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The Fed Needs Humility About Margin Rules

If the Fed introduces credit controls, what will be the implicit Fed message?

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I was astonished to read that the Federal Reserve is considering margin requirements ("Fed Eyes Old Rule to Bolster Oversight," page one, Jan. 11). Going down that route is foolish.
Every economist who has studied economic policy at even an elementary level understands the basics of control theory. A policy instrument that has uncertain and unpredictable effects is a bad instrument. Consider the credit controls the Fed introduced in March 1980 at the behest of President Carter. The Fed thought it had designed a system of credit controls that would have benign effects. Fed leadership was astonished at what happened. Consumer spending tumbled—an unanticipated outcome—and the economy fell into recession. Unemployment rose sharply. The Fed removed the controls a few months later. I urge every member of the Federal Open Market Committee to read the transcripts and staff documents of FOMC meetings of that period.

If the Fed introduces credit controls, what will be the implicit Fed message? If the controls don't work, will the Fed double down or will the FOMC raise the federal-funds rate target, or both? Introduction of controls will unsettle market expectations and make a return to a normal monetary policy more difficult. More important, suppose the Fed could design a perfect set of controls that would permit it to set the volume of credit with great precision. Do we want the Fed or any other government entity in a market economy to set prices and quantities in the capital markets?

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