Editor's Note

In November 2018, Fed Chairman Jerome H. Powell announced that, "With labor market conditions close to maximum employment and inflation near our 2 percent objective, now is a good time to take stock of how we formulate, conduct, and communicate monetary policy." Consequently, in 2019, the Fed undertook "a broad review of the strategy, tools, and communication practices it uses to pursue the monetary policy goals established by the Congress: maximum employment and price stability." The Federal Reserve Board, in its "Review of Monetary Policy," stated: It was time "to step back and consider whether the U.S. monetary policy framework can be improved to better meet future challenges." During 2019, the Fed held many events to achieve that goal, including a "Fed Listens" program, to allow the broader pubic to offer comments, and a major policy conference hosted by the Federal Reserve Bank of Chicago in June. A full report of the Fed's review is slated to appear this year.

The Fed's review takes the dual mandate as given and assumes that a long-run inflation rate of 2 percent is consistent with price stability. It also limits the range of allowable policy options in other ways. It sets aside alternatives to its present means for implementing monetary policy, including alternative means for conducting open-market operations. It also fails to consider the adoption of a rules-based monetary regime that limits Fed power and discretion, which grew considerably in response to the 2007–2009 global financial crisis.

Unconventional monetary policies—notably, large-scale asset purchases (also known as quantitative easing or QE)—gave the Fed a sizable footprint in credit markets, especially the mortgage market. Moreover, under Section 13 (3) of the Federal Reserve Act, the Fed used its emergency lending authority to set up a number of special purpose vehicles as off-balance sheet entities. The Fed also implemented a new operating system—the so-called floor system—in which the Federal Open Market Committee (FOMC) implements a target range for its policy rate using the interest rate on excess reserves (set by the Board of Governors) and the rate on overnight reverse repos. The use of interest on excess reserves to encourage member banks to hold large balances at the Fed has decimated the federal funds market while severing the long-standing connection between the stance of monetary policy and the size of the Fed's balance sheet.

It is fitting that the Fed wants to review how it formulates, conducts, and communicates monetary policy, both in light of the last financial crisis and especially considering recent developments related to the novel coronavirus (Covid-19) pandemic. Calling on the public to contribute to its review was also refreshing. Nevertheless, there needs to be a broader and deeper review of Fed policy by experts who can bring new ideas to the table. With that goal in mind, Cato's 37th Annual Monetary Conference was devoted to a "shadow review" of Fed policy. The Center for Monetary and Financial Alternatives hosted the event on November 14, 2019, in Washington, D.C. This special issue of the *Cato Journal* features the papers from that conference.

Fed Vice Chairman Richard Clarida, who has been instrumental in the review process, gives an overview of that process based on the FOMC's "Statement on Longer-Run Goals and Monetary Policy Strategy," adopted in January 2012. In doing so, he asks three questions: (1) "Can the Federal Reserve best meet its statutory objectives with its existing monetary policy strategy, or should it consider strategies that aim to reverse past misses of the inflation objective?" (2) "Are existing monetary policy tools adequate to achieve and maintain maximum employment and price stability, or should the toolkit be expanded? And, if so, how?" (3) "How can the FOMC's communication of its policy framework and implementation be improved?" Those questions are addressed in this volume.

Peter Ireland, Jeffrey Lacker, Carola Binder, and Eric Sims and Jing Cynthia Wu discuss *Targets and Mandates*; Charles Plosser, Manmohan Singh and Rohit Goel, Andrew Filardo, and David Beckworth provide a detailed analysis of *The Operating Framework*; Paul Tucker addresses the issue of *Central Banks and the Rule of Law*; Charles Calomiris and Harry Mamaysky, Sarah Binder and Mark Spindel, and Andrew Levin and Arunima Sinha cover *Communication Practices: Transparency and Forward Guidance*; and George Selgin, William Nelson, William Luther, and Steve

Hanke consider a foundational topic: *Creating an Optimal Monetary System for a Free Society.*

These authors offer insights into how the Fed and central banks in general can improve the conduct of monetary policy and avoid future crises. Yet no one was prepared for the huge shock brought about by Covid-19, the federal response to which has brought the United States and global economy to a sudden halt. In hopes of combating a steep recession (and possible depression), central banks have been given greater discretion and lending authority than ever before.

Monetary policy has morphed into fiscal policy. The Fed is in uncharted waters and a review of policies aimed at the 2008 financial crisis is inadequate. A major assessment of central banking and alternative monetary regimes is overdue.

The government-ordered slowdown in economic life due to Covid-19 is a unique situation for central bankers: they must try to stabilize nominal spending but can't prevent a sharp rise in unemployment and decline in output. The danger of an overextended monetary policy is that the Fed will become more politicized—and that economic freedom will suffer.

In thinking about monetary policy, a good starting point is to acknowledge its limits. As former Fed vice chairman Donald Kohn stated, in his remarks at the Shadow Open Market Committee conference honoring Marvin Goodfriend (March 6, 2020):

> True transparency acknowledges our limited understanding of underlying economic relationships and of the forces bearing on the outlook. Policymakers have an obligation to discuss their understanding and expectation about these relationships and forces, but they must be humble about what they know and transparent about the high likelihood of alternative outcomes.

That advice is certainly pertinent, especially in light of Covid-19.

Improving the monetary regime means understanding past mistakes, learning from them, and considering viable alternatives. In the search for better institutions and performance, it is essential to hear many informed voices. Paul Volcker, Alan Greenspan, Ben Bernanke, and Janet Yellen are on target when they argue: "A robust public debate helps make monetary policy better" (*Wall Street Journal*, August 5, 2019). It is in that spirit that the articles in this volume are presented.

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—J. A. Dorn