

# THE FUTURE OF THE FED: WE'RE NOT IN KANSAS ANYMORE

---



David Romer  
AEA Panel  
January 4, 2026

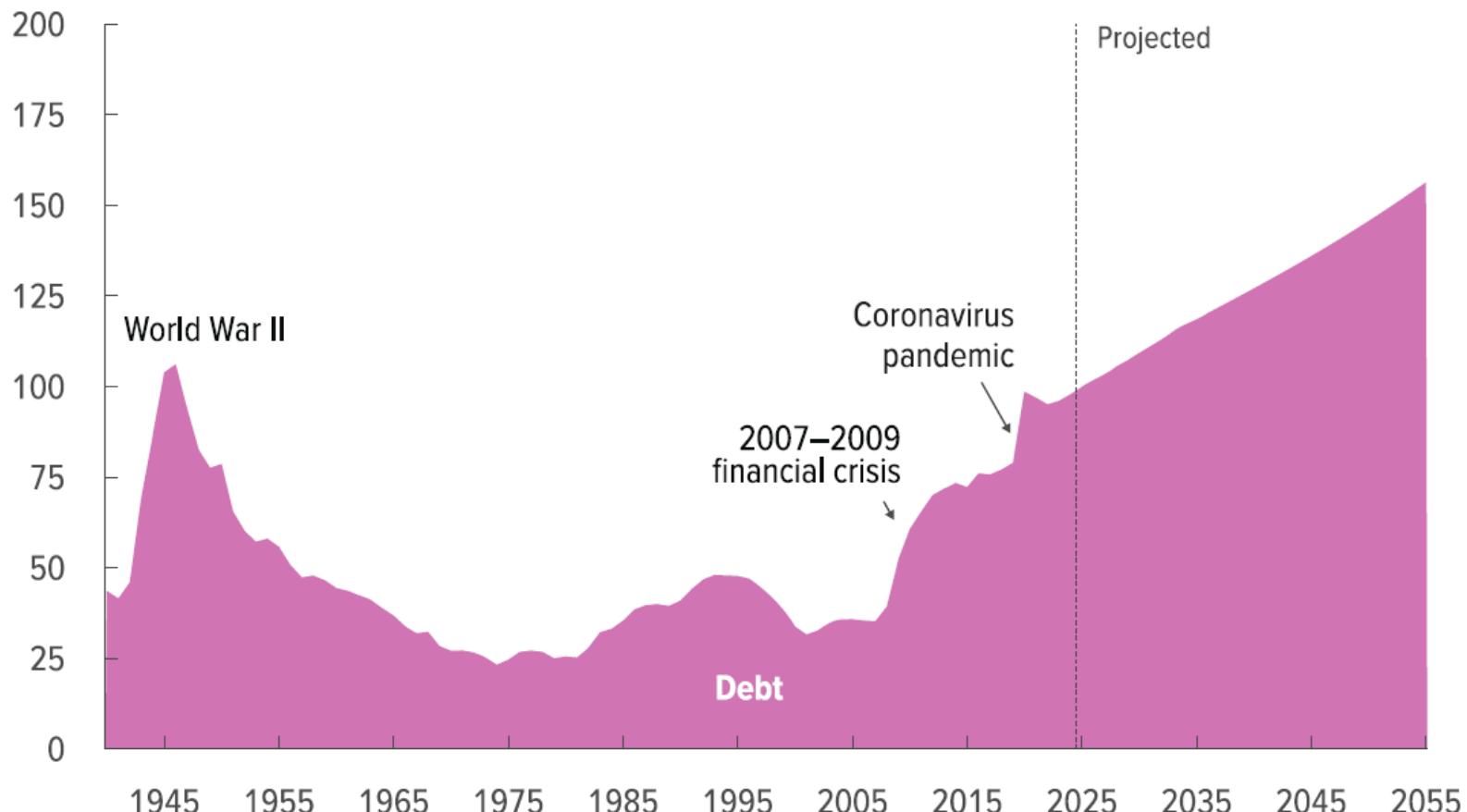
# Introduction

- Kansas: Pretty uniform, not very colorful, and you sort of know what life is going to be like.
- Not Kansas: Wild, colorful, and you have no idea what's going to happen.
- I'm going to argue that that's a useful metaphor for the future of the Fed.
- I'll discuss 3 areas in which things may be wild.
- Fitting with my theme that things are going to be very different, the areas are very different from one another.

# I. The Looming Fiscal Catastrophe

## Federal Debt Held by the Public

Percentage of GDP



Source: CBO.

# The Fed's Challenges

- In real time, distinguishing a full-fledged meltdown from a temporary liquidity problem is very hard.
- Example of the U.K. in September 2022.

## The Fed's Challenges (continued)

- If fiscal policy stays on an unsustainable path, in the long run the Fed has no good options.
- The combination of rising deficits and the short maturity structure of the debt mean that moderately high inflation would have only modest effects.

# Inflation Would Have Only Modest Effects

- Suppose at some point the Fed engineers an immediate, unexpected jump in inflation from 2% to 10%, with the debt's current maturity structure.
- With *no* increase in real rates or risk premiums, after 5 years this would erode only about 15% of the debt.
- If the risk premium rises by 2 percentage points, it would be only about 10%.
- The Fed's only other options are extremely high inflation and standing by as the U.S. defaults.

**Source:** Author's calculations based on maturity information from [Kozlowski and Jordan-Wood \(2023\)](#).

## II. New Technologies: Crypto and AI

- There's been explosive growth in both crypto and AI.

# Some Risks from Cryptocurrencies

- Potential runs on stablecoins, and resulting spillovers.
- Potential for spillovers and contagion from price collapse or market breakdowns.
- Harms to individuals from not understanding risks, being taken advantage of in various ways, etc.
- Deeper links with conventional financial markets (e.g., tokenized shares) leading to potential spillovers from crypto to conventional markets.
- Political pressures associated with possible introduction of central bank digital currency.

# Some Financial Risks from AI

- Micro: Exponentially better scamming, hacking, insider trading, market manipulation, ....
- Macro: Rogue AI trading algorithms; extremely correlated trading strategies; hacking at scale; ....

# The Fed's Challenges

- Even with appropriate regulation, the new technologies would create significant challenges.
- The Fed doesn't control regulation, and the current regulatory regime is very lax:
  - Basic disclosure and transparency requirements; limits on margin trading; promises of liquidity; promises of stable values; restrictions on price manipulation and insider trading; ....

### III. Disagreement about What the Fed Should Try to Accomplish—and about Who Should Judge What the Fed Can Accomplish

- For the past 40 years, there's been broad support for the ideas that:
  - The Fed should focus on low and stable inflation, macroeconomic stability, and financial soundness and stability.
  - Judgments about how to best achieve those goals and about what's feasible are best delegated to experts.

## 3 Examples Where We've Already Seen Pressures to Do Other Things

- Aim for a hot labor market.
- Conduct industrial policy or support specific businesses through credit allocation.
- View low interest rates for the government, households, and businesses as an important end in itself.

# The Fed's Challenges

- Why “What can the Fed do?” isn’t really a sensible question in this case.

# Conclusion: Two Common Threads in This Analysis

- #1: Declining belief in the value of expertise.
- #2: The challenges are for the most part not addressable through monetary policy, but they can be addressed.
- So, what can be done?
  - The current Fed can show the value of the arrangements we've had for the past 40 years by conducting policy well.
  - ***Much*** more importantly, lots of people need to make the case for addressing the challenges.