Bloomberg Businessweek
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Bloomberg News

Stanford's Taylor Says Fed Activism Puts Independence at Risk

By Craig Torres on March 27, 2012

The Federal Reserve's aggressive monetary policy is "endangering" the independence of the central bank, Stanford University economist John Taylor told members of the Joint Economic Committee today.

Taylor testified at a committee hearing on a bill written by Representative Kevin Brady, a Texas Republican, that would alter the structure and goals of the Federal Reserve System. Known as the "Sound Dollar Act of 2012," the bill would move the Fed to a single goal of stable prices, eliminating a second mandate to balance that with full employment. It would also amend the Federal Reserve Act to give all 12 district presidents a vote on Federal Open Market Committee, instead of five today.

"This is about getting the role of the Federal Reserve right going forward," Brady said in an interview. "I don't think, looking ahead, that the Fed should be balancing mandates. It should have a clear one from Congress."

The bill, which has 28 co-sponsors Brady said, would require support from the House Financial Services Committee, which has oversight authority over the Fed. No hearing at the House committee has been scheduled yet, Brady said.

The legislation shows the continuing interest by some members of Congress to further constrain the central bank, which will celebrate its 100th anniversary next year. The Senate's ranking Republican, Mitch McConnell, and House speaker John Boehner, an Ohio Republican, asked Fed Chairman Ben S. Bernanke in a September letter to "resist further extraordinary intervention in the U.S. economy."

Benchmark Rate

U.S. central bankers have held the benchmark lending rate near zero since 2008 and purchased $2.3 trillion in bonds, including mortgage-backed securities, to spur growth.

“The discretionary interventions of the Federal Reserve have been ratcheted up in such unprecedented ways in recent years that they raise fundamental questions about the future of monetary policy,” Taylor said in his testimony.

“The fact that the Fed can, if it chooses, intervene without limit into any credit market -- not only mortgage backed securities but also securities backed by automobile loans, or even student loans -- raises more uncertainty, and of course raises questions about why an independent agency of government should have such power,” Taylor said in prepared testimony. The Stanford economist was a U.S. Treasury undersecretary for international affairs from 2001 to 2005, and in prior years served on the President’s Council of Economic Advisers.

Lawmakers also heard testimony from former Fed Governor Laurence Meyer, who was on the central bank’s board from June 1996 to January 2002.

‘Clearly Partisan’

“Some of the provisions of this bill appear to me clearly partisan,” Meyer said in prepared testimony. “Please recognize that the greatest threat to the stability of long-term inflation expectations is an assault on the independence of the Fed’s monetary policy decisions.”

He said the expansion of the Fed’s balance sheet to $2.9 trillion in total assets does “not risk soaring inflation” because the central bank has the tools to drain bank reserves when necessary. Meyer said he prefers retaining the Fed’s dual mandate.

Meyer said he also opposed giving the Fed’s 12 presidents a permanent vote on monetary policy since they are “appointed by unelected and unrepresentative boards” while the members of the board of governors are nominated by the president of the U.S. and confirmed by the Senate. His opposition was echoed in

testimony by William Poole, a former president of the St. Louis Fed who would have had a permanent vote on monetary policy under the legislation.

'Worked Satisfactorily'

"Current arrangements have worked satisfactorily and the clarity of ultimate political control from Washington is appropriate," Poole, who also testified at the hearing, said in prepared remarks. Poole is a senior fellow at the Cato Institute, a scholar in residence at the University of Delaware and an adviser to Merk Investments LLC.

Poole said he "strongly" supported the legislation's push to restrict the Fed from purchasing assets other than U.S. Treasury securities for the central bank's System Open Market Account. Without this restriction, the Fed can venture into policies that ought to be the responsibility of Congress, he said.

"The bottom line is that use of the credit resources of the U.S. government should be decided by Congress and not by an appointed body such as the Federal Reserve," Poole said.