Assessing the Case for Simplifying the Federal Reserve's Mandate

In a recent article Joseph Tracy, An Economics Professor at Southern Methodist University and prior advisor to the Dallas and New York Federal Reserve presidents, argued the Federal Reserve should simplify its dual mandate to only focus on the price level stability side to address the administration's pressure. Reassigning responsibility for economic growth and employment entirely to fiscal authorities would place a substantial burden on Congress and the executive branch. Institutions that already struggle to reach bipartisan agreement under the current administration. In the absence of legislative consensus, pressure would likely shift toward the executive branch to use executive orders as a substitute for comprehensive fiscal policy, such as targeted tax incentives or regulatory adjustments aimed at stimulating business activity. However, these tools are inherently limited by statutory authority and increasingly constrained by the size of the federal deficit, which effectively caps the scope of discretionary fiscal expansion.

While political pressure to use fiscal policy to boost short-term economic performance has historically outweighed concerns over balanced budgets, such decisions are often driven by electoral incentives rather than forward-looking economic analysis. As a result, Congress is likely to adopt fiscal measures that respond to immediate political demands rather than long-run macroeconomic conditions, an area in which the Federal Reserve possesses far greater institutional expertise. Monetary policy is designed around economic forecasting, intertemporal tradeoffs, and expectation management, whereas fiscal policymaking reflects political compromise. Transferring responsibility without acknowledging this asymmetry risks can very well lead to a principal-agent problem, during times where future politicians will need to address the solvency crisis of the Social Security trust fund over the next 10 years. When politicians need to address long-horizon fiscal obligations it will require decisions that prioritize America's long-term economic soundness over short-term political incentives.

An economically successful outcome cannot be assumed in a system where expanded fiscal authority is exercised by agents whose incentives are shaped by electoral cycles rather than intertemporal economic stability. These institutional constraints raise a deeper macroeconomic question: Does changing the law about who is responsible actually matter, or do deeper institutional and political constraints dominate inflation outcomes?

In "Do Budget Deficits Cause Inflation" published by the Federal Reserve Bank of Philadelphia, Keith Sill argues that inflation risk does not arise from deficits typically, but it does when fiscal policy becomes unsustainable and monetary policy is forced to accommodate government financing needs. The paper shows that advanced economies avoid deficit-inflation spirals precisely because monetary policy is insulated from fiscal pressures. Tracy is arguing in his paper that the current administration is driving inflation by forcing the Fed's hand to cut the interest rates. Whether or not the Fed adopts a single inflation mandate, inflation outcomes will be shaped by expectations about the government's ability to finance long-term obligations without monetary accommodation. The concern is that shifting the responsibility of the Fed without institutional capacity of the federal government creates new distortions.

The deeper risk is not that the Federal Reserve abandons inflation targeting, but that persistent fiscal imbalances erode the conditions under which inflation targeting can be credibly sustained. If long-term fiscal commitments remain unfunded, rising risk premiums on government debt and increasingly constrained fiscal space may slow real economic growth while simultaneously increasing pressure on monetary policy to stabilize debt markets. In such a setting, stagflation could emerge not from policy error, but from institutional goal mismatch, where neither fiscal nor monetary authorities possess the capacity to fully address the economy's constraints. Over time, this dynamic risks undermining the Federal Reserve's credibility as an anchor for inflation expectations. This is the pathway through which stagflation becomes a risk, not by design, but by default.

As Tracy rightly emphasizes, institutional design matters. Yet whether mandate simplification alone can resolve the deeper fiscal–monetary tensions facing the U.S. economy remains an open question. As Albert Einstein once said, "We cannot solve our problems with the same thinking we used when we created them."

Work Cited

Sill, Keith. "Do Budget Deficits Cause Inflation?" Business Review, Q3 2005, Federal Reserve Bank of Philadelphia, https://www.philadelphiafed.org/the-economy/macroeconomics/do-budget-deficits-cause-inflation

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