

## **In Remembrance of Charles Plosser**

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It is a great honor for me to be asked to share some remarks at this Global Interdependence Center event in remembrance of Charles Plosser. I had the great pleasure of working with Charles at the Federal Reserve Bank of Philadelphia from August 2006 to June 2014 when I left to run the Cleveland Fed. He stayed on at the Philly Fed until his retirement on March 1, 2015. During his tenure he was a very good friend of the Global Interdependence Center, speaking on many of the GIC's programs, participating in its events, and earning the GIC's Global Citizenship Award in 2011. The speech he gave when accepting that award was "Strengthening Our Monetary Policy Framework Through Commitment, Credibility, and Communication," themes Charles turned to throughout his career.

Charles came to the Philly Fed after a distinguished academic career as a professor and researcher in econometrics, macroeconomics, and monetary policy. After receiving his Ph.D. in economics from the University of Chicago, he began his academic career at Stanford University and then joined the University of Rochester's business school in 1978 where he stayed until he joined the Fed.

Charles was one of the founders of real business cycle (RBC) theory, which is now a cornerstone of mainstream economic models. The theory recognized that shocks to technology and other supply-side factors could generate fluctuations in real variables like GDP. This was in contrast to the Keynesian view, the mainstream view at the time, that business cycles were mainly driven by demand shocks. As

RBC models developed and were able to give microfoundations for many of the macroeconomic relationships that were just assumed in Keynesian models, the Keynesian models had to adapt to incorporate the features of real business cycles.

In addition to his role as professor, Charles was a co-editor of the *Journal of Monetary Economics* and a member of the Shadow Open Market Committee. In addition, he served as the Dean of the Simon Business School at University of Rochester for 12 years.

When Charles came to the Philadelphia Fed I did not know whether or not he would want to keep me on as the Research Director or whether he would prefer to bring in his own person, which many presidents end up doing. But we both shared a belief that good policymaking has to be grounded in good, rigorous research. How I put it is that what might be fun to banter about at a cocktail party cannot be the basis of sound policymaking. Luckily, he decided to give me a chance as his research director. We worked extremely well together from the very beginning. I really enjoyed working with him and learning from him.

Charles took a principled approach to monetary policymaking. He was instrumental in the work the Fed did to establish an explicit, numerical inflation target. While this idea had been discussed for over a decade, there was always an event that would occur and postpone taking the plunge. In his November 2005 confirmation hearing to become chair of the Fed, Ben Bernanke discussed the benefits of an explicit, quantitative long-run inflation objective. Of course, the Global Financial Crisis intervened, which occupied the Fed for several years.

I am not at all sure that the Fed would have reconvened the work when it did had Charles not been a member of the Federal Open Market Committee (FOMC). He worked with several colleagues to reach a consensus on the strategy that included the numerical target. And I am sure that the original framework

and strategy document, which served the Committee very well, would have looked quite different had Charles not been a part of it. Working with him on the numerical target and framework project and getting it over the finish line was a highlight of my career. I think it is important to note that the Fed recently revised its framework document from what it adopted in 2020 and went back to many of the concepts that were in the original 2012 version on which Charles worked.

This is also something that we should remember about Charles. It is true that the Fed is a collegial place. Everyone has taken on the same mission -- to ensure macroeconomic and financial stability -- and you work with colleagues within your Bank and throughout the System. But the Fed is also a place where it takes an idea to beat an idea and there is some competition across different parts of the Fed. It is human nature for people to want others' approval for their ideas and actions. Despite the collegial culture, it does take some courage and fortitude to continue down a path that is not the expeditious one and not the common or modal view of the Committee, especially when you realize that the modal view is the view of the Chair. But Charles was not daunted even when it wasn't comfortable. For example, when the Fed was doing what it could to support financial markets during the Global Financial Crisis, Charles was one of the few who pointed out that there were potential moral hazard issues that could impact financial market participants' and institutions' risk preferences in the future. It was expeditious to bail out firms and markets, but it also creates future problems that the Fed would need to deal with.

Charles also had some skepticism about continued rounds of quantitative easing. His issue was not that the quantitative easing would necessarily be inflationary. Instead, his concerns were about the future challenges the Fed might face as its footprint in financial markets grew. He was concerned that decisions of private actors could become distorted and that while in the near term the actions the Fed took were likely positive for financial stability, they could lead to excessive risk appetite in the future, which would be detrimental to future financial stability.

Charles was also one of the most articulate of those voicing concerns with what came to be called the ample reserves operating framework for implementing monetary policy. He understood what advocates were saying about the regime seemingly being easier to implement: If the Fed supplies enough reserves to the market, then the Fed does not have to have a lot of staff estimating banks' demand for reserves every day in order to hit the fed funds rate target; instead it would just need to set the administered rates of interest on reserves and the primary credit rate. Charles pointed out that this presented governance issues, as the FOMC sets the fed funds rate and the Board of Governors sets those administered rates. There is a gentlemen's agreement that the Fed sets the fed funds rate and the Board follows by setting administered rates consistently. But this potential governance issue may yet become a more serious issue.

But Charles's main concern was that unlike an operating framework with scarce reserves, an ample reserves regime puts no limit on the size of the Fed's balance sheet. This might make it less complicated to implement policy, but Charles argued that it would increase demands on the Fed to purchase assets to help out particular industries or market segments, and go beyond the appropriate purview of the Fed and into credit allocation. This was not an idle concern. During December 2008, Congress debated a bailout for American automakers and several members of Congress asked of Chair Bernanke that the Fed lend directly to auto companies. The chair respectfully declined.<sup>1,2</sup>

Charles was one of the earliest on the FOMC to express concerns about the Fed's moving into credit allocation -- Jeff Lacker and Marvin Goodfriend at the Richmond Fed also were vocal. Charles championed maintaining a strict separation between monetary policy and fiscal policy actions. In his view, when the Fed went beyond purchasing Treasury bills and used its balance sheet to buy mortgage-

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<sup>1</sup> See the discussion in Chapter 17 of Ben S. Bernanke, *The Courage to Act: A Memoir of a Crisis and its Aftermath*, New York: W.W. Norton and Company, 2015.

<sup>2</sup> Congress used funds from the Fed's surplus account to pay for highways and other budget initiatives, and put limits on the size of the surplus. See the 2015 Fixing America's Surface Act, or FAST Act, and the Bipartisan Budget Act of 2018.

backed securities (MBS), commercial paper, and other types of assets, it was getting into the realm of fiscal policy. In a speech in 2009, he advocated for a new Treasury-Fed accord where the Treasury would take on those assets that the Fed had bought to stabilize financial markets and the economy.<sup>3</sup>

Another theme Charles emphasized was the importance of the independence of the central bank to set monetary policy. Just up the street from the Philadelphia Fed are the First and Second Banks of the United States. It was not lost on Charles that these two attempts at establishing a central bank in the U.S. before the Fed each did not last beyond their 20-year charters. Charles was very astute at tying pieces together: to maintain independence it was important for the Fed not to overstep its proper role. He saw the danger of the Federal Reserve's taking a larger role in financial markets and tied it to a widening mandate for the Fed, which he saw as problematic on two fronts. First, the Fed was starting to be asked to do things that it really was unable to deliver on. Maintaining price stability was hard enough. In Charles's view, expanding the Fed's role and giving the institution goals that were not achievable would lead to political problems and likely jeopardize the independence of monetary policy, which would lead to worse economic outcomes over time.

Charles held that in order to maintain independence it was important for the Fed to push back on other goals and keep razor focused on the goals Congress gave the Fed, namely price stability and maximum employment. Even there, his preference would have been for a single mandate of price stability as the goal that the central bank, and only the central bank, can achieve.

Maintaining independence also meant doing all one could to do the job right. Here, he was an advocate of transparency and clear communications, so that financial market participants and the general public

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<sup>3</sup> Plosser, Charles I., "Ensuring Sound Monetary Policy in the Aftermath of Crisis," Remarks at the U.S. Monetary Policy Forum, The Initiative on Global Markets, University of Chicago Booth School of Business, New York, New York, February 27, 2009.

would have a better sense of the Fed's reaction function, which would yield better results. For the same reason, Charles was also a strong advocate of systematic monetary policymaking as opposed to discretion. Although his views were sometimes mischaracterized as his wanting the Fed to adhere to a strict rule, his view was actually more nuanced than that, as he understood the value of applying judgment but advocated that more predictable policy was more effective policy.

At the time he was expressing his views, many Fed colleagues did not share Charles's concerns about the operating framework, the expansion of goals, discretionary monetary policymaking, or the potential loss of Fed independence. In fact, I believe some were wishing he would just keep quiet already!

But in more recent times, Charles is looking prescient. Many of the concerns that Charles brought up in speeches and at the FOMC table have become current issues facing the Fed. Although it still has many advocates, some policymakers – including potential candidates for Fed chair – have become skeptical about the ample reserves operating framework and a central bank balance sheet of unlimited size. Many now think that there should be more of a cost-benefit analysis of quantitative easing and asset purchases as a policy tool.

After the high inflation in the post-pandemic period, there is some appetite at the Fed on going back to basics and focusing in on the congressionally mandated goals. Policymakers are beginning to realize that when goals are not achieved, the institution loses credibility, which makes it harder to achieve goals in the future. In recent times we have all learned that it is easier to lose credibility than it is to regain it.

Finally, it goes without saying that we are living in a time when monetary policy independence is under grave threat. What looked to be a pretty distant possibility when Charles Plosser was expressing concerns, is now knocking at the door. Like most people, Charles liked to be right. But in this case, I am sure that he would have preferred to be wrong and that independence was not under threat. But that is not

the case and it is unfortunate that we will not have Charles's guiding wisdom to lead us through this existential challenge.

One final thought: with all of the fine scholarly and policy contributions Charles made over his exemplary career, he never lost sight of the people side of things. He was a great family man, taking pride in his wife Janet, their three children, and seven grand kids. Charles was a true professor in that he was always learning, he loved the give and take of sharing views, and he always wanted to impart what he had learned onto others. In that way, his legacy in academia and at the Federal Reserve will live on and on, passed down to his students and fellow policymakers, and from them to others, and so on and on. That is a legacy that Charles would be greatly proud of.

Now, please join me in toasting Charles Plosser, educator, policymaker, GIC Global Citizen, and friend.