Trust and Accountability

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Introductory Remarks for the Panel on Central Bank Frameworks Reviews
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Welcome to the Panel on Central Bank Frameworks Reviews. It has been a great discussion so far and I know this panel is going to continue that trend. It is great to see everyone here. And I mean that literally.

Last December, I spent the Christmas holiday in Australia with my husband's family. Overall, it was an excellent visit. However, it didn't go as planned. Unfortunately, I spent Christmas Eve in Canberra Hospital, where it turned out I had to have eye surgery to repair a tear in my retina. It was a bit disconcerting, but it all worked out fine and I was even able to celebrate with everyone later that evening.

But the whole episode got me to thinking about the topic of trust. Why was I willing to let someone I had never met before in a hospital I had never visited before burn my eye with a laser? I trusted them, but WHY did I trust them?

Pondering the question, I concluded that it came down to my having confidence in the institution. As Nobel Prize winner Douglass North emphasized, institutions matter.[1]

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[1] Douglass C. North, *Structure and Change in Economic History*, London, U.K.: W.W. Norton, 1981; Douglass C. North, *Institutions, Institutional Change, and Economic Performance*, Cambridge, U.K.: Cambridge University Press, 1990; and Douglass C. North, "Institutions," *Journal of Economic Perspectives* 5, 1991, pp. 97-112.

The value of a well-run institution is that one can have confidence in it without having to know individual personnel or the intricate procedures of the place. Canberra Hospital has a very good reputation; one of its core values is delivering exceptional patient care: it hires well-qualified doctors; and it provides the public with a summary of its framework for delivering high-quality care. I didn’t need to have details about the doctors because I knew that the institution sat on a well-constructed foundation and that meant I could trust in the institution.

But how does an institution build trust with its constituencies? Probably the number one way is to be excellent at what it does; that is, to reach the goals that it has been charged to achieve. That means hiring very well-qualified staff and making decisions and taking actions informed by the best information. Of course, the world doesn’t always cooperate – sometimes even decisions based on the best information and analysis do not produce intended results.

So how does an institution build trust even when it has difficult tasks before it and won’t be able to achieve its goals at all points in time?

Central banks are faced with difficult tasks and are critically important institutions because their decisions affect the economic and financial well-being of real people in crucial ways. As the esteemed monetary policy commentator, [Uncle] Ben Parker, said, with great power comes great responsibility. Every central bank has been given tremendous power, so each bank has a responsibility to ensure the institution and its decisions are built on a strong foundation.

Over the past 50 years, research and practice have increased our understanding of some basic principles that underlie effective central banking. Operating according to these foundational principles has built trust with the public.

These principles include clearly communicating the central bank's goals, making sure the goals are actually achievable ones, and designing institutional arrangements and operating procedures that foster excellent decision-making, e.g., incorporating scenario planning and routine consideration of alternative views in its decision-making.

Transparency about the central bank's strategy is important because it helps ensure that people can hold policymakers accountable. Adhering to a strategy makes policymaking more effective by making it more systematic and reliable, and less discretionary. This allows the public to better evaluate the central bank's performance.

But to build trust with the public, an institution has to be willing to hold itself accountable. Partly that entails periodically reviewing its strategy, objectively evaluating its own performance, and being willing to self-correct when necessary.

Central banks' frameworks for conducting monetary policy incorporate some of these institutional foundational elements. The Fed's monetary policy framework is summarized in its statement on longer-run goals and monetary policy, which was first published in January 2012 and established the Fed's explicit 2 percent inflation target. The Fed reviewed this framework in 2019-2020, including its monetary policy strategy, tools, and communication practices, and made some changes including moving to the so-called flexible average inflation targeting strategy. The Fed is currently undertaking another review of its framework. This year's review is focused on the consensus statement and policy communications. Chair Powell has said that the FOMC intends to complete the review in late summer.

The challenges over the post-pandemic episode of high inflation have put the Fed's current framework to the test. The economic environment today is considerably different from what it was in the decade leading up to the 2019-2020 review.

In my own view, an overarching principle for any framework is that it be effective across a *wide variety* of economic circumstances.[2] It is unwise to over-index on recent history or to one particular scenario, and potential changes to the framework should keep this robustness in mind.

I would also like to see the Fed's framework put more emphasis on a *symmetric approach*, which recognizes that inflation can go above target as well as below target, and that recognizes that the level of employment need not be consistent with stable prices.

In addition to adding back symmetry, I would like to see the strategy and consensus statement reinforce the *forward-looking and pre-emptive nature* of setting appropriate monetary policy.

But I am sure you are as eager as I am to hear the views of our panelists, who bring a wealth of central bank and academic experience and expertise to the topic of how central banks might change or augment their current frameworks to ensure more effective monetary policymaking.

Their bios are in your booklet, but briefly:

Pablo Hernández de Cos is the former Governor of the Bank of Spain, a role he held from 2018 to 2024. He is currently a professor at IESE Business School, University of Navarra.

[2] I discuss my views on the Fed's framework review in Loretta J. Mester, "Considerations for the Federal Reserve's Upcoming Framework Review," *Business Economics* 60, 2025, pp. 15-20 (https://doi.org/10.1057/s11369-025-00390-w).

Don Kohn is former Vice Chair of the Board of Governors of the Federal Reserve System, a role he held from 2002 to 2010. He also served as an external member of the Financial Policy Committee at the Bank of England from 2011-2021, and he currently holds the Robert V. Roosa Chair in International Economics and is a senior fellow in the Economic Studies program at the Brookings Institution.

Our third speaker is Matthew Shapiro, the Lawrence R. Klein Collegiate Professor of Economics at the University of Michigan, where he is also a Research Professor at the Survey Research Center at Michigan's Institute for Social Research at the University of Michigan.

We'll hear from our speakers in the order in the program. Each panelist will have 12-15 minutes and then we will open it up for discussion with all the participants.