clarify governance for such a monetary policy regime by assigning responsibility for setting the interest rate on reserve account balances to the FOMC, rather than the Board of Governors as under current law. The present arrangement confusingly divides monetary policy authority between the Board and the FOMC.

An Accord on credit policy: A new Accord along these lines would be consistent with a broader reform agenda aimed at narrowing the Fed’s focus to those monetary functions for which it is uniquely empowered, and shedding activities that are fiscal in nature and would be better handled by the Treasury, subject to Congressional authorization.⁹ This could include a more limited Federal Reserve role in credit markets, consistent with long-standing proposals for a Treasury-Fed “Credit Accord,” first advanced in the 1990s by the late Marvin Goodfriend, under which lending programs would be the responsibility of the Treasury. (Goodfriend 1994; Lacker 2009, 2022; Plosser 2009, 2022) A Fed retreat from ad hoc, discretionary interventions would dampen perceptions that it will act as supply-side savior in debt markets, reduce the risk-taking incentives engendered by “too big to fail” perceptions, and would in turn strengthen financial market resilience for the reasons spelled out so eloquently by Chairman Martin in the 1950s. (Lacker 2025a)

Conclusion

A modernized Treasury–Fed Accord should restore the clear institutional boundaries that once anchored U.S. financial credibility. The experience following the 1951 Accord, along with the deeper constitutional logic behind limited central bank independence, show how market stability can be enhanced by a disciplined separation between monetary policy and debt management. The ambiguity of the Fed’s policy toward intervention in longer-term Treasury markets risks weakening private market-making and amplifying volatility at a moment when fiscal pressures make the marketability of U.S. debt especially vital. Reaffirming transparent boundaries would strengthen market functioning, reinforce fiscal credibility, and better prepare the United States for the challenges ahead.

⁸ The Federal Reserve now sets the interest rate on reserve account balances at the Federal Reserve Banks, the interest rate on discount window loans to banks, a target for the overnight interest rate on interbank loans of reserve balances (the “federal funds rate”), and the interest rates on overnight reverse repurchase agreement operations (Fed borrowing in the repo market) and standing repurchase agreement operations (Fed lending in the repo market). The last three are unnecessary for interest rate control; they serve only to manipulate money market interest rate spreads, favoring particular financial institutions. Arguably, the discount window is also tangential to monetary control.

⁹ Concern is sometimes raised about speed of response in a “crisis.” The response of Congress and the administration to the pandemic in March 2020 indicates that speedy legislative response is feasible.

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