A rules-based Fed?

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Globe and Mail Update

Posted on Thursday, November 18, 2010 3:05PM EST

John Taylor, the Stanford University economics professor who developed a widely used equation for determining the appropriate benchmark interest-rate setting, has a new idea.

Prof. Taylor thinks the U.S. Federal Reserve needs to be made more accountable.

Speaking at a conference hosted by the Cato Institute in Washington Thursday, Prof. Taylor said monetary policy has become too discretionary and should become more standardized.

Adhering to the Taylor Rule, which suggests an interest rate based on the divergence between inflation and the inflation target and gross domestic product and potential GDP, would be an improvement, said the creator of that rule. But Prof. Taylor said there could be other guidelines.

Prof. Taylor said his research suggests the economy is smoother when central banks stick to rules. He proposed revising the Federal Reserve Act to force the Fed to tell Congress every year the methodology it will use to set policy. The Fed would be allowed to change course if conditions changed, but the chairman would have to report to Congress explaining the shift in strategy.

Before 2000, the Fed was mandated to link policy to monetary aggregates. It was recognized that the money supply was no longer a useful guide for policy and the law was revised. The reference to monetary aggregates was removed, but wasn't replaced with anything.

"This is not a radical proposal," Prof. Taylor said.

It's certainly not radical compared with another proposal that was raised more than once at the Cato conference: getting rid of the Fed altogether.