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Economist Taylor wants new law for Fed policy

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By Pedro Nicolaci da Costa

WASHINGTON, Nov 18 (Reuters) - The Federal Reserve should be subject to new legal boundaries that make monetary policy more predictable and leave give policymakers less wiggle room, a former U.S. Treasury official and prominent economist said on Thursday.

John Taylor, who invented a widely used monetary policy framework known as the "Taylor Rule", said he was proposing new legislation that would force the Fed to develop a clear strategy for meeting its inflation target.

"It is possible to legislate a rule for monetary policy," he said at a conference on monetary conference at the CATO Institute, a conservative libertarian think tank.

"A legislative rule can reverse the short-term focus of policy and restore credibility in sound monetary principles consistent with long-term price stability and economic growth."

Such a policy would bolster Fed independence by establishing clear guidelines for its conduct, said Taylor, who was Undersecretary for International Affairs at Treasury under George W. Bush.

TAYLOR RULE II?

"While passing such legislation necessarily involves the President and the Congress of the United States it does not mean that the President or Congress should insert themselves in the operation decision-making process of the Federal Reserve.

However, Taylor said he had not yet discussed the proposal with lawmakers.

Taylor was one of several economists earlier this week who signed a letter opposing the Fed's latest $600 billion round of monetary easing, arguing the policy has more risks than benefits.

The moves, known as round two of quantitative easing or QEII, has sparked criticism from those who, like Taylor believe it creates the risk of future inflation and will be difficult to reverse.

Asked about a Republican proposal to alter the Fed's mandate to force it to focus solely on inflation, rather than also aiming for "maximum sustainable employment," Taylor said he needed to review the bill but appeared open to the idea.

"For example, the word maximum employment is there, that's kind of an older term that's there, so I think's there (could be) adjustments in the language," he told reporters.

Loud Republican opposition to fresh bond purchases by the Fed have sparked some concern about excessive political intervention in monetary affairs.

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