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Plosser: Public Seeks Too Much from Fed, Policy

By: Gary Siegel – November 15, 2013

The public expects too much from the Federal Reserve, particularly monetary policy, Federal Reserve Bank of Philadelphia President and Chief Executive Officer Charles I. Plosser said Thursday.

"We have assigned an ever-expanding role for monetary policy, and we expect our central bank to solve all manner of economic woes for which it is ill-suited to address," Plosser told a Cato Institute conference, according to prepared text released by the Fed. "We need to better align the expectations of monetary policy with what it is actually capable of achieving."

The dual mandate helped expand the view of what monetary policy can do, he said. While the Fed "statement of objectives acknowledged that it is inappropriate to set a fixed goal for employment and that maximum employment is influenced by many factors," Plosser said recent FOMC "statements have increasingly given the impression that it wants to achieve an employment goal as quickly as possible."

He added, "I believe that the aggressive pursuit of broad and expansive objectives is quite risky and could have very undesirable repercussions down the road, including undermining the public's confidence in the institution, its legitimacy, and its independence."

The Fed's policy goal should primarily be price stability, he said, noting that monetary policy is limited in influencing employment, and price stability "is the one goal that the central bank can achieve over the longer run."

Furthermore, Plosser stated that the FOMC's emphasis is supposed to be long-term. "The act doesn't talk about managing short-term credit allocation across sectors; it doesn't mention inflating housing prices or other asset prices. It also doesn't mention reducing short-term fluctuations in employment."

"The public, and perhaps even some within the Fed, have come to accept as an axiom that monetary policy can and should attempt to manage fluctuations in employment," Plosser noted. But the Fed is actually charged with setting a monetary environment "commensurate" with the "long run potential to increase production."

"In my view, focusing on short-run control of employment weakens the credibility and effectiveness of the Fed in achieving its price stability objective," he said.

The Fed must be independent, but must remain accountable for its actions, Plosser said. Also, Congress should set "clear boundaries" for monetary and fiscal policy, with the Fed being "constrained from conducting fiscal policy," which Plosser suggested was breeched "by its purchase programs of assets that target specific industries and individual firms. One way to circumscribe the range of activities a central bank can undertake is to limit the assets it can buy and hold."

Plosser wants the Fed to deal in only "Treasury securities and return the Fed's balance sheet to an all-Treasury portfolio."

Policy should be conducted "in a systematic, rule-like" way, Plosser said, to "limit "\xA6 discretionary authority." The benefits of such a system, he said, are transparency, which "allow[s] for simpler and more effective communication of policy decisions."

To react to emergencies, Plosser suggested, if fiscal authorities seek Fed intervention, "by allocating credit to particular firms or sectors of the economy, then the Treasury should take these assets off of the Fed's balance sheet in exchange for Treasury securities."