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Approaching Policymaking Pragmatically

Remarks by

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Good afternoon.[1] It is a pleasure to join you for today's meeting of the Forum Club of the Palm Beaches. It is truly humbling for me to be invited to speak to your membership, in the company of the many influential leaders, authors, and other public figures this organization has hosted since its founding in 1976.

Before turning to the main topic of my remarks today, I want to briefly share with you a bit about my background. I am one of the longest serving members currently on the Board of Governors of the Federal Reserve System (Board), having served as a Board member since November 26, 2018. As a member of the Board, I am a permanent voting member of the Federal Open Market Committee (FOMC) and serve in other capacities—I lead the Board committees on smaller and community banks and on consumer and community affairs and serve as a member on other committees that broadly address supervision and regulation and payments. I also provide input into the full range of matters that come before the Board.

I am the first Governor appointed to fill the role created by Congress for someone with demonstrated primary experience working in or supervising community banks, banks with less than $10 billion in assets.[2] I have been both a banker, working in the community bank owned and operated by my family since 1882, and a bank supervisor—as the Kansas State Bank Commissioner. Early in my career, I spent almost a decade working in public service in several federal government roles, including setting up the Department of Homeland Security after 9/11 and as a Deputy Assistant Secretary and policy advisor to the first Homeland Security Secretary, Tom Ridge. I also served as a counsel on several U.S. House Committees, and as a staff member for the former U.S. Senator from Kansas, Bob Dole.

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[1] The views expressed here are my own and are not necessarily those of my colleagues on the Federal Reserve Board or the Federal Open Market Committee.

[2] See 12 U.S.C. § 241.

These experiences have provided me with a uniquely broad perspective about the role of government and the functioning of the U.S. economy—from the view of a regulated business, an executive branch agency, the legislative branch, and state and federal regulatory agencies.

Throughout my career, but particularly in my current role as a member of the Board of Governors, I have approached my responsibilities in an independent way, relying on facts, analysis, my own experience and judgment, and the pursuit of the congressionally mandated goals that guide the work of the Board.

In some cases, this approach has led me to depart from the views of my colleagues. At its September meeting, the FOMC voted to lower the target range for the federal funds rate, for the first time since we began tightening to combat inflation, by 1/2 percentage point to 4-3/4 to 5 percent. I dissented from that decision, preferring instead to lower the target range by 1/4 percentage point. In my statement published after the meeting, I agreed with the Committee's assessment that, given the progress we have seen since the middle of 2023 on both lowering inflation and cooling the labor market, it was appropriate to reflect this progress by beginning the process of recalibrating the policy stance toward a more neutral setting. As my statement noted, I preferred a smaller initial cut in the policy rate. With inflation continuing to hover well above our 2 percent goal, I saw the risk that the Committee's large policy action might be interpreted as a premature declaration of victory on our price-stability mandate. In addition, with the U.S. economy remaining strong, moving the policy rate down too quickly, in my view, would carry the risk of stoking demand unnecessarily and potentially reigniting inflationary pressures.

My dissent was notable in that the last dissenting vote from a Fed Board member on an FOMC vote occurred nearly 20 years ago. My dissent was guided by my view and interpretation

of the available data and my understanding of the Fed's dual mandate of maximum employment and stable prices, which I will discuss more in a moment.

Everyone in this room knows that experience is important. My experiences have shaped and reinforced my views on how policymakers can best serve the public—narrowly, including in monetary policy decisionmaking and the regulation of the banking industry, but also more broadly in thinking about policymaking in support of an agency's mission balanced with its extensive impact on the affected industry and the U.S. economy.

A Pragmatic Approach to Policymaking

A Goal-Oriented Approach

In the past, I have discussed the role of policymaking from the perspective of a Federal Reserve Board member. But taking a step back, there are some broader themes relevant to agency policymaking more generally, themes that are useful beyond the context of the Federal Reserve. At a basic level, I think of this as a pragmatic approach. It requires tradeoffs to balance regulation while also not inhibiting economic growth.

The first question I like to ask when confronted with a policy issue is, "Why are we here?" You may recognize this question from Philosophy 101, but this question also applies to the exercise of executive authority by regulatory agencies. The Federal Reserve has extensive responsibilities, and equally extensive powers, but it must exercise these powers only in furtherance of specific goals established by statute. The sheer scope of the Fed's powers can present a temptation to go beyond the statutory authority. For example, to play a more active role in the allocation of credit, or to displace other sources of bank funding even when market sources of liquidity are functioning well. It could also include the temptation to venture into policy matters unrelated to the Fed's responsibilities that are better addressed by Congress or other policymakers (here, a push for banking sector climate change related regulation comes to

mind). The goals Congress has laid out for the Fed are complicated and important. Congress should not expect the Federal Reserve, or any other agency for that matter, to solve problems beyond that agency's limited purpose. Doing so would contravene the intent and authority of Congress.

To begin, I will provide a few concrete examples of how the starting point for policy is the agency's mission, including in: (1) the execution of monetary policy, and (2) the conduct of banking regulation and supervision.

In conducting monetary policy, Congress has given us the dual mandate of maximum employment and price stability. Achieving these goals has often proven challenging, particularly over the last several years, as these policy objectives can sometimes be in tension. Policy actions to tame inflation, like raising the target range for the federal funds rate, can have an adverse effect on employment. A critical input to the FOMC decisionmaking process is an analysis of economic conditions and outlook. The real economy continues to be strong, with solid momentum in economic activity, robust household spending and business investment, and a healthy labor market that remains near full employment. Although economic conditions have been supportive of our employment mandate, they have been unsatisfying for our price stability mandate as inflation continues to be elevated.

We have seen considerable progress in lowering inflation since early 2023, but progress seems to have stalled in recent months. The 12-month measure of core personal consumption expenditures inflation—which excludes food and energy prices—has moved sideways at around 2.7 percent since May, and the latest consumer and producer price index reports point to a similarly elevated or even higher reading for October. The persistently high core inflation

largely reflects pressures on housing services prices, perhaps due to an increase in demand for affordable housing and an inelastic supply.

Gross domestic product (GDP) increased at a solid pace in the third quarter, maintaining the momentum from the previous four quarters. Growth continued to be driven by private domestic final purchases, as personal consumption, and retail sales in particular, strongly increased last quarter, more than offsetting further weakness in housing activity due to high mortgage rates. Retail sales continued to rise in October, even though Hurricanes Helene and Milton may have exerted a small drag on sales last month. The annual revision of the national income and product accounts confirmed that GDP has been providing the right signal about the ongoing strength in economic activity, as gross domestic income and personal income were revised up considerably for 2023 and the first half of this year.

The October employment report seems to have been affected by the recent hurricanes and the Boeing strike. It also featured the lowest response rate to the payroll survey in decades. After accounting for these special factors, it seems that payroll employment continued to increase in October at a pace close to the average monthly gain seen in the second and third quarters. The unemployment rate remained low at 4.1 percent in October, down from 4.3 percent in July. The labor force participation rate remains well below pre-pandemic levels and edged down further in October due to lower prime-age participation. While unemployment is notably higher than a year ago, it is still at a historically low level and below my and the Congressional Budget Office's estimates of full employment.

The labor market has loosened from the extremely tight conditions of the past few years. The ratio of job vacancies to unemployed workers has been close to the historically elevated pre-pandemic level in recent months. But there are still more available jobs than available workers, a

condition that before 2018 has only occurred twice for a prolonged period since World War II, further signaling ongoing labor market strength. Wage growth has slowed further in recent months, but it continues to indicate a tight labor market.

The rise in the unemployment rate this year largely reflects weaker hiring, as job seekers entering or re-entering the labor force are taking longer to find work, while layoffs remain low. In addition to some cooling in labor demand, a mismatch between the skills of the new workers and available jobs could further raise unemployment, suggesting that higher unemployment has been partly driven by the stronger supply of workers.

Monetary Policy

In the monetary policy function, we rely on the best data available, but without question the data are imperfect. We also consider a range of possible future economic conditions to help inform our monetary policy decisionmaking, which requires that we make assumptions and predictions about the future. Looking back over time, our crystal ball has never been perfect at predicting the risks that may emerge, how those risks may influence economic conditions, and how that should be considered in analyzing our monetary policy goals. To illustrate this point in terms of recent events, we have not yet met our inflation goal and, as I noted earlier, progress in lowering inflation appears to have stalled.

I see greater risks to the price stability side of our mandate, especially while the labor market remains near full employment, but it is also possible that we could see a deterioration in labor market conditions. These predictions always come with a dose of humility, however, particularly because they rely on imperfect data. The labor market data have become increasingly difficult to interpret, as surveys and other measurements struggle to incorporate large numbers of new workers and to account for other influences that we do not yet fully

understand and have not yet been able to accurately measure. As the dynamics of immigration and business creation and closures continue to change, it has become increasingly difficult to understand the payroll employment data. In light of the dissonance created by conflicting economic signals, measurement challenges, and data revisions, I remain cautious about taking signal from only a limited set of real-time data releases.

While the mandate for monetary policy is straightforward, its execution is complex. Our decisions are guided by our dual mandate, but arriving at them entails careful analysis of sometimes flawed data, and informed judgments about unknowable future conditions.

Bank Regulation and Supervision

In conducting bank regulation and supervision, the Federal Reserve promotes the safe and sound operation of individual banks, and the stability of the broader financial system. These bank regulatory goals have obvious synergies—individual banks operating in a safe and sound manner tends to create conditions that promote financial stability in the banking sector. The Fed's bank regulatory objectives include implicit tradeoffs: we aim to foster a banking system that is safe, sound, and efficient, while serving the U.S. economy, and facilitating economic growth. The objectives must also support the full breadth of the banking system from the very largest to the very smallest.

Striking a balance among these competing goals can certainly be a challenge, and policy views on where that balance should be struck may vary. We should approach the task of bank regulation with an understanding and appreciation of these tradeoffs, coupled with an affirmative acknowledgment that the banking system is an important driver of business formation, economic expansion, and opportunity. A banking system that is safe and sound yet irrelevant would not fulfill our regulatory objectives, but would be the inevitable outcome of following a path that

strives for elimination of risks rather than promotion of effective risk management. Banks are unique individual businesses, not public utilities.

The pursuit of these bank regulatory goals requires an approach that considers a range of regulatory and supervisory tools, from the quantitative—like the setting of bank capital and liquidity requirements—to the more subjective—like evaluating bank management during the examination process. And while the goals themselves seem straightforward, the tools available and the complexity and evolution of the financial system over time present real challenges from a policymaking perspective.

When we consider drafting a new regulation, we should always ask "What problem would this new regulation solve?" Policymakers should exercise restraint in the promulgation of a new regulation, by articulating the problem it purports to solve and presenting an efficient way to address it. Identifying the problem that requires addressing often poses one of the most significant challenges. Ideally, the process would begin by identifying the problem, then move to an analysis of whether proposed solutions are within the agency's statutory authorities, and finally whether targeted changes to the regulatory framework could result in improvements, remediation of gaps, or elimination of redundant and unnecessary requirements.

But for a number of reasons, the problem identification process can result in misidentification of issues, and a resulting failure to prioritize the most important ones. Take for example the failure of Silicon Valley Bank (SVB), and the regulatory response. At its root, this bank's failure exposed significant flaws in the bank's management and the regulators' oversight and supervision. The interest rate and funding risks, rapid growth, and the idiosyncratic business model and concentrated customer base of the bank, were apparent and obvious. These risks were mismanaged by SVB and not acted on early enough by bank supervisors.

These were not the only factors contributing to the firm's failure, but these critical elements should have been the key priorities for the supervisory function to address after the bank's failure. And yet in the aftermath of SVB's demise, we have focused on regulatory proposals ranging from substantial increases in bank capital requirements, to pushing down global systemically important bank (G-SIB) and large bank requirements to much smaller firms, finding supervisory deficiencies in the management of well-capitalized and financially sound firms, and considering widespread changes to the funding and liquidity requirements and expectations that apply to all banks.

A crisis is not a regulatory blank check. In some ways, it presents heightened risks that should prompt us to show our work even more carefully. A deliberate, transparent, and fact-based approach to pursuing statutory objectives also serves the goal of avoiding the impression of pursuing unrelated policy goals, particularly those that venture into political concerns outside of an agency's purposes or functions. Promoting safety, soundness, and financial stability should not devolve into an exercise of regulatory allocation of credit—picking winners and losers—or promoting an ideological position through more open-ended processes like bank supervision and examination.

Effective and Efficient Solutions

Once we have a clear and thorough understanding of our statutory objectives and have a framework to identify issues, gaps, or redundancies, the next task is to focus on finding efficient solutions to those issues. In doing so, we should consider policy alternatives and perspectives that may differ from our past approach. We should also acknowledge that we may not have all the facts or information necessary to immediately identify an effective solution. Successful policymaking requires openness and humility, caution, and a deliberate approach.

With respect to monetary policy, uncertainty surrounding available data and the many variables that can affect future economic conditions suggest that we should pursue a cautious approach. At the most recent meeting in November, the Committee decided to take an additional step along the path of moving toward a more neutral policy setting. I agreed to support this action, since it aligns with my preference to lower the policy rate gradually, especially in light of elevated inflation and the uncertainty about the level of the neutral rate.

My estimate of the neutral policy rate is much higher than it was before the pandemic, and therefore we may be closer to a neutral policy stance than we currently think. I would prefer to proceed cautiously in bringing the policy rate down to better assess how far we are from the end point, while recognizing that we have not yet achieved our inflation goal and closely watching the evolution of the labor market. We should also not rule out the risk that the policy rate may attain or even fall below its neutral level before we achieve our price stability goal.

It is important to note that monetary policy is not on a preset course. At each FOMC meeting, my colleagues and I will make our decisions based on the incoming data and the implications for and risks to the outlook and guided by the Fed's dual-mandate goals of maximum employment and stable prices. During each intermeeting period, we typically receive a range of economic data and information. In addition to closely watching the incoming data, I meet with a broad range of contacts to discuss economic conditions as I assess the appropriateness of our monetary policy stance. Especially in light of the data measurement challenges that I mentioned earlier, engaging with contacts helps me interpret the signals provided by the data and gain a better understanding of how the economy is evolving.

Consistent with this pragmatic approach, I am pleased that the November post meeting statement included a flexible, data-dependent approach, providing the Committee with

optionality in deciding future policy adjustments. As I noted earlier, my view is that inflation remains a concern, and I continue to see price stability as essential for fostering a strong labor market and an economy that works for everyone in the longer term.

In banking regulation, this pragmatic approach requires us to consider the costs and benefits of any proposed change, as well as incentive effects, impacts on markets, and potential unintended consequences. But it also means that we must consider the limits of regulatory responsibility—grounded by our statutory objectives—when taking regulatory action. In my view, these considerations apply beyond Federal Reserve policymaking to regulatory actions taken by any agency.

As I noted previously, statutory mandates guiding the Fed's bank regulatory responsibilities provide an important grounding for agency action. But they must be viewed in the broader context of promoting an effective and efficient banking system that supports market functioning and encourages economic growth, business creation and expansion, and opportunity. Our responsibility is not to look only at whether a proposal will promote greater safety and soundness, but to consider the broader context, including whether regulatory incentives will skew the allocation of credit, adversely affect capital markets, or push traditional banking activities outside of the banking system into less regulated non-banks.

Is the bank regulatory framework efficient? Does it allow banks sufficient freedom and flexibility to operate and meet customer needs? And importantly, are there areas within the approach to regulation and supervision that simply cannot be justified based on a cost-benefit analysis? The answer to the latter is "Yes." There are a number of areas where right-sizing regulation and our supervisory approach would be appropriate and can be done in a way that does not sacrifice safety and soundness or threaten financial stability.

Regulation is most effective when it strikes an appropriate balance between competing goals and objectives. In the banking system, this means operating in a safe, sound, and financially stable way, while also supporting economic growth and efficiency. When we fail to consider this broader context, we risk disincentivizing growth, imposing overly burdensome and unnecessary regulations, setting opaque and unreasonable expectations through the supervisory process, and forcing the inefficient allocation of capital.

Sometimes this debate escapes from the dusty offices of the banking regulators into plain view, as during the past year on the Basel III Endgame package of bank capital reforms. While this proposal prompted extensive comment from a wide range of commenters, it also inspired a negative television and radio advertising campaign, which is unprecedented for a relatively technical bank regulatory issue. But these ads highlighted an uncomfortable truth: the regulatory approach we took failed to consider or deliver a reasonable proposal, one aligned with the original Basel agreement yet suited to the particulars of the U.S. banking system. Instead, the proposal released last year opted for significant capital increases for some banks, in excess of 20 percent, departing significantly from the approach adopted by our international counterparts.

This public engagement has been useful, and it seems to have softened some of the over-calibrated positions underpinning the original capital reform proposal. But this level of public engagement and debate was also a byproduct of the rulemaking process. While regulatory overreach can threaten the credibility of agency action in the eyes of the public, a transparent process allows public commenters to pressure test and pushback on agency action.

However, when agencies overwhelm the process by publishing thousands of pages of rulemakings in a short period of time, the public's ability to provide meaningful feedback on our rules is compromised. Last year the federal financial agencies published over 5,000 pages of

rules and proposals. And yet, even when the public is able to comment on these voluminous proposals, regulators often ignore this constructive feedback and move forward to publish final rules with minimal or no changes relative to their proposals, as with the Community Reinvestment Act rule.

Maintenance of an existing regulatory framework is not glamorous but is perhaps one of the more important agency functions to ensure that the framework is striking the right balance between promoting a strong banking system and supporting economic growth. This requires reviewing and updating regulations to ensure that prior agency actions continue to address problems efficiently as industries and conditions change.[3] When agencies prioritize the creation of new regulation in the absence of a statutory mandate, harmful and unintended consequences can result. One such example is the adverse effects of regulatory constraints on Treasury market functioning. Rules like the Supplementary Leverage Ratio, the G-SIB Surcharge, and the Liquidity Coverage Ratio pose known and identified constraints on the Treasury market that may contribute to future stress and market disruption if left unaddressed.

Finally, while transparency—like that intended by the rulemaking process—can lead to better public engagement and outcomes, it is important that agency actions are transparent even when not legally mandated. The most obvious opportunity for additional transparency in the banking framework is in supervision. Supervision by its nature involves confidential and detailed inquiries into bank operations, with examiners evaluating quantitative measures like capital and liquidity, while making judgmental assessments of the activities and risks of the

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[3] In February, the Board announced the initiation of its review of its regulations to identify those regulations that are outdated, unnecessary, or overly burdensome in accordance with the Economic Growth and Regulatory Paperwork Reduction Act. See Michelle W. Bowman (2024), "Statement by Governor Michelle W. Bowman on the Review of the Board's Regulations under the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA)" press release, February 6, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20240206a1.htm.

institution, and its risk-management approach. Supervisory expectations should not surprise regulated firms, and yet transparency of these expectations is often challenging to achieve. In fact, since the failure of SVB supervisory surprises have become more common in bank examinations.

In light of the recent Supreme Court cases regarding agency actions, agencies should respond in a way that furthers the goals of transparency and accountability, and act as a check on regulatory overreach. The elimination of *Chevron* deference has the potential to transform agency rulemakings positively—in a way that promotes the pragmatic approach I outlined in this discussion. The same considerations we follow in the pursuit of our statutory objectives could help support rulemakings that are built upon a stronger factual and analytical basis, with a thorough and more comprehensive explanation of an agency's policy approach.

Closing Thoughts

While my remarks today have largely focused on Federal Reserve responsibilities, a pragmatic approach has broader applicability. Agencies can build public support for their activities by following these simple principles—a rigorous focus on statutory objectives, a foundation based on facts and careful analysis in forming policy, crafting efficient solutions, and public transparency and accountability. Agencies and their regulated businesses will benefit from a rigorous process that considers different perspectives, the intended and unintended consequences of decisions, and the costs and benefits of actions. The ability of the banking system to finance the future growth of the U.S. economy hinges upon our ability and willingness to shift our approach to regulation and supervisory oversight. A pragmatic approach to policymaking will better enable the U.S. economy to continue to grow now and into the future.