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Taylor Proposes Altering Fed Law to Require `Systematic' Rate-Setting Rule

By Scott Lanman - Nov 18, 2010

The Federal Reserve would be required to have a “systematic” rule for adjusting interest rates under a proposal raised today by Stanford University Professor John Taylor, a critic of the Fed’s monetary stimulus.

The Federal Reserve Act should be amended so the central bank has to tell Congress twice a year about its strategy for the “systematic adjustment of the federal funds rate in response to changes in inflation and in the real economy during the current year and future years,” Taylor, author of a formula used by the Fed for setting central bank interest rates, said in a speech in Washington.

Taylor, 63, is among the most prominent of Republican- leaning economists gaining influence in discussions of Fed policy after the party won control of the House and slimmed down the Democrats’ Senate majority in this month’s midterm elections. The former Treasury undersecretary was among 23 people who signed a letter this week calling for the Fed to halt its $600 billion of Treasury purchases aimed at lowering unemployment.

“Recently, policy has become more short-term focused, more discretionary and less rule-like,” Taylor said at the Cato Institute’s annual monetary conference. “The idea here is maybe with some legislation we could get policy to be more rule-like and less interventionist, if you like, and that that would improve performance. And that may get us back to the kind of good performance we had for a couple of decades.”

Taylor said he previously hadn’t advocated putting monetary-policy rules into law. His proposal would allow some discretion: If the Fed deviates from the rule, the chairman would have to tell Congress why, Taylor said.

‘Not a Radical Proposal’

“This is not a radical proposal,” Taylor said.

Taylor published his interest-rate formula in a 1992 paper while at Stanford. It suggests how a central bank should set interest rates if inflation or growth veers from goals. The Taylor rule is used more as a reference than a policy trigger. Fed Chairman Ben S. Bernanke said in 2007 that Taylor’s research provides “essential guidance” to central bankers on setting interest rates.

Since the financial crisis that began in 2007, Taylor has become one of the Fed's chief academic critics. In January, Bernanke said the Fed's monetary policy wasn't responsible for causing the housing bubble, a claim disputed by Taylor.

Taylor's proposal joins other potential changes to Fed law being pushed by Republican lawmakers. Senator Bob Corker of Tennessee and Representative Michael Pence of Indiana are proposing legislation that would remove the Fed's full- employment mandate and have the central bank focus on inflation alone.

To contact the reporter on this story: Scott Lanman in Washington at slanman@bloomberg.net.

To contact the editor responsible for this story: Christopher Wellisz at cwellisz@bloomberg.net

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