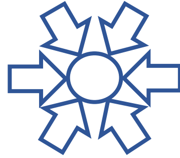

Federal Financial Analytics Brief

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How Fragile is the Fed's Independence? What a President and Congress Might do Next Year to the U.S. Central Bank

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- The President has little ability to direct the Fed despite a new chair in 2026. Even if he or she is able to confirm a problematic candidate, the FOMC will abandon its deference and stand firm unless or until Reserve Bank presidents and other governors are outvoted.
- Even if all stays calm, the Fed's plan to issue a new monetary-policy model will reignite Congressional debate about the Fed's mandate and architecture.
- Substantive structural change is unlikely, but fiscal pressure will return Congressional attention to the Fed's $106+ billion indirect cost to taxpayers and renew efforts to end interest on reserves from both sides of the aisle unless other national priorities take precedence.

As the 2024 Presidential election escalates, the Federal Reserve has found itself under political attack unseen since Donald Trump railed against what now seem like quaint interest-rate hikes in 2018. Doubtless remembering his inability to move the mountain that the U.S. central bank has become, Mr. Trump has reportedly charged his advisers with listing ways he could ensure victory over the Fed should he become President, also musing publicly about having direct and personal control over monetary policy based on the knowledge gained by making money. Vice President Harris stands by the Biden Administration's firm commitment to Fed independence and we doubt she will stray much from it.

Will threats to Fed independence end in a stand-off until the election concludes? Yes. Are they acute if Mr. Trump wins and off the table if the Vice President prevails? No.

Why? That is the subject of this brief.*

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Here, we lay out what presidents can do to the Fed under current law and the ways in which the next Congress could change that power or, more likely, set out a new roadmap for the U.S. central bank regardless of which party controls each of the chambers of Congress. Fed independence is fragile because Fed monetary policy has gone astray all too often even as the central bank angered some who might be allies by its stand on internal ethics, bank regulation, or other matters also within the central bank's remit.

As we will show, the Fed is fragile. Indeed, Democrats and Republicans are already united not just in complaints, but also on some potent legislative proposals. We thus turn to all of the ways Congress could redesign the central bank, noting both higher-probability/moderate-impact measures as well as a few low-probability/high-impact bills such as those the GOP is floating simply to abolish the central bank and measures with a moderate chance of final action — most notably an end or cut to interest on central-bank deposits — regardless of Congressional control. Enactment into law of course depends on who holds the veto pen, and this brief thus takes this fully into account. We also briefly note what key proposals might do to whom – more than essential if one is to forecast likely political outcomes.

The Limits of Presidential Power

The Fed has not succumbed to Presidential power since the Second World War when it voluntarily aligned monetary policy with the need to raise cheap funds to win the war. As noted in a recent Karen Petrou memo, the Fed refused to do so again during the Korean War; the Treasury/Fed Accord of 1951 was essentially a declaration of surrender by the Treasury to the central bank. Even threats of physical violence by President Johnson during the Vietnam War did not persuade the Fed to align its policy with the Administration's and it would clearly take a national emergency of similar scope for the modern Fed to concede unless the chair readily agrees to do the President's bidding like Arthur Burns in the run-up to the 1972 election.

As a result, the President's power is largely confined to whom he or she appoints to the Fed's Board of Governors and indirectly via who the chair agrees should head the Reserve Banks. These seemingly ancillary appointments matter because the Board and a rotating set of Reserve Bank presidents constitute the Federal Open Market Committee (FOMC) that sets monetary policy's course.

What might be different? The FOMC traditionally defers to the FRB chair, but we doubt it will do so if President Trump in 2026 appoints someone so outside the economic mainstream as to spark a revolt among remaining governors and Reserve Bank presidents. It would take a lot for the FOMC to buck the chair, but a Fed chair who demands a lot might well be out-voted.

What Congress Might Well Do

As noted below, there are a number of consequential ways in which Congress could redesign the Fed at grave cost to its independence, with odds for substantive action significantly higher if Congress is controlled by Republicans and Donald Trump retakes the White House. However, one issue will unite Members of Congress regardless of party: the growing size of the fiscal deficit in the face of many continuing constituent demands for more programs and the acute state of geopolitical risk. Making voters happy and protecting national security will not come cheap even if Congress eschews costly tax cuts or social spending. The Fed's current balance sheet makes the fiscal dilemma still more difficult, a point that has not escaped key Members.

The Fed's quantitative tightening (QT) program shrunk its balance sheet, but it still holds trillions in low-interest obligations with massive unrealized losses. Fed remittances to Treasury once exceeded $100 billion, a bit of payback to taxpayers for the Fed's huge role in financial markets thanks to its gigantic balance sheet.

With Fed gains turned to losses, remittances turn to billions Congress must replace from sources other than the central bank. With these sources all politically painful, the Fed might start to look like an easy way out.

Precedent along these lines was set in 2015 when Congress took a portion of Reserve Bank dividend income to fund highway infrastructure. It's been done already in 2024 with a new bill (S. 4912) from Sen. Lummis (R-WY) to use Fed gold and the capital banks hold at Reserve Banks to fund a controversial bitcoin reserve. That bill is unlikely to fly in the next Congress, but calls on what Congress sees as the Fed's money pots surely will.

How might this be done? One occasional focus of bipartisan interest is the amount of interest the Fed pays banks, credit unions, and participants in its overnight reverse-repo program. Last year, this resulted in a $106.6 billion loss to the central bank once its own interest earnings on low interest-rate securities on its balance sheet were totaled against the massive interest paid to financial firms at current interest rates.

Congress shied away from altering this in the mid-2010s, fearing it would undermine monetary-policy transmission as the Fed said it would. A Fed with less credibility is a Fed subject to renewed attack, particularly by Republicans who believe, like Project 2025, that the Fed's balance sheet is not only an inappropriate intrusion in private markets, but also a way of allocating credit to desired purposes such as housing.

What Congress Might Also Do

Could Congress abolish the U.S. central bank?

The most radical reform possible would of course be to abolish the U.S. central bank. This is not unthinkable. Project 2025 expressly favors it and two bills, S. 4463 introduced by Sen. Lee (R-UT) and H.R. 8421 introduced by Rep. Massie (R-KY) and a group of Freedom Caucus Republicans would actually do it.

That simply revoking the Fed's charter has regained some credibility suggests the extent of Fed fragility. Still, nothing along these lines is likely to be enacted even by a GOP-controlled Congress absent an end to the Senate filibuster rule and likely not even then. A President Harris would surely veto it; a new President Trump's view is uncertain, but we suspect he would be wary of sure and certain market chaos in the wake of or even ahead of abolishing the Fed unless Republicans come up with some sort of a plan to replace it in the event of liquidity or systemic crisis.

Could the Fed be Re-Engineered?

If Congress can't close the Fed down, could it change its structure?

Congressional complaints over the 1913 Act's decision to locate most Federal Reserve Banks east of the Mississippi and make them public-private entities have riled bipartisan Members of Congress since at least the early 1980s. Concerns along these lines more recently bubbled up with demands from Sen. Jack Reed (D-RI) for Presidential nomination and Senate confirmation of Reserve Bank presidents, with Democrats such as Sen. Reed seeking greater accountability and heightened diversity among Fed leadership.

Republicans share the accountability concerns, with legislation (S. 1155) in this Congress from Sen. Tillis (R-NC) and other Republicans also changing the Reserve Bank appointment process and that of certain key staff, going on also to make them subject to Presidential dismissal and meaningful residency requirements. The bill would also consolidate the System into only five Reserve Banks.

If Federal Reserve operations stoke renewed discontent in the next Congress, bills incorporating some or all of these provisions could be enacted and signed into law.

Will there be a new single mandate, a quadruple mandate, or something else?

Both sides of the aisle want to change the Fed's mandate, albeit very, very differently. 1977 law defines the Fed's mandate as "maximum" employment, price stability, and moderate long-term interest rates. The Humphrey-Hawkins Act of 1978 does more than mandate the semiannual Congressional appearances of the Fed chair often designated by the law's name. The Act also expands on the 1977 mandate, calling for "general full employment" and "real income."

Despite these express statutory requirements, the Fed chooses to interpret its "dual" mandate as one stipulating only maximum employment and price stability, leaving both sides of the aisle increasingly dissatisfied as Fed policy over the years veered to tolerate high unemployment or severe inflation. The Fed's plans to craft a new monetary-policy model in 2025 will, we forecast, renew debate about the mandate the central bank's model seeks to serve.

With inflation the problem of the day, Republicans have renewed longstanding GOP proposals to axe employment, confiding the Fed only to price stability. Often the bill's drafting also axes the moderate-long-term rate mandate, but this is generally accidental – accepting the Fed's mandate as "dual," Republicans want to turn it into a unilateral edict that controls inflation. The most recent effort to do so in this Congress (H.R. 6117) comes from two prominent Republicans. Short of ending the Fed, Project 2025 wants a unilateral price-stability mandate, and the Fed chair Donald Trump might appoint could well want the same. However, Democrats would oppose a single mandate with the same fervor as abolishing the Fed, making the odds of passage in the next Congress as dim as they have been over all the years Republicans tried this in the past.

But, that Democrats oppose a single mandate doesn't mean they like the Fed's mandate as the Fed chooses to read it. Prominent Democrats have introduced legislation (H.R. 4194, S. 2257) to add a "racial-equity" mandate to the Fed ensuring it focuses not only on the full-employment and real-income goals Democrats put in law when they could, but also an interpretation of these terms with an eye fixed on lifting the economic prospects for African-Americans or, in some versions, all persons of color. Republicans oppose this at least as much as Democrats dislike their mandate rewrite and the odds for enactment are also slim unless Democrats have decisive control of both Houses of Congress and Ms. Harris is in the Oval Office. Should the legislation get serious, we expect that it will also be significantly redrafted to encompass all lower-wealth households, not just those of color.

Democrats have also flirted with adding climate-risk mitigation to the Fed's mandate. No bills to do so have so far been introduced in this Congressional session, with Democrats instead pressuring the central bank to add climate risk to its stress tests. In sharp contrast, Republicans have taken every regulatory action addressing climate risk as a direct infringement on the Fed's limited mandate and the appropriate purview of federal financial-regulatory agencies. The Fed consistently seeks to reassure Democrats by stating that climate risk is well understood among many threats to safety and soundness even as it assures Republicans that recent actions, including big-bank scenario analyses, are strictly prudential initiatives with no effort in any way to expand the Fed's mandate. We expect this rhetorical push-pull to continue next year, but the extent of climate-focused regulatory actions is directly dependent on who heads which regulatory agency after the election.

What About Curtailing Fed Policy Discretion?

Reflecting the low odds for substantive changes along GOP-desired lines either to the Fed as an institution or via a new mandate, Republicans in prior Congresses have pressed for mandatory use of the "Taylor Rule" or a similarly-formulaic approach to setting monetary policy. There have been no bills to do so in this Congress, with Republicans clearly preferring to go after the Fed on structural and charter targets rather than the specifics of how monetary policy is made.

That said, Project 2025 hasn't forgotten about the Taylor Rule, urging policymakers to institute something along its lines to reinforce the focus principally on price stability. A Fed chair who agrees with this perspective could attempt to force the FOMC to open the rulebook, but we suspect Fed staff, current governors and Reserve Bank Presidents will staunchly oppose doing so and likely prevail.

Will the Fed Be Subject to GAO Audit?

When long-time Libertarian candidate for President Ron Paul wasn't trying to abolish the Fed, he used his seat as a long-time Member of Congress (R-TX) to press legislation to give the Government Accountability Office authority to audit the central bank's operations, up to and including those setting monetary policy. His son, Sen. Rand Paul (R-KY), picked up the torch in Congress after Congress, but the idea has gained a bit of momentum with Project 2025 and, in this Congress, a measure (H.R. 3566) from Freedom Caucus Republicans to do so.

A new approach from Rep. Roger Williams (R-TX) is a bill (H.R. 8591) that does not demand GAO audits, but instead forces the Fed to release rafts of data on matters ranging from supervisory activities to its work running the payment system. The measure also wants data on Fed and FOMC operations, but not the scrutiny a GAO audit would encompass. It may prove more difficult if Republicans really go after the Fed and press a measure seeking data on the Fed's regulatory, supervisory, and payment-system activities, activities outside the ambit of the market-moving decision-making that has long slowed GAO-audit proposals.

Conclusion

Chairman Powell has confidently said that Congress strongly supports Fed independence. This is a sensible defensive stance, but it's not an accurate read of what this Congress really thinks of the U.S. central bank as evident in the raft of bills introduced in this current Congress and the grilling Mr. Powell gets every time

he goes to the Hill. Yes, Members of Congress are generally courteous to him in private, but politics is set by what Members think benefits them in public.

What Congress says and does next year will depend on several imponderables: whether Congress will even have time to think about the Fed given everything else it may need to do, which chairs control which committees, the politics of being aligned with or opposed to whomever is in the White House, and what happens to the U.S. economy. There is, however, no high-probability scenario in which the central bank gets off scot-free. This would take a Harris Presidency, Democratic control of both Houses of Congress, Fed acquiescence to Members on ancillary issues such as its ethics and transparency, and a new golden age of economic prosperity and improving equality. Even then, Democrats will press the Fed on ancillary issues such as its ethics, payment-system operations, climate risk, and bank regulation.

The greatest risk to the Fed and all of the financial companies that receive interest income from it is Congress' fiscal desperation and a search for funds from anyone who doesn't vote for them. Bankers and asset managers of course vote, but they will be hard-pressed to avert Congress' hungry eyes from the over a hundred billion they receive instead of taxpayers – for that's how it will be perceived by Members who want the money.

Revenue transfer to the financial sector will go down a bit if rates recede and opponents point to persuasive, political arguments to preserve it. However, the best one the Fed has mustered so far is that it can't figure out any way to conduct monetary policy without paying bankers to do it for them. That's a hard sell.